ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

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size without calling for a new vote to subscribe more capital. The stockholders of the World Bank can increase the size of their institution by changing the leverage ratio, but it's quite difficult to change the articles of incorporation even though it can be done.

Mr. LeResche: The Alberta Fund sets proportions of loans that can be made for various purposes. A strong executive officer working under the Alberta rules would feel accountable.

Mr. Fuhrmann: He doesn't feel accountable with respect to the loans that are in the soft category because it's been removed from the fund by being put on the Legislature. He is accountable with respect to those things he has authority over. They have maintained the autonomy within the normal business environment with respect to soft loans but the responsibility really rests with the Legislature.

Mr. Love: Alaska seems to be a country that might have too much capital and would have a problem of how much capital we can absorb. Should we have a Development Bank approach? Is that the best vehicle for us in the investment of the Permanent Fund?

Mr. McDowell: That is true, but there are other issues that are addressed by the development banks--investment decisions that aren't made on economics alone, they're made on income distribution effects, employment effects, environmental considerations, health and social considerations, plus the economics of the project situation.

Mr. Love: What are the mechanisms for evaluating whether or not the loan programs that the state enters into are actually achieving the specific objectives being outlined?

Mr. McDowell: The reporting of the accomplishment toward this sort of objective is in the annual reports of the institutions.

Mr. Waldock: I have a few questions I'd like to put to the Committee. One is, exactly what criteria was used for the selection of all of these different financial consultants?

Mr. Gallagher: At the present time we've only got two under contract. Arthur D. Little is not under contract. We went in search of several firms who were knowledgeable in certain areas and called and talked to the ones we thought appeared to have the most to bear on the subject.

Mr. Motley: The Investment Advisory Committee, as an entity of the State, is subject to the procurement and purchasing rules and laws of the State. We have to keep that in mind.

Mr. Waldock: The second question is, "What exactly are the fees paid to these various consultants and what is the length of their contract?"

Mr. Edenso: The terms of the contract are general, they are intended to expire at the presentation or the completion of our task and then have the Committee itself return to its original condition after we have prepared some output for the 1977 Legislature. We anticipate completing the closed contracts sometime in January of 1977.

Mr. Rhode: I believe all the contracts are identical in that they expire with the convening of the Tenth Alaska Legislature and generally the compensation is based at their customary fees with a ceiling not to exceed.

Mr. Waldock: Which is?

Mr. Rhode: It depends on the contract. For White, Weld it is set at the amount of $20,000 ceiling, with allowances for actual expenses.

Mr. Edenso: The Lesiglature passed an appropriation of $185,000 and the Governor slashed that to $135,000. Getting down to the actual contracts; Bob Richards from Alaska Pacific Bank - his contractual services are at a ceiling of $15,000 and $2,000 for travel and expense purposes, in other words he is limited to a total of $17,000.

White, Weld and Company, Inc. of New York has a ceiling of $20,000 with $10,000 for travel and expenses, or a total of $30,000. Price Waterhouse has the same limitation on their contract.

We have on contract but not utilized, Professor Edward Solomon from Stanford University - contractual services of $5,000, travel and expenses of $2,500 or a total of $7,500. There is also an unsigned contract, but an agreement if we need it, with Dr. Richard Neve from the University of Alaska in Seward, to prvide us specific information on fisheries and fisheries related subjects. His contract is budgeted for at $5,000 and travel and expenses at $1.000, or a total of $6,000.

We have budgeted for the Legislators involved with the Permanent Fund and for their discretionary use a total of $30,000. We have budgeted for legal research purposes $5,000; we have also budgeted for travel contractual services for the State Investment Advisory Committee $3,000 in services and an additional travel and expenses of $5,000, for a total of $8,000.

There is also a contingency fund of $16,500. We had programmed, prior to our full realization of what the costs would be for the information we were asking from Arthur D. Little, we had programmed $10,000 and for their travel and expenses not to exceed $5,000. The information we are asking from Arthur D. Little is very complex and very difficult to gather. It requires some very talented people in the area of the national economy, interpretation of that with the State economy, and some econometric modeling, not techniques but the results of a developed econometric model. We have not signed this contract yet but we're contemplating asking for a supplemental appropriation to allow us to proceed with this.

I think that generally gives us a total of $135,000, contractual services of $109,500 and travel and expenses of $25,500. We have one other contract -- Mr. Bill Batko. He would come under the budget item of State Investment Advisory Committee. He was recommended to us by Mr. Love. His total contractual services is $500 and travel and expenses of $1,500.

Mr. Waldock: Since it is one of the responsibilities of the Investment Advisory Committee to advise the Commissioner of Revenue and the State of Alaska on their selections of financial consultants and since these financial consultants primarily for the help on the Permanent Fund have already been selected, can it be assumed that the Investment Advisory Committee is not going to be held responsible for any incorrect advice given by these consultants?

Mr. Wohlforth: I would say yes, that can be assumed.

Mr. Gallagher: It was an executive prerogative.

Mr. Edenso: For the information of the Committee -- Alaska Statutes, Chapter 37.10.070(f) states, "The investment policy shall be formulated by the

Commissioner of Revenue, who shall be advised by a committee appointed by the Governor but shall contain representation from the Legislature. In formulating investment policy they shall consider maximum income and safety as governed by the prudent man rule and the benefit to the private and public sectors of the economy in terms of increased housing and commercial credit, stimulated business activity, increased employment, support of the market for state and local bonds, increased public revenue, together with the possible inflationary effect of the investment and (h) and (i) of this section. The Commissioner of Revenue, with the consent of the Committee, may enter into contracts for services providing investment advice, custody of securities and execution of transactions in or out of Alaska." That pretty much spells out what the previous role of the Investment Advisory Committee was. However, in the expansion of the Committee to undertake the task of establishing the Permanent Fund, the Governor asked that the Committee address itself only to the Permanent Fund at this point in its expanded state. Now, were you to begin to provide advice to the Commissioner as an expanded Committee, I would suggest that with the new members of the Committee, that may be inappropriate at this time.

Mr. Motley: Mr. Waldock and I have not discussed this subject before, but I think I understand the thrust of his questions. I think, as a long-time member of this Committee he would like to continue to participate in some of the decision making processes with regard to the selection of criteria, consultants, et al. As a fellow member of his Committee, I think I understand what he's saying. I don't have any problems with the selections made, but I've taken note of his scrutiny of the process.

Mr. Waldock: I'd like to say the same thing and not just for myself. I think everybody on this Committee should have that opportunity to have that choice and we might as well get the course of the Committee aimed in the right direction.

Mr. Waldock: The final question is the conflict of interest law. The law came into effect in 1972 that anybody working in an advisory or consultant capacity may not act in a contra-capacity as an investment banker, dealer, or accountant due to the possibility of conflict of interest. My question is, will this also hold true for the Permanent Fund?

Mr. Motley: What is the statutory reference?

Mr. Wohlforth: The only one I'm aware of is that prohibition which applies to the state and local governments of having a financial advisor bid on bonds. Is there another one that I'm not aware of?

Mr. Rhode: It doesn't apply in this situation because they're giving advice on general public issues. They're not structuring debt, preparing a prospectus, advising us on any specific type of investment, nor are there any investments for them to deal in.

Mr. Waldock: Couldn't you possible see a conflict of interest in investment advice or a consultant in this particular case because it takes in a broader area? Couldn't there be a little bit of conflict of interest if that individual was to structure the way the Permanent Fund is to be run and then, in fact, turned around and be in the other end of the operation?

Mr. Rhode: This matter was specifically addressed. Every consultant was given a copy of the relevant statute. I'm not aware that Price Waterhouse is dealing in securities. In the case of White Weld, they're in virtually every type of investment that is possible, all the way from tax exempts to taxable debt. So any way the Fund turned out there would some kind of business that they might have a part in at some later point. But that would be true of any other highly reputed national investment banking house that we might bring before this Committee.

Mr. Waldock: That's the exact point. I think if they are used as consultants they should not be involved in the actual use of the Funds, once it's in operation.

Mr. Motley: I move that I would be happy to work with Mr. Waldock and anybody else to draft the question and ask the Attorney General for his advice. There may be ramifications later on and perhaps White, Weld and others would like to know what their ramifications are.

Mrs. Fleischer: I'll second it.

Mr. Wohlforth: Any discussion? All those in favor say, "Aye." Opposed. So ordered. Mr. Motley, will you and Mr. Waldock work on this question.

Mr. Urion: Before we get completely off of this subject matter, I'd like someone to explain what this $30,000 is for? You said it was budgeted for the legislators to use as they see fit. I happen to be a legislator. How is it being used?

Mr. Edenso: To the best of my knowledge, it's being used for expenses incurred by the legislators for matters relating to the Permanent Fund, for telephone calls; for some travel, etc.

Mr. Malone: The appropriation was made in the Executive Branch, so what they've done is actually set aside $30,000 for the Legislature to basically make proposals against. It's the budget for that $30,000 that Senator Kerttula and I have worked up. The primary expenses are staff and office expenses.

Mr. Love: It is my hope that one of our very next meetings will be a meeting where the public has an opportunity to appear before us and give us their ideas on what they want the permanent fund to do. There are probably many other different approaches to the investment purposes for the development, many different ideas and proposals that we should at least hear before we make our minds up about what the proper direction is. We should not be committed in any direction before we have an opportunity to hear from the public.

Mr. Motley: I don't think anybody is committed. We can't commit anything until after the election. What we did today was mostly for enlightenment. It's probably the initial intellectual exercise to figure out what may happen if certain things do occur. The one thing that changes the Constitution is it says income producing investment, and that's where you have to start from. There isn't any mention on the ballot about social benefits versus social costs; there's nothing about subsidies, soft loans, or anything like that. We have to keep that in mind.

Mrs. Fleischer: I'm reluctant to leave the room without some decision on establishing the goals and objectives of the Committee. I would like for us to decide to do that, and I so move. I move that we make the next order of business a discussion of and decision upon the goals and objectives for the permanent fund.

Mr. Love: I'll second

Mr. Wohlforth: It's open for discussion.

Mr. Motley: I think it's a little premature at this stage of the game. I really think it would be presumptuous for us to come down with all kinds of goals and objectives when there's just a one liner that's going to be on the ballot.

Mrs. Fleischer: By the next time we meet we'll know whether we have a task or not.

Mr. Malone: I have to agree with Commissioner Motley. The very creation of this fund in the first place is on the ballot to be decided November 2 by the people of the State, and while I'm quite hopeful the outcome of the election will be positive, I feel it is presumptuous right now to start laying out goals.

Mr. Love: I think this Committee is going to have to look at the question of developing some pretty important goals and objectives relative to investment policies regardless of what happens to the permanent fund. The reason the permanent fund is being created is to have some mechanism to deal with anticipated surpluses of revenue; we're going to have more revenue than the State is going to spend.

Dr. Logsdon: Am I correct that the purpose of the standing committee is to address itself only to the permanent fund?

Mr. Wohlforth: I think that's correct, yes.

Dr. Logsdon: So if there's a "no" vote on the ballaot, this Committee automatically goes back to its original status?

Mr. Wohlforth: I hadn't understood that until today, but I guess that's right.

Dr. Logsdon: May I offer an amendment to the motion, that if the voters approve the permanent fund before the next meeting that this issue be considered, the issue of objectives of the permanent fund be considered at the next meeting?

Mr. Wohlforth: Do you consent to the amendment?

Mrs. Fleischer: Is that the sole purpose of the expanded committee? If the voters disapprove what will the Committee do then?

Dr. Logsdon: Then the Committee is not going to look to the objectives of the permanent fund because there won't be one.

Mrs. Fleischer: I accept the amendment.

Mr. Gallagher: There's a broad base public support. There are those who believe in the savings account concept, there's those who believe in community development, and there's those who believe in economic diversification.

Mrs. Fleischer: You mean you're saying that's what the goals are?

Mr. Gallagher: That's among the wide range. There are at least those goals in front of the public. The choice hasn't been narrowed down to all three.

Mr. Wohlforth: The motion is to consider goals and objectives at the next meeting if the permanent fund passes. Do we have any further discussion? All those in favor signify by saying, "Aye." Opposed? It passes.

Mr. Gruening: It isn't very long before the election and the convening of the legislature in January. I feel we should have specific questions or goals to put before the legislature -- narrow it down a bit. We do have some real deep issues.

Mr. Wohlforth: How about November 5 for the next meeting and advertise it in plenty of time to also have public input on that date. Also have Mr. Edenso make up specific questions for the consultants to answer. I would entertain a motion that the meeting date be November 5, that there be time for public discussion, and that there be a sub-committee appointed to meet with the Commissioner or his Deputy to pinpoint specific questions we want answered at that meeting from the consultants.

Mr. Gruening: Let's take that suggestion in three motions. The meeting date sounds fine, how about the 6th also? I'll second the motion. The other one - public participation. I so move that we advertise ahead of time, perhaps starting now before the election.

Mr. Edenso: What do we do if it doesn't pass?

Mr. Love: I would say that the purpose of the meeting would be for people to come and address the Committee on the issue of investment policy because that issue is still before us regardless of whether we have a permanent fund or not.

Mr. Wohlforth: All right then, is that satisfactory, that the meeting day the morning be devoted to public input? Then finally, a sub-committee to work with the Commissioner of Revenue on pinpointing questions, specific questions, for the consultants to answer at that meeting.

Mr. Malone: If a general discussion is planned at the next meeting as well as participation by the public, I would think that the concept of sub-committees might be more valuable after some of those things are hammered out, the sub-committees after the charge.

Mr. Wohlforth: Scratch the idea of the sub-committee for now. I'll entertain a motion for adjournment.

Mr. Love: I would like to introduce Mr. Bill Batko. He's been doing some work which we submitted to the board in short papers having to do with different types of not such gigantic, but smaller development corporations. For personal services he'll be submitting some papers after he gets back to Vermont and thinks about all the discussions that went on here.

Mr. Edenso: I would also like to introduce Mr. Ken Jensen from Arthur D. Little at San Francisco. We have a tentative contract with them to provide us with some national economy questions, given the potential size of the permanent fund and the nature of Alaska's economy and what Alaska's economy might look like in the future. This will provide the Committee information which relates directly to potential investment policy.

Mr. Motley: With that in mind then, you're asking for the Committee's approval. I'd like to review that contract to make sure that we avoid any kind of duplication on the other efforts that are involved in establishing that for the State. I would withhold that until I've had a chance to review that contract.

Mr. Wohlforth: Is there any further business? Do I hear a motion to adjourn?

Mr. Motley: Yes, so move.

Meeting adjourned at 5:15 p.m.

CERTIFICATION

I, JIM EDENSO, Executive Secretary of the Alaska State Investment Advisory Committee, hereby certify that the foregoing Minutes of the October 13, 1976 meeting of said Committee duly called and held at Anchorage, Alaska, on said date, are a substantial verbatim extract of the recording of the proceedings of said meeting with deletion of insubstantial matter and changed only to clarify the statement.

Jim Edenso

Jim Edenso
Executive Secretary

STATE INVESTMENT ADVISORY COMMITTEE
MINUTES
November 5 and 6, 1976
Anchorage, Alaska

Chairman Eric Wohlforth called the meeting to order at approximately 9:00 a.m. on Friday, November 1976 in Room 406, State Courthouse Building, Anchorage, Alaska.

Members present were:

Dr. Logsdon, Association Director, Agricultural Experiment Station, Palmer
Mr. Eric Wohlforth, Attorney at Law, Anchorage
Mr. Robert Barnes, President, Alaska State Bank, Anchorage
Mr. Dennis Waldock, Foster & Marshall, Anchorage
Mr. Jamie Love, Alaska Public Interest Research Group, Anchorage
Mrs. Lanie Fleischer, Anchorage
Mr. James Crawford, Coordinator Alaska Offices, Anchorage
Mr. Langhorne A. Motley, Commissioner, Department of Commerce and Economic Development, Juneau
Mr. James Rhode, Anchorage
Mr. Robert LeResche, Director, Development Planning & Research, Juneau
Mr. Firchard Freer, Deputy Commissioner, Department of Administration (For Bill Allen, Commissioner)
Senator Jalmar Kerttula, Palmer
Senator Frank Ferguson, Kotzebue
Representative Clark Gruening, Anchorage

Absent Members:

Mr. Emil Notti, President, Alaska Native Foundation, Anchorage
Mr. Martin Pihl, Comptroller, Ketchikan Pulp Company, Ketchikan
Mr. Robert Thorstenson, Petersburg Fisheries, Inc., Petersburg
Mr. Robert McFarland, First Federal Savings & Loan, Anchorage
Senator John Butrovich, Fairbanks
Representative Hugh Malone, Kenai
Representative Richard Urion, Anchorage

Advisee:

Mr. Sterling Gallagher, Commissioner, Department of Revenue, Juneau

Others present were:

Mr. Bob Richards, Alaska Pacific Bank
Mr. Frank Murkowski, Alaska Bankers Association
Mr. Don Dickey, Alaska State Chamber of Commerce
Mr. Bill Scott, Chamber of Commerce
Mr. Phil Daniel, United Fishermen of Alaska
Mr. Robert Smith, Central Alaska Utilities
Mr. Dwight Bowden, Home Federal Savings & Loan
Mr. Paul Kapansky, Home Federal Savings & Loan
Mr. Dan Regis, Price Waterhouse & Co.
Mr. Al Fleetwood, Alaska Bankers Association
Mr. Charles Fuhrmann, White Weld & Co.
Mr. Ted Swick, White Weld & Co.

MINUTES:

Mr. Wohlforth: In Bob McFarland's absence I will now open the meeting. As you know, the Permanent Fund amendment passed last Tuesday. This has been the subject of study by this Committee for the last two meetings where the structure of the Permanent Fund and testimony has been taken at prior meetings from consultants.

This morning we've set aside some time for public hearings now the the Permanent Fund idea has passed. What kind of structure of operation, what kind of organization, what sort of use of monies for income producing investments is appropriate to recommend to the Legislature and legislative committees when they start their work in January. We'll briefly go through the agenda. This morning is set aside for a public hearing. This afternoon, Mr. Bob Butler will give a report on possible uses of the Permanent Fund to leverage investment. Mr. Richards will speak on the Alaska banking system and various kinds of investments that might be contemplated for the Permanent Fund. Tomorrow, Price Waterhouse will have someone report on management governing boards and problems encountered in both the operation of other permanent funds and in the operation of development loan situations elsewhere in the world In other words, how can we avoid some of the mistakes that have been made elsewhere. Then we will have a work session under the general topic of structural and organizational considerations.

Mr. Phil Daniel: I'm with United Fishermen of Alaska. I would like to speak in rather general terms about the present situation in the fisheries as it might relate to the Permanent Fund. The Alaska fisheries at this point is rather archaic in structure and scope. We are presently harvesting about four stocks; gourmet items, and neglecting things that could be done. There is no doubt but that in the future we will have to rely on renewable resources, such as tourism, fisheries, timber, and things of this type. So it might be worth considering what the Permanent Fund could do to stimulate the fisheries industry by way of investment, and certainly the movement into the bottom fish.

Our salmon fisheries are in great difficulties. We have only about a third of our salmon stock remaining. I don't want to go into detail on gravel incubators except to say they produce a very healthy smolt and at a much lesser cost than the so-called conventional hatcheries that have been employed for years in the northwestern part of the United States. I could see the Permanent Fund acting as a stimulant to the industry moving into the bottom fishery; acting as a stimulant to the hatchery production situation. I can certainly see a very significant role that could be played by the Permanent Fund to stimulate the industry and hopefully provide an economic base that we can turn to when other avenues have exhausted themselves.

Mr. Motley: What you are really saying is there is no domestic market for the 5.1 billion pounds of fish. Wouldn't you think it is a logical assumption that given a 200 mile limit that the people who have been used to eating fish aren't going to stop eating them. So what we're really talking about is a change in the relationship of the process in which they're caught and processed within the 200 mile limit, i.e., the exclusion of foreign fishing rather than necessarily disrupting the total market? You would envision the Permanent Fund to be a vehicle to possibly replace the Japanese mother ships with American mother ships or on-shore processing facilities?

Mr. Daniel: I think that, but I would like to go beyond that. We've done so little in the Lower 48 to convince people that fish is a good product. We should broaden the market in the Lower 48 by convincing people that good fish is really a desirable produce.

Mr. Motley: With regard to the fish hatcheries program under the Constitutional change, that they would be a more apt vehicle for this investment as opposed to a State-operated hatchery program?

Mr. Daniel: I really think they can do it more cheaply as far as the capital investment, the initial investment. They are going to have to have good biologists and they've got to have a good business manager.

Mr. Gallagher: Those mother ships or a like vehicle, how much would they run in American dollars? A million and a half?

Mr. Daniel: I think it would be very much more than that. Large crabbers, 80 - 100 feet, now run better than a million dollars. A floating factory ship is what we're talking about and that would probably run millions of dollars.

Mr. Love: What effect would all this off-shore operation have?

Mr. Daniel: There is real nervousness among the fishermen. There have been reports by the National Fishery Service that indicate vulnerability of crab and shrimp loss one part per million of oil actually dissolved into the water. They don't really know what that means but it doesn't sound good. So there is real apprehension about OCS. I've suggested to the oil companies that they take a group of fishermen to the Gulf of Mexico and allow those fishermen to talk to their counterparts. That way they would realize they could live with OCS development and I think it would go further to solve the problem than anything else.

Mr. Love: How much investment capital do [illegible] k would be advisable?

Mr. Daniel: I really can't answer that [illegible] fully. I believe if we got private industry into it we could do it somew[illegible] ch[illegible]er than the State. As far as developing markets and stimulating the harve[illegible] [illegible] bottom fish, I really don't have figures on that.

Mr. Love: I just wanted to point out in the interest of future deliberations that it would be useful to have some figures. Also if you see the need for an investment in the area of hatcheries and in building boats or in processing facilities.

Mr. Daniel: Well, I can see it in the boat building if you're moving into different fisheries. If you're using a boat for other purposes besides salmon it is justifiable. If you're looking at moving into these bottom fisheries, very definitely we could use State money. The burden right now for the fisherman who wants to develop a new technique or move into something is entirely upon that fisherman. I don't know of any experimental monies that are available except perhaps a very small amount. I see it certainly in the hatchery situation, but I want to emphasize that what we are really interested in is the loan program where the State gets its money back. Simply a loan that is repaid out of the sale of surplus fish at the hatchery racks and repaying these assessments on the fishermen.

Mr. Love: You think the big part of it is hatcheries.

Mr. Daniel: The bottom fish could be tremendously valuable.

Mrs. Fleischer: How renewable are bottom fish? You are not talking about hatcheries when you mention bottom fish.

Mr. Daniel: No. Hatcheries only apply to the salmon. Bottom fish is a more frustrating situation. Our halibut stocks are in big trouble. Bottom fish can be renewed but only by not fishing them for awhile. We need a better and more careful regulatory regime. Under the new bill we have the ability to tell the foreign fisheries where and when they can fish. We can insist upon it, but there is always the question whether our State Department is going to show any courage.

Dr. Logsdon: What is the existing capability of Alaska fishermen to take bottom fish?

Mr. Daniel: I would say that some of the crab fishing boats could be substantial in size and could be converted fairly easily but it would cost in the neighborhood of $45,000. The gear capability is another thing and I don't think we're very close to that and the cost for conversion in that case would be in excess of $50,000.

Mr. Waldock: If we funded the Fishery Department, we would want to know if it would be a profitable operation because part of the criteria of the Permanent Fund money is it has to have a return for the investors.

Mr. Daniel: No, I would say there isn't probably much being done there. It should be carefully looked into--whether you let the money go in the direction of private industry or whether you let it go into any department as to whether or not you get an attractive cost benefit ratio.

Mr. Wohlforth: This subject is one that would take weeks of testimony before we get finished with it. Hopefully, people like Mr. Daniel will work closely with us and the legislature on this problem.

Mr. Dickey: I want to commend the Legislature for their efforts and this Committee for their work on the Permanent Fund in presenting this package to the voters. Our purpose today, basically, is not so much to offer specific suggestions as to where the funds might be invested but more to speak to the point of the goals, the objectives and the structure that we see might be helpful.

I think the permanent Fund is an exciting concept, properly used can bring untold benefits to the wide cross-section of Alaskans. I think it has also the possibilities of abuse and, if abused, will create a boondoggle second to none that we've had and of unprecedented consequence. I am going to ask Bill Scott to speak first. He is past president of the Alaska State Chamber of Commerce and is Alaska managing partner of the accounting firm of Peat, Marwick & Mitchell.

Mr. Scott: It seems to me that the structure of the Fund itself needs strong management and leadership. The Fund needs to be in a separate State-created corporation or entity that would be answerable to the Legislature. Because the Legislature will set many of the guidelines. I believe the Fund should have constant and on-going review, not only from the financial transaction standpoint but also from an operational analysis standpoint, so that programs can be continually evaluated. Frank Murkowski will have comments on more specific investment areas.

Mr. Murkowski: The statement that the Fund is to be used for income producing investment is one of the things I wish to talk about. I don't feel the State can realistically involve itself in very broad loan programs for the benefit of the public as a whole in a general way because of the politics that enters into these programs once they are established and the lack of independence that a State agency has in loaning funds. The political pressures result in bad loans and severe losses, sometimes. I would suggest that the area to look into initially are some of the broad guarantee concepts. There is on the books at the present time the Alaska State Industrial Corporation which allows the State to use its tax exempt status. The concept has never been used because there has been a reluctancy in the administration to allow the State's credit to be on the line in the concept of a guarantee. It has an application from the standpoint of providing the development of industries that are of high potential but yet high risk from the standpoint of other adequate markets in the State. As an example, the cement business in Alaska today. We certainly have all the resources to develop a cement manufacturing process but it is questionable whether the markets are here. But a guarantee program where the Permanent Fund could guarantee the bonds has an application. That type of program would result in substantial new industry. It would not be a tax incentive per se, but it could have a very substantial assistance to the development of the industry.

If you get into participation in loans that you require 25% participation from the lending institution, then the policing is done by the lending institution that is directly involved in the credit. Agriculture is another area that the Permanent Fund could be involved in by developing and clearing the land.

I'll leave you with the warning, if the program does get into an area where it is a broad loaning function, then politics is going to enter into it. No administrator can hold up under that kind of pressure.

Mr. Gruening: Did you say the Veterans loan program was an example of a bad program?

Mr. Murkowski: No, I specifically stated that the Veterans program was an excellent program. It is not a broad loan program where somebody can come in with anything. It is secured by real estate, the safest kind of program there is.

Mr. Gruening: Is that because it's a housing loan?

Mr. Murkowski: That is one of the reasons. It has specific guidelines and collateral value. It takes reasonable discretion out because you've got specifics. But you get into areas where you're projecting what the cash flow of a new business is going to be and you've got to be realistic with it; if it's marginal, that means it is marginal and you've got to look at it that way.

Mr. Gruening: The fact that it is a home loan as opposed to, say, participating by the bank. Which factor is important?

Mr. Murkowski: There is no relationship. The real estate loan stands on its own. You've got guidelines and you loan a percentage to the value, you know what the value is and you look to the credit worthiness of the borrower. If he's got the income to pay for the loan, he gets the loan.

Mr. Gruening: Why couldn't the same kind of criteria apply to any business loan?

Mr. Murkowski: First of all, any kind of business loan doesn't fall into value. Usually the individual wants to start a business. He's an unknown entity and has no operating experience. He wants to borrow for the collateral, he has no equity. But he might have a great idea.

Mr. Gallagher: When I was in the banking system, we reviewed our reserve for bad debts and 89% of our charge-offs were commercial loans, 2% in real estate, and 9% in installment loans. We took all of our losses in commercial loans.

Mr. Murkowski: There is no politics in the Veterans program.

Mr. Gruening: I'm interested in why you can't insulate some of the politics from the business loan situation? Why can't we make the people that are administering it responsible?

Mr. Murkowski: It's a different type of politics. The banker is going to go broke or he's going to eat his bad loans, but with the government it doesn't work that way. I think the people are responsible, it's the pressures they get. And I don't have any suggestions.

Mr. Waldock: Rather than have a new vehicle for handling the Permanent Fund could the Alaska State Development Corporation handle it? Realizing there are a few pitfalls with it, could any safeguards be put in?

Mr. Motley: I think if you had the banks in then everybody has something at stake and you have two underwriting criteria.

Mr. Murkowski: If you keep the banks in enough and don't let them off with 5% or 10%.

Mr. Wohforth: I am aware of the Alaska State Development Corporation experience. I think the point of a higher degree of private participation is absolutely the key to any reinstitution of that kind of vehicle.

Mr. Scott: It is almost certain, if not extremely probable, that any loan that is made within the State will have social impact. To the extent that it creates a better economy and new jobs, that social impact will be good under all the guidelines we go by. I don't believe the social impact should be the prime consideration on a loan made from the Permanent Fund, or anybody else.

Mr. Love: Do you think the social impact should be the principal goal of the Permanent Fund or do you think that we should look to standards of the quality of life and whether or not certain types of development are necessarily good. Which direction should we work for:

Mr. Scott: Why can't we have both? Every goal I ever had in my life was toward the bettering of the quality of my life and in the process of everybody else's that I dealt with.

Mr. Love: There are going to be times when these can be best achieved through increased economic growth and times when it would adversely affect these.

Mr. Scott: That has to be the Legislature's decision and not the administrators of a loan program. The two should be separate and don't directly affect one another except incidentally.

Mr. Edenso: What do you think might be reasonable terms for a small loan program, whether it should have 10 years, 20, or 5, or whether or not it should have a fixed interest rate or should the interest rate be tied to some kind of market rate of interest?

Mr. Murkowski: I can't come up with a blanket suggestion. I would comment that the borrower needs 10 years instead of five. The longer you put it out the more risk you have in subsidizing interest rates. Is that in the best interest of the State? From the private sector, I don't like the word "subsidy" because of what it implies. I don't think the State loan programs should be subsidy programs from the standpoint of the application of the word subsidy. You have to establish the priority that the Permanent Fund is going to apply itself to. How broad you want to get, if and when or, if you get into a loan program on an expanded basis. Should you only come into those areas that the private sector can't serve adequatly. Who makes the decision whether the private sector is serving the public adequately.

Mr. Edenso: Do you see any problem with the State loaning, say, $1 million for 15 or 20 years?

Mr. Murkowski: Yes, very definitely. If the State gets into loans of that nature they are just one step away from a welfare state. State loan programs change with administration and you'd never be able to control the politics in it.

Mr. Edenso: We have a very rapidly growing influence or segment in the business community in Alaska with the Native regional corporations who have potentially a very high need or desire for capital. Suppose they express a strong desire to participate in a Permanent Fund, would you see the banks as well participing in this kind of a development or lending activity?

Mr. Murkowski: The experience that most banks have had with the Native regional corporations in their effort to acquire whatever their particular interest is, they are in a position to put in an equity contribution that makes the long-term financing available for whatever they have in mind.

Mr. Wohlforth: Part of the work session this afternoon deals with the structure of the Board or whatever it is that will administer the Fund. How would you like to see such a Board structured? Would you want appointments subject to the approval of the governor?

Mr.Dickey: We would like to come back later and talk specifically on that. We will have some suggestions that I hope will be useful.

Mr. Wohlforth: How many more would like to testify this morning?

Mrs. Fleischer: I don't understand the dividing line on subsidy. Isn't guaranteeing loans for a high risk cement industry with public money a form of subsidy? Or, if we use public money or bonds to build roads or hydroelectric plants, to help the mining, manufacturing industry, isn't that a form of subsidy? Or is that a different kind of subsidy?

Mr. Murkowski: It's inpterpretation, obviously. If the mine can't be developed without it and then the road is built theoretically to open the mine, it provides jobs, it provides a tax base for the State, etc. So it is returned.

Mrs. Fleischer: Theoretically, wouldn't there also be a return on other forms of subsidies?

Mr. Scott: You can build a return into any program. A guaranteed program could provide a percentage rate in exchange for the guarantee. It doesn't have to be a loan of money to justify a rate of return.

Mr. Wohlforth: Mr. Smith, Central Alaska Utilities, would like to speak now.

Mr. Smith: I represent two entities. I am president and general manager of Central Alaska Utilities, a water utility supplying the suburban area of Anchorage. I am also president of the Alaska Utilities Association, an association of regulated utilities throughout Alaska consisting of water, gas, telephone, electric, refuse and various other utilities that are regulated by the Alaska Public Utilities Commission.

One primary difficulty that we've all faced, not just in the State of Alaska, but nationally as well, is in obtaining long range financing for the development of these facilities. Apparently facilities such as reservoirs, transmission lines, extensions to serve new areas and source facilities such as wells and treatment plants are not attractive as an investment to the banking or financing community. However, these utilities are one of the most stable operations anywhere in the country. Our product is absolutely essential to the maintenance of life and health.

We feel the money is a good risk and would be spent in Alaska for Alaskans. We are asking for a program in which monies would be repaid with interest. We need a vehicle whereby funding is made available to utilities which are vital to the existence of the economy, health and happiness to the people of the State of Alaska and which are essentially not now available.

Mr. Gallagher: Is it not true that with the existence of the public utility any subsidy both for the private and the public utility, I'm thinking in terms of interest rate, does get passed onto the consumer through the rate making process?

Mr. Smith: That is correct. The cost of doing business is paid for by the customer whether it is in a department store or a utility company.

Mr. Love: You want long term loans?

Mr. Smith: Long term loans with a reasonable rate of interest is what we're suggesting.

Mr. Love: What is a reasonable rate of interest?

Mr. Smith: 3%; 9% I believe is the ceiling on the existing funds now. However, the problem is the term, not the interest rate.

Dr. Logsdon: Are you suggesting that the Permanent Fund should be subdivided into categories?

Mr. Smith: I think that would be helpful. Then the utilities or whatever would know what they had to work with and keep within that goal.

Mr. Gallagher: What is your own capital need?

Mr. Smith: Roughly a million dollars a year. It goes out very easily and fast. The water comes free, the reservoirs are roughly on the order of $750,000 each. One parting word -- the money is to be spent entirely within Alaskan industry and the service that we provide is entirely to Alaskans.

Mr. Crawford: What is the breakdown as far as water utilities and electrical utilities as compared to REA?

Mr. Smith: I believe we only have one REA in the group. All of the regulated utilities are not members of the Association.

Mr. Edenso: What is the average or normal turnover rate for long term debt in Alaska utilities? How long is the average long term debt kept on the books?

Mr. Smith: Except in extreme or unusual cases, long term debt has not been available for the utilities.

Mr. Edenso: Would $10 million be adequate if you have an average life of long term debt of 30 years?

Mr. Smith: There are a number of factors that will govern then. One, the rate of expansion given for a particular area. The Public Utilities Commissioner would have specific figures on all of this. Every utility is required to file an annual report to the Commissioner.

Mr. Wohlforth: Two gentlemen from the Home Federal Savings & Loan have been waiting patiently.

Mr. Bowden: I am Dwight Bowden, Chairman of the Board of the Home Federal Savings & Loan Association. I'm also a real estate broker and primarily interested in residential housing. Mr. Paul Kapansky is here as president of Home Federal Savings & Loan.

We feel one of the excellent uses of the Permanent Fund would be as a secondary market for residential home loans or multi-family housing loans in the State of Alaska. We feel this is an area the Permanent Fund could get into at fairly low risk and provide much needed housing for Alaskans who can't afford it.

Mr. Kapansky: We also feel that not only to compete with some of the existing secondary markets but perhaps create a secondary market where there is none, primarily residential lending. When we get involved in commercial projects, it is an extremely capital-short state. When we put a package together we can't sell it here and have to pay a higher rate for it. If we had something within the State of Alaska which we would not have to charge the buyer or the builder as much, it would be much better.

Mr. Love: Do you think we look more towards being involved in the housing market whether it is multi or single family homes because of the increasing cost of the single family home. How realistic do you think it is over the long run to really think in terms of providing single family homes?

Mr. Bowden: I would say multi family housing is going to be priced in the range that more people can afford than a single family home on its own lot because of the high cost of land and the high cost of developing that land.

Mr. Love: There is going to be a big move to have the Permanent Fund get involved in housing. Housing is a real tough item here and it is important that we get comments from the banks and savings and loan industry. Just exactly what areas are in need in terms of financing.

Mr. Kapansky: One of the restrictions is that we cannot collateralize deposits. So that in most instances we can only bid on $100,000 in increments.

Mr. Gallagher: The Department of Revenue put out of the pension fund large quantities of money into housing. Is that a successful program? Has it satisfied that market, or is the market quite a bit bigger?

Mr. Kapansky: We have utilized every nickel and the market is quite a bit bigger than you have funds to utilize. The money is essentially for low income people.

Mr. Wohlforth: Are there any other questions? If not, Mr. Fleetwood would like to say a few words.

Mr. Fleetwood: I'm Al Fleetwood, Secretary-Treasurer of the Alaska Bankers Association. In particular, we are pleased to support the creation of a Permanent Fund. We feel the Fund can be used as an economic stabilizer. It should be structured and maintained as a Trust for the lasting benefit of the citizens of the State of Alaska. As such, all objectives, investment policies and guidelines should be established within the context of the "reasonable or prudent-man" investment principle. We feel the Fund can be a tremendous asset for the State in terms of both a capital source for future development and a cushion for a possible period of inadequate State revenues.

Mr. Love: Will the Association try to have some specific suggestions on how to deal with some of the problems that have been brought up?

Mr. Fleetwood: It is difficult to get all of the banks together, but they are committed to come up with some composite position and I think it will be very meaningful to your Committee.

Mr. Wohlforth: Thank you. Any further questions? If not, we will recess until after lunch.

Mr. Fuhrmann: I am Charles Fuhrmann and with me is Ted Swick. We are from White Weld Incorporated, the New York office. We've been asked to speak on the use of leverage in the Permanent Fund. It is our feeling that it is premature for a detailed discussion of leverage because the goals and objectives of the fund have not been established. Nor has there been a decision taken as to whether or not leverage is appropriate for the Fund. It is appropriate, however, for the Committee members to be aware of the possibilities of leverage so they can focus on those decisions.

The Fund itself is going to have a pool of funds and a future cash flow. Leverage should be a means of magnifying the influence and maximizing the economic impact of the Fund. There are various ways of doing that; one is by direct borrowing of the Fund, either tax exempt borrowings or straight debt issues in either the public or private capital markets where the Fund was the borrower.

Among the various development banks and other funds in the world, many have used borrowings on their own assets either from their governments or from the public or private market. Another means of leverage is the use of guarantees, which allow you to have a multiple effect in the use of assets rather than being limited to the assets themselves, you could extend guarantees of other people's securities to an extent much greater than the assets you have. The value of the guarantee would be based on the amount of leverage you created and the form of the collateral behind the guarantee. A third means of leveraging the Fund or at least maximizing the economic impact, is the form of the participation or financial participation you take in a project's financial structure. Encourage and facilitate the participation of private capital because they come from behind that capital and create a sense of security and minimize the risk to that capital. In this way you have the means of expanding the size of the projects you can participate in without having to be the total lender.

Mr. Swick: Let's talk about tax exemption for a bit. It isn't always clear just what tax exemption means. The assets of the Fund itself and the source from which they come has no bearing on whether or not your activities can be tax exempt. The only restriction that I see based on Federal statutes, is that if you were using the proceeds of a bond issue issued by the Fund or an appropriate underlying entity that might be created, that those bond proceeds from that specific tax exempt issue could not be used for the benefit of a private person. That would include either individuals or corporations.

I don't whether there has been any decision on the tax exempt subject. The financing possibilities and the use of the Fund can be found when you decide what you want to do. I think the economic impact can be very pleasing as to what you are trying to accomplish.

Mr. Gallagher: Could you elaborate on public purpose in tax exempt financing, just what are the limits of public purpose?

Mr. Swick: The definition has been stretched beyond reason, particularly when you talk about industrial aid and lending credit to private persons. One recent development is where the IRS took a view of a public purpose is when they declared the handling of garbage or refuse as a public purpose. I think it is possible for this Fund and the source of its assets to be not restricted in the activities you can engage in with that money. If you do go into the borrowing market and expand the capital base in that manner, there should be legal documents to have that money segregated and just trace it through so it doesn't end up in an industrial private person's hands.

Mr. Love: Would you say that housing and public utilities, even investor-owned utilities are the more traditional areas?

Mr. Swick: Investor-owned utilities, the answer is no. They have entered into the tax exempt field in the area of pollution control in very significant amounts. It has been a more reasonable source of raising capital for non-productive expenses than they have to to comply with the environmental protection laws. Traditionally, the services you expect from your town, country, borough, or State such as schools, roads, sewers, water, and housing.

Mr. Waldock: I wonder if you would address the possibility of using an insurance program on some of our loans. The Alaska State Housing Development just put out some bonds within the last month and it is a fully insured program. Would there be any possibility of using this type of an insurance on various types of loans that we might be able to utilize through the Permanent Fund -- bond issues of local communities?

Mr. Swick: Yes, I think those techniques can be applied to this corporation mo.. .

Mr. Fuhrmann: There isn't much difference between a guarantee and an insurance program. With a guarantee program the Fund could get a fee for providing the guarantee. To the extent that they are putting assets aside to collateralize the guarantee, those assets will not be idle but will be invested. The combination of the guarantee fee and the earnings on the put-aside assets may be considered an attractive investment alternative.

Mr. Crawford: What is the point spread between tax exempt and non-tax exempt bonds?

Mr. Swick: It fluctuates and changes with maturity.

Mr. Wohlforth: We will need some expert advice perhaps from the Attorney General's office on some of these questions like what is income-producing investments and what can they invest it in. The concept of leveraging. It may be that the Legislature will consider that we will continue to borrow for public improvements and have the Fund provide a substantial reserve against the amount that is borrowed.

I think we ought to consider early whether or not, if we use a reserve fund concept for public borrowing, if we can do other than borrowing for so-called income producing investments, which a school obviously doesn't qualify for. Does the fact that ultimately the monies may be paid back to the reserve fund as a loan, does that qualify it as an income producing investment?

Mr. Fuhrmann: At noon today I was asked, "What happens if the Fund wants to get into research and development or front-end money or something that would lean to an income producing situation". My answer was that if the Fund is income producing that another form of leverage -- a sense of multiplying your economic impact and the ability to pledge future funds that will be coming into the Fund as opposed to current funds, you can provide a long term takeout to a bank so the bank is actually putting up the start-out money and is assured of a takeout from you when the project becomes operational. So you have the ability right away to encourage projects that are not initially income producing. The other alternative is having interest holidays until the project gets going, but that may not be consistent with the income producing concept.

Mr. Wohlforth: Mr. Richards, Alaska Pacific Bank.

Mr. Richards: My discussion today will really have two parts. The first part will be institutional in nature, comments on describing the Alaska Banking System. The other part is the initial observations on the relationship between the Permanent Fund and the Alaska Banking System. On a per capita basis there are more separate banking institutions -- not number of offices -- in Alaska than in all of the other weste states. That, of course, includes commercial banks, savings banks, and savings and loan associations.

I think the most important element of the Alaska banking system in terms of the Permanent Fund is the role which Alaska banks have played as a conduit for channeling funds from large, long-term investors to Alaska's families and businesses. They also serve as conduits through loan participation with Outside banks. The relevance of all this, is that the Alaska banking system is structured and has operating procedures established for serving as an effective conduit for the flow of funds from large investing agencies to Alaska's families and businesses. In conclusion, if a portion of the Permanent Fund is allocated toward loans to consumers, families and Alaska businesses and organizations, then it would make sense to do this through an efficient system of financial institutions already set up to perform this function.

Mr. Gallagher: I see a need for an institutional change. The tendency of the commercial banks in the State to send out relatively young and inexperienced managers to the small rural branches. Since they are young and inexperienced they seem to be unwilling to take risks or do any new sort of program. What sort of institutional change or emphasis could be accomplished in order to make them more responsive to that problem?

Mr. Richards: I don't necessarily concur with your thesis. It would be helpful to know what tack we're headed for. Are we discussing the Alaska Banking System, the Permanent Fund, or the relationship between the two?

Mr. Gallagher: The rural areas are not getting the loans that the Anchorage and Fairbanks communities are. The bank managers are usually not aware of the loans that can be made.

Mr. Love: I think it would be helpful to the Committee to have some indication from the banks where the Permanent Fund might fill gaps that are not otherwise met and I would like information on how we can better interface with Savings and Loans and credit unions. Also, before we start making a lot of plans for the Permanent Fund we need to know what the needs are in the State and what we're looking at in terms of this money. How do the banks fit in with the Permanent Fund?

Mr. Waldock: What is the length of a short term loan and what is the length of your long term loans? In other words, what the commercial banks are doing versus what you think the Permanent Fund should be doing in regards to length of time.

Mr. Richards: I think the Alaska banking system is set up to take care of credits generated by local Alaska businesses and families. They make consumer loans for as long as ten years. The Permanent Fund should be oriented more toward economic development type of loan.

Mr. Wohlforth: Is there a real demand for long term credit? What does real mean? Does that mean there are projects which should be financed now and which are not because of the lack of long term capital? We don't want to set up a credit mechanism which is inappropriate to the economic scene and climate of Alaska. Everyone has perceived the capital needs for Alaska but nobody has a real grasp on what they are, are they being unmet now for lack of capital?

Mr. Barnes: The Alaska banking system is a mortgage banking system plus we are filling a gap and that gap is real estate monies. That's where the real need is. We have to now write our mortgages to the underwriting standards of Outside lenders. Those, in many cases, are not realistic Alaska criteria. If the State had a program in which these criteria were eliminated, that I think would serve a real purpose.

Mr. Crawford: I notice on the agenda tomorrow we get into the structure. We still haven't decided what our goals are. I think we continue to put the cart before the horse. We should decide what the objectives of the Fund are and what direction we want to go.

Mr. Wohlforth: Do the members feel we are making any progress in our thinking? In the discussions we've had are the areas sharpened in your minds, the issues that the legislature has to face in determining the goals and the areas where the Fund can be effective?

Mr. Love: I think some of the most important things we can do now, we can't commit the State towards goals in different directions.

Mr. Wohlforth: It is frustrating for any group to be thrust with the job of finding the goals. It is only through a process of discussion of the segments of lending activities or capital needs in the State. At least we can be aware of some of the positive things that have happened elsewhere and that is what we want to avoid and we can transmit that to the legislature.

Mr. Edenso: Our task before us right now is to address what kind of structure and organization we may have. If we take it in the context that we do want to provide some kind of social service or social good, or if you do want to provide some economic development activity or if you do want to provide some conumuity development activity then you can begin to talk about structure, organization and management. We can't go along between now and January and not come up with a product. I fully intend to see that this Committee has some kind of product before the legislative body in January.

We have three major categories, one is what are the goals and objectives. I don't believe we have either the time or the money available to us between now and January to answer that. The second is, what kind of organization, what kind of structure, how does that relate to the general public, how does it relate to the legislative body and to the admiinistration. I think we can address that. And finally, you have a problem of what do you do with the income of the Permanent Fund. How do you distribute that to directly benefit Alaska. So tomorrow, I think we should address that problem first, do we want a dual board system or don't we?

Mr. Wohlforth: We will recess this meeting and resume at 9:00 tomorrow.

MINUTES of NOVEMBER 6, 1976

Mr. Wohlforth called the meeting to order at 9:00 a.m., November 6, 1976.

Mr. Regis: This is the second report of Price Waterhouse & Co. We will address three specific questions today. First, we'll take a look at the problems associated with development banks. The only notorious and widely-known case of a development bank failure occurred with the development bank of Ethiopia. The problems probably began as a result of a split between the agricultural and industrial sections of their charter. Originally it was a multi-faceted institution. Subsequently the agriculture was retained and the industrial section was put in a separate development bank. There was too much concentration in the agricultural sector of the economy. There was not adequate diversification to protect the portfolio as a whole when crop failure or whatever, hit. Also the loans were much too small to be adequately supervised and too small to be processed efficiently. Also the loans were to unsophisticated borrowers who did not properly use the proceeds to expand production and as a result were unable to repay them. Management was simply not adequate to the task. Finally, the control system which was devised for a multi-faceted bank and which were set up to handle a larger volume, were not revised when it went to a small operation. These problems were recognized with the Ethiopian bank and it was remerged into the industrial bank and it appears now to be operating successfully.

The main reasons for failure of a development bank or finance development company is: incompetent management, unusual or undue political influence, and lack of a clear operating mandate, and also too ambitious a program. A summary of lessons which could be learned from these experiences would be first of all that the operating management must be very capable as must the Board. The appointment power must be removed generally from the political influence so that operating management can exercise prudent decisions. The charter of the institution must clearly define the objectives. Impossible objectives should not be set. Finally, government influence must be reasonably controlled so as not to dilute the independence of the institution.

The second issue had to deal with measurement techniques. The World Bank has a section essentially for evaluating the results of particular programs which are undertaken. At the completion of every project there is a detailed project completion report submitted by the various sections involved in making the loan. Evaluation is really a three-fold process. The primary thrust is a comparison of actual to plan as it was originally proposed when the project was brought to the World Bank.

There are a whole series of specific things which are compared in this actual plan which include implementation, just how quickly it was done, if it was done in the same time as proposed, has a serious impact of a host of the benefits intended. Compliance, did the borrower and the government associated meet the loan covenants, etc. Did the consumer perform as expected. What is the financial performance of the borrower. What is the economic impact to the extent that it can be measured. Efficiency on the part of the lending institution. Could or should other projects of this like be offered and can it be done in a more expeditious manner?

The second thrust is a macro view of the impact on the economy of the country or area, whatever was intended and this would be cumulative as opposed to individual. The macro view is designed to see whether you help employment, income redistribution, whatever else was intended in that particular country, has the standard of living increased, etc.

And, finally, can we do a better job? Was the performance of the bank actually appropriate to the circumstances presented to it? Was the diagnosis of the borrower's needs appropriate? Was the definition of the objectives of the project correct at the outset, understood, whatever. Were there unintended effects, good or bad? Poor or good environmental impacts? Was the bank participation effective or was it detrimental? The purpose of all this is to restructure activities in future efforts.

The next one is Organization. The question essentially is, what is the appropriate organizational structure at the policy level for the Permanent Fund institution assuming that development financing is a significant part of the activities? Our conclusion is essentially it should be a dual board structure. The objectives of the dual board structure are, first, you want to avoid undue political influence while being responsive to the political system. You want to provide for public input. You want to make sure that the organization allows the selection of the most capable people. And, finally, you want to make sure that the organization preserves the operating management's prerogatives ordinarily associated with management exercise.

The dual board structure should be composed of a board of citizens and secondly a board of directors. The purpose of the board of citizens would be to review and suggest changes in the charter and to represent the citizens of the State of Alaska and voice their views with respect to the operation of the Fund. The board of citizens would meet annually only unless there were some other special purpose. They would not be compensated except to the extent of expenses and essentially they would be representatives in what might be termed Alaska, Inc. We feel that a popular election of some portion of the board would be appropriate because it allows the public input in the sense that the wishes of the majority of the State can be expressed, the views and concerns of minorities in geographic areas, and it would give life to the concept of Alaska, Inc. There is a very close analogy with the representatives elected here being very comparable to the board of directors or the board of governors being elected by shareholders.

Our view of the board of directors is that initially it be composed of a group of seven, or it could be as high as eleven, who would be appointed by the governor in staggered terms so that no one gubernatorial candidate or elected official can control it. These seven would be confirmed by the legislature so the legislature has its input. The board of directors would essentially be a policy making board. It receives and acts on the issues presented to it by management but does not intervene in management in the sense that it does not present specific loans, it does not suggest geographic redistribution emphasis. Its purpose is to set policy and to react to input provided by the staff.

The president of the Alaska Permanent Fund should be appointed by the board of directors. He should have the power to conduct all the ordinary business of the corporation, hire, fire, be responsible only to the board in the sense of what is normal prerogatives of management. He would serve also as ex-officio as chairman of the board of directors but would have no vote.

Mr. Gallagher: How could that large board and the board of citizens be more responsive than a body that is already elected every two years called the legislature? Why would that be more responsive to the Permanent Fund?

Mr. Regis: It would be more responsive because it would have only one issue to deal with.

Mr. Wohlforth: How far down in policy does the board of citizens go and where is the split between that board and the board of directors?

Mr. Regis: The split would be very narrow in the sense that it would be the issues that would affect it, for example, an ordinary corporation under the Articles of Incorporation or the bylaws associated therewith.

Mr. Wohlforth: You also state that the board of directors would be explicitly prohibited from suggesting or recommending any particular financing operation to be considered or made by the board. But it would have the power to decide on loans or equity investments proposed to it by the staff. What do you mean by particular fiancing operaton? Are you talking of the actual industry to which a loan would be made or the borrower?

Mr. Regis: The board would decide on issues presented to it and would query very closely the staff on all of the factors either for or against a particular loan. But it should not enter into the question of seeking out particular areas of loans other than by policy.

Mr. Crawford: If the board of citizens is a group that is only going to meet once a year why do we need it?

Mr. Regis: The purpose of the meeting once a year is to receive the report and the accountability of the operating personnel and board of directors. You make the Permanent Fund accountable to the board of citizens or the electorate itself. Also you want to be able to change the direction of the Permanent Fund if circumstances themselves change. There is no proviso without some kind of public input for the citizens to do that.

Mr. Love: One of the fears I have would be the whole issue of how much money they could spend to get elected, who they could get contributions from. I can see basically the recipients of a potential loan being very heavy contributors to the people who are running for office to decide where these loans are allocated.

Mr. Regis: You must make sure there is not undue influence from any one sector. To make unusual contributions to a member of the board of citizens, your prospects of achieving a loan under the protection built into this organization is not great.

Mr. Freer: Why couldn't the legislature sit once a year as a citizens board? They are duly elected by the citizens of Alaska.

Dr. Logsdon: One observation might be that the citizens board might be an awfully expensive group to bribe. We're trying to achieve insulation from political processes as it related to other things other than the Permanent Fund, which might be an argument against the legislature sitting as a citizens group.

Mr. Regis: That is right. We are suggesting this as entirely separate from the legislature.

Mr. Barnes: The function of a citizens board is like stockholders. They have an annual meeting and would certainly not pass on day-to-day operations. Couldn't the legislature do that just as easily?

Mr. Regis: They could. I would prefer to see something removed from the legislature so the legislature has its input through the board of directors instead of as controlling, as it would be under that method.

Mr. Edenso: A good many of the residents of Alaska perceived the Permanent Fund as a means of insulating government from the legislative body.

Mr. Gallagher: The purpose was to insulate it from undue political influence, not necessarily from the legislators. You need the proper political input.

Mr. Edenso: The Permanent Fund is viewed as a savings account or separate fund which the legislative body can in no way influence for budgetary purposes or government spending.

Mr. Crawford: They can't defeat the purpose if they can't spend the money.

Mr. Regis: But if they were to function as both a board of citizens and to pass on the board of directors that would give them a chief proportion of the influence. This insulates the Fund from any influence by the legislature but still allows very positive influence.

Mr. Wohlforth: I think we must distinguish between policy and influence.

Mr. LeResche: I'm still unclear as to where the line between policy and operation is.

Mr. Regis: The board of directors will overall decide the policy of the Fund subject to review by the citizens board. The citizens board votes on the Articles of Incorporation and the Bylaws and passes on the annual report made to it by the board of directors. If the citizens board disagrees with the direction of the Fund they can change that through the Bylaws if they wish.

Mr. LeResche: So the actual policy sits with the board of directors and the oversight policy is with the board of citizens.

Mr. Regis: That is correct.

Dr. Logsdon: What you are talking about is essentially establishing a separate corporation to handle the Permanent Fund. The stockholders of that corporation are all the citizens of the State of Alaska. In order to have a stockholders meeting and you can't find a room that is large enough to put everybody into, so you select a certain number of citizens to represent the stockholders and they perform the same function as stockholders of any corporation. The reason this is separated in this sense from the Legislature is because you've got a separate corporation. It's really two separate functions.

Mr. Regis: That is right. It is a State instrumentality so consequently you do have to put State input in it.

Mr. Motley: Who are the president and this board of directors directly answerable to? Who could fire the president and the board of directors?

Mr. Regis: The President can be fired by the board. The board -- either their term expires or they can be fired by the legislature and the governor.

Mrs. Fleischer: How is the fund to be structured if this is a development bank? I don't really see a use for the board of citizens. It would be a useless board if they met but once a year and had no real power. They might be cynical about the board of citizens if you told them they did have power and they didn't have power. I don't think it is realistic to think they can change the bylaws, especially if it has to go through the legislature, and if they did it would take them a long time. If the Fund were a savings account, if a decision were made to invest money and then put the income into a general fund, it would be set up entirely different. Then the legislature would make the decisions about how the money would be spent because they would be spending out of the General Fund.

Mr. Regis: I don't think this particular organization would fit those circumstances. If you're going to have a savings fund concept the relative risk becomes measurably less. Just a comment, if you go to solely a savings account concept, if that were the primary function, then a lot less complicated organization would be drawn up.

Mrs Fleischer: Maybe we should be laying out the alternatives. It could be a pure savings account, it could be a pure economic development fund, or it could be a broader economic development fund, or a combination of all three. How would you set it up if it were purely one of those or a combination? Each one would be different. What we need is the structure of at least those four alternatives. Then we could give that to the legislature and say if you make this decision it will then be structured this way. We could lay out the choices so it would be really clear to all concerned.

Mr. Gallagher: I agree. If your goals and objectives are savings account, then you're going to have a different structure. If we only have a savings account, then you don't need that large a board.

Dr. Logsdon: I'm not so sure a citizens board could function on the basis of the amendment; they may only be able to advise in a general sense. It may be a legal question.

Mr. Gruening: I think your point is that ultimately the goals will have to be established by the legislature only. That would clarify some of the problems we had initially -- in which people were alarmed that this group was going to decide the goals. I also think the savings account concept is a good one for a number of years.

Mr. Wohlforth: We can approac this from the point of view, does there have to be an economic study of just where we re, and a long term economic study of how effective our capital markets are, and what sort of projects are ready to be financed. What has been the effectiveness of our existing loan programs and how large is the State budget going to be in relation to the Permanent Fund in ten years. This has implications for the savings account concept. These are things really worthy of consideration.

Mr. Edenso: It is really nice to raise those questions and to seek answers to them, however, we are really faced with the question, do we or don't we want to address something called the structure of the Permanent Fund. We could spend the next years studying the nature of the capital market in Alaska and we would find on an actual basis as the price of oil fluctuates the capital market, Alaska so fluctuates. We would be a little remiss in waiting for some period of time to try to establish the structure of a Permanent Fund. In ten years we could have a $1.5 billion and we have to know what to do with it. We've got to address structural organization.

Mr. LeResche: The legislature certainly will have to deal with this, but our expert witnesses and consultants say the structure will vary according to the objectives we set forth. We haven't set any specific objectives for the Permanent Fund yet, therefore, it is premature to discuss specifics about the structure.

Mr. Rhode: It is quite clear that the legislature is not going to recommend that the Fund be turned over entirely to construct buildings at the University of Alaska.

There are three major areas of activity for the Fund. Given those broad goals, we expect this Committee to state its recommendations and preferences, but also to offer alternatives to the legislature.

Mr. LeResche: I'm talking at the level of savings account, direct social objectives, maximum return on investment, industrial diversification. Any one or all of them will have a different management structure.

Mr. Edenso: The problem is that without a goal or objective, we can't look at some reasonable approaches to management and structure. We are faced with a very critical time factor. In approximately 120 days we are going to start receiving funds into the Permanent Fund. We need to have something before the legislative body for their consideration. I don't believe it is possible, given the current level of resources,both monetary and human, to establish the goals and objectives of the Permanent Fund. Another major question is what do we do with the income?

Mr. Love: Without getting into too much controversy, let me just say that I feel we should put the money in conventional money markets for a period of time until a lot of the planning and work with the public and the legislature is done. I don't want to get into a big argument about goals and objectives because I think there is confusion about what those words mean. I think we should take the total amount of money in the Permanent Fund, the first half year is not going to be all that significant, in comparison with all the other State's revenue, and put it in conventional money markets for the time being.

Mr. Gruening: I don't think we need to come up with a permanent structure that is going to last for the next ten years in the first part of the legislative session. They might wish to just buy current investments for a time until they have a chance to really think about it more.

Mr. Edenso: This meeting wasn't intended to come out with something that would be our recommendation to the legislature for a structure and organization. It is a first effort at considering various structures that are available and getting some meaningful dialogue in trying to put it all together.

Mr. Gruening: Let's take the savings account aspect and if there are any differences that should exist in the structure to administer that kind of policy. What structure might you consider as an interim structure.

Mr. Ferguson: I'd go along withe the board of trustees -- 7 members appointed by the governor and confirmed by the legislature to take care of the administration of the investments in the Permanent Fund for x amount of years. The first thing we have to do is at least recommend that we have a structure set up to administer the investments of the funds as they come in until we actually see how much money we have.

Mr. Gallagher: I would like to accomplish at th. point a management structure. If we agree that the three goals are savings account, community development, and economic diversification, come up with a management structure at the next session. That we spend the interim between that session and the following thinking about the strategies as to how to accomplish those things. In those areas we need a lot of analysis In housing, what are some of the institutional things that we have to go through, where are the housing needs in the State? The same way with fisheries, or any other sector. In the following session, when we have $200 million probably in the Permanent Fund, then we have those policies established. The legislature has then had two years to work on the problem and at that point you can start accomplishing something.

Mr. Rhode: Representative Malone has always expected that a temporary statute would be necessary to provide for the routine investment of whatever revenues are reaching the Fund. What he is hoping for from this committee are recommendations and alternatives on structuring the fund given a set of goals. That does not have to be done under a crisis footing, it may well be a process that involves the 1978 session or beyond. This committee ought to be able by session time or in the early months to assess or make some recommendations along the lines of any development activity whether you ought or ought not to have a governing board insulated from those who make loan appraisals, etc. The legislature may well be able to resolve a lot of these organizational matters by the first session, but hold it until the goals have been settled and combined with the enabling act.

Mr. Love: If what we are really talking about in the first year would be a conservative approach on how to invest these funds, I am looking for you to think in terms of making a recommendation to us. One of the alternative structures would be to simply perform a function of very conservative investment the first year. Secondly, maybe provide some information and advice on the administration during that first period of time, planning for the second year. I would like to know how that structure would differ from the structure that is before us now.

Mr. Regis: My reaction is that probably the citizens board would not be required at all although you might want to have it provided for at a future point, at least in concept.

Mr. Love: One of the major recommendations we can make is the initial management structure for the Permanent Fund toward doing certain types of planning jobs, certain types of economic planning jobs. The types of analysis that we think are very important. Maybe that is more important a job in the first year than making loans.

Mr. Barnes: I think we should decide and make a motion that the legislature should make temporary legislation and then if they want to give us their goals and objectives, we can certainly work out the alternatives for them.

Mr. Gruening: I think that is a good suggestion, but let's go further. We might suggest to the legislature something they could consider in terms of structure on a more permanent basis -- on a structure and organizational basis.

Mr. Gallagher: One of the things I would like to accomplish now is, if we want to talk about savings account objectives, what sort of management structure the Committee would see. To me, there are two obvious things. One, you can either leave it in the Department of Revenue -- if your goal is only savings account, and have them manage it just like any other fund. That's the most inexpensive. Or, the other alternative is to have some sort of small board overview that activity but still have it accountable to one manager. If that is your goal, the savings account, what does the Committee think of those two alternatives?

Mr. Wohlforth: I don't think it makes any sense to have an operational board. You need one manager who should be the State Treasurer, or in this case, the Department of Revenue. I hope there will be an investment statute on the books by the time there is money in the Fund.

Mr. Gruening: I move that the Committee direct Commissioner Gallagher to draft for consideration at the next scheduled meeting of this Committee a temporary statute which authorizes management of the Permanent Fund monies in a manner similar to the Department of Revenue's present administration of surplus funds.

Mr. Love: I'll second it.

Dr. Logsdon; May I make an amendment that it be a statute and not a temporary statute?

Mr. Gruening: I concur.

Mr. Gallagher: Does that mean some sort of sunset provision like this one will self-destruct after one year?

Mr. Gruening: Make this discussion on the motion. Presently there exists a set of statutes which deal with the Commissioner' authority to invest surplus funds. Now, the Permanent Fund will have to have that kind of statutory authorization from it established forever. Because there always are funds that are not immediately invested in one of the goals; they are funds that are coming in; they are funds that haven't been administered for purposes of the goal. So you always have to have that kind of statutory authority. So, maybe this could be a statute that exists for the life of the Permanent Fund. On the other hand, I like the suggestion of a sunset provision. It may be in the structure. But right now we are concerned with strictly how are we going to administer this fund until we really get the structure for the goals more firmly established.

Mr. Gallagher: Do you mean that the Department of Revenue will invest the money during next fall and meanwhile the legislature will pass a statute creating the structure.

Mr. Gruening: What I'm saying in this particular recommendation is, the draft would not create any instruction that doesn't exist now. It's just authorizing the administration of funds that come in under some kind of arrangement.

Dr. Logsdon: I might suggest that there be a clause in the statute permitting the Commissioner of Revenue to invest these funds with a structure that was established in the future; to provide funds to this as established by the legislature.

Mr. Gallagher: I think when you revise in the following session under a strategy bill, the Commissioner of Revenue should phase out of it.

Mr. Gruening: The constitutional amendment itself establishes the Fund. There is nothing we have to do further to establish the Fund. Money is going to accumulate as of an effective date of 120 days after the certification of the last election. What we are talking about is a recommendation from this committee which would authorize somebody to handle those funds in some manner, a very conservative manner.

Mr. Motley: What do you visualize as far as the objectives of the Commissioner of Revenue? Can he invest in equities, invest just in savings accounts, or to deposits to banks?

Mr. Wohlforth: The questions has been called. The motion is that it is the direction of the Commissioner of Revenue to draw up a statute for presentation to the next meeting, which would authorize him to invest the Permanent Fund in a manner similar to other State funds. Included in the motion was some provision, some time limitation on that authority. Is that correct or not?

Mr. Gruening: I would use the language, "authorizes management" although it means investment. I think the public needs to know the distinction between the kind of investments the Fund will get into in the future and the need to manage the Fund as a surplus fund.

Mr. Gallagher: I want it very obvious that it is very temporary.

Mr. Gruening: Every statute is temporary in the sense that it can be repealed. You could put a self-destruct date on it which would make the legislature consider whether it wants to continue it.

Mr. Gallagher: The other assumption that underlies the whole thing is we are going to work on having a structure next year.

Mrs. Fleischer: Could we have a reading on the motion?

Mr. Gruening: The motion is the Committee direct Sterling Gallagher to draft for consideration at the next scheduled meeting of this Committee the statute which authorizes management of Permanent Fund monies in a manner similar to the Department of Revenue's present administration of surplus funds.

Mr. Wohlforth: All in favor say "aye." Opposed? Motion carries.

Mr. Wohlforth: We have accomplished only a small portion of the task.

Mr. Gallagher: I have to have a report to the governor on Monday having to do with a totally unrelated subject and that is going to take me about three hours to write I need some time, that report has to be typed all day Sunday. My time limits are getting short. I would like to talk now about maybe a savings account or maybe the four objectives and ask about just management structures overall and see how the committee reacts to them.

Mr. Love: I would like to hear if there are alternative ideas on the ways to do management. Maybe we should look at different models -- like the Regional Corporations are taking a much different direction in terms of funds and maybe splitting it up may be an alternative as opposed to a centralized fund.

Mr. Gallagher: Why don't we put the four different things we've been talking about in front of us: Savings account. Economic diversification. Community Development. Smorgasbord.

First, the savings account area. The Commissioner of Revenue can invest it under some sort of surplus, or you could have a separate institution do it. With the savings account you could just have a small board and that's the extent of it. Does anyone see any difference in the management structure? You can either do it through the Treasury and have an Advisory Board or have a full board with a director and two or three people to do accounting.

Mr. Love: You can really decide the purpose of the Fund is a savings account purpose but you can still get involved in quite a bit of social loans in the State that are income producing. You may make a decision that the money markets, which are not perfect or not adequate, are serving some very profitable and sound investments within the State of Alaska. Mortgage loans and areas outside of conventional neighborhoods.

Mr. Gallagher: Are you suggesting something like they do in the retirement fund, invest in the highest and best return. I do invest in mortgages.

Dr. Logsdon: What do you consider a savings account?

Mr. Gallagher: In my mind we mean government corporates and fixed income. You can also buy private placements and CD;s.

Mr. Edenso: Are we considering the different ways you earn income in the savings account approach, or are we considering some kind of a structure and organization for managing the savings account approach? Regardless, you have a pool of money there and you've agreed to manage it, you've got to have some kind of management decision making process which tells you which is a better investment. If it's going to be into some developmental activity or social goal, then you're going to have a board or management structure that somewhat varies from a pure investment banking function where you're making decisions on money market instruments, whether fixed income, equity or mortgage loans. It's a different kind of activity, a different decision making process. To try to get a board to agree on one instrument over a specific period of time when you know the money market is changing daily you might never gain any income opportunities. Under savings account we're talking about a straight money market activity.

Mr. Gallagher: When we're talking about savings account, we're mainly talking about investment decisions that arise outside -- it's a trust account and you look for the highest rate of return which quite likely may not be in Alaska.

Mrs. Fleischer: Would that include mortgage investments, secondary markets? If it is then could you also tie that to some decision to invest in home mortgages in the villages?

Mr. Gallagher: No, then that would become developmental.

Mrs. Fleischer: If a decision is made that it does not produce income, but experience shows that it is sometimes income producing. So, who is making the decisions as to whether ...?

Mr. Gallagher: That is an important structural question. The retirement funds try to fill the unfilled need in the Stat .

Mr. LeResche: Could we establish the incipLe that the savings account objective would require the simplest of all the manage ent structures? Is the board agreed on that?

Mr. Wohlforth: Yes.

Mr. Crawford: Possibly under options there, we should list the trust concept of managing for the highest return.

Mr. Gallagher: That is one of the goals you have to write up, Jim.

Mr. Love: I would like to look at the structure of the Regional Native Corporations as an alternative to that of a centralized system. There are separate corporations representing geographic areas of the State. Maybe the same thing could be done with the Permanent Fund.

Mr. Edenso: I don't see the similarities between the Permanent Fund and the Native Land Claims Settlement Act at all. I don't think there is any degree of comparison. The one has a completely different objective than the other.

Mr. Love: What's the difference?

Mr. Edenso: The difference is the Native Land Claims Settlement Act is mandated by law to provide in fee simple title, mainly land distribution to the 12 Regional Corporations and to provide monetary distribution to the 12 corporations. It also identifies specifically who the beneficiaries are under the Act.

Mr. Gruening: Decentralization of management is maybe a better term. I think that is a basic question, whether we're going to have a one management structure for development or whether you decentralize.

Mr. Edenso: Decentralization decision making.

Mr. Love: These are all various alternatives. It could be central management with regional decision making, development for a particular area. It could be a combination of the two. It could be completely autonomous Statewide that just did everything at a State level. Maybe that's the most efficient way to do everything.

Mr. Wohlforth: There is a Permanent Fund, not 12 or 14 permanent funds established by the voters. Almost certainly, there has to be a central governing body.

Mr. LeResche: I think we're talking about different objectives for different areas rather than about different management structures.

Mr. Love: I think we should be openminded about all possibilities. It may be that you would want 6 or 12 different management structures competing against each other.

Mr. Gruening: I think there has to be some central administration to determine which region gets it. But the idea would originate and be administered by a regional authority which may or may not be part of the Permanent Fund. But the concept would be that the Permanent Fund wouldn't take outside investors who want to move into a region for development.

Mr. Edenso: I think one of the things that was addressed by centralization, decentralization concepts was the idea submitted by Price Waterhouse and the recommendation for a board that would be composed from all the various election districts in the State. That would very definitely give you input on a regionalized basis as to how you would structure and possibly make decisions concerning either savings, development or community development types of activity. So far we haven't had anythig to do with structural organization.

Mr. Wohlforth: We could divide the decision making by regions and this raises the issue would there be some sort of subsidiary governing board by regions or does representation on the citizens board meet that problem? Central and regional boards might be better than funds.

Mr. Motley: If you decentralized this and went into various regions, let's assume, for example, a genuine need for electricity and a particular individual in that particular region where the dam is going to be constructed says I like to fish in that stream, therefore, I think this is really a disastrous thing, so henceforth let's say no to this particular area. Wouldn't this cause a lot of problems in some of these larger development programs that may be necessary for Alaska?

Mrs. Fleischer: Maybe the need is for energy, maybe thermal energy is a better answer than a hydroelectric dam.

Mr. Edenso: I think, central boards is descriptive of possibly more than one board.

Mr. Love: We have the Price Waterhouse model which is one model for development. Another approach might be to just turn the development completely over to the Department of Economic Development and make it a cabinet position.

Mr. Motley: Wouldn't that come under a great deal of political pressure? It means that the present governor or whoever designs that Cabinet can pretty much select in which direction the Permanent Fund's monies are going to go.

Mr. Love: It may not be all the money that is in the Permanent Fund. A certain percentage will be in savings account and a certain percentage in development. Mr. Meekins approached me about the legislature making up the board of the Permanent Fund.

Mr. Gallagher: They don't have the power under the constitution to be able to do it though.

Mr. Love: Maybe they were given that power by the constitutional amendment.

Mr. Gallagher: They weren't given any executive power, only policy making power.

Mr. Edenso: The question then comes, can a legislator also be on the board. Then you've got a board that is 60 members strong, not 40.

Mr. Rhode: I have had discussions with legislators on that point. It awaits legal advice by the Legislative Council or the Attorney General as to whether the legislature could be able to approve each and every loan over a certain size. I have been advised that possibly because the amendment was a separate part of the Constitution the normal doctrine of separation of powers might not apply.

Mr. Gallagher: we have a pretty clear case on the Royalty Board on which the people just voiced their opinion.

Mr. Wohlforth: There are some real legal questions here that I hope are being addressed at the outset. How much latitude is there in the legislature to divide the Fund up into regions? How much delegation is permissible by the legislature to aid the board? What does income producing mean? Can the legislature appoint members of the board directly, or sit as members of the board?

Mr. Gallagher: That's a question whether the legislature considers it executive.

Mr. Wohlforth: They are all interrelated. They are major questions that have to to be addressed very early.

Mr. Crawford: Is the Attorney General addressing those questions?

Mr. Gallagher: We have to know what the questions are before we can answer them.

Mr. Crawford: I would like to amend the motion to read either the Attorney General or a private attorney, whichever has the time prior to the next meeting.

Mr. Gallagher: The Attorney General has a staff of 35 attorneys.

Mr. Wohlforth: Let's move on to community loans.

Mr. Gallagher: There are a whole range of possibilities in community loans.

Mr. Love: We should call it community development.

Mr. Edenso: Bob, do you have any ideas on structural organization?

Mr. Barnes: I think the model that Price Waterhouse came out with is basically the model that everyone seems to be happy with, but we haven't addressed the citizens board yet. We've been philosophizing on how you do these things but not the structure of the entity that does it. That is what we should concentrate on.

Mr. Love: I think it should be decentralized as much as possible.

Mr. Edenso: Do you have ideas pertaining to the structure itself or the organization of the structure, possibly a board or not a board?

Mr. Barnes: I think the citizen board approach for the political sensitivity is important. That could be a small board appointed by the governor who actually operates the entity and let them choose the management. The legislature will tell us the goals that the board is supposed to meet. Basically that structure is going to serve if you have a developmental type approach. If you have the savings approach, you have a small board and a small staff. Those two alternatives are the only things we've been talking about.

Mr. Love: We're still going to have to deal with whether or not you want to have decentralized decision making about what the priorities are in different communities as far as development in those communities. You will still be able to have centralized management of the actual development but you may want the decisions made about what they want developed decentralized.

Mr. Barnes: I would say the citizen board concept answers that question. You have the input, that's what they are there for. If you put this decision out all over the State you're going to get nothing done.

Mr. Motley: What I would like to see basically, is a structure to manage the Permanent Fund. It does not have any objective goals or anything else, but at least establishes a centralized managerial group. The objectives will have to be settled by what the legislature says. I'll wait for my comments until we get to talking about the combination of these things.

Mrs. Fleischer: I don't understand how you'll get regional decisions reflected under community development. I think the people will have some priorities in their own communities that have to be reflected.

Mr. Rhode: They would approach the existing State agency to put a loan together and offer it to the Permanent Fund.

Mr. Crawford: Do you feel this recommendation is applicable to the four alternatives that we've had? Is it a management system that can be accepted?

Mr. Waldock: We tried to approach as a businessman's decision. You could have them decentralized to the point where you'd never get anything done. So starting here we've used the Department of Revenue, because the Department of Revenue has already got short term vehicles in charge of handling money for the State of Alaska. Then there's a totally separate group of people, starting from the top Chairman of the Board, president, vice president, etc., the same structure as the banks. Over here and totally separate from any other entity, we have a staff of people, for example, you decide to go just into a savings account, you might have one person investing the money, and they should have a board of directors. We selected, and this is open for discussion, 12 people. The 12 people are broken down into groups of three. The top group would be in power for four years, the next group is 3 years, 2 years, and 1 year.

The board of directors will be responsible to the people. The people can hire or fire them depending on the performance of what they are doing with the Fund.

We suggest that these 12 people be selected, 6 from the administrative group or the governor's group, and 6 from the legislative group. If you decide to go into general development of the State, needless to say this particular board is going to be much larger in size. If you elect just to put it in savings, probably one person would handle it.

As far as the structure is concerned, this will have to wait for a later date because the people of the State of Alaska or the legislature will have to decide what kind of vehicle they are going to want. If they want a combination of savings account, general development or community development. That is something the legislature itself is going to have to decide and that will be the proportionate or amount of money for each area that will go into it. At least by keeping this concept or working management, they can immediately take over the responsibility.

Mr. Barnes: I think you will need a tie-breaker on your board, say 11 or 13.

Mr. Waldock: We'll say 13, an odd number.

Mr. Freer: The six from the administrative side, do you contemple they would be existing employees of the State or would they be from the public sector.

Mr. Waldock: From the public sector.

Mr. Freer: Would they be full time paid employees?

Mr. Waldock: Our suggestion is that the governor would select six people, one from each section of the state. The same with the legislative people, they would choose one person from each section of the state so that the whole state would be represented.

Mr. Freer: Are they voluntary or are they paid?

Mr. Waldock: We believe they should be on a voluntary basis. The working board of directors are going to be paid very handsome amounts of money. The people would be supervising to make sure that your policies are carried out. If it isn't carried out you remove the board of directors and put in a new board of directors.

Mr. Gallagher: The third week in December is the next meeting.

Mr. Waldock: Is there a possibility to move it forward one week?

Mr. Edenso: Jim Rhodes and I have talked at some length about the next meeting. Due to travel schedules and time of the year, it looks as though the third week of December is probably the best -- and probably have another two day meeting.

Mr. Waldock: Would it conflict with the Department of Revenue if we had it sometime between the 6th and the 10th, which is the second week in December?

Mr. Edenso: If we're going to hold a meeting that soon I would like an idea of what we're going to discuss.

Mr. Love: I would like to talk about the two things mentioned previously. Distribution of earnings from the Fund and the effect of the investment policies.

Mr. Rhode: I will take each separate goal and start looking at how an organization under that would be structured.

Mr. Wohlforth: The idea of subcommittees makes sense.

Mr. Love: Let's have a couple of work session on community development and development and just those who are interested in those particular areas make up the the subcommittees.

Mr. Crawford: It is going to be very difficult for us to come up with any kind of consensus on a structural entity until we get the answers from the Attorney General so far as the constitutional questions.

Mr. Waldock: How about the 3rd and 4th of December for a full meeting?

Mr. Wohlforth: If no objection, so ordered.

Mr. Wohlforth: The 19th and 20th of November for a workshop, December 3rd and 4th for a regular meeting. May I have a motion to adjourn?

Mrs. Fleischer: I move we adjourn.

MEETING ADJOURNED AT 1:50 p.m. November 6.

CERTIFICATION

I JIM EDENSO, Executive Secretary of the Alaska State Investment Advisory Committee, hereby certify that the foregoing Minutes of the November 5 and 6, 1976 meeting of said Committee duly called and held at Anchorage, Alaska, on said dates, are a substantial verbatim extract of the recording of the proceedings of said meeting with deletion of insubstantial matter and changed only to clarify the statement.

Jim Edenso

Jim Edenso
Executive Secretary

STATE INVESTMENT ADVISORY COMMITTEE
MINUTES
December 16 and 17, 1976
Anchorage, Alaska

Chairman Eric Wohlforth called the meeting to order at approximately 9:00 a.m. on Thursday, December 16, 1976 in Room 402, Superior Court Building, 303 K Street, Anchorage, Alaska.

Members present were:

Mr. Eric Wohlforth, Attorney at Law, Anchorage
Mr. Jamie Love, Alaska Public Interest Research Group, Anchorage
Mr. James Crawford, Coordinator, Alaska Offices, Anchorage
Mr. Jim Edenso, Deputy Commissioner of Revenue, Juneau
Mrs. Lanie Fleischer, Anchorage
Dr. Dona Lehr, Policy Development and Planning, Juneau
Mr. Clark Gruening, Alaska State Representative
Mr. Robert Thorstenson, Petersburg Fisheries, Inc.
Mr. Langhorne A. Motley, Commissioner of Commerce and Economic Development, Juneau
Mr. Bill Allen, Commissioner of Administration, Juneau
Mr. Martin Pihl, Comptroller, Ketchikan Pulp Company
Mr. Robert Barnes, President Alaska Statebank, Anchorage
Mr. Robert McFarland, Anchorage
Dr. Charles Logsdon, Associate Director, Agricultural Experiment Station, Palmer

Absent Members:

Mr. Dennis Waldock, Foster and Marshall, Anchorage
Mr. Emil Notti, President, Alaska Native Foundation
Mr. Robert LeResche, Director, Development Planning & Research, Juneu
Mr. James Rhode, Anchorage
Mr. John Butrovich, Alaska State Senator, Fairbanks
Mr. Jalmar Kerttula, Alaska State Senator, Palmer
Mr. Frank Ferguson, Alaska State Senator, Kotzebue
Mr. Hugh Malone, Alaska State Representative, Anchorage
Mr. Richard Urion, Alaska State Representative, Anchorage

Advisee:

Mr. Sterling Gallagher, Commissioner, Department of Revenue, Juneau

Others present were:

Mr. Rodney Burgh, Alaska Bankers Association, Anchorage
Mr. Richard Alexander, State Investment Officer, Juneau
Mr. Charles Fuhrman, White Weld, Inc.
Mr. Art Peterson, Assistant Attorney General

MINUTES

Mr. Wohlforth: I will call the meeting to order. I want to introduce the new Commissioner of Administration, Mr. Bill Allen. If no opposition we will approve the minutes of the last State Investment Advisory Committee meeting. The next item is a report on existing State loan programs given by Mr. Motley.

Mr. Motley: There are some thirteen loan programs now existing in the State; ten of them in the Department of Commerce and Economic Development including public corporations, Alaska State Development Corporations, Small Business Development Corporations, Alaska Housing Finance Corporation, and Veterans Affairs. Generally, the loan programs were conceived to fill a void in private money markets, as determined by the legislature. They generally charge lower interest rates than banks and are considered to be higher risks. Some of them have social benefits as opposed to economic development, such as the Student Aid program and the Senior Citizens Housing programs. The rest are mainly economic development.

In speaking about the Permanent Fund and these loan programs -- the most important words are "income producing" and "permanent." We need to define those words. I think a proper legislative definition of permanent fund and income producing is paramount. That will guide the rest of it, setting up the mechanism, whether you have elected members or appointed members, whether you have two boards, it ought to be in layman's terms and and it should have a periodic accountability to the public, in simple terms. I'm not talking about balance sheets prepared by Price Waterhouse or anybody else. The average citizen should be able to know what was income producing and did it remain permanent. We should do something with the definition of income producing and permanent because that will set the groundwork for a lot of the rest.

Mr. Gallagher: What investments do you know of that keep up with the rate of inflation? The only thing I know of is commodities, and maybe oil.

Mr. Motley: Probably mortgages.

Dr. Logsdon: I think there's two points of issue here. One is the legal requirements of the Constitution which says the permanent funds will have the same dollar figure, at least at the end. You can meet the criteria even though the purchasing power is eroded to where it doesn't amount to very much. What we are talking about is what considerations we should do to try to protect it. As far as the legislature is concerned I'm not sure they will build in this kind of protection unless it's specifically stated that they should account for an inflation figure.

Mr. Pihl: I think the two points that Tony has identified are the two real key issues. Permanence of the fund and what is income producing.

Dr. Lehr: If one of the goals of the loan programs, say the business loan programs, is to encourage economic development, do you have any information on the effectiveness?

Mr. Motley: That's one of the gaps in the program. In some of them we do. When we deal with Small Business Adminstration, they have to show for every loan they make, how many jobs are created, primary, secondary; each loan fund states that it will do this, that, and the other, but we've never done an analysis on them.

Mrs. Lehr: I think if there are eventually specific objectives set up for the permanent fund, the measurement of the fund's success in achieving those objectives is an important part of the process.

Mr. Motley: I'm not pushing for any of the programs we now have. I think each one of them should be scrutinized individually for the permanent fund performance.

Mr. Gruening: One of the reasons that the term "income producing" appears is not so much to define investments and keep up with inflation but to define where the permanent fund can be spent; the idea was that it wouldn't be used for the operating expenses of State government.

Mr. Motley: All I'm saying is that I think in law some kind of accommodation ought to be made for inflation so that you establish a test for the managers.

Mr. Love: There are four things that I would like to know about the loan programs. They can be answered at some future time. I would like to know the dollar amount of each loan program, the gross and net yield of each program, the goals and criteria for each program, and the management structure of each program. I think we should do a better job in setting out specifically what we think these loan programs should be accomplishing so we can later evaluate.

Mr. Barnes: I agree that the issue of needing a legislative definition is critical, but I don't think this committee can do anything about it. That's up to the legislature. We have agreed that it is a trust fund, the principal should be protected and therefore the prudent man theory comes into effect, therefore the structure is relatively simple. If they envision it as something more than that, then the income producing is defined as social benefits, then I think you are into a development bank and a very complex structure with all kinds of sector analysis and staff.

Mr. Wohlforth: It's got to be something of a new ball game for investment advisors, and certainly the dramatic rate of inflation over the past three or four years has put that science or art into a whole new configuration.

Mr. Rhodes: The legislature's phrase "income producing" meant at the least that loans must bear some interest, there would be no transfer to communities or industries, nor used by the State budget. Nothing was said about how much income. The words "permanent fund" would seem to preclude undue risks of the principal no matter how much a particular investment might hold out. It's not just simply the yields but also the indirect benefits in terms of new income, new jobs, etc. Those are real dollar effects that don't show up on the plus sheet of the permanent fund, but they do benefit the economy of Alaska.

Mr. Motley: Nobody is talking about an ironclad rule. What we're talking about is inflation.

Mr. Burgh: I'm Rodney Burgh, Director of the Alaska Bankers Association. This is a preliminary presentation on behalf of the Alaska Bankers Association, representing our present position; it is anticipated we will desire to meet with you as future developments occur.

A trust type fiduciary responsibility of the fund's managers to the people of Alaska is inherent in the decision of the populace to set aside a portion of non-tax resource revenues. The tenor of the times indicates that the decision was motivated by a desire to control the spending of revenues which derive from exhaustible resources. If Alaskans had favored large capital spending programs by the State there would have been no reason to create the fund. Thus the fund has been created to accumulate revenues which can be conserved for use in the future.

A typical trust function is the preservation of capital, it undertakes to protect the real value of capital from inflation, and to increase the real value through prudent investments. This assignment requires careful analysis of risk for each investment considered and eliminates the consideration of high risk ventures. Generally speaking, the larger the dollar volume involved, the more complex is the risk analysis required and the more costly. The income earned from investments wihin Alaska large enough to be meaningful to a fund the size of the permanent fund would be eroded by the costs of investment analysis and other administrative expenses. More importantly, such investments are not likely to be within a risk category which is complimentary to the trust relationship mentioned earlier. Therefore, the best course of action seems to be for the permanent fund to place its funds in national money markets where risk analysis is performed in the most efficient manner by professionals and where a multitude of investment options is available.

Inasmuch as there is a trust relationship between the fund's management and the people of Alaska, it is critical that Alaskans be given a timely reporting of investment results. The most effective method of reporting would be through a direct economic return to the people. Such a return provides the most efficient incentive for Alaskans to gauge the performance of those persons who are tasked with fund management. An economic incentive can take many forms, for example, direct cash dividend, reduction in taxes, profit sharing plan with a vesting schedule, or other forms of pension plans. Our position calls for the creation of a trust relationship of legal standing which will incorporate the goals of preservation of capital, maintenance of real value, and reasonable and prudent capital appreciation. We feel it is against the interests of the people as represented in such a relationship to incur administrative costs associated with in-house investment risk analysis.

Mr. Allen: You addressed the situation of disbursing current dividends. It's my thinking that the makeup of the permanent fund is for future use, not current use.

Mr. Burgh: There's nothing in it that says the income is also supposed to become permanent; it's only the principal. You would preserve the principal but the income could be used for other purposes.

Mr. Wohlforth: I take it the general position is, let's invest in high quality instruments, either short term or corporate bonds of corporations which are in Alaska. First, is participation in any sort of development loan concept -- in participation with private borrowers. Is that the banks' correct position?

Mr. Burgh: Yes, we don't feel that the permanent fund is intended to be a risk fund.

Mr. Wohlforth: Admittedly every investment has a risk quotient, but you're saying the risk quotient should be absolutely minimum. Do you have any thoughts on the legislative structure, of who's responsible for handling investments?

Mr. Burgh: I would presume that someone with the State is going to have some area of responsibility for it.

Mr. Wohlforth: Are you recommending that investment advisors or fund managers be appointed for this function?

Mr. Burgh: Yes. People with investment expertise.

Mr. Edenso: Has your group considered any kinds of programs that would provide long term capital for economic development purposes?

Mr. Burgh: Most of the long term capital provision that we get is from outside investors that work in the long term investment field.

Mr. Edenso: Would you think that without the ready long term capital there would be adequate amounts for development within the State?

Mr. Burgh: Any social problem or any other economic benefits that you want to get from fund investment should be from the income rather than from the permanent fund itself. You should try to get the best protection and best yield from the permanent fund. The yield we get from that can then be invested in other programs. Utilizing the principal of the permanent fund for providing long term capital investments in the State is not a prime objective of the permanent fund. Possibly some diversification would include some.

Mr. McFarland: I think we should ask the Bankers Association to bring in what statistics they can on overlying. This is an area that the State could very well get good interest from. The banks are regulated and are only allowed certain limits, so really the Outside banking institutions are taking the cream off the interest. We should have some idea what the potential is if instead of using a corresponding bank, use the State.

Mr. Burgh: I think most of the banks, when reporting, do show the amount of servicing they are doing, which indicates funds have flowed through the bank from other institutions. It's quite sizeable in relationship to our own portfolio.

Mr. Allen: Your request for participation is because of your legal limit or because of the term?

Mr. Burgh: Both. If it's a working loan it's because of the legal limit. If you're talking about long term loans it's because of the term. Housing for example, the bank cannot afford to keep a lot of thirty year loans in its portfolio or it would soon not have money for other purposes.

Mr. Allen: As the years go by the capital starts increasing -- the availability to meet their demands as far as dollars are concerned, is increased. I would like to know if your committee has suggested us making loans on the income, a higher risk loan from the income, what gaps can we fill?

Mr. Burgh: We don't have any particular recommendations. I can say that we have some loans out that are many times our lending limit and we've not had any problems like corresponding banks to participate with us.

Mr. Allen: The corresponding relationships are getting the interest when the earnings should be here within our State.

Mr. Wohlforth: Thank you, Mr. Burgh. Next on the agenda is Richard Alexander, Investment Officer, Division of Treasury.

Mr. Alexander: I've been asked to describe the State's loan programs and their relationships to the general fund, and also other loan programs within the Department of Revenue. Our general fund has been decreasing for the past several years and at the same time the State's mortgage portfolio has been increasing rapidly. It has become one of the largest investments in the fund. Also, our mortgage activity within the two retirement funds has increased substantially in the last few years.

There are loans that are required to be purchased by the general fund; Veterans, Small Business, Fishing, and Tourism loans. The Veterans loans are by far the largest holding within the fund. The rate of return on these loans is 7-1/2%. The Small Business loans are presently earning 8%; Commercial Fishing loans earn 7%; and

Tourism loans earn 8%. All of these loans we are required to purchase. The rest of the loans, the Commissioner has the option to buy.

The optional loans are the Bank Incentive Loans which presently are inactive. Alaska Housing Finance Corporation is another type of loan within which we have various type notes for a total of $9.2 million. We also have Alaska State Housing Authority notes for a total of $4.5 million receiving 7-1/2% interest. Then we have a $1 million note loaned to the Medical Malpractice Revolving Loan Fund for an interest rate of 9-1/2%. The next category is Native corporations -- we're almost through with that as they will all be paid off by June. The last is entitled Municipal loans in which we have $3.4 million 5% note for the University of Alaska Activity Center. The remainder is made up of Alaska State Development Corporation Bonds, City of Nenana School Bonds, City of Palmer Industrial Park Revenue Bonds, all totaling around [illegible] million. We also have $.5 million in Agricultural loans.

The Retirement Funds are authorized to purchase FHA, VA, Federal Small Business guarantee loans, conventional residential and commercial mortgages. At the present time we have over $9 million invested at an average rate of return of about 9%. Approximately 32% of these funds are invested in mortgages at the present time. We are committed to purchase another $50 million by the end of March at rates from 9-1/2 to 10-1/2%.

We buy mortgages for the funds mainly because of the high rate available but also to help Alaskans obtain loans that might not be made if we were not in the market. We concentrate in areas that are not readily marketable Outside. For example, Fanny Mae will not purchase a mortgage over $87,500; we try to pick up that slack. The cost of housing in Alaska is pretty high and there are many mortgages over that dollar mark. Another example are commercial loans under $.5 million. Buyers Outside seem to want the loans over that amount. We've bought mortgages from all banks and savings institutions within the State. We look for special situations such as the Community Hospital in Fairbanks. On that loan we receive 10-1/2%.

Mr. Gallagher: We've got loans from Dillingham, Glennallen and Kodiak.

Mr. Wohlforth: I have added up the State Loan program including housing financing and I find a figure of $417,694, which is a pretty healthy figure. Next on the agenda are representatives of White, Weld on structural alternatives for the permanent fund, leveraging, etc.

Mr. Fuhrmann: My talk today will be mostly on what the group did and talked about in their trip to Alberta, New York and Washington a short time ago. So I'll pass out a booklet about the trip and let you read it rather than spend a lot of time on it today. At the work session tomorrow I'll spend time on the organizational structure and various alternatives. Did everyone get a copy of the book? If not there are more available.

Mr. Wohlforth: I'm interested in the leveraging section. Have you considered the fund being a lender to establish reserve funds of local government or agencies of the State? I'm thinking of reserve funds of 20 or 30 percent of whatever is really needed to enhance the credit worthiness of such an agency. So on a loan basis the debt of the agency would be retired before the fund would receive the principal back.

Mr. Fuhrman: Ostensibly making it appear as though it were equity in there to improve the credit rating?

Mr. Wohlforth: Right.

Mr. Fuhrman: Definitely. It was also discussed with the credit agencies. They wanted to focus more on what the definition of permanent fund was in income-producing and distribution of income.

Jim Rhode: At our discussion with Standard and Poors and Moody's, they wanted to know what would be the status of any further amounts that were put in the Permanent Fund, would it be placed there irrevocably or would it be treated again differently from income from taxation?

Mr. Fuhrmann: The amendment states that at least 25% of a combined pool of oil, or resource related revenue will go to the permanent fund, which has an implication that the legislature from time to time may wish to raise that to say, 40%. Their first question was if it was raised to 40% would it be 40% forever. The answer is clearly no, the legislature had a chance to take it back down again, but not below the 25%.

Mr. Love: What is the relevance of this material to the rest of the material? Does White, Weld make any recommendations in terms of structure?

Mr. Fuhrmann: All of this was material being used by various people in our firm for the purposes of their presentations to this delegation and has to do with the tentative organizational structure. We have been asked to propose alternatives, but we have not recommended anything.

Mrs. Fleischer: What exactly was the purpose of the whole trip?

Mr. Edenso: That's a good question. We intended to go to the various cities, first to meet with the Alberta Heritage Fund people and discuss with them the characteristics of the Heritage Fund as to its legal structure and the legislation that established it, its funding and management characteristics, some of the goals and objectives that they have established. We found a number of interesting points and comments concerning that. I'll try to cover some of them.

First, in Alberta we met with the counterparts to our Department of Revenue to discuss the structure, the organization, and the management of the Alberta Heritage Fund. It's interesting that their Heritage Fund is managed by the equivalent of our Department of Revenue. The decisions of the day to day activities are carried out by the equivalent of Commissioner Gallagher, myself, or investment officers. They also have a committee which determines and passes decisions on whether or not to make a particular investment. There are limitations or constraints in the areas of investment but I don't believe there is a limitation on the size of investments. Secondly, they have a program which calls for providing capital for social programs or social types of investments which do not necessarily tie into income-producing as our constitutional amendment calls for. We also discussed some of the concerns we had about subsidy financing.

It was interesting to note that where they are subsidizing an interest rate they actually go to their parliamentary body to obtain the subsidy from their general fund which states publicly and exposes publicly, the fact that there is a subsidy program going on and how many dollars are involved with it and for what it's to be used. That is something that we in the Permanent Fund State Advisory Investment Committee have not really considered.

Mrs. Fleischer: You haven't considered making it public?

Mr. Edenso: We haven't considered public exposure of any subsidy that we undertake.

Mrs. Fleischer: How do they do it?

Mr. Edenso: You go with an appropriation bill and say, "Well here's how many dollars we want and here's why we want it, and here's what we are going to use it for."

Mr. Rhodes: What I learned in Alberta was, the final purpose of the Heritage Fund so far as there is a defined purpose, is to insure that Albertans pay the lowest taxes in Canada. They admitted their fund wasn't really large enough to diversify the economy of Alberta enough to replace oil revenues with taxation on new private business, but they saw the fund as a way of closing or reducing future deficits of the profits.

I thought I might quickly tell you what the fund is doing. Up to 20% of the money can be capital outlays, and they are concentrating on irrigation for agriculture, and in medical research. Thirdly, a project with three oil companies to develop technology for recovering oil from oil sands. About 85% of the money they are loaning out in three ways. Home loan subsidies for middle income and lower, also in loans to their municipal authorities. The subsidies for the home loans and the subsidies for the local government are laid out plainly as a matter of public record -- who is getting it, when they are getting it, how much. The subsidies have to be voted on by Parliament. There are no concealed or under the table subsidies at special preferred interest rates to this group of homeowners or that group of towns. The reason they make loans to their local governments directly is they don't have the tax exempt privilege for their local governments. They borrow from taxable rates, which of course would be considerably higher than our local governments.

The third use is that it makes loans to its utilities, and there you have to know that the profits of the phone system and most of the electrical generation is passed through the Parliament. That's pretty much how the fund is laid out.

The government of the day runs the fund. It doesn't have its own staff. The Treasury people take care of the Heritage Fund in their spare time.

The high point from New York was exploring the different ways the fund could be leveraged. It seems that using the fund to guarantee this or that private corporation, or any other number of choices would be superior to having the fund make loans directly from its assets. Among the arguments advanced for using guarantees are that they are contingent liabilities, not direct liabilities. All things being equal, the fund would be able to do more guaranteeing than it would borrowing and lending. The credit rating can be better for any given amount of guaranteeing than it can for a like amount of borrowing. The point being that you get to keep your money while you are making guarantees in investment grade securities which are the very lowest risk.

In Washington it was pointed out that if you leave even a crack in the door open to the fund to lend financial assistance to the public sector, the fund will have an inevitable bias because it's also a public entity and it will favor public sector proposals that come to it. The experience of most development funds is that the private sector is very rapidly crowded out.

Mr. McDowell: There's two ways this can happen. The International Development Bank has full authority to lend to private enterprise and the public sector. The

World Bank has has in its charter full authority to lend to private enterprise. About 15 years after it was started it finally formed the International Finance Corporation, a subsidiary set up to do nothing but private enterprise. It has no Authority to lend to the public sector. The Sudan Development Corporation charter was set up without too much in it, it's probably the most general charter there is. But it did specify how that development corporation was supposed to relate to the Government of the Sudan. In its first two years of existence the Government of the Sudan borrowed back half of its capital. At this point in time it is not paying any interest and has no intention of giving it back. The company was set up to operate in the private sector. By not defining it carefully in the charter how it relates to its government, now half the money is gone from its original purpose.

Mr. Rhodes: A number of the people we saw in Washington alluded to this in one way or another and pointed out that this problem could be minimized by using intermediaries.

Mr. McDowell: This report has been prepared in response to four specific questions submitted several weeks ago. The first relates to what goes into a charter of a development institution, the second relates to loan standards and interest rate, the third, election of directors, and the fourth, the structures or alternate structures or modifications to the present proposed organization.

The first section of the report really deals with what broad statements of priority should be set in the charter and what policies should be set at the board level. I've selected 29 different things which I consider to be generally the substantive matters that are normally covered in a charter, at least in a general way. There are many other items covered in charters, but most of them are technical, legal matters. These are pretty much all of the substantive matters that you might find in a charter.

The terminology "development institution" as I've used it is an institution which provides longer term investment capital as opposed to operating or working capital, through intermediaries in the form of equity or debt to enterprises or projects, or directly. Enterprise being, say a business; a project being, perhaps, a dam. The permanent fund may or may not become an institution of that sort, but this material is based on the assumption that it will.

The 29 items I've broken up into general items. Every one has a general statement of purpose and function. Sometimes they'r mixed, sometimes they're separated. The operating philosophy is usually given. Legal personalities and capacities have to be there. Sectoral covers, if any, if any distinctions are made in terms of both economic sectors and size sectors. Geographic coverage. General criteria to be applied to the selection of capital investments is normally given. The kinds of capital to be provided; equity, direct loans, loan guarantees, convertible debentures. There's usually something about the general relationship of interest rates to market rates. Relationships with the private sector; relationships with governments; relationships with other sources of capital, with recipients of investment capital, particularly with regard to identifying investment opportunities and providing technical assistance. Relationship to capital markets; many of these are set up in order to encourage local capital markets. Organizational matters; the general powers and parliamentary rules of the board or boards are always included in the charter. The general powers of management are laid out. The composition, qualifications, methods of selection, and terms of the board's management and staff are referenced. There is some designation of the organizational levels with responsibility for relations with governments, the general public, the financial community, prospective recipients of investment capital. There are also conflict of interest policies for board members and the staff.

Under financial, there will be general financial goals of the institution, level of profits to be attained, protection of capital, prudent management of assets. Source and amount of capital. Borrowing powers and limits, if any. Sources of funds to pay for operating expenses, including general long-range economic and investment research. The disposition of net income from operations. Accountability. General requirements for independent audit and public reporting. Occasionally the general requirements for operational evaluations. This technique is relatively new and most charters don't have it, but I would recommend that you do. Finally, the general requirements for maintaining the confidentiality of information obtained from prospective and actual recipients of investment capital. This is a problem with public institutions. When you deal in the private sector you've got to have rules that the confidential data you obtain from your clients will remain confidential. You've got to say something about it in the charter because you may not get any private borrowers if they realize that what they consider their competitive information is going to be divulged.

For specific examples. In a charter there is a general absence of absolute quantities and percentages. What do you do with a fishing loan if it is only a hundred thouand and a boat costs a million? Why put yourself in a position of going out of business in a particular sector, two , three, or five years from now by putting a number in the charter. Because the charter of that loan program has a ceiling built in which appears to be getting unrealistic, the charter will have to be changed.

Mr. Gruening: Are you referring to the total loan amounts or the total category?

Mr. McDowell: Generally, the specific absolute quantities are not specified for any fund. A charter, usually, is a document that will withstand the test of time. What is important today may be totally unimportant in the future.

Mr. Gruening: But our charter here is the constitution. Goals would be the types of loans. I was thinking maybe the legislature might want to write a safeguard in it assuming one of the major motives of the fund was a savings aspect. You wouldn't want to allow the entity to make loans in an area that's committed for a long term basis at a certain amount of risk as opposed to having it in liquid form where if you decided you wanted to change the emphasis from community development to diversification, you could do so if there was a portion of it set aside as savings. Otherwise, I think the legislature might be worried that the managers might commit the fund within a short period of time.

Mr. McDowell: Once you appoint a board, the board will establish the policies. A policy can be changed by the board the next year or five years from now. As long as the policy remains in accordance with the charter, then the charter doesn't need any legislation to change it.

The purposes of these institutions nearly all are stated: to support and stimulate the establishment of new private enterprise and the expansion and modernization of existing private enterprises. The second purpose is to encourage and assist. The third purpose is to encourage, promote, and assist the securities market. The Industrial Finance Corporation of India is to make medium and long term credits more readily available to industrial concerns, particularly where they can't get it from a bank and there is no capital market to take a stock issue. The next one, carry on the business of assisting industrial enterprises within the private sector. That says it's got to be in the private sector, it's going to be industrial. It's going to assist in the creation, expansion and modernization, encouraging and promoting private ownership of industrial investments and the expansion of investment markets. How? By providing long and medium term loans or equity. To sponsor and underwrite new issues of shares and securities; guarantee loans from other private investment sources; make funds available; revolve their funds as rapidly as prudent, and furnish managerial, technical, and administrative advice and technical assistance.

Another example is the Inter-American Development Bank. This is a fairly recent institution, so it could have incorporated some of the lessons learned by World Bank and others who were in business before this. But they're going to contribute to the process of economic and social development, individually and collectively. What does this mean? It means they can provide finance for projects in one country; they can provide finance for projects in more than one country. This general wording has been expressed in their charter. They can also promote the investment of public and private capital for development purposes. It's going to utilize its own capital, funds raised by it in financial markets, for financing the development of the member countries, giving priority to those loans which will contribute most effectively to their economic growth. That's a constraint on them. It tells them they have to deal with priority matters. They're supposed to encourage private investment and supplement private investment when private capital is not available on reasonable terms and conditions.

They will have three categories of operation - their term for loan. They will make loans from ordinary funds into regional resource funds and the funds for special operations, that is the fund to subsidize interest rates. The basic principle of separation is that these three sources of money will be kept separate at all times. Under no circumstances will they be used to pay off the obligations of the other.

Under Organization and Management. The charter states they shall have a board of governors, a board of executive directors, a president, an executive vice president, a vice president in charge of the fund. That is the fund for special operations, for subsidies of interest rates, and such other officers and staff as may be considered necessary. They deal with the board of governors, how they get appointed or elected, how long they serve, who chairs the meeting, what powers they must retain unto themselves, or specify the other powers that they delegated a general statement of what they have delegated, how often they should meet, what a quorum for a meeting is.

The board of governors and other boards are in effect held accountable for doing things that are necessary or appropriate. There are two boards, two different sets of people. The board of directors shall elect a president who shall not be a governor or an executive director or alternate for either. He has a tie breaking vote on the board of executive directors. The Conflict of Interest statements, "the President, officers, and staff of the Bank, in the discharge of their offices, owe their duty entirely to the Bank and shall recognize no other authority. Each member r. the Bank shall respect the international character of their duty." This is saying no matter what country you are from you work for the bank independently of the politics of your own background.

Finally, there is a control saying, "the Corporation shall seek to maintain a reasonable diversification in its investments." I think that is something you could say in your charter. I view it as a financial control that any organization should have.

The interpretation of the charter should be a dynamic process that keeps recurring, and that function is normally delegated to the board.

Mr. Gruening: When they want to change these charters, what does it take?

Mr. McDowell: It takes a vote of the stockholders as represented by the board of governors - a two thirds vote.

Mr. Motley: Do they get involved in equity financing?

Mr. McDowell: Yes. They have to have reserves; it's left to the management to determine the absolute size of those reserves. I've listed some questions which are asked by the policy board: Is the proposed project in a sector in which additional investment is needed? Does the project fit in with a logical sectoral program? Does the project fit in with the most urgent needs of that sector? Does it contribute to diversification and/or better income distribution among regions or groups? What are the environmental and health impacts of the project including benefits or hazards to the environment and human well-being? In addition, the bank policy requires, and carries out, specific economic tests, including cost/benefit analysis measured by the internal economic return and/or the benefit cost ratio. I used the World Bank example because their charter is simpler than the rest. It really just says that loans should be made prudently for highest priority development projects on the basis of economic considerations.

As you can see, all these questions aren't just economic situations. The board itself over a period of time has had the flexibility to adopt new techniques such as cost/benefit analysis which wasn't there when the bank was set up. New criteria, such as health and environmental considerations which weren't important when it was established. They've done this by board policy because they had input from their staff, input from their borrowers to stockholders, and other people working in the area of development finance. They have to listen to their stockholders and be responsive to it. If the president and his staff are not responsive to what the board of executive directors wants, they fire him and get a new one. But they don't put the responsibility for any particular function at any higher level than it's supposed to be, the accountability goes up a step at a time. The fact is, the management is accountable to the board. If the board says you are not following our policies, then they get a new manager.

Mr. Gruening: The World Bank provides for two boards?

Mr. McDowell: Yes.

Mr. Gruening: The executive directors, what are their qualifications, are they financial types or do they try to get somebody with broad backgrounds?

Mr. McDowell: They tend to be out of the Ministries of Finance.

Mr. Gruening: So they have politicl and all sorts of background, not strictly financial?

Mr. McDowell: They are not strictly bankers. Should interest rates be set in the charter or by the board? In most cases, interest rates are required by charter to be appropriate or to approximate prevailing market rates. If they're just to be appropriate, then they pick and choose out of their funds whether they should make a subsidy or not, or to charge a higher rate. But they do charge rates which overall will come up with the profit for the institution every financial reporting period. They demonstrate that they have protected their capital by not dipping into it and also paid their operating expenses and perhaps even made a contribution against inflation, against the erosion of capital. So any project that can't pay back at market rates doesn't meet a market test. In practice the are usually set by board policies. The World Bank sets it by formula which is passed by the board. Any subsidies are normally, separately appropriated.

Getting into the proposed structure of the permanent fund. Essentially what you get from an election is direct representation of the interests and views of the constituents of the person that you elect. That is the pros of it. The cons, well, if you elect part of the board I think you create too many classes of directors, which is an intense degree of evil in itself. If you elect all members of a relatively small board, you would have equal directors, but you probably wouldn't include all representatives of all the significant minorities within the State. There just aren't enough positions to go around. Finally, election support is campaign financing, which could result in elected members being subject to undue influence by special interest groups.

Suggestions on alternate structures of modifications. The proposal as it currently stands does tend to strike a reasonable balance among the three groups, citizen, legislative, and executive influence and involvement. The operation of the fund is going to be under the supervision of a board, which will be made up mostly of private citizens, and proposed and confirmed by the executive and legislature. The board will be accountable to three parties and eventually also will be the power to amend the charter.

The important thing about the two board proposal is that they provide an important separation of responsibilities for policy and operation. This is an essential prerequisite for accountability for freedom from undue and improper political and special interest pressures. If you establish a policy board that does not have responsibility for operational decisions on specific loans and investments, you've got an organizational level that you can dedicate to being responsive to political, economic and social considerations as well as the views of individuals or groups. If you delegate the responsibility for specific investments to the investment committe, it provides the policy board with insulation from dealing with a specific project. Also, if you specify that the policy board is the only appropriate forum for all this input, then you insulate the investment committee from undue pressures as well.

Some suggestions for the powers and responsibilities for the policy board, the management board, or investment committee, and the chief executive officer. The function of the policy board should be an annual review and approval of long-range operating plans which include an investment program based on sectoral analysis of the Alaska economy, which include the budget for the forthcoming year and the financial plan for the following number of years. I would not suggest that the policy board just review the budget for a year, that's too short term function for a board member's level to be dealing with. I would also suggest that the management board have sole power to approve all investments rather than allocating part of that power to another body. The chief executive officer should be responsible or accountable for everything that's done so that in the minds of the legislature, the executive, and the public, that one individual will carry more accountability than anyone else in the institution.

Mr. Gruening: Who selects the chief executive officer, the management or policy board?

Mr. McDowell: It was proposed that the policy board would select all five members of the management board, including the chief executive officer. I think you must have the policy board select all of those people to get that step by step accountability. I would recommend that he be non-voting and to chair the policy board.

Mr. Gruening: We might be tending a little bit on the bureaucracy side by having two boards which would check and balance each other, but they might compete in terms of policy. We all know that staff can get involved in policy. I don't know if these people are going to be full time or not; the policy board probably isn't and they may be unpaid. On the other hand, the management board is making the loan decisions, so I think you pretty much have to pay them full time.

Mr. McDowell. I don't think so. You're getting to incorporate a few more outsiders to work with the present ones in making the final decisions, who have some of the technical skills but they may not necessarily be any good at holding a public forum and abosrbing the input from private citizens and reflecting it in policies, but are pretty good at investment programs. All of the loans would go to the board. You provide that management of the board will establish proper organizational operating financial controls in having that kind of process through the staff.

Mr. Wohlforth: Basically, aren't we talking about management or investment committee which is a pretty hard working committee, perhaps meeting as frequently as every two weeks; the policy board, on the other hand, meets much less frequently.

Mr. McDowell: I would estimate that you envision it quarterly, the policy committee, to review reports provided to them and make decisions they are empowered to do.

Mr. Allen: Wouldn't the chief executive officer have an authorized loan limit? Anything in excess of that be approved or passed on by the investment committe, and all loans or investments be reviewed by the investment committee?

The meeting was adjourned at 4:00 p.m., December 16, 1976.

Mr. Wohlforth called the meeting to order at 9:30 a.m., December 17, 1976.

Mr. Gallagher: Art Peterson is with us today. He is the Attorney General responsible for drafting the legislation. He is here to hear what people say directly so he can interpolate it and put it in the statute.

Mrs. Fleischer: Before we go to the actual legislation. Will there be a provision saying that if the particular community objects to a particular development, it would not be done?

Mr. McDowell: One of the mechanisms that exist is the zoning.

Mrs. Fleischer: A large part of Alaska is not zoned.

Mr. Wohlforth: I think it's a major issue. It appears in order to proceed on this in this way, by listing major questions, and I put it, "Consent of communities to enterprise location? Another question would be whether or not the enabling legislation should specify a dollar or other type of division between so called public sector activities, support of local government bonds and local borrowing, and private sector activities. Should there be a definition in the charter as to the amount of funds to go into each area?

Mr. Allen: Specified by a dollar amount or by percentages?

Mr. Wohforth: Dollar amount or other formula. Should the charter attempt to devise a formula to divide the fund's activities into public and private sector?

Mr. McDowell: I believe the question is very important. Just on the basis of the experience of the various institutions has indicated that if you do want to invest in the private sector then you must put a ceiling on what it can do in the public sector. Otherwise there won't be any investments in the private sector. In other words, if you want to invest in productive private enterprise then you must put a lid on the public sector portion, and the housing portion if it's separate. Those are the two needs which generally tend to become insatiable in terms of having a higher political priority than the productive private enterprise.

Mr. Gallagher: We have to go through two bills. Could we complete the one easy bill first. Is this the time to list questions?

Mr. Peterson: I suggest, if we keep it to major questions and then use the bill as a catalyst for traditional questions and then get into the specific questions. Not every question is going to be major policy type questions. Maybe list those and then go over the bill.

Mr. Wohlforth: Alright, we'll start with the questions.

Mr. Crawford: I think it should be addressed as to whether or not inflation is going to be part of the charter, part of the bill, or some provision for inflation.

Mr. Barnes: Is that setting a minimum return on any investment?

Mr. Crawford: Charter recognition of inflation, terms of minimum fund return.

Mr. Gallagher: How do you distinguish between the soft and hard loan programs? Maybe the charter has a preference for guarantees over direct lending. Also the ability of the fund to borrow.

Mr. Wohlforth: Should the charter encourage leverage?

Mr. Pihl: The point of leverage is where I had a question. Would the Fund be able to issue its bonds to finance the pipeline, finance the tankers, or finance the gas pipeline. I'm not advocating State ownership but using the fund as a vehicle for financing. Using this leverage and having a much lower interest rate chargeable to the wellhead value.

Mr. Gallagher: The wellhead on the gas situation is influenced by transportation costs.

Mr. Wohlforth: I can see the legislature, with this fund in existence, all of a sudden recognizing that there are different projects, gas pipeline, petrochemical, etc., it should be given a preference. So the question would be whether the charter should get into detail, preference detail of specific projects of finances. In other words, how much would the legislature be willing to delegate a board in terms of specific preference?

Mr. McFarland: It should include the right for legislation whether it's ever exercised or not.

Mr. Barnes: Another question should be about the direction of the income. Should the income go to the general fund or should it be directed to other projects or should it be returned to the fund itself?

Mr. Wohlforth: In the private sector should participation be mandated by charter?

Mr. Fuhrman: It seems to me that the two draft bills we were reading last night bring up a couple of potential questions, one being what the compensation of the members of the various boards or committees or staff people might be, or how determined, and also whether there should be any language dealing with the qualifications of those board members. Geographic or professional expertise or education or race, party affiliation?

Mrs. Lehr: I think there should be specification of membership. We talked before about two members of the Governor's cabinet and those have been specified in the bill. Another area that I think should be discussed is the budget procedures. It doesn't indicate whether it will be subject to the Executive Budget Act.

Mr. Peterson: My assumption when drafting the bill was that it would be under the Department of Revenue budget, but that may not be a committee assumption.

Mr. Gallagher: I thought it was the best idea, but then what about the accounting problem. How do you forecast the budget and reserve for bad debts? That's really a professional judgment. I would like the board people to make that decision and not have to go for a supplemental.

Mr. Wohlforth: The question here is whether the fund is going to be permitted to live off its income to a certain extent or not.

Mr. Rhode: I have discussed this formerly with a number of legislators, and one problem in bringing the operating budget of the fund before the legislature is that at the very least it will affect the independence of the fund to set its own rates to pay compensation. The legislature will be able to reach in and rip out $10 thousand on a salary they don't like. In the extreme case, it could very well jeopardize the action of the fund.

Mr. McDowell: You transfer accountability to the legislature if you do that. If you want the legislature to be accountable, fine. If you don't then you can't give them any control of the budget.

Mr. Wohlforth: Should the charter prohibit or permit equity -- private sector participation or should there be debt only? Should the Act be specific in terms of outlining the feasibility work that the banks should undertake before financing a private sector project?

Mrs. Fleischer: Should the charter specify that the productive enterprise should be financed at market rates so that we are not in the business of subsidizing?

Mr. Wohlforth: Let me run through these questions. (1) the consent of the community to enterprise location, should that be in the charter? (2) division of fund, whether the charter should specify the division of fund activity between public and private sector. (3) should the charter recognize the effect of inflation in terms of minimum fund return? (4) should the charter deal with the question of soft and hard loans and the subsidy recognition? (5) should the charter encourage leverage financing or be neutral? (6) should the charter specify specific projects to be financed? (7) direction of the fund income to the general fund for its other uses. (8) should the charter recognize any mechanics for division of activity between regions of the State? (9) where the fund should be located; (10) should the charter mandate participation in the private sector? (11) what is the compensation of the boards and staff and how would that be determined and what are the qualifications of the chief executive officer? (12) what would be the qualifications of the board members? (13) should the board of the fund be subject to the Executive Budget Act or be autonomous and be permitted to live off its earnings? (14) should the charter permit equity investments? (15) should the charter require market rate of return on investments?

Dr. Logsdon: How about segregation by industry?

Mr. Wohlforth: That is a good question. Last year there was actually enacted a bill that mandated that these investments be put into renewable industries which would provide this, fishing, timber, agriculture, forestry, outdoor recreation. Should the charter show an emphasis or mandate for renewable resources.

Mrs. Fleischer: That is a good idea. It may not be very important at the moment, but how would you classify wilderness, as a renewable resource or non-renewable resource?

Mr. McDowell: What's a wilderness? You can't consume it.

Mr. Wohlforth: I mean by renewable resource a reusable commodity, like timber.

Mr. Allen: There should also be audit procedures and powers and authority of the chief executive officer.

Mr. Gallagher: We should have a strong definition of what post audit is too.

Mr. Love: There should be some way of evaluating the fund's effectiveness in achieving the particular goal.

Mr. Wohlforth: All right. Establishment of audit procedures and performance evaluation.

Mr. Love: The charter should also state whether the fund is going to have to achieve some kind of income distribution.

Mr. Gallagher: That involves the subsidy question.

Mr. Love: Not entirely a question of subsidy.

Mr. McFarland: I understood when talking about the Heritage Fund that the Parliament could direct the subsidy. Do they have to come out of the general fund with the money to pick up the gap?

Mr. Gallagher: Yes.

Mr. Rhodes: Don't they touch on what's going to happen to the real per capita income?

Mr. McDowell: An example of a case we mentioned yesterday. The charter says the decisions should be based on economic considerations. It also says it should not be based on political considerations. The board of directors can make policy statements that economic considerations have to include distribution of income, and then the staff proceeds to implement it. So the project area is a statement not a project in itself. A statement of what the project will do. It would address the issues of health and environment.

Mrs. Fleischer: The charter should address the issue of goals and purpose of the fund.

Mr. Fuhrman: The real issue would seem to be how far do you go into those areas in the legislation and what portions of it are the responsibility of the policy board and what portions are the responsibility of staff and management of the fund.

Mrs. Fleischer: I think it would help the staff and policy board if they had some clear idea of what the purpose of the fund was, what the people in the State thought it was for, and how we are going to accomplish everything.

Mr. Fuhrman: It seems like the appropriate thing is that more detailed statements fall out as you go farther down the line, so very general statements would be at the top.

Mrs. Fleischer: Economic considerations should be defined to include employment, income distribution, environment, health and social issues.

Mr. Rhodes: That is really a question of degree.

Mr. Edenso: We're talking about criteria for making investments. You could specify that criteria in the charter or you could allow the policy board to specify it, or you could allow the legislative body to specify it in legislation. Some of the criteria are the creditability of any particular investment, whether or not the proposed investment falls within some kind of acceptable environmental impact statement, whether or not an investment falls within some kind of socially stated criteria, and finally whether or not it falls within some kind of acceptable income terms. Those are really the broad categories we've been trying to address.

Mr. McDowell: I would strongly suggest that you put that langugage in the with the addition of, "and other considerations." A very real potential future consideration would be how does this project or this investment program fit in with the United States National Economic Plan?

Mr. Gallagher: We're not accomplishing much this way. What I would like is for us to get the 29 points covered now so that at the next meeting we can have a complete bill to look at - which we can change then if desired. We could add to it or take it out at that time, but we would a complete bill to look at.

Mr. Peterson: What terminology do we use? Either the charter and mean legislature, or call it the bill and then clarify it.

Mr. Wohlforth: The charter is the bill.

Mr. Peterson: I've heard it used alternatively, let's put it in the charter or let's let the legislature handle it.

Mr. Gallagher: We've talked about it in very broad general outlines where small community development do some economic diversification and create a savings account to be used in the future. That's just the general language we will use for number one item.

Mr. McDowell: Are you assisting community development? Stimulating economic diversification?

Mr. Gallagher: And providing a savings account for the future.

Mr. Love: I think the savings account should be the first one, everything else to come afterwards. Just say, the single purpose of the fund would be to provide a permanent source of revenue for the citizens of the State of Alaska.

Mr. Edenso: What are we really attempting to do? We have a procedure and the procedure is a philosophical statement of what the permanent fund should accomplish. We have a charter which is a guideline for how it should accomplish it. I think the overall charter specifies in broad terms, the guidelines the permanent fund should function under. A preamble or a philosophical statement specifies in general terms what you want to accomplish with that permanent fund.

Mr. Rhodes: Why don't we steal the phrase from the Alberta Heritage Fund -- future generations, etc.?

Mr. Fuhrman: They say, "Whereas substantial revenues are being received by the Province in the sale of non-renewable resources; whereas there is a limited supply of non-renewable resources, and therefore revenues will ultimately be reduced; whereas it would be improvident to spend all such revenues as they are received; whereas the Legislature considers it appropriate that a substantial portion of those revenues be set aside and invested for the benefit of the people of Alberta in future years; therefore, Her Majesty, by and with the advice and consent of the Legislative assembly enacts as follows:"

Mr. Gallagher: Sounds great.

Mr. Peterson: We can embody that substance in the purpose clause without all the "whereas".

Mr. Gallagher: We've pretty well covered number one. As a general operating function, I see the permanent fund as a wholesale institution. Soft loan programs should be done through the Department of Commerce. Otherwise you are dealing with financial intermediaries, or the project is such a size you have resident experts in-house to handle it, or you are in the money market. I really see it as a wholesale institution.

Mr. Wohlforth: You might explain what you mean by that term.

Mr. Gallagher: Wholesale versus retail. Retail is making direct loans under a certain limit and working with the individual borrower. Wholesale banking gets into larger loans either direct or in combination with other financial institutions. They would be loans sold to the fund, not necessarily initiated.

Mr. Thorstenson: I don't think we should preclude ourselves in the charter from being involved in some of the business that the banks consider their own. It could well be a policy when there comes a time we don't feel that the banks are fulfilling their role and we may want some of that business.

Mr. Wohlforth: The question is then, the Legislature should pick up the subsidy - the subsidy interest rate -- what sort of operating philosophy do we have then?

Mr. Gallagher: You can break it down two ways. First the loan evaluation -- you never evaluate a loan in terms of subsidy. When you make a loan evaluation you require in the charter that it is done at economic interest rates, not at subsidized interest rates. And two, you should only subsidize in areas where the consumer will get the direct benefit. Also you should never subsidize below long term rate of inflation.

Mr. Fuhrman: Who's going to determine that?

Mr. Gallagher: The policy board can make that determination.

Mr. Edenso: If we subsidize we have to go to the legislature to appropriate the difference from the general fund.

Mr. Fuhrman: Is the word "subsidy" a correct word to use? Your capital is still at risk in that loan. Are you suggesting that the staff and the investment committee would determine that the project is financially viable on a capital basis? That the project can afford to pay the interest rate they're prepared to pay as long as the legislature is making up the difference?

Mr. Gallagher: Subsidy is a good word. And yes to the other questions.

Mr. Fuhrman: My reason for asking is I'm trying to think how the credit institutions will perceive the fund if they feel that you've taken on a capital risk despite the fact that you have been able to insulate yourself from the income risk. The income can go anywhere out of the fund. They only look at the assets as the source of the credit. It matters that you've been able to make a judgment that the capital is not at risk.

Mr. McFarland: I think the crux of this is who initiates the subsidy programs.

Mr. Love: I've got a suggested language to cover this whole section number two. Six points which I've written down are: (1) promote market returns; (2) promote renewable resource industries; (3) diversify the economy; (4) promote equitable distribution of the State's wealth; (5) protect the environment; (6) provide community development.

Mr. Wohlforth: What you stated are already within our goals. We were talking about structural treatment of subsidy loans and we've completed the methodology of structural treatment of these loans. I see a real constitutional problem with the legislature committing to pay a portion of a rate of interest on a private loan.

Mr. Edenso: Some phrases I took from one of the charters while we were in Washington, D.C. Loans should be made on terms and conditions and only obtained by private investors for similar financing. Here we would have the language, "And in the event that any loan is to be made below market rates of interest, the difference shall be subject to legislative appropriations." I think the word "subsidy" is a red herring.

Mr. McDowell: It would be a policy decision to provide an incentive for a loan in a particular sector. The legislature would make that policy decision.

Mr. McFarland: It seems to me the greatest contribution we can make here is to get the highest yield we can on the money and give it to the general fund and let the legislature take care of the subsidy programs, whatever they want to do in the social area. The social area is political, believe it or not.

Mr. Wohlforth: I like the idea, it has a lot of political advantages. We have faced the subsidy issue and when the bill is drafted it will be seen by the Legislature right off. Next, how can the legislature take the position that the fund itself should be the subsidy lender in fact of what we believe the people voted for. Third, they can't argue their prerogatives are being defeated because we've said if there are subsidies it is their prerogative to make and appropriate funds for them.

Mr. McDowell: It's probably the only way that you can be responsive to a need by the public and that the fund retain its integrity and credit value.

Mr. Wohlforth: All right, do you want to get to the question of division between the private and private sector?

Mr. Gallagher: I would like to do them through the Alaska Municipal Bond Bank as guarantees so the permanent fund doesn't get into making loans to political entities for day to day operations, they may have to get into the business of municipal utilities, but you would have to differentiate between the business and social areas of municipalities.

Mr. McDowell: The choices are: the fund will use its capital to make direct loans which will not have guarantee authority, that it can make no more than 20% of its loans to one sector. Another choice is to give guarantee authority -- capital will be used for direct loans to productive private enterprise.

Mr. Fuhrman: It is a way of maximizing the income on a secure investment by using that investment as collateral or pledge behind the guarantee. It has the effect of reducing the cost of capital for the person you are guaranteeing, and you get a guarantee fee which is added to the income you are making on your underlying investment, which may be a government security, a federal government security of some kind. I think that you have to determine that a guarantee or any kind of commitment has the same dollar value in terms of determining what your percentage of participation is in a sector.

Mr. Love: I'm afraid there's going to be a tendency of the permanent fund to make all public investments unless there is some requirement that they make a certain percentage to private enterprise.

Mr. Edenso: Why would you want to limit your guaranteeing just to political subdivisions or to such as the municipal bond. Why not make it to private enterprise as well?

Mr. Crawford: I think we've got to define those terms. What is "public sector" and "private sector?"

Mr. Wohlforth: For a working definition, can you say that a municipality or public agency of the State is public sector and the rest is private sector? The IRS has no trouble defining it. They know exactly what is public and what is private. We've talked about the question of percentages, now let's get back to whether there should be a mandated percentage for either one or not.

Mr. Fuhrman: I have the impression there will be investments in money market instruments or short term instruments; that may be a permanent event or just a place where you put funds while they wait to be put somewhere else, but that will be going on. I would assume the charter would allow for that to go on and there shouldn't be any maximum on that kind of involvement. There would also be a statement about investment grade securities which I define as being money market instruments, and some longer term corporate securities, government securities, or utilities securities. That would probably be the only category that you would consider putting a minimum on, i.e., at least a blank percent of the fund will be in these securities.

With respect to public sector finance, and by that I'm eliminating federal government paper which would be in the category of investment grade securities I just discussed. The private sector you would never want to consider at any point having a minimum percentage or minimum dollar amount because it will force you to look at your audit to see where you were against your ratios. It may cause you or your staff to actually have to seek out a loan to meet the requirement that would be a loan that no practical man would ever consider. There may not be an opportunity to invest in a good loan at that particular time. That is why we would say "up to" rather than "at least", in those categories.

Remember that you're not going to be investing in tax exempt securities which some of the public sector securities would be. It doesn't make any sense for a tax free institution to be investing in tax free securities.

Mrs. Fleischer: If we are in the business of making the division, I like what Mr. Fuhrman suggested, that we say "at least" when we're talking about money market securities and investments and use the words "up to" or "at most" when we're talking about the other.

Mr. Wohlforth: Fine, we're making progress. "At least" in a certain amount of money market instruments, and "up to" or "not exceeding" in the other two categories.

Mr. McDowell: The "at least" provides a savings account. Could I raise the issue of this, just briefly. You're talking about carving up a pot which has three elements in it. You've got the 25% that is your capital. If you allow the fund to borrow, you've got the borrow interest, and if you allow the fund to guarantee you've got the guarantee authority. This is the money that you would or could make direct loans with. That implies an operating philosophy and organization structure. That's not a direct loan; somebody else made the loan, somebody else appraised it, somebody else decided it was a loan worth making, and somebody else administered it. So there's two different organizations -- the guarantee authority which doesn't require much of an organization, someone else does all the work.

Mr. Fuhrman: The question is if you have to call on your capitalization, how do you determine what percentage of what is what?

Mr. McDowell: The guarantee authority cannot be part of your capitalization. It's a part of your financing ability.

Mr. Edenso: The guarantee authority only inhibits the amount of capital you have on hand, it restricts it. It states that you will hold aside so many dollars to guarantee somebody else's debt.

Mr. Fuhrman: What we're really trying to determine, if you deal with percentages, what the definition of the makeup of that percentage is. Percentage of the total capitalization. Is it the percentage of the total capitalization plus the guarantee authority, or what is it?

Mr. McFarland: Suppose you set a 30% figure. I think if you have set up reserves that has to fall within that 30% figure. I don't think you can commit your reserves for more than one thing.

Mr. Edenso: I would say if you're going to have a guarantee, it would be best to talk to your raters, Moody's or Standard and Poors, and find out what they think, because they are the ones who are really going to be the most interested in how you set up a contingent liability and the effect it might have on your rating.

Mr. McDowell: That's the issue. If you set aside a third and invest in investment grade securities and that's where it stays, how much guarantee authority do you think we ought to have?

Mr. McFarland; I think if we set a figure I would recommend that the figure not exceed 30% in the public sector.

Mr. Gallagher: I move for zero in the public sector except through guarantees.

Mrs. Fleischer: Let's define public and private sector.

Mr. Wohlforth: We've suggested that the public sector be confined to the municipalities, everything else be considered private including co-op, utilities, etc.

Mr. Love: How about things like housing projects for the elderly?

Mr. Gallagher: I agree with you, but there are certain things I would like to weed out at the start, like school loans.

Mr. Wohlforth: Your feeling is not so much against fund assistance to municipalities but through vehicles other than direct loans, is that it?

Mr. Gallagher: Right. I would like a market test on municipalities -- market test on a municipal investment.

Mr. Fuhrman: Why not put a low percentage figure in and let the policy board decide what to do with it.

Mr. Thorstenson: We're getting too specific for the charter. We've got a policy committee that will be sitting that will determine policies.

Mr. Crawford: If we're talking in the savings account concept of investing in mortgages for the State, then what are we talking about as far as the private sector?

Mrs. Fleischer: What's wrong with saying at least 40% or 50% of the money to go into investment grade securities.

Mr. Fuhrman: The definitions can be built into the language.

Mr. Gallagher: Why don't we just leave that whole question until the next meeting?

Mr. Fuhrman: Why not leave the percentage blank until the actual writing of the bill when you could expand on it?

Mr. Gallagher: There is one other operating philosophy that has been brought up, how much can you loan to any one borrower.

Mr. Rhodes: That's addressed in the questions.

Mr. McDowell: Most of the charters don't do this but there should be at least a general statement for adding appropriate controls of various kinds. Diversification is the thing to control in an institution like this.

Mr. Wohlforth: Is there a percentage limitation?

Mr. McDowell: No, it's a prudent man test.

Mr. Gallagher: The only other general operating philosophy is maybe the prudent man rule.

Mr. McDowell: You don't really know the exact amount of lending power at this point. You don't really know what the total amount of capital is ever going to be. It's just 25% of certain levies.

Mr. Wohlforth: Shouldn't there be a maximum percentage?

Mr. Barnes: I think a limitation is really a policy board decision.

Mr. Fuhrman: If you leave it there, it's easier to change it and it can be more responsive to the levels of the fund's earnings.

Mr. Crawford: I've got a suggestion on the percentage. The one concern is limiting the public percentage, not the private or the money market. I don't think it's appropriate at this time to set those, but the public could be set.

Mr. Wohlforth: We had a suggestion of 30% previously.

Mr. McDowell: The issue is, the permanent fund, only being a minor portion of the State's resources in the future, should any of it go to the public sector? I've heard that only 17% of the total revenue is really going to wind up in this fund. Shouldn't all public sector projects that have to be financed be financed out of the 83% left?

Mr. Wohlforth: Again, what do you mean by public sector? What kind of involvement is there going to be? Involved in a leveraging capacity, with loans to establish reserve funds for borrowing, or would it be a direct loan?

Mr. McDowell: No matter how you provide financing, it is a public sector need that is being financed. I just want to raise the question of total magnitude, is whatever is going to wind up in this fund so significant that it has to go to public sector needs?

Mr. Wohlforth: Should we move on to legal personality? The board needs to be given a judicial identity.

Mr. Edenso: It's got to have a corporate identity to protect the managers of the fund.

Mr. Peterson: There are some basic ones like ASHA and development corporations that like to sue and be sued in their own name. Is it clear that the committee wants to take that approach, and not simply treat this as a State agency like the loan programs that Tony Motley always handles. Most of them are not of this separate corporate identity type.

Mr. Gallagher: We want separate corporate identity.

Mr. Peterson: Is that the general feeling?

Mr. Gallagher: Yes.

Mr. Wohlforth: The list goes next to sectoral coverage in terms of both economic and size factor. We have dealt with that somewhat already, particularly with what charters say on the subject, if anything.

Mr. McDowell: You don't see much more than the split between public and private, or the exclusion of one or the other as far as economic sectors are concerned. Some institutions are set up as an agricultural development bank. It just says you will invest in agriculture. At the present time here, no one seems quite ready to say one sector within the productive private enterprise is more significant than another. That will probably be the first job of the management of the fund, to have those studies done and submit it to the policy board as an investment planning policy statement.

Mr. Peterson: Would you want any sort of bill statement to the effect that the policy board could give consideration to the various other economic sectors, or just some general statement like that or just leave it blank?

Mr. Wohlforth: You've got to be a little realistic there. I think that a number of legislators feel that the renewable resource field is the one that should be promoted.

Mr. McFuhrman: It's in the self interest of the fund to consider investments in the non-renewable's that are currently not being exploited as well because it will have the benefit of producing additional revenues to which the fund may draw -- from which the fund may draw.

Mr. McDowell: The policy board would not approve an investment program unless in their view it agreed with what they are hearing from executive, legislative, public, special interest groups, regional groups, etc. That's why they should be the recipient in a forum of these views. The structure provides the authority for them to come up with a program that is acceptable to the people in Alaska.

Mr. Wohlforth: What do you mean by geographic coverage?

Mr. McDowell: Do these investments have to be physically located in Alaska? That's one question of geographical coverage. Another question is, should the institutions seek to promote investment or employment in certain kinds of areas within the State? Those are the two issues. Do you limit it to the State and do you seek to emphasize certain parts of the State?

Mr. Gallagher: I think you should do it by economic sector rather than geographical sector. Fishing is pretty well coastal and mining is pretty much interior.

Mr. McDowell: Utilities could be anywhere.

Mr. Gallagher: Yes, and the economic sector goes into that.

Mr. McDowell: you might want to confine, at least some of the expenditures, to take place just within the State of Alaska.

Mr. Gallagher: All of the loan programs should only go to the State of Alaska.

Mr. Edenso: You might want to reconsider that, depending on what your economics tell you. We might want to lend to somebody who is going to construct something out of State that is going to help an industry in the State.

Mr. Wohlforth: General criteria to be applied to the selection of capital investments.

Mr. Pihl: Isn't that a policy board matter?

Mr. Gallagher: What is considered capital investments?

Mr. Wohlforth: Appreciable assets, that's a capital investment.

Mr. Fuhrman: I think you have it with income-producing. The specific criteria are policy and even down at the staff level.

Mr. Fuhrman: At one of these meetings I read a list of all the criteria that had been used. Some of the language used were: "not readily available from other sources - commercial liability - impact on economy - satisfactory return - terms consistent with risk - fixed rates no greater than private - only to government or government guarantee - only for productive purposes - prudent - diversification of equity ..." Those are all the kinds of criteria for judging loans by various parties. When you have a structure that is being proposed here, a charter, a policy board, an invstment committee, and a professional staff, that needs to be particularly specific at the first level, are not as great.

Mr. Wohlforth: Don't we need some broad statements?

Mr. Edenso: Wouldn't that be more in the area of guidelines that a management of investment committee would be utilizing to determine decisions on investments?

Mr. Wohlforth: Yes, but the question is do we put some general language like that in the charter?

Mr. Edenso: What I'm trying to determine is are we getting down to the staff level or are we going to stay at some upper management level?

Mrs. Fleischer: I accept the question as: Is this the area where the general criteria is defined?

Mr. McDowell: The charter says that loans should be made on the basis of priority considerations -- priority and economic considerations.

Mr. Pihl: I think we should go down the list of 29 items and key the items as either charter items or policy board items, and then concentrate on the charter items. I would like to move that we appoint a drafting committee composed of Eric Wohlforth, Sterling Gallagher, Jim Edenso, Peter McDowell and Art Peterson. For the rest of the day let's limit our discussion to the charter items first and then if we have more time go on. But let's talk about the charter items and leave the drafting committee to come back with a product.

Mr. Edenso: That makes a lot of sense. I would suggest that Mr. McDowell be asked to be available to work with the committee to draft the proposed bill and get it ready for a meeting sometime in early January.

Mr. Wohlforth: I'm taking a two week vacation from the 27th to the 12th of January. I'll ask that Jim Rhodes be a member of that committee in my place.

Mr. Love: When this subcommittee meets there should be some way of recording the actions they are taking and that those meetings also be for the public for anyone who wants to attend. These are very important deliberations.

Mrs. Fleischer: Does it matter that there's no non-staff person on the drafting committee?

Mr. Wohlforth: Are you ready for the question?

Mr. McDowell: I can't be on the subcommittee as a member, if you want to rephrase the motion to consultant to the subcommittee, that's fine.

Mr. Wohlforth: Any more discussion? Any objections?

Mr. Love: I would register an objection.

Mrs. Fleischer: I'd like to see Jamie on there just so there is someone on who's not staff.

Mr. Wohlforth: Motion carries. Objections noted. I assume the time and place will be ...

Mr. Gallagher: To me the best day to work on it is Monday.

Mr. McDowell: This coming Monday?

Mr. Love: The next working day.

Mr. Edenso: I would suppose it would take more than one day.

Mr. Gallagher: Well, Monday and as many other days as it takes until it's done.

Mr. Wohlforth: Are we through with number six? I'm not sure whether we decided on general language in terms of investment criteria or not.

Mr. Love: What about the requirement - the criteria that says, "And that economic considerations should be defined to include employment, income distribution, environment, health and social considerations." We were going to add "and others."

Mr. McDowell: You might add another phrase in the beginning of it, use investments where it says "loans". It's not defined yet what an investment will be, but could read, "that investments be made in a prudent manner for high priority projects on the basis of economic considerations which are defined as . . ."

Mr. Gallagher: I'm not sure I want to include employment. I'd rather have capital in intensive industries that require very little employment.

Mrs. Fleischer: I'd rather have employment than labor.

Mr. Edenso: This sentence completely ignores anything to do with income and the earning of income, which is the primary charge of the constitutional amendment.

Mrs. Lehr: It is defined to include; it doesn't exclude anything with the "and others."

Mr. Crawford: In the clause "environment, health and social cosiderations" does that mean we have to have an EIS for every loan that is being considered? Why in a loan program do we put the management for this entity under that type of analysis? They should deal with the financial end and not the environment issue.

Mr. Edenso: We are considering item number six, the general criteria to be applied to the selection of capital investments and then we say, "economic considerations and ..." This completely ignores anything to do with earning income of any kind.

Mr. Peterson: Then add "income."

Mr. Edenso: The primary consideration should be some kind of emphasis on income, maximizing income.

Mrs. Lehr: That's stated in the purpose.

Mrs. Fleischer: I believe that the people in the State would like to know that whatever investment decisions are made to use the money are not counter-productive to the other goals of the State. That means you don't make decisions that do not take into consideration the environment and health and social considerations. You might want an aluminum plant but if it discharges mercury poisoning in the water then perhaps we might not want it but we might also decide it is economically viable to build it.

Mr. Crawford: The Department of Environmental Quality has veto power of water discharges and will not issue the permit for that plant if it is going to be harmful.

Mrs. Fleischer: Then it should be in here.

Mr. Crawford: Why duplicate it?

Mrs. Fleischer: Why duplicate anything then. Many of our departments should be involved. I think they should all be considered.

Mr. Wohlforth: Where it says "economic considerations should be defined to include", then you list three things that are not economic considerations. List, maybe, proper conditions on financing, something that you're sure has no adverse environmental impact, but don't say economic considerations to include social considerations, because in the plain fact of the English language, they don't.

Mrs. Fleischer: Even though they are negative impacts?

Mr. Wohlforth: I'm just talking about grammar and English.

Mr. Love: It costs a lot of money to finance health and social considerations; it costs money to repair the environment that's damaged. I'm not so sure I would go along with such a strict definition.

Mr. Rhodes: You could talk about the economic costs of environmental problems and social problems but the point is a social problem isn't an economic problem as such.

Mrs. Fleischer: But if it costs money, then it turns out costing more money in the long run.

Mr. McDowell: What you're really trying to define in the charter is what considerations should be included. You might say the group now is looking at the considerations that should be included in evaluating an investment are economics, and the other list, perhaps the policy board may decide. Putting it in the charter just puts the policy board on notice that their policy should recognize this kind of a statement.

Mr. Wohlforth: This kind of statement should recognize that they can't ignore, there are conditions to consider, but the prime thrust is economic in the traditional sense. I'm saying that those costs, which are social costs, have to be weighed.

Mr. Love: Part of the problem is these things are not appropriate to any of the items we've discussed so far, so just where do they fit into the charter?

Mr. Wohlforth: You can give all six equal weight, employment, income, environment, health, social, you may have a project that is 20% justified by traditional economics, and 40% social and environment. I happen to disagree with it.

Mr. McDowell: However, they must be income producing to the standards set elsewhere in the charter.

Mr. Pihl: This paragraph says that the board of executive directors is going to give attention to this kind of item. It's not in the charter. I thought we were going to identify the charter and the policy board items.

Mrs. Fleischer: I think we should want to say in the charter here is the general criteria that they should look at.

Mr. Wohlforth: Are you saying that although it is primarily economic, consideration should be given to these other factors or are you saying all these factors have equal weight? Which way are we going to say it?

Mrs. Lehr: The policy board can decide what the weights are.

Mr. Wohlforth: Do we feel we've beaten this enough to leave it to the committee to decide?

Mrs. Fleischer: Yes, let's do.

Mr. Crawford: Could we go down these and decide which is charter and which is policy board?

Mr. Pihl: Items one, two, and three are charter items, and four, five, six, and seven are policy board items.

Mr. Love: All of these things be included in the charter as general statements.

Mr. Pihl: What should be charter acts and what should be policy board acts?

Mr. McDowell: This is a list of general statements which provide the framework for the establishment of policies by the board in the following areas of concern. The charter will address at least these 29 points plus other matters which are very substantive, like where the headquarters are. It might be politically important but not substantive in terms of what it is going to do. I would suggest that the charter include a reference to each of these items, in general terms.

Mr. Pihl: I thought a general statement on prudence would cover all that.

Mrs. Fleischer: I assume you meant to the extent that geographic coverage shall be left open.

Mr. McDowell: Or remain silent. One of the options of all these is to remain silent. The charter can and should be silent in certain areas where you don't think it is appropriate to Alaska situations.

Mr. Gallagher: Something should be mentioned of financial prudence, adequate controls.

Mr. Wohlforth: Numbers 10 to 14 categorize relationships with other persons and institutions.

Mrs. Fleischer: Should we make provision here for relationship to community needs? I've not seen anything that says the permanent fund is going to respond to the felt needs of communities. Like housing.

Mr. Wohlforth: One of the problems we've had is poor communications. Perhaps we should put it that the board will get together with local governments and find out what they want.

Mr. Edenso: The whole purpose of getting a broad base policy board is to include that, I would assume.

Mr. Love: While they're doing sectoral analysis they can do this too. There's hundreds of communities around the State.

Mr. Edenso: Would you rather have a board with a member from every community?

Mr. Love: No.

Mr. Fuhrman: You could have a 65 member policy board,

Mr. Edenso: One of the unique characteristics about Alaska's population and the political figures involved with that population is that they are first of all, visible, and secondly, accessible. If you do something that is earth shattering or government shaking in this State everyone is going to hear about it.

Mr. Love: There's many cases where entire regions of the State have been totally angry because they don't feel there is any method of formally saying what the Alaska Housing Authority ought to be doing in their communities, what they think the priorities are. There isn't any type of consulting or formal dialogue.

Mr. Edenso: There's about 250 villages. I would estimate the cost of doing that with a ten member board would largely inhibit accomplishing any kind of program.

Mr. Love: You wouldn't have to send the board to every village, just write a letter asking them every year to submit a statement or proposal on a project.

Mr. McDowell: By assigning responsibility for receiving information from the public to government units, legislature, etc., to the policy board to take care of because later on you designate the policy board as the appropriate recipient for the views of every community. Does that take care of the relationship?

Mr. Crawford: Could we vote on it?

Mr. Wohlforth: We should have some statement in the charter that the policy board will consult with local governments.

Mr. McFarland: So move.

Mrs. Fleischer: Second it.

Mr. Love: You might want to say that a project over a certain dollar amount in a specific community could be turned down by the local government in that area.

Mr. Edenso: That doesn't make any economic sense. If somebody wants to put a project in, a private citizen can get a petition signed by a few of the people in the community and kill the project. You've already done that when you say "shall consult with local governments.

Mr. Love: On priorities. We didn't say on loans. There is a difference in consulting with them on priorities and consulting with them on specific loan projects.

Mr. Fuhrman: You're only attacking the financial impact.

Mr. Love: Let's just say the project impacts that specific area.

Mr. Wohlforth: Shall we have that in a motion, whether there should be a restriction based on consent of local government to a project financed by the permanent fund?

Mr. Love: Primarily in it's own community over a hundred million dollars.

Mr. Wohlforth: Is there a second to the motion.

Mr. Barnes: I second it.

Mr. Wohlforth: All those in favor of the motion say "aye".

Motion defeated.

Mr. Wohlforth: Do we want to require participation financing in a particular project?

Mr. Love: Would you say either that they have some private mortgages or that they require 25% participation by another lender?

Mr. Gallagher: I think we might tell the policy board that they should consider those things.

Mr. McFarland: Are you talking about mortgages now?

Mr. Gallagher: Anything. Wherever it's deemed desirable.

Mr. McFarland: Let's suppose you buy an $80 thousand mortgage from a bank and insist that the bank participates in that mortgage to the extent of 25%. That type of deal will wipe out all the small banks. They can't tie their money up like that.

Mr. Gallagher: What we're saying is that they should consider it in the charter where it is deemed desirable.

Mr. Wohlforth: I'm thinking about $50 million project loans, I've long felt it was a real break or imprudence to have participation.

Mr. Gallagher: Any project that size should be mandatory.

Mr. Wohlforth: Shouldn't we think about something like that in the legislation just to guard the public against the unhappy eventuality of poor management or whatever.

Mr. Edenso: To require a percentage like 75%, 25% participation where it is deemed desirable.

Mr. Crawford: On larger projects -- a $100 million projects -- long term money you've just cut all the Alaska banks out.

Mr. Edenso: It's not exactly undesirable to have outside banks make a capital investment in the State. I think that's really a help to the economy; we're importing money for a change instead of exporting it.

Mr. Wohlforth: The question is, if we're talking participation, should we have a dollar floor on the participation requirement, should there be a percentage?

Mr. Edenso: The big concern is with residential housing -- let's exempt residential housing.

Mr. Gallagher: How about a percentage of the fund?

Mr. Edenso: I think it's pretty unreasonable to tie down a percentage of the fund without knowing the potential size of any kind of investment market we're going to have.

Mr. Wohlforth: I'm talking about a percentage of financing the project. Should we establish a percentage on that? Do we simply say we're going to do it in participation with other sources?

Mr. Barnes: And let the policy board from time to time set the limit.

Mr. Edenso: I think we ought to define what reasonable is; we ought to say 25%.

Mr. McDowell: It might be totally unreasonable in specific cases.

Mr. Gallagher: I think the words, "where it's reasonable".

Mr. Allen: Say we have a loan for $100 million for 25 years. You know the banking industry will not participate in that and their success in attracting outside investors to feed money into the State of Alaska is very limited.

Mr. Edenso: The banking system shouldn't be in the position of making long term capitalization loans to begin with. You can probably find 25 year long term funds if you require participation with a responsible financing company such as life insurance, that's the proper place for long term investing capital, not the commercial banking system.

Mr. Gallagher: How about projects where there are guarantees from insurance companies and guarantees from the Federal government?

Mr. Love: When you've got insurance or guarantees you don't need participation, do you?

Mr. Gallagher: That is participation.

Mr. McFarland: If you're talking about participation of a bank that is trying to sell a package, that's one thing. If you're talking about going into a $100 million project and you want insurance to put in $25 million, do you consider that participation?

Mr. Gallagher: Financial participation means someone else making a credit check, either guaranteeing or taking 25% of the project. If you guarantee you also make the same credit check as you do in making an investment.

Mr. Edenso: When you require participation you are not buying as large a piece of the action and you're insuring that someone else is going to be involved. You'll get the involvement when you guarantee only if you go to the point where you have to call that guarantee. The exposure is there regardless of whether it is direct or indirect.

Mr. Wohlforth: Should there be a percentage or should we use just general language encouraging participation guaranteeing our returns?

Mr. Crawford: General language.

Mr. Gallagher: There should be a general statement that we encourage Alaskan ownership.

Mr. McDowell: To encourage an Alaskan market for Alaskan equities.

Mr. Love: I would certainly endorse that because they recycle the money back into the economy at a better rate than an outsider will.

Mr. Wohlforth: So fourteen is finished; we'll pass to fifteen - general powers and parliamentary rules. We talked about the fact that we're going to have general corporate powers -- parliamentary rules, the board will set up its own rules of procedure. General powers of management - sixteen.

Mr. McDowell: The defined powers and responsibilities of management -- in this case the chief executive officer -- are normally stated vey simply. His sole power is to present investment proposals to the management board. This clearly puts accountability and responsibility together. It says, "no one except the management and staff can present the proposal to the investment committee."

Mr. Gallagher: When you present it, do you have to come in with a positive recommendation?

Mr. McDowell: There are going to be certain cases where the staff may want to go to the board for a final clear decision.

Mr. McFarland: I think we should get a recommendation one way or the other even if it goes to the board. Either we favor this or we don't. It could save a lot of time.

Mr. Edenso: I have a question on number 14. We said limit these geographically to Alaska, or can we participate or help to finance an investment in Alaska that's owned by or initiated by somebody in the lower 48?

Mr. Wohlforth: As far as we got was giving Alaskans preference everything else being equal.

Mr. Pihl: That's as far as a project is concerned?

Mr. Edenso: Is the limitation geographically to Alaska or is it a limitation to Alaskan-owned industries?

Mr. Crawford: How do you define Alaskan? The election rule is 30 days before election.

Mr. Gallagher: That's for the policy board to decide.

Mr. Wohlforth: We're down to the chief executive officer and the suggestion that he be required to recommend or not recommend a particular financing.

Mr. McFarland: It's a waste of time if he doesn't make a recommendation.

Mr. Love: If the staff makes a recommendation and the board approves a lot of the loans that the staff disapproves, that makes them more accountable. They've got to answer as to why they made that loan.

Mr. McDowell: I think you have to hold back on that until you decide exactly what the fund's going to do. It's just too far down the organization to clearly define all of its functions.

Mr. Fuhrman: While we're talking about organization, doesn't it make sense to either start at the top down or the bottom up in our conversation now?

Mr. Wohlforth: The policy board, the management board, etc.

Mr. Fuhrman: And the staff. It's easier to talk from the bottom up than down. What I'm suggesting is that the staff, including the president, be responsible for accounting and control on a daily basis and prepare reports along the way. They would be responsible for employing and compensating people on the staff and external or internal advisory assistance in their functions which would include evaluating loan investment proposals, preparing and packaging loans and investment proposals for presentation to the investment committee for approval.

Mr. McDowell: All those matters are covered in the phrase, "responsible for ordinary operations." The charter should say just about that.

Mr. Fuhrman: Right, and "invest or reinvest monies not subject to investment committee or policy board approval", which is a general statement and avoids the issue.

Mr. McDowell: Without clearly saying exactly all the things it's going to do you can't define the operating organization yet.

Mr. Wohlforth: Do we agree with the general statements as it concerns the chief executive officer?

Mr. Fuhrman: I don't envision the chief executive officer is going to arrive alone at the investment committee to present the proposal. He would bring that member of his staff who has worked on the packaging to make the presentation with him.

Mr. McDowell: You must make him responsible and accountable for it, even though he is completely supported by his staff.

Mr. Fuhrman: He's not responsible for it at all if the investment committee decides to make that investment. Then it is the investment committee as a whole that is responsible.

Mr. McDowell: He has recommended it and he is reponsible for presenting it.

Mr. Fuhrman: He has presented it on a financial basis and the investment committee is going to look at it on a financial basis and in conjunction with the policies which they have interpreted as coming down from the policy board.

Mr. McFarland: Then he will either recommend it or not recommend it. He has to be able to tell a person that his loan is not so good and not to expect to get it. But if he insists on it going to the board it should go to the board.

Mr. McDowell: There are a lot of ways that could be handled in a positive manner but are not techniques that could be defined in a charter. You just have to make someone responsible.

Mr. Wohlforth: We all seem to be agreed on this. If the draft workshop plus the Price Waterhouse comments are acceptable, then we are at nineteen -- conflict of interest.

Mr. Gallagher: This should only go down to the chief executive officer level. Below that you can handle it as internal policy.

Mr. Crawford: The chief executive officer is going to have to disclose? How far does it go in State government?

Mr. Gallagher: It goes to directors level.

Mr. Love: All of the staff below the chief executive officer you want an internal policy. Do banks have internal policies for loan committees?

Mr. Allen: You file a public financial statement.

Mr. Love: When you talk about the board, there are two boards, a policy board and a loan committee which included four outside directors. Would those four outside directors file a public conflict of interest report?

Mr. Gallagher: Yes.

Mr. Love: That seems like an adequate procedure to me. If all those people are filing conflict of interest statements it seems perfectly appropriate for the other staff to conform to whatever internal policy you have.

Mr. Wohlforth: All right. General financial goals, level of profits to be attained, protection of capital, prudent management of assets are next on the list.

Mr. Gallagher: It's pretty well covered. The only thing is level of profit, make sure that we have a reserve for bad debts.

Mr. Pihl: We were going to have something on seeking to compensate for inflation -- I mean building your principal by leaving that amount of your income to compensate for inflation.

Mr. Gallagher: I'd be against that because there would be nothing left over. No income if you added to the principal every year from the income to compensate for the inflationary loss of the dollar value to the principal.

Mr. McFarland: But for a certain period of years your income would be inflated. If you sold oil ten years ago at a certain price, ten years from now it will have escalated considerably.

Mr. Gallagher: That would be returns off the fund.

Mr. Edenso: That assumes the only capital in the fund is going to be contributed capital mandated by the constitution. It doesn't take into consideration the possibilities of issuing debt to obtain debt capital.

Mr. McFarland: If we put the inflationary factor in and retain that, I don't think we'll get past the legislature with it.

Mr. Wohlforth: We seem to have some general agreement about not having a retained earnings requirement equal to inflation rates, unless someone feels strongly otherwise, we'll go on. Borrowing powers and limits, if any, of the corporation.

Mr. Gallagher: I think it should be able to borrow, but that's a policy matter.

Mr. Pihl: But the charter has to say that you want the power to borrow.

Mr. Rhodes: Can we at this point, not knowing the size of the fund really in five years, can we establish some overall ration of the leveraging total on loan guarantees, treat it as direct liabilities?

Mr. Fuhrman: We've discussed this and indicated that we wouldn't anticipate much leveraging in the early years, but that perhaps the legislation should at least allow for it and then let the policy board make a decision later on management's recommendations as to needs or what they would do with it, whether to take advantage of it. The concept we're recommending is that you at least have the ability to leverage and then let time determine whether you do or not. Then we discussed whether or not you wanted to have built into the legislation capital ratios beyond which you wouldn't go if you were to leverage or that you would always at all times maintain at least so much equity per debt or various units. Whether or not guarantees should be counted as a liability on a dollar for dollar basis. Our thought there was that if you chose to have those kinds of limitations at this point they would be in the charter, much broader than what the market place will ultimately let you have anyway. That whenever you enter the market place to borrow, or whenever you place your first guarantee on something that someone else is borrowing there will be built into the purchase agreement restrictions on what the permanent fund can do from then on with respect to its capital ratios, which will be more restrictive than anything you put into the charter. Therefore it's not very important one way or the other whether you have it in the charter.

Mr. Wohlforth: So the borrowing powers should be in the charter but limits should not be. Is that the consensus? All right, twenty three.

Mr. Gallagher: I think the expenses should all be paid by the fund.

Mrs. Lehr: What would be the determination of the budget? Is there any limit to having fancy offices?

Mr. Gallagher: The policy board would have to approve the budget.

Mr. Love: Let's say that the budget go to the legislature.

Mr. Wohlforth: Should the budget be subject to the Executive Budget Act?

Mr. Gallagher: I used to be for it until I saw the accounting implications if you have a reserve for bad debt -- the political implications of going to the legislature for supplemental for reserve for bad debts.

Mr. Crawford: It should be exempted from the Budget Act for a couple of reasons. The primary purpose is insulating this from political influence.

Mr. Wohlforth: Would you make a motion to that effect?

Mr. Crawford: I so move.

Mr. McFarland: I second.

Mr. Love: I want to speak against it. I don't think we can give a blank check in the face of the amount of income that the fund has to spend. I don't think that's responsible fiscally and it's not a good public policy. I feel we would be making a major mistake by exempting the permanent fund from some type of legislative review as to it's level of expenditures for managing the fund.

Mr. Wohlforth: How does the World Bank do it? Is the operating budget taken out of income without regard to national government's direct line item appropriation?

Mr. McDowell: They are completely independent of the governments on that matter. The board of executive directors has the final word. In this case it would be the policy board. The policy board is charged in the charter by the legislature with behaving in general in a responsible, reasonable and prudent way. It is accountable to the public, the executive, and the legislature for behaving in that manner. You appoint those policy board members to represent the interests of the people of the State of Alaska and expect them to do it.

Mr. Edenso: I'm in favor of the motion. The quality of the people you're going to hire, the process that is going to require them to be placed in that position, the public visibility of them before they get to that position, are all going to work to insure that we have people of integrity who are not going to do damage to the State. They've got a responsibility to execute to the best of their ability the income earning side of the permanent fund which also means holding down expenditures. Finally, I think a major reason for not having the permanent fund chief executive officer go through the legislative process is that it would force him to acknowledge that first he has the policy board to answer to and secondly he has to go to the legislative body annually to obtain what he thinks is a reasonable amount of dollars to carry out his job. That means he has not nine but 69 bosses. He will spend most of his time lobbying the legislature just to get what he wants.

Mr. McDowell: The budget in this kind of an institution, also includes its operating revenues, which in effect includes its loan and investment program. The budget is the complete financial plan.

Mr. Love: What we're really debating here are issues like staff, salaries, travel, office space, consultants, etc.

Mrs. Lehr: What control does the legislature have? It can only remove the members of the policy board for cause. I don't see where the control comes in from that highest level.

Mr. Rhodes: Their reach is the charter. They can lay more specific priorities down. They have the final remedy of taking the budget process in hand if it turned out that lowest staff members was being paid an exorbitant amount.

Mr. McDowell: Their first option would be to fire the policy board. Their second option would be to change the charter. The policy board is not being paid. They do not share in the benefits of any of the operating expenses of the fund other than probably the conference room and per diem to attend the meetings. They are going to decide on what all the rest of the people get, but they themselves will not benefit from their decisions. You've got a very good separation of power.

Mr. Peterson: This policy board is appointed by the Governor. There's no confirmation by the legislature, there's no direct appointment by the legislature.

Mr. Phil: It is confirmed by the legislature.

important thing is for the public to know there will be checks and balances on the fund.

Mr. Rhodes: I'm not sure in the case of the permanent fund if described as independent, that the public would necessarily be reassured, that the legislature had auditors looking after it. Peter, where would operational evaluations, post audits, be done?

Mr. McDowell: That depends. There are very few people outside the institutions qualified to do operational evaluations of capital investmen development investments. It's a specialized internal audit function of a development institution and it's the normal pattern that they report to the audit committee rather than to the management.

Mrs. Lehr: It is not the same staff making the loan decisions and doing the post evaluation.

Mr. McDowell: No, they are separate.

Mr. Love: My question is in what instance is the public given the right to examine the conclusions of the evaluations so they can react and have their input into the way the permanent fund is being managed?

Mr. McDowell: The only thing you have to watch out for is that you reserve the confidentiality of information given to you.

Mr. Wohlforth: that takes us right through number twenty nine. This meeting is adjourned.

Meeting adjourned at 4:00 p.m.

Mr. Peterson: I'm tal g about the draft we submitted yesterday. Then there are a couple of Alaska Constitutional provisions plus a recent Supreme Court Decision that deals with the separation of powers and the confirmation ability of the legislature. What is the accountability to the legislature? They have the continuing legislative authority to change the legislation or charter, but beyond that I think they would probably have little authority.

Mr. Wohlforth: We did say that we would have a policy committee appointed by the Governor, subject to legislative confirmation, if this is constitutional. So we just have to determine if we can make it subject to the legislature.

Mr. Gallagher: There is a possibility that legislators may be on the board without voting power - in an advisory capacity only.

Mr. Wohlforth: Could we get to the question of w' : or not we are subject to the Executive Budget Act? All those in favor that the . .d not be subject to the Executive Budget Act signify by saying "aye". Opposed?

Mr. Love: Nay.

Mr. Wohlforth: Number twenty four. Source of funds to pay for any subsidy of loan interest, etc. That we've already discussed. Twenty five, disposition of net income from operations. Twenty six, proportion of the total capital of an enterprise or project which the institution may provide. We've been over that. Twenty seven, general requirements for independent audit and public reporting.

Mr. Gallagher: On public reporting - at least as the Treasurer I'm required to report either annually or semi-annually, including a list of my investments, and I don't find that objectionable.

Mr. Wohlforth: Is it agreed that we need independent audit and public reporting including performance evaluations? All right. Twenty eight, general requirements for operational evaluations, post audits of capital investments. Do we agree on that?

Mr. Crawford: In the draft bill there was a provision that the executive directors were the ones who did the audit. I think the audit should go to the policy board rather than the executive directors. The executive directors and the investment committee are making the investments and you can't have anybody who is making investments doing the audit.

Mr. McDowell: I think the policy board should be the audit committee and should be the only recipient of reports from the outside auditors.

Mr. Wohlforth: There is a legislative audit which could be their control.

Mr. Love: I think we should recommend that they have an audit. It would serve the public interest better to have an audit.

Mr. Rhodes: I think the most recent precedent would be the Alaska Power Authority where they chose an independent audit rather than a legislative.

Mr. Love: That audit would be satisfactory, but I think it would be good to say that an independent audit would be done annually, but the legislature would have the authority to do its own independent audit if it deems necessary. I think the

CERTIFICATION

I, JIM EDENSO, Executive Secretary of the Alaska State Investment Advisory Committee, hereby certify that the foregoing Minutes of the December 16 and 17, 1976 meeting of said Committee duly called and held at Anchorage, Alaska, on said dates, are a substantial verbatim extract of the recording of the proceedings of said meeting with deletion of insubstantial matter and changed only to clarify the statement.

Jim Edenso

Jim Edenso
Executive Secretary

STATE INVESTMENT ADVISORY COMMITTEE
MINUTES
January 6, 1977
Anchorage, Alaska

A special meeting of the State Investment Advisory Committee was convened at 9:00 a.m., January 6, 1977 with Mr. Robert McFarland presiding. The meeting was held in Room 19, 509 West Third Avenue, Anchorage, Alaska.

Members present were:

Dr. Charles Logsdon, Director, Agricultural Experiment Station, Palmer
Mr. Robert McFarland, Anchorage
Mr. Martin Pihl, Comptroller, Ketchikan Pulp Company, Ketchikan
Mr. Jamie Love, Alaska Public Interest Research Group, Anchorage
Mr. Bill Allen, Commissioner, Department of Administration, Juneau
Mr. Langhorne A. Motley, Commissioner, Department of Commerce and Economic Development, Juneau
Mrs. Lanie Fleischer, Anchorage
Dr. Dona Lehr, Development Planning & Research, Office of the Governor, Juneau
Mr. Sterling Gallagher, Commissioner, Department of Revenue, Juneau
Mr. Jim Edenso, Deputy Commissioner, Department of Revenue, Juneau

Absent Members:

Mr. Eric Wohlforth, Anchorage
Mr. Robert Barnes, President, Alaska State Bank, Anchorage
Mr. Dennis Waldock, Anchorage
Mr. Emil Notti, Alaska Native Foundation, Anchorage
Mr. Robert Thorstenson, Petersburg Fisheries, Inc.
Mr. James Crawford, Coordinator, Alaska Offices of Ted Stevens/United States Senator
Mr. Robert LeResche, Development Planning & Research, Juneau
Mr. James Rhodes, Anchorage
Senator John Butrovich, Fairbanks
Senator Jalmar Kerttula, Palmer
Senator Frank Ferguson, Kotzebue
Representative Hugh Malone, Kenai
Representative Richard Urion, Anchorage
Representative Clark Gruening, Anchorage

Others Present:

Mr. Peter McDowell, Price Waterhouse, Inc.
Mr. Ted Swick, White Weld, Inc.
Mr. Bob Richards, Anchorage
Mr. Frank Reed, Dean Witter and Company

MINUTES

Mr. McFarland: We will open our meeting by everyone introducing themselves.

Mr. Gallagher: I would like to review the more current bill, then I would like to discuss with the committee as to what direction they want to go -- look at some of the sectoral analysis and lending functions or activities we should be doing. Also at what point do we do it, who is going to do what, and how to develop the data on these various sectors.

Mr. Edenso: Perhaps we'd better look this bill over to see the differences since there have been a number of changes.

Mr. McFarland: Has the constitutionality of the proposed bill been checked? Do we have the right under the Constitution to do the things asked for in the bill?

Mr. Gallagher: Yes.

Mr. McFarland: Why don't we go over it point by point? Does anybody have any changes for the first page?

Mr. Gallagher: Several people of the financial community wanted a better definition of "encourage and assist the participation of private capital . . . in private enterprises of benefit to Alaskans." They didn't understand what that meant.

Mr. Motley: I think their problem was they thought that was getting to be a specific guideline. Once it was explained that it was a broad-brush type of approach they understood it better.

Mr. Love: I don't remember us really taking a position on number one and two, smoothing out cyclical pattern of growth.

Mrs. Fleischer: What does that mean?

Mr. Gallagher: I'm not sure number two should be in.

Mr. Edenso: If you look at the characteristic of the fishing industry in Alaska today, you have several species at several different times of the year. I think it should apply to fisheries as well and tourism.

Dr. Logsdon: Perhaps you do not want to invest the Permanent Fund money in Alaska at certain times, you may want to move it out of Alaska to avoid the impact of investing in extra billion dollars.

Mr. McDowell: The issue of timing investments could become important because of the cyclical pattern. There should be discretion in timing investments and this should be one of the criteria.

Dr. Logsdon: My reasoning was that the big push in Alaska has been to increase government activities and 25% of the royalties monies will go into the Permanent Fund, leaving 75% in government which is going to increase the government even faster. During this period I think it may be well to back off on the Permanent Fund, or withhold it until you are ready to see which direction things move. If you pump the whole bit in at once you could have a big explosion.

Mrs. Fleischer: You're not saying this would mandate smoothing out the cyclical cycle?

Dr. Logdson: I'm not talking about a seasonality employment, not on an annual basis but on a longer term basis.

Mrs. Lehr: This list is fairly generalized and I don't think it could be interpreted to mean that every investment has to meet every one of these criteria. They are just general guidelines.

Mr. McDowell: The crucial sentence in paragraph 17 is the last one. It says, "The Permanent Fund shall be guided in all its decisions by the purpose set forth above." There's only one purpose set forth above and that is to provide a means of conserving a portion of the State's revenues from mineral resources. That is the purpose, the rest is elaborating on it. The Permanent Fund's management is put on notice that decisions should always be considered in light of paragraph 17.

Mr. McFarland: Anything else? Can we go on to page two?

Mr. Love: Can we insert before the word "seek" at the top of the page, the words, "primary purpose"?

Mr. Pihl: The overriding or controlling principle shall be to seek to maintain the principal.

Mr. McDowell: There are six or more ways of going about that.

Mrs. Lehr: The purpose is the ultimate benefit of present and future generations of Alaskans.

Mr. Love: I think it should be to conserve.

Dr. Logsdon: I tend to scratch the last half of that sentence because that's the only way in which you are supposed to seek to preserve the capital of the Fund. You do these other things for some other purpose, but this is the one that you use to preserve the capital.

Mr. Love: Should we put a period after sound investments or after future generations?

Dr. Logsdon: Either one -- probably through sound investments. Sounds like the only way you can preserve it is through investment grade securities. We are actually talking about preserving it through other means as well.

Mr. Love: Maybe after generations. Maybe you want to make some sort of investments which in themselves would be risky but if you maintain a system of reserves, overall it would be a sound investment policy.

Mr. Allen: That's prudent management but has no effect on risks.

Mr. Gallagher: You could set up a reserve when you make the high risk investment at the start. The idea of reserve is for bad debts -- I guess the definition could be made to cover prior and active reserve, but the usual definition of reserve for bad debts is after the fact, after you've made sound investments.

Mr. Love: I move that we reword number six to say, "seek sound investments in investment grade securities."

Mrs. Fleischer: I second it.

Mr. Gallagher: I think the way you are describing it "further benefit to Alaskans" it's a benefit to Alaskans to seek to preserve it for future generations. Something that you're not going to be presently investing in the State to do it outside the State. And that's the way to preserve it.

Mrs. Fleischer: I thought that was the main idea of preserving the Fund.

Mr. Gallagher: It is, but you're describing further benefits to Alaskans. When you describe further benefits to Alaskans you're deciding that you want to preserve some of this money so that it could be invested later maybe inside the State. The Fund may not be growing as fast at that point in time, so you are preserving this money at this point in time to conserve it later to be used in the above five purposes.

Mr. McFarland: It's window dressing. Why don't you say, "seek also to preserve the Permanent Fund for future generations."

Mr. Love: That sounds good.

Mr. Motley: There's a motion on the floor.

Mr. Love: I will amend the motion to incorporate the language that Mr. McFarland just used.

Mr. Motley: Would you like to restate your amendment?

Mr. McDowell: "Seek also to preserve the Permanent Fund capital . . ."

Mr. McFarland: All those in favor signify by saying "aye".

Mr. Gallagher: No.

Mr. McFarland: Adopted. Can we go on to composition of the Permanent Fund?

Dr. Logsdon: One thing that keeps bothering me and that's the Corporation as something separate from the Fund. The Fund I think of as money and in the last sentence of the first paragraph it says" except that income in the following amounts may be retained by the Corporation." Because if you say, "by the Permanent Fund" it goes back into the Fund and can this be used?

Mr. Edenso: Throughout the bill we've used the Alaska Permanent Fund interchangeably to refer to the Fund, the capital of the Fund, and the Corporation.

Mr. McDowell: We talked about this quite a bit and tried to use a different name but we kept running into all kinds of problems because the fund of money and the organizational entity just are inseparable. There has to be legal entity in addition to the Fund. The Fund is a governmental accounting classification; there has to be an organizational entity as well, so we put in 015 to define that there would be a corporation and would be called the Alaska Permanent Fund; 010 says there is a fund called the Alaska Permanent Fund. Both things exist and both are used exactly the same way all through. Whether you're talking about the account or whether you're talking about the corporation, it didn't seem to matter once we said there were two and they are essentially the same.

Dr. Logsdon: I guess I have to accept it because everybody seems to agree to it.

Mr. Motley: We're using interchangeably the principal of the Permanent Fund and the entity of the permanent Fund, that's what you're concerned with?

Mr. McDowell: Let's put it aside for now. Finish the bill and then see if there are any problems with this part.

Mr. Love: Is there going to be someone from the Attorney General's office here if we should need any legal help?

Mr. Gallagher: When the Governor's Office saw the bill they said it was a very professional looking bill and was it drafted by the Department of Law.

Mr. McFarland: I think in the normal process of this bill it will pass through these types of hands.

Mr. Pihl: A question on paragraph 020 - whether it should not read "at least twenty five percent" and also provide for the legislature to establish a percentage at something higher than that annually if they so choose.

Mr. Love: You could say 25% plus money appropriated annually.

Mr. Allen: That isn't how the Constitution reads.

Mr. McFarland: The money has to come from mineral resources.

Mr. Allen: Where does it have to do with the budget?

Mr. Gallagher: This bill will last from year to year. If you set a good number it will last without getting another bill introduced. Let's go through section by section, 020.

Mr. Edenso: I would like to ask the committee to announce their feelings on 020, paragraph 1, the amount needed to pay the operating and administrative expenses of the Permanent Fund. I think that's a very important item.

Mr. Gallagher: I thought we would take that up under the budget section.

Mr. McFarland: Under allocating a reserve account. Do you contemplate holding out reserves at national schedule -- 3%, 5%, or whatever the national norm is?

Mr. Gallagher: No, this reserve is a financial reserve, and under 090 it says, "consistent with sound financial practices." In other words, an audit or CPA firm looks at the quality of the assets, they will pick a number that is appropriate and reserve for bad debts.

Mr. McFarland: Are you going to rely on them to pick the number that you reserve?

Mr. McDowell: They will evaluate management's estimates and comment accordingly.

Mr. McFarland: Bad debts come out of dividends and not out of the general fund -- not out of the expense fund.

Mr. Motley: It will come out of reserves.

Mr. Swick: Are the provisions of one and two of 020 the law that is allowing you to keep earnings from going to the general fund?

Mr. Gallagher: Yes.

Mr. Swick: Does the words "reserve account" address itself only to the reserve for bad debts concept or does it go beyond into a credit reserve for some other entities?

Mr. Motley: It's not just reserve for bad debts. I think it's broad enough in its language.

Mr. Richards: We are limited to 25%.

Mr. Love: Should we be recommending 35% the first year? Is 25% too low or is it about right according to the revenue needs of the State?

Gallagher: I'll be discussing that with the Governor on Friday. There is a possibility that it will be a figure other than 25%.

Mr. McFarland: How about 025 (b)?

Mr. Love: I got a little lost with "reasonable proportion of longer-term . . . " What do you mean by "reasonable?"

Mr. Motley: It's a limit factor.

Mr. Gallagher: We had a hard time with definitions in (c), so we finally defined it as to municipalities and state agencies, things like that. In (b) the words "private enterprises" does not include things that are not enterprises. A person in a single family dwelling is not an enterprise.

Mr. Motley: But you've covered it under (c). Public corporate entities.

Mr. Gallagher: How about private businesses? How about changing the word "enterprises" to "entities"?

Mr. Allen: How do you define "entity"?

Mr. Gallagher: A home is a productive asset of an individual. Where does it fall under these three definitions?

Mr. Richards: Housing loans?

Mr. Motley: Why don't you add that. Say productive private enterprises and home loans.

Mr. Edenso: I would suggest that when you are financing a home that it is an investment grade security -- mortgage of some kind.

Mrs. Fleischer: Is that true of every home you finance or just some homes?

Mr. Love: How about the center for old people in Fairbanks?

Mr. Gallagher: I move that we amend section (b) -- strike the word "enterprises" and put in the word "entities".

Mrs. Fleischer: I think it should be clear that home loans be in here, and if changing the words to "entities" doesn't do it, then we should add a (d) and do it that way, but we should do it explicitly.

Mr. Edenso: Why don't we take the last sentence and say, "These investments may take the form of equity, loans, mortgages, home loans, housing financing, or loan guarantees," or something of that nature.

Mrs. Fleischer: That would satisfy it, I think.

Mr. McDowell: I'll explain this best by example. The way (a), (b), and (c) are written, the mortgage on a specific home of somebody in the State or anywhere else, would be financed under (a) or (c). An investment in a home building company, privately owned, would be financed under (b). But if you squeeze (b) and allow it to do what (a) and (c) should be doing on home mortgages, then I don't think you will ever make an investment in the home building.

Mr. Gallagher: Then I would move it into a (d) category. I'll withdraw my previous motion.

Mrs. Fleischer: I'll second the withdrawal.

Mr. Gallagher: I move that we add an additional section called (d) that the Permanent Fund may invest not more than blank percent of its resources to provide a reasonable portion of long term investment capital for financing the establishment, improvement, and expansion of, - - I want to use a word that describes housing but that is productive. I want it to specifically include the Alaska Housing Finance Corporation but I don't want to preclude it.

Mr. McFarland: Is a house considered an investment grade security?

Mr. Gallagher: Your mortgage is.

Mr. McFarland: Do you want to write another section to cover housing and let someone else write it out for us?

Mr. Gallagher: Yes.

Mr. McFarland: Is that agreeable to everybody? Will you have somebody do that?

Mr. Edenso: Draft a (d) on dwellings.

Mr. Love: I would move on section (b) on the second line, the word "longer term" is removed, and ask for unanimous consent.

Mr. Motley: What's your motion?

Mr. Love: To deduct the word "longer-term" on (b), second sentence down.

Mr. McFarland: In other words it would read, "The Permanent Fund may not invest more than "x" percent of its resources to provide a reasonable proportion of investment capital for financing the establishment, improvement, ... " etc.

Mr. Love: I don't think we should limit ourselves in terms of long or short term. I'll make a motion to remove the word, "longer-term" from (b).

Mrs. Fleischer: I'll second it.

Mr. McFarland: All those in favor signify by saying "aye". Opposed? Motion lost.

Mr. Edenso: Is it the direction of the committee that we do want a section (d)?

Mr. McFarland: Yes.

Dr. Logsdon: Could I have an explanation of the term "equity" in the last sentence?

Mr. Motley: You could buy stock in a company, for instance.

Mr. Richards: This would imply equity as distinguished from debt or ownership.

Mr. Love: Or ownership? Isn't equity ownership?

Mr. Motley: You could buy stock. Isn't that equity position?

Mr. Love: Are we going to move on any of the specific percentages of any category?

Mr. Gallagher: Yes.

Mr. McFarland: I hate to see us lock in the percentages because this is not easy to change should it become law. The requirements of Alaska shift all the time.

Mr. Pihl: I think the words "at least" in (a) provide us with that flexibility, and that we really ought to recommend percentages.

Mr. Motley: In some place you put a floor and in another place you put a ceiling.

Mr. McFarland: Jim, do you have any recommendation on percentages? Do you want to get into that right now?

Mr. Love: Maybe 40% for (a) and 30% for (b).

Mr. McFarland: Let's do them separately. Forty percent for (a).

Mr. Edenso: I'm still not convinced that we need to add a (d) section.

Mr. McFarland: All those in favor of adding a (d) section say "aye". Motion carried.

Mr. Edenso: We're talking about three sectors of the overall economy. The public area, the private area, and the concept of the savings account. I believe you're going to lock in the investment committee to making a certain number of loans in the housing area regardless of the credibility or desirability.

Mr. Allen: We don't want to do that and I hope it doesn't come about.

Mr. Motley: There is only one floor and that is in investment grade securities.

Mr. Allen: I think you did a good job and I understand the language and the intent, but if someone else doesn't understand you can tell him it is right there in (d).

Mr. Gallagher: There is nothing in my area of investment grade securities that includes the word "mortgages".

Mr. Edenso: In (b) we might be able to say, "These investments may take the form of equity, loans, housing loans, or loan guarantees."

Mr. Gallagher: The reason I want to put a lock on housing was to make sure it didn't swamp private enterprise, so that's why I want a section (d).

Mr. Edenso: At no other place in the bill are you referring to any particular section of the economy. You don't refer to fishing per se, or forest products per se, so you're going to get the question raised "why not so many percent to something else?"

Mr. Gallagher: How about productive private enterprises and housing?

Mr. McDowell: Put it sepearately if you're going to put it in, otherwise one could crowd the other out.

Mr. Gallagher: We don't want to use the word "housing".

Mr. Love: We could change it to expansion of productive private enterprise and facilities which will benefit Alaskans. That could include utilities, houses, etc.

Mr. Richards: I don't think you would find any economist who would go along with the notion that housing is included in the intent of a bill that used the word "productive".

Mr. Love: Well just eliminate "productive" and have private enterprise by itself.

Mr. Richards: Why don't you just explicitly deal with the matter of putting shelters over people's heads as a separate item.

Mr. Gallagher: Alright, I move that we have a (d).

Mrs. Fleischer: I second it.

Mr. McFarland: Any further discussion? All those in favor signify by saying "aye". Opposed? Motion carried. Let's go to percentages now.

Mr. Love: 40% -- 20% -- 20% -- 20%.

Dr. Logsdon: 40% -- 25% -- 25% -- 10%.

Mr. Gallagher: I move 40% -- 25% -- 25% -- 10%.

Mr. Pihl: I'll second it.

Mr. McFarland: Moved and seconded. Any discussion?

Mrs. Fleischer: Is there a ceiling or a floor on housing?

Mr. Allen: There is a ceiling.

Mrs. Fleischer: In other words you're saying no more than ten percent in housing.

Mr. Gallagher: Ten percent would be $180 million in direct loans. That doesn't mean you can't assist it through loans of Alaska Housing Finance under (c).

Mrs. Fleischer: I would speak against the motion because I want to see 50% in (a). If the purpose of the Permanent Fund is to conserve a portion of the State's revenues for the ultimate benefit of present and future Alaskans I think we should put 50% in (a).

Dr. Logsdon: All of it is towards conservation of the principal.

Mr. Love: At this point we shouldn't lock outselves out of investment opportunities in Alaska.

Mr. Allen: You've got to consider your yield is going to be less.