

ALASKA LEGISLATURE COMMITTEE FILES 1981-1982
1801A SLC SB 684

Review of Current Provisions

Early in the year, in a paper entitled "Thoughts of the Chairman", Mr. Rasmuson observed that the narrow range of allowable investments in the current law prevents the Trustees from providing an effective hedge against inflation. He called for consideration of modifications in the Fund legislation to allow investments which would offset inflation, and he also identified the need to coordinate any examination of the Fund, which automatically receives only about 11% of the state's oil wealth, with plans for the remaining 90% of the revenues. This approach was endorsed by the Trustees, who further agreed that the task of shaping the Fund must be a continuing process and that if the Fund is to have a stabilizing role in the Alaskan economy, any changes must be made with careful deliberation.

Subsequently, a special legislative panel was appointed to work with the Trustees. Appointments were made both by Senator Sturgulewski, Chairwoman of the Legislative Budget and Audit Committee, which has statutory oversight responsibility for the Permanent Fund, and by the presiding officers of the Legislature. A series of seminar/work sessions was scheduled and the Trustees and legislators are meeting regularly to examine the issues and discuss recommendations.

Examination of Issues

A consensus has emerged as to the questions which must be addressed and on which recommendations ought to be made.

Assuming the fundamental role of the Fund to be provision of high quality savings, with both present and future residents enjoying the income, is there also a possible development role and is that role desirable? What are the risks of concentrating investments within a single state? Is the present investment list adequate and, if not, would it be prudent to diversify into other asset classes such as equities, real estate or foreign assets? What are similar institutions doing in this regard? Given the fact that the principal and income of the Fund will be eroded by inflation, should some provision be made to pay out only "real" or inflation-adjusted income rather than all income? Should an objective rate of return over the rate of inflation be set as an overall performance measurement goal (i.e., 2% over the rate of inflation)? What management changes may be needed (such as composition of the board, size of internal staff)? What legal constraints must be considered in making recommendations? And, finally, what is the proper size of the Fund? This last question turns on how the income may be used. Several proposals for the use of income have been advanced; distribution to residents, covering some part of future state budgets, and endowing central programs in the budget, such as education, housing, or local grants, are some of the possibilities.

Guest speakers of national repute have been featured at the series of seminars. Broad questions of state spending and distribution of oil wealth were dealt with by Professor Don Gordon of City University of New York, Katherine Peden, a private industrial development consultant, Nobel laureate Kenneth Arrow from Stanford, Professor Maxwell Fry of University of California at Irvine, and Professor Richard Coffman of University of Idaho. George Russell of the Frank Russell Company, Robert Greeley, manager of corporate investments at Hewlett Packard, and Sam Nakagama of Kidder, Peabody & Co., specifically addressed investment strategy.

To obtain more detailed information on investment and management questions, representatives of the Permanent Fund, Treasury Division, the Legislative Budget and Audit Committee and the Attorney General's office had a series of meetings with prominent New York financial houses, reports were filed upon their return.

Meetings and Information

Four regular meetings and two special meetings were held during fiscal year 1981 and two meetings have been held thus far in fiscal year 1982. Dates and places are noted below. Summary minutes are available for all meetings. In addition, a compilation of papers presented by guest speakers, together with an executive summary, will be made available to the Legislature in January. Copies of that report will be furnished upon request to any interested groups or individuals.

Regular Meetings

September 12, 1980 — Juneau
November 21, 1980 — Juneau
March 20, 1981 — Juneau
June 30, 1981 — Anchorage
September 10 & 11, 1981 — Juneau

Special Meetings

January 9, 1981 — Juneau
May 8, 1981 — Juneau
August 20, 1981 — Fairbanks

Future meetings are scheduled for October 22 and 23 in Anchorage, December 3 in Juneau, and at a date uncertain in January in Juneau. The public is always encouraged to attend meetings and is given an opportunity to address agenda items.



FUND PERFORMANCE DURING FY 1981

(July 1, 1980—June 30, 1981)

Investment Strategy

Fiscal year 1981 was a period characterized by extreme volatility in financial and capital markets. As measured by the accepted bond indices, the first and third quarters of calendar year 1980 were the worst two in fifty years, while the second quarter was the best ever recorded. Declining interest rates in the second quarter encouraged both consumers and corporate borrowers to resume their earlier spending patterns. As a result the economy experienced the shortest recession on record—three months—and then bounced back to produce extraordinary growth in early 1981 before weakening in the second quarter of 1981. While inflation has abated recently, there is nothing substantive to indicate that this improvement is anything more than a temporary phenomenon. Wage demands continue strong and there has been no improvement in productivity.

Fund investments during FY 81 were concentrated in two year and shorter maturities, with investments in progressively shorter maturities as the year advanced and the economic climate remained unpredictable. By mid-June, 90.7% of the Fund portfolio matured within two years, 66.9% within one year, and 49.8% within six months. On June 30, 1981, the average weighted life of marketable securities was one year one month as compared to three years one month on the same date in 1980.

Performance Versus Goals

AS 37.13.170 requires that the annual report include a comparison of corporation performance with the goals outlined in AS 37.13.020. These goals are: (1) conservation of a portion of the state's mineral resource revenues to benefit all generations of Alaskans; (2) maintain safety of principal while maximizing total return; (3) management of Fund as a savings device to allow maximum use of disposable income for purposes defined by law.

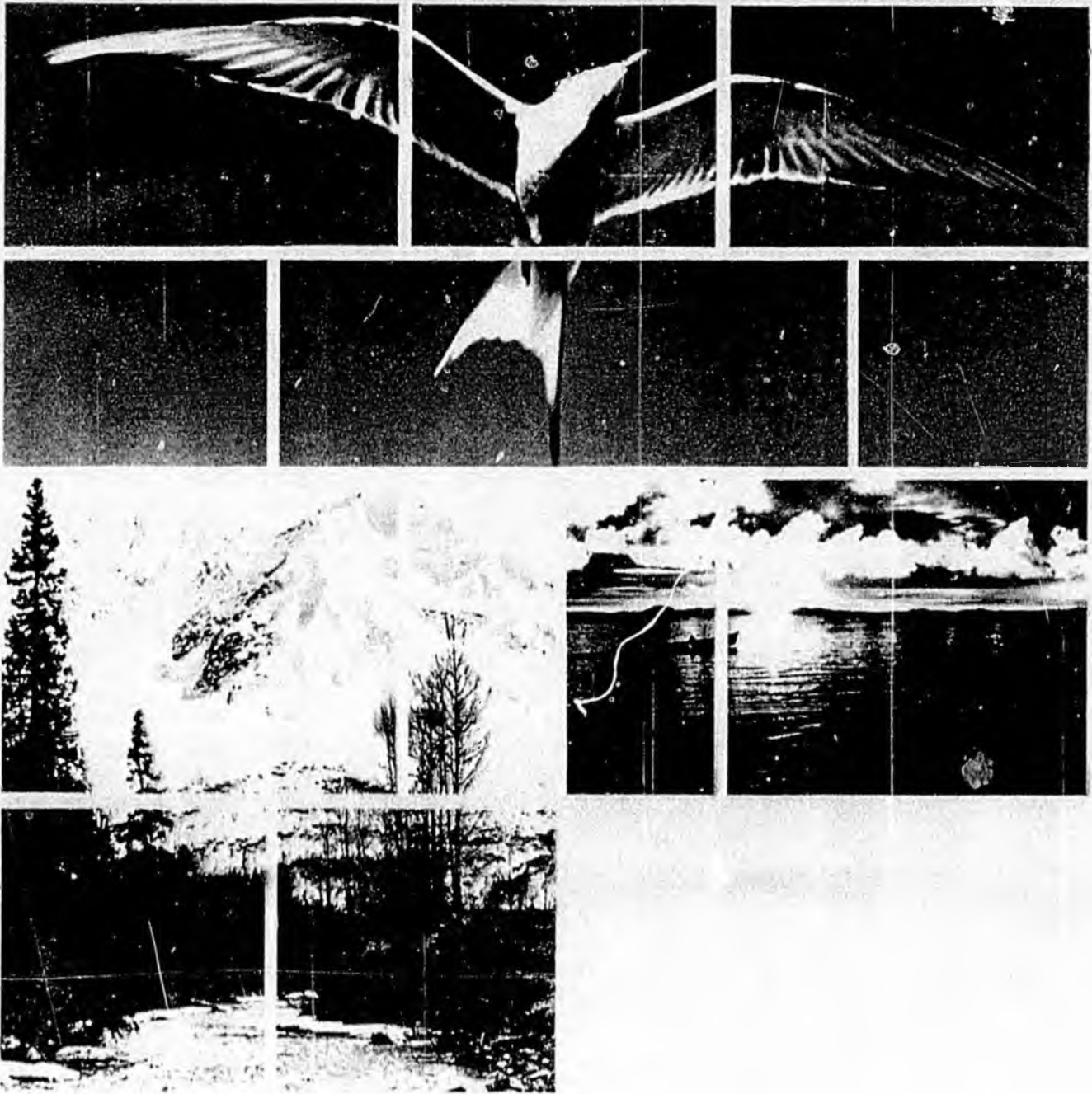
Through the regular contributions required by the constitutional amendment and by the Permanent Fund Act, plus the special appropriation of \$900 million made during the 1980 legislative session, the Permanent Fund grew from \$483,208,000 on June 30, 1980, to \$1,827,299,000 on June 30, 1981.

The realized rate of return on Fund investments has climbed steadily and was 16.0% as of June 30, 1981. The net realized gain on transactions retained in the Fund's principal during fiscal year 1981 is \$219,388. All principal contributions have been retained in the Fund's balance, and disbursement of income earned has been limited to cash amounts received.

The Permanent Fund Dividend Plan is the only provision currently in law for the use of disposable income. According to the constitutional amendment which created the Permanent Fund, all disposable income of the Fund is transferred to the General Fund and is available for expenditure by the Legislature, unless otherwise provided by law. The statutory provision for payment of dividends in proportion to duration of Alaska residence has been challenged. The Alaska Supreme Court decision upholding the dividend distribution plan is presently under review by the U.S. Supreme Court; a decision is expected sometime in early 1982.

Audit

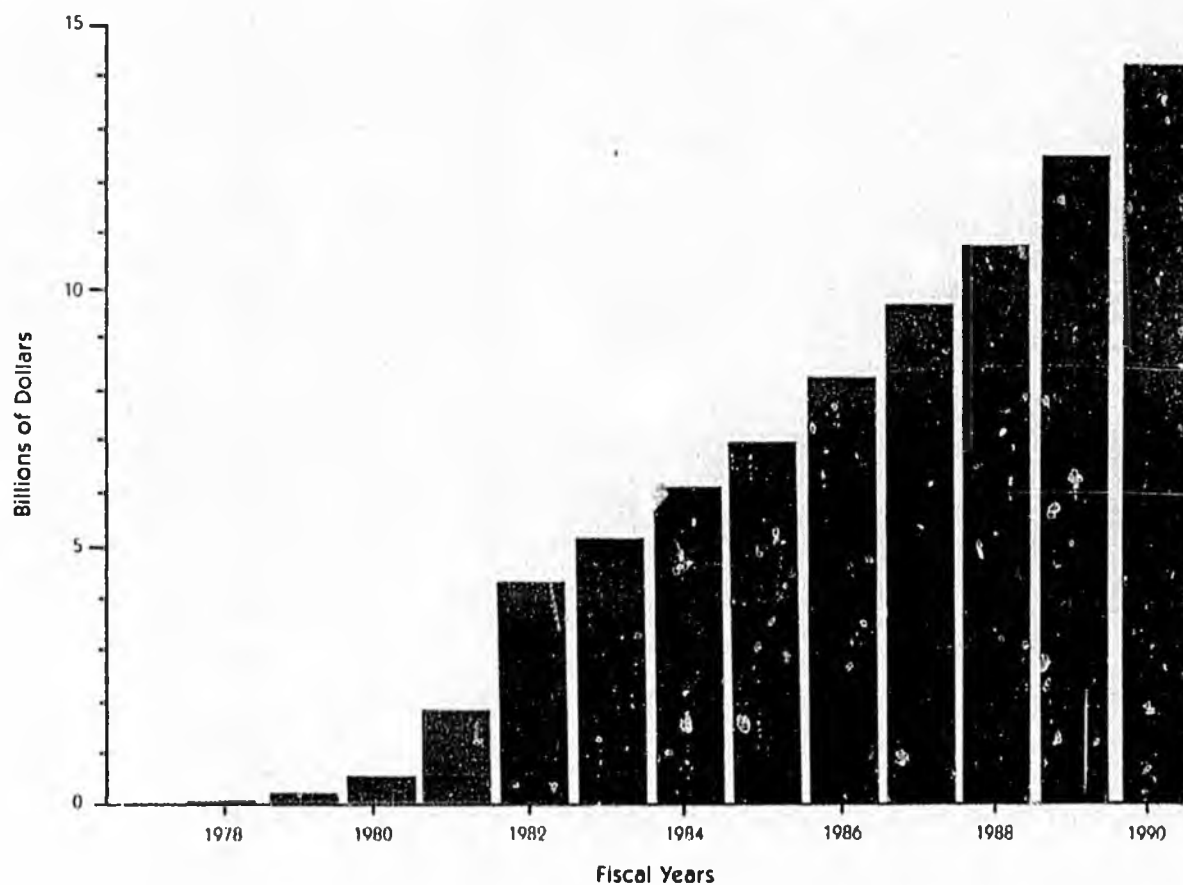
The Fund was audited by Price Waterhouse & Co., independent public accountants, for the 1981 fiscal year. The auditors expressed an unqualified opinion as to Statements of Net Assets, Investment Income and Changes in Net Assets.



OUTLOOK FOR FISCAL YEAR 1982

Cumulative Balances

- Historical Cumulative Balance
- Projected Cumulative Balance



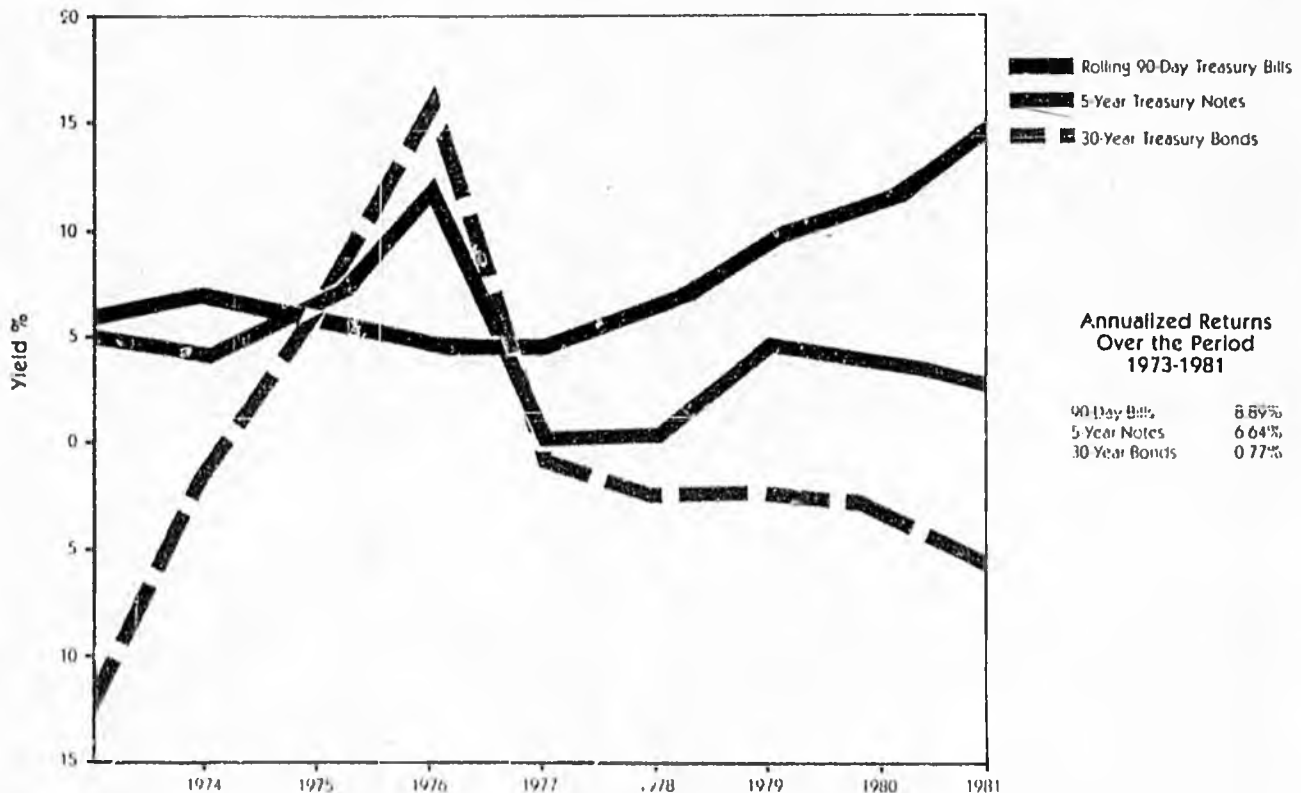
Fund Balance

During the 1981 legislative session, a special appropriation of \$1.8 billion was made to the Permanent Fund under the provisions of Chapter 51, Session Laws of Alaska 1981. With the addition of that amount plus regular contributions, the Fund is projected to be \$4,273,900,000 on June 30, 1982.

Economic Outlook and Investment Strategy

The central concern in the development of any coherent investment strategy is the willingness of the U.S. government to come to grips with inflation and the nature of policies proposed to bring it under control. The Administration's budget cutting and tax cut victories along with its defense program have raised a number of significant concerns within the investment community. There is a growing realization that the U.S. Treasury and federal agencies will continue to make heavy demands on the credit markets for the remainder of this year and 1982. The Treasury's early estimate of \$42.5 billion deficit for federal fiscal year 1982 is proving to be unrealistic, and a number of private analysts are projecting a deficit in the \$70 to \$80 billion range. The Administration is currently searching for new areas to cut spending, but any search will likely involve some extremely difficult political struggles.

Fixed Income Total Returns
(Revised Sept. 1981)



Alaska Permanent Fund

Realized rates of return, income, and portfolio balances
for the fiscal years ended June 30, 1981, 1980, 1979, & 1978

	Fiscal Year 1981	Fiscal Year 1980	Fiscal Year 1979	Fiscal Year 1978
Realized rates of return (based on accrued income)	16.00%	11.29%	8.24%	7.53%
investment income (including amounts earned but not rec'd. by year end)	\$ 149,867,000	\$ 32,426,923	\$ 7,967,131	\$ 1,791,000
Case earnings received transferred to general fund	\$ 54,931,481	\$ 23,675,560	\$ 5,702,926	\$ 900,434
Average portfolio balance	\$ 936,243,000	\$ 287,255,000	\$ 96,700,000	\$ 23,800,000
Marketable securities on June 30, at cost	\$1,846,491,000	\$493,427,071	\$137,783,958	\$ 54,387,000
Marketable securities on June 30, at market	\$1,795,730,000	\$493,444,000	\$136,140,000	\$ 52,300,000

There appears to be a growing perception in the financial markets that a strict monetarist monetary policy and supply-side oriented fiscal policy are not entirely mutually compatible. Those advocating most strongly the supply side fiscal policy are already beginning to contend that high interest rates are suppressing economic growth, pushing the federal budget further out of balance and jeopardizing the tax cut's chance of success. The Federal Reserve Bank, on the other hand, is undoubtedly concerned that a significant easing in interest rates would start another inflationary surge in pent up consumer demand for housing and automobiles. These concerns are also no doubt compounded by fears that this surge could be reinforced by the administration's three year tax cut and a planned surge in defense spending. Fixed income investors seem to sense that eventually one philosophy will have to be deemphasized.

Given the volatility of the economy and interest rates, a conservative investment strategy emphasizing short term investments appears best suited to providing high rates of return while at the same time minimizing the risks of capital depreciation. Until such time as fiscal and monetary policies are brought into a more harmonious relationship, interest rates are likely to remain highly volatile.

ALASKA PERMANENT FUND Corporation
Financial Statements
June 30, 1981

Rice
Waterhouse & Co.



101 WEST BENSON BOULEVARD
ANCHORAGE, ALASKA 99503
907-279-1424

August 13, 1981

To the Board of Trustees
Alaska Permanent Fund Corporation

In our opinion, the accompanying statements of net assets, of investment income and of changes in net assets present fairly the financial position of the Alaska Permanent Fund Corporation at June 30, 1981 and its investment income and changes in net assets for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances, including at June 30, 1981 confirmation of securities owned by correspondence with the custodians. The financial statements of the Alaska Permanent Fund Corporation for the year ended June 30, 1980 were examined by other independent accountants, whose report dated August 29, 1980 expressed an unqualified opinion on those statements.

Price Waterhouse & Co.

Price Waterhouse & Co.

ALASKA PERMANENT FUND Corporation

Statement of Net Assets

	June 30	
	1981	1980
Cash in Savings Account	\$ 43,000	\$ 39,000
Contributions receivable from the State General Fund	92,000	34,000
Interest Receivable	26,925,000	9,377,000
Loans and Mortgages	1,086,000	
Investment Securities, at cost		
U.S. Treasury notes and bonds	670,771,000	303,964,000
Bankers acceptances	537,715,000	23,510,000
U.S. Treasury bills	466,615,000	20,583,000
Certificates of deposit	137,600,000	111,879,000
Corporate bonds	13,487,000	13,487,000
Federal agency notes	13,004,000	13,004,000
Securities purchased under agreements to resell	7,300,000	7,000,000
	<u>1,846,492,000</u>	<u>493,427,000</u>
Amounts due to the State General Fund	<u>(47,339,000)</u>	<u>(19,669,000)</u>
Net Assets	*1,827,299,000	\$483,208,000

See accompanying notes to financial statements

ALASKA PERMANENT FUND Corporation

Statement of Changes in Net Assets

	Year Ended June 30	
	1981	1980
Assets Were Provided By:		
Investment income	\$ 149,867,000	\$ 32,427,000
Contribution from the State of Alaska General Fund	900,000,000	
Royalties and other State receipts	385,128,000	344,396,000
Total assets provided	1,434,995,000	376,823,000
Transfers of investment income to State of Alaska General Fund	(90,904,000)	(32,161,000)
Increase in net assets	\$1,344,091,000	\$344,662,000
Increase (Decrease) in Components of Net Assets:		
Cash in savings account	\$ 4,000	\$ 8,000
Contributions receivable	58,000	(205,000)
Interest receivable	17,548,000	5,936,000
Loans and mortgages	1,086,000	
U.S. Treasury notes and bonds	366,807,000	231,530,000
Certificates of deposit	25,721,000	106,865,000
Bankers acceptances	514,205,000	(4,843,000)
U.S. Treasury bills	446,032,000	20,583,000
Federal agency notes and bonds		5,008,000
Securities purchased under agreements to resell	300,000	6,500,000
Commercial paper		(10,000,000)
Amounts due to the State General Fund	(27,670,000)	(17,720,000)
	\$1,344,091,000	\$344,662,000

See accompanying notes to financial statements

ALASKA PERMANENT FUND Corporation

Statement of Investment Income

	Year Ended June 30	
	1981	1980
Interest Income:		
U.S. Treasury notes and bonds	\$ 61,279,000	\$13,060,000
U.S. Treasury bills	32,229,000	808,000
Bankers acceptances	28,115,000	5,251,000
Certificates of deposit	22,636,000	10,130,000
Securities purchased under agreements to resell	1,950,000	306,000
Corporate bonds	1,140,000	1,140,000
Federal Agency notes and bonds	1,082,000	1,069,000
Commercial paper	1,062,000	387,000
Other interest income	120,000	
Savings account	35,000	10,000
	<u>149,648,000</u>	<u>32,161,000</u>
Net securities gains	219,000	266,000
Investment income	\$149,867,000	\$32,427,000

See accompanying notes to financial statements

ALASKA PERMANENT FUND Corporation

Notes to Financial Statements

Note 1 — Authorization

The State of Alaska Constitution was amended by voter approval in 1976 to provide for the segregation of certain mineral lease rentals, bonuses, royalties, royalty sale proceeds and federal mineral revenue sharing payments received by the State for the use and benefit of present and future residents.

Distributable income from the Corporation is defined by statute and further clarified by administrative regulation to be the lesser of the latest fiscal year's income or the average annual current income calculated using a simple average of the last five years or the number of years in existence if less than five after adjustment for capital gains and losses.

All of the Corporation's investment securities are held by a commercial lending institution pursuant to a custodial agreement, except for certain certificates of deposit purchased from Alaska banks.

Note 2 — Summary of Significant Accounting Policies:

The accounting and reporting policies of the Alaska Permanent Fund Corporation conform to generally accepted accounting principles. The more significant accounting policies are as follows:

Interest Income

Interest income on loans is accrued monthly as earned.

Interest income on investments is shown net of amortization of premium and accretion of discount.

Investment Securities

Investment securities are carried at cost adjusted for amortization of premium and accretion of discount. Investment securities are expected to be held to maturity and, therefore, will be fully realized.

Gains or losses on the sale of securities are determined on a specific identification basis.

Provision for Loan Losses

The provision for loan losses is determined from specific evaluation of delinquencies and would be charged directly to operations in the period that the loss exposure becomes known. At June 30, 1981 no provision has been made since no losses are presently anticipated.

Note 3 — Marketable Securities:

The cost and estimated market value of investment securities at June 30, were as follows:

	1981		1980	
	Cost	Market	Cost	Market
U.S. Treasury notes & bonds	\$ 670,771,000	\$ 633,501,000	\$303,964,000	\$304,967,000
Bankers acceptances	537,715,000	536,411,000	23,510,000	23,692,000
U.S. Treasury bills	466,615,000	464,330,000	20,563,000	20,924,000
Certificates of deposit	137,600,000	134,120,000	111,879,000	113,899,000
Corporate bonds	13,487,000	8,135,000	13,487,000	10,753,000
Federal Agency notes	13,004,000	10,642,000	13,004,000	12,209,000
Securities purchased under agreements to resell	7,300,000	7,300,000	7,000,000	7,000,000
	<u>\$1,846,492,000</u>	<u>\$1,794,439,000</u>	<u>\$493,427,000</u>	<u>\$493,444,000</u>

Note 4 — General Fund Contribution:

For the year ended June 30, 1981, the State of Alaska Legislature appropriated \$900,000,000 to the Corporation from the General Fund. For the year ended June 30, 1982, the Legislature appropriated an additional \$1,800,000,000 to the Corporation from the General Fund of which at least \$1,400,000,000 is to be contributed prior to June 30, 1982.

Note 5 — Administrative Expenses (Unaudited):

Administrative and other expenses are paid by the State of Alaska General Fund and are not included in the accompanying statements. The related budget and actual expenses for 1981 and budgeted expenses only for 1982 for operations of the Permanent Fund Corporation are as follows (unaudited):

	1981	1982
Budget		Budget
\$206,800	Actual	\$450,500
	\$165,000	

Photographs courtesy of the Division of Economic Enterprises
Department of Commerce and Economic Development.

Legislative Committee of Oversight

Legislative Budget and Audit Committee
Senator Arliss Sturgulewski, Chairwoman

Special Legislative Liaison Committee

Senator Arliss Sturgulewski, Chairwoman
Senator Patrick Rodey
Senator Vic Fischer
Senator Bob Mulcahy
Senator Ed Dankworth
Representative Al Adams
Representative Hugh Malone
Representative Boo Bettisworth
Representative Oral Freeman
Representative Sam Cotten
Representative Ernie Haugen

Cross references. — For provisions concerning application to the Department of Revenue for permanent fund dividends for 1979, see editor's note following the chapter analysis to AS 43.23.010 — 43.23.100.

Sec. 43.23.030. Amount of dividend. By December 1 of each year the commissioner shall give public notice of the value of each permanent fund dividend to be paid in the following year. The commissioner shall determine the value of a permanent fund dividend by

(1) determining the amount of income of the Alaska permanent fund transferred to the dividend fund under AS 43.23.050(b) in the current year, less the amount, if any, to be repaid in the current year to the general fund under AS 43.23.050(c);

(2) determining the number of permanent fund dividends paid during the current year; and

(3) dividing the amount determined in (1) of this section by the amount determined in (2) of this section. (§ 2 ch 21 SLA 1980)

Editor's notes. — For 1979 the value of a permanent fund dividend is \$50. See § 3, ch. 21, SLA 1980, in the 1980 Temporary and Special Acts and Resolves.

NOTES TO DECISIONS

Chapter is constitutional. — See notes under same catchline following chapter analysis. Stated in *Williams v. Zobel*, Sup. Ct. Op. No. 2201 (File No. 5400), 619 P.2d 448 (1980).

Sec. 43.23.040. Penalties and enforcement. (a) In addition to any criminal penalties imposed by state law, if an individual is convicted of unsworn falsification for a statement made in a certification of residency made for purposes of AS 43.23.010 — 43.23.100, and the conviction is not reversed, that individual is not, and may never become, eligible for a permanent fund dividend, and he forfeits all permanent fund dividends paid to him.

(b) If the commissioner determines that a permanent fund dividend should not have been claimed by or paid to an individual, he may use any collection procedures or remedies available under AS 43.05.010 — 43.80.040 to recover the payment of a permanent fund dividend which was improperly made. (§ 2 ch 21 SLA 1980)

Sec. 43.23.050. Dividend fund established. (a) The dividend fund is established as a separate fund in the state treasury. The dividend fund shall be administered by the commissioner and may be invested by the commissioner in the same manner provided for the investment of the Alaska permanent fund under AS 37.13.120. Money in the dividend fund and any interest earned from investment of money in the dividend fund shall be used to pay permanent fund dividends annually and to repay loans from the general fund as provided in (c) of this section.

(b) Each year the commissioner shall transfer to the dividend fund 50 percent of the income of the Alaska permanent fund which was earned during the fiscal year ending on June 30 of the preceding year and which is available for distribution under AS 37.13.140.

(c) The legislature may annually appropriate money from the general fund to the dividend fund if there is not enough money in the dividend fund to pay each eligible individual an annual permanent fund dividend valued at \$50. One-fifth of the amount transferred to the dividend fund each year under (b) of this section shall be annually withdrawn from the dividend fund by the commissioner and deposited in the general fund to repay appropriations made under this subsection. (§ 2 ch 21 SLA 1980)

Cross references. — For provisions concerning application to the Department of Revenue for permanent fund dividends for 1979, see editor's note following the chapter analysis to AS 43.23.010 — 43.23.100.

NOTES TO DECISIONS

Chapter is constitutional. — See notes under same catchline following chapter analysis. Stated in *Williams v. Zobel*, Sup. Ct. Op. No. 2201 (File No. 5400), 619 P.2d 448 (1980).

Sec. 43.23.060. Duties of the department. The department shall

(1) by the 10th day of each regular legislative session, present a request to the legislature for an appropriation from the general fund to the dividend fund to satisfy the requirements of AS 43.23.050;

(2) annually pay permanent fund dividends from the dividend fund;

(3) adopt regulations under the Administrative Procedure Act (AS 44.62.010 — 44.62.650) which establish procedures and time limits for claiming a permanent fund dividend; the department shall set the time limit for applications for permanent fund dividends so that single-payment permanent fund dividends for a year are paid before October 15 of the following year and so that installment-payment permanent fund dividends for a year begin by October 15 of the following year; and

(4) assist residents of rural areas who because of language, illness, old age, or inaccessibility to public transportation need assistance to establish eligibility and to apply for permanent fund dividends. (§ 2 ch 21 SLA 1980)

Sec. 43.23.070. Exemption of permanent fund dividends. (a) An eligible individual may assign, pledge, or encumber not more than 50 percent of the annual permanent fund dividends which are due and payable or which may become due and payable to the individual.

(b) Fifty percent of the annual permanent fund dividends payable to an individual is exempt from levy, execution, garnishment, attachment, and any other remedy for the collection of a debt.

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Established 1879 Members New York Stock Exchange, Inc. and Other Principal Exchanges

Denali Towers North, 2550 Denali St., Suite 1603, Anchorage, Alaska 99503 (907) 276-6939

Handwritten note:
M. J. ...
L. J. ...

March 16, 1982

Senator Bob Mulcahy
Pouch V
Juneau, Alaska 99811

Dear Senator Mulcahy:

As a follow up to our discussion on March 12, 1982, with regard to the Permanent Fund, it is hoped that this letter can be entered into the record.

The purpose of this letter is to insure that if the Permanent Fund is allowed to invest in Equities and Bonds, that as long as Alaskan Brokerage houses can be competitive that they should be permitted to participate in the purchase and sale of Securities.

Alaska has four major brokerage houses at present, all with world wide offices and major institutional trading departments in New York and San Francisco.

I would like to be kept advised of our request and if necessary I would like the consideration to introduce Legislation to protect the Alaskan Brokers who are taxpayers and residents.

Very truly yours,

Handwritten signature: Dennis L. Waldock
DENNIS L. WALDOCK
Vice President

DLW/dm

STATE OF ALASKA

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

DIVISION OF INSURANCE

JAY S. HAMMOND, GOVERNOR

POUCH D
JUNEAU, ALASKA 99811
PHONE: 465-2515

March 17, 1982

Honorable Bob Mulcahy
Alaska State Senate
Pouch V
Juneau, Alaska 99811

Dear Senator Mulcahy:

Re: CS SB 684 Informational Request

In insurance language "Capital" is invested money by investors that is not encumbered.

"Surplus" is added funds accumulated over a period of time. These funds are not encumbered.

"Capital" and "Surplus" are for the benefit of all policyholders should the need arise for their use.

"Reserves" in insurance language is the amount of money set aside for known losses or losses incurred but not reported. "Reserves" in insurance language is encumbered money.

Sincerely,


Kenneth E. Moore
Director

KCM/lt3/12

cc: Charles R. Webber, Commissioner

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

167-00
STATE OF ALASKA
LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

May 14, 1981

SUBJECT: Confirmation of appointees of the board of trustees of the Alaska Permanent Fund

TO: Senator Arliss Sturgulewski

FROM: John B. Chenoweth
Legislative Counsel

You have directed my attention to two provisions relating to legislative review and confirmation of the members of the board of trustees of the Alaska Permanent Fund:

The Legislative Budget and Audit Committee has the power to:

* * *

(9) hold public hearings on the confirmation of the members of the Board of Trustees of the Alaska Permanent Fund Corporation . . .

AS 21.20.201(a).

The Legislative Budget and Audit Committee shall

(1) report to the legislature its recommendations relating to the confirmation of appointees to the Board of Trustees of the Alaska Permanent Fund Corporation . . .

AS 24.20.206. You have inquired as to "the right of the legislature to hold confirmation hearings for appointees to the permanent fund board of trustees".

Legislative confirmation on these appointees may not constitutionally be required. The decision in Bradner v. Hammond, 553 P.2d 1 (1976), contains the most pertinent discussion of the underlying reason:

May 14, 1981

"In Alaska State-Operated School System v. Mueller, 536 P.2d 99, 103 (Alaska 1975), we observed that '[E]hose who wrote our constitution followed the traditional framework of American government. The governmental authority of the State of Alaska was distributed among the three branches, the executive, the legislative, and the judicial'. Analyzing this tripartite form of government provided for Alaska, this court concluded, in Public Defender Agency v. Superior Court, Third Judicial District, 534 P.2d 947, 950 (Alaska 1975), that . . . it can be fairly implied that this state does recognize the separation of powers doctrine.

* * *

"A problem inherent in applying the doctrine of 'separation of powers' stems from the fact that the doctrine is descriptive of only one facet of American government. The complementary doctrine of checks and balances must of necessity be considered in determining the scope of the doctrine of the separation of powers.

* * *

"In the instant appeal, the parties, in recognition of the controlling nature of the issue, dispute the meaning of the doctrine of separation of powers, and its implication for the determination as to whether Chapter 82 is violative of Alaska's constitution. In our view, the doctrine is of importance to the resolution of the merits of this appeal, for if the doctrine clearly precludes legislative intervention (by confirmation) in the appointment of executive officials, or requires 'strict departmentalization,' then Chapter 82, which purports to authorize legislative 'meddling' in the exercise of an executive power, is unconstitutional because it would be violative of separation of powers requirements.

"In determining if Chapter 82 violates the doctrine of separation of powers, which is implicit in Alaska's constitution, it is necessary to answer whether the appointment of executive officers is a legislative or executive function.

* * *

"Appellee [Hammond] contends that the appointment of executive officers is an executive function. We find appellee's contention most persuasive. In addition to vesting the executive power of the state in the governor, Section 16 of Article III provides that '[t]he governor shall be responsible for the faithful execution of the laws'. In view of the responsibilities imposed by Section 16, and the authority granted by Section 1, the governor is necessarily clothed with the power to appoint subordinate executive officers to aid him in carrying out the laws of Alaska. Thus we conclude that the appointment of executive officers is an executive function; for without such a power, the responsibility of executing executive duties would be diffused and the goal of separation of branches of government avoiding too great a concentration of power in one branch, would be defeated.

* * *

"[I]t is then necessary to determine the nature of the legislature's confirmation powers. Here we are in agreement with appellee's analysis that under Alaska's constitution confirmation is a specific attribute of the appointment power of the executive. Other courts which have been called on to resolve this issue have been unanimous in their holdings that confirmation is not a distinct legislative power, but rather a part of the executive power of appointment which in turn has been delegated in some specific instances by constitution to the legislative branch of government.

"In light of the nature of the legislature's power of confirmation, the question whether Sections 25 and 26 of Article III describe the outer limits of the legislature's confirmation authority, or whether the legislature may be statute require confirmation of other high-level, policy making officials within the executive branch, admits of but one resolution. As to this issue, we think the provisions of Sections 25 and 26 of Article III are clear and unambiguous. Thus we conclude that Sections 25 and 26 mark the full reach of the delegated, or shared, appointive function to Alaska's legislative branch of government.

May 14, 1981

"The lack of ambiguity in Sections 25 and 26 of Article III of the Alaska Constitution mandate that this court interpret these express provisions as embodying not only the maximum parameters of the delegation of the executive appointive authority through the legislative confirmation function but, further, that they delineate the full extent of the constitution's express grant to the legislative branch of checks on the governor's power to appoint subordinate executive officers. In our view, the separation of powers doctrine requires that the blending of governmental powers will not be inferred in the absence of an express constitutional provision." (Emphasis and bracketted material added, footnotes omitted). 1/

1/ I cannot find that, in preparing the many drafts of the 1980 permanent fund legislation, this office ever formally advised a committee or member of the legislature that the confirmation requirements under consideration were unconstitutional. There is only a handwritten note from the revisor to the file:

For the file: The appointment and removal provisions violate Bradner v. Hammond re confirmation. This is not (1) a regulatory board, (2) a board at head of dept. Confirmation is unconstitutional. . .

However, the governor had the benefit of timely advice:

"The bill has some provisions which are in conflict with the constitution; however, they appear to be severable, and the bill should otherwise be effective and valid.

"The unconstitutional provisions are those which provide or relate to the legislature's confirming the appointment of board members or to the legislature's vetoing their removal. In Alaska, the constitution prescribes which offices are subject to confirmation, and the legislature

Apparently, it is the position of the attorneys in the executive branch that the requirement of confirmation of permanent fund trustees is a requirement of Chapter 18, SLA 1980 which is severable. Hence, they have suggested that the legislation may be carried out as if the unconstitutional provision did not exist. Quoting, again, from the advisory letter:

As a general rule, unconstitutional provisions may be treated as severable and the remainder of the bill upheld if (1) the bill would be whole and effective so severed, and (2) the legislature would have enacted the bill even without the severed provisions. Here, the bill obviously forms a whole and effective law without the unconstitutional provisions. Additionally, the Eleventh Legislature's enactment of legislation prescribing the fund's management was its number one priority. We cannot conceive of its not enacting this legislation with or without its unconstitutional features. Accordingly, they are severable, and the bill should be applied just as if those provisions did not exist.

Letter of the Attorney General, April 7, 1980, pp. 1, 2.

There is support for the position taken by the Attorney General in his letter, chiefly in a lengthy consideration of the applicability of severability principles in Lynden Transport, Inc. v. State, 532 P.2d 700 (1975):

1/ Continued

has no power to add to that list without a constitutional amendment. Bradner v. Hammond, 553 P.2d 1 (Alaska 1976). The constitutional also prescribes which executive actions are subject to a legislative veto, and the legislature has no power to add to that list without a constitutional amendment. State v. A.L.I.V.E. Voluntary, ___ P.2d ___ (Alaska 1980). Accordingly, those provisions of the bill which require legislative confirmation of appointments and authorize a legislative veto of removals from office are unconstitutional."

Letter of the Attorney General of April 7, 1980, p. 1.

"[AS 01.10.030] contains the following general savings clause:

"Any law heretofore or hereafter enacted by the Alaska legislature which lacks a severability clause shall be construed as though it contained the clause in the following language, 'If any provision of this Act, or the application thereof to any person or circumstance is held invalid, the remainder of this Act and the application to other persons or circumstances shall not be effected thereby.'

"This is designed to preserve to as great an extent as possible all valid portions of enactments by the Alaska State Legislature.

"The federal rule with regard to specific severability sections which are enacted as part of a challenged statute is relatively well settled. In Carter v. Carter Coal Co. [298 U.S. 238, 80 L.Ed.1160 (1936)], the Supreme Court stated the effect of such a provision:

"In the absence of such a provision, the presumption is that the Legislature intends an act to be effective as an entirety -- that is to say, the rule is against the mutilation of a statute; and if any provision be unconstitutional, the presumption is that the remaining provisions fall with it. The effect of the statute [specific section] is to reverse this presumption in favor of inseparability, and create the opposite one of separability. Under the nonstatutory rule, the burden is upon the supporter of the legislation to show the separability of the provisions involved. Under the statutory rule, the burden is shifted to the assailant to show their inseparability. But under either rule, the determination, in the end, is reached by apply the same test -- namely, What was the intent of the law makers?

"Under the statutory rule, the presumption must overcome by considerations which establish 'the clear probability that the invalid part being eliminated the Legislature would not have been satisfied with what remains.'

"By interpreting the statutory severability provisions as reversing the common law presumption that a statute void in part was void in its entirety, the Supreme Court intended to provide a rule of construction which may sometimes aid in determining that [legislative] intent. But it is an aid merely; not an inexorable command." (Footnotes omitted).

536 P.2d 700, at 711, 712. There is additional support provided in Sutherland's treatise on Statutes and Statutory Construction:

"Although there is no measureable differences in effect between general separability acts and particular separability clauses in individual statutes, it is reasonable inference that because a general act cannot control subsequent legislative intent and therefore is questionable evidence if it, less weight may attach to such a general rule of separability than to the clause in a separate act. Thus general separability statutes have been regarded as mere codifications of a canon of statutory construction. One state has given the same effect to a general severability statute as to particular saving clauses, applying the usual federal rule that it substitutes a presumption in favor of severability in place of the common-law presumption against it. But generally these statutes are treated only as aids to interpretation and not as commands.

"If the valid parts are dependent or not severable from the invalid parts, all must fall. The valid parts must be enforceable as a separate law. If the remaining valid portions would not be passed by the legislature without the invalid, the statute must fail in its entirety. When the most important features or the paramount intent is invalid, the entire act must fall. Thus the rules concerning normal separability are still present.

"The principle of separability is sometimes separately enacted as general law applicable to all acts subsequently adopted in the state irrespective of whether such subsequent acts contain their own separability clauses. Courts have considered these clauses as codifications of general rules of interpretation, not binding as fixed rules of law."

2 Sutherland, Statutes and Statutory Construction, sec. 44.11 (4th ed., Sands, 1973). Lynden Transport, and cases cited therein 2/ which construed Alaska's severability clause, AS 01.10.030, enunciate the general rule:

The test for determining the severability of a statute is twofold. A provision will not be deemed severable "unless it appears both that, standing alone, legal effect can be given to it and that the legislature intended the provision to stand, in case others included in the act and held bad should fall." 3/

432 P.2d 700, at 713. Clearly, in the case of the permanent fund legislation, Chapter 18, SLA 1980, the remaining provisions of the legislation may stand even absent the legislative confirmation requirement.

From the record of the legislation, I cannot say that the legislature intended the entirety of the bill to be set aside in the event the confirmation requirement would be found invalid. The legislature did not specifically include a provision setting aside the bill in its entirety in the event any portion of it were set aside. While the legislature did underscore the significance of legislative oversight of permanent fund corporation activities, 4/ the confirmation requirement is not particularly significant to that "oversight" when considered in context.

2/ State v. Baker, 363 P.2d 892 (Alaska 1964) and Speidel v. State, 460 P.2d 77 (Alaska 1969).

3/ Quoting Dorchy v. Kansas, 264 U.S. 286, at 290, 68 L.Ed. 686 at 690 (1924).

4/ See Sec. 1, Chapter 18, SLA 1980:

FINDINGS. The legislature finds that there is a substantial need for oversight of the performance of those agencies of the state which perform lending or investment functions since those functions do not receive the

In conclusion, I share the Attorney General's counsel to the governor expressed in his April 7, 1980 letter. The confirmation provisions are unconstitutional and almost assuredly are severable. You should not expect the governor formally to submit the names of individuals appointed as trustees of the Alaska Permanent Fund for your committee's review and legislative approval.

JBC:ljb

4/ Continued

detailed review to which other expenditures of public money are subject, and therefore the knowledge necessary for sound legislation in this area is not readily available. There is a need for legislative oversight which will provide information on the policy and performance of these agencies, the extent to which the agencies conform to statutory intent, and the impact of their performance on the economy and the state treasury.

Meetings with Investment Firms
Week of July 6-10

SUMMARY OF INVESTMENT DISCUSSIONS

People in attendance:

Permanent Fund Staff
James B. Rhode
Susi Gregg Fowler
Department of Revenue,
Treasury Division
Peter A. Bushre
William L. Means
Legislative Budget and Audit
Steven Rieger
Department of Law
Laura Davis

The question that rose most frequently in New York was "What is the objective of the Alaska Permanent Fund?" The near unanimous opinion was that this question must be addressed by the Trustees before meaningful discussion can occur on such questions as allocation of investments and investment strategy. Robert Salomon, of Salomon Brothers, asked whether the Board of Trustees realized that if the Permanent Fund paid out more than 3% to 5% of its earnings, a level of earnings above inflation which might be attainable, the Trustees would be operating a fund with diminishing real capital and real income. At such time that the Permanent Fund ceased to grow in real terms, either through inflation or a fall in contributions, it would become self-liquidating. The crucial decision is whether the Permanent Fund is going to pay out real earnings, all earnings or a portion thereof. This is a grave problem being faced today by a growing number of foundations and university endowments. The Rockefeller Foundation, a \$1 billion foundation, has grown substantially in nominal terms, but has experienced an actual 35% contraction in real earnings power while the Ford Foundation, a \$2.5 billion foundation, has contracted in real earnings power by 55%. If nothing is done to curb these foundations' spending programs, Robert Salomon stated that he could project for their trustees the dates on which they would be totally self-liquidated.

Once the objective of the Permanent Fund has been decided, much will be determined as to level of risk which will be required to meet that objective. Long term studies, for example, have indicated that it is unrealistic to expect to earn more than a 2% real rate of return on a high grade fixed income portfolio, whereas a 3% to 5% real rate of return has been attainable in common stock over an extended period of time. Questioning Salomon Brothers as to what percentage

of common stock that they thought might be appropriate to the Permanent Fund given an earnings objective of a 3% to 5% real rate of return, the response was 80%. U. S. Steel Pension Fund, a pension fund in a mature industry, has approximately 80% of its assets currently in common stock, 10-15% in real estate, and the balance in fixed income securities. As reported by the S. E. C., the typical large corporate pension plan is approximately 55% invested in common stock. The normal asset mix of a portfolio under management by the Prudential Insurance Company of America is 40% to 60% in common stock and 20% to 30% in real estate equity, with the balance in fixed income securities. Mr. William Field, Senior Vice President of Prudential's Asset Management Department, indicated that for reasons of political toleration a 20% commitment to common stock might be more advisable for the Alaska Permanent Fund.

Mr. William Field, Mr. Robert Salomon and Mr. Heath McLendon, President of the investment management firm of Bernstein-Macaulay, Inc. agreed that the Trustees should seek authority from the Legislature to invest in domestic common stock, foreign securities, and real estate equity. They also volunteered that in their respective opinions, the timing for purchases in foreign securities and real estate was not good. However, they all felt that there would be better opportunities in the next two or three years, and any program to make major commitments in foreign securities and real estate should be understood by all to be a three to five year program. However, in their judgment, it is highly desirable to obtain authority as soon as possible so as to maximize flexibility.

With the exception of the U. S. Steel Pension Fund, it was the opinion of those that we contacted that the Alaska Permanent Fund, as a consequence of its sheer size, should utilize an index fund approach for its core holdings of common stock. Mr. William Field suggested that otherwise the investment management fees would become prohibitively expensive. It was suggested that outside managers be utilized in such specialized areas as high technology stocks, energy development stocks, foreign securities, and real estate equity to provide the Permanent Fund an extra increment of yield above that which an index fund would provide. It was the unanimous opinion of those to whom we talked that the significant danger in hiring a number of investment managers to manage the common stock portfolio was that the Permanent Fund would end up de facto as an expensively managed index fund. The largest acceptable number of outside managers suggested by anyone was six, and these six would cover the full gamut of investments from domestic common stock, foreign securities, to real estate equity. If more are hired, the feeling was expressed that the Trustees and staff are apt to find increasingly large segments of their time devoted to monitoring the managers performance and trying to determine how new flows of investable funds are to be allocated among the various investment managers.

Typically most large corporate pension plans are handled by outside investment managers with a number of plans managing only fixed income assets in house. Among the people we visited, only the manager of the U. S. Steel Pension Fund unqualifiedly thought that the entirety of the Alaska Permanent Fund could be managed in house in Alaska. The U. S. Steel Pension Fund is managed entirely in house with a staff of eleven investment professionals. This staff consists

of nine Certified Financial Analysts, one trader, and one specialist in money market and fixed income securities. It is interesting to note, however, that although the headquarters for the U. S. Steel Corporation is in Pittsburgh, the Company chose to run its pension fund out of New York City. Also the manager of the Fund felt that they were not close enough to the European markets to run a portfolio of European securities out of their New York office. Mr. William Field of the Prudential Insurance Company of America, on the other hand, felt on the basis of his experience with governmental bodies that the Trustees would likely have great difficulty in obtaining funding from the Legislature to run an in house operation with first class talent. To attract a top administrator to the Permanent Fund would require, in his opinion, a salary of approximately \$250,000 per annum with other positions scaled down to \$70,000.

The consensus opinion was that, if the Trustees chose to run fixed income securities in house, an index fund for core domestic stock holdings, and to choose outside investment managers for other specialized investment areas, a staff of four investment professionals plus clerical help would be adequate to manage a \$6 billion or larger fund. Assuming a staff of four investment professionals, one should specialize in fixed income securities; one should manage the index fund; one should monitor the outside managers; and one should have expertise in the field of real estate investments.

In selecting investment managers, the general feeling was that enough information is published regarding the performance of investment managers that the Board of Trustees should utilize its staff to select the most promising managers to make investment presentations before the Trustees. It was also strongly urged by Mr. Heath McLendon and Mr. William Field that the Permanent Fund staff make visits

directly to potential managers' offices to meet their staffs and discuss with them their investment philosophies and how they visualize investing for the Permanent Fund. It was felt that only after the Permanent Fund staff has made its selection of potential managers should a consultant be hired for the specific purpose of reviewing this list to see if any managers of merit have been missed.

It was interesting to note the generally low regard held for performance measurement analysts by most people we visited. While agreeing that they are necessary for public bodies in order to provide an element of comfort to them, they felt that they are expensive and that undue heavy reliance on them may result in inappropriate comparisons. In measuring performance, Mr. William Field strongly urged that the Standard & Poor's 500 not be used as the measurement of performance. Rather, in his opinion, the measure should be the ability of a fund to earn a specific positive rate of return above inflation on a consistent basis. Consistency, in his view, is the most important element of measurement.

In conclusion, there are two basic questions which the Board of Trustees should address before deciding questions of organization and investment strategy. As Robert Salomon said these are questions which your Trustees cannot avoid for they will ultimately be held responsible for the answers whether or not they address the questions directly or leave them to members of their staff. The questions are as follows:

1. What is to be the objective of the Alaska Permanent Fund?
2. How is the corpus of the Alaska Permanent Fund to be allocated to different types of investments?

Once the first question is answered, much will have been determined about the level of liquidity which can be maintained and the parameters of risk that the Permanent Fund will have to assume in order to attain its objective. Quite obviously the level of risk toleration would have to be substantially higher should the Board seek to obtain a 5% real rate of return as opposed to a 2% real return, and the allocation of investments would have to be concentrated in those areas which have a higher element of inherent risk but also offer potentially greater investment rewards.

INVESTMENT MEETINGS
New York City

Monday - July 6

9:30 A. M. Bache Halsy Stuart Shields Inc.
Bache Building
100 Gold St.
6th Floor
New York City, N. Y.
Sam Plia, Lou Auer, Executive Vice President
212-791-2467

12:00 Noon (To include lunch)
Prudential Insurance Company
Newark, N. J.
William Field 201-877-7979

Tuesday - July 7

11:30 A. M. (To include lunch)
Shearson Loeb Rhoades Inc.
2 World Trade Center
106th Floor
John McDougall 212-577-2718

Wednesday - July 8

10:00 A. M. The First Boston Corporation
20 Exchange Place
8th Floor
(To include lunch)
Gene Boehringer 212-825-2096

3:30 P. M. Discount Corporation of New York
58 Pine Street
Rodney Bird 212-248-8931

6:00 P. M. (To include dinner)
The Leash Club
41 East 63rd St.

Thursday - July 9

11:00 A. M. (To include lunch)
U. S. Steel Pension Fund
General Motors Building
767 Fifth Avenue
Graham Harrison, President & John Van Duesen, Vice President
212-826-8472

3:00 p.m. Buck Consulting Group

INVESTMENT MEETINGS - New York City Continued -

Friday - July 10

10:00 A. M. (To include lunch)
Salomon Brothers
One New York Plaza
42nd Floor
R. S. Salomon 212-747-7000

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K -- STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

July 31, 1981

Mr. Elmer Rasmuson, Chairman
Board of Trustees
Alaska Permanent Fund Corp.
Box 600
Anchorage, AK 99510

Re: Legal assistance re
investment practices

Dear Mr. Rasmuson:

I am writing to inform you of the current activities of the Department of Law relating to the investment of state funds. As background, the current status of the investment of state funds may be summarized as follows:

The monetary assets of the State of Alaska now consist of four funds: the general fund, the public employees' retirement system fund, the teachers' retirement system fund, and the permanent fund, all of which are managed and invested by the Treasury Division of the Department of Revenue, under the authority and supervision of the commissioner of revenue. The approximate aggregate balance of these funds at present is \$4.9 billion (approximately \$510 million in the PERS fund, \$385 million in the TRS fund, \$1.8 billion in the permanent fund, and \$2.2 billion in the general fund). These figures represent the amount of money for which the treasury has investment management responsibility (not the amount available for appropriation or expenditure), and they vary from day to day depending on the flow of income and the demand on state warrants.

The investment of each of the four funds is regulated by a separate statute (AS 14.25.180, TRS fund; AS 37.-10.070, general fund; AS 37.13.120, permanent fund; and AS 39.35.110, PERS fund), and in the case of the permanent fund, by a constitutional provision requiring investment only in income-producing assets. Alaska Const., art. IX, § 15. These statutes vary in terms of the list of specific types of investments which are authorized, but each contains a general provision commonly known as the prudent-man or prudent-investor rule.

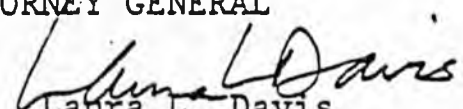
There is a large body of law interpreting the prudent-investor rule in the context of both public and private funds. It is our opinion that prudence in the management of all of these state funds requires the development and implementation of consistent procedures and practices for the evaluation of investment opportunities, and the execution of investment agreements, which conform to the prudent-investor rule. The development of such routine practices and procedures is particularly important at present, because of the rapidly expanding variety of investment alternatives, the volatility of financial markets, and the rapid expansion of the state treasury.

While in New York with the permanent fund and treasury staff, I met with members of two law firms (Shearman & Sterling, and Debevoise, Plimpton, Lyons, and Gates) to discuss their ability to provide legal assistance on matters related to state investment practices. I also met with the chief general counsel in the Investment Management Group of Citibank, N.A. to discuss matters related to the function of general counsel to an institution which manages large investment funds.

We have retained Shearman & Sterling to assist us in preparation of an agreement related to investment in gold by the retirement funds. We are now discussing with both firms their ideas for assisting us in the development of standard investment practices and procedures as discussed above, and hope to retain one of them for this purpose in the near future. We believe that the development of such investment practices with the assistance of a law firm which is actively involved in advising major public and private financial institutions will be important in helping our investment managers to carry out their fiduciary responsibilities for our rapidly increasing state funds over the next several decades. Our current work in this area is aimed primarily at investment management for the retirement funds and the general fund, but will be directly relevant to developing investment management guidelines for the permanent fund.

Sincerely yours,

WILSON L. CONDON
ATTORNEY GENERAL

By: 
Laura L. Davis
Assistant Attorney General

LLD/pjg

cc: Thomas K. Williams
Robert W. Ward
George Rogers
Peter McDowell
Jim Rhode ✓
Peter Bushre

Memorandum to the Trustees of the Permanent Fund
After a Year - Some Decisions we all Face

INTRODUCTION

The objective of this memorandum is to take stock of where we are with the Permanent Fund, identify where we are going, and indicate some of the policy decisions on which the Governor and the Legislature would want our views.

The decision which the Trustees made early last year to work in close liason with the Governor's office and the Legislature in evolving operational and future policy has proven a wise one. Everyone has been kept informed, and participation has been sincerely invited, including from the general public. Since the time for any legislative recommendations from our Board is rapidly approaching, I am setting down various observations for purpose of discussion, amplification and final decision, not later than our December meeting.

I. History

- A) The Permanent Fund was created by constitutional amendment in 1976. The key features are:
- 1) "no less than" 25% of royalty and related mineral income goes into the Fund automatically (about 10% of total oil receipts today).
 - 2) The money is to be used only for "income producing investments", this precludes using the principal for government spending, presumably rules out barren assets such as gold, and could bar taking equity positions that have delayed income.
 - 3) Fund income goes into the general fund "unless otherwise provided by law", which the framers considered the most neutral place for the income pending legislative action.
- B) Following a determined legislative struggle of four years, the Permanent Fund Act of 1980 provided:
- 1) Management by six trustees, three from the public, the Commissioner of Revenue, and the Governor's choice of any two other commissioners.
 - 2) Independent staffing, internal or retained, with (rare) authority to hire without the normal restrictions and pay scales of the civil service.
 - 3) A consciously restricted investment list (largely to forstall financial adventures by the Fund), focusing on U. S. government securities, money market paper, bank CD's, mortgages and other fixed income paper. Common stocks, income property, and foreign assets were not allowed.
 - 4) Unusual rules were imposed to insure full disclosure of the Fund's activities and financial health, including special legislative oversight. These rules have since become a model for the laws governing other state corporations.

II. Possible Changes in the Permanent Fund

A) Perspective

- 1) In order to play a stabilizing role in state affairs (and to guard the independence of the Fund), changes ought to be careful and gradual.
- 2) The sheer magnitude of the Fund requires caution in making changes.
 - a) If all goes well, the Fund will have over \$4 billion by next July. Alaska's economy, with \$4.5 billion personal income last year, could not absorb this level of investment. Department of Revenue forecasts estimate the Fund to be \$28 billions by the year 2000.
 - b) Even if we could force a large part of this money into our economy,

- 1) The "savings-income approach" is to convey the principal of the Fund to future generations, while both current and future residents enjoy the income.
- 2) The "full-scale development approach" is to have the Fund take the central role in the growth of the Alaskan economy, either by direct lending, the guarantee of business and municipal borrowings, or even the building of capital projects that earn user fees (at a market rate).
- 3) There are many problems with this second, "full-scale development approach".
 - a) The evidence presented to the Trustees is that major, sound business proposals do not lack investors here and from Outside. Indeed, the Native corporations, which have powerful reasons to find investment opportunities in Alaska, have a continual problem in finding new businesses for their money. A so-called "capital gap" usually turns out to be a gap in managerial skill or markets or labor costs between here and other places.

Asking the Fund to carry out this role may only result in displacing private capital, and may take us into risks and losses that betray the name of a "Permanent Fund."

- b) If we choose to favor a sector of the economy with special programs, I believe that decision belongs in the Legislature. Even there, as we know, it is difficult to measure success, efficiency, and the fairness of programs. Correcting problems seems harder still. Cut off from elected officials, such programs seem bound to be a case of public money used for private policy.
- 4) I believe, however, there is a proper role for the Fund to play in our economy, as part of having a balanced portfolio. A year ago, I set out some of my first ideas on this matter. Essentially, a Fund taking part in Alaskan investments on equal terms and conditions with other investors is not the same thing as being the "Lender of First Resort."

III. Implications of the Basic Choice

- A) Management under the "savings-income approach", with its clear aims, is fully consistent with the present independent status of the Fund. But I would ask you to consider these changes.
 - 1) The effective supervision of a large investment pool, one day the largest of any state, cannot be an occasional thing. It is not for any of us today and the challenge can only increase. I believe that recognition of the time expected of each trustee is best made by an ample, but not full-time salary. In this way, people of the necessary background can be retained, without the Board ever becoming a place to reward political allies. Many large corporations compensate their directors on this basis.
 - 2) If the true responsibilities of each trustee are extensive, their selection must be made, not only on a basis of special competence, but also on availability for the job. This raises a question as to availability of Commissioners for future trustee duties, since they presumably are already burdened with full-time responsibilities. The participation of the existing Commissioners has been excellent in this formative policy period but we will soon pass to an operational stage. Probably the Commissioner of Revenue should always be a trustee because of the information he brings as chief fiscal officer of the state and the consequent ease in coordination with the major force in Alaska's economy.
 - 3) A Fund of this kind will not require a large, locally based staff. At this point, I see a place for some internal staff, both to share in placing the portfolio and to monitor specialty firms that will have to be retained. We cannot hope to draw people who are expert in some special areas of investment and, even if we could, they would be too far away from market centers.

The criteria for selection of investment managers necessarily depend upon the investment and Fund objectives.

B) If our basic choice is the "savings-income approach", then we have to deal with inflation. We may not have to spend principal for long decades, but a fall in real principal (adjusted for inflation) always brings a like fall in real income.

- 1) The first defense is to widen the list of legal investments to include some equities--both in stocks and real estate. All that "equity" means is residual ownership, after any debts have been satisfied. We all know that debts are paid off in fixed sums of money. Thus in times of inflation, the increased value of the property or security belongs to the equitable owner--the common stockholder.

This is the advise we are receiving from our visiting advisers and financial consultants outside the state. Our investments should be broadened to include some common stocks, income property and perhaps even foreign assets. Changes of this kind can be done prudently; but we must come to understand what it means to invest for the long term, which involves a patient outlook.

- 2) A second defense of the real principal is to return a portion of the Fund's earnings to the Fund for reinvestment. Perhaps we can limit outgo to real income, or simply half the earnings. One of the most powerful and prudent ways to expand the Fund (and at the same time offset inflation) is by reinvestment of income. Certainly, for the time being the General Fund of the state is not in need of supplements from the Fund.

Let me illustrate what happens if we do nothing. Suppose we had a \$10 billion Fund earning 15%, and paid all of it out despite a 10% inflation. The result in 30 years is a fall in real income from \$1.5 billion to \$86 million at the end. To make the same point, a \$1.5 billion Permanent Fund dividend will then only buy what \$86 millions buys today.

- 3) This emphasis on maintaining purchasing power gives the clue to evaluating investment performance. We have been advised that the best measurement of performance should be the ability of the Fund to earn a specific rate of return above inflation on a consistent basis.

Inflation can be tracked through the Consumer Price Index (CPI). Some investment managers recommend comparison with the Gross National Product (GNP) deflator as a less volatile indicator.

The advantages of this approach is that the Trustees and Legislature can agree on a percentage above the inflation rate as being the target real income. This fits in with the concept of total asset management--both short and long term. It avoids striving for excessive and speculative returns which could lead to eventual losses.

C) Under this "savings-income approach", a number of uses for the income suggest themselves.

- 1) Cash dividends. This is already on the books, but pending, as you know, before the U. S. Supreme Court, and may have to be changed. This certainly brings the widest possible constituency for the Fund, but not a few have various problems with this approach, especially the problem of in-migration as the plan now stands.
- 2) Others speak of using the Fund income to cover future budgets for as long as possible. But there are serious doubts about this, first about our readiness to put the large sums aside in time, secondly about the wisdom of giving (another) blank check to the state government.
- 3) I want to offer a third approach, which compliments the idea of the dividends, although these are tax-free. It would be to endow central programs in the budget, those which benefit the widest cross-section of the public. They include education, housing, block grants to cities and boroughs, Alaskan oriented research, possibly energy.

Some of the thoughts expressed in my memorandum of November 21, 1980, are equally applicable today in our formulation of policy. They are thus incorporated herein by reference.

Memorandum from the Chairman of Trustees

The desirable changes in the legislative act creating the Alaska Permanent Fund are simple in concept and appear to need only be three in number. Most of the policy decisions and operating procedures of the Fund can better be defined through Board of Trustees Resolutions. This gives flexibility and, at the same time, clarity to the public.

The three legislative changes can be classified as follows:

1. Structure of the Board of Trustees to achieve a desirable degree of independence.
2. Expansion of the legal investments of the Fund to include equities-- both in securities and in real estate.
3. Permission for the Trustees to reinvest part of the investment income of the Fund to offset the impact of inflation and to permit growth of the Fund.

These changes are discussed in supporting memoranda.

Structure of the Board of Trustees

The most fundamental part of the Permanent Fund and the determining factor in its success or failure is the Board of Trustees. Water cannot rise higher than its source.

The Board sets the policy for:

1. The goals of the Fund.
2. The investments within the limits set by the Legislature.
3. Selection of investment managers--whether in-house or outside.

In addition, the Board operates in close coordination in policy and practice with the executive and legislative branches of the state government.

The public image and confidence in the Fund rests with the Board.

Qualifications of the Trustees:

It is not reasonable to expect that the Trustees should be especially skilled in investment management. The prime requisites are that the Trustees be Alaskans of integrity and favorable public image.

However, it is desirable that each Trustee have a background in decision

appointment by the Governor, it is essential that the Board be reasonably insulated from the fluctuating winds of politics--either executive or legislative.

This is in order to:

1. Enable consistency in policy to be developed and implemented.
2. Give confidence to prospective staff in recruitment and in retaining of investment managers.
3. Attract top quality trustees.

The recommended independence has adequate safeguards built in for protection against an irresponsible independence of the Board.

From the standpoint of the executive branch, this results from the fact that the Governor:

1. Appoints all trustees and may remove them at will.
2. There is a continuous liason through the Commissioner of Revenue.

From the standpoint of the Legislature, this results from the fact that the Legislature:

1. Sets the legislative guidelines (i.e. the charter) of the Fund, which can be changed by any succeeding Legislature.
2. Determines the disposition of the earnings of the Fund.
3. Has review on a continuous basis through the joint Legislative Budget and Auditing Committee.

Conclusion:

The trustees can neither in theory nor in practice operate without joint support and confidence of both the Governor and the Legislature. The degree of independence recommended is merely to slow down precipitous action. This enables a reasonable time to:

1. Develop proper organization and investment strategy.
2. Evaluate the Board's policies and action by the Governor, the Legislature and the public.

The greatest safeguard from undesirable action by the Board, political office holders, or the public is through accepted tradition--and the next three years are crucial.

Implementation:

The movement towards beneficial independence can be facilitated by a change in the composition of the Board of Trustees to limit the cabinet representation to the Commissioner of Revenue and have four public members with staggered terms of

primarily associated with the responsibilities of their respective departments. However, because of the close relation necessary with the Department of Revenue, the duties of its Commissioner naturally flow into the work of a Fund Trustee. The close identity with the Governor's office inherent in having half of the Trustees represented by Commissioners has been very effective in the organizational stage of the Board. However, the operational stage which is forthcoming, will involve considerable travel, probably monthly meetings and numerous consultations, thus requiring commitments difficult for Commissioners to include in their busy time schedules.

If this change in composition of the Board is acceptable to the Governor and the Legislature, the necessary enabling legislation could be passed at the forthcoming session. Attached is a schedule showing the effect of the suggested change in composition and terms.

With the operational stage of the Board developing, it is logical to change the compensation of the public members by eliminating the honorarium for attendance at meetings and substitute an annual fee for all personal services of each public Trustee.

Reasoning:

The attendance honorarium is illogical in that it assumes that the Trustees' services are performed only at a stated meeting. It ignores the fact that the Board is a working body involving continuous services in committees, traveling, consultation with staff, investment managers, other fund trustees, participation in work shops with legislators, interested public groups, etc.

It is suggested that the public members receive an annual fee on a par with that of the legislators. This does not introduce an employee relationship but assumes the fiduciary relation comparable to that of directors of a corporation.

1. The suggested compensation would be in line with compensation of legislators, state of Alaska staff and private industry.

2. It assumes a dedication of 25% to 50% of the public members' time, depending on assignments.

3. The suggested fee is set to be midway between the value of the Trustee's services in the market place and a pure donation of time which is not within the ability of many fine, potential Trustees. It is not so large as to be a sought-

Accountability of the Board:

The Legislature has provided for independence of Board management of the Fund by transfer of Fund assets to the Permanent Fund Corporation and instructions to manage and invest. However, there are problems of identity which soon will be upon us and deserve clarification.

1. There is no place under present law where the complete financial performance of the Fund is summarized and disclosed. Administrative and other expenses (e.g. supplies, safe keeping, travel, auditing consultants' fees, etc.) are paid by the General Fund and are not included in the statements of the Permanent Fund. This is so significant an omission that our auditors have to mention it through footnote. This has also been commented on in public hearings. The forthcoming large expenses in staff and management consultants, this lack of centralization of all income and expenses of the Fund will prevent any proper accountability of Fund performance and the published statements will be a distortion of results.

2. To the extent that professional in-house investment management is built up, certain key personnel will probably require compensation at rates higher than presently contemplated in state salary structures. Those individuals are highly trained and, since the best are limited in supply, command specialty compensation. To the extent that investment managers are retained, their services, based on market value of assets could be greater than any previously paid state departments.

3. Another requirement for proper management of the Fund is strict confidentiality during sensitive operations. This includes the negotiation with investment managers, decisions on investment strategy, receipt and study of evaluations of both securities and the performance of investment managers. While the security portfolio held by the Fund would be published in detail, the decisions during the purchases and sales would require confidentiality.

A simple and straightforward solution to the foregoing problems is to designate the Permanent Fund Corporation as a separate entity for budgetary and accountability purposes. All income and expenses attributable to the Fund operation should flow through the Fund accounts. By this means, the financial statements of the Fund would disclose all results of operation and the complete performance of the Board Management could be easily monitored by the Governor, the Legislature and the public.

difficult to determine in advance but the number of positions could be estimated and then fixed by the Legislature if they so desire.

Expansion of Legal Investments of the Fund

The Legislature has charged the Board with the obligation of "conserving a portion of the state's revenues from mineral resources to benefit all generations of Alaskans." (Sec. 37.13.020(a)).

It would be of little benefit to future Alaskans to hand on to them a Fund of the same dollars but of sharply reduced purchasing power because of inflation. This has a double doleful impact, because a fall in real principal (adjusted for inflation) always brings a like fall in real income.

The advice we have received from visiting advisers, financial consultants and the fund managers is consistent. Our investments should be broadened to include equities--both in stocks and real estate.

The reasoning of the advice is clear and simple. Under present law, the only legal investments for the Fund are debt instruments. Debts are repaid in fixed sums of money. In times of inflation, the increase in value of the underlying property of a company belongs not to the debt holder but to the stockholder. Therefore, to offset inflation, the Fund needs to have a substantial part of its investments in the form of equity ownership.

There is another compelling reason for the Fund to hold common stocks and that is to share in the growth of the company and the country. With population increases in Alaska, the per capita value of the Permanent Fund can be increased by adding to the Fund's principal at a faster rate than the population growth. But this ability to add to the capital may not continue indefinitely. Furthermore, why turn down the opportunity to share in the economic growth of the companies whose securities are available for investment?

An obvious and legitimate concern in the expansion of the legal investment list is the matter of risk. There are three main types of risk to which the Fund management must address itself.

The first risk is the erosion of value through inflation. By confining the investments only to debt instruments, this risk is assured and devastating.

in market value than debt instruments. However, in recent years, bonds of both medium and long term have experienced as great a market risk. No one recommends that a large pension or endowment fund be concentrated entirely and permanently in short-term investments. The answer to this type of risk is to have a long-term outlook in investments--a patient capital approach. Statistical summaries for practically any ten year period selected, show a positive appreciation for equity investments.

The third risk is variability in rate of investment return. This should be of great concern to all interested in the performance of the Permanent Fund. Consistency of return will yield better long term results than a fluctuating return. Dependability in return is necessary for making budget forecasts by those who are designated to receive the income.

The factors which must be considered in this type of risk are varied and complex. However, modern portfolio management has learned to overcome such risk. Diversification of investment by security, issuer, industry and location is a useful tool. The impact of business cycles, interest movements and political changes can be dampened out by a proper mix of equity and fixed income securities in the portfolio. The risk in investment management is best countered by having a number of managers with their performance monitored by professional experts and their retention based on their results.

Changes by the Legislature in the investment guidelines for the Fund should be gradual and step by step. Fortunately, there exists a precedence in the investment authority for the Teachers Retirement System and the Public Employees Retirement System which is familiar to the Legislature. It appears that the investment criteria for these retirement funds could be flexible enough for a positive performance by the Permanent Fund.

It should be noted that the permission to the Retirement Funds to invest in gold is not desired for the Permanent Fund. The constitutional requirement for investments to be income producing would probably eliminate it anyway.

The proportions of the Fund to be invested in stocks should best be left to the discretion of the Board and will vary over years as the mix between equities and fixed income securities is determined to meet the objectives of the Fund.

The retirement funds of the state of Alaska allow real estate investment in national pooled funds. This would be the principal kind of real estate investment for the Permanent Fund. In the opinion of the writer, there are profitable and very safe investments that could be made directly in improved real estate on a selective basis. However, if there is any hesitation on the part of the Legislature to grant this kind of real estate investment authority, it could await further experience in the management of the Fund.

Permission to Reinvest Part of Investment Income
of the Fund

The most important legislative change necessary to enable the Board to carry out its implied mandate to conserve the real principal of the Fund for future generations is to permit reinvestment of investment income. Investment in equities will help the Fund grow. But if a permission to invest in equities is granted, it need be coupled with a redefinition of income to include dividends and capital gains. Then, regardless of the rate of income, if all income is transferred to the Permanent Fund, the value of ^{the} Fund will inevitably decline in purchasing power and income.

To illustrate the point: If the Fund has \$10 billion, earning 15%, and pays all of it out despite an inflation of, say 10%, in 30 years there would be a fall in real income from \$1.5 billion to \$86 million at the end.

Redefinition of income:

If equities are permitted for investment by the Fund, the income therefrom,-- dividends, rents and capital gains and losses--must be netted out and included in that investment income. This is necessary to compute the true income of the investment and to yield the cash for purposes of distribution to beneficiaries as determined by the Legislature.

If this expanded definition of income is made in the existing law, it should be coupled with a change to charge all security losses to income as incurred. This would be in accordance with generally accepted principles of accounting.

Amount of income to retain in Fund.

The most effective way to retain income is for the Legislature to authorize

A portion of this income, say one-half, should be carried to surplus and permanently retained as part of the principal of the Fund. The resultant earnings would aid in the dollar growth of the Fund and help in part to offset inflation.

The other half can best be carried to a reserve, subject to appropriation by the Legislature. The decision as to how much to appropriate, and for what, can perhaps better be done later. A good argument can be made to not appropriate the entire half, but let inflation and investment results enter also in the picture.

The practice of the Harvard Management Company is helpful in this regard. This is a growing fund of approximately \$1.7 billion at present. Income distribution is predicated on the anticipation that total investment return will be 8% annually on market value over the long term. 4% is distributed to University Departments and is used for planning purposes. The other 4% is retained for reinvestment. The actual earnings in most years have been higher and the excess of the distributable 4% goes into a stabilization reserve so as to meet the budgeted distribution rate. It should be noted that an 8% anticipated return on market value of investments is substantially more than on historical cost.

Elmer Rasmuson

T E R M

Under present law:

<u>Inception</u>	<u>Expiration</u>
------------------	-------------------

First year of office of new Governor -		
Commissioner of Revenue	1983	Pleasure of Gov
Two other Commissioners	1983	"
One public member	1983	1986
Second year of office -		
One public member	1984	1987
Third year of office -		
One public member	1985	1988
Fourth year of office -		
No new appointment		

Result: Under present law, four of the six trustees are appointed by the incoming Governor within six months of his office.

Under proposed law:

if approved at next legislative session:

Governor Hammond would appoint -		
Commissioner of Revenue	1981	Pleasure of Gov
One public member	1982	1986
(present term of Elmer Rasmuson)		
New Governor would appoint in first year of office -		
Commissioner of Revenue	1983	Pleasure of Gov
One public member	1983	1987
(present term of George Rogers)		
Second year of office -		
One public member	1984	1988
(present term of Peter McDowell)		
Third year of office -		
One public member	1985	1989
Fourth year of office -		
One public member	1986	1990

Stability consequences of proposed legislation:

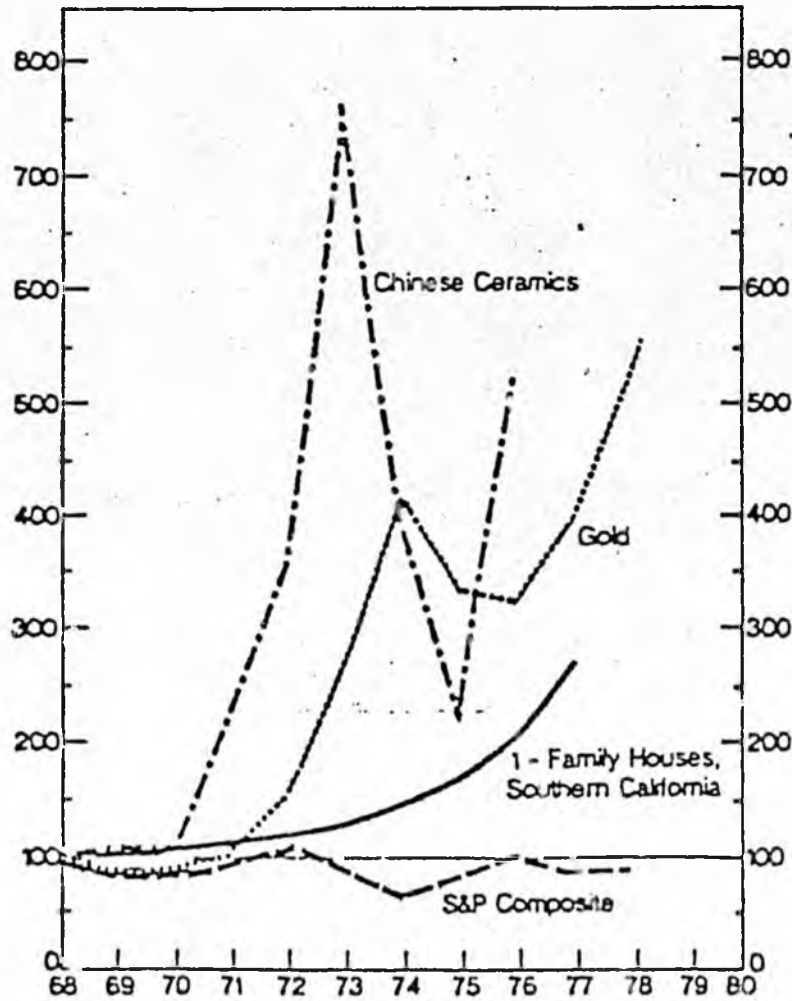
1. None of the terms of the present public members would be abridged.
2. Governor Hammond would maintain his right to have the Commissioner of Revenue on the Board, and his present authority to appoint a public member in 1982 would not be changed.
3. The three public members appointed by Governor Hammond would continue into the administration of the succeeding Governor.
4. The incoming Governor would have the right to appoint his Commissioner of

ALLIANCE CAPITAL MANAGEMENT CORPORATION

INFLATION IMPACT

	<u>1975-1979</u>	<u>9 MOS. 1980</u>
CONSUMER PRICE INDEX	47.9%	9.5%
STANDARD & POORS 500	99.9	21.0
ALLIANCE EQUITY FUND COMPOSITE	141.1	28.0

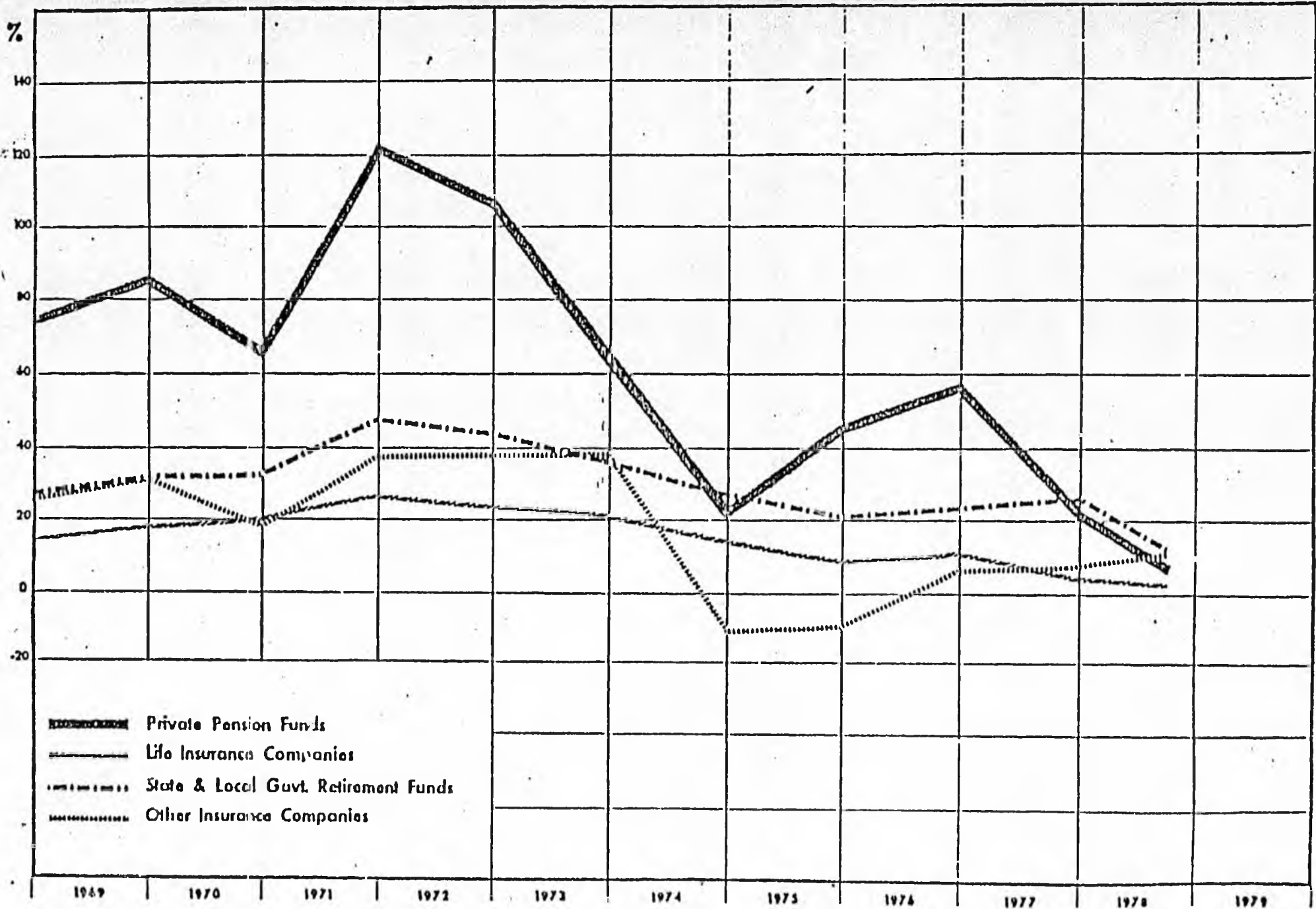
MOVEMENT OF TANGIBLE ASSET INDICES
1968=100



Source: Lehman Brothers Kuhn Loeb Research, Commodity Research Bureau, Real Estate Research Council of Southern California, Sotheby's and Parke-Bernet.

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978
Gold	100	84	90	104	155	268	417	336	322	395	541
Year to Year % Change		-16	7	16	49	73	55	-19	-4	23	45
Chinese Ceramics	100	110	111	229	359	762	371	223	530	N/A	N/A
Year to Year % Change		10	1	106	57	112	-49	-43	137	N/A	N/A
1-Family Homes So. Cal.	100	105	109	114	119	128	146	168	205	267	N/A
Year to Year % Change		5	4	4	5	8	14	15	22	30	N/A
S&P Composite	100	86	85	93	110	89	63	83	98	88	90
Year to Year % Change		-14	-1	10	18	-19	-21	32	18	-10	2

Net Purchases of Equities as a Percentage of Cash Flow



STOCKS, BONDS, RISK FREE ASSETS & INFLATION

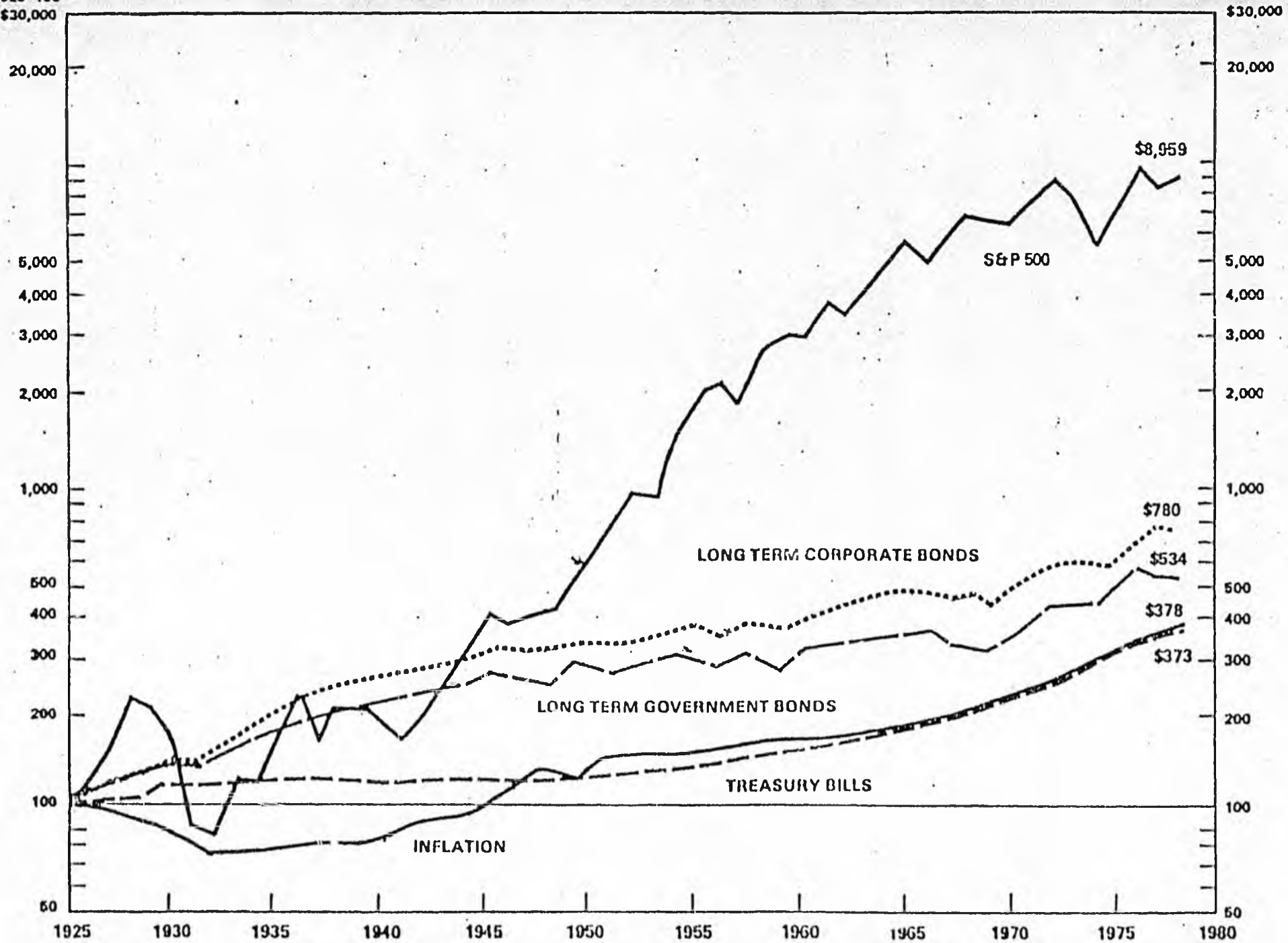
COMPOUND GROWTH RATES: 1926 - 1979

	NOMINAL	REAL
COMMON STOCKS (S & P 500)	9.0%	6.1%
LONG-TERM CORPORATE BONDS	3.8%	1.0%
TREASURY BILLS	2.7%	(0.1%)
INFLATION	2.7%	---

Source: Ibbotsen-Sinquefeld

WEALTH INDICES OF INVESTMENTS IN THE U.S. CAPITAL MARKETS 1926-1978

Index:
1925=100
\$30,000



Prepared by Alliance Capital Management Corporation based upon data presented in *Stocks, Bonds, Bills and Inflation: The Past (1926-1976) and The Future (1977-2000)* published in 1977 by the Financial Analysts Research Foundation.

THE CASE FOR EURODOLLAR DEPOSITS AND C. D.s

Eurodollar time deposits and Eurodollar certificates of deposit are time deposits denominated in U. S. dollars and accepted or issued by the London branches of major European, United States, Canadian, and Japanese commercial banks as well as the international subsidiaries of United Kingdom clearing banks. The Eurodollar deposit and C. D. markets grew rapidly in the 1960's in response to measures taken by the United States to restrict the outflow of dollars. Significant growth is also attributable to the tight money periods of 1966 and 1969 when short term rates in the United States rose above the maximums U. S. commercial banks could pay on domestic time deposits in accordance with Regulation Q. This forced U. S. banks to borrow heavily from their branches abroad where interest rates were not regulated.

As the result of recurrent balance of payments problems during the 1960's, such foreign investment controls as the Interest Equalization Tax, Voluntary Foreign Credit Restraint Guidelines, and Overseas Foreign Direct Investment Regulations were instituted. Although these controls effectively closed the U. S. capital markets to foreign borrowers and prevented U. S. firms from transferring capital abroad, they contributed significantly to the development of an active market for U. S. dollars on deposit outside the U. S. In early 1974, these control programs were all eliminated. Many observers thought that the Eurodollar market as a result would disappear. However, since no reserve requirements were levied on these deposits, the continued growth of the Eurodollar market was assured. The lack of reserve requirements enabled banks to pay higher interest on deposits while at the same time charging a lower rate on loans and still to increase profits. The volume of outstanding Eurodollar negotiable C. D.s continued to grow to its present size of approximately \$32 billion while the much larger Eurodollar deposit market has grown to an estimated \$425 billion.

Most Eurodollar negotiable C. D.s are issued with maturities up to one year by prime international banks. Banks usually quote rates for three, six, and twelve month maturities, corresponding to their loan rollover requirements, rather than for all maturities as in the United States. U. S. purchasers of Eurodollar C. D.s include commercial bank portfolios and trust departments, corporations, insurance companies and various other institutions. In addition, a large number of foreign entities are active participants in the Eurodollar C. D. market. Investors generally receive an additional 1/8 to 1/4% in yield over domestic C. D.s of the same issuer and maturity while a holder of a non-negotiable Eurodollar time deposit normally picks up still an additional 1/8 to 1/4%. These spreads may change as the result of the recent (November 13, 1980) requirement that U. S. and foreign agency banks hold 3% reserves against their net balances due to foreign branches. It is still too early to determine what the likely impact of this reserve requirement on the Eurodollar markets will be.

Many investment bankers and commercial banks actively trade Eurodollar C. D.s providing liquidity to these investment instruments. The standard trading units are multiples of \$1,000,000. The trading volume of Eurodollar

C. D.s has grown steadily from a monthly average turnover of about \$2.1 billion in 1974 to more than \$12 billion in mid-1979 with trades of \$20 to \$25 million not uncommon. Trading activity in the market is influenced not only by normal seasonal pressures affecting the domestic C. D. market but also by periodic loan rollover pressure and foreign exchange developments which may have a significant impact on rates, thereby presenting opportunities for the investor.

With regard to credit risk, the deposits are general obligations of the issuing bank under the laws of England where they are issued and payable. Holders of these deposits are creditors of the entire bank and not just the issuing branch. If a branch failed to pay a C. D. because of insolvency, it could be enforced against the head office of the bank. A depositor or C. D. holder could be negatively affected by government action in two ways. One would be an action of the English government such as its imposition of currency controls or interest limitations and the other would be by the action of the bank's head office. This could take the form of modification or termination of the issuing bank's liability regardless of where the holder sought payment. The chances of such governmental action are viewed as highly unlikely.

**Yields of Three and Six Month-Eurodollar Certificates of Deposit
and their Yield Spreads above U.S. Prime Certificates of Deposit**

<u>First of Month</u>	<u>Yields-</u> <u>Eurodollar C.D.</u>		<u>Yield Spreads-</u> <u>Euro \$ vs. U.S. C.D.s</u> <u>(In Basis Points)</u>	
	<u>Three</u>	<u>Six</u>	<u>Three</u>	<u>Six</u>
	<u>Month</u>	<u>Month</u>	<u>Month</u>	<u>Month</u>
1974-Jan.	10.00%	10.00%	+ 80	+150
Apr.	9.81	9.81	+ 6	+ 51
July	13.31	13.31	+121	+151
Oct.	11.69	11.75	+ 89	+105
1975-Jan.	9.63	9.44	+ 53	+ 74
Apr.	6.56	6.94	+ 46	+ 54
July	6.50	7.00	+ 20	+ 30
Oct.	7.63	8.25	+ 53	+ 20
1976-Jan.	5.63	6.25	+ 13	+ 30
Apr.	5.31	5.88	+ 11	+ 28
July	5.88	6.50	+ 14	+ 30
Oct.	5.56	5.75	+ 21	+ 25
1977-Jan.	4.88	5.00	+ 23	+ 20
Apr.	5.06	5.31	+ 16	+ 16
July	5.63	5.81	+ 25	+ 21
Oct.	6.69	6.94	+ 29	+ 24
1978-Jan.	7.00	7.25	+ 20	+ 25
Apr.	7.20	7.50	+ 35	+ 20
July	8.35	8.70	+ 25	+ 15
Oct.	8.30	9.60	+ 40	+ 35
1979-Jan.	11.45	12.00	+ 55	+ 50
Apr.	10.35	10.62	+ 35	+ 32
July	10.40	10.38	+ 60	+ 51

**Volume Outstanding of U.S. and Eurodollar Certificates of Deposit
and Secondary Market Turnover of Eurodollar Certificates of Deposit
(Billions of U.S. Dollars)**

Mid-month (Approx.)	U.S. C.D.s	Eurodollar C.D.s	
	Total Outstanding (1)	Total Outstanding (2)	Secondary Market Turnover (3)
1974-Jan.	65.6	11.1	2.3
Apr.	71.8	13.7	2.0
July	83.0	13.0	1.4
Oct.	88.7	12.5	2.6
1975-Jan.	61.4	11.6	3.3
Apr.	85.2	11.2	2.2
July	80.9	11.8	2.1
Oct.	83.3	12.4	3.7
1976-Jan.	79.1	13.3	5.1
Apr.	69.9	14.1	4.6
July	69.5	14.9	5.0
Oct.	64.6	15.7	5.4
1977-Jan.	62.8	15.9	6.2
Apr.	59.9	17.0	5.7
July	62.5	19.0	6.3
Oct.	68.5	21.7	6.1
1978-Jan.	75.8	21.9	7.4
April	80.7	21.9	7.5
July	87.3	22.0	4.7
Oct.	90.0	23.5	6.8
1979-Jan.	96.5	27.5	11.6
Apr.	86.5	28.1	9.3
July	79.3	32.2	12.4

REAL ESTATE INVESTMENT MARKET & REAL ESTATE EQUITY POOLS

Until the early 1960's the real estate investment market in the United States was primarily controlled by the real estate developer and the small investor or investor group. There were few large real estate projects and those that were built were either financed or owned by one of a few insurance companies purchasing for their own investment account. Industrial property was usually owned by the corporate user or leased from local investors. The market place was highly fragmented and very much an activity at the local level. Developers had small organizations and essentially seat-of-the pants entrepreneurs.

The 1960's saw an explosive demand for manufacturing warehousing, retail, commercial and office facilities. The larger industrial and office park concepts were created and the increasing demand for capital led most corporations to a leasing posture. This was appropriate for warehousing and office facilities as a way to conserve capital for business and as a strategy which allowed reaction to changing markets. Family formation growth led to rapid residential suburban growth and as residential developments grew so did retail and commercial developments. The shopping center grew from infancy to maturity as regional enclosed mall centers creating a mini-down town which had a major impact on residential and commercial growth patterns. During this period a very few pension funds began to acquire industrial and commercial properties for investment. At the same time, more insurance companies began to add properties to their investment portfolios. The institutional real estate investment market began to take on the characteristics of a regional and in some cases a national market.

As we moved into the 1970's real estate projects increased rapidly in size and complexity demanding a broader range of professional skills. The size of real estate development organizations expanded to handle regional as well as national areas as well as a national market.

The 1974-1976 recession dampened much corporate involvement in real estate but the demand and growth for investment grade real estate product remained intense. Demand for pension fund real estate investments during the latter part of the 1970's drove down the current cash return on investments. Appreciation in value and rapidly rising rental rates created even more demand as real estate appeared attractive as an alternative pension investment vehicle.

As we move into the 1980's, commercial and industrial grade real estate will become more and more an institutional market. The long term mortgage market is likely to see a radical change necessitating substantial equity to be raised for larger real estate projects. This will squeeze the smaller developers or will force them to sell or joint venture their projects with institutions and pension funds. The very large development projects will become exclusively an institutional and pension fund market.

Consequently, the demand for real estate facilities from the user side is currently very strong and promises to remain so during the 1980's and beyond. The demand for quality investment grade real estate by institutions and pension funds will be even stronger. This will predictably result in lower current returns and stretched out

periods to realize long term return on investment objectives. The demand from both the user and investor side combined with the effects of inflation and government regulations will continue to push real estate up at a substantial rate. Commercial and industrial real estate investments should continue to provide superior long-term returns on investments.

In the last 10 years many trust, pools or funds have been established to participate in the advantages of real estate investments. They consisted of larger mortgage companies, banks, brokerage houses and insurance companies to name a few. Insurance companies led the way since in many cases they had been involved in real estate lending or purchasing for their portfolio for the past 100 years or longer.

Real estate is not a passive investment. It is a highly complicated field requiring creative ability, qualitative as well as quantitative analysis, and most of all experience. Owned real estate has its own risk parameters quite different from those of other investments. Once purchased, it has to be managed properly. Real Estate is susceptible to vacancies, demographic change, imbalance of income to expenses, and overbuilding to name a few. Major insurance companies have the expertise as well as offices all over the country, and this is a major advantage not available to most other managers. Real Estate pools offer protection against downside risk due to vacancies or rapidly escalating operating costs. Prudently selected and maintained Real Estate can be considered a viable supplement to other portions of a portfolio.

Funds accepted for real estate pools are limited to the properties available for purchase in any given period. You advise them of your intention to join and give them an indication of the amount you would like to deposit. They will accept your funds on a quarterly basis only, and then only if they have sufficient properties in line for purchase the following quarter. They will not guarantee acceptance of your funds in a specified time frame. They will not purchase unqualified properties just because funds are available.

Just as it is sometimes difficult to get in a real estate pool, it also takes time to withdraw. It must be realized that real estate investments are relatively illiquid and should be considered long term investments. They will not force sell a property just because you want to withdraw your funds. Most pools require 90 days written notice prior to any quarterly date. This allows them time to find other investors who want to invest in the pool, thus allowing you to withdraw. However, if cash available in the pool is sufficient to allow your withdrawal earlier, they will honor your request.

We're sure everyone will agree that any investment portfolio, pension fund or permanent fund in this case, should have the ability to diversify its investments. We have all witnessed the ups and downs in stock and bond markets over the years. Good real estate on the other hand on average has always increased in value. Investment decision makers have finally been convinced that real estate deserves a place in a well diversified portfolio. We believe that the current trend toward real estate as a major investment asset is both justified and of growing importance.

Many investment managers have been aware of the advantages of real estate investing but were discouraged from participating in real estate due to the lack of liquidity and risk characteristics associated with outright ownership. Real estate pool investments are designed to overcome these problems. Pool investment offers well managed diversification characteristics tailored to meet the risk to expected return and liquidity requirements of participants. The pools offer the investment advantages of a portfolio of high quality real estate, diversified by property type, lease term, tenant type and geographic location, combining a potential for capital appreciation with an attractive level of current income.

That last sentence says it all and deserves expanding upon:

Advantages

Real Estate equity pools are designed to deliver all of the advantages investors seek from real estate, without the complexities of outright ownership.

Return Potential

Over the years, carefully selected real estate has demonstrated a consistent ability to produce attractive yields.

Inflation Hedge

A rapid increase in real estate values has become increasingly evident in recent years as escalating construction costs have exerted upward pressure on the replacement cost of commercial and industrial properties. An attractive hedge against inflation.

Portfolio Diversification

Real estate assets produce very positive diversification characteristics when introduced into the typical portfolio of stocks, bonds, mortgages and money market investments to name a few.

A real estate pool also provides diversification of property types such as shopping centers, apartment and office buildings, motels, hotels, industrial and warehouse buildings, etc. Geographic diversification is provided through purchases of property from coast to coast including Alaska.

As more and more investors become aware of the advantages of diversification and returns available on these pools, the demand has been increasing. With this demand there has been an increasing number of pools going on line, which makes good real estate investments harder to find.

The better real estate pools do not speculate as Real Estate Investment Trusts (REIT's) did back in the late sixties and early seventies. Real Estate Investment Trusts began in 1960 when Congress passed the Real Estate Investment Trust Act.

The purpose was to provide more capital to satisfy the growing demand for long term investment money by opening the field to individual investors. The mortgage type REIT created the surge of popularity between 1969-71. Underwriters encouraged banks and others to establish trusts because the shares were easily sold and good fees were to be made. The REIT's borrowed heavily from banks and others to support their demand for more money to lend construction and development projects. Serious problems began to surface in 1974 when the prime rate soared past 12% and some construction loans reached 18% to 20%. Many could not pay and projects could not be completed and many failures resulted. Insurance company pools do not sell shares to the public, do not get involved in development projects until completed, and best of all do not borrow money to purchase real estate investments.

The insurance companies described on the following pages, in our opinion, are among the best in the industry. Other pools are available, some managed by non insurance companies, and other insurance companies also have pools. We presently have retirement systems funds in the pools with companies used as examples.

PRUDENTIAL INSURANCE COMPANY OF AMERICA

Prudential is the largest private real estate investor in the United States. As of June 1980 their estate investment department employed a professional staff of almost 500 persons located in Prudential Corporate Headquarters and 71 field offices in the United States and Canada. They manage nearly \$18 billion of real estate investments, including \$14 billion in mortgages, \$3 billion in wholly owned properties and over \$1 billion in joint ventures throughout the United States.

Because of their nationwide structure, the real estate department has established direct working relationships with regional and national real estate developers, brokers, managers, and investors. These relationships allow Prudential to consider property opportunities on a national basis.

Prudential Property Investment Separate Account (PRISA)
 (\$2 billion) Annual Historical Performance

<u>Year</u> <u>Ending</u>	<u>Gross</u> <u>Return</u>	<u>Net</u> <u>Return</u>	<u>Breakdown of</u> <u>Net Return</u>	
			<u>Income</u>	<u>Appreciation</u>
12-31-79	25.4%	23.9%	8.8%	15.1%
12-31-78	20.9	19.5	9.0	10.5
12-31-77	12.0	10.7	7.8	2.9
12-31-76	9.8	8.5	7.5	1.0
12-31-75	9.5	8.3	7.0	1.3

Geographical Location

As of 6/30/80-%

Regions (30 States)

22%	West
20%	South
18%	Mid-West
40%	East

Property Diversification

39%	Office Buildings
23%	Industrial Buildings
16%	Hotels & Motels
19%	Shopping Centers
3%	Apartments

AETNA LIFE INSURANCE COMPANY

Aetna's Real Estate Department has been in operation for over 100 years, and in the last 10 years has established an equity unit responsible for buying and managing equity real estate. Aetna's real estate and mortgage portfolio exceeds \$5 billion. The real estate department is comprised of 130 employees with a variety of backgrounds in real estate. The department utilizes both correspondents and direct lending capabilities. They are affiliated with over 85 mortgage bankers in major metropolitan areas who are under contract to produce real estate and mortgage investments. Their internal National Accounts unit deals directly with major real estate development companies which operate on a national basis.

Aetna Real Estate Separate Account
(\$300 MM) Annual Historical Performance

	<u>Yield</u>	<u>Appreciation</u>	<u>Total Return</u>
Jan.-Dec., 1978	7.73%	0.82%	8.55%
Jan.-Dec., 1979	9.03%	3.54%	12.57%

Geographic Distribution

<u>As of 6/30/80-%</u>	<u>Regions</u>
30%	Rockies
16%	South
18%	Mid West
3%	East
33%	West

Property Diversification

45%	Retail Buildings
2%	Land
20%	Office Buildings
19%	Industrial
14%	Warehouse Buildings

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY

The John Hancock's Real Estate Department has been in existence for over 100 years and currently manages a portfolio of commercial and agricultural real estate and mortgages of all types in excess of \$4 billion. In addition to a staff of in-house professionals including 50 mortgage investment officers, they have advisory and origination capability from a network of 58 mortgage banking firms and their branch offices located in major metropolitan cities from coast to coast. They also have eight agricultural loan agencies in the major farm areas of the country, and maintain extensive contact with major property developers as well as the mortgage and real estate brokerage community.

(\$350 M) Equity Real Estate Account (ERA)
Annual Historical Performance

	<u>Yield</u>	<u>Appreciation</u>	<u>Total*</u> <u>Return</u>
Jan. - Dec., 1977	9.1%	1.2%	10.3%
Jan. - Dec., 1978	9.3	2.5	11.8
Jan. - Dec., 1979	10.2	8.8	19.0

Geographic Distribution

<u>As of 6/30/80-%</u>	<u>7 Regions (21 States)</u>
11%	New England
13%	Middle Atlantic
15%	Southeast
30%	Midwest
5%	Southcentral
13%	Mountain/Southwest
13%	Pacific

Property Diversification

32%	Industrial Buildings
8%	Hotel
28%	Warehouse Buildings
13%	Office Buildings
17%	Shopping Centers
3%	Retail Stores

EQUITABLE LIFE ASSURANCE COMPANY

Equitable's Real Estate Department has been in operation for over 115 years and has been involved in equity real estate ownership and management for over 25 years with over \$3 billion under management. The real estate department presently has a staff of over 500 full-time real estate professionals. The department utilizes both correspondents and direct lending capabilities with their own nationwide network of 40 offices. They are also the investment advisor to Equitable Life Mortgage and Realty Investors, a Boston based real estate investment trust listed on the New York Stock Exchange.

Equitable's Equity Real Estate Account
(\$1 billion) Annual Historical Performance

<u>Year</u> <u>Ending</u>	<u>Yield</u>	<u>Appreciation</u>	<u>Total</u> <u>Return</u>
12-31-75	9.8%	(2.2%)	7.6%
12-31-76	8.7%	1.5%	10.2%
12-31-77	9.1%	2.2%	11.3%
12-31-78	9.2%	4.7%	13.9%
12-31-79	9.3%	5.5%	14.8%

Geographic Distribution

<u>As of 6/30/80-%</u>	<u>Regions</u>
32%	Southern
29%	Central
15%	Western
14%	Mid-Atlantic
10%	Northeastern

Property Diversification

64%	Retail
16%	Office
15%	Industrial
2%	Hotels
2%	Land

PERFORMANCE FIGURES - POOLED REAL ESTATE ACCOUNTS

INVESTMENT RETURN NET OF INVESTMENT FEES

<u>YEAR</u>	<u>INSURANCE COMPANY</u>			
<u>Ending 12/31:</u>	<u>Prudential PRISA</u>	<u>Aetna</u>	<u>John Hancock</u>	<u>Equitable</u>
1979	23.9%	12.6%	17.8%	13.9%
1978	19.5	8.6	10.8	14.4
1977	10.7	--	9.3	10.0
1976	8.5	--	--	8.9
1975	8.3	--	--	6.3
Assets at Market 12/79 (000)	\$1,493.70	\$184.75	\$180.02	\$903.09

THE CASE FOR INTERNATIONAL DIVERSIFICATION

International diversification of an investment portfolio can provide four benefits: reduction in the volatility of the portfolio; an increase in the return; an increase in the marketability of the portfolio as a whole; and protection against an unexpectedly high rate of inflation in the United States..

1. Protection from Inflation

Diversification into markets of different countries with different economic cycles and different rates of inflation reduces the risk that an entire portfolio will show a low real rate of return. The return of the international element of the portfolio will not be impaired by an unexpectedly high level of inflation in the United States. Indeed it will tend to benefit since the growth of the inflation differential is likely to be reflected in exchange rates so that overseas holdings will rise in terms of the United States dollar. A rise in the exchange rate of the United States dollar might lead, on the other hand, to the returns on overseas investments not matching those on United States investments. Any fall in the United States rate of inflation would, however, be highly beneficial to the performance of United States investments. Since the proportion invested in overseas markets would likely be relatively small, the overall performance of a portfolio with 90 per cent invested in the United States and 10 per cent in overseas markets would still be quite satisfactory during this period of low domestic inflation. International diversification protects the assets of a fund in that it provides a higher return on overseas securities at the time it is most needed - when the rate of domestic inflation is unexpectedly high.

2. Reduced Volatility

The prices of different shares in any one market tend to move fairly closely together, but the correlation between share price movements in different markets is low.

Correlation coefficients between United States and Foreign Stock Markets 1970-1979.

United States	1.00
United Kingdom	.54
Japan	.52
Germany	.51
France	.48
Hong Kong	.45

One study has indicated that the reduction in volatility for the period 1959 to 1979 for a portfolio with 90 per cent invested in the Standard & Poor's Composite Index and 10 per cent equally divided among the equity markets of France, Germany, Japan, and the United Kingdom (as represented by the Capital International Index for each of these markets) from the volatility of a portfolio invested wholly in the Standard & Poor's Composite Index would have been nearly half that which would have been obtained by holding 10 per cent of the portfolio in cash equivalents. International diversification thus leads to a substantial reduction in volatility.

3. Greater Return

The rate of return in the years 1959 to 1979 was generally greater in the major markets outside North America than in the United States. A study made by InterSec Research Corporation shows the rates of return achieved by investment in the Capital International Indices of the markets of Canada, France, Germany, Japan, and the United Kingdom and in the Standard & Poor's Composite Index in the United States over four periods (1959 to 1979, 1965 to 1979, 1970 to 1979, and 1974 to 1979), after taking account of dividend yield and adjusting for fluctuations in exchange rates. The returns in every period were higher in each of the overseas markets than in the United States except in the case of the French market in the longest period. The rate of return of a portfolio divided equally among the four markets outside North America would have been higher by about 70 per cent in the first period, 150 per cent in the second period, 160 per cent in the third period and 85 per cent in the final period. The investment of even a small proportion of a United States portfolio in international markets would, therefore, have resulted in a significant increase in the return of the whole portfolio.

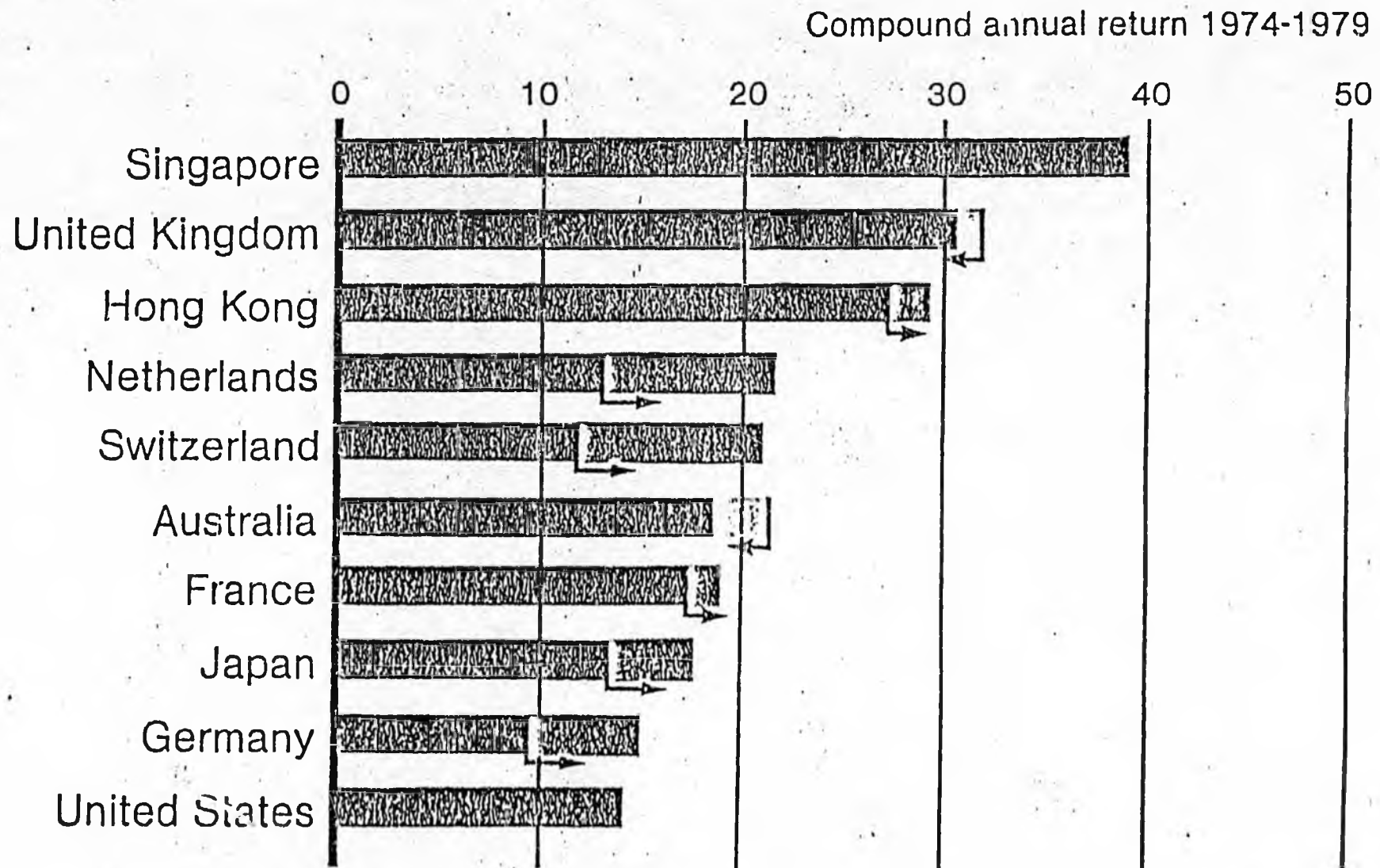
4. Increased Marketability

Capital International has published figures for turnover in 1979 in 14 stock markets in Europe and the Far East. Turnover in these 14 markets amounted to \$220.7 billion, over 86 per cent of the turnover of the United States and Canadian equity markets in the same year. Capital International has also published figures for the market capitalization of equities on 16 stock exchanges outside North America. At the end of 1979 the total amounted to \$755 billion, almost 71 per cent of the combined market capitalizations of the United States and Canadian stock markets at that time. The size of markets outside North America is thus considerable, and turnover forms a larger proportion of market capitalization in them, taken as a whole, than in North America. Moreover, there were 127 companies listed on these 16 markets outside North America with a market capitalization which was greater than that of the 200th largest listed United States company at the end of 1979. There is thus considerable opportunity for large scale investment in markets outside the United States and Canada.

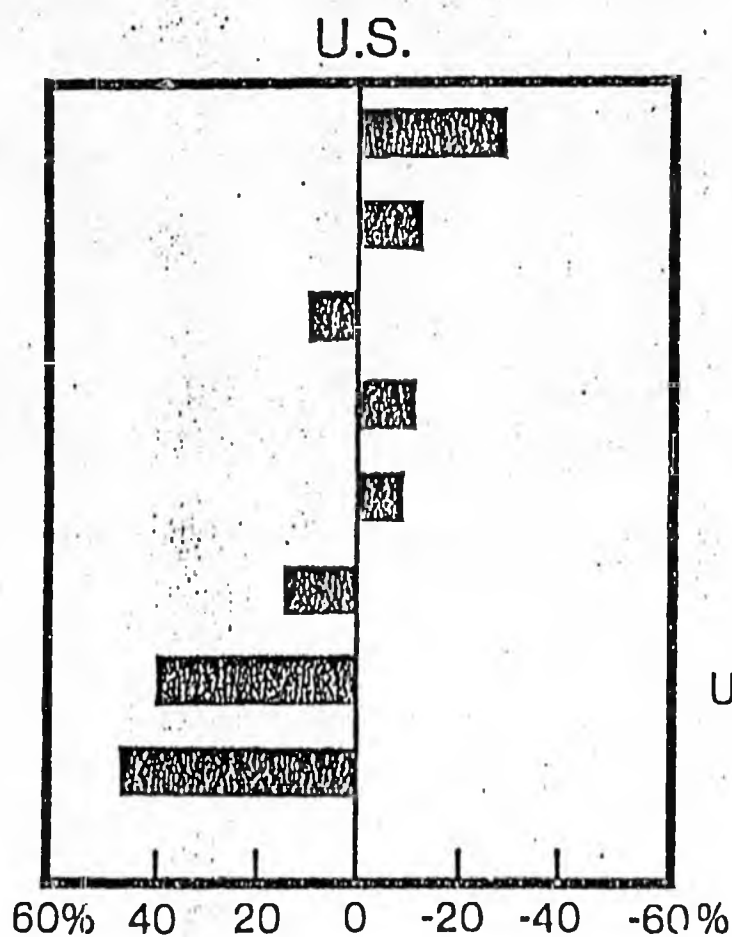
5. Investment in International Bond Markets

The total capitalization of the Eurobond market and the nine national bond markets of Australia, Denmark, France, Germany, Japan, the Netherlands, Sweden, Switzerland, and the United Kingdom at the end of 1979 was about \$1,414 billion. By comparison, the taxable bond market in the United States had an estimated capitalization of about \$1,400 billion and that of Canada a capitalization of about \$105 billion. The large size of international bond markets provides United States investors with a further means of benefiting from international diversification, but with a lower degree of volatility than that involved in equity investment.

Some return comes from currency exchange rate changes.

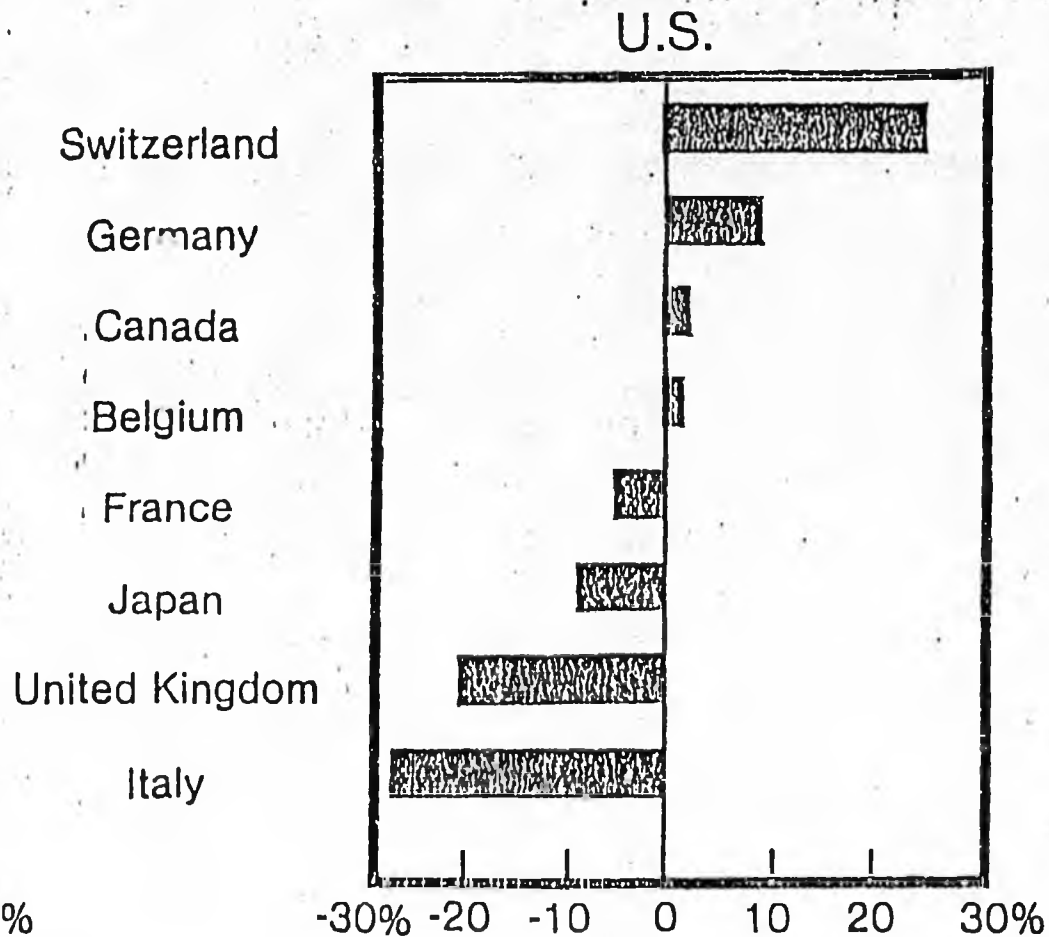


Currency exchange rates (longer term) depend on differences in inflation rates.



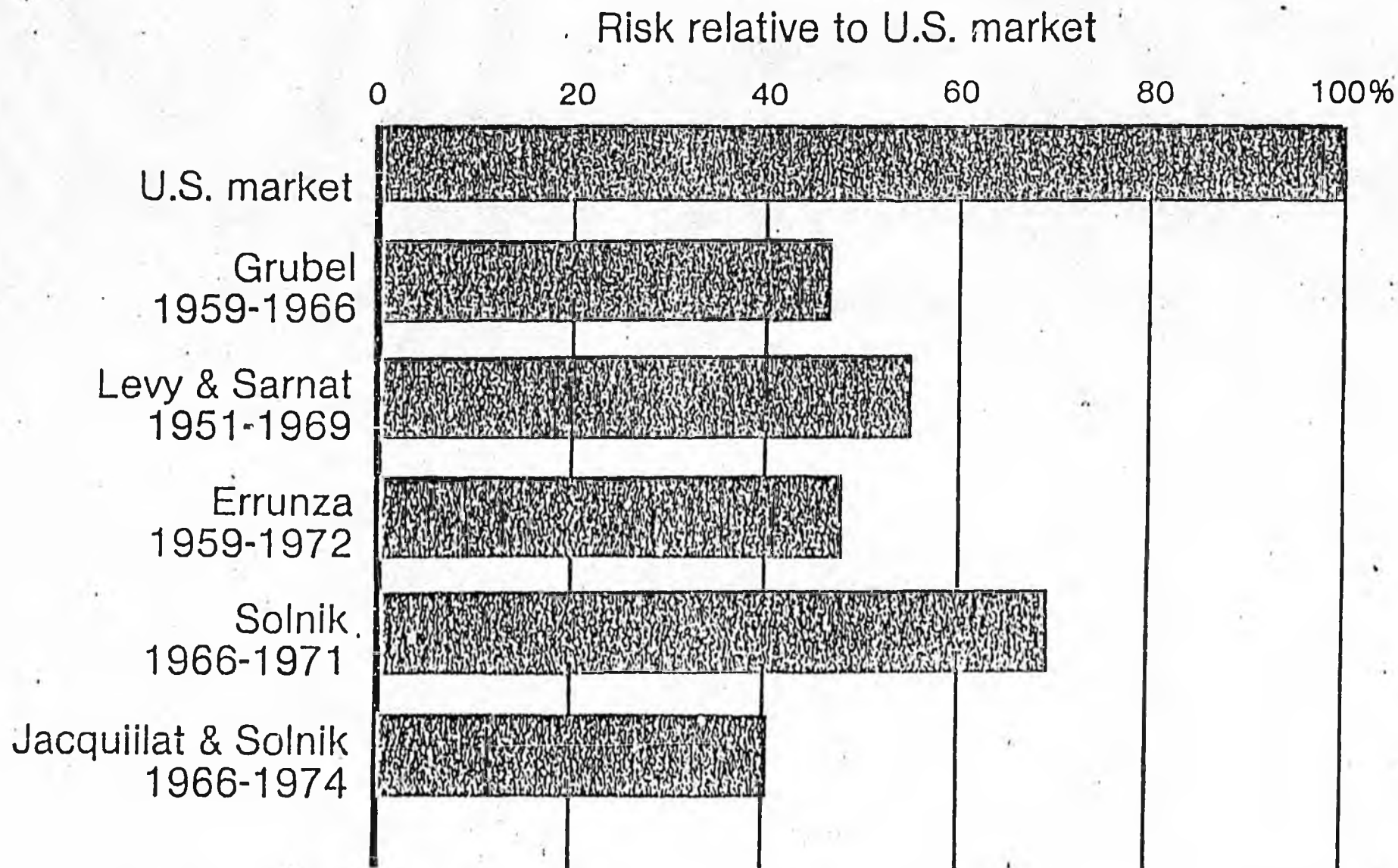
Cumulative inflation difference with U.S.

Wholesale price index

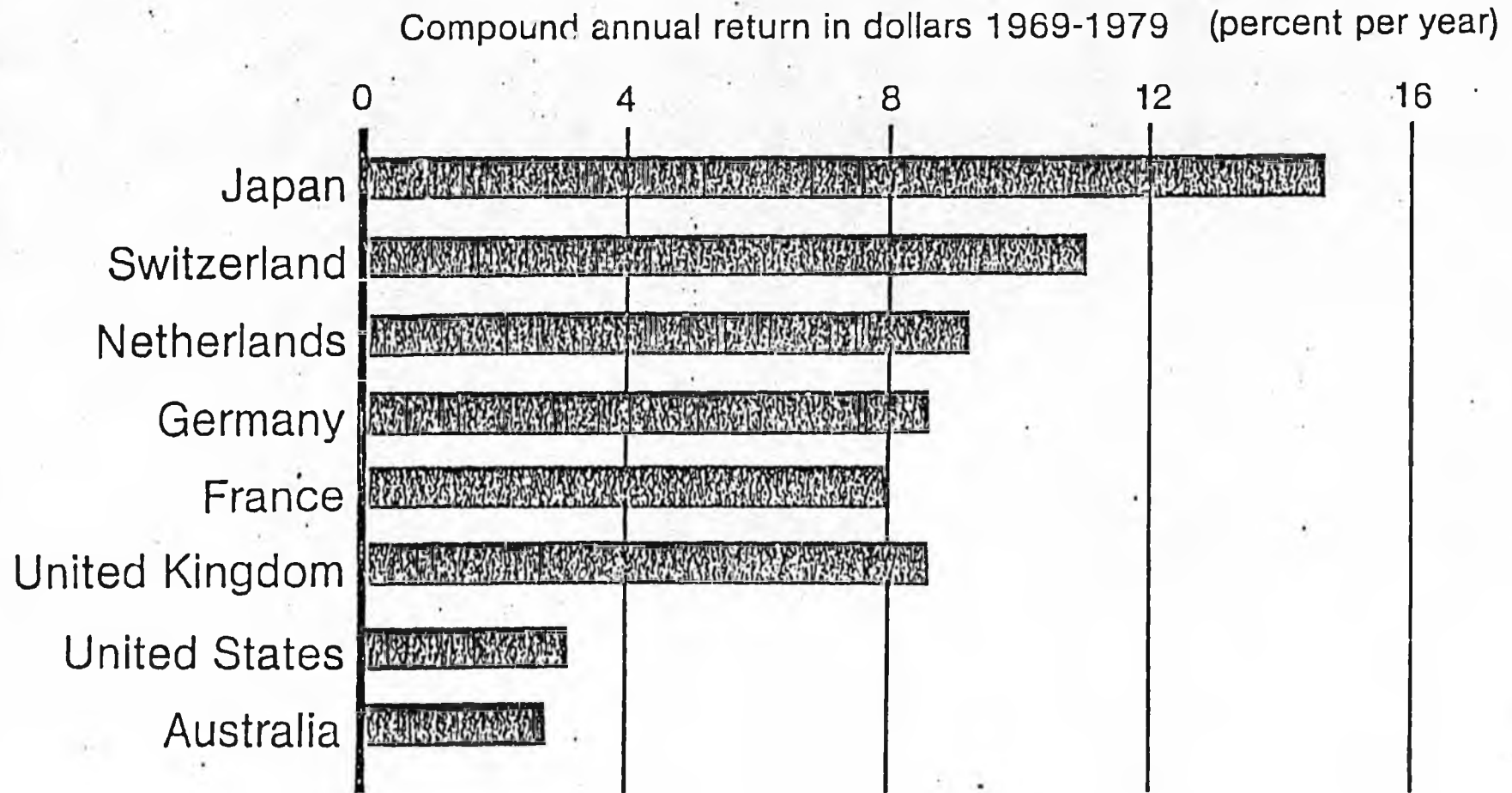


Cumulative exchange rate change vs. dollar

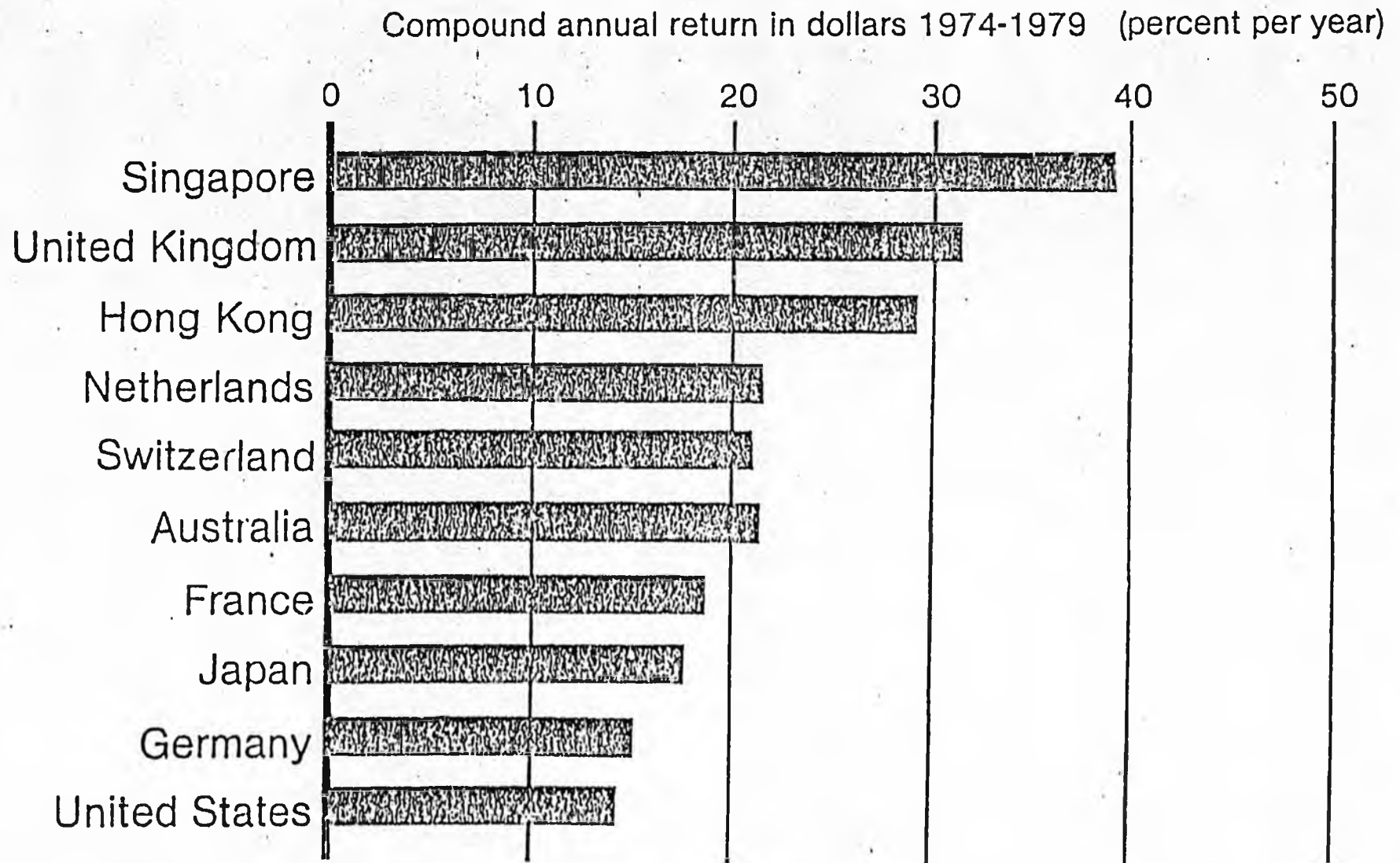
Studies show that international diversification reduces risk substantially.



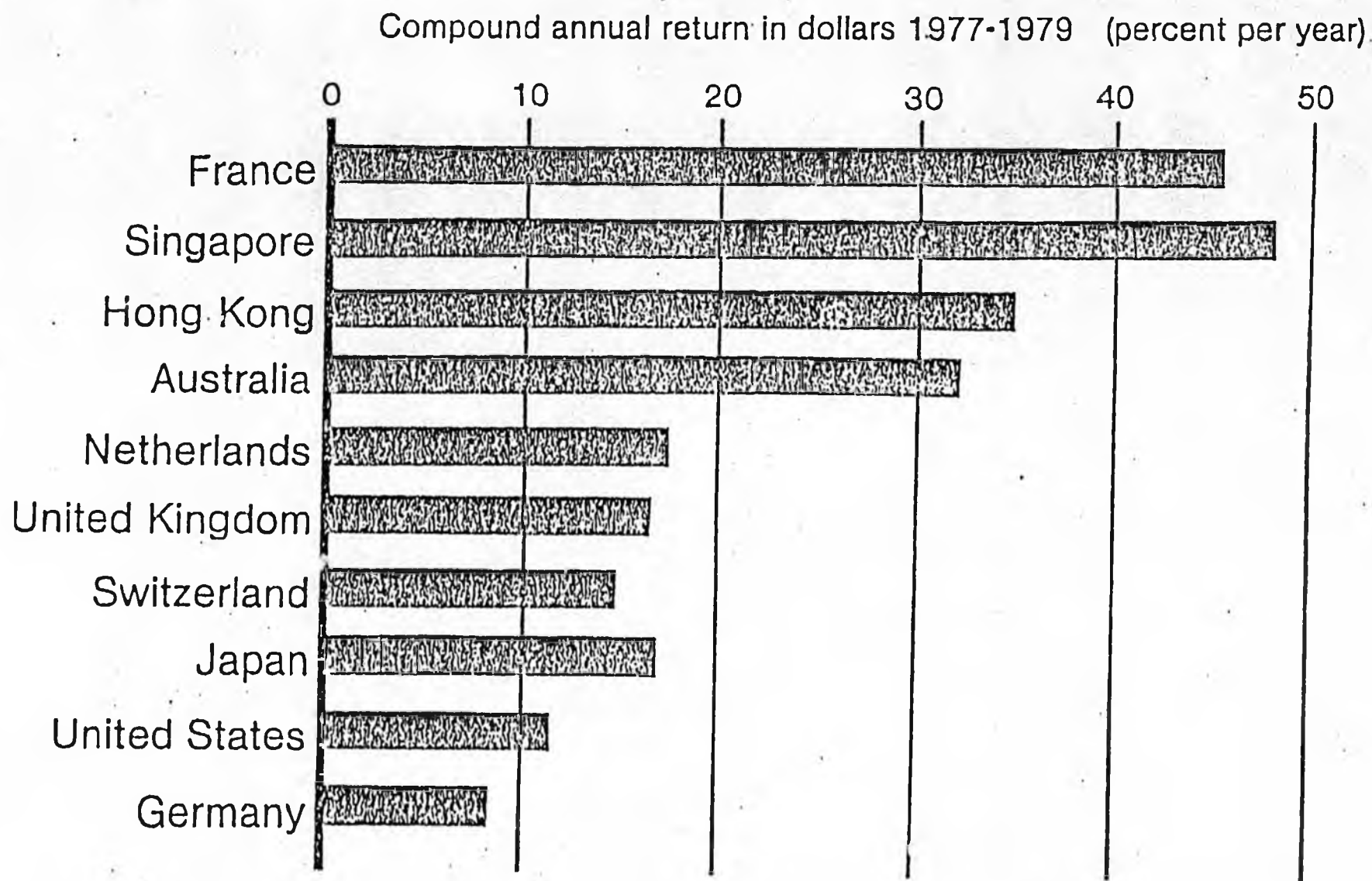
Foreign markets have shown better returns than the U.S. market for the past ten years.



Foreign markets have shown better returns than the U.S. market for the past five years:



Foreign markets have shown better returns than the U.S. market for the past two years.





TOTAL RETURNS ON INVESTMENT FROM MAJOR WORLD STOCK MARKETS
BEFORE AND AFTER U.S. INFLATION FOR THE FIVE YEARS 1974-'78+

	TOTAL RETURNS LOCAL CURRENCY	TOTAL RETURNS U.S. \$ TERMS	INFLATION in U.S.	TOTAL RETURNS AFTER U.S. INFLATION
U.S.	4.29	4.29	7.94	-3.38
Japan	9.48	17.72		-9.06
U.K.	14.54	11.61		3.40
Germany	11.65	21.04		12.14
France	6.70	10.13		2.03
Switzerland	1.37	16.84		8.25
Australia	9.92	4.44		-3.24
Canada	5.40	1.93		-5.57
EAFE*		12.11		3.86

*Europe, Australia, Far East Indices of sixteen markets, weighted according to their size. Prepared by Capital International, Geneva.
+ percent per annum, compounded.



INTERSEC RESEARCH CORP.
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TOTAL RETURNS ON INVESTMENT FROM MAJOR WORLD STOCK MARKETS
BEFORE AND AFTER U.S. INFLATION FOR THE THREE YEARS 1976-'78+

	TOTAL RETURNS LOCAL CURRENCY	TOTAL RETURNS U.S. \$ TERMS	INFLATION in U.S.	TOTAL RETURNS AFTER U.S. INFLATION
U.S.	6.92	6.92	6.86	.06
Japan	24.49	30.73		22.33
U.K.	17.12	17.42		9.88
Germany	3.82	19.49		11.82
France	10.28	12.93		5.68
Switzerland	2.34	20.76		13.00
Australia	10.31	7.16		0.28
Canada	14.77	9.13		2.12
EAFE*		18.39		10.79

*Europe, Australia, Far East Indices of sixteen markets, weighted according to their size. Prepared by Capital International, Geneva.
+ percent per annum, compounded.

