

ALASKA LEGISLATURE COMMITTEE FILES 1983-1980 00/2

3703 HSTA HB 458 - HB 465 59

1 available to the public a final justification of need concerning the
2 regulation or order of repeal. The final justification shall include

3 (1) the complete text of a regulation that is adopted or
4 amended and a list of regulations repealed;

5 (2) a summary of each comment or objection received and an
6 explanation of changes made to the proposed regulation in response to
7 the information or the reasons for rejecting the comment or objection;
8 and

9 (3) the reasons for rejecting proposed alternatives.

10 (c) An agency is not required to prepare an initial or final
11 justification of need for a regulation that interprets, implements, or
12 makes clear a law if the agency has not previously adopted a regula-
13 tion under that law.

14 * Sec. 5. AS 44.62.210 is amended by adding new subsections to read:

15 (c) If at least 10 interested persons submit a written request
16 for a public hearing at least 10 days before the end of the initial
17 comment period, a state agency shall hold a public hearing on the
18 proposed action.

19 (d) A state agency may not add documents to the record of a
20 regulation-making procedure after the end of the public comment period
21 unless the agency provides an adequate opportunity for public comment
22 on the added documents.

23 * Sec. 6. AS 44.62.230 is amended to read:

24 Sec. 44.62.230. PROCEDURE ON PETITION. Upon receipt of a
25 petition requesting the adoption, amendment, or repeal of a regulation
26 under AS 44.62.180 - 44.62.290, a state agency shall, within 30 days,
27 deny the petition in writing, including the reasons for the denial, or
28 schedule the matter for public hearing under AS 44.62.190 - 44.62.210.
29 However, if the petition is for an emergency regulation [,]

1 and the agency finds that an emergency exists, the requirements of
2 AS 44.62.190 - 44.62.210 do not apply, and the agency may submit the
3 regulation to the lieutenant governor immediately after making the
4 finding of emergency and putting the regulation into proper form.

5 * Sec. 7. AS 44.62 is amended by adding a new section to read:

6 Sec. 44.62.275. RECORDS OF PROPOSED ACTIONS. (a) A state
7 agency shall maintain a file of the proceedings concerning the adop-
8 tion, amendment, or repeal of a regulation. The file shall include

9 (1) petitions received under AS 44.62.220;

10 (2) published notices of proposed action under AS 44.62.-
11 190;

12 (3) justifications of need required by AS 44.62.205;

13 (4) fiscal information and financial estimates under
14 AS 44.62.195;

15 (5) each document submitted in connection with the proposed
16 action;

17 (6) each document upon which the agency is relying for the
18 proposed action;

19 (7) a transcript, recording, or minutes of each public
20 hearing connected with the proposed action; and

21 (8) other information that the state agency is required by
22 law to consider or prepare in connection with the proposed action.

23 (b) The agency shall maintain a log that identifies each item
24 contained in the file and the date on which the item was received.
25 The file shall include an affidavit by the employee responsible for
26 maintaining the file stating that the file contains all of the docu-
27 ments required by this section and the date the file was completed.

28 (c) The file is a public record.

29 * Sec. 8. AS 44.62.300 is amended to read:

1 Sec. 44.62.300. COURT REVIEW. An interested person may get a
2 judicial declaration on the validity of a regulation by bringing an
3 action for declaratory relief in the superior court. In addition to
4 any other ground the court may declare the regulation invalid

5 (1) for a substantial failure to comply with AS 44.62.010 -
6 44.62.320; [, OR]

7 (2) in the case of an emergency regulation or order of
8 repeal, upon the ground that the facts recited in the statement do not
9 constitute an emergency under AS 44.62.250; or

10 (3) in the case of a regulation subject to AS 44.62.205(a)
11 and (b), for failure to comply with AS 44.62.205, or if the justifica-
12 tion of need fails to present sufficient facts to establish by a
13 preponderance of the evidence the need for the regulation.

14 * Sec. 9. AS 44.62.640(a) is amended by adding a new paragraph to read:

15 (5) "document" means a written or electronic communication
16 of any kind, except a telephone communication, submitted to an agency
17 for consideration during the adoption, amendment, or repeal of a
18 regulation.

19 * Sec. 10. AS 44.62.190 as enacted by sec. 1 of this Act, AS 44.62.-
20 205(b) and 44.62.205(c) as enacted by sec. 4 of this Act, and the amend-
21 ments made by secs. 5 and 9 of this Act apply to proposed regulations,
22 amendments, and orders of repeal that have not been submitted to the lieu-
23 tenant governor for filing before the effective date of this Act. The
24 amendment made by sec. 6 of this Act applies to petitions that have not
25 been scheduled for public hearing or denied before the effective date of
26 this Act.

27 * Sec. 11. The amendments made by secs. 2, 3, 7, and 8 of this Act, and
28 AS 44.62.205(a) enacted by sec. 4 of this Act do not apply to proposed
29 regulations, amendments, or orders of repeal for which a notice of proposed

1 action has been published before the effective date of this Act.

2 * Sec. 12. This Act takes effect July 1, 1986.

A M E N D M E N T

#2

Offered in the
TO: SSHB 458

By Pignalberi

Page 1, lines 16 - 23, delete all material and insert a new bill section to read:

"* Sec. 2. AS 44.62 is amended by adding a new section to read:

Sec. 44.62.197. REGULATORY ANALYSIS. (a) An agency shall issue a regulatory analysis of a proposed regulation if, within 20 days after publishing the notice of proposed action, a written request is submitted to the agency by a legislator, another agency, a political subdivision of the state, the governor, as authorized by a vote of the Administrative Regulation Review Committee, or by ³⁰⁰ five persons signing a single request. (50)

(b) Upon receipt of a request under (a) of this section, the agency shall prepare the regulatory analysis. The analysis must quantify the data to the extent practicable, take into account both short-term and long-term consequences, and

(1) describe the classes of persons who probably will be directly affected by the proposed action, including the classes who will bear the costs of the proposed regulation and the classes who will benefit;

(2) describe the probable quantitative and qualitative effect of the proposed regulation, economic or otherwise, on the

classes of persons affected;

(3) set out the probable cost to the agency and any other agency for implementing and enforcing the proposed regulation and the anticipated effect on state revenue;

(4) compare the probable cost and benefits of the proposed regulation with the probable cost and benefits of inaction;

(5) determine whether there are less costly or less intrusive methods for achieving the purpose of the proposed regulation.

(c) The person or persons requesting the regulatory analysis may, by express statement in the request, waive one or more of the requirements of (b) of this section.

(d) A concise summary of the regulatory analysis shall be published in the administrative journal at least 20 days before the earliest of

(1) the end of the period for making written comments on the proposed regulation;

(2) the end of the period during which an oral public proceeding may be requested; or

(3) the date of a required oral public proceeding on the proposed regulation.

(e) The published summary must indicate where to obtain copies of the full text of the analysis and when, where, and how persons may comment on the proposed regulation.

(f) If an agency has made a good faith effort to comply with the requirements of (a) - (c) of this section, the regulation may not be invalidated on the ground that the contents of the regulatory analysis

are insufficient or inaccurate."

Page 2, lines 10 - 11, delete "and financial estimate"

Page 2, lines 13 - 14:

Delete: "Except as provided in (c) of this section, when"

Insert: "When"

Page 2, line 23, delete "each document" and insert "documents"

Page 2, line 27:

Delete: "Except as provided in (c) of this section, when"

Insert: "When"

Page 3, line 5:

Delete: "each comment or objection"

Insert: "the comments and objections"

Page 3 - lines 10 - 13 technical

Page 3, line 7:

Delete: "comment or objection"

Insert: "comments or objections"

Page 3, line 14:

Delete: "new subsections"

Insert: "a new subsection"

Page 3, line 15, delete "10" and insert "15"

Page 3, line 17, delete "hold" and insert "promptly schedule"

Page 3, line 18 after "action." insert:

"The agency may extend the comment period if necessary to provide at least 14 days' notice of the public hearing."

Page 3, lines 19 - 22, delete all material.

Page 4, line 13, delete "and financial estimates"

Page 4, after line 14, insert:

"(5) a regulatory analysis, if required under AS 44.62.-
197;"

Renumber remaining paragraphs.

Page 5, lines 10 - 11, delete:

"in the case of a regulation subject to AS 44.62.205(a) and (b),"

Page 5, line 16, delete "submitted to" and insert "considered by"

Page 5, line 17, delete "for consideration"

Page 5, line 20, delete "and 44.62.205(c)"

HB 458: PETERSON MEMO REBUTTAL

In response to Art Peterson's memorandum, I will concentrate my counter arguments to his objections to: 1) the financial impact analysis, and, 2) the justification of need requirements. These two provisions, Section 2 and Section 4 of the Bill respectively, spark the most hyperbolic commentary from the representative of the Department of Law.

Section 2:

Section 2 requires preparation of "a financial estimate of the cost or savings that will be incurred by individuals and entities directly affected by the proposed action."

Mr. Peterson says, "Section 2 is a nightmare. It would be virtually impossible for an agency to comply with it." He does not believe it would be possible for an agency to formulate a reasonable estimate without incurring unreasonable expenses in terms of time and administrative fees.

As we all know, an estimate is a general calculation of size, value, etc. Agency preparation of estimates is not an "impossible" task. No regulation should be seriously considered before investigation into its impact on the people of the state. We're not running a government for the convenience of state agencies and to ignore the public. No responsible agency head I know of would deny that he or she

takes into account the effect of proposed regulations on the public, because the fact is that they do. Mr. Peterson gives the Executive Branch too little credit. Section 2 merely codifies what is usually done informally, and requires it to be publicly disclosed. The new requirement is that the impact be expressed in financial terms and disclosed to the public. If an agency's rationale for regulations is in error, better that the error be dealt with than persisted in at the expense of people affected.

Mr. Peterson complains that, "an agency cannot anticipate inefficient operations, intentional waste, and the infinite variety of situations that will cause one regulated individual to have to spend more than another." This is not the type of analysis involved in preparing an estimate of "the annual cost or savings that a representative individual or entity would incur in complying with the proposed regulation." Mr. Peterson is trying to make an extreme interpretation of Section 2 by saying it requires a degree of exactitude that it does not, in fact, require. (Old lawyer trick.)

Mr. Peterson goes on to voice concern about an agency's ability to discern "directly affected" entities. It is my belief that any executive agency which has authority to promulgate a regulation should know the territory, i.e., who they are regulating. If the agency doesn't know, then this bill will help them find out. Is that so bad? But as a

practical matter, a representative individual and/or entity who is impacted by a proposed regulation will in most cases be obvious to the promulgating agency.

The fisheries example used by Mr. Peterson is not a good case in point. Regulations relating to fishery openings are part of an overall area's management plan. The regulations are not promulgated by an agency per se, but by the Board of Fisheries, which is a Section 26 Board established by the Constitution. Additional regulating authority is delegated to the Commissioner. In such cases when the Commissioner changes an opening or closing date he or she does so by Emergency Order or under emergency regulation. The bill does not apply to emergency regulations or regulations promulgated by a Section 26 Board. (Emergency regs. are exempted by statute in 44.62.250 and Title 26 Boards are exempted by amendments presented today.)

In an attempt to deliver a rhetorical coup de'grace, Mr. Peterson points out that the legislature has imposed no requirement on itself to estimate the financial impact on the public of legislation we pass. Mr. Peterson ignores the deliberative essence of a legislative body. How many times, in committee and on the floor, do we debate impacts, financial and otherwise, of legislation under consideration? How often do we research data for our positions? He ignores the meaning of being elected officials. The public has recourse on

election day every two years to "annul" unfavorable legislators. There is no direct method for the public to strike down an unfavorable regulation.

Section 4:

Section 4. says "when a state agency files a notice of proposed action under AS 44.62.920, the agency shall make available to the public an initial justification of need for the proposed action."

Mr. Peterson bases his objection to Section 4. on "the large potential for disagreement about the accuracy of its contents," and the potential conflict involved in applying an existing regulation to future problems or situations.

Since when has it been state government policy to stifle informed disagreement from either the public or the private sector? It is precisely this type of dialogue which should occur before an agency regulation is adopted. An agency's objective should be to take into consideration as many perspectives on a given situation as possible before imposing its regulatory authority.

Retroactive Application of Regs:

As to the question of applying existing regulations to new problems, that situation exists now. HB 458 wouldn't change it. It deals with the process of promulgating new regulations, not interpretation and application of pre-existing regulations.

In closing, I will briefly walk through the amendments dated 3-10-85 which are before you today.

(AMENDMENTS)

Conclusion:

In many ways HB 458 puts added force behind procedures which are currently sanctioned but not always practiced by regulating agencies. Passage of the Bill before you would ensure consistency of practices within and among agencies. Indeed, the bill incorporates many of the provisions recommended in the 1981 Model State Administrative Procedure Act to which Mr. Peterson refers on pages 1,4,5,7,and 8 of his memo. Representative Pignalberi's bill is not any more onerous than the section of the Model Act dealing with regulation, a copy of which is attached to this testimony. One would assume the Model Act is designed for obtaining the highest standard of procedure for the fifty states. Representative Pignalberi would have no problems with adopting

the language set forward by the National Conference of Commissioners On Uniform State Laws in the Model Act if that would meet the Department of Law's standards.

The Attorney General does not argue with the intent and goal of HB 458. He simply argues that "we can't do it." My rebuttal has attempted to show that his premises for not being able to fulfill HB 458's goal are based on misinterpretation, and I'm afraid, institutional inertia. Where there's a will there is a way. The true premise of HB 458 is that this committee and this legislature have the will to make regulators account for the impact they have on people's lives.

STATE ADMINISTRATIVE PROCEDURE (1981) § 3-104

Administrative bulletin would not in fact provide those persons actual notice. Unlike the 1961 Revised Model Act, this section also requires the initial notice

of proposed rule adoption to indicate expressly the right of persons to demand an oral proceeding pursuant to Section 3-104.

3-104. [Public Participation]

- (a) For at least [30] days after publication of the notice of proposed rule adoption, an agency shall afford persons the opportunity to submit in writing, argument, data, and views on the proposed rule.
- (b)(1) An agency shall schedule an oral proceeding on a proposed rule if, within [20] days after the published notice of proposed rule adoption, a written request for an oral proceeding is submitted by [the administrative rules review committee,] [the administrative rules counsel,] a political subdivision, an agency, or [25] persons. At that proceeding, persons may present oral argument, data, and views on the proposed rule.
- (2) An oral proceeding on a proposed rule, if required, may not be held earlier than [20] days after notice of its location and time is published in the administrative bulletin.
- (3) The agency, a member of the agency, or another presiding officer designated by the agency, shall preside at a required oral proceeding on a proposed rule. If the agency does not preside, the presiding official shall prepare a memorandum for consideration by the agency summarizing the contents of presentations made at the oral proceeding. Oral proceedings must be open to the public and be recorded by stenographic or other means.
- (4) Each agency shall issue rules for the conduct of oral rule-making proceedings. Those rules may include provisions calculated to prevent undue attention in the oral proceedings.

Commissioners' Comment

Subsections (a) and (b)(1) are modified and extended versions of 1961 Revised Model Act, Section 3(a)(2). Significant changes include a specification of a number of days within which persons have a right to submit written comments; use of the terms "oral proceeding" and "oral argument" for the more ambiguous and troubling terms "hearing" and "hearing," see *U. S. v. Florida East Coast R. Co.*, 410 U.S. 224 (1973); and the addition of a legislative committee and the administrative counsel to those who may induce an oral proceeding. The terms "oral proceeding" and "oral argument" make it clear that there is no right under this statute to a trial-type hearing before an agency in the making of a rule. For an explanation of the unavailability of any requirement for trial-type hearings on most rules of general applicability, see Hamilton, *Procedure for the Adoption of Rules of General Applicability: The Need for Federal Innovation in Administrative Rule Making*, 60 Calif. L.Rev. (1972); 2 *Recommendations and*

Reports of the Administrative Conference of the U.S. 68 (1970-1972), Recommendation 72-5. See also Bonfield, "The Iowa Administrative Procedure Act: Background, Construction, Applicability, Public Access to Agency Law, the Rulemaking Process," 60 Iowa L. Rev. 731 at 852-856 (1975). As drafted, therefore, the statute only contemplates that in specified situations some sort of an "oral proceeding" must be made available in rule making, and that in most cases the proceeding will be legislative rather than adjudicative in form. Of course, these provisions do not preclude an agency from exercising its discretion to allow a legislative-type of oral proceeding on the adoption of a rule in situations where it is not required by this section; nor do they preclude an agency from allowing a trial-type proceeding on the desirability of adopting a rule if the agency chooses to do so. To the extent another statute expressly requires a particular class of rule making to be conducted pursuant to the adjudicative procedures provided in

§ 3-104 STATE ADMINISTRATIVE PROCEDURE (1981)

Article IV, Section 4-101(b) makes them applicable. See Comment to that section for additional discussion on this point.

If all of the suggestions for those who may trigger a required oral rule-making proceeding are enacted, it will obviously be very easy for persons who are upset about a proposed rule to invoke this requirement. But it seems unwise to require an oral proceeding in all cases of rule making. The costs imposed by such a universal requirement would seem to outweigh any potential benefits.

Subsection (b)(2) adds to the 1961 Revised Model Act provision a requirement that notice of the time and place of any oral proceeding be published a specified time before it is held. Note that an agency may substantially compress the period necessary for adoption of a rule by including in the original notice of proposed rule adoption an indication of the place and time of an oral argument-style proceeding thereon, rather than waiting for a request

that would make such a proceeding mandatory and then publishing advance notice of the proceeding's place and time.

Subsection (b)(3)-(4) adds to the 1961 Revised Model Act provision an explicit designation of the persons who may preside at oral rule-making proceedings; a requirement that a written report on those oral proceedings be prepared by the presiding officer if the agency did not preside; a requirement for the making of a record of required oral presentations; and a clear authorization for agencies to keep control over the oral proceedings by reasonable rules issued for that purpose. Nothing in the subsection requires the agency to transcribe the record, although any member of the public may do so at his or her own expense.

Like Section 3-101, this provision does not preclude an agency from seeking information from the public on a formally proposed rule by means that are in addition to those specified herein.

§ 3-105. [Regulatory Analysis]

(a) An agency shall issue a regulatory analysis of a proposed rule if, within [20] days after the published notice of proposed rule adoption, a written request for the analysis is filed in the office of the [secretary of state] by [the administrative rules review committee, the governor, a political subdivision, an agency, or [300] persons signing the request]. The [secretary of state] shall immediately forward to the agency a certified copy of the filed request.

(b) Except to the extent that the written request expressly waives one or more of the following, the regulatory analysis must contain:

- (1) a description of the classes of persons who probably will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule;
- (2) a description of the probable quantitative and qualitative impact of the proposed rule, economic or otherwise, upon affected classes of persons;
- (3) the probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenues;
- (4) a comparison of the probable costs and benefits of the proposed rule to the probable costs and benefits of inaction;
- (5) a determination of whether there are less costly methods or less intrusive methods for achieving the purpose of the proposed rule; and
- (6) a description of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule.

(c) Each regulatory analysis must include quantification of the data to the extent practicable and must take account of both short-term and long-term consequences.

(d) A concise summary of the regulatory analysis must be published in the [administrative bulletin] at least [10] days before the earliest of:

- (1) the end of the period during which persons may make written submissions on the proposed rule;
- (2) the end of the period during which an oral proceeding may be requested; or
- (3) the date of any required oral proceeding on the proposed rule.

(e) The published summary of the regulatory analysis must also indicate where persons may obtain copies of the full text of the regulatory analysis and where, when, and how persons may present their views on the proposed rule and demand an oral proceeding thereon if one is not already provided.

(f) If the agency has made a good faith effort to comply with the requirements of subsections (a) through (e), the rule may not be invalidated on the ground that the contents of the regulatory analysis are insufficient or inaccurate.

Commissioners' Comment

This section is a very substantially modified and extended Florida Act, Section 120.54(2)(a). See also Iowa Act, Section 17A.4(1)(c). The preparation of such a regulatory analysis is clearly very burdensome. It is also hazardous because of the large potential for disagreement about the accuracy of its contents. Furthermore, the right to require the issuance of such a regulatory analysis in particular instances of rule making could be subject to great abuse. In light of this, states may want to require its issuance only upon demand by directly elected officials with general responsibility for state government. The governor and/or a legislative committee specially charged with administrative agency oversight are the most obvious examples of politically responsible state officials of this type. In subsection (a) the directly politically responsible state officials entitled to make the requirement operative in a given case of rule making are bracketed so that each state may determine independently how it wants to solve that problem. Some states may also wish to permit members of the public and/or other agencies or political subdivisions to invoke this requirement even though there is a danger that such a power in the hands of those persons might be abused. For these states, other bracketed alternatives are included. In states desiring to permit members of the public to invoke this requirement, consideration might also be given to authorizing a waiver of the requirement in particular cases by the administrative rules review committee or the governor once it has been invoked by members of the public. A waiver device of this kind might act as an effective check on invocation of the regula-

tory analysis requirement by members of the public seeking only to delay issuance of a clearly justifiable rule or to harass the issuing agency.

The regulatory analysis is, however, an important device with which to assure sound agency consideration of the desirability of a rule. It is also a useful device to help assure public support for, or opposition to, a rule, to the extent either is warranted, based upon a fully public description of its potential costs and benefits.

The regulatory analysis will not be helpful if, by the time it is issued, the period for public participation on the rule has already passed. To assure full utility for the analysis, therefore, subsection (d) establishes a minimum period between publication of a concise summary of the analysis and the time when the public may make written comments on the rule, demand an oral proceeding thereon, or participate in such an oral proceeding if one is held on that rule. If the demand for the regulatory analysis comes at the end of the 20 day period provided for in subsection (a), this provision will have the effect of extending the time when the conditions specified in subsections (d) (1)-(3) may occur according to other provisions of this Act. Note, however, that an agency desiring to avoid delays in a rule-making proceeding because of the requirements of subsection (d) may voluntarily issue such an analysis at the time it publishes the notice of proposed rule adoption and include the summary thereof as part of the original notice, rather than waiting for a subsequent written request for such an analysis.

Obviously, predictions of the type required by this section cannot be executed with any guaranteed precision.

As a result, subsection (f) generally removes the sufficiency and accuracy of the contents of such a required regulatory analysis from the judicial review process relying, instead, on the political muscle of the administrative rules review committee and the governor to assure adequate compliance with this requirement when either of them makes it applicable to the proceeding in question. If judicial review of the adequacy of the contents of the regulatory analysis were permitted as a basis upon which to attack the validity of a rule, it could be used as a means of harassing agencies and unduly delaying their rule-making efforts. But note that if the agency fails to make a "good faith" effort to comply with the requirements of subsections (a)-(c), or fails to live up to the requirements regarding the analysis imposed by

subsections (d)-(e), that may grounds for judicial invalidation of the rule. Since subsection (f) provides a "good faith effort to comply with the requirements of subsections (a)-(c)" entirely precludes invalidation of the rule "on the ground that the contents of the regulatory analysis are insufficient or inaccurate." "Good faith" must be ascertained for its purpose without any judicial evaluation of the actual sufficiency or accuracy of the contents of that regulatory analysis. To ascertain "good faith" for its purpose, therefore, a court should determine if the analysis was actually issued, and if on its face it actually dresses in some manner all of the points specified in subsections (b)-(c). If so, the sufficiency or accuracy of contents are not subject to judicial view.

§ 3-105. [Time and Manner of Rule Adoption]

(a) An agency may not adopt a rule until the period for making written submissions and oral presentations has expired.

(b) Within [180] days after the later of (1) the publication of the notice of proposed rule adoption, or (2) the end of oral proceedings thereon, an agency shall adopt a rule pursuant to the rule-making proceeding or terminate the proceeding by publication of a notice to that effect in the [administrative bulletin].

(c) Before the adoption of a rule, an agency shall consider the written submissions, oral submissions or any memorandum summarizing oral submissions, and any regulatory analysis, provided for by this Chapter.

(d) Within the scope of its delegated authority, an agency may use its experience, technical competence, specialized knowledge, and judgment in adoption of a rule.

Commissioners' Comment

Subsection (a) makes explicit that which provisions of the 1961 Revised Model Act and other provisions of this Act only imply.

Subsection (b) is a modified form of Iowa Act, Section 17A.4(1)(b). On occasion, an agency has published notice of proposed adoption of a rule, encountered a furor which prevented further action at that time on the proposed rule, waited a year or two until people forgot about the proposed rule because they assumed it was dead, and then suddenly adopted the proposed rule. This subsection assures that an agency may not use undue delay between publication of a notice of proposed rule adoption and actual adoption of a rule pursuant thereto as a

means of defusing or circumventing widespread public opposition to its action. See Bonfield, "The Iowa Administrative Procedure Act: Background, Construction, Applicability, Public Access to Agency Law, the Rulemaking Process," 60 Iowa L.Rev. 731 at 858 (1975).

Subsection (c) is a modified form of 1961 Revised Model Act, Sec 3(a)(2), dropping the words "fully" after the word "consider" on the ground that they are redundant.

Subsection (d) is a modified form of 1961 Revised Model Act, Section 10 which was applicable only to an agency's findings of fact in formal adjudicatory proceedings. There is no reason that the same explicit deference

DEPARTMENT OF LAW

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OFFICE OF THE ATTORNEY GENERAL

April 3, 1986

Honorable Marco Pignalberi
Alaska House of Representatives
P. O. Box V
Juneau, Alaska 99811

Re: CSSSHB 458(SA) -- adoption
of regulations
Our file: 66-3-86-0343

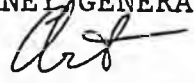
Dear Marco:

It was my understanding, from the House State Affairs Committee hearing on March 21, that, during the hearing, you had agreed to a "good faith" clause for the justifications of need requirement (sec. 4 of the bill) like the one that your amendments of that date had provided for the regulatory analysis requirement (sec. 2 of the bill). See proposed AS 44.62.197(f), at page 2 of the committee substitute. Fearing that that additional amendment might have gotten lost, I reminded the committee staff person of that point a few days after the hearing and discussed it with you in the hallway a few days after that. You said that you would check on it to be sure that it was in the committee substitute.

Despite everybody's efforts and good intentions, it appears that that provision indeed got lost. CSSSHB 458(SA), reported out of committee April 1, does not include that "good faith" protection for the justifications of need. (Including it would, of course, require deletion or amendment of the proposed AS 44.62.300(4) [page 6 of the committee substitute].) Do you know what happened?

Yours truly,

HAROLD M. BROWN
ATTORNEY GENERAL

By: 
Arthur H. Peterson
Assistant Attorney General

AHP:md

Honorable Marco Pignalberi
Alaska House of Representatives

April 3, 1986
Page 2

cc: Hon. Katie Hurley, Chair
House State Affairs Committee
Alaska State Legislature

Hon. M. Mike Miller, Chair
House Judiciary Committee
Alaska State Legislature

STATE OF ALASKA 1986 LEGISLATIVE SESSION FISCAL NOTE

Revision Date : _____

REQUEST

Bill/Resolution No. : CS SB No. 8
 Title : An Act relating to safety curriculum in schools.

Sponsor : HESS
 Requestor : _____
 Date of Request : 4/3/86

FISCAL DETAIL

Agency Affected : Health & Social Services
 BRU : Social Services

Components : Social Services

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		-0-	-0-	-0-	-0-	-0-

CAPITAL		-0-	-0-	-0-	-0-	-0-
----------------	--	-----	-----	-----	-----	-----

REVENUE		-0-	-0-	-0-	-0-	-0-
----------------	--	-----	-----	-----	-----	-----

FUNDING : (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL		-0-	-0-	-0-	-0-	-0-

POSITIONS :

FULL-TIME		-0-	-0-	-0-	-0-	-0-
PART-TIME		-0-	-0-	-0-	-0-	-0-
TEMPORARY		-0-	-0-	-0-	-0-	-0-

ANALYSIS : Attach a separate page if necessary

N/A

Prepared by : Michael L. Price *Michael L. Price* Phone : 465-3170
 Division : Family & Youth Services Date : 4/3/86

Approved by Commissioner : Connie J. Jipka *Connie Jipka for* Date : 4/3/86
 Agency : Health & Social Services

Distribution (by Agency preparing fiscal note) :

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

**STATE OF ALASKA 1986 LEGISLATIVE SESSION
FISCAL NOTE**

Revision Date : March 27, 1986

REQUEST

Bill/Resolution No. : SSHB 458
Title : ...adoption of regulations.

Sponsor : Pignalberi, et al
Requestor : House State Affairs
Date of Request : March 27, 1986

FISCAL DETAIL

Agency Affected : Department of Education
BRU : Executive Administration

Components : Commissioner's Office

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES		33.6	33.6	33.6	33.6	33.6
TRAVEL						
CONTRACTUAL		5.0	5.0	5.0	5.0	5.0
SUPPLIES		5.0	5.0	5.0	5.0	5.0
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		43.6	43.6	43.6	43.6	43.6

CAPITAL						
---------	--	--	--	--	--	--

REVENUE						
---------	--	--	--	--	--	--

FUNDING : (Thousands of Dollars)

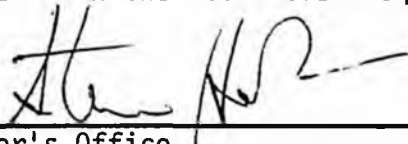
GENERAL FUND		43.6	43.6	43.6	43.6	43.6
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS :

FULL-TIME		1	1	1	1	1
PART-TIME						
TEMPORARY						

ANALYSIS : Attach a separate page if necessary

Costs are associated with the activities required by Secs. 2 and 4.

Prepared by : Steve Hole 
Division : Commissioner's Office

Phone : 465-2800
Date : March 27, 1986

Approved by Commissioner : Marshall L. Lind
Agency : Department of Education

Date : March 27, 1986

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

Proposed amendments to SSHB 458

Page 1, Line 17

AS 44.62.195 is amended to read:

(b) The state agency shall prepare an [financial] estimate of the annual cost or savings that will be incurred by a typical individual [s and entities] or entity directly affected by the proposed action. The estimate shall include the aggregate annual cost or savings that would be incurred by [a] representative individuals [or entity would incur] and entities in complying with the proposed regulation [and the total annual cost or savings of all individuals and entities directly affected].

(c) This section does not apply to regulations proposed by a board that is the head of a principal department or agency in accordance with Article III, Section 26 of the Constitution of the State of Alaska.

Page 2, Line 13

Sec. 44.62.205. JUSTIFICATIONS OF NEED is amended to read:

(a) [Except as provided in (c) of this section, when] When a state agency files a notice of proposed action under AS 44.62.190, the agency shall make available to the public an initial justification of need for the proposed action. The initial justification shall

(1) describe the problem, condition, or circumstance the regulation is intended to address;

(2) specify the purpose of the regulation and the factual basis for the agency's determination that the regulation is reasonably necessary to carry out the purpose;

(3) identify [each] documents upon which the agency is relying in proposing the action; and

(4) describe practical and reasonable alternatives to the proposed action.

(b) [Except as provided in (c) of this section, when] When a state agency submits a regulation or order of repeal for filing with the lieutenant governor under AS 44.62.040, the agency shall make available to the public a final justification of need concerning the regulation or order of repeal. the final justification shall include

(1) the complete text of a regulation that is adopted or amended and a list of regulations repealed;

(2) a summary of [each] the comment s and [or] objections received and an explanation of changes made to the proposed regulation in response to the information or the reasons for rejecting the comment s or objections; and

(3) the reasons for rejecting proposed alternatives.

(c) [An agency is not required to prepare an initial or final justification of need for a regulation that interprets, implements, or makes clear a law if the agency has not previously adopted a regulation under the law.] This section does not apply to regulations proposed by a board that is the head of a principal department or agency in accordance with Article III, Section 26 of the Constitution of the State of Alaska.

Page 3, Line 14

Sec. 5. AS 44.62.210(c) is amended to read:

(c) If at least [10] 15 interested persons submit a written request for a public hearing at least 10 days before the end of the initial comment period, a state agency shall promptly schedule [hold] a public hearing on the proposed action and shall have authority to extend the comment period so that 14 days notice shall be given for the required public hearing .

Page 5, Line 10

Sec. 44.62.300 (3) is amended to read:

(3) [in the case of a regulation subject to AS 44.62.205(a) and (b),] for failure to comply with AS 44.62.205, or if the justification of need fails to present sufficient facts to establish by a preponderance of the evidence the need for the regulation.

Page 5, Line 15

Sec. 9, AS 44.62.640(a)(5) is amended to read:

(5) "document" means a written or electronic communication of any kind, except a telephone communication, [submitted to an agency for consideration] considered by the agency during the adoption, amendment, or repeal of a regulation.

Page 5, Line 20

delete "and 44.62.205(c)"



Alaska State Legislature

House

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

February 10, 1986

Representative Katie Hurley, Chairwoman
House State Affairs Committee
Capitol, Rm 102
P.O. Box V
Juneau, AK 99811

RE: HB458 (SSHB458)

Dear Katie:

I am requesting that you calendar the above-referenced bill for hearing before your committee.

Attached is a copy of SSHB458, an act relating to adoption of regulations, along with a copy of the sectional analysis of this bill. The sponsor substitute is a more comprehensive bill than the original. It relates to the procedures required for adoption of regulations. Initially, my original bill (also attached for your reference) required that justification of need be given in the adoption process so that people would have a better understanding of why the proposed regulation was needed.

After receiving input from others, we have developed a revised bill which not only requires justification of need, but also includes the following:

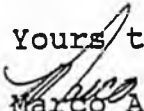
1. Puts time limits on adoption of regulations,
2. Requires a financial estimate of cost or savings that will be incurred by those directly affected,
3. Requires a hearing if at least 10 persons make a request for one,
4. Requires that records be kept of all written or electronic testimony that is received.

I feel this is a good bill since, all too often, regulations are passed without the people understanding why or without the people being assured that their testimony has even been seen or considered.

I would appreciate your consideration in hearing this.

Thank you.

Yours truly,


Marco A. Pignalberi
Representative
MAP:mep
enc.

STATE OF ALASKA
THE LEGISLATURE

POUCH Y - STATE CAPITOL
JUNEAU ALASKA 99811
907-465-3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

January 31, 1986

SUBJECT: Sectional analysis of SSHB 458
TO: Representative Marco Pignalberi
FROM: Teresa B. Cramer *TBC*
Legislative Counsel

You have requested a sectional analysis of SSHB 458. The sponsor substitute as drafted contains a number of changes from the information provided in your work request. Please let me know if the draft needs to be rewritten.

Section 1 amends AS 44.62.190, which requires publication of notices of proposed actions in a variety of forms, to prohibit an agency from adopting a regulation if more than one year has elapsed since the first publication of the notice.

Section 2 adds a new subsection to AS 44.62.195, which requires that agencies prepare fiscal notes on regulations, to also require financial estimates of the impact of the regulation on individuals and entities.

Section 3 amends AS 44.62.200, which requires certain information to be included in the notices of proposed action, to also require summaries of the initial statement of reasons (provided for in section 4 of the draft) and financial estimates.

Section 4 requires an agency prepare an initial justification of need when it files a notice of proposed action for a regulation and a final justification of need when it submits a regulation to the lieutenant governor for filing. Subsection (c) limits the requirement for justifications by exempting regulations on laws for which the agency has not previously adopted a regulation.

Section 5 adds new subsections to AS 44.62.210, which provides for public hearings on regulation adoption. Subsection (c) requires an agency to hold a public hearing if

one is requested at least 10 days before the end of the initial comment period by at least 10 persons. Subsection (d) prohibits an agency from adding documents to the record of a proceeding after the end of the public comment period unless an opportunity for further comment is provided.

Section 6 requires an agency to explain its reasons for denying a petition for a regulation.

Section 7 requires agencies to maintain complete files on regulation-making proceedings and to also maintain a log of the items that are part of the file. Subsection (c) provides that the file is a public record. As such, its contents would be admissible in proceedings to the extent permitted by rules of evidence applicable to the proceeding.

Section 8 permits a court to invalidate a regulation if the agency has not prepared a justification of need when required or if the justification fails to present sufficient facts. It does not distinguish between initial and final justifications of need.

Section 9 defines "document."

Section 10 addresses when the sections of the bill apply to regulations that have not been submitted to the lieutenant governor for filing. The sections that apply to pending proceedings are

AS 44.62.190, requiring republication of a notice of proposed action after one year

AS 44.62.205(b) and (c), requiring an agency to prepare a final statement of reasons when a regulation is submitted for filing

AS 44.62.210(c) and (d), requiring public hearings on request and limiting addition of documents to the record

AS 44.62.640(a), defining "document"

Sec. 11 precludes application of sections of the bill to regulations for which a notice of proposed action has been published before July 1, 1986. Those sections are

Representative Pignalberi
Page 3
January 31, 1986

AS 44.62.195(b), requiring the agency to prepare a financial estimate

AS 44.62.200(a) requiring publication of the financial estimate and the initial statement of reasons

AS 44.62.205(a) requiring an agency to prepare an initial statement of reasons

AS 44.62.275, requiring an agency to maintain a file of the regulation proceedings

AS 44.62.300, concerning court review

Section 12 makes the Act effective July 1, 1986.

If I may be of further assistance, please advise.

TC:mkr
M2:118

STATE OF ALASKA 1986 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: 2/25/86

<p>REQUEST</p> <p>Bill/Resolution No.: <u>SSHB 458</u></p> <p>Title: <u>An act relating to the adoption of regulations; and providing for an effective date.</u></p> <p>Sponsor: <u>Pignalberi, Cato, Marrou & Shultz</u></p> <p>Requestor: _____</p> <p>Date of Request: _____</p>	<p>FISCAL DETAIL</p> <p>Agency Affected: <u>Department of Administration</u></p> <p>BRU: <u>Administrative Services</u></p> <p>Components: _____</p>
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EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
OPERATING						
PERSONAL SERVICES	0	7.4	7.6	7.8	8.0	8.2
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	3.1	3.2	3.3	3.4	3.5
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	10.5	10.8	11.1	11.4	11.7
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	10.5	10.8	11.1	11.4	11.7
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	10.5	10.8	11.1	11.4	11.7

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	1	1	1	1	1
TEMPORARY	0	0	0	0	0	0

ANALYSIS: Attach a separate page if necessary

Attached

Prepared By: Gary M. Bader *Gary M. Bader* Phone: 465-2277

Division: Administrative Services Date: February 25, 1986

Approved by Commissioner: Eleanor Andrews *Eleanor Andrews* Date: _____

Agency: Department of Administration

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

CONTINUATION of FISCAL NOTE ANALYSIS
For Sponsor Substitute for House Bill 458

ANALYSIS:

A. Assumptions

1. Enactment of Sponsor Substitute for House Bill No. 458 would amend AS 44.62 as it pertains to regulations. In addition to current regulatory procedures, this bill would require the completion of new tasks. The estimates which follow are based on the existence of fourteen chapters of regulations of the Department of Administration in the Alaska Administrative Code and the assumptions of at least two changes per year per chapter and five public hearings.

2. Listing of Activities

<u>Section</u>	<u>Task Description</u>	<u>Regular Change</u>	<u>Required Hearing</u>
44.62.190(d)	Age proposed action	.25 hrs	
44.62.190	If greater than 1 year, republish in accordance with 44.62.190(a)	1.0 hrs	
44.62.195(b)	Prepare financial estimate of those affected	3.0 hrs	
44.62.200(a)	Prepare summary of initial justification of need	2.0 hrs	
44.62.205	Prepare final justification of need	3.0 hrs	
44.62.210(c)	Public Hearing		4.0 hrs
44.62.230	Written reason of denial	.5 hrs	
44.62.275(a)	Maintain file of proposed actions	5.0 hrs	
44.62.275(b)	Log of filed items	1.0 hrs	
44.62.300	Court review as specified by AS 44.62.205		2.0 hrs
		<u>15.75 hrs</u>	<u>6.0 hrs</u>

3. Inflation is estimated at three percent per year.

B. Staff Requirements

1. Each regulation change is estimated to require 15.75 hours per year. If each chapter of the Department of Administration changes two regulations

which do not require a public hearing, $2 \times 14 \times 15.75 = 441.0$ hours per year of additional processing are required by House Bill 458. Pending legislation provides the basis for the assumption that at least five public hearings can be expected regarding regulation changes by the Alaska Public Offices Commission and the Division of General Services & Supply. A proposed regulation requiring a public hearing requires an additional six hours of additional tasks, as required by this Bill. Five of these twenty-eight regulation changes will thus require $5 \times 6 = 30$ hours.

2. $441.0 + 30 = 471.0$ emp. hours \div 47 weeks = 10.0 emp hrs/wk.

COMPUTATION APPENDAGE of FISCAL NOTE ANALYSIS
FOR SSB 458

1. Additional Staff Requirements Analysis

a. General Government Unit (GGU)

Hours per Year	=	1,950 hours per year
Annual Leave	=	(75)
Five Days Sick Leave	=	(37.5)
Holidays (ten days)	=	<u>(75)</u>
Employee Annual Hours Worked	=	1,762.5 hours per year

1,762.5 hours per year ÷ 37.5 hours per week = 47 weeks per year

b. Staff--one part-time Administrative Assistant I, Range 12

\$12.75 per hour X 10 hours per week X 52 weeks	=	\$6,630.00
Benefits for less than 15 hours per week: 11.16%	=	<u>\$ 739.91</u>

TOTAL: \$7,369.91

2. Other Costs Analysis

Contractual Total: \$3,094

Copier per Duplicating--\$294

Assume 28 regulations to be published at two pages each to meet criteria as established by AS 44.62.200, mailed to 25 interested/affected parties in addition to the Legislature as required by law (AS 44.62.190)

28 regulations X 2 pages X 150 parties X \$.035 = \$294

Advertising--\$2,800

Current charges for the publishing of advertisements in Fairbanks, Anchorage, and Juneau average \$75 per day for a 2" X 2" advertisement. The size of the advertisement currently required to contain the necessary information averages 2" X 6" and costs an average of \$225. The required size would increase due to the required additional information (AS 44.62.190 and AS 44.62.200) and an average regulation advertisement would increase to 2" X 10" at an average cost of \$325.

28 regulations X (\$325 increased size - \$225 current size) = \$2,800

Position Title Administrative Assistant I			No. of Positions 1	Range/Step 12A	Flag Unit G	Gov.	Approv.	Disapp.
Time Status Part-time	Staff Months 3.2	RP Number	Location Juneau		Election District 4	Leg.		
Justification								
Duties would include, but not be limited to:								
<ul style="list-style-type: none"> a) maintenance of file of proposed action; b) log of filed items; c) preparation of financial estimate; d) preparation of initial justification of need; e) preparation of final justification of need; f) preparation of reason of denials; and g) publishing in accordance with AS 44.62.190. 								
Type of Expenditure			Amount					
1	2	3						
Salary	6,630							
Benefits	739							
Premium Pay	0							
Other	0							
Total Personal Services		7,369						
Travel		0						
Contractual		3,094						
Commodities		0						
Equipment		0						
Other		0						
Total Cost		10,463						
Receipt Code			Funding Source					
			Federal Receipts 1002					
			G. F. Match 1003					
			General Funds 1001		10,463			
			I-A Receipts 1005					
			Program Receipts 1028					
			CIP Receipts 1061					
			Other					
For B&M Use Only Key Number _____								

14/101/0225-01/1

**Request For
New Position**

Agency Department of Administration
 BRU Administrative Services
 Component _____

Page _____ of _____
 Revised Date _____

FY 87

STATE OF ALASKA 1986 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date : 2-27-86

REQUEST

Bill/Resolution No. : SSHB 458
 Title : "An Act relating to the adoption of regulations; and providing for an effective date."
 Sponsor : Repr. Pignalberi
 Requestor : Repr. Pignalberi
 Date of Request : February 25, 1986

FISCAL DETAIL

Agency Affected : Department of Law
 BRU : Legal Services
 Components : Legal Services Operation

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		-0-	-0-	-0-	-0-	-0-

CAPITAL						
---------	--	--	--	--	--	--

REVENUE						
---------	--	--	--	--	--	--

FUNDING : (Thousands of Dollars)

GENERAL FUND		-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS :

FULL-TIME		-0-	-0-	-0-	-0-	-0-
PART-TIME						
TEMPORARY						

ANALYSIS : Attach a separate page if necessary

Please see attached analysis.

Prepared by : Richard I. Pegues, Director Phone : 465-3672
 Division : Administrative Services Division Date : 2-27-86
 Approved by Commissioner : Harold M. Brown, Attorney General Date : 2-27-86
 Agency : Department of Law

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

CONTINUATION of FISCAL NOTE ANALYSIS

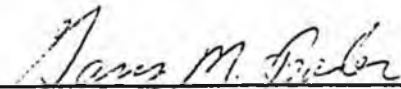
For Bill/Resolution No. SSHB 458

Although the sponsor substitute adds new sections that will have substantial fiscal impact on other departments, we still cannot say that it will have a fiscal impact on the Department of Law, because the department adopts few regulations of its own. The department does, however, review all regulations prior to their adoption, and it sometimes assists other departments in drafting their regulations. To the extent that we are requested to advise other agencies about the sufficiency of their efforts to conform to the provisions in this bill, we can expect innumerable requests for advice. These requests will probably result in our regulations and legislative drafting staff becoming more swamped than they already are.

Because we cannot accurately predict the additional workload that will occur if this bill becomes law, we are not requesting fiscal note funds at this time. Such a request may become necessary in the future, and the potential for this additional cost should be noted while the bill is being considered.

Position Paper
SSHB 458

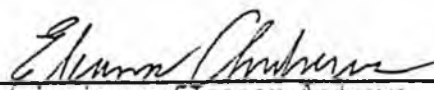
This bill makes myriad changes to the establishment, abolition, or modification of regulations under the Administrative Procedures Act. The department cannot support the bill in its present form because it provides too many stumbling blocks for the efficient operation of State government. One primary objection to the bill is the matter of AS 44.62.195(b), which requires that each agency prepare a financial impact statement on all individuals and entities who will be affected by the regulations. Although the above citation allows the maker of regulations to show a typical example of the financial impact on a single individual or entity, it requires that an estimate be made with regard to the total impact on all individuals and entities. These estimates would be unreliable. It should be kept in mind that there is already a requirement that a fiscal note be prepared regarding the impact on State. One of the purposes of public input on regulations is to ascertain the financial impact on those affected. This bill requires that such an assessment be made prior to public notice on public input. Administrative regulations are similar in nature to statutes in the manner that they are passed. Both statutes and regulations require a period of public testimony at which individuals or entities have an opportunity to advise the body in question concerning the financial impact as well as other considerations that the proposed statutes/regulations will have on the individual or entity represented. I am unaware of any mandatory statement of financial impact on the public prior to passage of legislation. The Executive Branch does not require such statements prior to the amendment or abolition of regulations for the same reason. The department has no aversion to publishing or otherwise making available to the public a justification of need for the regulations as long as that justification does not require a financial impact statement.



Gary Bader, Director
Division of Administrative Services
Department of Administration

2/25/81

Date



Commissioner Eleanor Andrews
Department of Administration

2/25/86

Date

ROBERT M. ARVIDSON
Box 258
Cordova, Alaska 99574
Jan. 19, 1986

House State Affairs Committee ✓
House Judiciary Committee
Pouch ✓
Juneau, AK. 99811

Re: HB 458

Dear Committee Members,

This is a letter of support for HB 458 pertaining to agency justification of need when proposing regulations.

I am enclosing some correspondence that indicates the psychology board did not take "need" into account when they recently proposed new regulations.

The only question that I have at this time concerns the word "law" in Sec.

44.62.05(b) on page 2, lines 6-9. Does "law" refer to a complete chapter such as Chapter 86 or also to sections, sub-sections and paragraphs?

Sincerely yours,

Robert M. Arvidson
Robert M. Arvidson

Enc: AS stated
cc: Rep. Cato

-over-

ROBERT M. ARVIDSON
Box 253
Cordova, Alaska 99574

Jan 17, 1986

Sen. Bettye Fahrenkamp
Chair, Senate HESS
Pouch 7
Juneau, Alaska 99811

Re: Senate Bill 251 and Public opposition to proposed psychology regulations.

Dear Senator Fahrenkamp,

I have recently reviewed the public response to regulations proposed by the psychology board that would restrict exemptions to the psychology practice act. These proposed regulations were public noticed Oct. 29, 1985. The public, including licensed psychologists, educators, state officials and concerned ~~concerned~~ citizens, is strongly opposed to the proposed regulations.

My count indicates that 61 (sixty one) letters express opposition to the proposal. Many of these letters have multiple signatures and represent organizations. Only 4 (four) letters support the psychology boards' attempt to require licensure or supervision of currently exempt agency employees (12AAC60.910 referenced to AS CR.26.150).

I believe that many of these letters can be viewed as support for SB 251, either indirectly or directly. For example, Dr. Kenneth Green, a licensed psychologist and Asst. Professor of Psychology at the University of Alaska -Fairbanks states, "Alaska has too many mental health problems to unduly restrict the practice of psychology. I think that the present Alaska Psychology Regulations are unduly restrictive and elitist, and serve to penalize the consumer by making therapy and counseling too expensive."

I am enclosing a sample of 15 of the letters (copies) opposed to the restrictive regulations. I feel that these letters support the continued delivery and development of maximum mental ~~health~~ ^{health} services in the state.

I am also enclosing a proportional sample of the letters supporting the psychology board's restrictive proposal. This sample consists of a copy of one letter.

Looking to the future, I am sending a copy of the above information to the House HESS Committee and I am asking that they keep it on file for reference to SB 251.

Best wishes for the session.

Sincerely yours,



Robert M. Arvidson

Encs: As stated

cc: Senator Kerttula
House HESS Committee

HESS

BILL SHEFFIELD, GOVERNOR

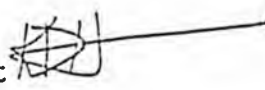
**DEPARTMENT OF COMMERCE &
ECONOMIC DEVELOPMENT**

POUCH D
JUNEAU, ALASKA 99811
PHONE: (907) 465-2534

DIVISION OF OCCUPATIONAL LICENSING

DATE: December 17, 1985

TO: Board of Psychologist and Psychological
Associate Examiners

FROM: Kevin D. Henderson 
Regulations Specialist

RE: Proposed regulations 12 AAC 60.910

I have enclosed a copy of all comments received to date concerning the proposed adoption of 12 AAC 60.910, PERSONS NOT EXEMPT FROM LICENSURE. Officially, the period for public comment ended December 13, however, because of the great interest in this proposal, I have notified several persons that I will be accepting comments through March 3, 1986, three days prior to your next meeting. The written comment received following this letter will be periodically mailed to each of you. Because of the overwhelmingly negative reaction to this proposal, the board should take no further action to adopt it until the board meets to discuss it again. Any subsequent proposal of the board should be renoticed and include a public hearing.

Please read all of these comments carefully before your next meeting. Many valid concerns and unanswered questions are addressed. It appears that the board's authority to promulgate such a regulation is still questionable in light of AS 44.62.030, which states, "No regulation adopted is valid or effective unless consistent with the statute and reasonably necessary to carry out the purpose of the statute" (emphasis mine). In the opinion of school psychologists and vocational rehabilitation counselors, licensing or supervision by a licensed clinical psychologist is completely unnecessary and, considering those as specialized fields, even inappropriate. If it was the board's intent that these professions continue to be exempt from licensure or supervision, then the proposed regulation is unclear and will need to be rewritten. The board needs to define work "of a psychological nature."

Of even greater concern is the fiscal impact such a regulation would have on public and private agencies alike. Education and social service agencies are commonly underfunded and the burden of adding a licensed psychologist to the staff must be adequately considered by the board. This proposal would have to be "reasonably necessary" despite the increased cost to the State and the public. I believe the burden of proof is on the board in this regard.

December 17, 1985

Finally, several sources have indicated that there is already a shortage of licensed psychologists available in this State. What effect would this regulation have on the available counseling provided to low income citizens of the State, especially those who would have to pay higher fees or who would find themselves without any service at all because the appropriate supervision of counselors or teachers was not available?

Considering the controversial nature of this proposal, a teleconference public hearing is warranted. I recommend, however, that a hearing be held only after the board has been able to meet together to evaluate the public comments received so far and to address the unanswered questions they raise. Better still would be to drop this proposal and continue to seek legislative change to the statute. While that has been unsuccessful so far, it is still the only way the board will clearly have the specific authority to require the licensure and supervision you feel necessary to protect the health and welfare of those seeking psychological help. The ramification of this proposal, however, appears more complex and far reaching than this simple regulation has adequately addressed.

Please contact me if you have further concerns regarding this or other proposed regulations.

KDH/dg13902D
121785c

cc: Loren Lounsbury, Commissioner
Richard Long, Acting Director
Senator Jay Kerttula
Senator Bettye Fahrenkamp
Representative Virginia Collins
Representative Max Gruenberg
Kay E.M. Gouwens, Assistant Attorney General
All interested parties



Resource Development Council

for Alaska, Inc.

807 "G" Street, Suite 200, Anchorage, Alaska 99501-3440
Box 100516, Anchorage, Alaska 99510-0516 - 907/276-0700

EXECUTIVE DIRECTOR
Paula P. Easley

February 14, 1986

FEB 25 1986

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Representative Katie Hurley
Alaska State House of Representatives
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Juneau, AK 99811

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Jed Holley, Staff Consultant

Dear Katie:

The House State Affairs Committee is the first committee referral for a piece of legislation the Resource Development Council strongly supports, SSHB 458.

The goal of this legislation is to force administrative agencies to fully disclose the impacts of proposed regulations to the public. This bill will generate better public input for agencies proposing, amending or deleting regulations.

The Resource Development Council has consistently supported legislation which improves the regulatory process. One obvious element of any such program must include a positive and informative process for the adoption of new or changed regulations. SSHB 458 speaks directly to this issue.

During the last six months a group within RDC has been working on language we think would improve the Administrative Procedures Act. Following are the significant points of our proposal included in SSHB 458.

- 1) Estimates of the costs or savings which will be incurred by private persons and entities directly affected as a result of the regulatory change will be included in the public record. We want to shed light on the monetary impacts that seemingly "harmless" regulations have on the private sector. With this cost/benefit information, the merits of a regulatory change can be better evaluated.
- 2) An agency must hold a public hearing on a regulatory change if a hearing is specifically requested by at least ten individuals. This will mandate broader public involvement in regulatory issues where demonstrated concern exists.
- 3) Agencies must adopt proposed regulations within one year. At present, an agency can promulgate regulations, withdraw them, and then adopt them years later without notice. We want to limit the time between initial promulgation and adoption to one year. After a year, proposed regulations must be resubmitted for public review.

EX-OFFICIO MEMBERS
Senator Ted Stevens
Senator Frank Murkowski
Congressman Don Young
Governor Bill Sheffield

Representative Katie Hurley
February 14, 1985
page 2

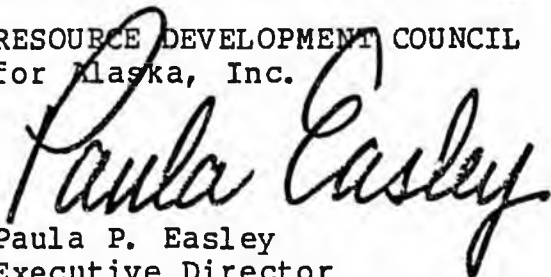
- 4) If an agency chooses to deny a petition requesting a regulatory change it must defend its position with a statement of reasons for the denial.
- 5) Every agency must keep a complete record of all public comment on regulatory changes. This record will be available to the public.
- 6) An agency promulgating a proposed regulatory change must prepare a statement of the justification of need. This statement must include a description of the problem the regulation addresses, the purpose of the regulation, identification of the support material on which the regulation relies and a description of potential alternatives.
- 7) Any agency must prepare a final statement of justification of need concerning adopted regulations which would include the complete text of the regulation, a summary of each comment and objection and a defense of the adopted regulation against the proposed objections or amendments.

We are basically attempting to change the Administrative Procedures Act to insure that regulatory changes are well thought out, necessary and defensible. We feel this process needs to take place with as much public oversight as is reasonable. Our goal is not necessarily to see fewer regulations generated--although that may be the impact; we are interested in seeing better regulations.

The Resource Development Council would appreciate an opportunity to present testimony on this bill to a hearing of the House State Affairs Committee as soon as possible. A timely hearing before your committee is obviously essential to the success of the ideas contained in this bill.

Thank you for your consideration,

RESOURCE DEVELOPMENT COUNCIL
for Alaska, Inc.


Paula P. Easley
Executive Director

cc: Members, House State Affairs Committee
Representative Marco Pignalberi ✓
Phil Holdsworth

STATE OF ALASKA
THE LEGISLATURE

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JUNEAU, ALASKA 99811
907-465-3900

May, 1986

Copies of minutes listed below were originally included in this file. The minutes are available on the STAIRS date base CM 14. In order to save space copies of minutes have not been left in the files.

Jeanie Henry

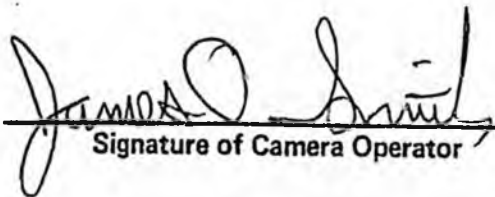
House State Affairs Committee, 2/28/1986, 3:00 pm
" " " " , 3/10/1986, 3:00 pm
" " " " , 3/21/1986, 3:00 pm

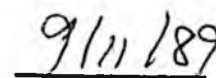


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Signature of Camera Operator


Date

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LIST OF BACK-UP MATERIALS FOR HB 465

February 10, 1986

HB 465 - An Act relating to fiscal matters involving the state and persons doing business in the Republic of South Africa.

Letter from Rep. Don Clocksin, sponsor, dated 12/30/85.

Testimony from Robert B. Zevin, Economist and Senior Vice President, United States Trust Company of Boston.

Letter and attachments from Commissioner Mary Nordale, Department of Revenue, dated 12/16/85.

State Restrictions on Public Investments in Companies Doing Business in South Africa, from July 1985 National Conference of State Legislatures.

American Corporations With Direct Investments in South Africa (cross checked with State of Alaska, Department of Administration Vendor List dated 2/3/86).

List of all U.S. corporations that do business in South Africa and Alaska (from Alaska Permanent Fund).

List of all stocks the Permanent Fund owns in U.S. companies doing business in South Africa.

South Africa: Questions and Answers on Divestment, from American Committee on Africa.

South African Fact Sheet.

Press Clippings.



REPRESENTATIVE DON CLOCKSIN

Alaska House of Representatives

MAJORITY LEADER

1024 WEST SIXTH AVENUE
ANCHORAGE, ALASKA 99501
(907) 274-4031

WHILE IN JUNEAU:
POUCH V
JUNEAU, ALASKA 99811
(907) 465-3704

Rep. Katie Hurley, Chair
House State Affairs Committee
1024 W. 6th Avenue
Anchorage, Alaska 99501

December 30, 1985

Dear Representative Hurley:

When you held hearings in September on HCR 17, relating to state investments in South Africa, I indicated I would be filing legislation on the issue. It appeared that, although HCR 17 created much discussion, it would be necessary to mandate disinvestment by a change in the law. The attached pre-filed bill does that.

The bill takes several steps in our effort toward disinvestment.

- 1) It requires withdrawal of state funds from companies doing business in South Africa no later than December 31, 1988.
- 2) During the period before total divestment, state agencies with South African investments will vote the stock in a manner designed to encourage disinvestment.
- 3) A state agency may not purchase products made in South Africa and is encouraged not to do other business with companies involved in South Africa.
- 4) State agencies and the Governor will submit annual reports on the progress made toward disinvestment.

Continuing developments in South Africa make it clear that strong action is necessary. As Alaskans we have the right to decide our money should not be spent to support the racist South African government.

I am requesting that this bill be referred to you committee. I hope early action can be taken on it.

Thank you very much for your support on this issue, and I hope this bill addresses concerns raised in your committee.

Sincerely,

A handwritten signature in cursive script that reads "Don Clocksin".
Representative Don Clocksin

ON THE CONSEQUENCES OF DIVESTING ALL SECURITIES OF FIRMS DOING
BUSINESS IN OR WITH SOUTH AFRICA AND NAMIBIA FROM LARGE
INVESTMENT PORTFOLIOS

BEFORE THE STATE AFFAIRS COMMITTEE OF THE STATE OF ALASKA HOUSE
OF REPRESENTATIVES, FEBRUARY 10, 1986

BY ROBERT B. ZEVIN, ECONOMIST AND SENIOR VICE PRESIDENT

Members of the State Affairs Committee, I am pleased to share my knowledge and experience with you by way of this written testimony. I hope it will be helpful to you in deciding whether and how you can proceed to achieve implementation of divestment of South Africa related businesses from your investment portfolios.

My qualifications to address this topic include the following. I hold a Ph.D. in economics from Harvard University. I have taught economics and investments at Berkeley, Boston University, Columbia and currently at Harvard. I have been a professional investment manager since 1967. From then until 1975 I was the proprietor of my own registered investment counseling firm. Since 1975, I have been continuously in charge of investment policy and until 1980 the chief executive officer of the Trust Department and Asset Management Division of the United States Trust Company of Boston.

Throughout the past 19 years I, and the firms with which I have been associated, have managed funds that were completely free of securities of firms doing business in South Africa. Thus I believe that I and my bank have more experience, managing more money, for more years subject to a complete South Africa exclusion than any other investment person or firm in the world.

Although U.S. Trust's investment management business has grown rapidly, we still manage only about \$550 million. However, we have served on numerous occasions in the past dozen years as professional advisors to multi-billion dollar portfolios with respect to general investment policy and specific divestment issues. These include the City of New York combined Retirement Systems, the States of Connecticut and Massachusetts, and a major national church. We have also been invited about 100 times in the past two years to provide expert testimony to universities, city councils, state legislatures and the U.S. Congress.

When I began managing South Africa free portfolios, I told my clients that they would have to expect some combination of lower return and higher risk as a consequence of their divestment decisions. This was and still is the conventional wisdom. After all, divestment meant throwing away what was then about half the market value of the Standard & Poor's 500 Stock Index. How could anyone do as well fighting with one arm tied behind his or her back?

About 10 years ago, I realized that the results in our South Africa free portfolios were better than this logic suggested. Our South Africa free accounts were doing just as well as our unrestricted accounts. Of course this could be because we purchased securities in the same South Africa free companies for both types of accounts. Still, both types outperformed the stock market averages and other professional managers by substantial margins. And at the same time that they earned superior returns, these portfolios showed less risk than the stock market or other professionally managed portfolios by all of the usual measures of risk.

For the entire 19 years our fully-divested, all stock portfolios have outperformed the stock market by about 4% a year on a risk-adjusted basis and our balanced portfolios have outperformed balanced funds by about the same margin.

We tested these results by looking at the Standard & Poor's 500 Stock Average minus 143 companies that we identified as having a role in South Africa. We computed the quarterly investment return of this South Africa free S&P 357 for the ten years, 1972 through 1981. We found that the 357 outperformed the 500 (including the same 357) by more than 1.5% a year. That doesn't sound like much; but, if you started with \$3 billion dollars and made an average 11.5% a year instead of 10% a year, the difference at the end of ten years would amount to \$1.128 billion. In our study, we found no statistical evidence that this superior performance was reliable enough to forecast into the future.

We also found that the two most common measures of risk produced very moderate estimates when applied to the portfolio of 357 South Africa free stocks. That portfolio was not any more volatile, did not bounce up and down any more or less, than the S&P 500. The portfolio was also well diversified in the sense that most of its return over a one or two year period, versus a different one or two years, could be explained by the change in the comparable return for the S&P 500. It was our finding and it has been our experience, that portfolios that are entirely South Africa free might do somewhat better or somewhat worse than similarly managed unrestricted portfolios for periods of a few years; but that the differences disappeared over longer intervals.

There are now numerous academic and practical studies that confirm our finding and our experience. A large number of multi-billion dollar investment managers are offering various South Africa free investment capabilities. All of them report actual experience as well as theoretical studies identical to our own. South Africa free index funds are available from Alliance Capital and Loomis Sayles.

Indeed it is a curious fact that Wilshire Associates and Trinity Investment Management each manages retirement funds under circumstances that would make them named fiduciaries in the ERISA sense at the same time that their personell have authored the leading articles questioning the investment prudence of divestment. I am submitting with my testimony a copy of a letter from me to the office of California Regent and Lieutenant Governor Leo McCarthy, dated May 8, 1985. That letter provides a detailed refutation of the Wilshire Associates article.

I believe that most of the critics of divestment also believe that the evidence supports the viability of South Africa free investing; otherwise they would not undertake, as fiduciaries, to manage funds subject to such conditions. When I paraphrased the Wilshire article as suggesting that divestment was imprudent, its authors objected vehemently that they had said no such thing. They have also conceded much else in exchanges with me over the past nine months. But the important thing is that they themselves manage South Africa free money for the District of Columbia and have advised the State of Massachusetts about selecting managers (including us) for South Africa free investments

A policy of complete divestment still leaves ample room for implementing diverse investment strategies and achieving optimal combinations of return and risk. While a priori theory suggests that one might not find the tallest mountain in the United States after eliminating all the states east of the Mississippi from the search, the actual lay of the land is such that this exclusion doesn't matter. A South Africa exclusion is similarly inconsequential for the investment problem.

If the set of South Africa free stocks closely duplicates the performance of all stocks it follows that almost any investment style or strategy can be implemented after divestment. Meaningful strategies involve being undiversified so as to overweight areas that will provide superior performance. Since the market is the sum of its components it must be true that virtually all major components are available among the South Africa free stocks.

How can this be with some 350 investments excluded including many of America's largest and best known companies? The divestment results are only a specific example of the general finding that stock market movements can be decomposed into six to twelve primary components. Some might call them names like growth, cyclical and resource. Others might discover beta, yield and foreign exposure among the components. Everyone agrees on their small number. Superior investment management consists of an ability to pick and choose among them. The availability of thousands of different stocks or eighty different standard industries is simply not important.

For example, investors can profit or avoid losses by anticipating the price of oil. But, having done so, it is not necessary to invest in the industry called "international oil" since the industry called "domestic oil" contains many large, well-managed companies that are not in Southern Africa and which will respond in the same way to oil price developments.

The real proof of these points is that the three largest managers of divested portfolios, Trinity, Wilshire Associates and my bank, have all achieved the same, superior results for these portfolios as for the others that we manage. The only strategy that cannot be completely implemented is an overweighting of the biggest capitalization stocks. Sometimes, as in 1983 or 1972, this is a superior strategy which would not be available to the South Africa free manager. However, as a long-term strategy, emphasizing the size component has been a surprisingly inferior strategy.

To the extent that investing adds value by actively choosing among stocks, bonds and cash and among major categories of stocks, a South Africa exclusion is relatively unimportant. To the extent that investment policy seeks to duplicate the performance of a stock market average at minimum transaction cost, divestment has little impact. On the other hand, if your managers seek to own a portfolio of very large companies and to hold them with very infrequent trading, then a divestment policy will certainly have some impact on initial transaction costs and on the ability to duplicate the characteristics of the original portfolio in the replacement portfolio.

The attack on the feasibility of divestment has shifted from these questions to transactions costs which are said to grow prohibitive for large portfolios. To the extent that divestment mandates the sale of stocks that otherwise would not have been sold and the reinvestment of the proceeds in South Africa free holdings, there will be an inescapable additional cost.

In a study that I authored with SEI Funds Evaluation, Inc. for the State of Michigan's \$ 5.2 billion stock portfolio, we have estimated this initial transaction cost at .35% (sales and repurchases) of the value of the stocks that would not otherwise have been divested.

There will also be an addition to annual transaction costs as a result of investing in smaller companies that will be traded more frequently at higher costs. Again, in our Michigan study, we have estimated this as .1% of the proportion of the portfolio affected. I have submitted the Michigan study as an exhibit to my testimony.

I have said nothing so far about bonds. Divesting a bond portfolio is far less problematic than divesting a stock portfolio and we have seen that the latter is not much of a problem. Corporate stocks are the entire universe of stocks; but corporate bonds are only part of the universe of bonds. There are also the bonds of the United States government, its agencies and numerous sovereign governments and international organizations. Moreover, individual bond selection is a less important component of bond investment results than individual stock selection is of total stock results. Changes in interest rates and changes in spreads between different maturities and qualities are the overwhelmingly important components of bond returns. To that extent, divestment restrictions have relatively little impact.

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

BILL SHEFFIELD, GOVERNOR

POUCH 5
JUNEAU, ALASKA 99811
PHONE: (907) 465-2300

December 16, 1985

The Honorable Katherine T. Hurley
Chairman
House State Affairs Committee
1024 West Sixth, Suite 200-A
Anchorage, AK 99801

Dear Representative Hurley:

I would like to respond to your letter of November 25 concerning the financial consequences of divestiture of State funds invested in U.S. corporations doing business in South Africa. I trust this response will suffice to answer the same questions you asked of Commissioner Eleanor Andrews in a letter which she has referred to me.

With respect to the Permanent Fund, I would like to refer your questions to the Permanent Fund Corporation so that they may respond to you directly. I shall answer your questions in the order presented with regard to all other funds.

1. What is the breakdown of Alaska investments and public funds invested in South Africa?

Please see the enclosed table which provides amounts as of September 30, 1985 which were invested in banks or corporations with operations in South Africa. These banks and corporations were identified on the basis of a January 1985 list of 284 companies published by the Investor Responsibility Research Center (IRRC).

I would like to stress that no funds are invested by the State in South Africa, either in the equity or debt securities of South African banks or corporations, the debt securities of the South African government, or directly in gold, property, or mortgage loans on property in South Africa. It is even arguable whether State funds are invested indirectly in South Africa since in purchasing securities of companies with operations in South Africa State funds go to the seller of the security, not the company that issued the security. (All State purchases of corporate securities are in the secondary market.)

I would like to note that the IRRC list is not necessarily an adequate or fair measure of the significance of U.S. corporate activity in the South African economy. Many other corporations without employees in South Africa sell goods, either directly or through middlemen, or buy South African

The Honorable Katherine T. Hurley
December 16, 1985
Page 2

exports--particularly strategic metals such as platinum, manganese, chrome, etc.--in quantities which far outweigh in economic significance the activities of many companies on IRRC's list.

These questions about the scope of economic activity as well as very practical information-gathering problems lead to widely divergent rosters of corporations involved in South Africa. They vary in number of companies from 201 to 6,000. With all the merger, divestiture, buy-out, and raider activity going on in today's corporate world, monitoring of South African connections necessarily is quite imprecise.

That said, you will note that the enclosed table shows that 40 percent of domestic common stock investments, 82 percent of commercial paper, 24 percent of corporate bonds, and 100 percent of interest-bearing bank deposits were invested in firms with operations in South Africa on September 30, 1985. It is probable that the percentage for foreign common stock investments is higher than domestic, but we do not have any information to identify such companies at this time.

The domestic companies in which the State was invested on September 30, which were in South Africa, include General Motors, Ford, General Electric, Mobil, Xerox, IBM, Kodak, Westinghouse, Dow, DuPont, Gillette, Revlon, Johnson & Johnson, John Deere, NCR, Coca-Cola, Pepsico, Sohio, Good Year, Boeing, Lilly, Hewlett-Packard, 3M, Bristol-Meyer, Singer, and many other household names.

2. What is the risk of losing public funds invested in South Africa? What is the degree of non-market risk? What is the risk if we don't divest?

There is almost no risk of loss of public funds. Again, we do not invest funds in South Africa. We invest some funds in the stock of U.S. and foreign multinational corporations which may or may not do business in South Africa.

Those corporations which actually have physical assets in South Africa are heavily capitalized. The value of the South African assets is such a small portion of their total wealth that loss of the entire value of those assets would not have material long-term affect on the value of the shares of stock held by the retirement funds.

The following information from the "Statistics of Income Bulletin" published by the IRS and covering 1980, the most recent year available, illustrates how peripheral South African operations are to U.S. corporations. Assets of South African companies controlled by U.S. corporations were \$5.1 billion, less than 1/2 percent of the \$1,457.5 billion in total assets of the 1,474 controlling corporations. The \$493 million in taxable income from South African operations was slightly more

than 1/2 percent of the \$77.7 billion in total taxable income for these corporations and only 1 percent of their total taxable income from foreign sources.

Individual corporations which are heavily invested in assets in South African would not be suitable as investment opportunities in any event. Given current conditions in South Africa, such stocks would not accord with the statutorily mandated "prudent investor rule."

A similar question is presented when discussing the stock of corporations which trade with South African corporations but have no physical assets located in South Africa. At that point one must examine the volume of sales or purchases from South Africa-based companies to determine the relationship to total sales or purchases. A significant percentage of sales or purchases to total volume would indicate a degree of risk to the corporation which should not be taken by the retirement funds, again, in any event. Thus, a corporation dealing, for example, in South African metals deemed of industrial or strategic importance would be a high risk investment which would be inappropriate as an investment vehicle unless that trading was a minor part of the corporation's business.

As an illustration of these points, consider General Motors which has an assembly plant and distribution network in South Africa. The retirement funds' risk depends on the United States economy, GM's worldwide sales, and foreign competition, particularly from the Japanese. Loss of all GM's assets in South Africa would have negligible effect on share values or profits.

Non-market risks associated with divestment include the need to diversify investments and to assure liquidity. Some of the problems in doing so are addressed in articles enclosed with this letter.

3. How would limiting the portfolio to non-South Africa investments affect performance in the short and long term?

Enclosed is a calculation of the effect on the retirement funds' performance estimated over a five-year period. As you can see, the overall loss is estimated at approximately \$178 million. This is not a dollar outflow but a loss of opportunity. The effect on the retirement funds would be to increase the required employer contributions.

The retirement fund employer contribution rates are set annually at a level to fund retirement benefits for current employees as well as to retire the accumulated unfunded liability over a 25-year period. Both funds are deemed on an actuarial basis to be funded in excess of 80 percent. We are gradually liquidating the balance to achieve 100 percent funding. The rate of liquidation of the unfunded liability has been

accelerated because of the performance of the funds' portfolios. However, were the retirement funds constrained in the scope and quality of their investments, we might be unable to adhere to the liquidation schedule under the present contribution rates. If that were to occur, rate increases would be applied not only to the State but to all of the municipalities and school districts who are members of the funds. Enclosed are lists of these other employer members and their contribution rates.

Also enclosed are three documents that provide some background on the effect of South African divestiture on investment performance. One--"South African Divestment: The Investment Issues"--is a research piece that appeared in the Financial Analysts Journal. The other two are letters from Trinity Investment Management Corporation to the New Jersey Department of Treasury that point out some of the very practical problems that divestment poses for investment performance.

4. What would be the effect of divestment if it were conducted gradually over a two, six, twelve, or twenty-four month period?

The only prudent time frame for divestment would be five years unless extraordinary losses were acceptable. In order to adhere to any extent to the prudent investor rule, replacement investments must be sought which will minimize risk. Because the funds would be limited to corporations of lower capitalization, the amounts invested in any one firm would have to be scaled down. Thus, finding alternatives and achieving a balanced portfolio would take several years. It could not be accomplished in months if the prudent investor rule is retained.

5. If the State decided to divest, what would be the actual transaction costs?

The following estimate of trading costs is based on an analysis by Thomas Loeb as summarized in the "South African Divestment: The Investment Issues" article. The estimate includes direct broker commission costs, market-maker spreads, and the impact on price as a result of trading.

The one-time cost of selling South Africa-related stocks would be 1.5 percent, or \$2,190,000, of the value of the stocks sold, \$146, 100,000 as of September 30, 1985. If the State were to buy South Africa-free replacement stocks (which is not assumed in the enclosed estimate of portfolio performance, rather South Africa-related stocks are replaced with fixed income securities whose acquisition cost would be less than stocks), the acquisition cost would be \$3,300,000 as of September 30, 1985. These costs would increase in the future as the State's stock portfolio grows and the average size of the State's position in any one stock increases.

The size of stock holdings in any one company is important because the greater the size of the holdings, relative to a company's total market

capitalization, the greater the impact a trade of that holding has on market prices. The average position size of the State's holdings of any one company on September 30, 1985 was \$1,078,000. Interpolation of the Loeb analysis for a position of this size means that the State would incur trading costs of 1.5 percent for South Africa-related companies (large blue chips) as opposed to 2.3 percent for replacement stocks (small capitalization stocks).

A second trading cost effect would be attributable to divestment because of the .8 percent higher cost of trading the replacement stocks on an on-going basis. For the first quarter of FY 86, total domestic common stock sales and purchases for the retirement systems were \$131 million, or \$524 million at an annual rate. Multiplying the September 30, 1985 ratio of South Africa-related stocks in the retirement system, 40 percent, by the .8 percent higher trading costs that would be incurred permanently on the turnover in this portion of the portfolio, and the projected \$524 million turnover for FY 86, one gets an increase in FY 86 trading costs related to divestment of \$1,677,195. Escalating this cost by the projected growth in the retirement funds stock portfolios (as contained in James Wilson's enclosed memo) one would get the following annual and total trading costs for divestment:

Divestment's Effect on Trading Costs

Annual Increased Turnover Costs

FY 86	\$ 1,677,195
FY 87	2,322,770
FY 88	2,961,855
FY 89	3,656,090
FY 90	<u>4,335,010</u>

Total Increased Turnover Costs \$15,003,920

One-Time Divestment Costs

Sale	2,190,000
Purchase	<u>3,300,000</u>

Total Five-Year Trading Costs \$20,493,000

In conclusion, the Department of Revenue believes that there would be significant costs attached to a South African-related divestment program. In addition to the approximately \$200 million in opportunity losses and transaction costs detailed in this letter, there would be real if non-quantifiable costs for additional administrative efforts to monitor and ensure compliance.

The Honorable Katherine T. Hurley
December 16, 1985
Page 6

In the 1970s and early 1980s, corporations of lesser capitalization out-performed the blue chips which constitute the core of State investment portfolios. Because of this, there are those who will assert that divestment would not harm investment performance, even though the record for small capitalization stocks since 1981 has not been good.

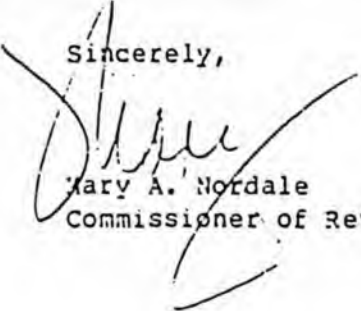
Small capitalization stocks are more risky and the returns from them more volatile. It is widely recognized in the research literature on this issue that no study has addressed what the returns would be for a South Africa-free portfolio that is restructured so as to maintain the same level of risk. The returns might not necessarily be greater than portfolios with South Africa-related stocks.

The possibility of diminished returns would be compounded in Alaska's case because of statutory restrictions on investments that are designed precisely to avoid greater risk. Such statutory provisions as limiting common stock investments to companies that have paid dividends in each of the last three years would be a much more onerous restriction if the field were limited to small company stocks rather than blue chips.

Thus, divestment cannot be viewed in isolation but must be considered in light of the overall risk posture of State investments. Divestment would precipitate a major restructuring of State investment portfolios with results that would be less than certain.

If there is any additional information that the Department can provide or if you have additional questions, please let me know.

Sincerely,



Mary A. Nordale
Commissioner of Revenue

MAN/MB/gb
85-125

Enclosures

STATE OF ALASKA
 PUBLIC EMPLOYEES' RETIREMENT FUND
 Employer Contribution Rates
 Fiscal Year 1984

<u>Employer</u>	<u>Percentage</u>
Alaska, State of	
Policemen, Firemen	19.90
Inland Boatmen	14.31
All Other Employees	13.20
Alaska Housing Finance Corporation	13.70
Alaska Municipal League	29.79
Alaska State Housing Authority	17.02
Alaska, University of	12.04
Alaska, University of, Geophysical Institute	12.04
Aleutian Region School District	8.62
Anchorage, Municipality of	14.83
Anchorage School District	15.29
Annette Island School District	10.10
Barrow, City of	12.60
Bering Straits School District	11.46
Bethel, City of	12.58
Bristol Bay Borough	8.45
Bristol Bay Borough School District	15.96
Chatham School District	11.62
Chugach Regional School District	7.94
Copper River School District	9.08
Cordova, City of	16.23
Cordova Community Hospital	10.10
Cordova Public Schools	16.34
Craig, City of	10.14
Dillingham, City of	10.00
Fairbanks, City of	16.98
Fairbanks Public Utilities	16.98
Fairbanks North Star Borough	11.57
Fairbanks North Star Borough School District	11.57
Fort Yukon, City of	12.54
Galena, City of	13.28
Galena City Schools	11.93
Haines Borough	13.73
Haines, City of	12.10
Hoonah City Schools	12.26
Hydaburg City School District	12.03
Iditarod Area Schools	10.88
Juneau Borough Schools	13.19
Juneau, City and Borough of	10.89
Kenai, City of	9.88
Kenai Peninsula Borough	14.39
Kenai Peninsula Borough School District	15.42
Ketchikan, City of	23.50
Ketchikan Gateway Borough	11.75

STATE OF ALASKA
 PUBLIC EMPLOYEES' RETIREMENT FUND
 Employer Contribution Rates
 Fiscal Year 1984

Continued

<u>Employer</u>	<u>Percentage</u>
Ketchikan Gateway Borough School District	15.72
King Cove, City of	10.30
King Cove City School District	12.46
Kodiak, City of	13.29
Kodiak Island Borough	12.17
Kodiak Island Borough School District	13.35
Kotzebue, City of	11.53
Kuspuk School District	11.17
Lake & Peninsula School District	11.30
Lower Kuskokwim School District	10.28
Lower Yukon School District	10.54
Matanuska-Susitna Borough	13.42
Matanuska-Susitna Borough School District	13.42
Nenana, City of	14.97
Nenana City Public Schools	13.64
Nome, City of	15.66
Nome City Schools	13.39
Nome Joint Utilities	7.41
North Pacific Fisheries Mgt. Council	10.89
North Pole, City of	12.81
North Slope Borough	10.29
North Slope Borough School District	11.01
Northwest Arctic School District	10.06
Palmer, City of	14.98
Petersburg, City of	15.45
Petersburg General Hospital	15.45
Pribilof Region School District	9.70
Railbelt School District	10.42
Saint Paul, City of	9.55
Sand Point, City of	11.29
Sand Point City School District	11.19
Saxman, City of	12.03
Seward, City of	15.21
Sitka, City and Borough of	16.68
Sitka Community Hospital	11.84
Sitka Borough School District	16.68
Skagway, City of	16.97
Soldotna, City of	10.88
Southeast Islands School District	10.13
Southeast Regional Resource Center	11.37
Southwest Region Schools	10.44
Tanana, City of	12.03
Tanana City School District	12.03
Unalakleet, City of	13.89
Unalaska, City of	11.63

STATE OF ALASKA
PUBLIC EMPLOYEES' RETIREMENT FUND
Employer Contribution Rates
Fiscal Year 1984

Continued

<u>Employer</u>	<u>Percentage</u>
Valdez, City of	11.23
Valdez City Schools	10.91
Wasilla, City of	12.03
Wrangell, City of	13.06
Wrangell City Schools	20.11
Yukon Flats School District	8.82
Yukon Koyukuk School District	11.85

STATE OF ALASKA
TEACHERS' RETIREMENT FUND
Employer Contribution Rates
Fiscal Year 1984

<u>Employer</u>	<u>Percentage</u>
Adak Region School District	8.71
Alaska Gateway Schools	
Alaska, University of	
Alaska, University of, Geophysical Institute	
Aleutian Region School District	
Anchorage School District	
Annette Island School District	
Association of Alaska School Boards	
Bering Straits School District	
Bristol Bay Borough School District	
Chatham School District	
Chugach Regional School District	
Copper River School District	
Cordova School District	
Craig School District	
Delta-Greely School District	
Department of Education, State of Alaska	
Dillingham School District	
Fairbanks North Star Borough School District	
Galena City School District	
Haines City Schools	
Hoonah City Schools	
Hycaburg City School District	
Iditarod Area School District	
Juneau Borough School District	
Kake City Schools	
Kenai Peninsula Borough School District	
Ketchikan Gateway Borough School District	
King Cove City School District	
Klawock City Schools	
Kodiak Island Borough School District	
Kuspuk School District	
Lake & Peninsula School District	
Lower Kuskokwim School District	
Lower Yukon School District	
Matanuska-Susitna Borough School District	
National Education Association	
Nenana City Public Schools	
Nome City Schools	
North Slope Borough School District	
Northwest Arctic School District	
Pelican School District	
Petersburg City Schools	

-----Same for all Employers-----

STATE OF ALASKA
TEACHERS' RETIREMENT FUND
Employer Contribution Rates
Fiscal Year 1984

Continued

<u>Employer</u>	<u>Percentage</u>
Pribilof Region School District	8.71
Railbelt School District	
Sand Point City School District	
Sitka Borough School District	
Skagway City School District	
Southeast Islands School District	
Southeast Regional Resource Center	
Southwest Region School District	
St. Mary's School District	
State Legislature	
Tanana School District	
Valdez City Schools	
Wrangell Public Schools	
Yakutat School District	
Yukon Flats School District	
Yukon Koyukuk School District	

---Same for all Employers---

by Wayne H. Wagner, Allen Emkin and Richard L. Dixon

South African Divestment: The Investment Issues

Divestment restrictions on companies that do business in South Africa may have substantial impacts on the investment management activities of large portfolios. In general, they will increase investment risk, reduce investment and diversification opportunities, and increase the costs of research, trading and administration. Large funds may have to alter their investment targets and restructure their investment process.

South African Divestment: The Investment Issues

More and more U.S. cities and states are weighing legislation that would restrict public pension plans from investing in companies that do business in South Africa. Divestment has potentially serious implications for the investment policies and practices of large funds.

Consider what happens if each of the 152 South African-related companies in the Standard & Poor's 500 is replaced by the largest "unrestricted" company in its industry. The new Alternative Universe amounts to less than 62 per cent of the capitalization value of the "old" S&P 500. Large multinational companies are replaced by smaller, domestic companies. The capitalization weights of some industries (including drugs, motor vehicles and product equipment) are more than halved. The Alternative Universe has 8 per cent more risk, as measured by beta, and 3 per cent less diversification than the S&P 500.

A pension fund restricted to this universe may expect higher trading and administrative costs inasmuch as its portfolios will contain smaller, riskier and less liquid companies. The larger the fund, the more likely it will have to restructure its plan investments completely in order to achieve targeted risk/return goals.

A COALITION OF RELIGIOUS, political and labor groups opposed to South Africa's race policies is placing increasing pressure on public pension funds to restrict or eliminate investments in companies doing business in South Africa. Massachusetts, Connecticut and Nebraska, New York City, Philadelphia and Washington, D.C. have already imposed such restrictions on their pension fund portfolios. This article does not attempt to address the moral, political or ethical issues involved. Rather, it addresses the practical implications of divestment for pension fund managers.

Several studies have argued that prohibitions on investment in South African-related companies would not have a significant impact on pension fund portfolios:

"The effect on portfolio risk of excluding the companies operating in South Africa . . . is, contrary to intuition, not particularly important."¹

" . . . such a restrictive policy really is not all that inhibiting."²

"A skilled investment manager should be confident that exemplary returns can be achieved within the guidelines of the proposed legislation."³

According to the opinions gathered for the Washington, D.C. Retirement Board, professional investment managers disagree. The vast majority of managers felt that performance would be reduced. Nine out of 10 thought diversification would be hampered. Three out of four thought that quality would be impaired. Half said they would refuse to accept fiduciary responsibility under such conditions.

The National Association of State Investment Officers, concerned about compromising fidu-

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1 Footnotes appear at end of article.

ciary responsibilities, has adopted a resolution opposing laws that force managers to make investments based on "anything but the best interests of pension fund members." State retirement officers also question whether it is possible to implement restrictions, particularly on large portfolios, without reducing investment opportunities and, ultimately, investment results.

Investment officers, advocates of divestment and previous studies all agree that divestment restrictions have minimal practical effects on portfolios of \$50 million or less. But what about larger funds that have billions of dollars to invest? Would they be able to continue their current risk-reward strategies to fund future benefits, or would radical restructuring be required?

The Scope of the Challenge

A list of all companies with employees in South Africa or business relations with the government of South Africa includes 229 companies with a market capitalization on December 31, 1983 of over \$600 billion. This represents over half the total capitalization of the Standard & Poor's 500 (often considered to be the "opportunity set" for institutional investors) and almost 35 per cent of the weight of all common stocks as represented by the Wilshire 5000 index. Included are 31 of the 50 largest U.S. companies—such institutional favorites as IBM, Exxon, Merck and 3M—and 49 of the 100 largest.

The 229 companies on the list tend to be concentrated in those industries whose products or production processes are readily transportable and whose maturity, size and product acceptance have led them toward international markets. As Table I shows, companies on the list account for virtually all of the capitalization

weight of some S&P 500 industry groups and large percentages of others. Utilities, trucking, real estate, and other industries that are by nature domestic are not heavily represented by the companies on the list.

The size of a company and its industry clearly affect the probability of its being on a divestment list. Companies that are too small or too localized to have developed international markets are not likely to be affected by investment restrictions. Unfortunately, neither are these companies likely to offer the reduction in risk available from the size, financial strength, diversification of product line and dispersion of markets enjoyed by the large, international companies that are the likely candidates for any "prohibited" list. The challenge for restricted investment managers, then, is to construct from a reduced universe of smaller, generally riskier companies, portfolios that offer, at comparable risk levels, returns comparable to those offered by investments in large companies.

To analyze the effects of divestment and to examine the practical problems it creates, we constructed an "alternative investment universe" that is free of South African influence. We replaced each prohibited company in the S&P 500 with another company in the same industry. In total, 152 companies were replaced. In all cases, the substitutes were the largest available American companies without South African connections.

The Alternative Universe

At the end of the first quarter of 1984, the S&P 500 was worth over \$1.175 trillion. The 152 companies doing business with South Africa accounted for \$554 billion of the S&P 500's capitalization value. Their 152 replacements

Table I Industry Weighings and Companies Eliminated by Divestment

Industry	% of S&P 500 Cap. Wt. Eliminated	Largest Company Eliminated	Replacement Company
Industrial Equipment	99	General Electric	Dover
Banks	97	Citicorp	Texas Communications
Photographic	93	Eastman Kodak	Xidex
Chemicals	87	DuPont	Diamond Shamrock
Drugs	87	American Home Prod.	Syntex
Conglomerates	86	MMM	Greyhound
Tire & Rubber	85	Goodyear	Gencorp
Office Equipment	84	IBM	Commodore
Motor Vehicles	81	General Motors	Mack Trucks
International Oils	76	Exxon	Murphy Oil (domestic oil)

were worth \$107 billion. The Alternative Universe thus came to \$728 billion—less than 62 per cent of the value of the S&P 500.

Rates of Return

Some researchers have noted that the average investment return on those companies that would be affected by divestment is significantly lower than the returns on companies free of South African connections. Indeed, it has been suggested that investment results could actually be improved by a divestment policy.

Our computations show that one dollar invested five years ago in the 152-stock portfolio of companies doing business in or with South Africa would have grown by now to \$1.94, including dividends. A dollar invested in the 152 replacement stocks would have grown to \$2.60—a difference in annual rate of return of over 7 per cent. But what is the source of this substantial difference?

Numerous studies have indicated that stocks of small firms have been outperforming those of large firms by substantial amounts.⁴ Wilshire Associates estimates that the 500 largest U.S. companies returned 9.7 per cent per year over the last 10 years, whereas the second largest 500 returned 17.9 per cent annually.⁵ The higher return on the replacement portfolio may thus be a reflection of this small firm effect.

Smaller, riskier companies promise higher returns and, in recent years at least, have delivered them. But high returns do not accrue without incurring greater investment risk. In the down market from July of 1983 through June 1984, the largest 500 stocks decreased in value 6.6 per cent; the second largest 500 declined 15.0 per cent.

Retirement plans are not free to take unlimited risks in pursuit of higher returns. The appropriate level of risk depends on the actuarial requirements of the plan, its funding status, legal restrictions and the retirement board's interpretation of fiduciary responsibility. All these factors affect a fund's ability to bear added risks in the hopes of higher, but uncertain, returns. Relative rates of return can be judged only in the context of risk assumed.

Investment Risk

A portfolio's risk tolerance is appropriately measured by its beta—i.e., its sensitivity to changes in the overall market. The market, as represented by the S&P 500, has a beta of 1.0. A

portfolio whose beta is greater than one is more volatile than the market, whereas one with a beta of less than one is less volatile. Another measure of portfolio risk is its R-squared—its degree of a diversification in comparison to the market benchmark. The market, as proxied by the S&P 500, has an R-squared of 1.0. An actively managed portfolio concentrated in favored securities and sectors would be less diversified than the market and have an R-squared below the 1.0 indicating perfect diversification. Most active equity portfolios have an R-squared between 0.80 and 0.92; the R-squares of index funds approach 1.0.

The Alternative Universe is very well diversified, having an R-squared of 0.968, partly because of the high percentage of common holdings with the S&P 500. Although well diversified, it is riskier than the market, having a beta of 1.08. The Alternative Universe will rise or fall, on average, by 8 per cent for every 1 per cent change in the S&P 500.

Large funds that employ a multiple manager structure often specify a target beta as a means of controlling total portfolio risk. To meet a specified target with securities selected from the riskier Alternative Universe, managers may either have to select from among the least risky alternative stocks or hold larger cash positions.

Divestment may also involve strategic risks that are more difficult to quantify than investment or diversification risk. For example, during late 1983 and early 1984, energy was the only sector to show positive price appreciation.⁶ But energy stocks would have been heavily affected by divestment restrictions. Divestment may thus lead to diversification loss beyond the manager's control; the fund must bear the risk of foregoing profitable investment opportunities.

To construct the Alternative Universe, some large companies in the S&P 500 were replaced by other, smaller companies in the same industry. The relative importance of these industries was thus reduced in the Alternative Universe, while industries less affected by divestment gained in importance. Table II shows how industry weights of the Alternative Universe differ from the weights of the S&P 500. Note that the industries that have gained weight in the Alternative Universe are primarily domestic in nature. These industries are thus more susceptible to U.S. economic risk, which is not offset by sales and earnings from foreign countries.

Table II Industry Weight Changes

Industry	% of S&P 500	% of Alternative	% Difference
Business Mach.	8.7	3.1	-5.6
Inter. Oil	8.0	4.5	-3.5
Drugs	6.2	3.1	-3.1
Motor Vehicles	4.0	1.8	-2.2
Prod. Equip.	4.1	2.0	-2.1
Insurance	2.2	3.3	-1.1
Railroads	1.9	3.0	-1.1
Paper	2.0	3.1	-1.1
Energy Explor.	3.5	5.4	-1.9
Domestic Oil	6.6	8.9	-2.3
Utilities	5.6	8.8	-3.2
Telephone	5.8	9.2	-3.4

Investment Desirability and Quality

Value Line publishes Timeliness Ratings, which measure stocks' anticipated 12-month price performance, and Safety Ratings, which measure companies' relative financial strengths. Table III compares the S&P 500 and the Alternative Universe on the basis of the distribution of timeliness ranks.

The Alternative Universe contains almost as many companies ranked in the top two categories for timeliness as the S&P 500. However, their capitalization value is substantially less. Institutions currently hold \$203 billion of the top rated stocks, representing 41 per cent of the total institutional holdings in S&P 500 stocks. Divestment would reduce institutional holdings of top rated stocks by \$110 billion; only 34 per cent of institutional holdings would be top rated.

Table III Proportions of S&P 500 in Top Two Value Line Timeliness Ranks

Universe	Number of Stocks	Capitalization (billions of dollars)	% of Total Cap.	Institutional Holdings (billions of dollars)	% of Inst. Hold.
S&P 500	137	440	37	203	41
Alternative	133	216	30	93	34
Difference	4	224	7	110	7

Table IV Proportions of S&P 500 in Top Two Value Line Safety Ranks

Universe	Number of Stocks	Capitalization (billions of dollars)	% of Total Cap.	Institutional Holdings (billions of dollars)	% of Inst. Hold.
S&P 500	179	688	59	285	58
Alternative	137	316	43	116	42
Difference	42	372	16	169	16

The effects of divestment on Safety Rating are shown in Table IV. In terms of top Safety Ratings, the Alternative Universe falls short of the S&P 500 by 42 companies and \$372 billion in market capitalization. Companies rated highly for safety represent 59 per cent of the market capitalization of the S&P 500 but only 43 per cent of the Alternative Universe. Institutional managers now have 58 per cent of their S&P 500 holdings in the top Safety Ratings; only 42 per cent of institutional holdings in the Alternative Universe are top rated in safety.

Restricted institutional managers attempting to maintain the same standards of portfolio desirability and safety would be forced to compete for the smaller share of top rated Alternative Universe companies. If all institutional managers were subject to the same constraints, \$285 billion of current investments in high safety companies and \$203 billion of current investments in high desirability companies could be forced into \$116 billion worth of high safety companies and \$93 billion worth of high desirability companies in the Alternative Universe. It seems clear that only smaller funds could easily make such a transition without compromising portfolio attractiveness and, in particular, investment safety.

Liquidity and Trading Costs

Liquidity is one of the key areas in which large funds may experience difficulties not encountered by smaller funds. Thomas Lueb constructed a table of actual dealer quotes to show how company size and trade size affect transac-

tion costs.⁸ Loeb's cost of trading includes direct commission costs, market-maker spreads and trading impact.

According to Loeb's study, larger trade sizes lead to higher trading costs. For example, the cost of acquiring a \$250,000 position in a billion dollar company is estimated to be 1.6 per cent, whereas a trade of \$2.5 million—10 times the size—would cost 3.9 per cent, or more than double. Similarly, trading in smaller companies is significantly more expensive than trading in larger companies. A \$500,000 trade involving a \$100 million company is more than twice as expensive as a \$100,000 dollar trade involving a billion dollar company (4.1 per cent vs. 2.0 per cent).

We used Loeb's figures to estimate transaction costs for acquiring (or selling) \$25,000, \$250,000 and \$2,500,000 positions in each of the 152 companies involved in South Africa and their 152 replacements. These three position sizes imply equally weighted portfolios of \$3.8 million, \$38 million and \$380 million. Table V shows the results. The replacement companies are significantly more expensive to trade than the original companies because of company size. Furthermore, the cost of trading increases as fund size increases.

The problem may be even more severe than Table V suggests. Because large portions of many of the smaller replacement companies are held by company officers and employees, the amount of stock actually available on the open market is in many cases substantially less than the apparent supply. Furthermore, if restrictions were implemented at about the same time, large funds' demand for replacement stocks could raise execution costs significantly higher. Finally, the higher transaction costs will persist after initial portfolio adjustment, as restricted

portfolios continue to trade among generally smaller companies.

Research and Administrative Costs

The larger a company and the greater its institutional ownership, the easier it is to obtain reliable information about it. The replacement companies in the Alternative Universe are less well known than their counterparts and are currently followed by fewer analysts. Brokerage house analysts submitted to Lynch, Jones & Ryan's I/B/E/S Service an average of 19.9 estimates on each of the companies involved in South Africa, but only 10.9 estimates on each replacement company.⁹ It may be expected that funds would require additional manpower to follow the replacement companies.

In addition, to the extent that the replacement stocks are riskier, hence subject to more frequent changes in fortune, higher turnover—executed at higher transaction rates—can be expected. More transactions lead to higher custodial activity, hence higher administrative costs.

Implications for Management Style

In the investment environment of the 1980s, managers are often retained as specialists, utilizing specific investment skills to attain particular investment objectives. Plan sponsors often hire a complementary set of managers, hoping to employ different expert manager skills within the context of an overall objective and structure.

Not all management styles would be equally affected by restrictions on South African companies. An "emerging growth" manager, for example, would be likely to be less affected than a "core" manager. Table VI gives some idea of how divestment might affect management structure. Core-oriented managers would be

Table V Transaction Costs

Company Size (millions of dollars)	No. Companies		% Transaction Cost for Position of		
	So. Afr.	Repl.	\$25,000	\$250,000	\$2,500,000
Under 100	1	1	2.0	3.0	7.9
100-500	19	57	1.1	1.6	4.0
500-1,000	21	67	1.0	1.6	3.9
1,000-1,500	20	17	1.0	1.4	3.1
Over 1,500	91	10	0.6	0.7	1.4
South African-Related Average Cost (%)			0.8	1.0	2.3
Replacement Average Cost (%)			1.0	1.5	3.7

Table VI Manager Style and Divestment Effects

Style	% Cap. Eliminated	Re-Security		Beta		Risk	
		St. Dev.	Beta	St. Dev.	Beta	St. Dev.	Beta
Passive Core	47	0.99	0.96	1.00	1.08	2	1.4
Active Core	40	0.97	0.91	1.01	1.07	1	1.7
Yield Defensive	46	0.90	0.88	1.02	1.04	3	3.6
Rotator	46	0.93	0.89	1.02	0.95	1.8	3.9
Contrarian	26	0.94	0.93	1.09	1.10	4.6	5.1
Small Cap	26	0.79	0.79	1.36	1.29	12.3	12.4
Growth	3	0.86	0.83	1.21	1.27	7.4	10.0
Aggressive Grow	22	0.88	0.85	1.48	1.46	17.8	18.3
Combined	31	0.94	0.92	1.17	1.22	5.2	6.3

affected the most, because they tend to hold the "blue chip" investments that are most affected by divestment. Growth-oriented managers would be less affected, but would face higher market risk (beta) and less diversification.

The growth and risk-oriented portfolios of most multimanager plans represent a substantially smaller part of the total fund than the core portfolio. With divestment, core managers would be forced either to hold larger amounts of securities not eliminated as a result of divestment or to select new companies from the Alternative Universe without changing the target portfolio characteristics.

If divestment makes it impossible for the core managers to hold to target investment characteristics, the plan administrator may have to compensate by requiring growth stock managers to lower their risk-taking. This would imply a complete restructuring of plan investments. How any particular manager would adjust is beyond our speculation, but the evidence cited above indicates that restructuring would not be simple or inexpensive.

One other factor should be considered. Many investment management and brokerage firms are part of or affiliated with companies on the divestment list. In particular, most of the largest, best capitalized and most frequently used brokerage and investment banking firms have contacts with South Africa. Use of the services of these organizations would presumably be prohibited under a divestment policy.

Fixed Income Management

The implications of divestment for fixed income portfolios are similar to those for equity portfolios—a smaller universe of corporate issues with lower average quality. At the end of 1983, the amount of outstanding corporate debt rated Baa or higher by Moody's approximated

\$300 billion. Of this, the 152 S&P 500 companies doing business with South Africa accounted for \$133 billion, or 44 per cent. The 152 replacement companies had only \$28 billion in outstanding debt at the end of 1983. The total amount of corporate debt available from the Alternative Universe was \$195 billion. This represents a 35 per cent reduction in the amount of corporate debt securities.

Furthermore, the corporate debt universe under divestment is of lower average quality. The companies that would be eliminated by divestment are larger, financially stronger and more diversified than the replacement companies. Table VII compares the original and replacement companies in terms of the distribution of corporate debt by Moody's ratings.

Ninety-two per cent of the securities that would be eliminated by divestment are rated Baa or better, versus only 72 per cent of the debt securities of the replacement companies. Fixed income managers subject to divestment will have substantially less corporate debt of investment grade available. They would have to accept lower quality bonds or compete for the remaining higher quality issues.

Table VII Corporate Debt Outstanding

Moody's Rating	South African-Related		Replacement Companies	
	Debt (billions \$)	% of Total	Debt (billions \$)	% of Total
Aaa	10.40	5	0.00	0
Aa	60.60	46	0.65	2
A	36.60	28	9.50	35
Baa	15.00	10	4.60	16
Ba	1.40	1	4.70	16
B	2.20	2	0.85	3
Caa	1.70	1	0.00	0
NR	5.50	4	7.90	28

Table VIII Effects on Commercial Paper Quality

Moody's Rating	No. of S. Afr. Related Companies	No. of Replacement Companies
Prime-1	91	29
Prime-2	30	14
Prime-3	3	0
Not Rated	152 36	109 152
	152 152	109 152

The effects of divestment on fixed income managers are softened, however, by the large supply of government issues available. At the end of 1983, government and corporate bonds outstanding amounted to approximately \$954 billion, only 12 per cent of which was related to South Africa. When government debt is included, 85 per cent of the debt securities free of South African influence are rated Baa or higher by Moody's. The effects of divestment would thus be felt most by managers who take advantage of higher yields from corporate issues and by managers who actively move from industry to industry to take advantage of yield spreads.

Cash Management

Cash management will be affected if managers are not permitted to purchase the commercial paper of companies doing business with South Africa or certificates of deposit of banks lending money to South African businesses or government agencies. Prime commercial paper is typically issued on an unsecured basis only by large, financially secure, diversified corporations, such as the companies on the divestment list. Most other companies are unable to issue commercial paper unless it is insured or guaranteed. Thus divestment would reduce the universe of companies issuing commercial paper and its average quality.

Table VIII shows the distribution of Moody's commercial paper ratings for the 152 companies on the divestment list and their replacements. Of the ~~152~~ eliminated companies, ~~75~~ 60 per cent are rated Prime-1, whereas only ~~28~~ 17 per cent of the replacement companies achieve that rating. Most importantly, of the 152 eliminated companies, 75 per cent are rated. Only 28 per cent of the replacements are even rated. Divestment would reduce substantially the commercial paper available to cash-equivalent managers.

If divestment prohibits managers from purchasing certificates of deposit from banks that make loans to South African companies or government agencies, 13 of the 15 largest banks and 64 smaller banks would be affected. Divestment would thus reduce the universe of available bank CDs to only CDs from smaller, less diversified banks, which would carry more default risk.

Conclusion

Divestment restrictions may have a substantial impact on the investment management activities of large portfolios. In general, the restrictions will increase investment risk, reduce investment and diversification opportunities, and increase the costs of research, trading and administration. And the larger the fund, the greater the impact will be. ■

Footnotes

1. Andrew Rudd, "Divestment of South African Equities: How Risky?" *The Journal of Portfolio Management*, Spring 1979.
2. Stanford Calderwood, Working paper and presentation to the Conference on South African Investment Policy, University of Michigan, December 1 and 2, 1983.
3. Robert A. Schwartz, Testimony before the Committee on Consumer and Regulatory Affairs, City Council, District of Columbia, March 4, 1983.
4. See, for example, Rolf W. Banz, "The Relationship Between Return and Market Value of Common Stocks," *Journal of Financial Economics*, March 1981; Marc R. Reinganum, "Abnormal Returns in Small Firm Portfolios," *Financial Analysts Journal*, March-April 1981; and Ivan L. Lustig and Philip A. Leinbach, "The Small-Firm Effect," *Financial Analysts Journal*, May/June 1983.
5. Stephen L. Nesbitt, "'Hot Money' Can Trip Up Fast-Track Advisory Firms—Stockpicker's Universe Contracts As Assets Grow," *Pension and Investment Age*, September 5, 1983.
6. "The Forbes Wilshire 5000 Review," *Forbes*, ongoing.
7. *The Value Line Investment Survey* (New York: Value Line, Inc.).
8. Thomas F. Loeb, "Trading Cost: The Critical Link Between Investment Information and Results," *Financial Analysts Journal*, May/June 1983.
9. I B E S (The Institutional Brokers Estimate System) is a service of Lynch, Jones & Ryan, New York.

TRINITY INVESTMENT MANAGEMENT CORPORATION
 TEN TREMONT STREET, BOSTON, MASSACHUSETTS 02108-2003 • (617) 742-9525

September 4, 1984

Mr. Roland M. Machold
 Director
 Division of Investment
 Department of the Treasury
 State of New Jersey
 Trenton, New Jersey 08625

Dear Mr. Machold:

Thank you for your request that we share with you some of Trinity's experiences in managing a portfolio for Michigan State University, whose policy prohibits us from using common stocks of companies doing business in South Africa. You seem to have information that we have had good performance, and that our example might be an endorsement--in investment terms--for the policy proposed for the State of New Jersey.

Yes, we won't deny it, we have been very successful with the MSU portfolio using the investment community's traditional benchmark--the S&P 500. Because our record is in the public domain, we see no point in not telling you what it has been:

	Total Return Since Inception <u>7/30/82 to 8/31/84</u>
S&P 500	+ 71.9%
South Africa Free Universe*	+ 68.7%
INDATA Median Equity Manager	+ 57.5%
Trinity's MSU Portfolio	+105.0%

*A capitalization-weighted universe of 470 stocks of USA companies not doing business in South Africa.

Unfortunately, a Misleading Example

We are both proud and pleased that we have been able to serve MSU so well.

But, we would be professionally negligent, if not downright misleading, if we were to tell you--or let you infer--that we would have done as well with New Jersey's \$3.5 billion in equities as we have managed to do with MSU's mere \$9.6 million.

Quite the contrary--in our judgment based on our day-to-day experience of identifying undervalued stocks within the limited South Africa Free Universe and then going into the market to buy them--we are convinced that what we have been able to do with Michigan State University's portfolio could not be translated into much larger portfolios, such as the New Jersey portfolio.

The Critical Difference

Market liquidity is the critical difference.

For MSU, we run a portfolio of about 60 issues. That many issues, by the way, is more than most managers would use for a portfolio with total assets of only \$9.6 million.

With rare exceptions, when we identify an undervalued issue within the SAF Universe that we want to use in the MSU portfolio, we can buy that position within a single day, and without disturbing the market price because we are taking, on balance, less than 20% of a single day's volume. On rare occasions we may be in the market for two days.

But if we had your problem of investing \$3.5 billion in equities--that's over 360 times the size of the MSU portfolio--we honestly wouldn't know how to do it and still preserve any selectivity capability.

Remember, Trinity's record with MSU was built on being able to select what we felt were the 60 most undervalued stocks out of a Universe of 470 stocks. We used virtually every stock we felt confident was in fact undervalued--and the 20% of the SAF Universe we ranked as solid BUYs is a much higher percentage than most investment processes are willing to rank as solid BUYs.

A Vivid Example

Let's assume we know for sure that the 60 stocks now held in MSU's portfolio will be as successful over the next year as were the stocks we held one year ago.

Furthermore, assume that the only New Jersey dollars that you want to invest in those stocks are dollars that would have to be raised by selling off stocks now held in the New Jersey equity fund that includes companies doing business in South Africa.

That would mean you are faced with finding a new home for the proceeds from 43 stocks that you would be forced to sell off by the adoption of such a policy. Those 43 now prohibited stocks are equal to 36.8% of your portfolio or \$1.4 billion.

Now, we wave the magic wand, and tell you to BUY what Trinity is owning in MSU. After all, look at the record on the previous page. After all, those guys at Trinity know what they are doing. They have a record to prove it.

It wouldn't be easy:

- o You have some advantage. You only have to sell off 43 stocks and you have 59 stocks into which to invest the money.
- o But, because the South Africa Free stocks are smaller, and because they have much lower average daily trading, it would be an impractical transition.
- o We begin by using two common sense rules:

--trading in any stock will be limited to 20% of that day's volume

--no new position in the New Jersey portfolio will be less than 0.5% of the total portfolio, nor more than 5.0% and/or 5.0% of a company's capitalization. (This latter rule is, in fact, New Jersey's own operating guideline.)

Under those perfectly proper realities, here's what any manager would face in making the transition:

- a. The minimum number of days it would require to establish a full position in some stocks would be 20 days.

The median days required to trade all the stocks would be 71 days.

For some of the stocks it would require more than 100 days, and for one stock an impossible 1,429 days.

- b. It would take 27 trading days (more than a calendar month) to complete only 50% of the program.

You know by experience that how you would rank a stock on Day One may be a whole lot different than on Day 27. Many stocks you start out to buy might well give you second thoughts as they run up in price and/or have other problems.

An Unfair Example?

Perhaps so. After all, the SAF Universe was designed for MSU's very small portfolio. To put part of New Jersey's money into those 59 stocks might be rigging the answer.

Let's loosen the noose. Let's assume:

- o You can use every stock on the current New Jersey Approved List except the 67 that would have to be eliminated by an SAF policy.

This means that there will be absolutely no selectivity whatsoever involved. You simply are going to take the money you must raise because of the proposed SAF policy, and invest it in the stocks that have been carefully identified as a suitable universe from which you are now identifying undervalued stocks for the portfolio.

- o You use only the existing New Jersey guidelines; i.e., at least 0.5% positions, and no position more than 5.0% and/or 5% of a company's capitalization.

Here's what you would be faced with:

- a. The minimum number of days it would require to establish a position in some stocks would be 9. That's less than the 27 to get into the MSU portfolio, but still a great many days at the minimum.

The median days required would be 29--nearly 1.5 calendar months.

The maximum required would be 607--better than 1,429 for the MSU list, but still a silly number.

- b. It would take 12 trading days to reach 50% of the transfer.

In both cases--using the highly successful MSU list or in using New Jersey's entire approved list less the restricted stocks--the time at the trading desk would be very costly in terms of performance.

There is no way of telling how much damage would be done while you were in there day after day after day taking 20% of the volume of a stock. But we would be suspicious of any so-called "expert" who said there wouldn't be a market impact.

You may decide--as an investment decision--to buy a \$50 stock. But after you have been in there steadily for a month buying 20% of the volume, that stock is likely to move up, and may no longer be undervalued in your investment judgment.

And this problem is a two way street. Getting into any stock that is thinly traded in the context of a portfolio's needs can be costly. Generally, it is more costly to get out. When you don't want it any longer, much of the rest of the world feels the same way and will extract a penalty as you try to unload.

One Final Scenario

Let's assume that you do want to exercise some selectivity, not simply buy everything on your approved list.

Thus, instead of using your 177 issue approved list, we use the much larger universe of SAF stocks, and then through a selectivity process agree to buy only issues of above-average quality that are also ranked in the top 3 deciles by Trinity's Multiplex model. (This is a looser constraint than we use for MSU, where we limit BUYs to the top 2 deciles.)

Let's compare all three possible portfolios:

	<u>MSU's Current Portfolio</u>	<u>New Jersey's Current Approved List</u>	<u>Selected BUYs From 674 Stock Universe</u>
# of Issues Available	59	177	136
Average Market Cap. (Billions)\$	1.9	\$ 2.0	\$ 1.5
Days needed to get 50% Done	27	12	18
Median Days to Trade	71	29	54
Minimum Days to Trade	20	9	21
Maximum days to trade	1,429	607	1,231

What drives the trading days--and thus the price pressure up--in all of these cases is the reality that a SAF policy eliminates from consideration stocks with more than \$300 billion in market capitalization that are the backbone of any large portfolio such as New Jersey's.

In the current New Jersey portfolio, the average market capitalization is \$4.5 billion. But the average market capitalization of the stocks that would have to go out of the current portfolio is \$7.0 billion.

Finding a new place to invest money that comes out of stocks with an average \$7.0 billion in market capitalization when you are forced to use stocks whose average

market capitalization is only \$2.0 billion, or roughly 72% smaller, is at the heart of these difficult trading scenarios.

Focus Only on Trading

In this letter we have focused only on the trading problems. We have not discussed the distorted characteristics of a SAF Universe in other terms. Virtually entire Industry Groups are eliminated by a SAF policy, and this means opportunity cost. Being sealed off from the complete market will create diversification problems and thus non-market risk problems that other managers don't face.

And so on. The list is a long, long one and we assume you already know those hazards.

Yes, Trinity's MSU Experience is Meaningless in New Jersey's Terms

Let me conclude by coming back to your basic request. You said in your call that other "professional investors" had cited our MSU experience as an example that a SAF policy is manageable without inhibiting investment results.

Trinity does not see it that way. What we did for MSU worked for their \$9.6 million dollars--and we hope it continues to work.

But, by first-hand experience, we would be the first to tell you that we haven't the foggiest idea how to translate our investment process--working in such an inhibited and limited universe--into New Jersey's needs for its \$3.5 billion.

To cite Trinity as an example is ridiculous. It's like some promoter watching his neighbor's kid make a very successful sled run down a gentle slope and deciding that kid is just right for the Olympic bobsledding team. Hungry for business, the promoter has nothing to lose.

But the kid on the sled--who knows his capabilities--has much to lose (and in our analogy that kid would be Trinity). More importantly, the parent of the kid, holding the ultimate responsibility, should know the risks involved and listen to both his kid on the sled and his own common sense, before he signs up. That parent is perhaps your legislature.

Data Available

You can meet with our Paul Reeder who crunched the summary numbers cited in this letter. He has pages and pages of computer printout that explore many other aspects of the challenge you face with a SAF policy. From that work you will find a great many other cautions over and above the liquidity ones cited in this letter.

Please keep in mind that our comments in this letter are limited to the investment aspects of the SAF policy. We are personally very sympathetic with the aims of such a policy, but as professionals in response to your question, we are willing to point out the risks being taken in investment terms.

If you have more specific aspects you would like explored, please give me a call.

Sincerely,


Stanford Calderwood

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September 4, 1984

Mr. Roland M. Machold
 Director
 Division of Investment
 Department of the Treasury
 State of New Jersey
 Trenton, New Jersey 08625

Dear Mr. Machold:

This is my second letter of this date. In our telephone conversation, I mentioned tongue-in-cheek that the challenge you face with a possible SAF policy is very akin to a man going into a poker game with a deck stacked against him. You asked if I could be specific.

This letter tries.

Methodology

We first had to relate an individual stock to a particular card.

I don't have to tell you that when you manage billions of dollars in an equity portfolio it is much more complicated than simply finding undervalued stocks that are going to outperform the S&P 500.

Under New Jersey's rules you have to buy at least 0.5% positions, but no more than 5% of a company. At the same time, you cannot have more than 5% of your dollars in any one company. These are common sense rules, widely used. Clearly, even if both stocks had equal chance of outperforming the S&P 500, there is considerable difference between the index's largest and smallest stock:

	Largest <u>IBM</u>	Smallest <u>Eagle-Picher Ind.</u>
Market Capitalization	\$ 67,635 mm	\$ 217 mm
Average Daily Trading	\$ 154.9 mm	\$ 0.1 mm

Thus, to relate stocks from top to bottom, from Aces to Twos, we multiplied the market capitalization times the daily trading (and then took the square-root for an easily read figure).

Under such a scheme, IBM would be an Ace. The smallest company, Eagle-Picher, would be a Two.

Next, we ranked stocks in your total universe and broke the list into 13 equal levels to represent each card in the deck—Two to Ace.

Thus, there were 21 stocks ranked as Aces, 21 ranked as Kings, and so on down to 21 ranked as Twos.

As you might expect, in your actual portfolio, you had many more Aces (19 stocks) than you did Twos (4 stocks). This simply validated the underlying assumption that stock size and trading were important considerations beyond simple selectivity.

Impact of SAF Policy

We next looked at the cards (stocks) that would be eliminated by an SAF Policy from your total Universe.

Here's what we found:

<u>Card Category</u>	<u>Stocks Lost</u>	<u>% of Cards Lost</u>
Ace	10	47.6%
King	12	60.0%
Queen	9	42.9
Jack	9	42.9
Tens	3	14.3
Nines	8	38.1
Eights	4	33.3
Sevens	11	52.4
Sixes	4	33.3
Fives	3	14.3
Fours	7	33.3
Threes	7	33.3
Twos	3	14.3
Total	90	32.7%

So there you sit at the table.

- o The other players around the table are getting cards from a 52-card deck. They have available to them all the Aces, all the Kings, all the Queens, and so on.
- o But you are getting cards from a deck that has been reduced by 17 cards to a total of only 35.
- o And among the 17 missing cards are ones you need desperately in your \$3.5 billion fund:
 - 2 Aces
 - 2 Kings
 - 2 Queens
 - 2 Jacks

But, take heart, you at least have 3.4 Tens and about as many Eights.

What is The Opportunity Cost?

The casual investment "expert" who is testifying that the SAF policy won't inhibit performance tends to answer the opportunity question with "...nobody knows for sure." The implication is that because stocks that are SAF do have, on balance, performance that about equals the normal institutional stocks, there isn't any real problem. The question of size and liquidity, the basis for classifying our cards, is generally ignored and passed over lightly.

But the money at stake is not that of the experts who say there are no investment implications of working from a list that denies about \$400 billion in market capitalization to the portfolio manager.

If it were your money, would you want to sit at the table and be denied 17 critical cards the other players could use if they wished?

Missing the Point

It does not boil down to a comparison of the performance of stocks in an SAF Universe and those in a non-SAF Universe.

The dimensions of size and trading liquidity are critical to large funds such as New Jersey's.

What good is it if there are stocks in a SAF Universe that perform as well as the prohibited stocks, if the portfolio involved is so large it can't practically buy enough of those better performing stocks.

It is economically costly in terms of research to identify an undervalued stock. And that cost is not related to size or trading liquidity. If anything, it costs more to identify the smaller stocks that are thinly traded because so few Street Analysts are watching such stocks.

So, you wind up paying more to identify a stock you can use under an SAF policy and then find out you can't buy as much as you would like. You look around the table, discover that the other players have identified an Ace at much less cost, and can buy all they want and need easily. You could have identified that Ace, but you can't buy it.

Valid Analogy?

We can't say for sure, but we suspect it can be tested easily.

The next time an "expert" testifies that dropping \$400-plus billion in market capitalization isn't going to be costly, invite him to the back room to play a little poker.

My guess is he wouldn't want to expose say \$50,000 of his own capital in a game where he was being dealt from a deck of only 35 cards and you were being dealt from a full deck. If he doesn't want to play that game in the real world with his own real money, why is he so generous about going into a much more serious game with such obvious inhibitions and with billions at stake?

He may be looking for business. He may be using his role as an "expert" to push a perfectly good social cause he feels strongly about.

In any event, we urge strongly that the situation be explored in real terms, not in

Mr. Roland M. Machold
September 4, 1984
Page 4

Appendix 2

global terms that can hide the realities of the trading desk where big stocks with big daily trading are mandatory for multi-billion dollar funds.

Again, let me stress that these views are based purely on investment considerations, and are not an expression of any opinion about the social issue involved.

Sincerely,

A handwritten signature in cursive script, appearing to read "Stanford Calderwood".

Stanford Calderwood

SC:wp



Alaska State Legislature

House of Representatives

Committee on State Affairs

Official Business

November 25, 1985

Commissioner Mary Nordale
Department of Revenue
Pouch S
Juneau, Alaska 99811

Dear Commissioner Nordale:

As you are aware, House State Affairs Committee held a public hearing on HCR 17 "Relating to Investment of State Assets in Companies Doing Business with the Republic of South Africa." At that time, various questions and concerns were raised regarding the possible affect of divestment of state funds. The committee hopes you will be able to provide information, differentiating between the general fund, public employee retirement fund and the Permanent Fund, which addresses the following questions:

1. What is the breakdown of Alaska investments and public funds invested in South Africa?
2. What is the risk of loosing public funds invested in South Africa? What is the degree of non-market risk? What is the risk if we don't divest?
3. How would limiting the portfolio to non-South Africa investments affect performance in the short and long term?
4. What would be the effect of divestment if it were conducted gradually over a two, six, twelve, or twenty-four month period?
5. If the state decided to divest, what would be the actual transaction costs?

On behalf of the committee, I want to express appreciation for providing this information which will be of great assistance as the members consider the complex issue of divestment.

Sincerely,

Katie

Rep. Katie Hurley, Chair

RECEIVED
ALASKA DEPARTMENT OF REVENUE

DEC 05 1985

OFFICE OF THE COMMISSIONER

Pouch V
State Capitol
Juneau, Alaska 9981

(807) 488-4883

Navy

Combined Retirement Systems' Investments
Average Assets & Yields During Fiscal Years
(\$ Millions)

	1986		1987		1988		1989		1990		Sum of 5 years
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	
Common Stocks	\$ 517.9	15.00%	\$ 716.6	15.00%	\$ 913.2	15.00%	\$1,127.1	15.00%	\$1,352.6	15.00%	
Industrial Bonds	97.8	12.00	162.2	12.00	251.9	12.00	345.4	12.00	416.2	12.00	
Utility Bonds	69.1	12.25	162.2	12.25	251.9	12.25	345.4	12.25	416.2	12.25	
Treasury Bonds	658.4	10.90	727.4	10.90	691.2	10.90	667.2	10.90	715.9	10.90	
Money Market	262.4	9.20	162.2	9.20	188.9	9.20	218.1	9.20	249.7	9.20	
R. E. Equities	168.0	14.00	202.8	14.00	242.5	14.00	287.2	14.00	333.0	14.00	
Mortgages	529.5	12.50	570.5	12.50	609.3	12.50	645.4	12.50	678.4	12.50	
Total	<u>\$2,303.1</u>	<u>12.31%</u>	<u>\$2,703.9</u>	<u>12.60%</u>	<u>\$3,148.9</u>	<u>12.73%</u>	<u>\$3,635.8</u>	<u>12.83%</u>	<u>\$4,162.0</u>	<u>12.88%</u>	
Return	<u>\$283.51</u>		<u>\$340.69</u>		<u>\$400.85</u>		<u>\$466.47</u>		<u>\$536.06</u>		<u>\$2,027.58</u>

Divestment Effects (Less 47% stocks, 60% industrial bonds, 87% of CD's, BA's, & 77% of cml. paper)

Common Stock	\$ 274.6	12.15%	\$ 379.8	12.15%	\$ 484.0	12.15%	\$ 597.4	12.15%	\$ 717.1	12.15%	
Industrial Bonds	39.2	12.00	64.9	12.00	100.8	12.00	138.2	12.00	166.5	12.00	
Utility Bonds	34.5	12.25	64.9	12.25	100.8	12.25	138.2	12.25	166.5	12.25	
Treasury Bonds	994.9	10.90	1,258.8	10.90	1,422.6	10.90	1,611.3	10.90	1,850.8	10.90	
Money Market	262.4	9.10	162.2	9.10	188.9	9.10	218.1	9.10	249.7	9.10	
R. E. Equities	168.0	14.00	202.8	14.00	242.5	14.00	287.2	14.00	333.0	14.00	
Mortgages	529.5	12.50	570.5	12.50	609.3	12.50	645.4	12.50	678.4	12.50	
Total	<u>\$2,303.1</u>	<u>11.48%</u>	<u>\$2,703.9</u>	<u>11.60%</u>	<u>\$3,148.9</u>	<u>11.61%</u>	<u>\$3,635.8</u>	<u>11.62%</u>	<u>\$4,162.0</u>	<u>11.61%</u>	
Return	<u>\$264.40</u>		<u>\$313.64</u>		<u>\$365.59</u>		<u>\$422.48</u>		<u>\$483.58</u>		<u>\$1,849.69</u>
Divestment Loss	- \$19.11		- \$27.05		- \$35.26		- \$43.99		- \$52.48		- \$177.89

State of Alaska Investment Funds
Assets as of 9/30/85*
(\$ Millions)

	General Fund	Public Employees Retirement Fund	Teachers Retirement Fund	Public School Fund	U of A Permanent Fund	International Airport Fund	Total	% of Total
Repurchase Agreements	170.0	41.4	18.9				230.3	5.
South African Amount*	(0.0)	(0.0)	(0.0)				(0.0)	(0.)
Commercial Paper	370.0	35.0	25.0				430.0	9.
South African Amount	(295.0)	(35.0)	(25.0)				(355.0)	(7.)
Interest Bearing Bank Deposits	3.7	.4	-				4.1	-
South African Amount	(3.7)	(.4)	-				(4.1)	-
Alaskan Certificates of Deposit	43.2						43.2	1.
Government Obligations	1,390.3	486.0	310.6	66.0	6.0	41.6	2,300.5	51.
Corporate Bonds	2.9	84.0	56.0	8.2	2.3		153.4	.3.
South African Amount	(.0)	(18.0)	(12.0)	(4.8)	(1.2)		(36.0)	(.)
Government Agency Obligations				3.0	1.7		4.7	-
Domestic Corporate Stock	31.8	220.9	141.9				394.6	8.
South African Amount	(.0)	(90.0)	(56.1)				(146.1)	(3.)
Foreign Corporate Stock		49.3	31.9				81.2	1.
Mortgages & Loans	74.5	295.1	199.9				569.5	12.
Real Estate Equities	_____	88.6	58.3	_____	_____	_____	146.9	3.
TOTAL	2,086.4	1,300.7	842.5	77.2	10.0	41.6	4,458.4	100.
South African Amount	(298.7)	(143.4)	(93.1)	(4.8)	(1.2)		(541.2)	(11.)

* The figures shown in parentheses for "South African Amount" are investments of State funds in U.S. banks or corporations which do business in South Africa. It is likely that a significant portion of foreign corporate stock investments are in banks or corporations which do business in South Africa. However, information is not available to identify those corporations. No State funds are invested in banks or corporations domiciled in South Africa.

STATE OF ALASKA
DEPARTMENT OF REVENUE

M E M O R A N D U M

TO: Milt Barker ^{AB}
Deputy Commissioner

FROM: James R. Wilson
State Investment Officer

DATE: September 9, 1985

RE: South African Divestment Effects

The proposed divestment of investments in companies doing business in South Africa would have the effect of removing

- 62% of the 50 largest U.S. companies,
- 57% of the Fortune 100 companies,
- 47% of the S & P 500 companies, and
- 35% of the Wilshire 5000 companies

and would constitute avoiding, to name a few,

- 91% of international oil companies,
- 90% of office equipment companies,
- 89% of drug companies,
- 88% of chemical companies, and
- 87% of automobile manufacturers.

The common stock portfolios would have to avoid most of the large, heavily capitalized, successful, and relatively secure U.S. companies and would have to concentrate on utility, transportation, and retail stocks. Because the smaller companies in which investments would have to be made are inherently riskier on a credit basis, they also have more volatile stock prices and hold a greater chance of losing money on the investments. The non-South African S & P 265 (what is left of the 500) has been shown to be 1.84 times more volatile on the upside but 2.27 times more volatile on the downside. This translates to a drop of 18.9% in the probable rate of return over long periods of time. For large funds like the Alaska Retirement Systems, common stock holdings would have to be excessively diversified into too many small holdings. It has been demonstrated that common stock portfolios approaching 100 or more stocks have virtually no chance of surpassing the general stock market's average performance -- ergo, a lower