

ALASKA PERMANENT FUND PROTECTION ACT

SECTIONAL ANALYSIS HB 245

FOR THE HOUSE FINANCE COMMITTEE

Section 1 - Revenues to the Corpus

Section 1 amends AS 37.13.010(a) to increase the petroleum revenues directed to the corpus of the permanent fund, subject to a redirection mechanism that ensures the earnings reserve account is not degraded.

- **Production Taxes:** 100% of production taxes are directed to the corpus
 - Currently, these funds go to the general fund
 - Requires an appropriation
- **Mineral Royalties:** 49.5% of all mineral royalties are directed to the corpus
 - Constitutionally mandated 25% (no change)
 - An additional 24.5% (an increase from 5%)
- **Redirection Mechanism:** if needed to maintain the target balance (*see* Sections 2 and 6), some petroleum revenue may be redirected to the earnings reserve account
- Removes distinction between old and new leases

Section 2 - Target Balance of the Earnings Reserve Account

Section 2 adds subsection (d) to AS 37.13.010, which cross-references AS 37.13.145(1) (*see* Section 6), setting the target balance at equal to four times the prior year's sustainable draw.

Section 3 – Conforming Amendment

Section 3 is a conforming amendment to AS 37.13.140 that removes the calculation of “income available for distribution” because (1) the term relates to the current dividend formula, which would change (*see* Section 4), and (2) other revenues, including production taxes and royalties, may also be available in the earnings reserve account.

Section 4 – Transfers from the Earnings Reserve Account to the Dividend Fund

Section 4 amends AS 37.13.145(b) to change the calculation of the annual dividend.

- Changes the amount transferred from earnings reserve account to the dividend fund to 50% of the prior year royalties instead of approximately 50% of realized investment earnings
- Changes timing of the transfer from the end of the fiscal year to the beginning

Section 5 – Transfers from the Earnings Reserve Account to the Corpus

Section 5 amends AS 37.13.145(c) to change the timing and amount of transfers from the earnings reserve account to the corpus.

- Changes amount transferred to the corpus from the amount necessary to inflation proof the corpus to funds in earnings reserve account exceeding the “target balance”
- Changes timing of the transfer from every year to when excess funds are available
- Flexible inflation proofing and a presumption of savings
 - Over time, these transfers inflation proof the corpus
 - Transferred funds may exceed the amount needed for inflation proofing
 - The flexibility in timing improves the durability of the earnings reserve account and protects the corpus

Section 6 – Revenues to the Earnings Reserve Account and the Sustainable Draw to the General Fund

Section 6 adds subsections (e) to (l) to AS 37.13.145 to direct some petroleum revenues to the earnings reserve account and establish the endowment transfer to the general fund.

- **Redirection Mechanism:** Subsections (e) and (f) mirror the redirection provisions in Section 1. Specifically, if needed to maintain the target balance, up to 100% of production taxes and 24.5% of royalties that are otherwise deposited in the corpus may be redirected to the earnings reserve account.
 - Durability of the earnings reserve account: making these petroleum revenues available to the earnings reserve account helps ensure it is not depleted if there are several consecutive years of low petroleum revenue and low investment income

- Protects the corpus: depleting the earnings reserve account would put the corpus at risk as the state searches for additional funds to pay for government
 - Savings: establishes a presumption of saving excess revenue in the corpus when possible

- **Dividend Royalties:** Subsection (g) provides that funds for the dividend (50% of royalties) gather in the earnings reserve account until they are transferred to the dividend fund under Section 4.
 - Retains the connection between the dividend and the permanent fund.
 - Helps with cash flow, particularly in first few years.
 - Establishes the cash flow pathways in the first year and minimizes departures from the permanent framework.

- **Sustainable Draw:** Subsections (h) and (i) provide for the annual endowment transfer from the earnings reserve account to the general fund.
 - \$3.3 billion fixed-draw
 - Maximum amount
 - Adjusted for inflation beginning in FY 2020
 - Flexible transfer timing allows the Treasury and the Alaska Permanent Fund Corporation to work out a practical and efficient system based on cash flow needs and investment practices

 - Appropriation
 - Framework relies on legislature partnering with the executive
 - The Alaska legislature has a long history of following a rule-based policy for the earnings reserve account

- **Periodic Review:** Subsections (j) and (k) provide for a periodic sufficiency of assets review and adjustments to the draw amount.
 - The Commissioner of Revenue, in consultation with the Alaska Permanent Fund Corporation, conducts a review of the state's financial assets and forecasts and may recommend adjusting the draw amount

 - Scheduled: 2017, 2020, then every 4 years

 - Formulaic: the periodic review uses the same approach and variables used to calculate the initial draw

 - Protects the permanent fund: the periodic review ensures that, in light of experience, Alaska remains on a sustainable fiscal course

- Collaborative: the review is provided to the legislature
- Transparent: all supporting material – data, modeling, etc. – must be made available to the public in its native file format (except for confidential taxpayer information which may be provided in aggregated form)
- Subsection (l) defines “sustainable draw amount” and “target balance.”

Section 7 – Conforming Amendment

Section 7 is a conforming amendment to AS 37.13.300(c) isolating income of the mental health trust fund from net income available for transfer to the general fund.

Section 8 – Conforming Amendment

Section 8 is a conforming amendment to AS 43.55.080 directing production taxes to the permanent fund.

Section 9 – \$1,000 Dividends in 2016

Section 9 amends uncodified law to specify that 2016 dividend checks will be \$1,000 per person. This provision eases the transition to the new dividend formula.

Section 10 – July 1, 2016 effective date