

# PERMANENT FUND PROTECTION ACT

## SECTIONAL ANALYSIS

### SB 26

#### FOR THE SENATE STATE AFFAIRS COMMITTEE

#### **Section 1 – Legislative Intent**

Section 1 expresses legislative intent to reevaluate the use of permanent fund earnings in three years.

#### **Section 2 – Dedicated Mineral Royalties**

Section 2 amends AS 37.13.010(a) to reduce the percentage of mineral royalties directed to the principal (or corpus) of the permanent fund from about 30% of all mineral royalties received by the state (25% from pre-1980 leases and 50% from later leases) to 25% of the total.

#### **Section 3 – Conforming Amendment**

Section 3 deletes the definition of “income available for distribution” in AS 37.13.140. An amended definition of this term will appear in a new subsection, AS 37.13.140(b), created by section 4 of this bill.

#### **Section 4 – Draw formula** (the amount to appropriate from the ERA to the general fund)

Replacing the language removed in section 3, section 4 adds new subsections (b) and (c) to AS 37.13.140. These new subsections contain the new formula for determining “the amount available for distribution each year” from the earnings reserve account (ERA). This “draw formula” has two parts: (1) a percent of market value (POMV) calculation and (2) a “draw limit.”

Contained in new subsection (b), the POMV calculation is 5.25% of the average value of the fund for the first 5 of the last 6 years. The 5.25% POMV is the maximum amount that would be taken from the ERA under the plan. This amount may be reduced by the draw limit contained in new subsection (c).

New subsection (c) provides that after calculating the 5.25% POMV, the draw limit reduces that amount by one dollar for every dollar by which unrestricted (*i.e.*, non-

dedicated) production taxes and mineral royalties exceed \$1.2 billion. Basically, when oil revenues go up the draw from the permanent fund goes down.

Together, the POMV calculation and the draw limit create a draw formula that: (1) stabilizes general fund revenues; (2) avoids using permanent fund earnings when oil revenues are high; (3) allows larger withdrawals (larger than what would be sustainable under a simple POMV) when oil revenues are low; and (4) creates more opportunities for the permanent fund to grow, resulting in larger dividends and more funding available for the general fund when it is most needed.

## **Section 5 – Conforming Amendment**

This conforming amendment updates a cross-reference to the calculation of the “amount available for distribution” or the “draw formula.” The cross-reference is in AS 37.13.145(d) which exempts income from the *Amerada Hess* portion of the fund from the calculation of the amount available for distribution, directing it to the Alaska capital income fund instead.

## **Section 6 – Appropriations out of the ERA**

Defining two types of appropriations out of the ERA, one to the general fund and one to the principal, section 6 adds new subsections (e) and (f) to AS 37.13.145.

To the general fund: New subsection (e) contemplates an appropriation from the ERA to the general fund of the amount determined by the draw formula in section 4. This provision specifies that the appropriation is “up to” the amount determined by the draw formula.

To the principal: New subsection (f) amends the timing and amount of transfers from the ERA to the corpus (the inflation proofing mechanism) currently in AS 37.13.145(c). The current inflation proofing mechanism in AS 37.13.145(c) contemplates an annual appropriation from the ERA to the principal of the amount necessary to offset the effect of inflation in the prior year. AS 37.13.145(c) would be repealed by section 13 of this bill.

To replace AS 37.13.145(c), new subsection (f) instead contemplates appropriating any balance of the ERA that exceeds four times the maximum 5.25% POMV draw (after the transfer to the general fund contemplated in new subsection (e)). In other words, when the ERA reaches 21% of the total value of the fund (5.25% multiplied by four) any money in the account over that amount goes to the principal. Over time, these transfers will inflation proof the principal (grow the principal in pace with inflation). This new formula also means that the timing of inflation proofing transfers changes from a fixed annual event to a more flexible “as we can” schedule.

Inflation proofing transfers to the corpus are, without question, an important element of protecting the permanent fund. However, depleting the ERA would create pressure to realize earnings based on general fund needs rather than on good investment policy. Thus, to ensure investment decisions remain independent of political considerations, the ERA should hold a balance sufficient to bridge several years of low or negative investment returns (and low oil revenues). This more flexible inflation proofing mechanism helps bolster the ERA balance to prepare for that possibility while keeping a mechanism for transfers to the corpus in place.

## **Section 7 – Appropriations from the General Fund to the Dividend Fund**

Adding a new section (AS 37.13.146), section 7 effectively amends AS 37.13.145(b) (which is repealed in section 13) to change the dividend calculation. The new formula has two parts. It contemplates an appropriation from the general fund to the dividend fund of an amount equal to:

- (1) 20% of non-dedicated royalties (which is about 15% of all royalties), plus
- (2) 20% of the POMV calculation (or about 1% of the total value of the fund).

This only relates to the total amount appropriated for dividends. The rest of the formula for per person dividend check is in the dividend fund statute.

## **Section 8 – Conforming Amendment**

Like the conforming amendment in section 5, this provision updates a cross-reference to the “amount available for distribution” or the “draw formula.” The update is in AS 37.13.300(c), which exempts income from the mental health trust fund from the calculation of the amount available for distribution.

## **Section 9 – Conforming Amendment**

This conforming amendment updates a cross-reference to the formula for the amount to appropriate to the dividend fund.

## **Section 10 – 2018 and 2019 Dividends**

Section 10 specifies that, notwithstanding the new dividend formula, dividend checks in 2018 and 2019 will be \$1,000 per person.

## **Section 11 – Conforming Amendment**

Section 11 updates AS 43.23.045(a), specifying that the dividend fund consists of money appropriated to it under the new section AS 37.13.146 (section 7 above).

## **Section 12 – Conforming Amendment**

Amends AS 43.23.055 to clarify that, once funds are appropriated to the dividend fund under AS 37.13.146 (section 7 above) to pay dividends the Department of Revenue may pay dividends without another appropriation.

## **Section 13 – Repeals**

Section 13 repeals three provisions in current statute:

1. AS 37.10.430(c), which creates a CBR subaccount and requires that the main account be invested short-term if the Department of Revenue anticipates a need for those funds within 5 years;
2. AS 37.13.145(b), which contains the current formula for appropriations to the dividend fund that would be replaced by the formula in section 7 of this bill;
3. AS 37.13.145(c), which contains the current inflation proofing formula that would be replaced by the new mechanism in section 6 of this bill.

## **Section 14 – Repeal**

Section 14 repeals AS 42.23.025(c) on June 30, 2020. Created by section 10 (above), this provision applies to dividends in 2018 and 2019 and will be superfluous after the October 2019 dividend distribution.

## **Section 15 – Immediate effective date**