

How the PFD Came to be at Risk

By

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1976 amendment to Alaska's Constitution:

- “At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. ...”
- —Article IX, Section 15 [Effective February 21, 1977].

Orange County Debacle

- “The new rule arises in part out of the losses incurred in 1993 by the government of Orange County. Managers of county investments were able to avoid showing the declining market value of bad investments because they were not required to show the loss on the county-owned fund’s income statement. Accounting experts believe that requiring unrealized gains and losses to be reported will help provide early warning of such investment problems.”
- —“APFC asks for legal opinion on status of income, principal,” *Alaska Budget Report*, February 17, 1999

GASB 31

- “Governmental entities, including governmental external investment pools, should report investments at fair value in the balance sheet. ... Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.”
- —“Summary of Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools,” Government Accounting Standards Board, March 1997

1999 Request for Legal Opinion

- “The Alaska Permanent Fund Corporation has asked the national law firm of Morrison and Forrester to prepare a legal opinion on whether the governor’s proposal in HB 90 to remove \$4 billion from the permanent fund would invade the principal of the fund.
- “...Communications Director Jim Kelly told the Senate State Affairs Committee that a legal opinion had been requested. The issue arose in the context of ... testimony on ... a bill by Sens. Jerry Ward and Rick Halford to transfer ... the fund’s earnings reserve to the principal.”
- — “APFC asks for legal opinion on status of income, principal,” *Alaska Budget Report*, February 17, 1999

1999 Legal Opinion

- “Attorneys from Morrison and Foerster say Gov. Tony Knowles’ proposal to take \$4 billion from the permanent fund won’t violate the Alaska Constitution. But a formula in state law that is used to calculate income available for dividends (or other purposes) should be changed to avoid a possible conflict-of-laws situation that could occur under new accounting interpretations, the lawyers said in a March 3 opinion.”
- — “Lawyers OK \$4 billion transfer from earnings reserve to CBR,” *Alaska Budget Report*, March 10, 1999

The 2002 Crisis, Part 1

- “For a few days in July a falling stock market shaved \$399.9 million off the principal of the permanent fund. The erosion of principal, the first such event in the fund’s 25-year history, reached its deepest point on July 23, culminating a slide that took the fund’s reserves from a comfortable \$8.6 billion in the spring of 2000 to a negative value in July.”
- —“Fund recovers after market slide eats \$400 million hole in principal,” *Alaska Budget Report*, September 17, 2002.

The 2002 Crisis, Part 2

- “Later in July rising market values erased the deficit, but the issues raised by the episode remain, including
- “• worries that fund’s constitutional structure is more vulnerable to meltdown than officials had ever realized,
- “• unsettling legal questions about APFC’s authority to transfer money to the state government when reserves drop into the red, and
- “• increased doubt over whether the fund will be able to meet its dividend and inflation-proofing obligations in 2003.”
- —“Fund recovers after market slide eats \$400 million hole in principal,” *Alaska Budget Report*, September 17, 2002.

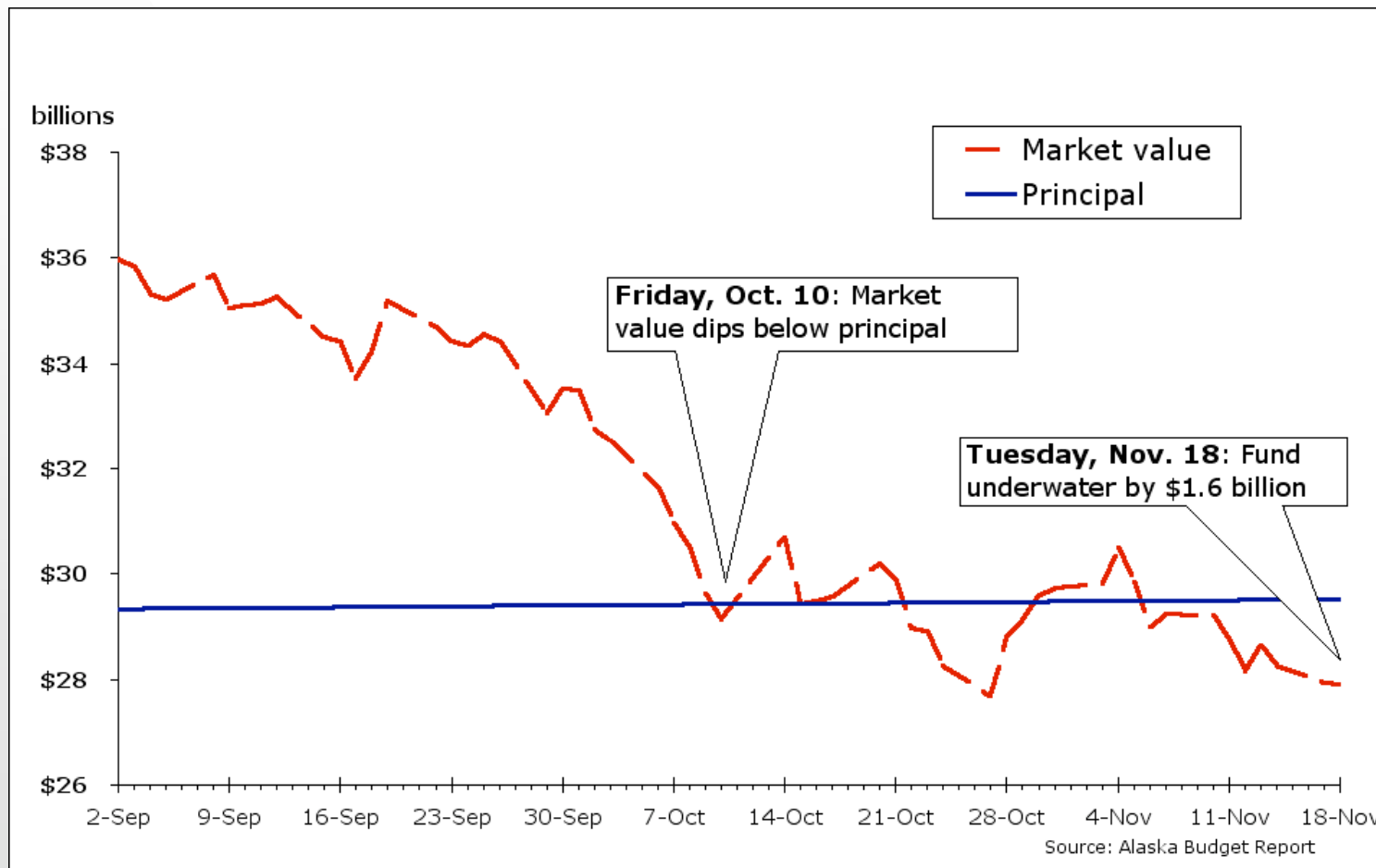
Renkes' Opinion and POMV

- “Only through a constitutional amendment, like that currently proposed by the corporation trustees establishing a payout limit of 5 percent of the total fund value, can the rate of dedication be increased and the deposit of income available for distribution be limited. Absent such an amendment, the full amount of income, made up of the realized gains and losses, is available for expenditure.”
- —Renkes 2003 opinion AG file 663-03-0153

Renkes' Legal Opinion, Part 2

- “There is no basis for expanding the concept of principal by creating a notational number that serves as a limitation on the deposit of income for distribution purposes.”
 - —Renkes 2003 opinion AG file 663-03-0153
- “Rep. Eric Croft of Anchorage says he is still pondering a lawsuit to challenge Attorney General Gregg Renkes’ opinion that unrealized gains shouldn’t be considered ‘available for appropriation.’”
 - —“What do Democrats really want,” *Alaska Budget Report*, December 33, 2003.

Investment losses of 2008-2009



APFC October 23 letter to OMB

- “Erosion of the supposedly permanent principal has stimulated Alaska Permanent Fund Corporation (APFC) officials to seek guidance from the Palin administration on the appropriateness of continuing to draw money from the fund to pay their own salaries and other corporation expenses. ... ‘In times of extreme market volatility with downward trends, as is the current case questions arise regarding the Permanent Fund’s ability to make cash payments **for items such as its operating budget,**’ wrote APFC executive director Mike Burns ... in an October 23 memorandum to OMB Director Karen Rehfeld.”
- —“Principal erodes, payouts questioned, as managers seek cover,” *Alaska Budget Report*, October 31, 2008.

OMB's Reply to Burns

- “A consultation with the Department of Law regarding the corporation’s current circumstances affirms APFC’s interpretation that the [APFC] operating budget should be paid from the positive cash flow in order to meet the FY09 appropriated budget.”
- —OMB Director Karen Rehfeld, Memorandum to APFC Executive Director Mike Burns, November 5, 2008

Current Status

- Principal exceeds market value: fund is \$1.6 billion under water.
- \$1.1 billion needed on June 30 to pay PFD
- \$3.9 billion in realized earnings “reserve” account, but ...
 - ◆ fund investments must grow by about \$2.7 billion (\$1.6 billion + \$1.1 billion) to avoid threat of court intervention.

Options

- Take no action.
 - ◆ Hope markets rise as in 2002.
 - ◆ Hope nobody sues.
 - ◆ If dividends are blocked, deal with economic consequences separately.
 - ◆ Try to find consensus on a POMV amendment for that can win voter approval in 2010.
- Adopt backstop plan.
 - ◆ Pay PFD (all or part) out of CBR, AHFC equity, or other sources.
 - ◆ Hope markets rise before June 30, 2010.
 - ◆ Try to find consensus on a POMV amendment for that can win voter approval in 2010.