APFC ALASKA PERMANENT FUND CORPORATION
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# Memo

To: Governor Mike Dunleavy
State of Alaska

President Peter Micciche
Alaska State Senate

Speaker Louise Stutes
Alaska State House of Representatives

From: Bill Moran, Chair
Board of Trustees

Angela Rodell, CEO

Date: June 22, 2021

Re: Risks of Government Shutdown to the Permanent Fund

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In accordance with our fiduciary role, the Alaska Permanent Fund Corporation (APFC) is proceeding with plans to ensure that the assets of the Alaska Permanent Fund and money managed on behalf of the Alaska Mental Health Trust Authority are prudently overseen in the event of a government shutdown. This includes ensuring that protocols with the Fund's custodial bank are in place and that the ability to transfer money and make certain payments under existing agreements are secured.

Any and all 'activity' will be halted, including exploring new investment opportunities, rebalancing portfolio constituents based on factors including market movements, investment performance, external partner/asset manager issues, etc. Therefore, there can be no assurance that a shutdown will not have a material impact on the earnings and performance of the Fund.

Managing over $80 billion of financial assets requires a tremendous amount of diligence, resources, and commitment, a responsibility that we all hold to the highest standard of fiduciary duty. The absence of this daily stewardship through our management and investment activities can significantly negatively impact the Fund.

With no business activity being conducted starting July 1, 2021, this memo brings to your attention some of the substantial risks and impacts of a shutdown.

## Investments

### Private Markets

APFC's private markets portfolio is large and dynamic, spanning across fund investments, direct investments, and co-investments. For example, APFC holds direct ownership of approximately fifty large commercial real estate properties and holds direct investments in dozens of private companies through its private equity portfolio. While APFC engages with many external advisors and managers on this multi-billion dollar portfolio, a wide range of asset-level issues arise on a daily basis that require various levels of input from APFC Staff to resolve.

Delayed decision-making and input from APFC Staff on its private markets holdings could result in costs and losses that are difficult to estimate. Additionally, the Fund currently has close to $10 billion in committed but undrawn obligations to various private market investments. The Fund's partners and managers can call this capital generally with ten business days' notice and typically without requiring APFC's prior consent. If, in a shutdown, APFC lacks staff resources to responsibly receive, evaluate, and ultimately fund these capital calls, the resultant damages to the Fund could run into *the hundreds of millions of dollars*. These high estimates reflect the punitive penalties standard for missed capital calls in the private equity industry.

Finally, in a shutdown scenario, new private market investment activity would be halted. This halt of in-process investment activity could cause reputational risk to the Fund and opportunity cost from missed investments.

### Public Markets

For Public Markets, in addition to allocating capital to external managers, APFC, over time, has added material value versus its benchmarks through tactical trading decisions. Within the fixed income and public equities asset classes, these trading actions can include, among others: (a) purchasing new issue securities at advantageous pricing relative to seasoned securities, (b) over or underweighting various market factors (e.g., value stocks vs. growth stocks) or market sectors (e.g., overweighting the energy sector when it looked undervalued in the past twelve months), and (c) overweighting different risk premia in the market based on relative attractiveness (e.g., overweighting corporate bonds vs. structured product). In a shutdown scenario, these types of value-added portfolio management activities will cease.

Perhaps a larger issue regarding public market activities is overall Fund rebalancing and rebalancing between asset classes in turbulent markets. For example, significant value was added in the depths of the market drawdown in March 2020 when APFC aggressively purchased equities on a mid-month basis, while the industry convention and actions of most of our peer plans were to wait for more typical month-end rebalancing. Starting July 1, APFC will not be in a position to evaluate portfolio-level rebalancings or to execute any related trades.

## Risk Management

Any and all risk management activity will be halted, including measuring and reporting risks across the Fund, monitoring positions and portfolios relative to investment policy, and reviewing holdings for potential downside risks due to market and/or investment-specific factors.

Further, all activity pertaining to regulatory compliance will be halted, including potential regulatory reporting and filings and counterparty correspondence. Updating and monitoring of all risk systems and databases will also be halted.

Information Technology
A total or partial shutdown brings serious cybersecurity risks, which will grow exponentially each day as the shutdown is extended. Basic IT functions such as security patching along with malware/intrusion detection and monitoring of systems will essentially be halted.

With current press coverage of a possible government shutdown, APFC has already seen a 16% rise in phishing, Spear Phishing and attempted malware/intrusions in viewing current monitoring tools. A government shutdown (and the associated press coverage) will effectively place a "welcome mat" at the door of APFC ingress points to hackers attempting all known vectors of attack with no IT staff available to mitigate threats actively.

Human Resources
Over the past 14 months, APFC has hired sixteen new team members, including eight who have relocated to work and live in Alaska; this includes investors in Real Estate, Fixed Income, Public and Private Markets teams. Over the past few days, the APFC team has had several conversations with staff who are genuinely concerned about the potential shutdown and its implications. All APFC Staff are fully exempt, and for APFC to consistently attract and retain the world-class talent needed to continue the level of success the State expects of them, they need to know they can focus on managing the Fund and not worry about if they will have a job come July 1.

Operational
In April, APFC requested an FY21 supplemental for investment management fees be 'fast-tracked' to meet our contractual obligations to our external managers. The additional funds are needed due to exceptional performance and outperformance over benchmarks, resulting in higher returns for the portfolio. We are appreciative of the Legislature's action to include this appropriation in the final budget. However, with the close of the fiscal year, the delayed budget impacts our ability to pay outstanding obligations. Avoiding the fees and legal remedies incurred from being delinquent is in the Fund's best interest, as our partnerships are a vital component to our ongoing success in generating returns for Alaska.

In summary, a shutdown of APFC will expose the Permanent Fund to a myriad of costly risks, some of which include investment loss, adverse regulatory and legal implications, operational and transactional risks and reputational risk.

We encourage you, our Alaskan leaders, to work together to seek a timely resolution.

Your continued support of the Corporation and the Permanent Fund is deeply appreciated.

Cc:
APFC Board of Trustees
Senate Finance Committee Co-Chairs
House Finance Committee Co-Chairs