

SENATE FINANCE COMMITTEE  
March 31, 2016  
9:03 a.m.

[9:03:42 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:03 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair  
Senator Pete Kelly, Co-Chair  
Senator Peter Micciche, Vice-Chair  
Senator Click Bishop  
Senator Mike Dunleavy  
Senator Lyman Hoffman  
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Angela Rodell, Executive Director, Alaska Permanent Fund Corporation; Senator Lesil McGuire; Laura Achee, Director of Communications and Administration, Alaska Permanent Fund Corporation; Representative Lora Reinbold.

SUMMARY

SB 114 PERM FUND: EARNINGS, DEPOSITS, ACCOUNTS

SB 114 was HEARD and HELD in committee for further consideration.

SB 128 PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS

SB 128 was HEARD and HELD in committee for further consideration.

#sb114

#sb128

SENATE BILL NO. 114

"An Act relating to deposits into the dividend fund; and relating to the Alaska permanent fund."

SENATE BILL NO. 128

"An Act relating to the Alaska permanent fund; relating to appropriations to the dividend fund; relating to income of the Alaska permanent fund; relating to the earnings reserve account; relating to the Alaska permanent fund dividend; making conforming amendments; and providing for an effective date."

9:04:56 AM

ANGELA RODELL, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, presented four sets of slides (copy on file).

Co-Chair MacKinnon noted that the two bills would limit or change how the permanent fund dividend (PFD) was calculated.

Ms. Rodell shared that she hoped to address some misinformation regarding the forecast of the permanent fund.

Mr. Rodell looked at slide 1, "Transfers to principal as of June 30, 2015":

Mineral royalties: \$15.9 billion  
Transfers from General Fund: \$2.7 billion  
Lawsuit settlement proceeds: \$169 million  
Inflation proofing transfer: \$16.2 billion  
Transfers from Earnings Reserve: \$4.2 billion

9:08:45 AM

Ms. Rodell highlighted slide 2, "The Alaska Constitution":

Article IX, Section 15  
Alaska Permanent Fund  
Section 15. Alaska Permanent Fund  
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. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law [Effective February 21, 1977].

Ms. Rodell stressed that the constitutional amendment was required, because the state had a prohibition against dedicated funds. She explained that the amendment was very straight forward. She read the amendment. She stated that the bills would amend the statutory framework.

Ms. Rodell discussed slide 3, "Statutory findings":

Section 37.13.020. Findings. The people of the state, by constitutional amendment, have required the placement of at least 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments and bonuses received by the state into a permanent fund. The legislature finds with respect to the fund that

- (1) the fund should provide a means of conserving a portion of the state's revenue from mineral resources to benefit all generations of Alaskans;
- (2) the fund's goal should be to maintain safety of principal while maximizing total return;
- (3) the fund should be used as a savings device managed to allow the maximum use of disposable income from the fund for purposes designated by law.

Ms. Rodell addressed slide 4, "Investment Authority":

AS 37.13.120 "Prudent Investor Rule"

- Exercise judgment and care of similar institutional investors,
- while considering preservation of the purchasing power of the fund over time, and
- while maximizing the expected total return from both income and the appreciation of capital.

9:13:14 AM

Ms. Rodell stressed that there would be no changes in the sections. Therefore, there would continue to be investment in the fund.

Senator Dunleavy looked at slide 1, and queried additional legislative action to add money to the fund. Ms. Rodell replied that the slide was the total of all the legislative decisions.

Co-Chair MacKinnon referred to a slide from a previous meeting, which showed the PFD amount distribution, and asserted that the legislature had contributed nearly \$20 billion above the mandatory 25 percent contribution.

Senator Dunleavy stated that he had misread his notes.

Ms. Rodell shared that there was a reference of approximately \$20 million.

Senator Bishop stated that Ms. Rodell had answered his previous question. He wondered whether the board had conducted an analysis. Ms. Rodell responded that the board had not undertaken that endeavor, because the investment decisions and timing caused a difficult analysis.

Senator Olson looked at the ten-year period, which had doubled the fund doubling in value. Ms. Rodell stated that there was an important change in that doubled the fund.

9:17:18 AM

Ms. Rodell looked at the investment returns, and shared that there had been some confusion regarding the forecast. She explained that, previously, the permanent fund provided a forecast at the request of Department of Revenue (DOR). She stressed that the forecast was intended for the supplemental budget and operating budget changes. She furthered that the forecast also provided the previous year numbers in order to calculate the upcoming PRD payout. The ten year forecast had shifted further, so there were two different rates.

Senator Hoffman queried the institution year of inflation proofing. Ms. Rodell replied that it was instituted in 1982.

Senator Hoffman noted that, since 1982 there was \$16.2 billion deposited to the fund. He queried the total realized amount in the reserve account. Ms. Rodell agreed to provide that information. She deferred to Ms. Achee.

[9:20:56 AM](#)

LAURA ACHEE, DIRECTOR OF COMMUNICATIONS AND ADMINISTRATION, ALASKA PERMANENT FUND CORPORATION, introduced herself.

Senator Hoffman queried the amount of deposits in the reserve since its inception. Ms. Achee agreed to provide that information.

Co-Chair Kelly queried the management statuses for paying out annuities. He felt that 6 percent was a high number. Ms. Rodell stated that the board of trustees had a target real return of 5 percent. The 6 percent had a fixed inflation adjustment. She shared that the bar was set, because of the long time horizon to weather the market volatility. She remarked that the corporation was currently even for the year, with three months remaining.

Co-Chair Kelly noted that the governor had hoped move \$3.1 billion from the CBR to the corpus of the permanent fund, so there would be \$55 billion in the fund. He felt that the CBR would not be put in the earnings reserve pot. He did not feel the CBR would be put in the earnings reserve. He wondered that would occur. Ms. Rodell replied that it would make it difficult to keep the flat draw about at the \$3.2 billion amount.

[9:28:07 AM](#)

Co-Chair Kelly did not want there to be conflict with the governor. He asserted that the model must be POMV, should there be no draw from the CBR. He felt that the governor's plan would not work without the POMV withdrawal.

Co-Chair MacKinnon shared that there would be documents provided with more information.

Co-Chair Kelly felt that the document would answer many of his questions.

Vice-Chair Micciche noted that there was a political difficulty of the CBR withdrawal. He remarked that conservative management pushed a POMV. He worried that the fixed draw had too great a failure rate. He queried the opinion of fixed draw versus POMV. Ms. Rodell responded that each had pros and cons. The pros for the fixed draw required a plan. The proposed bill recognized that the amount may need adjustment. She stressed that there would be \$3 billion on July 1, and any other revenues of the state would be directed to the earnings reserve. She felt that there was tremendous value in the known amount. She stressed that there may be challenges in the process for adjusting the amount. She was uncomfortable with putting a fixed number into statute. She felt that the statutory restraint made it difficult to adjust the fixed rate.

Co-Chair MacKinnon queried a position that the board may have previous taken. Ms. Rodell replied that the board of trustees had a resolution in place for a constitutional amendment for a POMV draw on the fund.

Co-Chair MacKinnon wondered whether the legislature had the ability through statutory changes. Ms. Rodell replied in the affirmative.

Co-Chair MacKinnon surmised that the policy decisions were either an annuity style or percent. She stated that both were effective models, and there would be a fixed draw versus something more volatile. Ms. Rodell agreed.

[9:35:27 AM](#)

Vice-Chair Micciche felt that a fixed draw may create an artificial security and would detach from the volatility of a static return. He wanted to be forced to "live within our means", and not count on the absence of a failure rate.

Co-Chair Kelly noted that there was some discussion regarding a spending cap, but he felt that spending caps did not generally work. He stated that the constitutional spending cap that was flawed. He remarked that there could be a percent of market value, and apply a cap that would not exceed \$3.6 billion in any year. He felt that there was discipline in place to live within the means.

Co-Chair MacKinnon stated that a document was distributed to the members.

9:39:18 AM

AT EASE

9:40:19 AM

RECONVENED

9:40:21 AM

Co-Chair MacKinnon stated that the documents would be posted online.

Vice-Chair Micciche felt that Co-Chair Kelly had a valuable point.

Senator Hoffman stated that the constitution was forcing the legislature into the discussion. He stated that, regardless of the formula, there would not be enough to address the issues in the state. He remarked that there were other measures in play, and stressed that there should be a total package option.

Senator Bishop shared that the committee was funding a budget with no capital. He stressed that the state should not be dependent on the federal government.

Ms. Rodell offered that the limitations in place under each bill were limited to the amounts available in the earnings reserve account.

Senator Bishop noted that the only difference between the two plans was that one guarantees a return on the permanent fund, and the other one did not guarantee a return. Ms. Rodell disagreed. She felt that one plan would require a set dollar amount be delivered regardless of the return on the fund; and the other would take into account the actual returns, and set a limit based on the percent of market value.

Senator Bishop surmised either plan would only payout what the earnings reserve earns in one year. He felt that, hypothetically, the earnings reserve was intended to produce 3.3 percent. Ms. Rodell replied that stated that the ramifications were unclear, so it did not matter how

much money the earnings reserve made in that year. She stated that there would be an increase in the balance to generate the funds, and hopefully exceed the draw.

Senator Bishop stressed that the balance in the earnings reserve would self-regulate. Ms. Rodell agreed.

Senator Bishop felt that either plan required a healthy oil and gas, and mining industry.

[9:48:12 AM](#)

Co-Chair MacKinnon wondered how the fixed rate draw or percentage would affect earnings, or the asset allocation under the permanent fund board's jurisdiction. Ms. Rodell shared that, from an investment return perspective, it is better to lower the number of draws to extend the investment time. She shared that DOR was paying bills on a daily basis, so there was a need for more frequent draws.

Co-Chair MacKinnon asked if it was better establish a memorandum of understanding with the administration to create the timing, rather than drafted in statute. Ms. Rodell replied in the affirmative.

Co-Chair MacKinnon noted that school districts were allowed two draws per year, and she believed that the state was advancing the money. She wondered if there was interplay there with the cash management. Ms. Rodell deferred to the commissioner of Department of Education and Early Development (DEED).

Co-Chair MacKinnon stated that DEED drew three to six months of value in interest, once the money was transferred in the form of the Base Student Allocation (BSA).

Ms. Rodell wondered if the corporation would move to a fixed asset in order to do annuity rather than a percentage payout. Ms. Rodell stated that there was a focus on income, while maximizing return. She shared that there were asset classes, such as real estate, that generated great returns for the state. She furthered that the asset classes generated tremendous monthly income that was deposited in the earnings reserve account. She explained that there would be an examination of utilizing the asset classes as effectively as possible.

9:55:16 AM

Co-Chair MacKinnon noted that there was no new money for Alaska, and there was a desire to use available assets in order to help mitigate the loss nearly 80 percent of the revenue. She looked at inflation proofing, which was paid on an annual basis in order to keep it in today's dollar value. She remarked that the withdrawal were either the annuity draw or fixed rate draw. Ms. Rodell replied that inflation proofing was applied in 1982; at a time when the fund was solely invested in bonds. It was an effort to preserve the purchasing power of the fund. She explained that, as bonds mature, cash was received. The cash may not buy as many bonds at the time of initial investment, because of inflation proofing. She explained that 20 percent of the portfolio was in fixed income, so it would benefit from inflation proofing. She remarked that the other 80 percent of the portfolio included inflation in the valuation and capital appreciation of the investments.

Co-Chair MacKinnon noted that Alaskans were concerned about protecting the corpus of the permanent fund. She stressed that the corpus was protected under the constitution. She queried a different way to protect or allocate the permanent fund under a different model. She wondered whether there was a short-term mechanism to use the inflation proofing to benefit Alaskans. Ms. Rodell replied that the calculations were conducted under the current statute, and the operating budget held the various appropriations under the calculations for inflation proofing or the dividend. She stated that there was nothing to prevent the legislature from making any general fund appropriations back to the corpus. She furthered that the corporation may ask for that appropriation in the future.

10:00:21 AM

Co-Chair MacKinnon wondered if the board had made recommendations to the legislature on the unrealized or realized earnings. She also queried the calculation process. Ms. Rodell replied that the purpose of the board's resolution in 2004 to ask for a constitutional amendment was because the 1976 amendment stated that the generally accepted accounting rules only provided for realized income. Therefore the financial statement income and the bond income could be easily tied and reconciled.

She remarked that the accounting community had made changes with the increased complexity of investments and the financial community. She shared that generally accepted accounting principles required that the net income include both unrealized and realized gains in the calculation. She furthered that there was a statutory definition, which only recognized realized gains. She stressed that the realized gains were the only moneys available for appropriation.

Senator Olson queried the likelihood of not being able to access the unrealized earnings. Ms. Rodell replied that in 2009 there was a loss in statutory net income, and money was moved from the earnings reserve account to make the corpus whole. She stressed that it was an unusual occurrence.

Senator Olson looked at the fixed draw, and noted that the commissioner did not invest at one point. He remarked that the state lost money because of that hesitancy. He wondered whether a similar situation would occur with the fixed draw. Ms. Rodell replied that at the time of the hesitancy, the CBR had significantly more assets. She remarked that the fixed draw would go directly into the GF, and have GF authority.

Senator Olson wondered whether the scenario was likely to occur. Ms. Rodell replied that it was less likely to occur.

[10:06:56 AM](#)

Co-Chair MacKinnon queried feedback regarding the concept of rolling all investment under one "roof" of the Alaska Permanent Fund Corporation. She stated that there were two entities: one under the leadership of Department of Revenue (DOR), and the Permanent Fund. She shared that she had offered the idea of only one engine. Ms. Rodell replied that she had been in conversations with Commissioner Hoffbeck regarding that subject. She remarked that funds had been consolidated as much as possible. She noted that there was a question of whether there were efficiencies that could benefit the state.

Co-Chair MacKinnon stated that there had been inserted intent language, with another way to create efficiencies and managed in a safe way.

Ms. Rodell shared that the total amount of statutory net income that had been moved into the earnings reserve account was \$45.9 billion. She added that she had provided some history of the Permanent Fund. She remarked that many questions posed in the meeting had been asked in previous years.

Co-Chair MacKinnon wondered whether the \$45.9 billion was paid in dividends. Ms. Achee replied that \$20 billion was moved into principal from the earnings reserve. She furthered that another approximately \$20 billion had been paid in dividends since 1982. The remaining money was approximately \$7 billion in the earnings reserve.

Co-Chair MacKinnon asserted that the legislature did not spend that money. Ms. Achee agreed, and announced that the legislature saved \$20 billion.

SB 114 was HEARD and HELD in committee for further consideration.

SB 128 was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

10:12:40 AM

The meeting was adjourned at 10:12 a.m.