HOUSE FINANCE COMMITTEE
January 22, 2018
1:33 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Les Gara, Vice-Chair
Representative Jason Grenn
Representative David Guttenberg
Representative Scott Kawasaki
Representative Dan Ortiz
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Angela Rodell, Executive Director, Alaska Permanent Fund Corporation.

PRESENT VIA TELECONFERENCE

None

SUMMARY

OVERVIEW: AK PERMANENT FUND BY ANGELA RODELL, CEO

Co-Chair Foster relayed the agenda for the day and invited Ms. Rodell to the table.

^OVERVIEW: AK PERMANENT FUND BY ANGELA RODELL, CEO

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ANGELA RODELL, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, introduced herself and indicated questions were welcome. She introduced the PowerPoint presentation: "Overview: Alaska Permanent Fund."

Ms. Rodell began with slide 2: "The Alaska Constitution." She reminded members of the establishment of the Alaska Permanent Fund in the Alaska Constitution. The language concerning the fund was approved more the forty years prior in 1976 by a significant margin. She read a portion of the Alaska Constitution:

> Alaska Constitution Article IX, Section 15
> 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.

Ms. Rodell moved to the flow chart on slide 4: "How the Fund Works." The chart showed the source that flowed into the principle: royalties, inflation proofing appropriations, and special appropriations. The principle, an asset managed by the Alaska Permanent Fund Corporation (APFC), was constitutionally protected. The resulting income was deposited into an earnings reserve account (ERA). The earnings reserve account was comprised of net investment earnings, statutory net income, realized gains and losses, and cash flow income (stock dividends, bond interest, real estate leases, and alternative investment distributions). The earnings were available for appropriation under AS 37.13.145(a). Some of the money was appropriated for AFPC's operating and investment expenses. The legislature used some of the earnings to inflation proof the principle, pay the Permanent Fund Dividend, and pay for some state government needs. She continued that each investment made by APFC was owned on a pro-rata basis by the principle and the ERA. The principle was only entitled to a recovery of the cost basis of an investment. The earnings reserve account received its cost basis and any gain that was realized by both the principle and the ERA.

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Ms. Rodell continued to slide 5: "Invested as One Fund." The Alaska Permanent Fund Corporation invested the assets under management as one fund. The corporation was responsible for the investment and management of the fund. The board of trustees adopted one target asset allocation for all of the funds under management. Investments were purchased on a pro-rata basis by the principle and ERA.

Ms. Rodell advanced to slide 6: "Statutory Net Income AS 37.13.140." She explained that the money the corporation was able to move into the ERA constituted statutory net income. At the time the Alaska Constitution was originally adopted, the generally accepted accounting principles defined income as anything that was realized. However, in 1997, generally accepted accounting principles changed, adopting a new definition of income. It included realized and unrealized income. Recognizing the difficulty in appropriating unrealized gains or unrealized losses, the legislature adopted a new definition of income, the statutory net income as presented on the slide:

> Statutory Net Income AS 37.13.140
>
> Pursuant to state law (AS 37.13.140), at the end of each fiscal year APFC calculates and reports on the net realized gains accounted for during the fiscal year.
> - These net realized gains and investment income are the funds in the ERA that are subject to appropriation by a simple majority of the Alaska Legislature.
> - Net realized gains = realized gains accumulated during the fiscal year (-) minus realized losses accounted for during the year.
> - Unrealized gains earned by Principal are part of Principal, only until realized at which time they are transferred to the ERA.

Ms. Rodell pointed to the graph on the right of the slide which showed that from 2013 to 2017, the state had a fairly steady statutory net income. In 2018, the corporation was projecting a statutory net income of $4.4 billion. She would not be surprised if it was slightly higher. She provided an example of why it was growing. The market had been robust for well over a year, and APFC had been required to do some rebalancing to avoid being overweight in public equities asset allocations. As the corporation trimmed down the allocation it was realizing the gains. It meant that statutory net income increased, and the gain was deposited into the ERA.

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Representative Ortiz was looking at the net income from 2013 through 2018. He wondered if the income was the same as the annual return of 6.9 percent. Ms. Rodell responded that it was not. The difference was in the unrealized gain. When APFC calculated income for accounting purposes, everything including realized gain, unrealized gain, realized loss, and unrealized loss. The amount represented only the net realized gain minus realized loss. It did not take into account any of the realized gains and losses.

Representative Guttenberg asked about the thought process behind rebalancing funds. He wondered about the effect of the money becoming earned income. He asked about the rebalancing of money available, money going back into the principle, and money outside of making the Permanent Fund healthy. Ms. Rodell explained that the only thing that drove rebalancing efforts was keeping the fund within the parameters and target asset allocations approved by the board of trustees. She furthered that the individual portfolio managers made decisions as to where the money should come from within their public equity portfolio. For example, the US domestic equity market had been particularly robust. The board had approved a tactical tilt. In other words, the trustees liked what they saw in emerging markets outside of the US. Some of the investments were taken out of domestic markets and deployed into other asset allocations rather than taking the investment pro-ratably from every manager across public equities.

Ms. Rodell reviewed slide 7: "Assets Under Management in billions." She noted that in terms of the total assets under management over the previous 4 years (FY 14 - FY 17) and in FY 18(unaudited) the principle of the fund remained steady. As the accounts realized gains, they were moved into the ERA, which had benefited and grown from the activities of the fund over 4.5 years.

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Ms. Rodell scrolled to slide 8: "Principal." She reminded members that the principle was built primarily through royalty deposits, inflation proofing, and special appropriations. Over the years the legislature had acted to put additional revenues into the fund. She reported that approximately $16.5 billion in mineral royalties had been deposited. Transfers from the ERA for inflation proofing equaled $16.2 billion. Also, special appropriations had been made from the ERA and the general fund (GF) in the amount of $7.1 billion.

Ms. Rodell detailed slide 9: "Inflation Proofing." The board continued to emphasize the importance of inflation proofing the principle. In September 2017, at its annual meeting, board members adopted Resolution 17-01 directing the corporation to identify and pursue support for inflation proofing the principle in order to preserve the purchasing power of the principle account for all generations as stated in AS 37.13.020. She noted the contributions over the years as depicted on the slide. She pointed out there was not an inflation proofing deposit into the principle in 2010. The appropriation was also not included in the budget for FY 16, FY 17, or FY 18. She has included the amount proposed in the governor's budget for FY 19 to restore the inflation amount. She thought the amount demonstrated the movement of inflation and how it has started to pick up. She also thought it reflected how the rapid size of the fund contributed to how quickly the corporation could fall behind on the principle account regarding inflation. The slide also included the estimated royalty deposits for FY 18 and FY 19 provided by the Department of Revenue (DOR) Fall Forecast at the 25 percent amounts.

Vice-Chair Gara referred to the royalty portion. He relayed that originally 25 percent of all royalties was deposited into the Permanent Fund. In the 1990s, it was determined that for the newer fields 50 percent of royalties would go into the fund. In the early 2000s, when things were going poorly, a bill was passed that moved the percentage back to 25 of royalties for new fields. However, it did not happen. He asked about the difference of the "then" newer fields going from 50 percent to 25 percent. He wondered what would be left for the general fund on average. Ms. Rodell responded that APFC did not track information by field or lease type. The corporation simply received a lump sum from the Department of Natural Resources (DNR) and used DOR's forecast. Vice-Chair Gara jokingly asked her to explain why the corporation did not invest in Bitcoins.

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Representative Wilson asked if it was the intent of the governor to inflation proof the fund in FY 19 to make up for the prior 3 years or just inflation proof the fund in the amount of $943 million. Ms. Rodell responded that the governor had 2 appropriations in his proposed budget; one for FY 16, FY 17, and FY 18 and one for FY 19.

Representative Wilson asked about the ramifications of removing the royalty deposits. Ms. Rodell assumed that the representative meant anything over 25 percent otherwise it would be a violation of the constitution. She did not know what the difference would have been had the fund received the full percentage it had received in the past. She thought the information could be provided by either DNR or DOR.

Ms. Rodell discussed slide 10: "Unrealized Gains in billions." She informed members that the slide showed how much in unrealized gains had been added to the Permanent Fund and to the assets under management between the accounts. Currently, in the principle of the account there was approximately $40 billion in contributions and $8.7 billion in unrealized gains. She suggested that if APFC sold and realized every one of the dollars, $8.7 billion would be transferred to the ERA. She wanted to provide a sense of how much was due to the pro-rata share being bought by the principle investments and how it did not contribute to the amount available to invest by the principle. She continued that the ERA had $12.6 billion in realized earnings and $2.7 billion in unrealized gain. There was a total of about $15.3 billion marked into the ERA with a nod towards the additional $8.7 billion if it was sustained and no losses occurred until those dollars were realized.

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Ms. Rodell pointed to actual balances on slide 11: "Fund Balance FY 18 Q2 and FYE 17." She noted that the balance sheets we posted on APFC's website monthly. The balances were unaudited through December 31, 2017 compared to where the fund started in the fiscal year. She highlighted that total assets had increased from $60.5 billion to $64.4 billion in 6 months. The majority of the increase came from preferred and common stock accounts which were part of the public equity bucket. She noted that the corporation continued to book for inflation proofing, an amount based on the statutory formula. Given how the dividend had been negotiated over the previous couple of cycles, APFC's auditors had recommended the corporation not book anything for the dividend as an ongoing liability. She also pointed out that the realized earnings had increased by about $1 billion along with the unrealized appreciation in uninvested assets. She noted that in looking at the non-spendable balances of $40 billion from contributions and appropriations. It came in a non-spendable form because it was an unrealized net gain of $8.7 billion. The earnings reserve account balances could be found under the subtitle, "Assigned for future appropriations.".

Co-Chair Seaton noted there had been discussion about inflation proofing and that there was automatic inflation proofing because of investments. He asked Ms. Rodell to elaborate on those discussions.

Ms. Rodell suggested returning to the previous slide which she thought provided the best example of automatic inflation proofing. She suggested taking the principle as an example. The growth of $8.7 billion that was coming in unrealized gain had the concept of inflation attached to it. There were investments that naturally embedded inflation in them, such as real estate. If a person were to buy a piece of property and it grew in value it would be embedding the notion of inflation over the time period. It would not be like a fixed income bond that was purchased at a certain price and it lost value with high inflation. In looking at the principle, it had increased to $48.7 billion, except the principle of the fund was not entitled to any of that inflation gain. To make sure that the $40 billion coming directly from the non-renewable resource that had been preserved for current and future generations of Alaskans, the state needed to put back some of the gain. This was done through inflation proofing into the corpus of the fund.

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Co-Chair Seaton mentioned inflation proofing inflation. He thought that if the unrealized value had increased by $8.7 billion, and the legislature was inflation proofing that number as well as the invested amount, it would be inflation proofing inflation even though it was unrealized gain. He wondered how inflation was being considered in calculating inflation proofing.

Ms. Rodell reported that the corporation was only calculating inflation on the $40 billion. It was not calculating inflation proofing on any unrealized gain.

Vice-Chair Gara referred to page 9. He noted that in looking at FY 11 through FY 15 there was inflation proofing and the deposits from the 25 percent royalty were about the same as inflation proofing. There were additions to the PF to grow it from the deposits and about the same amount from inflation proofing. In the prior year the legislature had indicated it could not afford inflation proofing. However, the failure to inflation proof had started 2 years prior to the current majority forming. He wondered if it was accurate to say that in the prior 3 years the legislature had not inflation proofed the fund. Ms. Rodell responded that he was correct.

Vice-Chair Gara asked her if it was her preference to see the fund inflation proofed. Ms. Rodell responded that reinjecting some of the wealth the fund had created over the previous 2 years through the inflation proofing mechanism was important. She also emphasized that royalty deposits should not be confused with inflation proofing the fund. Royalty deposits were the non-renewable resource coming in and being saved for future generations of Alaskans. It was not inflation proofing the fund.

Vice-Chair Gara thought everyone would agree that they wanted to grow the fund. He commented that it was a conundrum the legislature would have until a fiscal plan was in place.

Representative Wilson asked if the committee could hear from DNR about the discrepancy with some of the numbers.

Co-Chair Foster noted there was no one available from DNR and asked his staff to get a response from the department.

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Ms. Rodell scrolled to slide 12: "Changes to Fund Balance." She indicated that the slide reflected the activity of the corporation for the prior 6 months and for the current month. She thought it would be evident where money started coming in. The corporation received interest income of $224 million, dividends of $310 million, and real estate and other income for a period of 6 months. She suggested that members should think of these revenues as regularized income that she expected to see totaling about $711 million. Next, she pointed to the increase or decrease in the fair value of investments. It spoke to Representative Ortiz's question about the difference between accounting income and statutory net income. The Alaska Permanent Fund Corporation recognized the change in fair value just in 6 months ending December 31, 2017 and the large boost the bull market had given the public equity portfolio to about $2.6 billion. She also noted the amounts that had flown out of the fund for operating expenditures. They were the corporation's expenditures, expenses having to do with external management, and other legislative appropriations. The other legislative appropriations were monies paid to DNR to collect the corporation's share of royalty, the Department of Law, and other entities for similar items. She noted the transfers in and out of the account including $726 million which paid for the Permanent Fund Dividend. The fund balance changes could be seen on the slide as well. The statutory income calculation was reflected in the box. The corporation made the adjustments for the unrealized gains (adding back losses and subtracting gains). The statutory net income for 6 months equaled $2.4 billion.

Representative Pruitt asked about currency and the associated loss reflected for the year ending June 30, 2017. He asked if it was because the cash the state had on hand had been affected by inflationary forces. He wondered if it had to do with investments outside of the United States and the exchange in currency values. He asked her to elaborate.

Ms. Rodell responded that the currency line Representative Pruitt referred to, was the effect of having investments outside in currencies other than US denominations. She relayed that when the value of the dollar was strong, it tended to widen, and more losses could be seen. Conversely, when the value of the dollar went down gains or losses could be seen equivalent to the change in value. She explained that he was seeing the effect of the global portfolio. She pointed to the disclosure in the annual report that relayed the forty or more currencies that the state was exposed to and the amount each of the exposures had contributed to or subtracted from the currency line on the slide.

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Ms. Rodell advanced to slide 14: "Board of Trustees." She relayed that one of the questions the corporation was asked frequently was how it invested. She relayed that it was up to the board of trustees:

> Board of Trustees
>
> As the fiduciaries, the Trustees have a duty to Alaskans in assuring that the Fund is managed and invested in a manner consistent with legislative findings: AS 37.13.020
>
> - The Permanent Fund should provide a means of conserving revenue from mineral resources to benefit all generations of Alaskans.
> - The Permanent Fund's goal should be to maintain safety of principal while maximizing total return.
> - The Fund should be used as a savings device managed to allow the maximum use of disposable income from the Fund for the purposes designated by law.

Ms. Rodell continued to slide 15: "Investment Oversight":

> AS 37.13 .120 Investment Responsibilities - Mandates Use of the Prudent Investment Rule
>
> Board of Trustees
>
> As fiduciaries of the fund, full authority to make investment decisions.
> - Provide authority to invest within set bands
> - Approve target asset allocation
> - Adopt investment policy

Chief Executive Office

Assures strategies adopted by the board are successfully implemented.

Chief Investment Officer

Makes strategic and tactical allocations to allow the fund to grow in value.

Portfolio Managers

Responsible for the investment and performance of each asset class.

Ms. Rodell turned to slide 16: "The Portfolio $64.0 Billion as of FY18 Q2." She read the target allocation percentages for FY 18 from the pie chart:

The Portfolio $64.0 Billion as of FY 18 Q2

Target Allocation (FY 2018)

39 percent: Public Equities
22 percent: Fixed income plus

Ms. Rodell indicated that the two allocations were the tradable liquid portions of the Permanent Fund and made up about 61 percent of the total assets under management.

Ms. Rodell would walk through each of the asset classes and provide a sense of management, cost, and the amount each of the portfolio managers were responsible for. She reviewed public equities on slide 17: "Public Equities $26.1B audited value as of 6/30/17." She would tie the information back to the fiscal year audited figures because it was in the annual report. The corporation had $26.1 billion dollars on June 30, 2017 in public equities. She provided a perspective on size: the amount was the entire size of the fund 10 years prior. The director of public equities oversaw an internal team of 2 and oversaw 28 external managers with strategies in US domestic, global, and international funds. He held quarterly meetings with each manager, confirmed strategies and performance, and gauged and adjusted mandates as required. Currently, he was going through a large rebalancing effort because of the bull market taking too much of the asset allocation. He was also responsible for internally managing the tactical portfolio and provided active oversight of the external portfolio managers. The stock holdings were liquid-growth, international equities, global equities, and domestic equities. The Alaska Permanent Fund Corporation's operating fund attributable to the public equities portfolio, including Ms. Rodell's time and overhead, the back office, and the middle office, was about $2.9 million for the FY 17 budget. The corporation paid external fees of $60.7 million to external managers along with $3.7 million in performance fees. They were net of fees.

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Representative Pruitt brought up the notion of internal investment managers versus external investment managers. He believed there should be a balance of both. There had been discussion in the previous year about additional funding for APFC to bring in additional internal investment managers. He noted that within public equities there were 2 internal employees and 28 external investment managers. He wondered if Ms. Rodell thought bringing in more internal investors would save the corporation and the state more money. He asked how the legislature could help save money so that APFC had more money to invest.

Ms. Rodell answered that it was an ongoing priority of the board of trustees to bring managerial assets in-house where it made sense. She noted how grey the line was between internal and external management. She opined that it would never be cost effective or prudent to manage a $26.1 billion public equities portfolio internally solely by Alaskans in Juneau. She relayed that when she spoke with some of the external managers, they reported that technology had allowed them to do much more with fewer traders. The corporation wanted to rely on "boots-on-the-ground" information they had access to by being in various markets - one reason for having a mix of internal and external management. She had one public equities director with two people working internally for him. She thought more could be done internally, but it would be a constant balance. Not only did the corporation want the flexibility that internal management provided to shift between strategies and the lower cost, the corporation wanted to be very nimble with all of it. She thought the corporation could do better internally.

Representative Pruitt appreciated the notion of getting to a balance. He wondered if part of getting to a balance was the legislature allowing for the appropriation. He wondered about making recruitment competitive and whether Ms. Rodell wanted assistance from the legislature.

Ms. Rodell commented that the corporation needed assistance in a couple of different ways, first of which was funding. For example, the corporation could hire an external manager. However, if the corporation were to do direct investing, she might need a data feed to help an internal manager with their job. She would have to go through the procurement process, which was not necessarily flexible. She thought it was important for the corporation to let the legislature know what it was doing and how. The next few slides would provide information about where money was being targeted.

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Ms. Rodell advanced to slide 18: "Fixed Income Plus $11.7B audited value as of 6/30/17." She indicated that public equities represented the corporation's largest asset allocation of 40 percent. Fixed income plus was the second largest portfolio. At the end of the fiscal year the audited value was approximately $11.7 billion. The director of fixed income plus oversaw a team of four. The corporation had been handling the asset allocation internally for more than 20 years. The team actively traded and assessed the fixed income plus portfolio. She reported that currently $7.7 billion was internally managed, and $4.0 billion was managed externally due to a change the board of trustees made to the asset allocation in 2016. She pointed out that the portfolio was called, "Fixed Income Plus" which meant that the corporation added listed infrastructure and real estate investment trusts (REITS) to the assets that the team managed. The additions required more money to be managed externally than in the past. She indicated the list of assets could be found on the right-hand side of the slide. The operating expense associated with the allocation was about $4.8 million and approximately $10.2 million was paid in external fees.

Ms. Rodell moved to slide 19: "Private Equity and Special Growth $7.0B audited value as of 6/30/17." She reported that the private equity and special growth portfolio had an asset allocation of about $7.0 billion. The director oversaw a team of two. It was a very labor-intensive asset allocation. The team was responsible for looking at direct private equity investments, evaluating and doing due diligence on co-investments, and working with fund managers on the monies they managed. The corporation had a $2.9 million allocation for operations and external fees of $11.5 million along with $182.9 million in net fees. They were some of the higher fee investments the corporation had and significantly contributed to returns.

Ms. Rodell advanced to slide 20: "Infrastructure, Private Credit and Income Opportunities $3.2B audited value as of 6/30/17." The portfolio was very similar to the previous allocation. The difference was that the infrastructure, private credit and income opportunities portfolio was private income as opposed to private growth. Money was invested in illiquid income structures such as infrastructure, private credit, and income opportunities. The director of private income was also responsible for another portfolio. He had one person on his team that worked on the asset holdings with an operating budget of $1.4 million.

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Ms. Rodell slide 21: "Absolute Return $2.2B audited value as of 6/30/17." The director of private income was also the director of the absolute return portfolio of $2.2 billion. The asset allocation was also referred to as the "hedge fund" portfolio. The director was responsible for selecting each of the funds the corporation invested in. The portfolio was very illiquid, although the investment strategies included global, macro, and commodities. She remarked that the items were counter and cyclical.

Ms. Rodell continued to slide 22: "Real Estate $5.6B audited value as of 6/30/17." She reported that the real estate asset class was a fund that had been invested in for a long time. The fund had $5.6 billion in private real estate. The director oversaw a team of three along with a group of external advisors of five. The advisors provided the property management services needed to ensure that the properties performed. The fund had 56 properties in the US and Europe including residential, retail, industrial, and office properties. The operating budget for the asset class was $3.8 million plus external management fees.

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Ms. Rodell explain the last portfolio on slide 23: "Asset Allocation and Risk $4.5B audited value as of 6/30/17." She opined that the asset class was the most challenging to describe. The asset allocation and risk portfolio comprised the strategies that the corporation used to overlay the rest of the portfolio. The director was responsible for overseeing a team of one, managed all of the cash, and invested the cash as it came in. The director also monitored risk factors such as market risk, liquidity, and any concentrations and inflation. The director was in charge of the currency overlay program that the board of trustees approved in the prior year to help mitigate some of the losses seen on currency. The director was also responsible for conducting a much more active liquidity management program to be more fully invested.

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Representative Thompson referred back to Ms. Rodell's comment about the state's cumbersome procurement process. He asked about the Executive Budget Act and how it would help save the state money. He asked how it worked with APFC.

Ms. Rodell responded that getting relief from some of the procurement requirements had been one of her priorities and a priority of the board for a couple of years. The challenge for the corporation was that there were a number of exceptions to procurement for state agencies to do things such as procuring professional services. The Alaska Permanent Fund Corporation did not fall into that set of exceptions. Rather, the corporation was subject to the standard procurement procedure which meant it had to go out to bid for everything non-investment related. She elaborated that investment related meant directly managing funds on behalf of and delegating that investment authority to an external manager. She conveyed that to the extent that the corporation needed consultants to help with due diligence on a private equity investment, it might want to hire someone such as an engineer, biotech doctor, or a research doctor who could provide intimate knowledge of a subject. However, the corporation was required to go through the regular procurement process. She suggested there were ways the corporation could work with the legislature to find a way forward with procurement.

Ms. Rodell tried to respond to Representative Thompson's question regarding the Executive Budget Act. The challenge was that the management of the fund required an appropriation. It was clear from constitutional language that the money from the fund would be used for income-producing investments. It made no reference to the cost of making those investments, which was the reason the corporation believed it needed an appropriation. She continued that while the Executive Budget Act would give the corporation some relief, she felt that APFC still needed an appropriation.

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Ms. Rodell reviewed the outcomes for the State of Alaska on slide 25: "Fiscal Year 2017 Performance as of 6/30/2017: Realized and Unrealized Gains." The Alaska Permanent Fund Corporation invested the fund for the long-term. The corporation's strategies were put in place for long-term investment horizons. The five-year column was very important to the corporation because 5 years provided a sense both up markets and down markets. She explained that for a 5-year period in FY 17 the return on the fund was 8.85 percent. Compared to a passive index benchmark, the fund beat the benchmark by 1.7 percent. She suggested thinking of the passive index benchmark as a portfolio of index funds with 60 percent allocated to stocks (the fund was 40 percent to stocks), 20 percent to bonds, 10 percent to real estate, and 10 percent to treasury inflation proof securities (TIPS). Basically, it was what a computer would do without the benefit of active management by the corporation. The corporation generated an additional 1.7 percent over and above the previous 5 years.

Ms. Rodell continued that the performance benchmark, the asset allocation and all the individual asset benchmarks rolled together, returned 8.15 percent. The corporation was able to generate an additional 70 basis points. It was a nuance of picking and choosing when and where the corporation rebalanced the fund. The board of trustees had a total fund return objective of the consumer price index (CPI) plus 5 percent. She reported that CPI plus 5 percent for the previous 5 years would have been 6.32 percent, which the corporation well exceeded.

Ms. Rodell slide 26: "Asset Class Performance (Realized and Unrealized Gains)." The chart showed where the returns were coming from within the fund. She highlighted that domestic equities of 14.62 percent contributed a much larger portion than international equities in the public equities portfolio. In addition, REITS contributed over 8 percent to the portfolio. The private equity portfolio, with its high fees, contributed 18.3 percent to the growth of the fund over 5 years. Infrastructure contributed over 15 percent. The privet market, illiquid areas of the asset allocation, contributed greatly to the overall growth of the fund.

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Ms. Rodell turned to slide 27: "Callan's Capital Markets Forecast as of September 2017." She shared that in September 2017 the board had heard from [consultant] Callan Associates on the capital market forecast. She explained that Callan Associates took the target asset allocation and their individual asset category outlook, their projected returns for each of those outlooks, and derive a new forecasted return for the following 10 years. She highlighted that the total return went down from 6.95 percent in the prior year to 6. 5 percent for FY 18. The statutory return increased from 6.2 percent to 6.53 percent because of the rebalancing activity of taking some of the gains and feeding the statutory net income number. Also, inflation had stayed flat in the Callan Associates forecast at 2.5 percent. She took a pause for questions about how the corporation invested or what it was doing before moving to the topic of stress tests.

Representative Wilson understood the difference between the corpus and the ERA. She was also clear that the fund had seen gains which went into the ERA. She asked what would happen if there was a realized loss in the fund corpus. She wondered if money from the ERA replaced any realized loss.

Ms. Rodell replied "yes and no." She explained that during the course of a year on a monthly basis the corporation reconciled realized gains with realized losses. Under statute, once a year the corporation made a transfer of the net amount (gains and losses added together) to the ERA. There was only one time in 38 years, in 2008, the corporation reversed the transfer moving money from the ERA to the corpus because of losses. At the time the state suffered 28 percent in losses. In the other 37 years the fund experienced net gains.

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Representative Wilson spoke to positive performance in the market in recent months. She asked how the corpus would be affected by taking out more realized gains. She wondered if the corpus would be jeopardized at all or whether everything would balance out in the end.

Ms. Rodell replied that due to the current cushion she believed it would balance out. She suggested that it was a strange time, because every time the corporation went to rebalance, the market kicked up. The circumstance defied description in several ways. If there was a substantial fall off, there was a scenario where all of the losses would wipe out the ERA, but the corpus would remain somewhat whole. She elaborated that the fund would not realize those losses but would leave them alone in hopes that the fund would recuperate.

Representative Wilson asked for the amounts the dividend would have been, as it was a question her constituents asked frequently.

Ms. Rodell replied that she could provide Representative Wilson with what the total transfer amount under the statutory formula would have been. However, APFC did not calculate the dividend; it only did a transfer.

Representative Wilson surmised if committee members used their math skills, they could calculate the dividend amount. Ms. Rodell agreed.

Representative Ortiz asked about Ms. Rodell's inflation figure. He referred to slide 27 and asked if the 10-year previous average annual inflation rate was 2.25 percent.

Ms. Rodell responded in the negative. She explained that it was the forecasted rate of inflation for the following 10 years that Callan Associates was assuming.

Representative Ortiz asked if Callan Associates had a record of performance of their prediction of inflation rate that Ms. Rodell felt comfortable with. He thought the state had been through a period of relatively low inflation. He could not see where it would only be 2.25 percent in the following 10 years. He asked her to comment.

Ms. Rodell suggested looking at slide 25 in the last row showing the total fund return objective of CPI plus 5 percent. She explained that CPI was considered inflation. It was a proxy for actual inflation. Since inception the corporation had returned the total fund return objective of 5 percent plus CPI for a total of 7.67 percent. If the 5 percent was subtracted from the return inflation would be 2.67 percent. For the last 5 years the inflation rate was and over 3 years it was .92 percent. Inflation had been low. However, looking forward and looking at what was happening globally and in the United States, inflation was starting to increase. She thought it was fair to assume 2.67 percent.

Representative Ortiz assumed that inflation or the rate of inflation did not necessarily impact the corporation's strategies of investments.

Ms. Rodell responded affirmatively.

Representative Pruitt referred to an article in the newspaper about some of the decisions she had to make in the previous year that affected the 12.89 percentage based on her need to ensure availability of liquid money. He asked her to comment on the impact of the total percentage increase to the fund and how it was impacted by the changes she had to make.

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Ms. Rodell noted that in March 2017 there had been a general agreement between the bodies about the draw percentage from the ERA. It was approximately 2.5 billion or 2.7 billion. The corporation on average tried to hold about $1 billion in cash for the corporation's own investment purposes. The amount was based on operating costs, the need to pay external managers, and what APFC expected in terms of capital calls from its private equity managers. The corporation had started targeting a cash balance of about $3.5 billion, given the narrowing of the agreement. As the debate continued, the number did not move for a long time. In June, the debate led to a number closer to $5 billion, then settled on a total draw of about $725 million. Focusing on just the $2.5 billon or $2.7 billion, leaving the $1 billion for investments aside, compared to the $725 million the corporation was holding about $1.7 billion or $1.8 billion in investments in Fixed Income Plus with returns of 1.5 to 2 percent versus across all the asset allocations. The corporation could not have the money in an illiquid asset class because of not being able to liquidate it. The corporation was unwilling to have the money in the public equities portfolio because the money would be needed for state government purposes. She did not feel like it was a viable option to go to the legislature to relay that the money was lost in the stock market. She was not willing to take that risk. As soon as the corporation had confirmed the $725 million amount the last week in June, it immediately deployed out and got the money back to work in the equity and the illiquid asset classes. Subsequently, the money had been invested.

Ms. Rodell continued that currently the corporation was in the planning stages using the draw amount outlined in the governor's budget. Until there was additional clarity, the corporation would continue operating as if the governor's draw amount from the ERA was correct.

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Representative Pruitt thought she was saying that absent a long-term stable Percent of Market Value (POMV) plan, the corporation had to make sure liquid money was available within a 6-month timeframe. Therefore, the return rate would be much lower than 1.4 percent. The draw number had been estimated between $2.5 billion to $5 billion and only $725 million was actually drawn. He wondered about the lost opportunity. He asked if the corporation would be able to eliminate the swings and lost opportunities if a plan was adopted.

Ms. Rodell answered that he was correct. She added that a plan also allowed the corporation to fully develop the corporation's business plan in terms of internal and external management. She elaborated that it made sense to manage the private equity portfolio internally because of the high returns and high costs. However, it would not make sense to invest in the asset class if the corporation had to maintain liquidity measures due to uncertainty. From a business plan perspective certainty allowed for more choices around where the corporation hired and brought in external management functions.

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Representative Pruitt wanted to understand the parameters provided to Callahan Associates in terms of stress tests. He wondered if instructions were provided about modeling uncertainty.

Ms. Rodell corrected Representative Pruitt that it was Bridgewater that performed the stress test. She relayed that the instructions to Bridgewater were to create the new liability to see what would happened in terms of the asset allocations and what the expectation for returns might be in the future.

Representative Pruitt asked if the liability was a POMV type of model, a $2.6 billion liability. Alternatively, h wondered if the liability was between $700 million and $5 billion.

Ms. Rodell answered that it was a POMV liability. It would be as if a statutory framework was put in place to determine how the funds would be drawn.

Vice-Chair Gara remarked that a few people on the committee had expressed interest in an amendment that he was having drafted. He reported hearing from several constituents that they would be interested in not accepting their Permanent Fund Dividend check. The money would be left in the ERA. The way the law was currently written, if they did not apply, the money would go to everyone else's dividend rather than the ERA. Also, if a person applied for the PFD and gave it back to the state, he wondered if they would be taxed on it or whether it would be tax deductible. He suggested that some people wanted a clean way of returning the funds to the ERA. He had worked with Legislative Legal Services and thought they were okay with the language. He had also talked with the attorney general's office about the taxability issue. He wondered if he should be working with Ms. Rodell on the issue or if she would differ to the Department of Law. Ms. Rodell responded that the corporation would defer to the Department of Law.

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Ms. Rodell continued to slide 29: "What are the stress tests?" She indicated that the chairman's office had requested that the corporation review the stress tests. They were stress tests conducted in the previous fall at the request of the board chair, Bridgewater, one of the corporation's partners in portfolio management, was asked to develop and present stress test scenario analyses to the board of trustees. In the past, the board of trustees had been very direct in not weighing in on the debate as to whether to use the ERA. The analyses were designed to gain information in understanding what impacts could affect the fund in the event a draw was enacted. The analyses demonstrated the effect of stressful conditions on the fund assuming two draws. One draw scenario was to draw 5.25 percent in years 1-2, and 5 percent in years 3-10. This draw was, in essence, Senate Bill 26 [Legislation passed in 2018 - Short title: Appropriation Limit and Permanent Fund: Dividend Earnings] in conference committee. A second scenario assumed a 5.25 percent draw in years 1-2, and 4.5 percent in years 3-10. The second scenario recognized the existing environment and a long-term ongoing plan. The analyses estimated the returns required to achieve assumed draw outcomes. Bridgewater compared the return hurdles to the range of returns implied by forward looking assumptions, Callan estimates, and historical returns adjusted for current cash rates. She relayed there had been times in history where cash rates had been considerably higher than the 1.3 percent or 1.4 percent environment of the current day.

Co-Chair Seaton asked if the numbers were based on the previous 10-year assumption of 5.95 percent or the currently adopted board assumption of .5 percent less. Ms. Rodell explained that Bridgewater assumed the asset allocation that had been approved by the board, the target allocation of 39 percent public equities. Callan's return forecast for the individual asset classes were also being assumed.

Co-Chair Seaton suggested that on slide 27 there was an average of either 6.95 percent or 6.5 percent of an overall return to the fund. He asked what the stress test was based on. Ms. Rodell responded that it was 6.5 percent taking into account the standard deviation which could be seen on the right column on slide 27. The standard deviation was a measure of volatility. She highlighted the deviation of 18.55 percent for global equities which had a projected return of 7.0 percent. The standard deviation indicated that the range of outcome for global equities could be 7.0

percent or as high as 25 percent over a 10-year period. It could also be as low as 11 percent over the 10-year period.

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Ms. Rodell advanced to slide 28: "APFC Stress Tests." She reported that Bridgewater made 3 observations:

- Total returns for savers are likely to be historically low over the next decade.

Ms. Rodell noted that it was no surprise that the total returns would be historically low because inflation had been low for a significant amount of time and 10-year treasury rates (subtracting inflation of 2.25 percent) would be negative for 10 years. The savings rate was expected to be low over the following 10-year period. She continued to review Bridgewater's observations:

- Forecasting future returns is inherently imprecise; however, there is confidence that low cash rates will be a drag on all assets for the medium term.

- This development presents a significant challenge to investors whose spending plans are based on higher expected returns than are now likely.

Vice-Chair Gara asked Ms. Rodell to return to slide 29. He noted that drawing 5.25 percent to the value of the fund was not really 5.25 percent but rather 5.25 percent of some portion of the previous 6 years. In prior years, the fund was worth less. He suggested that 5.25 percent was really closer to 4.75 percent of the value of the fund, and 5 percent was closer to 4.5 percent. He asked her to explain the numbers and whether the Callan estimates were based on the previous 5 of 6 years. He wondered if they were talking about a percentage of the current value of the fund. Ms. Rodell replied that the POMV calculated draw of 5.25 percent stepping down to either 5 percent or 4.5 percent was calculated on the average fund value of 5 out of the previous 6 years. There was a 1-year lag. It took into account the years where the fund balances were lower. There was a lower effective draw than the rate of 5.25 percent or 5 percent.

Vice-Chair Gara clarified that when she stated 5.25 percent under the methodology that was discussed the previous year, it was actually less than 5 percent, closer to 4.5 percent. He wondered if the recommendations from the consultants were based on 5 out of the previous 6 years or on a true percentage of the current value of the fund. b Ms. Rodell answered, as a matter of clarification, that the consultant was not making a recommendation. The consultant was hired to help understand what affect the percentages would have on the ability of the fund to grow over time and to deliver on draw amounts. In calculating the amount of the draw over a 5-year smoothing period, the draw money would be coming out of the fund that would no longer be available for investment purposes. Depending on various economic conditions, it would have an overall long-term affect on the fund. The board's goal was to understand the range of potential effects and what earnings were necessary to keep the fund in its status quo.

Vice-Chair Gara asked if the numbers in the following slides were based on 5 of the prior 6 years. Ms. Rodell answered in the affirmative. The numbers were based on an average. She added that while the effective rate was lower because of the growth of the fund balance over 5 years, if the fund rate were to decline in the subsequent 5 years, the effective rate would rise above 5 percent.

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Ms. Rodell continued to slide 31: "Methodology." She relayed that there were two stress tests conducted. The first was to make payments according to a distribution plan until the ERA was exhausted. The consultant used the audited balances from June 30, 2017 as the starting point. The earnings reserve account balance of $13 billion was used as the starting buffer. The first stress test was conservative with respect to potential distributions and represented a lower boundary of distributions.

Ms. Rodell explained the second stress test, which was to continue to make the payments until the overall economic surplus was exhausted - the amount of the ERA plus the unrealized gains. The second test recognized that the unrealized gains acted as an additional buffer. The stress test was less conservative because it allowed continued distributions even after the ERA balance was zero.

Representative Pruitt asked if inflation proofing was included in the stress test. Ms. Rodell responded that it did not make the assumption that the legislature restored inflation proofing for the prior 3 years. However, it assumed the state would make inflation payments equal to 2.25 percent after the draw was made. There was a waterfall effect: A Percent of Market Value draw would be made prior to an inflation draw.

Representative Pruitt wanted to make sure there was a calculation for money going from the ERA, therefore, requiring the ERA to make up the amount to keep the ERA at its present level. Ms. Rodell responded, "Correct."

Representative Ortiz asked about the starting point of the stress test being the balance of the ERA on June 30, 2017. Ms. Rodell responded positively.

Representative Ortiz asked if the outcome of the test would be significantly impacted if it were to be conducted again based on the ERA balance on December 31, 2017. Ms. Rodell did not think the outcome would be impacted substantially.

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Ms. Rodell scrolled to slide 32: "Assumptions":

Draws

- Scenario 1:
  Distributions are Calculated as 5.25% of the 5-Year Average of the Total Fund Size in years 1-2, and 5.00% in years 3-10.
- Scenario 2:
  Distributions are Calculated as 5.25% of the 5-Year Average of the Total Fund Size in years 1-2, and 4.50% in years 3-10.

Distributions

- Limited by either the size of the ERA (Stress Test 1) or the ERA plus current unrealized gains (Stress Test 2).
- Prioritized over inflation proofing payments – partial payments allowed.
- ERA can be drawn to zero, but never have a negative balance.

Inflation Proofing

- Assessed on the Principal Fund Balance, excluding any unrealized gains.
- 2.25% Annual Inflation (unless otherwise noted).

Ms. Rodell walked through the first scenario on slides 33: "Scenario 1: 5.25 percent years 1-2 and 5.00 percent years 3-10" and slide 34: "Required Return (5.25 percent to 5.00 percent Scenario)." She noted that Bridgewater could not model APFC's rebalancing efforts because the corporation did not conduct hard daily rebalancing. Rebalancing was left up to the discretion of the corporation's internal managers. She reported that Bridgewater asked what type of return would be needed to make distributions, inflation proof, and maintain $13 billion in the ERA and $7 billion in unrealized gains. In other words, what would it take to keep the fund whole year-after-year. An annual return of 6.3 percent would be necessary. She conveyed that if drawing into the ERA was allowed without tapping into the unrealized gains portion, an annual return of 4.5 percent would be required. In 10 years the $13 billion in the ERA would be drawn down, but there would still be $7 billion left in unrealized gains. If the unrealized gains of $7 billion were tapped into, an annual return of 3.3 percent would be necessary.

Ms. Rodell continued that when volatility, the standard deviation, was applied the probability of achieving an annual return of 6.3 percent (making all distributions including inflation proofing), was 52 percent. The probability of falling short was 48 percent in at least 1 out of 10 years.

Representative Wilson referred to Ms. Rodell's note, "The probabilities shown above assume all distributions are made in full." She asked if she was talking about the dividend or the distribution based on a percentage of what would be withdrawn. Ms. Rodell responded that she was not talking about how the money would be used, but about the amount that would be taken.

Representative Pruitt asked if the stress test was using the previous 10 years which included 2008 and 2009. Ms. Rodell replied that it was the test time she was highlighting in the current day. She mentioned that the board had seen a number of different tests which were available on APFC's website. She would point out some of the lines on the chart on the following slide. She highlighted just one because it reflected a recent 10-year period.

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Representative Pruitt believed the board had changed the manner in which the fund's investments fell from the 2008-2009 timeframe. He mentioned a 30 percent drop. He asked Ms. Rodell to describe how the corporation currently invested versus in the previous timeframe. He asked if the fund would be in a position of incurring a downturn similar to the past.

Ms. Rodell responded that the target asset allocation changed as a result of a number of things. She elaborated that in 2005 or 2006 the legislature removed the required list of investments and gave the board of trustees the full gamut of possibilities. Adjustments had started being made when the downturn hit. She thought it was important to recognize that the test was using the fund's current asset allocation which had a smaller allocation for public equities than 10 years prior. The corporation had attempted to mitigate some of the risk and volatility by having certain private market investments. The corporation had taken a number of mitigation steps which were recognized in the analysis. The analysis assumed the target asset allocation stayed static and that no adjustments were made by the board of trustees as a result of what might be happening currently. There were too many variables for anyone to model.

Ms. Rodell finished her presentation of slide 34. She reiterated that there was a 48 percent chance of not maintaining a surplus balance of $13 billion. There was a 30 percent chance of not maintaining the $7 billion in unrealized gains. Also, there was a 20 percent chance of going further downward without maintaining a return percentage of 3.3.

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Ms. Rodell moved to slide 35: "Stress Test Example: 2007-2016 (5.25 percent to 5.00 percent Scenario)." She reported that Callan had collected investment data regarding how investments had behaved over the last 100 years. They had created proxies for investment types that had not been in existence 100 years prior. They had done a significant amount of research on the subject. They had adjusted the cash rates, as there had been periods over the 100 years where the cash rate was considerably higher than 1.3 percent. Each of the grey lines on the chart represented a distinct 10-year period beginning in January 1925. She highlighted the number of scenarios where performance was positive over the following 10-years - a period where there were no extended periods of negative returns. There might be high returns versus lower ones. She believed the chart provided a sense of the spread of all the different stress scenarios in 10-year increments. It could be stagflation, the oil embargo of the 1970s, the tech crisis, and other things.

Ms. Rodell pointed to the highlighted line on the chart which represented the most recent 10-year period. The financial crisis and its recovery occurred from 2007 to 2016. The rolling 5-year average fund size was used as the starting point for 2018 and noted in the left column. She reported that 2007 investment results were applied in that period with a target distribution of 5.25 percent. The portfolio would have returned 2.0 percent based on current asset allocations. There would have been an actual distribution based on a calculation of $2.7 billion, 100 percent of the requested distribution. The fund total under management would have grown to $58.6 billion, the ERA would have been $10.4 billion (a recognition of gains), and the accumulative distribution would have been $2.7 billion. She moved across the chart and pointed to a portfolio return of minus 30 percent in 2019. She relayed that the portfolio distribution would still be allowed out of the ERA in the amount of $2.9 billion calculated on 5 of the prior 6 years because of a small amount remaining in the ERA. The distribution combined with the losses would take the ERA to zero and would have eaten into the economic surplus by $3.9 billion.

Ms. Rodell continued that the financial recovery could be seen in the out years. In 10 years, when the legislature would be ready to do another 10-year plan, there would be a back-up fund in the amount of $64.2 billion, accumulated distributions would accrue to the amount of $22.6 billion, and an inflation proofing payment of $2.6 billion would be missed. Through the financial recovery the fund would have recouped the unrealized losses in the principle. She emphasized that there might be years in which the distribution could not be made, but recuperation would be possible and actual distributions could be made in the size requested. She encouraged members to contact her for additional scenarios.

Ms. Rodell moved to the scenario on slide 36: "Scenario 2: 5.25 percent years 1-2 and 4.50 percent years 3-10" and slide 37: "Required Return (5.25 percent to 4.5 percent Scenario)." She noted with the draw at 4.5 percent it lowered the required returns. In order to maintain $13 billion in the ERA the annual would shift from 6.3 percent to 5.9 percent. If the draw had to go through the ERA, the annual return would need to be 4.1 percent. She thought it was intuitive because in taking less, less would have to be earned to maintain the minimum balances. She commented that the odds of maintaining the balance in the ERA would be 56 percent (or 44 percent odds that the fund would fall short). The odds were slightly better in maintaining the balances with a lower 4.5 percent distribution.

Ms. Rodell advanced to slide 38: "Stress Test Example: 2007-2016 (5.25 percent to 4.50 percent Scenario)." She highlighted a similar hit to the ERA where nothing would be available for 2020 or 2021. However, in the current scenario, the total fund would increase to $74.2 and the cumulative draw distributions would be lower at $21 billion.

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Representative Pruitt suggested that in both examples there was a zero percent payout. He mentioned the dire situation in 2018 and reflected in 2019. He asked if the same challenge would exist no matter the distribution. He thought that because of the dramatic drop, there would likely be a zero-percentage available. He asked her to comment on his observations. Ms. Rodell responded that Representative Pruitt was correct that the draw amount would not have likely mattered. In that year, there was a 30 percent loss. She used $60 billion as an example. She calculated a 30 percent loss on $60 billion which equaled $18 billion. She pointed to the negative number in the unrealized gain amount minus 3.9 percent. It was a recognition of taking from an economic surplus.

Representative Pruitt suggested that if the state was moving in the direction of being dependent on the Permanent Fund, there was the need to recognize that a dramatic shift

could put the state back in the same situation where it did not have money available, without having a damaging affect on the corpus. He argued that the state still had the challenge of managing the budget long-term.
Senator

Ms. Rodell indicated that the stress test maintained the target asset allocation, and the corporation managed the fund in a certain way mandated in statute. It did not account for the possibility of the corporation being directed to bifurcate the asset allocation in any way and manage the ERA, for example, under a different allocation than the corpus of the fund. She suggested that assuming everything was equal, the corporation would continue to do everything the way it had always done. The stress tests were designed to give members a sense of what might happen. In the current case, the returns were adjusted, and the money was made back. However, there would be a year or two where the fund would be unable to make a distribution because the corporation did not do forced realization of gains. It begged the question about the possibility of the trustees realizing the gains and making the draw happen. However, it was not what the corporation had been asked to do. She highlighted that if the corporation acted in the way it had always acted under the same principles it always acted under, it was possible that the corporation would not be able to make a distribution. She wanted to provide this information for the legislature as it moved forward putting a plan together. She reported that she had heard from members of the general public that if the corporation made 6.5 percent there would be an excess of 1.5 percent which would be fine. Her point was that the fund did not make 6.5 percent statically. The fund made 6.5 percent over a 10-year period, and within that timeframe a significant number of things happened. One year the fund might make minus 30 percent and the next year it might make 27.9 - a swing of 50 percent. It averaged out to a 6.5 percent return over a 10-year period. The board of trustees, with the help of the stress tests, were trying to delve into what boundaries were necessary for discussing the use of the ERA going forward.

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Ms. Rodell reviewed slide 39: "Summary Comparison." She summarized that the required return was 6.3 percent or 5.9 percent depending on the distribution percentage in years

3-10. The probability of falling short fell 4 percent through the two scenarios. In terms of expected 10-year outcomes based on the Callen capital market estimates the cumulative distribution would be roughly $30 billion. The fund size would have stayed and continued to grow to about $75 billion to $78 billion. The ending of the ERA would be between $14 billion to $17 billion. She relayed that the 6.3 percent would not be going into the ERA. There would also be an economic surplus. The gains would continue to accumulate to between $21 billion to $24 billion. There would not be any missed inflation proofing dollars. She made herself available for questions.

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Co-Chair Seaton appreciated the stress test because things were not static. He asked about when the corporation decided to put more cash in the previous year because there was a variable amount and the state lost money and investment. He recalled Ms. Rodell wanted to go to cash because she anticipated the money getting lost in the stock market. He suggested that in her forward looking investment strategy she was not secure enough to say that the returns would not fall. He thought she made a rational decision to have liquid assets available. She did not know how the stock market or other assets would perform. He asked if his rendition was correct.

Ms. Rodell responded that because of having to come up with a certain amount of cash on July 1 and not know how the markets would perform, it was better to maintain safety of that portion of the fund from which the cash would be drawn. She knew she would be expected to deliver a portion of revenue for state government purposes.

Co-Chair Seaton asked if there was an expectation that the draw would be instantaneous, and all of the cash would be needed at once. He wondered if something was in statute that would require the transfer to be made on July 1.

Ms. Rodell responded that there was nothing in statute that provided direction on this issue. The corporation was operating under the same knowledge as it had before. Previously the majority of cash was taken in by DOR in the first part. The corporation had always transferred the amounts needed for the dividend in August and September to be distributed in October. It was possible that the corporation could have worked with DOR to time out the distributions once the corporation knew the amounts. She continued that whether the corporation needed the cash in 3 months on July 1, 6 months on September 1, or 9 months on January 1, the short time horizon meant that the corporation had to maintain the safety of being able to access cash. The corporation could have put the money in longer duration fixed income. The return would have been greater than 1.4 percent but would not have reached 12.89 percent. It was an opportunity cost.

Representative Pruitt provided a hypothetical scenario. He asked what the cost would have been to the state to liquidate an additional $2 billion that would have been needed. He asked how much more than $2 billion would have had to be liquidated.

Ms. Rodell answered that the corporation would have had to start realizing gains because of being in a bull market. She explained that when the corporation realized gains currently, it reinvested immediately. Part of the job of the director of asset allocation and risk management was to sometimes hold cash rather than deploying it. The director would have been looking forward to seeing what was expected in current income and not deploying it into the asset allocation. The director also worked with the portfolio managers for public equities and fixed income plus to determine how to best accumulate the additional $1.2 billion.

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Vice-Chair Gara conveyed that the lesson he was getting from the discussion was the longer the state waited and looked over the fiscal cliff, the fewer options it would have. He and Representative Thompson had suggested a temporary dividend amount of $1500 that could be reformed later. Several people did not support the idea and no changes had been made. Many people at the legislature wanted things to happen but there were not enough votes to make thing happen. He stated that the lower draw, the less the state would have for services and a dividend. Ms. Rodell agreed.

Co-Chair Foster reviewed the agenda for the following day and encouraged Ms. Rodell to provide any additional information she deemed necessary.

#
ADJOURNMENT

3:31:57 PM

The meeting was adjourned at 3:31 p.m.