

**ALASKA STATE LEGISLATURE  
HOUSE STATE AFFAIRS STANDING COMMITTEE**

March 29, 2018

3:21 p.m.

**MEMBERS PRESENT**

Representative Jonathan Kreiss-Tomkins, Chair  
Representative Chris Tuck  
Representative Adam Wool  
Representative Chris Birch  
Representative DeLena Johnson

**MEMBERS ABSENT**

Representative Gabrielle LeDoux, Vice Chair  
Representative Gary Knopp  
Representative Andy Josephson (alternate)  
Representative Chuck Kopp (alternate)

**OTHER LEGISLATORS PRESENT**

Representative Jennifer Johnston

**COMMITTEE CALENDAR**

CONFIRMATION(S) :

State Commission for Human Rights

Christa Bruce-Kotrc - Ketchikan  
Megan Mackiernan - Nome  
Freddie Olin IV - Anchorage

- CONFIRMATION(S) ADVANCED

State Board of Parole

Sarah Possenti - Fairbanks

- CONFIRMATION(S) ADVANCED

Personnel Board

Alfred Tamagni, Sr. - Anchorage

- CONFIRMATION(S) ADVANCED

Police Standards Council, Alaska

Michael Craig - Anchorage  
Justin Doll - Anchorage  
David Knapp -Palmer  
Larry Nicholson - Kodiak

- CONFIRMATION(S) ADVANCED

Public Offices Commission, Alaska

Anne Helzer - Anchorage

- CONFIRMATION(S) ADVANCED

Public Defender

Quinlan Steiner - Anchorage

- CONFIRMATION(S) ADVANCED

PRESENTATION(S): ALASKA PERMANENT FUND GOVERNANCE BY ANGELA  
RODELL, CHIEF EXECUTIVE OFFICER

- HEARD

PRESENTATION(S): FISCAL PLANS OVERVIEW BY LEG. FINANCE DIV.

- HEARD

PRESENTATION(S): OVERVIEW OF PERMANENT FUND PROPOSALS IN THE  
LEGISLATURE BY REID MAGDANZ AND ROB ERVINE, LEGISLATIVE STAFF.

- SCHEDULED BUT NOT HEARD

SENATE CONCURRENT RESOLUTION NO. 17  
Proclaiming April 2018 as Sexual Assault Awareness Month.

- BILL HEARING CANCELED

HOUSE BILL NO. 83

"An Act relating to new defined benefit tiers in the public  
employees' retirement system and the teachers' retirement  
system; providing certain employees an opportunity to choose  
between the defined benefit and defined contribution plans of

the public employees' retirement system and the teachers' retirement system; and providing for an effective date."

- BILL HEARING CANCELED

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

ANGELA RODELL, Chief Executive Officer (CEO)  
Alaska Permanent Fund Corporation (APFC)  
Juneau, Alaska

**POSITION STATEMENT:** Gave a PowerPoint presentation entitled "Alaska Permanent Fund Governance".

DAVID TEAL, Director  
Legislative Finance Division  
legislative Agencies & Offices  
Juneau, Alaska

**POSITION STATEMENT:** Gave a presentation entitled "Fiscal Plans Overview".

**ACTION NARRATIVE**

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**CHAIR JONATHAN KREISS-TOMKINS** called the House State Affairs Standing Committee meeting to order at 3:21 p.m. Representatives Kreiss-Tomkins, Wool, Birch, and Tuck were present at the call to order. Representative Johnson arrived as the meeting was in progress.

**CONFIRMATION(S) :**  
**State Commission for Human Rights**  
**State Board of Parole**  
**Personnel Board**  
**Police Standards Council, Alaska**  
**Public Offices Commission, Alaska**  
**Public Defender**

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**CHAIR KREISS-TOMKINS** announced that the first order of business would be the confirmation hearings for the [governor's 11 appointments] to various boards and commissions.

CHAIR KREISS-TOMKINS stated that all the names were circulated to the committee members. If any member had expressed a desire to hold a confirmation hearing for any appointee, the committee would have held a hearing; however, no names were singled out.

[CHAIR KREISS-TOMKINS reminded committee members that signing the reports regarding appointments to boards and commissions in no way reflects individual members' approval or disapproval of the appointees and that the nominations are merely forwarded to the full legislature for consideration during the joint session of the House and Senate for the purposes of confirmation.]

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REPRESENTATIVE WOOL made a motion that the names of nominees before the House State Affairs Standing Committee for the State Commission for Human Rights, State Board of Parole, Personnel Board, Police Standards Council, Alaska, Public Offices Commission, and Public Defender be forwarded to the joint session of the House and Senate for consideration. There being no objection, the names of the appointees were advanced from the House State Affairs Standing Committee.

**PRESENTATION(S) :**  
**ALASKA PERMANENT FUND GOVERNANCE BY ANGELA RODELL, CHIEF**  
**EXECUTIVE OFFICER**

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CHAIR KREISS-TOMKINS announced that the final order of business would be three presentations: a presentation by Angela Rodell, Chief Executive Officer on Alaska Permanent Fund Governance; a presentation by David Teal on Fiscal Plans Overview; and third, an Overview of Permanent Fund Proposals in the Legislature by Reid Magdanz and Rob Ervine, legislative staff.

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ANGELA RODELL, Chief Executive Officer (CEO), Alaska Permanent Fund Corporation (APFC), introduced herself. She described the presentation as being focused primarily on the governance aspect, including the duties and management of the Alaska Permanent Fund (PF). She expressed a willingness to answer any questions members may have about the corporation.

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MS. RODELL turned to slide 2, titled "1969: The Debate Begins," which read as follows [original punctuation provided]:

- Alaska receives \$900 million in Prudhoe lease sale bonuses.
- Debate on Use of Royalties
  - Fund State Infrastructure and Social Programs
  - Establish a Development Bank
  - Create an Investment Fund

MS. RODELL said that in 1969 when Alaska received \$900 million in Prudhoe lease sale bonuses, the unrestricted operating budget for the State of Alaska was \$178 million. This was a huge windfall to the state. She reminded members that in 1969 Alaska had only been a state for 10 years. Discussions were held as part of the statehood debate on how the state would support itself. There were significant demands and the \$900 million was quickly spent on projects throughout Alaska. That level of spending concerned legislators and a debate began about whether the royalty - a non-renewable resource - would be available to benefit future generations, especially since the value was unknown.

MS. RODELL highlighted that the debate was around three uses; first, to fund state infrastructure and social programs; second, to establish a development bank; and third, to create an investment fund.

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MS. RODELL turned to slide 3, titled "The Alaska Constitution," which read as follows [original punctuation provided]:

Over four decades ago, in 1976, Alaskans in an historic vote amended the Constitution of the State of Alaska by a margin of 75,588 to 38,518 and created the Alaska Permanent Fund.

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, reviewing the slide, stated that the fund was created through a constitutional amendment approved by the voters in 1976 by a margin of 75,588 to 38,518. She pointed out that there was not uniformity in the decision to create the fund. Some people felt very strongly that the funds could be used for other purposes rather than an investment fund.

MS. RODELL, referring to the paragraph on slide 3, commented that the language within the [Alaska] Constitution was quite simple. She read the paragraph [as above].

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CHAIR KREISS-TOMKINS asked whether there has been a point in time where more than 25 percent of royalties have been deposited into the Permanent Fund (PF).

MS. RODELL answered yes. She explained that as leases, including terms and royalties, have been reviewed and approved over the years by legislative bodies, there have been determinations within those statutes. She said she would cite the specific statute that allows the Alaska Permanent Fund Corporation (APFC) to designate royalties in excess [of 25 percent] to the PF depending on when the lease agreement was entered, or which field was leased.

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REPRESENTATIVE BIRCH commented that he was one of the 75,518 votes that established the PF.

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MS. RODELL stated that the first deposit of \$734,000 came in in February 1977, which was managed by the Alaska Department of Revenue (DOR), because APFC did not form as the entity for managing the PF until 1980. The allowable investments were initially fixed income bond investments but over the years that list expanded. Currently, the direction is to follow the prudent investment rule.

MS. RODELL reviewed slide 5, titled "The Corporation," which read as follows [original punctuation provided]:

The Alaska State Legislature passed SB161 in 1980 establishing the Alaska Permanent Fund Corporation and providing:

- a sound management structure to maximize the Fund's ability to generate investment returns
- a Board of Trustees entrusted with fiduciary oversight. APFC's Mission To manage and invest the assets of the permanent fund and other funds designated by law.

MS. RODELL reported that currently, the APFC has responsibility for one other fund it manages, which is the Alaska Mental Health Trust Authority (AMHTA) principal.

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MS. RODELL turned to slide 6, titled "Fiduciary," and remarked that although we often use the term "fiduciary" and know what it means, it can be difficult to pinpoint or define the term. She read from slide 6, stating a fiduciary was "relating to the responsibilities of a person or organization that manages property or money belonging to another person or organization."

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MS. RODELL turned to slide 7, titled, "AS 37.13.120 Investment Responsibilities Mandates Use of the Prudent Investment Rule." She said this is where you will find the mandate to use the prudent investment rule. She read:

"The Rule requires the test of fiduciary conduct be undertaken from a portfolio formulation perspective without considering the subsequent performance of the portfolio. Formulation means assembling and maintaining a portfolio of assets with a risk tolerance suitable for the purposes, term, distribution requirements, and other conditions of the trust."

MS. RODELL commented that it was important to understand how these two relate to one another: "The Prudent Investment Rule" and fiduciary conduct be undertaken from a portfolio formulation perspective. The prudent investment rule requires the APFC to take a perspective of construction of the portfolio without consideration to subsequent performance. She acknowledged that

this might seem counter to what one would expect. She stated that rather one should assemble a portfolio of assets with a risk tolerance that the investor believes is suitable for the purposes, term, distribution requirements, and other conditions of the trust which generates the return on investment.

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MS. RODELL explained that when discussing how the APFC structures its portfolio and conducts its asset allocation, the reason is not to drive returns. Otherwise an argument could be made that [investments] should be 100 percent in private equity, which has the highest returns for 2017, or in public equity because it has higher returns and better liquidity. However, the APFC does not do that; instead, it assembles the portfolio and asset allocation with an eye towards what is the corporation's risk tolerance. That risk tolerance must be set in terms of the purpose of the fund, which is to hold these funds in trust in perpetuity for all current and future generations of Alaskans. She stated that different types of risks can be taken, depending on the terms, if the [investor] knows that he/she will have ten years to ride through different business cycles. She identified it as a different risk profile than if one needs the money in six months.

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MS. RODELL related that the distributions requirement feed into that assumption of term, such as the length of time of the investment, and any other conditions of the trust imperative to the objective of the trust.

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REPRESENTATIVE BIRCH asked for clarification on differences between a fiduciary and a trustee. He further asked what sort of competency expectations exist for one or both.

MS. RODELL responded that she is a fiduciary and her portfolio managers are considered fiduciary since they have been entrusted with those responsibilities; however, the trustees have an even higher standard since they are the ones who will ultimately be held responsible for the delegations and actions of staff. The trustee has a higher legal standard and has the right to delegate certain responsibilities. Backing up to the definition of fiduciary, she indicated that she and her managers have certain responsibilities in managing certain day-to-day trades,

which is what makes them fiduciary. She pointed out that the external managers have a fiduciary standard; however, the trustees are responsible for the trust itself.

MS. RODELL said that the statutes have requirements for the APFC Board of Trustees in terms of qualifications. She reviewed qualifications that the four public members of the board must have: recognized competence and wide experience in finance investments or other business management related fields. The other two members of the Board of Trustees are the Commissioner of Revenue and another member of the Governor's cabinet; currently that is Commissioner Andrew Mack.

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REPRESENTATIVE TUCK offered his belief that the trustees have a fiduciary responsibility, but they are not necessarily fiduciaries. He related his understanding that any trust can be sued but wondered if a fiduciary could also be sued.

MS. RODELL related her understanding that all fiduciaries can be held personally liable to the extent that criminal activity is associated with the failure. She explained that tests apply to a failure as a fiduciary, whether it was through circumstances beyond his/her control or if it was knowingly and intentionally a violation of that duty.

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MS. RODELL reviewed slide 8, titled "APFC's Governance, which read as follows [original punctuation provided]:

Key determinates of APFC's governance success include:

- an effective independent management and organizational structure,
- the adherence to accountability measures,
- defined legal and regulatory responsibilities,
- established policies and procedures,
- being a leader in establishing best practice standards.

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MS. RODELL, turned to slide 9, titled "Perspective." She turned to slide 10, titled "The Pew Charitable Trusts Oct 2016," and said to give members a sense of how the APFC

operates in this word of sovereign wealth funds, that in October 2016 "The Pew Charitable Trusts" wrote a report on sovereign wealth funds and the movement from volatile severance taxes to a sustained revenue model. She recalled that the APFC sent the report to the committee. She paraphrased from slide 9, which read:

"Governments use sovereign wealth funds, so-called because they are established by a sovereign nation or U.S. state, to deposit a portion of revenue in an investment account intended to generate returns that will be used to achieve a specific public purpose or set of goals."

MS. RODELL stated that one of the today's challenges has been that "a specific asset or set of goals" is under debate. She said that recognizing that is the challenge for Alaska, and how the APFC governs and manages its sovereign wealth fund, is key to understanding why the APFC's Board of Trustees has taken some of the actions it has taken to date.

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CHAIR KREISS-TOMKINS pointed out that there was a much-publicized legal analysis from the Legislative Legal and Research Services counsel, relating to what constitutes public purpose or benefit. He recalled a bill before the House Finance Committee and legal speculation on whether that would lead to the fund being taxable. He asked whether the APFC has had its own counsel currently or previously explore that question or if she had thoughts or commentary on that question.

MS. RODELL answered that the APFC has not had separate counsel and has relied on the Department of Law (DOL) for the department's interpretation. The DOL has reached out to private counsel in instances in which it lacks the specific expertise. She related the APFC's understanding was that it is unclear how that would "play out." However, she said, the APFC universally agreed that the APFC is an asset of the sovereign that is the State of Alaska. What that asset gets used for may have potential tax consequences if the federal government interprets that [public purpose] is for private benefit and not a public benefit. She pointed out that sometimes a lot of attention has been paid to this and sometimes not. Thus, the APFC has not seen the need to get private letter rulings or additional opinions on this. The legislature appropriates the earnings of the PF and that is where it stops for APFC, she said. The APFC

does not make the determination as to what the earnings are used for.

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CHAIR KREISS-TOMKINS asked whether the DOL or outside law firms that the executive branch has retained explored this question and come to different conclusions than Legislative Legal and Research Services attorneys have expressed.

MS. RODELL related her understanding that over the years there have been differences of opinions expressed, but she thought it had been years ago. She acknowledged that at one time there may have been a potential disagreement between the DOL and Legislative Legal and Research Services on the matter.

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MS. RODELL said the APFC thought it might be helpful to pass on Pew Recommendations for US State Policy Makers with respect to sovereign wealth funds. She turned to slide 11, titled "Pew Recommendations for US State Policy Makers," which read as follows [original punctuation provided]:

1. Identify the purpose of their state's sovereign wealth fund and clearly articulate its goals in law.
2. Establish policies for the governance, investment, and public disclosure of the fund's activities in law.
3. Provide statutory or constitutional guidance regarding withdrawals from the principal.
4. Be aware of volatility in interest earnings from the fund.

MS. RODELL reviewed the first point and reported that the statute surrounding the PF do articulate clear goals for the fund and for the corporation. Reading point 2, she reported that the APFC has clear guidance in its statute for how the trustees will govern, on investments, and with its disclosures. For example, the APFC must make annual disclosures by September 30 of each year as to the performance of the fund. The APFC has oversight in statute by the Legislative Budget [and Audit Committee] and all board materials are distributed to the LB&A committee. Turning to point 3, she offered that the APFC has had statutory guidance in the past and continues to urge statutory guidance in the future with respect to withdrawals. Finally, the APFC has had numerous discussions on market

volatility, which has been apparent in the market in recent weeks.

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MS. RODELL reviewed slide 12, titled, "Best Practices," which read as follows [original punctuation provided]:

"By establishing independent entities to oversee their sovereign wealth funds, New Zealand and Alaska have ensured prudent governance, monitoring, and disclosure of their financials and management practices. They stand as examples of many of the best practices for sovereign wealth funds domestically or internationally."

MS. RODELL pointed out that Norway was not listed on this slide. The APFC felt proud to "get the shout out." She said she thinks it is important for Alaskans to know the APFC was recognized for its governance and in how the state established and continues to have oversight governance monitoring of the fund.

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MS. RODELL turned to slide 14, titled "Resolution 17-01 Inflation Proofing," which read as follows [original punctuation provided]:

- AS 37.13.145 (c) provides the inflation proofing mechanism which is calculated at the end of the fiscal year. Historically, the Legislature has included an estimated amount in the language of the operating budget to fulfill this statutory obligation.

- The Board of Trustees emphasized the importance of inflation proofing by unanimously adopting Resolution 17-01 during their September 2017 Annual Meeting.

Directing APFC to identify and pursue legislative support for inflation proofing the Principal of the Alaska Permanent Fund to preserve the purchasing power for all generations as stated in AS 37.13.020.

MS. RODELL stated that the Board of Trustees identified two things that have caused increasing concern. In September, the Board of Trustees passed Resolution 17-01 on inflation-proofing.

This came about due to three years of non-appropriation for inflation-proofing of the PF and protecting at least a portion of the fund for future generations, she said. She said it directed the APFC to identify and pursue legislative support for inflation-proofing the principal of the PF to preserve the purchasing power for all generations as stated in AS 37.13.020.

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MS. RODELL turned to slide 15, titled "Resolution 18-01 Rules Based Legal Framework for Fund Transfers," which read as follows [original punctuation provided]:

"Alaska has a long tradition of following a rules-based system for Permanent Fund withdrawals and savings. Since the Fund's inception, with the exception of certain one time deposits into the corpus, the State has adhered to a combination of constitutional and statutory law to manage cash flows into and out of the Fund, as well as those between the corpus and earnings reserve. ..."

MS. RODELL stated that earlier in the month the Board of Trustees went further and passed Resolution 18-01 to encourage a rules-based framework for fund transfers. This goes back to the desire to have a known distribution requirement for policy. She paraphrased the resolution.

MS. RODELL, turning to slide 16, titled "Resolution 18-01 Best Practices," which read as follows [original punctuation provided]:

"...Adherence to a rules-based system for Fund transfers is a basic element of best practices for management of sovereign wealth funds. The International Forum of Sovereign Wealth Funds, of which the Permanent Fund is a member, has adopted a set of Generally Accepted Principles and Practices, including that, "There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the fund's general approach to funding, withdrawal and spending operations on behalf of the government."1 "Such a system helps provide a clear basis for deriving the expected time horizon and efficient investment policy for the savings, and promotes macroeconomic stability and accountability."2 ..."

MS. RODELL strongly urged members to continue to follow a rules-based system, whether it is one currently in statute or one to come. She related her understanding that it is perfectly within the legislature's purview to adjust the rules over time; however, having an adherence to a rules-based system is a basic element of best practices for the APFC.

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MS. RODELL directed attention to slide 17, titled "Resolution 18-01, be it resolved," which read as follows [original punctuation provided]:

- 1) The Board of Trustees believes that adherence to a legally established rules-based framework governing Fund transfers is warranted and necessary, and such transfers should not occur ad hoc;
- 2) The Board of Trustees acknowledges and supports that with the fiscal challenges facing the State a new rules-based framework established in law for the Fund is likely necessary;
- 3) The Board of Trustees expresses appreciation to all stakeholders involved in the difficult and timeconsuming task of proposing, evaluating, and deliberating a new rules-based framework to govern Fund transfers;
- 4) The Board of Trustees and staff of the Permanent Fund will continue to provide support to stakeholders to develop a new rules-based framework established in law to govern Fund transfers; and
- 5) That the Board of Trustees directs the Executive Director to distribute this Resolution and Resolution 2017-1 (regarding inflation-proofing) to the Members of the 30th Alaska State Legislature and offer to testify in support of the need to follow a rules-based framework.

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MS. RODELL said she was pleased to distribute the resolution to the committee and glad to have the opportunity to testify in support of the need to follow a rules-based framework. She reiterated that for the APFC to perform its fiduciary responsibilities and follow the prudent investment rule, that part was a requirement on distribution.

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CHAIR KREISS-TOMKINS, in terms of a rules-based framework, asked to have her comment on the value of rules being in the [Alaska] Constitution versus in statute. He further asked her to comment as manager protecting the real value of the fund for future generations, how those two things differed.

MS. RODELL answered that there is need for flexibility. By putting the language "at least twenty-five percent" in the Alaska Constitution, it was recognized the statute would be inflexible as to the minimum amount that would go to the PF. However, there may be times when more than 25 percent would be deposited. Further, there was a recognition that times change, so the income was directed to the general fund (GF) unless otherwise provided by law. This could mean that the legislature could statutorily direct the income to the PFD or other fund, such as the constitutional budget reserve (CBR) account to allow flexibility since circumstances change.

MS. RODELL said that looking forward, the legislature must weigh carefully the decision between what is immovable and unchangeable because the constitutional language has not been touched since its inception in 1976. Remember, this debate started in 1969 so it took seven years before a constitutional amendment was formulated and adopted. Again, the constitutional language has not been touched since then. Alaska does not change its constitution easily or lightly she said. She highlighted that as potential changes are drafted, it is important to remember that aspect.

MS. RODELL recommended that what should stay in statute, arguably, are the things that should remain flexible. She said she would argue that might be the purpose and expense of the PF. The legislature needs this flexibility because things change, and the state has numerous needs and unforeseen events that future legislatures might need to consider or be required to adjust how the PF is used.

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REPRESENTATIVE BIRCH said he reviewed the constitutional amendment recently. He read a portion of Alaska Constitution Article IX, Section 15, "All income from the permanent fund shall be deposited into the general fund unless otherwise provided by law." He recalled from an earlier briefing that the PF and earnings account is \$65 billion, but the corpus of the fund is \$40 billion, of which \$16 billion has been deposited per

the constitutional provision. He related his understanding that since 1976, the legislature has supplemented that amount to build the corpus of the fund to \$40 billion. He asked whether that was accurate.

MS. RODELL responded that was correct. She clarified that \$16 billion represented the lease royalty payment with approximately \$7 billion in special appropriations. She recalled that at times after dividends and inflation-proofing the legislature would sweep out the account and deposit it to the principal of the fund. An additional \$16 billion came from inflation-proofing appropriations, she said.

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REPRESENTATIVE BIRCH recalled that last year the legislature attempted to adopt an inflation-proofing measure. He further asked whether Ms. Rodell had a sense of the amount of inflation-proofing required to protect the fund into perpetuity.

MS. RODELL answered that the fiscal year (FY) 19 Governor's Proposed Budget restored appropriations for inflation-proofing for FY 16, FY 17, and FY 18 in the amount of approximately \$1.4 billion. In addition, a separate appropriation for FY 19 was estimated to be \$942 million. She explained the calculation was based on the actual inflation rate, CPI [Consumer Price Index] as published, which is calculated on the principal or corpus of the fund. It was not based on the entire assets under APFC management. She compared the FY 16 inflation-proofing of \$47 million appropriation with the \$942 million for FY 19. This was due to the rise of inflation and the growth of the fund, but primarily indicates how inflation has shifted in the last four years, she said. This created a need for a larger deposit to maintain the purchasing power of the \$40 billion, which then becomes \$42 billion; thus, the inflation-proofing calculation would be done on the \$42 billion. She highlighted the compounding effect that happens.

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REPRESENTATIVE BIRCH said that it strikes him as a very reasonable thing to do since any realized earnings or gains of the corpus of the PF are subject to appropriation and statutory management. He related his understanding that the earnings are subject to appropriation and statutory management. He offered his belief that if the legislature does not inflation-proof the

PF, the fund will not grow, other than the 25 percent that is deposited.

MS. RODELL answered yes. She referred to the 25 percent in statute and stated that AS 37.13.010(a) outlines the different percentages of the Alaska PF. She paraphrased AS 37.13.010(a)(2), which read as follows [original punctuation provided]:

(2) 50 percent of all mineral lease rentals, royalties, royalty sale proceeds, net profit shares under AS 38.05.180(f) and (g), and federal mineral revenue sharing payments received by the state from mineral leases issued after December 1, 1979, and 50 percent of all bonuses received by the state from mineral leases issued after February 15, 1980; and

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MS. RODELL said that answers Chair Kreiss-Tomkin's question of whether more than 25 percent has been deposited into the PF. Statutes have been written to do that; however, the appropriations last year reduced it to the 25 percent, she said.

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CHAIR KREISS-TOMKINS referred to one of the resolutions the APFC passed and whether it was fair to assume that the APFC Board of Trustees supported retroactive inflation-proofing of the PF for the years that the legislature failed to do so.

MS. RODELL answered yes, the APFC does support retroactive inflation-proofing of the PF.

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REPRESENTATIVE WOOL referred [to slide 12, "Best Practices"] to other countries that have sovereign wealth funds. He asked whether Alaska was the only one that paid a dividend and whether it mattered.

MS. RODELL offered to clarify that she did not mean to indicate that Norway has poor governance of its funds; however, she was happy that Alaska received the recognition. She responded that Alaska is the only one that currently pays out a dividend. North Dakota set up its legacy fund when it had the shale oil boom but place a moratorium on the dividend program. She

recalled that North Dakota decided not to pay out any funds until the fund was five years old. She was unsure of the status, but North Dakota was considering whether to pay a dividend and had expressed an interest in Alaska's PF.

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REPRESENTATIVE WOOL asked whether if a fund produces wealth and 3 percent or 4 percent was drawn from it, it really matters how those funds are used.

MS. RODELL answered yes. She acknowledged that while we may all care as individual Alaskans, the APFC must be indifferent as to the use. She provided an example, such that with the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS), the focus is to provide an annual beneficiary payment, not on how the beneficiaries would use it. She suggested the PF as a similar concept, which is to ask, "What is the number, what is the bogey, is it that you need us to hit, to target, so."

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REPRESENTATIVE WOOL, in terms of inflation-proofing, asked whether if the bogey was lower, for example, at 2 percent, the inflation-proofing would be taken care of since it would be a lower number. He asked whether it is that simple.

MS. RODELL answered that she wished it was that simple. The reason that it is not that simple is because of the construct of the earnings reserve account (ERA) versus the principal of the PF. So long as the state was able to take an ad hoc draw up to 100 percent of the ERA, the APFC must always request an appropriation for inflation-proofing the PF, in order to ensure that the principal can capture back some of its purchasing power.

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REPRESENTATIVE WOOL asked for further clarification on inflation-proofing the PF. He asked if Alaska had one PF, instead of the fund being separated into an ERA and the principal of the fund, if it would be accurate that it would not be necessary to inflation-proof the fund so long as the legislature did not take off too much.

MS. RODELL responded that was correct.

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CHAIR KREISS-TOMKINS asked to cover the merits of ERA corpus structure versus an endowment model.

MS. RODELL answered that from the APFC's standpoint, there is very little merit to the ERA corpus structure. She elaborated that for ease of managing the investments, having one fund with a strict endowment payout would be a very clean approach. It would meet the criteria, previously discussed, such that the APFC could build a portfolio that recognizes the purpose to payout "x" percent. We know the terms into perpetuity, with some having a different term from the corpus.

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MS. RODELL explained that the APFC currently manages the PF as if "both buckets" have the same term, but the debate over the past three years makes it very clear that both accounts do not have the same terms. She stated that the distribution requirement has changed considerably; however, [the state] does not yet have a requirement. She said she understood the merits, from the state's policy perspective, of the reason to keep the ERA and the principal separate.

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CHAIR KREISS-TOMKINS asked whether the perceived merit would be that the legislature has a "big pot of money" that it can access when needed.

MS. RODELL answered yes; but the legislature also has a limitation to the amount of funds it could access. She stated one of the fears she has heard expressed over making it "one pot" was "oh, my goodness, now you're really going to spend all of the principal" without recognizing, as Representative Wool pointed out, setting the balance between not overdrawing and being able to recoup what you spend.

4:04:31 PM

REPRESENTATIVE BIRCH thanked Ms. Rodell for the great briefing and the work being done on behalf of all Alaskans.

CHAIR KREISS-TOMKINS concurred.

[4:04:51 PM](#)

The committee took an at-ease from 4:04 p.m. to 4:09 p.m.

PRESENTATION(S): FISCAL PLANS OVERVIEW BY LEG. FINANCE DIV.

**PRESENTATION(S):**  
**FISCAL PLANS OVERVIEW BY LEG. FINANCE DIV.**

[4:09:23 PM](#)

CHAIR KREISS-TOMKINS announced the next order of business would be a presentation: Fiscal Plans Overview by the Legislative Finance Division.

[4:09:41 PM](#)

DAVID TEAL, Director, Legislative Finance Division (LFD), Legislative Agencies & Offices, introduced himself. He began by describing fiscal plans. He said that this is about the fifth or sixth iteration of developing fiscal plans, noting that they tend to go in cycles; that each time the state faces low revenues, people want a fiscal plan. In the past, oil prices have recovered, and fiscal planning has been set aside.

[4:10:41 PM](#)

MR. TEAL offered his belief that ideally fiscal plans should be developed when the state has lots of revenue; however, it has never worked that way. Back to the question of what a fiscal plan is, he recalled an individual asked during public testimony, "So why don't you just say what you mean? Fiscal plan, that's just bureaucrat speak for - you want to tax me and take my [Permanent Fund Dividend] PFD." He acknowledged that that was not far from the truth. He said that fiscal planning addresses revenue, spending, and use of reserves to balance the budget. The three options to balance the budget or the three legs of fiscal planning are to use the Permanent Fund (PF), reduce government services, and reduce spending.

[4:12:04 PM](#)

MR. TEAL advised that to compare the fiscal plans would be very difficult because the only fleshed-out fiscal plan is the governor's fiscal plan. He submitted a plan last year, revised it, and resubmitted it this year. Although individual legislators have their ideas about a fiscal plan, neither body

has reached consensus. He offered his belief that people were waiting for the House and thought perhaps it may reach consensus, but it has not yet.

[4:13:02 PM](#)

MR. TEAL stated that fiscal plans evolve over time. The House could have a fiscal plan now, which could change in a week or a month and the Senate has not yet come forward with a fiscal plan this year. The Senate might argue that it still has a fiscal plan in SB 26, which is pending in conference committee, where it now resides. Some senators would like to "tweak" it but there is not any real consensus. He related that the LFD has a model designed to help the legislature with fiscal planning. It allows many user inputs to be changed. He characterized the model as complicated, so he did not bring it today. He offered to speak on some of the elements, specifically use of PF earnings.

[4:14:01 PM](#)

MR. TEAL said that to get into the model, the various taxes that could be imposed, what can be done with spending cuts or growth rates on expenditures - gets long and involved. The focus today is really on the use of PF earnings, he said. One reason was that it is by far the most powerful tool the legislature has since the fiscal deficit runs about \$2.6 billion. Using PF earnings, as proposed by the governor, would close about \$2 billion of that gap. Taxes at most would raise about \$700 million, he said. Thus, using [PF earnings] represents the key tool in fiscal planning.

MR. TEAL pointed out that one thing the model indicates is that balancing the budget without using the PF earnings would be very difficult. He said, "We cannot make it work without using earnings." Another thing the model indicates is the difficulty in agreeing on a more comprehensive plan - meaning reserves, expenditures, and revenue. He offered that the problem was not that there are not solutions; instead, there are lots of solutions.

[4:15:37 PM](#)

REPRESENTATIVE WOOL referred to the \$2.6 billion deficit mentioned and that the governor's fiscal plan would address \$2 billion. He said if the PF balance is \$60 billion, and the legislature takes a 5 percent POMV [percent of market value] if

the deficit would really be \$3 billion. He asked him to identify the error.

MR. TEAL answered that Representative Wood had not made an error. He explained that under the governor's POMV plan, as with most of the POMV plans, there is a payout. Under the plan, only \$2 billion goes for public services and the remainder goes to dividends, he said.

MR. TEAL stated that LFD has been looking at the use of earnings reserve account (ERA). He clarified that this did not mean using the PF since it is not available to the legislature.

[4:16:56 PM](#)

MR. TEAL said that given that the legislature has been arguing about POMV payouts for four or five years, one may infer there is some deep-seated opposition to using the PF earnings or at least irreconcilable differences in plans. He offered his belief that most of the differences did not really matter much; in fact, the plans are similar in concept although they differ in detail. For instance, most of the POMV plans have a "five-year lookback," which is generally agreed upon as resulting in a stable payout. He pointed out the earlier discussion about the dangers of POMV versus earnings. He deferred to the next presenters to discuss this as part of their overview of PF proposals. He offered to come back for their presentation and answer any questions that arise.

[4:18:33 PM](#)

MR. TEAL stated that the five-year lookback provides stability for government since it is difficult to start up a program and decide not to fund it the next year since people move on and the infrastructure is gone so programs tend to last awhile in government. He turned to the discussions on the payout rate. He related that it was a narrow range, with one plan using 4 percent, but most plans use between 4.5 percent to 5.25 percent payout.

MR. TEAL offered that there has been some confusion about what would be sustainable and some of this comes from the [Alaska] Permanent Fund [Corporation] (APFC) comments. He suggested that the math was simple. For example, if the PF earns 6.5 percent interest and inflation was 2.25 percent, it would result in a 4.25 percent sustainable payout, he said. Given the lookback, the nominal payout of 4.25 percent would not be paid on the

current value, but on the six-year lookback; thus, the payout would basically be based on the PF balance three years ago. Since the PF continues to grow, the effective payout rate is always lower than the nominal rate. He characterized it as a "25 basis points" difference; therefore, the state could afford a 4.5 percent payout, which is clearly sustainable, based on inflation.

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MR. TEAL said the APFC has also said that its target rate of return is a real rate of 5 percent. Again, that would indicate that the legislature could have a 5 percent sustainable payout which based on the lookback, could go to 5.25 percent and still be sustainable. He related that his attitude has been that it does not really matter since it is not a big range. Pick a number. They all work. He explained the difference, which was that picking a low number would result in a lower payout in the early years, but because of the lower payout the overall fund increases so future payouts would be higher. The reverse would be to pick a high number now, which would result in higher payouts; however, the fund would not grow as fast resulting in the "lines crossing" in about 20 years.

MR. TEAL emphasized that the real argument over the POMV is inter-generational equity. He said, "Do you want more now, or do you want more left for future generations?"

[4:21:53 PM](#)

CHAIR KREISS-TOMKINS asked whether he had a sense of other sovereign wealth funds and what the median POMV payout is.

MR. TEAL answered that other sovereign wealth funds fall within the same ranges. He reminded that Ms. Rodell briefly touched on the key point, which was that a 4.25 percent payout rate might be deemed sustainable; however, the large deficit would remain. In fact, the deficit would be large enough with a payout that low, that the Constitutional Budget Reserve Fund (CBR) would be depleted in a couple of years, at which point the state would need to implement a tax, spend, or use reserves.

[4:22:51 PM](#)

MR. TEAL offered to compare some options. The easiest option for the legislature would be to agree to a 4.25 percent payout and take an ad hoc draw, which is essentially a 4.25 percent

payout plus \$800 million. However, that does not work, he said. The difference between using 4.25 percent or 5.25 percent payout does not matter either, since it would only affect the ad hoc draw. The ad hoc draw at 5.25 percent would be lower because the stated payout was higher. "But you simply cannot do ad hoc draws and have a sustainable fund," he said. Instead, the legislature must pick a sustainable payout and stick to it. He predicted that if the legislature uses ad hoc draws it will result in the reserves being drained, which will mean that the legislature did not protect the PF.

[4:23:40 PM](#)

CHAIR KREISS-TOMKINS asked for Mr. Teal's viewpoint on the constitutional amendment to prohibit ad hoc draws.

MR. TEAL responded that it was a tough question because statutes clearly cannot prevent ad hoc draws. He said that the [Alaska] Constitution is the only way to prevent ad hoc draws. The only safe way to have the PF support government or dividends would be to put it in the [Alaska] Constitution; however, it then becomes very inflexible and means the legislature cannot take any ad hoc draws. There may come a time when an ad hoc draw becomes necessary.

MR. TEAL said that the provision in Alaska's Constitution to set up the PF has worked well for many years because the constitutional language is vague. It requires a minimum of 25 percent be deposited in the fund, but it does not set a maximum amount, nor does it specify what to do with the funds except to invest it.

MR. TEAL related that Alberta [Canada] used to have a heritage PF, which was larger than Alaska's PF, but Alberta invested in infrastructure by building government buildings. Unfortunately, there was not any return on its investment. By comparison, Alaska very wisely stuck to financial investments rather than infrastructure in Alaska with little or no cashflow return to the PF.

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MR. TEAL acknowledged that he felt "a little nervous" about a constitutional amendment, but it would provide the only real protection the fund can have. It would assume, in many ways, the state would go to an endowment plan.

MR. TEAL mentioned testimony before the House Finance Committee on a bill creating an endowment. He offered his belief that it was obvious that either the public does not understand endowment theory at all, or the public has a great fear of government, or both. The testifiers expressed concern that having an endowment instead of a separate ERA, [the legislature] would begin spending the corpus of the fund.

MR. TEAL further acknowledged it could happen since spending 5 percent without earning 5 percent. Earnings might be low for several years which might mean dipping into principal. However, in the long run the fund would grow, dependent on managers picking a sustainable yield and the endowment earning enough to make the payout plus inflation. He predicted an endowment would continue to grow and spin off 5 percent. In fact, that is the reason universities and foundations use endowment theory instead of trying to run off earnings. "Earnings are inherently unstable," he said.

[4:27:52 PM](#)

REPRESENTATIVE WOOL referred to slide 3, to the amendment to language added to the Alaska Constitution at the time the PF was created. He recapped that it sets the minimum amount to be placed in a PF, but it does not set the maximum, nor does it say what to do with the earnings. He suggested if the PF was a true endowment model and it established a draw, but it did not indicate what to do with it, that could make people uncomfortable. As the legislature has been having discussions on constitutional amendments, how to divide the earnings has created some discomfort. Although education was listed in the Alaska Constitution, it does not indicate how much funding should go towards education, he said. He acknowledged that the chair was interested in endowments and constitutions.

CHAIR KREISS-TOMKINS agreed that he was very interested in constitutions.

REPRESENTATIVE WOOL highlighted that the provision provides "a lot of latitude."

[4:29:06 PM](#)

MR. TEAL directed attention to the last clause on slide 3, which read, "...unless otherwise provided by law." He stated it is provided by law that the ERA is part of the PF. He said:

It is not in the general fund; it resides by law in the permanent fund. Easy to change. But it does not change the fact that the entire earnings reserve, despite the fact that it is considered part of the permanent fund, is fully subject to appropriation. And, of course, that's the underlying problem, all along, but it wouldn't matter if that earnings reserve were in the general fund or it stays where it is. The point is, it can be spent at any time, in any amount, with a simple majority.

[4:30:24 PM](#)

REPRESENTATIVE BIRCH said that the legislators and governor would need to decide, and each person probably has a different opinion. He offered his belief that appealing (indisc.) the approach was reasonable and would provide a steady, predictable draw on an annual basis. He related his understanding that the Alaska Supreme Court last year decided that a dividend was not a birthright but was basically "a line item in the budget." He offered his belief that if the state cannot reduce spending appropriately, that [the legislature] has an obligation to meet that financial obligation. He wondered what was wrong with paying the state's bills first and if money was left over to pay a dividend for those who need it, that the legislature should do that. He asked whether any work has been done on a "needs-based" dividend, or perhaps a way to meet the needs of the 25,000 Alaskans that are in poverty [without it]. He said he has frequently heard the argument that the people who rely on the PFD.

[4:32:23 PM](#)

MR. TEAL responded that if the legislature could reach an agreement on payout, which seemed likely, the split for dividends was "a big deal." He said that there was not a real economic government rationale for dividends. "We are the only sovereign wealth fund that pays dividends," he said. He offered his belief that paying dividends is a political decision with large fiscal impacts, because every dollar spent on dividends increases the deficit by a dollar. That "dividend split" becomes a real fiscal issue. He related a scenario in which the state had an \$800 million deficit and added that, coincidentally the state is paying out \$800 million in dividends. If the state asked a consultant for ideas, the consultant would advise that it does not make sense to pay out a dividend, which no one else

in the world does. He suggested the answer was too easy since the solution to the scenario would be not to pay dividends.

MR. TEAL recalled previous proposals ranging from not paying a PFD if the state has a deficit, to paying a full PFD despite having a deficit. He said that there was not a right answer to this question. He acknowledged that some people have grown to rely on the PFD and so it becomes a political decision. Some constituents may not understand the fiscal situation, but they certainly understand that the PFD arrives in October. They may threaten that they better receive their dividend in October, or they will not vote for the incumbent legislator who voted to reduce or eliminate it. He cautioned the public against blaming legislators for any vote related to the PFD since each legislator must vote for what he/she believes to be right. He reiterated that there was not any right or wrong on these dividends so long as the legislature understands that every dollar paid out for the PFD adds to the deficit by a dollar; and the legislature must find a way to address the larger deficit. He said it was not easy.

[4:36:10 PM](#)

CHAIR KREISS-TOMKINS, with respect to ongoing discussions in the Capitol building, asked for his speculation on the probability of an ad hoc draw by the legislature in the next two budget cycles. In response to Mr. Teal, he added that he would consider anything greater than 5.25 percent of POMV.

MR. TEAL asked for clarification on whether last year's draw that was not taken was considered. He reminded the committee that SB 26 has been before the conference committee for over a year and if it was acted upon would have an effective date in 2018. He asked whether that would be considered an ad hoc draw. He suggested that if it happened, it would be considered a double draw. He wondered whether procedurally the House would be able to get a super majority vote on the budget, and if not, that the chances of an ad hoc draw continue to rise as time goes on. He speculated that the only way to avoid it would be to have a draw in 2018, which some people would consider an ad hoc draw. He reiterated this was speculation rather than an opinion.

[4:38:30 PM](#)

MR. TEAL recommended if the legislature wanted to move forward, it should "get out of the weeds" and focus on the goals. He

advised members that his office has run the model to the point that his staff can show [outcomes]. He related that people get very lost in the individual details of the plan. He reiterated that the payout is not critical since it represents between \$100 million to \$200 million per year, which would not be enough to close the deficit or to move the legislature into the unsustainable range. He said, "Pick a number. They all work." He further suggested that members focus on goals and try to figure out how to measure whether a fiscal plan is successful. That would not happen by examining the details of the fiscal plan but by developing a broad fiscal plan.

[4:39:51 PM](#)

MR. TEAL outlined one measure that the agency uses to assess how well a fiscal plan works was by determining whether it maintains the real value of the PF. He said it represents a key model output for the agency, which is linked to the sustainable ERA. When the agency examines the PF, the agency reviews the ERA combined with the corpus of the fund. The state should be maintaining the inflation-adjusted value of the combine the ERA and the corpus of the fund.

MR. TEAL attested that the legislature cannot maintain that with ad hoc draws or unsustainable draws. The health of the PF means examining the health of the ERA since the legislature cannot use the corpus of the PF.

[4:40:46 PM](#)

REPRESENTATIVE BIRCH expressed an interest in hearing the final presentation, an Overview of Permanent Fund Proposals in the Legislature by Reid Magdanz and Rob Ervine, legislative staff.

CHAIR KREISS-TOMKINS stated it may make sense to hold off on the presentation.

[4:41:54 PM](#)

MR. TEAL reiterated that in evaluating a model, the division first reviews the health of the CBR, which is linked to deficits. Next, it looks to the PFD, which there is no right answer on. The state can pay a higher PFD if the state has taxes or by implementing other things.

MR. TEAL said some people might argue that having any broad-based tax required to balance a successful fiscal plan means an

unsuccessful fiscal plan. He suggested that he had provided the division's measures of success, but each legislator should have his/her own measures. If the legislature can agree on the goals, it would find that the details are not as important as they seem to be in some of the fiscal plans. Some get wedded to a specific payout rate, or a linkage, but a successful plan would consist of picking a rate, paying the rate, and not taking ad hoc draws on the fund, and paying a PFD that members believe is affordable. He said it would not "kill" one to pay a dividend once, but it cannot be done long-term. He emphasized that the key was to look ahead at the sustainability of a fiscal plan instead of asking, "How do we get out of here?"

[4:43:46 PM](#)

CHAIR KREISS-TOMKINS announced that the final presentation, an Overview of Permanent Fund Proposals in the Legislature by Reid Magdanz and Rob Ervine was held over.

[4:44:08 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House State Affairs Standing Committee meeting was adjourned at 4:44 p.m.