

SENATE FINANCE COMMITTEE  
February 21, 2017  
9:02 a.m.

[9:02:30 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair  
Senator Click Bishop, Vice-Chair  
Senator Mike Dunleavy  
Senator Peter Micciche  
Senator Natasha von Imhof

MEMBERS ABSENT

Senator Lyman Hoffman, Co-Chair  
Senator Donny Olson

ALSO PRESENT

Angela Rodell, Chief Executive Officer, Alaska Permanent Fund Corporation; Senator Gary Stevens.

SUMMARY

^ALASKA PERMANENT FUND CORPORATION OVERVIEW

[9:03:21 AM](#)

ANGELA RODELL, CHIEF EXECUTIVE OFFICER, ALASKA PERMANENT FUND CORPORATION, discussed the PowerPoint, "Alaska Permanent Fund; February 2017" (copy on file).

[9:04:20 AM](#)

Ms. Rodell highlighted Slide 2, "The Corporation":

AS 37.13.040. Alaska Permanent Fund Corporation.  
There is established the Alaska Permanent Fund Corporation. The corporation is a public corporation and government instrumentality in the Department of

Revenue managed by the board of trustees. The purpose of the corporation is to manage and invest the assets of the permanent fund and other funds designated by law in accordance with AS 37.13.010-37.13.190.

[9:04:52 AM](#)

Ms. Rodell addressed Slide 3, "The 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.

[9:05:43 AM](#)

Ms. Rodell discussed Slide 4, "Corporate Mission":

**"to manage and invest the assets of the Permanent Fund and other funds designated by law"**

AS 37.13.120. Investment Responsibilities

- Designate types of investments
- Use the prudent investor rule
- Related to an investment, may only borrow money if the borrowing is nonrecourse to the Corporation and the Fund
- Shall maintain a reasonable diversification among investments

[9:06:36 AM](#)

Ms. Rodell highlighted Slide 5, "APFC's Vision":

**"to deliver sustained, compelling investment returns as the United States' leading sovereign endowment manager,**

**benefitting all current and future generations of Alaskans"**

- Reflects statutory language and intent, as well as Board and staff aspirations.
- Emphasizes maximizing returns in a fully sustainable manner.
- Underscores the intention for the Fund to be a perpetual resource for the State of Alaska.
- Embodies core values of Integrity, Stewardship, and Passion.

[9:08:23 AM](#)

Ms. Rodell discussed Slide 6, "Strategic Plan":

Every 5 years, as required by the Board of Trustees' Charter, a strategic plan is developed.

- APFC's 2017-2021 Strategic Plan was developed by staff; reviewed then adopted by the Board of Trustees during the Annual Meeting in September 2016.
- Four strategic priorities were identified to be pursued over the next five years.
  - o Takes into account stakeholder expectations.
  - o Builds on a common vision for the Corporation.

[9:09:03 AM](#)

Ms. Rodell highlighted Slide 7, "APFC's Strategic 5 Yr Plan":

Strategic Priorities FY17-FY21

- Gain greater control of resource allocations
- Optimize APFC's operational processes and use of financial networks and resources
- Develop best-in-class investment management capabilities, partnerships, and geographic reach to maximize investment returns
- Enhance talent and staff across APFC

[9:09:32 AM](#)

Ms. Rodell looked at Slide 8, "APFC Values Human Capital":

- APFC needs to have all the tools necessary to recruit and retain the best professionals.
- APFC appreciates the support of the Legislature for the positions authorized in past years for internal management of assets.
- Current budget has a vacancy rate of 7.82 percent which translates to a funding deficit of \$811,901. This requires positions to be held vacant.

Ms. Rodell noted that the corporation had 51 total positions, including vacancies and summer internships. She said that the current budget shoed a vacancy rate of 7.8 percent; 6 positions in the corporation were currently being held vacant, with 2 more becoming vacant within the next two months.

[9:10:28 AM](#)

Co-Chair MacKinnon spoke of the assumed difficulty the corporation faced in attracting investors. She asked whether there were applicants that could fill the vacant positions, or were they being held open specifically for the vacancy factor.

Ms. Rodell replied that the positions were being held open due to the vacancy factor. She furthered that 3 people had been recently hired for positions in investments that had been added in FY 16, for which 91 applications had been received from around the world. She believed that the corporation's ability to recruit was strong.

[9:11:47 AM](#)

Co-Chair MacKinnon wondered who requested that the positions be held open in FY 16. She queried the difference in cost between hiring an in-house investor manager versus hiring one from out-of-state.

Ms. Rodell replied that there were slides further in the presentation that would touch on the subject. She added that in-house management allowed the corporation more flexibility and the ability to generate additional returns to the state, while reducing fees. She related that the in-house Juneau staff allowed the corporation to maximize savings when hiring.

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Ms. Rodell relayed that the request to include the vacancy factor had been made by the Governor's office because the corporation was part of the executive budget act and was required to carry a vacancy factor similar to other departments.

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Senator von Imhof asked whether the corporation engaged in peer comparisons with other large funds in term of staff ratios and appropriate staff levels for the fund's size and asset mix.

Ms. Rodell replied that peer comparisons for fund size did exist. She offered to provide the statistics to the committee at a later date. She shared that funds that managed \$30 to \$100 billion had an average of 23 information technology (IT) staff alone, compared to the corporation's 5 IT positions. She noted that, on average, comparable funds retained bigger back office and support staff than the corporation.

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Senator von Imhof asked whether the comparisons had been published for the public in an annual report.

Ms. Rodell responded that the reports were publicly available.

[9:16:10 AM](#)

Senator Dunleavy looked at Slide 6, and queried a defined list of stakeholders.

Ms. Rodell replied that the stakeholders were defined as "Alaskans".

[9:17:11 AM](#)

Co-Chair MacKinnon understood "Alaskans" to mean future Alaskans and the current generation of Alaskans.

Ms. Rodell replied in the affirmative.

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Vice-Chair Bishop queried the length of the hiring process.

Ms. Rodell replied that the hiring process took approximately sixty to ninety days.

[9:19:33 AM](#)

AT EASE

[9:22:44 AM](#)

RECONVENED

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Senator Dunleavy wondered whether the fund invested in derivatives.

Ms. Rodell replied in the affirmative. She explained that they were not purchased directly, but through funds that the corporation owned.

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Senator Dunleavy understood that derivatives would be incidental to the purchase of a fund.

Ms. Rodell replied in the affirmative.

[9:23:21 AM](#)

Co-Chair MacKinnon queried the definition of "derivative" for the listening public.

[9:23:30 AM](#)

Senator Dunleavy wondered whether it would be possible for the legislature to modify the definition of statutory net income; could the definition of net income be modified to eliminate the need to make legislative appropriations inflation proof to the corpus.

Ms. Rodell deferred the question to the Department of Law and Legislative Legal Division. She said that state Constitution was clear in directing that all income should go to the general fund.

[9:24:32 AM](#)

Ms. Rodell explained the definition of "derivative". She said that derivatives were generally used to hedge different market movements as predicted by investors.

[9:26:07 AM](#)

Ms. Rodell shared that the corporation had a fund value well in excess of \$55 billion, and addressed Slide 9, "Renewable Resource Use of Income Since Inception":

\$29.1 billion

- **Saved for Future Generations Alaskans**
- ERA
- Inflation Proofing
- Other Appropriations

\$24.3 billion

- **Distributed to Current Generations Alaskans**
- Dividend Fund
- Alaska Capital Income Fund

\$52.8 billion

- Fund Value FY16
- **Principal \$44.2**
- **ERA \$8.6**

[9:27:42 AM](#)

Ms. Rodell discussed Slide 10, "Value of the Fund." She relayed that in FY 14 the principal of the fund was \$45 billion, with \$6.2 billion in the ERA. She noted that through the second quarter of FY 17 the corpus had grown to \$45.1 billion, and the ERA had grown to \$10.3 billion.

[9:28:04 AM](#)

Ms. Rodell looked at Slide 11, "Inflation Proofing":

- Provides a deposit back to corpus
- Maintains purchasing power of corpus

Since Inception of the Fund -

- Inflation Proofing
  - added \$16.2 billion to corpus
- Royalty Deposits

- o added \$16.2 billion to corpus
  - Based on value of corpus on June 30 and the change in inflation rate over the prior two calendar years

Ms. Rodell stated that over the years inflation proofing had varied widely based on what inflation was for the given year; for example, in 2010 the inflation calculation was zero, which resulted in zero appropriation.

[9:28:47 AM](#)

Ms. Rodell discussed Slide 12, "\$55.4 Billion Portfolio; Target Asset Allocation." She relayed that approximately 62 percent of the portfolio was in public markets, which included public equities and fixed income plus. 38 percent of the portfolio was in private markets, which included private equity/growth opportunities, absolute return (hedge funds), real estate, private infrastructure/private credit/income opportunities, and asset allocation strategies/cash. She noted that allocation strategies were overlay strategies that could involve multiple asset classes and were used to manage the portfolio.

[9:29:45 AM](#)

Ms. Rodell addressed Slide 13, "Performance FY 17 Q2." She said that the slide showed short-term performance returns for periods ending December 31, 2016; total funds versus total fund targets. The green bars represented the total fund, the orange bar reflected the passive index benchmark (60/30/5/5), the brown bar marked the performance benchmark, and the teal bar represented the TF return objective (CPIU+5 percent). She noted that the benchmark had been made over the past two years. She shared that the board of trustees set the performance benchmarks.

[9:31:41 AM](#)

Co-Chair MacKinnon thought that the slide was intended to reflect that the leadership in investments that the fund had made for the people of Alaska had been fruitful.

Ms. Rodell replied in the affirmative.

Co-Chair MacKinnon asked whether the 8.10 percent total fund return could be maintained under changes that was occurring in the international and national markets, specifically to consumer confidence under the Trump Administration.

Ms. Rodell replied that the next slide would speak to volatility in the current market. She stressed that the permanent fund was invested in the long-term, and the corporation recognized that the priority should be to maintain safety of principal while maximizing returns.

[9:33:38 AM](#)

Ms. Rodell highlighted Slide 14, "Performance Past 20 Years." The slide illustrated how the diversification of the asset allocation had weathered various incidents in the financial market over the past 20 years.

[9:35:03 AM](#)

Senator Micciche queried the total 40-year return of the fund.

Ms. Rodell replied that the information was available on the website.

[9:35:37 AM](#)

Ms. Rodell addressed Slide 15, "Statutory Net Income":

- o Statutory net income excludes unrealized gains and losses; only realized gains are transferred to ERA.
- o In 1998, the definition of "income" for accounting purposes was modified to account for "unrealized gains and losses."
- o Unrealized gains earned by principal are a part of principal until realized, and unrealized gains earned by ERA are part of ERA.

Ms. Rodell explained that in 1997, the generally accepted accounting principals changed some of the rules for income, unrealized income became required to be included as income. She said that there had been a recognition that it was difficult to spend or appropriate unrealized gains and

losses, which had resulted in the current exclusion of unrealized gains and losses. She noted that over the years the realized net income had been between \$2 and \$3 billion, and was a function of the regular monthly cash-flow that was coming in from investments, and any gains that were made because of investment decisions being made by corporation staff and external fund managers. She stated that a statutory net income number had never been targeted.

[9:37:45 AM](#)

Co-Chair MacKinnon wondered whether the board made the determination to hold a loss for a while, in anticipation of a recovery, and wondered about the criteria used to move things into a loss or a realized gain.

Ms. Rodell responded that it would depend on the asset class. She said that for some asset classed the corporation would be patient in recouping the loss. She related that if losses continued for an extended period (2 to 3 years) the corporation would mark them down and begin to recognize the loss. She said that in the public market, where buying and selling occurred more frequently, the loss would be recognized more quickly. She stated that taking a loss meant that the corporation would need to reinvest somewhere else, so the loss would be booked but cash would need to be put to work in the asset class.

[9:39:48 AM](#)

Co-Chair MacKinnon wondered whether there had ever been a struggle to deploy cash resources over the asset allocation.

Ms. Rodell answered that there had been times when higher cash positions had been deliberately held due to market volatility. She said that external fund manager was forbidden to hold significant cash balances, but the corporation managed well internally the several times that they had been cash-rich and had deliberately moved into other asset classes.

[9:41:07 AM](#)

Senator von Imhof looked at Slide 16, which listed the corporations top three successes over the past 5 years. She lamented that past returns were not a guarantee of future

returns. She queried the future returns on the fund in terms of the asset mix.

Ms. Rodell said that the corporation had worked to move into asset classes and create more international and global exposure. She said that the global portfolio and diversification within each asset class would be beneficial for expected growth areas during demographic shifts. She reiterated that her first job was to protect principal and her second was to maximize returns.

[9:44:00 AM](#)

Senator von Imhof queried the associated risk in volatility by making the shift in investment.

Ms. Rodell believed that that volatility and risk were being reduced by making the shift in investment. She offered an overview of the concept of "value at risk." She expounded on the low level of volatility in the private markets. She stressed that the corporation was considered a very patient, long-term investor.

[9:46:46 AM](#)

Ms. Rodell discussed Slide 16, "Last 5 Years, APFC has:

- o Beat Passive Performance Benchmark: Outperformed 60% stock, 30% bond, 10% real assets mix by 2.07% (8.36% versus 6.29%).
- o Improved Diversification: Reduced value-at-risk from 24% to 19% by increasing private markets investments from 22% to 30%.
- o Reduced Management Expenses: Declined from 42bps on assets-under-management to 29bps (a 31% reduction).

Ms. Rodell pointed out that the 2.07 percent equated to \$4 billion in value. She relayed that having the corporation staff direct external managers, and making investment decisions internally, an additional \$4 billion had been generated into the fund that would no be there otherwise. She stressed that the corporation had work diligently to reduce management expenses, which had declined from 42 basis points to 29; a 31 percent reduction on management fees.

[9:48:11 AM](#)

Ms. Rodell addressed Slide 17, "Management of the Fund":

- o In FY16, 39% of the total assets were under in-house management.
- o Over the last 10 years, the Board of Trustees has set a priority of building in-house talent.
- o Private markets have received most recent investment of talent and resources.

[9:49:02 AM](#)

Co-Chair MacKinnon wondered whether the trustees had an ideal amount of asset allocation, internal versus external, for management of the portfolio.

Ms. Rodell replied that there was a target of 50/50. She asserted that there was value to external management, which was why the goal was not 100 percent internal.

[9:50:11 AM](#)

Co-Chair MacKinnon asked whether the 6 vacancies were in the investor category.

Ms. Rodell said no. She explained that one of the positions was a part-time position, three others were in investments, two were back office support.

[9:50:45 AM](#)

Co-Chair MacKinnon recalled that 3 investor positions had been added within the past few years, and wondered whether those were the same as the currently vacant positions.

Ms. Rodell replied that 4 positions had been added in FY 16, and 6 in FY 17. She relayed that one out of the FY 16 positions, and 2 from FY 17, were vacant.

[9:51:14 AM](#)

Senator Micciche queried the returns for internal and external investors.

Ms. Rodell replied that internal and external returns were not tracked, which was the reason for the creation of the benchmarks. She said that the portfolio was nearly entirely

managed in-house, with a few high-yield bond funds that were managed externally.

[9:52:42 AM](#)

Senator Micciche wondered whether the management cost of the external investments brought greater value to the overall investment.

Ms. Rodell said that external managers had done well for the fund. She shared that there had been a move toward more performance driven fee arrangements so that there would be more incentive compensation built into the external management contracts.

[9:54:11 AM](#)

Vice-Chair Bishop commented that if the incentives were performance based, investors could take higher risks.

Ms. Rodell said that the investment staff was on due diligence on a regular basis to be sure not to engage in risky behavior that was outside of the mandate they had been directed to fulfill.

[9:55:01 AM](#)

Ms. Rodell looked at Slide 18, "Real Estate":

- Value of Direct RE Investments: **\$5.5 billion**
- Real Estate Internal Mgmt. \$83,333/month
- Monthly Cash Flow: **\$21.2 million** (gross of fees)
- Compare to: 30-year Treasury Bonds, 2.875% coupon rate
- Monthly Cash Flow **\$13.2 million**

Ms. Rodell explained that the corporation generated an excess of \$8 million by managing the portfolio and having the asset class in-house.

[9:57:12 AM](#)

Ms. Rodell addressed Slide 19, "Best Practices":

"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."

[9:58:41 AM](#)

Ms. Rodell discussed Slide 20, "Peer Recognition":

- Two aiCIO Industry Innovation Awards (2011, 2015)
- Public and Private Fund Managers
  - Singapore Government Investment Corp
  - Norway Government Pension Fund
  - Massachusetts PRIM
  - Finance Ministry of Mongolia
  - International Forum of Sovereign Wealth Funds

[9:58:48 AM](#)

Ms. Rodell highlighted Slide 21, "Key Takeaways":

- Fortitude: Strength
- Flexible, Adaptive: Role is Changing
- Corporation Key to Success of The Fund
- Continued Investment into The Corporation:
  - People
  - Workplace Environment
  - Resources

[9:59:28 AM](#)

Senator Dunleavy solicited Ms. Rodell's advice on how the state should move forward using the fund to "do more for Alaska."

Ms. Rodell thought that allowing the corporation to continue to operate independently was important.

[10:01:00 AM](#)

Senator Dunleavy wondered whether the drop in the price of oil had cause investors to approach the fund differently.

Ms. Rodell replied that greater pressure was being placed on funds to become budget stabilization funds, which were very different than long-term endowment or sovereign wealth funds.

[10:02:07 AM](#)

Senator Micciche asked whether the fund's trustees were knowledgeable on the early formation of the fund and the purpose of its creation, and whether that knowledge informed their policies. He wondered whether trustees considered that someday the fund would transfer into a source of revenue for partially funding government.

Ms. Rodell stated that when trustees were new they were given a thorough orientation. She said that trustees were Alaskans, and the history of the fund was shared with them. She related that the current board had strong and long-lived ties to the state and took their jobs as trustees and fiduciaries of the corpus of the fund very seriously. She said that the subject of spending the ERA was a sensitive to trustees because they believed that the account had always been viewed as a state spending account. She added that statute had directed the ERA to be invested alongside the corpus of the fund, but that it was available for appropriation - in its entirety - every year. She thought that trustees had refrained from taking a position on the subject to maintain the integrity of the corporation, while recognizing that they are not politicians; their job is to protect the fund and not to weigh in on political debates.

[10:05:24 AM](#)

Senator Micciche understood that the trustees could experience changes in investment philosophy associated with the use of the ERA for government funding.

Ms. Rodell replied in the affirmative.

[10:05:53 AM](#)

Senator von Imhof felt that the corporation would retain independence once the ERA was used to fund government. She asked about the third bullet on Slide 3, and wondered what the maximum use of an annual income draw would be under a long-term and predictable endowment model.

Ms. Rodell replied the corporation did not have an opinion of what the draw should be. She stated that the range of numbers in all the bills that were currently in play regarding the use of the fund, ranging from 4.5 to 5.25 percent draw amounts, were all reasonable draw amounts.

[10:08:11 AM](#)

Co-Chair MacKinnon reminded that committee that for the past three years the state had drawn from its savings accounts, and that the state faced a deficit. She said that using the ERA was not ideal, but necessary given the current fiscal climate. She lamented that the state could be losing returns on assets. She stressed that the number one goal for all parties involved was the safety of the principal of the corpus of the fund. She asked if there were specific characteristics in any of the bill in play that would allow the corporation the flexibility, and when would the board be reviewing this year's legislative actions.

Ms. Rodell noted that when talking about a budget stabilization fund as a glide path down to a new revenue balance, people generally assumed that the drawing would be for a limited period until the revenue and expenditures equalized. She said that this differed from an endowment that would be a revenue source every year going forward. She stated that if investments in the ERA were going to need to be moved into short-term, liquid investments because the budget stabilization factor was at play, the percentage of generated returns would decrease. She highlighted the differences in the bills pertaining to the use of the fund for government. She said that when the trustees evaluated the bills a year ago, there had been less information than what was currently available. She thought that if the bills gained momentum that the trustees would consider considering them.

[10:16:10 AM](#)

Senator Micciche noted the subject of liquidity. He wondered whether the board of trustees had been frustrated with the lack of healthy fund balance in the CBR. He wondered whether the corporation should be managing the CBR for greater return.

Ms. Rodell responded that as the revenue commissioner for the administration she had been a trustee of the permanent fund, and she furthered that during that time she did not recall any discussions on the issue of how the funds should be managed. She believed that having the revenue commissioner as both the fiduciary for state funds and on the board for the trustees provided a consistency of application for the entire financial portfolio. She hailed the treasury division for their daily cash management, particularly at a time when revenue was not meeting target numbers. She noted that payroll for the state was made every 15th and final day of every month, with limited tax revenue flow. She warned that if the corporation managed too much of the state's money an external bank would need to be added. She felt that the CBR should be managed more conservatively than the permanent fund, and that the state's prudent handling of the CBR to date has been wise.

[10:21:10 AM](#)

Senator Micciche felt that Ms. Rodell had misinterpreted the question. He agreed that the CBR had been managed prudently and well for the past several years, but thought that when things were more stable, and the CBR was fully funded, lost opportunities for investment could be expensive.

[10:21:50 AM](#)

Senator Dunleavy spoke to the "rainy day" account with the understanding that it was a temporary approach to temporary issue. He understood that the concept of an endowment was that the approach became permanent. He wondered whether investment strategies would be impacted once the legislature determined whether the fund was a "rainy day" account or an endowment.

Ms. Rodell replied that if the fund remained an endowment there would be very little shift in the investment strategy. She believed that the asset allocation would need to shift for a "rainy day" fund to make sure that there was cash and liquidity when necessary because many of the bills currently circulating in the legislature had a 5 to 6 year look back timeframe. She stressed that the corporation did not want to be in the uncomfortable position of being the sole funder of state government.

10:25:01 AM

Vice-Chair Bishop thanked the presenter and noted her as an example of grace under fire.

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Senator Micciche noted that SB 128 had a maximum draw, which he characterized as a combination of a "rainy day" fund and an endowment model. He wondered how SB 128 presented from a management perspective.

Ms. Rodell replied that it did create some management flexibility, because it would not exceed a dollar amount for liquidity purposes.

10:26:45 AM

Co-Chair MacKinnon offered a brief history of SB 128, which had died in chamber in June of 2016.

Ms. Rodell agreed with her comments.

10:27:02 AM

Senator Micciche hoped that the corporation could view a bill of the nature of SB 128 as a protection of their responsibility for maximum returns.

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Co-Chair MacKinnon noted that the limit that had been included in SB 128 had a draw limit of \$1.2 billion, which dropped with increases in revenue from other sources, on a dollar per dollar basis. She discussed housekeeping.

#

ADJOURNMENT

10:29:05 AM

The meeting was adjourned at 10:29 a.m.

