

SENATE FINANCE COMMITTEE  
January 25, 2019  
9:01 a.m.

[9:01:28 AM](#)

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:01 a.m.

MEMBERS PRESENT

Senator Natasha von Imhof, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Click Bishop  
Senator Lyman Hoffman  
Senator Peter Micciche  
Senator Donny Olson  
Senator Mike Shower  
Senator Bill Wielechowski

MEMBERS ABSENT

Senator David Wilson

ALSO PRESENT

Angela Rodell, Executive Director, Alaska Permanent Fund Corporation; Craig Richards, Chairman, Alaska Permanent Fund Corporation; Senator Shelley Hughes; Senator Chris Birch.

SUMMARY

^ALASKA PERMANENT FUND CORPORATION (APFC) - OVERVIEW, MISSION, and UPDATE

[9:03:24 AM](#)

ANGELA RODELL, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, discussed her background. She discussed the presentation, "APFC Alaska Permanent Fund Corporation, Senate Finance Committee, January 25, 2019" (copy on file). She looked at slide 2, "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.

[9:05:01 AM](#)

Ms. Rodell highlighted slide 3, "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.

Ms. Rodell looked at slide 4, "APFC's Strategic 5 Year Plan":

Priorities for FY 17-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.

Over the course of 2019, the Board will be working on a new strategic 5 year plan.

Ms. Rodell addressed slide 6, "How the Fund Works."

Ms. Rodell looked at slide 7, "Assets Under Management in billions."

Ms. Rodell addressed slide 8, "Values."

[9:09:55 AM](#)

Co-Chair Stedman requested a brief view of what the Earnings Reserve Account (ERA) was in 2009.

Ms. Rodell replied that she would provide that information.

Co-Chair Stedman stated that there could be an answer later in the presentation. He requested //

Ms. Rodell agreed to address that question.

Ms. Rodell discussed slide 9, "Principal":

- The Principal is constitutionally established and permanently protected; it can only be used for income-producing investments.
- The Principal is built through royalty deposits, inflation proofing, and other special appropriations.

Ms. Rodell looked at slide 10, "Use of Fund Earnings from ERA Since Inception":

- Paid out of ERA = \$27.8 B
  - Dividend Transfers
  - General Fund Appropriations
  - Alaska Capital Income Transfers
- Transfers from ERA to Principal = \$20.6 B
  - Inflation Proofing
  - Special Appropriations
- Unspent Realized Earnings in ERA = \$13.7 B

Co-Chair von Imhof looked at slide 9, and noted the special appropriation. She surmised that the legislature had made conscious decisions to take money from the ERA and put it into the principal.

CRAIG RICHARDS, CHAIRMAN, ALASKA PERMANENT FUND CORPORATION, gave an incorrect response.

Ms. Rodell replied that in the early 1980s, the legislature made a decision to make an appropriation of general fund money to the principal. She furthered that as the ERA continued to build balances, the legislature appropriated money from the ERA back to the principal.

Co-Chair von Imhof noted that there was a precedent in the past that the legislature had decided to move excess funds from the ERA into the principal.

Ms. Rodell agreed.

Co-Chair Stedman recalled that it had occurred on several occasions.

Senator Micciche wanted to know the history of the dividends.

Ms. Rodell wondered about his question.

Senator Micciche clarified his question. He wanted to know whether there was a difference on the over-deposits from the general fund into the principal, and whether that affected dividends in the long-term.

Ms. Rodell agreed to determine whether that could be measured, and agreed to get back to the committee.

Ms. Rodell highlighted slide 11, "POMV - SB 26, CH 16 SLA 18":

Percent of Market Value: draw of the average market value of the Fund for the first five of the preceding six fiscal years, subject to annual appropriation by the Legislature.

- 5.25 percent - Effective July 1, 2018 (FY19)
  - FY19 5.25 percent POMV = \$2.7 billion
  - FY20 5.25 percent POMV = \$2.9 billion
  - FY21 5.25 percent POMV = \$3.1 billion estimate
- 5.0 percent - Effective July 1, 2021 (FY22)

[9:16:37 AM](#)

Co-Chair Stedman requested the definition of "POMV."

Ms. Rodell replied that POMV was percentage of market value.

Co-Chair Stedman remarked that the dividends would be subtracted from the \$2.9 billion, and the remaining would be discussed. He queried how inflation would be managed in the concept.

Ms. Rodell replied that inflation was not addressed in SB 26, because there was still a requirement for an appropriation from the ERA back to the principal.

Ms. Rodell looked at slide 13, "The Portfolio":

- Public Equities
- Fixed Income Plus
- Private Equity and Special Opportunities
- Real Estate
- Infrastructure, Credit, and Income Opportunities
- Asset Allocation Strategies
- Absolute Return

[9:24:17 AM](#)

Ms. Rodell highlighted slide 14, "Management of the Fund":

The Board of Trustees continue to work towards an optimal mix of in-house versus external management capabilities based on resources and opportunities.

In-House Management Allows for:

- Alignment of investment goals and mandates
- Increased flexibility in timing/tactical decisions
- Lower fees with investment benefit of active management

Senator Hoffman wondered whether there was an increase in personnel as a result of the movement.

Ms. Rodell replied in the affirmative. She explained that there was an addition of 10 positions in the most recent budget.

Ms. Rodell addressed slide 16, "Fiscal Year 2018 Performance."

Co-Chair Stedman queried the fees.

Ms. Rodell replied that they were net of return benchmarks.

Senator Micciche wondered whether the net cost was a wash, and whether it was beneficial.

Ms. Rodell replied that the benefit was that there were less fees being paid. She remarked that they were all net of fee returns.

[9:29:53 AM](#)

Ms. Rodell discussed slide 17, "Value Generated":

FY 18

Revenues: \$5,671,500,000

Operating/Investment Expenses: \$138,800,000

Value Generated Per Day

Total Fund: \$5.67 B / 251 = \$22.6 M per day

Statutory Net Income: \$6.3 B / 251 = \$25.2 M per day

Value Generated Per Day (based on 251 active trading days through FY18)

APFC staff is actively engaged in making direct investments and overseeing our external manager partnerships:

APFC = 57PFT, 2PPT, 2 Summer Interns

28 External Public Equities Managers

5 Real Estate Advisors

Private Markets Partnerships:

Fund to Fund / Co-Investments / Direct Investments

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Ms. Rodell displayed slide 18, "Awards and Accomplishments":

- Nominated for Limited Partner of the Year for 2018 by Private Equity International

- APFC received dual nominations for 2018 Partnership of the Year for Institutional Investor's Allocators' Choice Awards and won the award for our Capital Constellation Partnership:

- Private Market Partnership, Capital Constellation - won
- Public Market Partnership, Middle East Africa South Asia (MEASA) Fund with McKinley Capital - nominated
- PEI's Private Debt Magazine recognized APFC in their inaugural 30 Most Influential Investors in Private Credit
- Recognized as North American Private Equity Institutional Limited Partner Investor of the Year for 2017 by Private Equity International
- Awarded Institutional Investor's Sovereign Wealth Fund of the Year in Hedge Fund Investments in 2017

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Senator Hoffman congratulated the Board and management. He looked at slide 17, and recalled discussion about having some investment managers in Juneau. He wondered what percentage of the positions were located in Alaska.

Ms. Rodell replied that the 57 permanent full-time, 2 part-time, and 2 intern positions were all in Juneau.

Co-Chair von Imhof remarked that the accomplishments on slide 18 were tremendous. She stressed that it gave the Permanent Fund access to global meetings and conventions to discuss best practices. She asked for elaboration about the September meeting.

Ms. Rodell responded that the Permanent Fund was a member of the International Forum of Sovereign Wealth Funds. The Permanent Fund had been asked to host the eleventh annual meeting of that group in Juneau in September.

[9:34:59 AM](#)

Mr. Richards highlighted slide 20, "Board of Trustees":

As the fiduciaries, the Trustees have a duty to Alaskans in assuring that the Permanent Fund is managed and invested in a manner consistent with legislative findings: AS 37.13.020.

- The Fund should provide a means of conserving a portion of the state's revenue from mineral resources to benefit all generations of Alaskans.

- The 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.

[9:37:28 AM](#)

Mr. Richards discussed slide 21, "Alaska Investment":

APFC's statutory responsibilities pertaining to in-state investments are set forth in AS 37.13.120 (c) which specifies if an Alaskan investment has equivalent risk and expected return comparable to or better than a similar non-Alaskan investment, the Alaskan investment should be preferred.

In recognition of AS 37.13.120 (c), APFC's Board of Trustees took two actions during their September 2018 Annual Meeting:

- Amendment of the Alaska Investment section of APFC's Investment Policy and Procedures to establish a target for increased Alaska investment.
  - As of June 30, 2018, 1.25 percent of the Fund's portfolio, totaling \$819.5 million, was invested in-state through Alaska-based external investment managers and through ownership of APFC's office building in Juneau.
  - The aspirational goals set forth in the policy amended by the Board in September 2018 call for 2 percent of the portfolio to be invested in-state by 2020, increasing by 1 percent each year up to 5 percent of the Fund being invested in-state by 2023. (Does not include in-house management by APFC).
- Passage of Resolution 18-03 Supporting An In-State Emerging Manager Program.
  - This resolution directs the implementation of an In-State Emerging Manager program with an initial allocation up to \$200 million within the Private Equity and Special Opportunities Asset Allocation.

- The goal of the Emerging Manager Program is to seed new private equity or venture capital fund managers in Alaska.
- APFC will work with an external manager to oversee the program.
- Board guidance that in-state investments should meet same investment criteria and expectations as out of state investments.

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Co-Chair Stedman noted that there was currently a review of all the agencies to streamline costs and create efficiencies. He felt that there was some crossover in the energy agencies, such as Alaska Industrial Development and Export Authority (AIDEA). He noted the crossover into the banking arena. He stressed that there were more funds in the state than there were projects in the commercial bank. He did not like the looks of politics in the Permanent Fund.

Mr. Richards responded that the 5 percent was not the instate investment initiative. The instate investment initiative was \$200 million of a \$65 billion fund, which was a third of a percent. He stated that the 5 percent aspirational goal was assets under management in state by external managers.

[9:46:18 AM](#)

Co-Chair Stedman surmised that the 5 percent was managed by instate managers, and was not 5 percent of instate invested capital.

Mr. Richards agreed.

Co-Chair von Imhof expressed concerns about competing with AIDEA. She noted the occasional shortage of investments. She remarked that there were private equity firms that were playing in the space currently. She wondered whether the activity was worth the small investment.

Mr. Richards felt that the question was legitimate. He shared that there were conversations on the Board about investing in the state relative to the statutory investment guidelines. He shared that staff had the general inclination to not invest in Alaska, because it sometimes

felt political. He noted the Alaska barbell problem, which was that Alaska investments were often very big or very small. He stated that the emerging managers program used an external manager because it relieved the concern of political pressure, and the external manager could examine smaller projects.

Senator Hoffman noted that the committee should realize that the Board had already taken the two actions. He looked at the second bullet point, and the \$200 million. He queried the long-term prognosis of how large it would grow to in the upcoming five years.

[9:50:12 AM](#)

Mr. Richards replied that there was no blueprint, but was entirely dependent on whether the program was successful. He stressed that there was no way of knowing the amount in the long-term.

Senator Wielechowski appreciated the concerns about the instate investing. He often wondered why there was not more investment in the state of Alaska. He wanted the state investments taken a step further, and perhaps tying those investments to Alaska Hire and Alaska-based companies. He wondered whether there was ever a consideration in tying the investments to Alaskan companies.

Mr. Richards replied that those conversations had not occurred. He explained that the Board gave the staff broad authority to set up the emerging manager program in the manner that was most likely to lead to returns and risks. He remarked that the "flavor" that the manager used to apply what was used for investing would be developed between staff and the external manager. He remarked that there had not been an examination of non-economic factors other than encouraging instate investment.

Co-Chair von Imhof queried the threshold of return under the program.

Mr. Richards replied that it was not defined in a specific way. He stated that, rationally, there would two things it would be measured against: 1. the overall performance expectation of the Permanent Fund of inflation plus 5 percent; and 2. its private equity peers.

Co-Chair von Imhof understood that the risk was not commiserate with a fixed income portfolio.

Mr. Richards agreed.

[9:54:51 AM](#)

Co-Chair Stedman noted that the 5 percent target for the management instate was approximately \$3 billion, and correlated with the equity need in a potential gas line. He stated that there was a dose of political skepticism in how things were set up in the state.

Mr. Richards replied that he had never had a conversation about using Permanent Fund money for a gas line.

Co-Chair Stedman felt skeptical.

Mr. Richards felt that skepticism was very healthy.

Senator Hoffman recalled Resolution 18-03 regarding the instate emergency manager program passed by the Board in September. He queried the status of the request for information (RFI) in that resolution.

Ms. Rodell replied that RFI was posted on the website. She explained that those indications of interest were due the following week, and then there would be a process to determine a manager to build a program and refine the goals.

Senator Shower asked for confirmation that the guidance for the fund managers were examining economic factors not non-economic factors.

Mr. Richards replied in the affirmative. The only guidance that was not economic was the \$200 million should be focused on instate investment, and the overriding guidance for that instate investment was that the returns need to be competitive and the risk must be commensurate with those returns.

[10:00:27 AM](#)

Mr. Richards displayed slide 22, "Contributions to Principal":

Royalty Deposits -AS 37.13.010 (a) (1) and (a) (2)

- The constitutionally minimum required 25 percent of royalty proceeds.
- The statutorily mandated deposits of 50 percent for leases after 1979.

Inflation Proofing -AS 37.13.145 (c)

- The inflation proofing projection is based upon estimates for deposits into the Principal of the Fund and the projected inflation rate as calculated per statute.
- The Legislature appropriated FY19 inflation proofing estimated to be \$942 million on June 30th, 2019.
- The FY20 inflation proofing amount is estimated to be \$943 million, the actual amount will be calculated at the end of the fiscal year. \$1.4 billion for FY16-FY18 remains unappropriated.

The Board of Trustees adopted Resolution 17-01 asserting the importance of inflation proofing to preserve the purchasing power of the Principal. Subsequent Resolutions 18-01 and 18-04 reiterate that the prudent reinvestment of a portion of the Fund's earnings to protect the future value of the Principal is essential to maintaining the long term sustainability of the Fund and establishing a solid fiscal foundation for Alaska.

Mr. Richards discussed slide 23, "Earnings Reserve Account":

The Earnings Reserve Account (ERA) is established in Alaska Statutes as an account to hold the realized earnings from the Permanent Fund's investment portfolio; it does not have its own investment mandate.

- The ERA is subject to legislative appropriation.
- FY 19 Appropriations from the ERA
- POMV \$2.7 billion
- APFC Operations \$18.1 million
- APFC Investment Management Fees \$150.5 million
- Dept. of Law \$2.6 million
- Dept. of Natural Resources \$5.9 million

Mr. Richards highlighted slide 24, "Resolution 18-04."

Senator Hoffman noted that the Board had passed Resolution 18-04 in October. He looked at bulled point 3, which requested legislation for automatic inflation proofing. He wondered whether the Board had conveyed that to the current administration. He wondered where the Board and management were at to ensure that the automatic inflation proofing was implemented.

Mr. Richards replied in the affirmative, and stated that there were conversations with the Attorney General. He noted that the process was ongoing.

Senator Bishop felt that it was a defined benefit program, and it required increasing membership contributions to meet the guidelines.

Mr. Richards agreed with that analogy.

Mr. Richards discussed slide 25, "Resolution 18-04":

Sustainable Rules- Based Legal Framework For Fund Transfers

In providing guidance on rules-based withdrawals for the Fund and to help ensure the long-term sustainability of using Fund earnings for the benefit of all generations of Alaskans, the Board passed Resolution 18-04 at a special meeting on October 17, 2018.

This resolution affirms the importance of formulaic management of transfers into and out of the ERA to ensure sustainability and long term growth of the Fund, by identifying four key principles:

Adherence - Sustainability - Inflation Proofing - Real Growth

[10:05:21 AM](#)

Mr. Richards addressed slide 26, "Resolution 18-04":

Adherence: A rules-based framework includes adhering to the formulaic calculations provided for in statute for transfers into and out of the Permanent Fund, such as dividends, royalty deposits, and inflation

proofing. Adherence to the rules increases the likelihood that systematic draws from the Permanent Fund will be sustainable over time and will allow for more prudent investment of the Permanent Fund due to the predictability of liquidity needs.

Co-Chair Stedman queried the definition of Ad Hoc.

Mr. Richards replied that ad hoc was a non-rules based transfer.

Mr. Richards discussed slide 27, "Resolution 18-04":

Sustainability: Any rules-based system for drawing from the Permanent Fund (to support government spending and for dividends) should be sustainable, meaning the formulaic system for withdrawals should be projected to result in the Permanent Fund growing annually by at least the rate of inflation. Sustainability also requires annual formulaic withdrawals from the Earnings Reserve Account at an amount that the long-term balance of the account is able to fund. The Board recommends instituting a process that would require periodic review of these assumptions as market conditions change so that a timely reduction to the annual draw could be effectuated, if necessary, to maintain the long-term sustainability of the Earnings Reserve Account.

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Co-Chair Stedman asked for an explanation of the ad hoc draw and the limit of \$2.9 billion. He wondered whether there should not be a draw of more than \$2.9 billion from the Permanent Fund.

Mr. Richards replied that the Board was not provided that specific of guidance. He stated that the sustainability rule in combination with the ad hoc rule, it was advised that the legislature should not take more than what was sustainable allowing for inflation under best practices. He furthered that it was also advised that when the legislature took, it should do so consistent with the rules-based system.

Co-Chair Stedman noted that there was a limit \$2.9 billion that could be withdrawn from the Permanent Fund to pay a dividend and pay for part of the deficit.

Mr. Richards replied that it was conceptually correct, but that number could be adjusted. He stressed that was not the level of granularity in the Board. The Board noted that a larger number would not be sustainable.

Co-Chair Stedman remarked that SB 26 was 5.25 percent, and the five-year lookback was \$2.9 billion.

Mr. Richards agreed.

Co-Chair Stedman stated that the 5.25 was within reason of the expectation. He stressed that a large deficit with a dividend requirement required a cognizance with the Permanent Fund.

Mr. Richards agreed.

Co-Chair von Imhof remarked that Callan had provided percentages, and felt that they were well above the hurdle rate. She noted that many people were doing the modeling. She felt that there were ways to test the percentages to see the overall long-term effects.

[10:15:33 AM](#)

Mr. Richards agreed.

Co-Chair Stedman asked that straight speak was important, and reiterated that the point was to not go above \$2.9 billion.

Senator Hoffman looked at the automatic inflation proofing, and wondered whether the Board felt that it should come out of the 5.25 percent.

Mr. Richards replied that it worked differently. He explained that the 5.25 percent is what could come out of the total aggregated value of the fund. He furthered that inflation proofing was not a transfer out of the fund, rather it was a transfer between the ERA and the corpus.

Senator Hoffman stated that it was referred to the POMV.

Mr. Richards agreed.

Mr. Richards highlighted slide 28, "Resolution 18-04":

Automatic Inflation Proofing: The Board believes that the inflation-proofing transfer should become a guaranteed annual event rather than a discretionary transfer that is subject to appropriation. To achieve this goal, the Board supports passage of legislation that would define net income to require realized gains that are accumulated throughout the fiscal year be used to offset the impact of inflation on the principal of the fund with the remainder of net realized gains being accounted for in the Earnings Reserve Account.

Senator Bishop queried the percentage of inflation proofing, if the ERA and the corpus were inside the constitution as one fund.

Mr. Bishop replied that it would be zero.

Senator Micciche noted that there was a draw limit in the original SB 26 that would have reduced the draw on years when there was other state funding. He wondered whether it was possible to provide the committee with a "wish list."

[10:20:25 AM](#)

Mr. Richards looked at slide 29, "Resolution 18-04":

Promote Real Growth When Possible: While providing for a sustainable draw by preserving the purchasing power of the fund and ensuring a durable Earnings Reserve Account is a primary goal of the Board, recognizing and executing on opportunities to grow the real value of the fund is also important. Real growth will not only result in more income and thus higher sustainable draws in the future, it is necessary to preserve intergenerational wealth as Alaska continues extraction of its finite natural resources. Thus, the Board supports thoughtful strategies to grow the fund on a real, and not just nominal, basis.

Senator Olson remarked that there was concern about the governor making additional draw to the ERA, and wondered how that might affect the POMV draw. He also wondered

whether there was a difference between the Board and administration. He stated that he could receive the answer at a later date.

Co-Chair Stedman requested that the answer be provided at a later date.

Ms. Rodell stated that the principal balance in 2009 was \$29.5 billion; the ERA had a \$420 million balance; the total fund combined at that time was \$29.9 billion. She stated that a 5 percent POMV draw would require a calculation. She stated that the 2010 principal was \$32 billion.

Co-Chair Stedman stressed that there was a curiosity about when the 5 percent draw would get into the constitutionally protected corpus.

Ms. Rodell agreed, and noted that a straight 5 percent on the \$29.9 billion would result in a \$1.5 billion, but there was only \$420 million in the ERA in 2009.

Co-Chair Stedman asked that there be a back test on those numbers.

#

ADJOURNMENT

10:25:33 AM

The meeting was adjourned at 10:25 a.m.