

HOUSE FINANCE COMMITTEE
January 25, 2022
1:34 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Kelly Merrick, Co-Chair
Representative Dan Ortiz, Vice-Chair
Representative Ben Carpenter
Representative Bryce Edgmon
Representative DeLena Johnson
Representative Andy Josephson
Representative Bart LeBon
Representative Sara Rasmussen
Representative Steve Thompson
Representative Adam Wool

MEMBERS ABSENT

None

ALSO PRESENT

Valerie Mertz, Acting Executive Director and Chief Financial Officer, Alaska Permanent Fund Corporation; Chris Poag, Legal Counsel, Alaska Permanent Fund Corporation.

PRESENT VIA TELECONFERENCE

Marcus Frampton, Chief Investment Officer, Alaska Permanent Fund Corporation.

SUMMARY

PRESENTATION: ALASKA PERMANENT FUND by the ALASKA PERMANENT FUND CORPORATION

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VALERIE MERTZ, ACTING EXECUTIVE DIRECTOR AND CHIEF FINANCIAL OFFICER, ALASKA PERMANENT FUND CORPORATION, provided a PowerPoint presentation titled "Alaska Permanent Fund Corporation: House Finance Committee," dated January 25, 2022 (copy on file). She briefly introduced herself and shared that she had lived in Juneau most of her life. She was a certified public accountant (CPA) and had been with the Alaska Permanent Fund Corporation (APFC) for 18 years. She had been the acting director during the transition between the former Director Mike Burns to Director Angela Rodell in 2015. She offered assurance to the committee that employees at APFC had not let recent controversies impact the work that they were doing.

Ms. Mertz advanced to slide 2 and relayed that the fund was created in 1980 as a separate state entity. The fund was overseen by a board of trustees who served as its fiduciaries. The mission of the corporation was to manage and invest the assets of the Permanent Fund and other funds designated by law in accordance with AS 37.13.010 through AS 37.13.190. She pointed to the right side of the slide which showed the items managed by the corporation.

Representative Edgmon asked for more information about the maximum returns and the vision of the corporation as indicated on the slide.

Ms. Mertz answered that APFC was required to follow the prudent investor rule and that the mission and vision of the corporation were driven by the rule.

Representative Edgmon stated that "maximum" was an important word in the prudent investor rule.

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Ms. Mertz turned to slide 3 and detailed that the fund had a balance of just under \$81 billion at the end of November 2021, with \$65 billion in the fund principal. The Earnings Reserve Account (ERA) balance was \$15.7 billion. She

relayed that \$3.4 billion of the \$15.7 billion had been set aside for the FY 23 percent of market value (POMV) transfer to the general fund, and another \$3.4 billion for the unrealized gains of ERA. In total, there were uncommitted earnings of just under \$9 billion.

Ms. Mertz addressed slide 4 which included a list of the sources of change in value for the fund from the end of FY 21 to FY 22 as of November 30, 2021. The bottom of the slide showed how APFC calculated statutory net income, which did not include the unrealized gains and losses. She reported that the FY 22 year-to-date to ERA was just under \$3 billion.

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Ms. Mertz advanced to slide 5 which compared APFC's return on investment between FY 21 and FY 20 using a variety of metrics. She relayed that FY 21 was an extraordinary year for the fund in terms of performance, earning an average of \$77 million per trading day. In FY 20, the fund earned about \$7 million per trading day. She noted that APFC's operating budget and management fee budget in FY 21 totaled about \$168 million, which meant that all operating expenses for the year had been recovered by about the sixth trading day.

Representative Johnson pointed to the last box on slide 5 regarding APFC investment management. She asked for more details about what investment management entailed for the corporation.

Ms. Mertz answered that it represented the amount that was paid out to investment managers, which included the publicly traded securities, systems and analytics, and due diligence and legal fees needed to manage the fund.

Representative Johnson asked if the category included all contractors working outside the APFC building.

Ms. Mertz replied that it did not include all contractors. She explained that employees who did administrative work would not be included, but employees who did investment management work were included.

Representative Wool asked which category the performance bonuses fell under.

Ms. Mertz responded that the bonuses were in the operations budget.

Representative Wool asked why there was a decrease in the operations budget from FY 20 to FY 21.

Ms. Mertz clarified that the figures on the slide were actual expenses, not the budget authorization. She would have to follow up on exactly what constituted the reduction.

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Ms. Mertz moved to slide 6 which included a graphical representation of the structure of the fund. She pointed out the mineral royalties flowing into the principal on the left side of the slide, which were distributed into income producing investments, and the earnings then flowed into the ERA account. She noted that the ERA account was also invested alongside the principal and available for appropriation. She explained that appropriated amounts would flow out of the ERA and back to the principal in the form of inflation proofing. The ERA was also used to fund corporate operating expenses and the POMV transfer to the general fund.

Ms. Mertz discussed the principal of the fund on slide 8. She detailed that the principal was established in the constitution as a permanent savings account and was used only for income-producing investments and was protected from appropriation. Historically, the principal grew in three ways: royalty deposits, inflation proofing, and special appropriation. The slide showed that the expected royalty amount in FY 22 was \$429 million.

Representative Edgmon did not see reference to the special appropriations the legislature had made over the years. He asked if special appropriations would be more than royalty deposits over the year.

Ms. Mertz responded she would answer the question on the next slide.

Representative Josephson asked whether the special appropriations were known as inflation transfers.

Ms. Mertz answered that APFC considered inflation proofing appropriations to be separate from everything else.

Representative LeBon noted that the royalty deposits shown on the chart on slide 8 consisted of the 25 percent of royalty proceeds and the statutorily mandated deposits of 50 percent for leases after 1979. He asked if there was a comment about the relationship between the two pools of money flowing into the fund. He asked if the state was up to date with the 50 percent deposit for leases.

Ms. Mertz responded that APFC did not make a distinction between the constitutionally required amounts and the statutorily required amounts. She noted that the Department of Natural Resources (DNR) oversaw the matter.

Representative LeBon pointed out that royalty deposits included mining in addition to oil and gas. He acknowledged the important role mining had played in building up the fund.

Representative Wool asked if royalties from federal lands such as the Natural Petroleum Reserve-Alaska (NPRA) followed the same deposit structure.

Ms. Mertz replied that federal deposits were included as received from DNR.

Ms. Mertz continued to address slide 8 and relayed that the second way the principal grew was inflation. She explained that the inflation proofing calculation was based on deposits into the principal and on the inflation rate that was calculated as per statute. An appropriation was needed to fulfill the statutory obligation. She noted that there were a handful of years that did not include an inflation transfer because the inflation rate was negative.

Ms. Mertz addressed the third way the principal could grow, which was through special appropriation. The growth came about when there were legislative deposits from both the general fund and ERA.

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Ms. Mertz moved to slide 9 which included a graph outlining the principal contributions since FY 78. She believed it applied to Representative Edgmon's previous question. The

gold bars represented the mineral royalty deposits, which totaled about \$18.4 billion since the inception of the fund. The bright blue bar reflected inflation proofing, which was tied to the inflation rate and varied from year to year in magnitude. Since the inception of the fund, \$18 billion had been transferred from the ERA to the principal.

Co-Chair Merrick asked for an explanation of the settlement category represented by the red bars.

Ms. Mertz answered that there was a lawsuit in which the state was involved and the settlement money from the lawsuit was deposited into the principal. She was not appraised of the particulars of the lawsuit.

Representative Edgmon noted that there were some years where the state was not able to fund inflation proofing. He thought the fact that the legislature had been intent upon growing the fund needed underscoring.

Ms. Mertz reviewed the ERA beginning on slide 11. She explained that it was established in AS 37.13.145(a) as a separate account to hold the realized earnings from the fund's investment portfolio and it grew through the receipt of statutory net income. She advanced to slide 12 and added that statutory net income included two components: the regularized monthly cash flows that the portfolio investments were generating and the capital gains and losses. She thought that FY 22 was shaping up to be fairly profitable. The bars on the chart on slide 12 represented the total returns as compared to the statutory net income since FY 01. There was not an immediate correlation between the statutory net income and total return. She thought that the statutory net income was more dependent upon the activity in the portfolio.

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Ms. Mertz discussed the cumulative fund earnings and how the earnings had been used on slide 13. Since inception, the fund had generated almost \$80 billion in realized earnings. Of the \$80 billion, about \$37 million had been paid out in the form of dividend appropriations, POMV distributions to the general fund, and Alaska capital income. There had been \$30 billion in savings from ERA to the principal. The current realized earnings were about \$12

billion and there was \$9 billion left over for uncommitted earnings.

Representative Edgmon remarked that when the first dividend had been distributed in 1982, it consisted of money that had been appropriated by the legislature rather than money in the fund. He asked if there had been occasions when more than five percent POMV was paid out as the fund was growing.

Ms. Mertz thought the question was interesting and that it would be valuable to find out the answer.

Representative Edgmon would appreciate a follow up with the information.

Representative Carpenter thought there were two statutes that directed the corporation on how to determine earnings. He asked how the corporation decided which of the two statutes to follow.

Ms. Mertz answered that the APFC's accounting followed generally accepted accounting principles. The principles required that earnings be committed when the amount was known. The only way a payout would not happen was if the legislature decided against it. The corporation was able to accurately predict the POMV transfer amount well in advance and had decided the likelihood of that payment not occurring was remote.

Representative Carpenter understood that SB 26 [adopted in 2018] relating to the POMV draw was in conflict with another statute. He thought that APFC assumed that in the next budget cycle, the legislature would choose the POMV model and not the 21 percent model as outlined in SB 26. However, if the legislature chose to not continue with the POMV model for whatever reason, other statutes would apply equally to APFC's obligations.

Ms. Mertz agreed that APFC followed the appropriations as acted upon. She stated that the calculation under the statutory dividend would result in less of a commitment from the ERA than the POMV calculation would. She thought the approach was conservative because it required that the maximum amount possible be set aside.

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Representative Wool stated that the SB 26 statute was not just a calculation statute but was a funding source statute. He was not certain that there was a funding source included in the original statute [AS 37.13.010 through 37.13.190]. He recalled that the legislature was told in 2008 that the ERA might not be substantial enough to pay out a dividend. He guessed that the ERA might have exceeded five percent POMV in 2008.

Ms. Mertz replied it was possible. She could not provide a definitive answer without running the numbers.

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MARCUS FRAMPTON, CHIEF INVESTMENT OFFICER, ALASKA PERMANENT FUND CORPORATION (via teleconference), apologized for not being present in person. He was currently traveling visiting external investment managers. He continued the presentation on slide 15 to discuss the investment oversight. He relayed that the investment team had 52 employees with five investment directors that reported directly to him. He stated that the team made his job fairly easy in terms of managing the fund and there was a significant amount of experience within the team. He reported to the executive director, who was currently Ms. Mertz.

Representative Thompson asked about the amount of turnover of investment officers and portfolio managers. He asked how the corporation compared to other funds in term of staff retention.

Mr. Frampton answered that there had been some turnover within the team. He thought there were good retention rates for senior level investment officers, but he had a more difficult time retaining junior and mid-level employees due to the competitiveness of the industry. He noted that he had some trouble recruiting and retaining employees. Although there had been turnover, he believed the corporation had a stable team and that key positions had a long tenure.

[2:13:29 PM](#)

Representative Edgmon thought that the fund had recently won a fairly prestigious award as a good place to work. He

remarked that turnover was part of the investment industry and there would always be higher turnover rates.

Ms. Mertz replied that the corporation had won an award in 2021 for being one of the best places to work from a publication called Pensions and Investments. The award was based on a survey by the human resources director and completed by employees. She agreed that turnover was part of the game. She remarked that recruiting in Juneau was particularly difficult because not many people wanted to live in Juneau.

Representative Edgmon understood that the award was international and only sovereign wealth funds were eligible.

Representative LeBon referred to the chart on slide 15 and asked how involved the board of trustees was in the decision to consider private investments offered to the fund by venture capital investment companies. He asked for more details about the role the board played in investment decisions.

Mr. Frampton responded that there was less board involvement in investment decisions in Alaska than there was in other states with similar plans. Every year during the month of May, APFC presented the board with a pacing analysis that outlined the recommended amount of capital that should be deployed in venture capital private equity and other private equity to achieve the exposure target. For example, the target for venture capital private equity in 2021 was \$1.6 billion. He relayed that all of the investment discretion was at the staff level. He understood that based on ten-year returns, Alaska had the top performing private investment program in the country.

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Mr. Frampton advanced to the discuss some current topics in the investment department on slide 16. The corporation was currently working off of a November 2021 performance report that showed the fund was up by 2.8 percent. He noted that public equities accounted for about 38 percent of the fund, but the equity benchmark had appreciated by about 4 percent in December of 2021. There were strong marks coming in for December 2021 on private equity as well. He believed the fund was increasing in value despite the stock markets

appearing to be in a decline. He thought that the fund was up by perhaps a bit more than the reported 2.8 percent but it was difficult to say. He stated there were three open positions in the investment department, which seemed like it had been the average number of open positions during the ten years he had worked for the corporation. There was a new credit analyst position that had been recently approved and for which APFC was recruiting, however it had been difficult to fill. There was also a portfolio manager of real estate position that was open as a result of someone leaving the corporation. He reiterated that the turnover was normal. The corporation was always focusing on the assessment of internal versus external management but was especially focused on public equities in the current year. He added that the corporation was always very cautious as internally managed equities grew. Every year, Callan Associates presented an asset allocation analysis to the board which fed into the return of the fund. For the last couple of years, the Callan capital market forecasted that every asset apart from private equity would be under the consumer price index (CPI) plus five percent.

Mr. Frampton skipped slide 17 and moved to slide 18 showing pie charts of the fund's asset allocation over time. He relayed that in 1980, an investor could earn a double digit return just in fixed income. Over time, asset classes had been added and the equity mix had grown. After 2006, the fund began adding numerous private asset classes and alternatives. He pointed to the pie chart on the right side of the slide which showed the corporation's current target. The dark blue and light green sections combined reflected 58 percent of the fund in the 2022 target. He stated that some of the asset classes had high market exposure and others had low market exposure. He added that the corporation would only support hedge funds that were market neutral and the returns portfolio was uncorrelated to the stock market due to the cautious investing. He tried to keep a thoughtful amount of assets in low exposure classes to ensure that there would still be returns when the market was behaving differently.

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Vice-Chair Ortiz stated the committee had heard from Callan Associates the previous day. The president of Callan, Mr. Greg Allen, had relayed that the ERA was a distraction and suggested constitutionalizing the POMV to end the

distracted. He asked how much the distribution chart on slide 18 was impacted by the potential that the legislature could overdraw the ERA at any time. He asked if the charts would change in any way if the ERA were eliminated.

Mr. Frampton replied that he did not believe the chart would be at all impacted if the ERA was eliminated. He and the investment team did not pay attention to the difference between the ERA and principal from a daily management perspective. He thought the corporation's chief risk officer as well as Callan would not want more than 45 percent of the fund invested in illiquid assets because it would not be possible to rebalance the fund. He relayed that his goal was to compile a liquid asset portfolio that could deliver a real return of five percent. More private equity had been allocated because the goal was difficult to accomplish given the current market.

Representative Wool asked for a definition of private income and risk parity.

Mr. Frampton answered that private income involved investing in private infrastructure and private credit. He explained the corporation was a limited partner in funds that extended private loans to private companies. He noted that private infrastructure was the same, and the corporation was generally a limited partner in funds that were managed by purchasers of infrastructure assets such as airports and toll roads. The corporation was aggressive in coinvesting without incurring fees. He noted that currently the high yield market was at about four percent and risk parity was a small one percent allocation. It was a complicated concept, but generally it consisted of managers who were weighing global balance portfolios, commodities, bonds, stocks, and treasury inflation-protected securities (TIPS) and applying leverage to the non-equity investments to achieve the same volatility contribution. For example, the managers aimed to ensure that the volatility contribution within the bonds was the same as the stocks. He explained that generally, 90 percent of volatility in a portfolio was from equity because bonds did not change. In simple terms, risk parity managers applied leverage to the bonds.

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Representative Edgmon pointed to the pie chart on slide 18 detailing the 2022 target. He understood that the 38 percent section representing stocks was most sensitive to inflationary activity.

Mr. Frampton answered that the fixed income portfolio was most sensitive to inflation. If there was eight percent inflation in the next seven years it would negatively impact the value of the bond portfolio. He thought that stocks had some ability to pass through price increases. If inflation continued at its current rate, businesses would experience a significant amount of pressure on wages. He was concerned about inflation and thought it was the biggest investment risk and that most portfolios were not well positioned for it. The corporation had added some gold investments and a portion of the corporation's cash was held in gold exchange traded funds (ETFs).

Representative Edgmon asked how it would play out if there was a draw that exceeded the five percent POMV.

Mr. Frampton answered that an ad hoc draw would come out of the liquid assets. Depending on the magnitude of the draw, the other exposures might need to be adjusted.

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Representative Edgmon asked who would be involved in the decision making process if an overdraw occurred.

Mr. Frampton asked for clarification on whether Representative Edgmon was referring to the decision to overdraw or the decision on what would be done after an overdraw occurred.

Representative Edgmon responded that he was curious about what the process would be if an overdraw were to occur. He presumed that the payout would not occur all at one time. He suggested that the investment decisions would be significant enough to involve the board of trustees.

Mr. Frampton answered that there were specified ranges around each asset class in the investment policy statement. He relayed that the permitted ranges were referred to as the green zone. If there was an overdraw, APFC would work to stay in the green zone when withdrawing the funds. He

was confident he would be able to stay in the green zone and would communicate his plans with the board of trustees.

Representative Edgmon stated that the process was outlined in program benchmarks. He was trying to get a better sense of the decision making process and thought it was important to understand what would happen in the case of an overdraw.

Mr. Frampton advanced to slide 19 and discussed the total fund positioning and performance. There were a few notable deviations from the fund's benchmarks. As of June 3, 2021, the asset allocation was up from the target by three percent in the private equity category. He had looked at other funds such as the California Public Employees' Retirement System (CALPERS) and noticed that most other funds also differed from the target in private equity. Generally speaking, the private equity asset class had been successful. He also highlighted that the state was defensively positioned in public equity as well.

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Representative Johnson asked for clarification on the 0.1 percent risk parity. She asked if the asset allocation was intended to balance risk because bonds were low-risk investments.

Mr. Frampton answered that Representative Johnson seemed to understand it well. He added that it was a balanced portfolio holding a wider range of assets than were held by most traditional portfolios. The whole portfolio had the volatility of an equity portfolio but behaved slightly differently because there were risk contributions from other areas. The fund had no exposure to leverage and it was unlikely to be affected by outside sources. The asset allocation was small, but there were two large and separate accounts of \$400 million. He thought the managers of the accounts interacted well with staff from APFC and that the relationship was sound.

Representative Johnson thought it would make sense for there to be a research component within the strategy.

Mr. Frampton turned to a chart on diversification on slide 20. He relayed that Alaska had a much more global portfolio than its peers. The United States' stock market had been the stand-out performer in the the past ten years and had

consistently outperformed its targets. The graph on the slide compared the U.S. market's returns since 1900 to other markets.

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Mr. Frampton briefly highlighted the global portfolio on slide 21. He addressed the current market environment on slide 22 which provided data from Bridgewater Associates. One of the duties of APFC was to work with Callan to project what the future would look like, which was challenging. It was possible to go back and look at the market valuation in the past and make projections based on the data. He noted that the stock market had only been as expensive as it currently was in 1929 and 2000, and both of the periods had weak equity markets. The chart on the right of the slide was produced by Bridgewater Associates using a valuation-based expected return approach. The 10-year outlook for nominal returns on U.S. equities was about five percent using the approach. He believed the investing market would become more difficult than it had been in the past ten years.

Mr. Frampton skipped slide 23 and moved to slide 24 where he discussed risk management. He explained that APFC was in the business of taking risks in order to achieve its return objectives. The corporation could choose to take no investment risks and still achieve its goals; however if the corporation abstained from taking risks over a 10 to 15 year period of time, it was likely that the goals would not be reached. He thought APFC had a sophisticated approach to risk management.

Representative Wool remarked that investment decisions sometimes hinged upon political considerations. He thought the board had likely been lobbied to take a particular political approach, but he guessed that the board and the corporation were not persuaded. He mentioned that New Mexico had a sovereign wealth fund with a three percent yearly draw, and a portion of the draw was allotted to in-state investments. He acknowledged that Mr. Frampton might have planned to address the topic later in the presentation.

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Mr. Frampton responded that environmental, social, and governance (ESG) investing was a current buzzword in the investment industry. The corporation allowed for public comments at board meetings and the comments currently tended to be around divesting from fossil fuels. The corporation had not incorporated ESGs into the portfolio. Much of the success of the fund was related to the oil and gas industry and the corporation made investment decisions purely on financial merits. The corporation was holding its private equity investments and its other investments to the same benchmarks.

Representative Wool shared his understanding that investments were held to the same benchmarks. He indicated that New Mexico had \$30 billion in its fund with a three percent annual draw. He asked if APFC had a similar percentage benchmark. He was glad that investments were held to the same performance levels.

Mr. Frampton answered that private equity performance was complicated. Generally, returns were categorized as either realized or unrealized. He thought it was too early to properly evaluate the performance, but the early private equity returns had been promising. He added that APFC had made \$200 million in commitments in 2019. He was pleased with the results, but again it was still early on in the process.

Representative LeBon noted that some national banks had announced a reluctance to invest in the oil and gas industry in Alaska. He asked whether APFC was willing to invest in any of the national banks through stock holdings.

Mr. Frampton answered that every major bank had stated that it was against investing in arctic oil and gas. He thought that fixed income trading would be difficult if the corporation was not able to trade through market makers and brokers. He added that the big banks were major components in state industries and the corporation did not avoid investing in the banks. He was skeptical about the basis of the decision to refrain from investing in arctic oil and gas and thought it was based more in public relations than in environmentalism.

Representative Josephson asked if there was anything in statute that was prohibiting APFC from adopting an ESG perspective.

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Mr. Frampton responded that he did not know. He thought that there were elements of ESG that were important and valid, and he did not intend to be dismissive of the idea. It was vital to the corporation for companies to have an independent board and strong governance in order for the corporation to invest. It would be a mistake to ignore ESG risks, but it would also be a mistake to ignore technology changes. He did not mean to give the impression that the corporation did not factor in ESG risks, but he simply wanted to relay that the corporation was laser-focused on performance and not distracted by ESG risks.

Representative Josephson indicated that the Exxon board was doing substantive things to move in an intentional direction in terms of how it wanted to grow. He thought one of the first things that came before the board in the late 1980s or early 1990s concerned Apartheid and investment in South Africa. He remarked that "these are things" the state should historically be tuned into.

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Representative Rasmussen asked if the Permanent Fund would be impacted if royalty deposits ceased.

Mr. Frampton replied that there would be an impact on the growth of the fund if it no longer received royalties.

Representative Carpenter asked if APFC could meet its mission without investing in private equity in Alaska. He understood the importance of transparency in the private equity field.

Mr. Frampton responded that the private equity portfolio was \$16 billion, and \$200 million was allocated to the in-state program. He relayed that if the program had not been realized, the corporation's ability to achieve its goals would not have been inhibited. He did not want there to be a law that impeded a private equity firm from performing transactions of its own volition in the state. The in-state program was relatively small compared to the private equity portfolio and if the program did not exist, the corporation would not be inhibited.

Representative Carpenter commented that \$200 million might seem like a small sum to APFC but it seemed like a large sum in Alaska politics as a whole. He was not aware of how the money was being spent and he was trying to understand the implications of the lack of transparency.

Mr. Frampton responded that he did not intend to diminish the importance of the private equity program and agreed that it was significant.

Representative Wool added that \$200 million was a substantial amount of money for local businesses. He asked if there was a similar program in place prior to 2019. He understood that due to the nature of private equity, Mr. Frampton could not reveal which entity or entities were receiving the \$200 million sum. He asked if a recipient or recipients could be revealed if a private equity firm cashed out and it resulted in a gain.

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Mr. Frampton answered there had been investments prior to 2019. When he first began working at APFC, there was an Alaska certificate of deposit (CD) program where the corporation deposited some of its cash with banks around the state. The program had been discontinued, but he did not remember the detailed history. The corporation owned its building in Juneau which was valued at about \$9 million. There had been some past real estate investments as well, such as retail properties. He reported that the first time the corporation had employed a private equity directive was in 2019. There were specific confidentiality provisions in all of APFC's private equity partnership agreements, and other investors that did not have similar confidentiality agreements were not able to access top funds. There had been some investments where public announcements were made and there were other investments for which details would be kept private.

CHRIS POAG, LEGAL COUNSEL, ALASKA PERMANENT FUND CORPORATION, noted that there had been requests for more transparency and the corporation was working with its managers to come up with solutions. He added that the corporation was following state law, and the ability to be protected by state law gave the corporation access to higher performing funds. The particulars of a company in which APFC invested would not change once the corporation

exited the company. He thought there was a multitude of reasons why a company might want investment particulars to remain private. However, there also may be cases when companies would volunteer to disclose information. For example, some companies had regional distributions and could benefit from global distributions with the assistance of a private equity partnership, and it was not uncommon for companies to publicly announce such partnerships. He thought that everyone was trying to protect the Permanent Fund and that the returns from private equity were an important factor in the fund's success. He was working on a solution to increase transparency while closely following statute, and he would get back to the committee with a more detailed response.

Mr. Poag suggested that if the committee was more concerned about the implications of in-state investment, members should revisit AS 37.13.120(c). He emphasized that in regard to ESG investments, the corporation made its investment decisions based on risks and returns and did not examine social considerations simply for the sake of social considerations. He reported that a prior legislature had placed a stipulation in statute that the corporation would prioritize in-state investments if the investments were as profitable as investments from other states. The corporation's preference was to make in-state investments but only if it benefited the state. It was a difficult policy decision and that it had been a struggle for the entire life of the fund. He relayed that the corporation was doing its best to honor statutes and state preference, but it was difficult to please everyone as it was a contentious topic.

Representative Wool responded that he understood Mr. Poag's perspective. He would look at New Mexico's fund to determine how it handled similar situations. He noted that Alaska also had the Alaska Industrial Development and Export Authority (AIDEA) which invested in the state.

Representative Edgmon thought transparency was not contemplated when the governing statute was crafted. He asked if Mr. Poag would like to comment on the interpretation of the statute.

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Mr. Poag answered that AS 37.13.200 was enacted in 1980 and he had not been able to access the transcripts of the historical discussion around the statute. He was uncertain if the statute was intended to allow the board to invest in private equity. He credited the legislature for creating the statute because he had learned that the state's access to private equity was contingent on the state being a Freedom of Information Act (FOIA) investor. The state was required to be subject to public records requests in order to qualify. He often used AS 40.25.120(a)(4) to illustrate that if the corporation was given proprietary information, the corporation was obligated to maintain the confidentiality of the information. Through the statute, he could reassure entities that confidentially would be maintained. However, APFC was taking the request for more transparent information very seriously. He thought that if the corporation had foreseen the issue, it might have been built into the program during its inception. He reiterated that external private equity investments were held to the same standards as in-state investments. It was difficult to discern whether the corporation would receive incentive compensation through the program because the program was still in its infancy. He concluded that investment decisions were complicated, but he hoped to provide some solutions that would appease the rightful concerns about transparency.

Representative Edgmon appreciated the historical perspective. He asked how public beneficiaries of a public corporation could be reassured that the \$200 million would not increase to something more like \$200 billion. He asked if there was any public participation or public disclosure in the process. He thought that AS 37.13.120 was vague and that there was no inherent obligation for disclosure.

Mr. Poag asked for clarification.

Representative Edgmon responded that he appreciated Mr. Poag's characterization of the risk threshold. However, he wondered if there was any fiduciary responsibility for disclosure. He referred to slide 18 and asked how the \$200 million was incorporated in the 2022 asset allocation target pie chart. He thought the need for public transparency would be even more significant if \$200 million became \$200 billion.

Mr. Poag responded that the \$200 million came about through a board resolution. He envisioned that if the program was successful, the board would consider continuing the program, and the discussion on the matter would be open to the public. The committee could expect the corporation to report on the funds as the funds became realized. He did not think it would be difficult to provide statistical reports about the investments, but he emphasized that it was simply too early to know and there was not enough data to report upon. He added that language from the legislature was what led to the genesis of the program. He thought the ideas that the corporation would be presenting to the legislature at a later date would appease most of the concerns.

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Co-Chair Foster noted the meeting was almost over. He asked if the presenters were available to stay beyond the allotted meeting time.

Ms. Mertz was available to stay.

Mr. Frampton did not have any other obligations and was available.

Representative Wool referred to AS 37.13.120. He asked if there was a reason why it took as long as it did for the board to determine whether the \$200 million private equity investment would produce returns. He asked at what point would there be a decision on whether it was successful, and would the public have access to the results.

Mr. Frampton replied that there had been a resolution during a board meeting in either September of 2018 or December of 2018 that dictated the process. He elaborated that APFC had spent several months researching the ways in which other states approached similar mandates and then met with managers from various firms to discuss the best way to structure the arrangement. He explained that it was typical for private equity firms to invest a fund over the course of three to four years. It had been about two and a half years since the contract was released and the two managers had participated well. He shared that McKinley Capital Management was fully invested and Bering Capital was around two thirds invested. There was a separate line in the performance report for in-state private equity which

currently showed a one-year return on the program of 60 percent. The return was great but it was still very early. Both managers had one investment that had gone public, and that performance was good, but funds had not been realized yet. The success of the program was somewhat subjective, and it was difficult to determine at what point success could be claimed. It was not uncommon to re-up managers if they had realized around 25 percent of their investments if the managers had crafted a productive model.

[3:33:16 PM](#)

Mr. Frampton quickly addressed fund performance on slide 26. He noted that private equity had done well as according to the data from November 30, 2021.

Mr. Frampton skipped slide 27 and ended his portion of the presentation on slide 29 with benchmarks. He thought APFC was positioned to outperform its benchmarks and that the last ten years had been strong. However, any investor must recognize that the last ten years had been a historic bull market. He noted that real estate had been a difficult market for the corporation and would be an area of improvement going forward. Real estate was an expensive market and it had taken the corporation a few years to adjust to it. He reported that 2021 was the first year in four or five years that the corporation had beat its benchmark in real estate. When strategies were not eliciting a strong performance, the corporation worked diligently to make improvements.

Representative Johnson noted that was a prior presentation that indicated there was a heavy focus on real estate in the fund, and there was some desire to change the allocation. She asked if real estate sales had decreased the heavy focus on real estate and made the portfolio more cohesive with the corporation's goals.

Mr. Frampton responded that he did not recall the instance Representative Johnson was referencing. In the past, the corporation allocated closer to 12 percent of the fund to real estate. The combination of selling the real estate portfolio in 2018 and the depreciation of other assets drove the real estate percentage down to around six percent. The corporation reset the target allocation to eight percent and in the last few years had focused heavily on building up the apartment and industrial portion of the

fund. He would like there to be more real estate representation within the fund. He indicated that APFC was working towards increasing the allocation amount from eight percent to 12 percent.

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Ms. Mertz continued the presentation on slide 31 and discussed distribution calculations. She explained that the slide showed the two statutes that dictated the ways in which the fund was distributed: the statutory dividend fund transfer calculation in AS 37.13.145(b) and the POMV calculation in AS 37.13.140(b). Both distribution statutes required an appropriation in order to make a draw from the ERA. The statutory dividend fund transfer calculation was based on realized income and the POMV calculation was based on value. There had not been an appropriation under the statutory dividend fund transfer calculation since 2019, but it was still an active statute and the amount generated from the statute were still being monitored and tracked. There was a lag built in to the POMV calculation which allowed for calculation of the appropriation amount well in advance.

Representative Wool understood that the sums from the two calculations were not in conflict because as long as the sum of the five percent draw based on the POMV calculation was higher than the statutory dividend fund transfer calculation, the draw would cover the Permanent Fund Dividend (PFD).

Ms. Mertz agreed it was the case under the given scenario. However, there were scenarios where the sums could be in conflict depending on the values involved.

Ms. Mertz moved to slide 32 to discuss the return and POMV draw. She noted that only three and a half years had passed since the POMV draw began and that it would continue to be monitored as time went on. Due to the timing lag built in to the calculation, the effective rate was less than the actual rate. The timing lag also created stability in the draw amount. She highlighted that although the actual performance of fund over the last few years had been volatile, the draw amounts had been stable.

[3:43:47 PM](#)

Ms. Mertz advanced to slide 33 to explain the resolutions the board had supported over the years. The board had a long history of supporting a rules-based draw scenario dating back to 2000. Additionally, two resolutions were passed in 2018 supporting a rules-based legal framework to govern fund inflows, outflow, and internal transfers. In 2020, the board passed a resolution restructuring the fund from its current two account system into a single fund. However, the board acknowledged that such restructuring might not be achievable. If it was not achievable, there were additional recommendations in the resolution.

Ms. Mertz turned to slide 34 and reported that the Trustees' Paper Volume 9 was published in 2020. The paper proposed a number of reforms that would strengthen the stability and sustainability of the fund. It also compared the Permanent Fund to other sovereign wealth funds around the country and the world and examined the successes and failures. The paper concluded that successful sovereign wealth funds operated within a rules-based system that allowed the funds to perform a combination of saving, stabilization, and income-generation functions.

Ms. Mertz continued to slide 35 to address accountability on slide 35. She relayed that APFC worked diligently to be accountable to its stakeholders and to the people of Alaska. The corporation published accurate and timely information on its investment work in an effort to be accountable. She concluded the presentation on slide 36, which included links to APFC's website.

[3:47:25 PM](#)

Representative Edgmon thanked the presenters for the information and thought the presentation helped break down some walls of misunderstanding. There were topics the committee would not talk about and should not talk about during the current meeting, but the information offered by the presenters was a great place to start. He recalled attending an APFC meeting in 2019 and having a positive exchange with the trustees. He stressed the importance of continuing the communication between the corporation and the legislature.

Representative Thompson thanked the presenters. He thought that there were some missed investment opportunities in the

past due to heavy procedural requirements and was unsure if the issue was resolved.

Ms. Mertz responded that the corporation had specific exemptions from the procurement process around its investing. She thought the corporation had been able to be nimbler due to exemptions.

Representative Thompson asked if there were exemptions that allowed the corporation to act quickly on timely opportunities.

Ms. Mertz responded in the affirmative.

Vice-Chair Ortiz echoed Representative Edgmon's comments and thanked the presenters.

ADJOURNMENT

[3:52:05 PM](#)

The meeting was adjourned at 3:52 p.m.