

HOUSE FINANCE COMMITTEE
February 10, 2023
1:35 p.m.

[1:35:11 PM](#)

CALL TO ORDER

Co-Chair Johnson called the House Finance Committee meeting to order at 1:35 p.m.

MEMBERS PRESENT

Representative Bryce Edgmon, Co-Chair
Representative Neal Foster, Co-Chair
Representative DeLena Johnson, Co-Chair
Representative Mike Cronk
Representative Alyse Galvin
Representative Sara Hannan
Representative Andy Josephson
Representative Dan Ortiz
Representative Will Stapp
Representative Frank Tomaszewski

MEMBERS ABSENT

Representative Julie Coulombe

ALSO PRESENT

Deven Mitchell, Executive Director, Alaska Permanent Fund Corporation; Jim Parise, Deputy Chief Investment Officer, Alaska Permanent Fund Corporation.

SUMMARY

PRESENTATION: ALASKA PERMANENT FUND CORPORATION

Co-Chair Johnson reviewed the meeting agenda.

^PRESENTATION: ALASKA PERMANENT FUND CORPORATION

[1:36:08 PM](#)

Co-Chair Johnson invited the presenters to the table.

DEVEN MITCHELL, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, introduced himself and staff present. He shared that he was relatively new to the position and had been in the job for about three months. He provided detail about his past work as debt manager and the executive director of the Alaska Municipal Bond Bank Authority.

Mr. Mitchell introduced a PowerPoint presentation titled "APFC: House Finance Committee," dated February 10, 2023 (copy on file). There were three components of the presentation including the Permanent Fund's historical construct, the enduring financial resource created in the Permanent Fund, and the intergenerational aspect of the plan implemented by predecessors. He began on slide 2 and provided a history of the fund. He detailed that in 1969 the Prudhoe Bay lease sale brought more than \$900 million to the state. He reminded legislators that in the 1960s the state's budget was around \$150 million a year, which was starkly different than present day. He noted that \$900 million had been an extraordinarily large sum of money for the state to oversee. In 1971, President Richard Nixon signed the Alaska Native Claims Settlement Act (ANCSA) that paved the road for the Trans-Alaska Pipeline Authorization Act and the construction of Trans-Alaska Pipeline System (TAPS) in the mid-1970s.

Mr. Mitchell believed in part because of the \$900 million that came into the state previously and how quickly it found its way through the state treasury due to the significant need of the state, the leaders recognized the incoming wealth was likely more than the state could spend prudently at the time. Additionally, the revenue stream was projected to end by the late 1990s (the Prudhoe Bay curve went to zero in the late 1990s in projections from the 1970s). Therefore, leaders at the time decided to set aside a portion of the funds for the benefit of future generations. He relayed that the constitutional amendment establishing the Permanent Fund was approved by the legislature and went to the voters in 1976.

Mr. Mitchell continued to review the history of the fund. The first deposit of oil royalty revenue was \$734,000 in 1977. In 1980 the Alaska Permanent Fund Corporation (APFC) was established to manage and invest the fund. He noted the state budget was \$4.5 billion in 1981, much of which was capital. He moved to slide 3 titled "The Permanent Fund" showing the state's constitutional language pertaining to

the fund. He read from the first portion of the statutory language:

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...

Mr. Mitchell elaborated that in general, the majority of the revenue provided into the fund came from royalty revenue. He noted that the other sources added incremental value. The state legislature authorized an additional 25 percent to be deposited into the fund by statute. He explained that the statute had been followed or had appropriations adopted subsequent to the year they were due. He highlighted the intergenerational concept of the fund where a finite resource became an unlimited or renewable resource.

[1:41:36 PM](#)

Mr. Mitchell asked Co-Chair Johnson's preference in terms of taking questions.

Co-Chair Johnson relayed that members could ask questions throughout the presentation.

Co-Chair Edgmon looked at slide 3 and stated he believed the legislature overall had done a pretty good job regarding its debt service. He noted the fact that the legislature had been pretty responsible in terms of putting special appropriations into the Permanent Fund; however, it tended to get lost in the shuffle. He stated it typically went unrecognized that the legislature, to a large degree, played a role in the growth of the fund in terms of statutory changes and investment policy in addition to putting additional money into the fund. He stated the legislature got a bad rap for overspending or irresponsibility in the budget; however, the record to a certain extent was much to the contrary - the legislature had been responsible and fairly forward thinking. The APFC and legislators had worked together to grow the fund to its current balance. He highlighted the fund was one of a kind in the country and possibly Western civilization in terms of its ability to provide for essential services and an individual payout to every citizen.

[1:44:08 PM](#)

Mr. Mitchell stated the presentation included slides on the topic. He relayed that the constitutional royalty revenue deposited into the fund on a nominal basis was around \$15 billion. The principal fund balance was currently \$52 billion; the difference reflected optional contributions made by the leadership beginning in 1977 going forward.

Mr. Mitchell advanced to slide 4 titled "Renewable Financial Resource." He referenced the principal balance of \$52 billion. He noted there were different numbers in the presentation, some of which was a convention of the financial and accountancy rules not being aligned with the statutory construct or rules for accounting for earnings for example. The fund had received earnings of \$82.1 billion. He provided a breakdown of the earnings use beginning with \$18 billion for inflation proofing the principal and \$12.3 billion for special appropriations to the principal. There was \$0.4 billion for the Alaska Capital Income Account funded through the Amerada Hess settlement. He explained the settlement came from a court case related to royalty revenue payments of oil companies where the judge had ordered any money deposited into the Permanent Fund as a result of the settlement to be segregated from the Permanent Fund Dividend (PFD) calculation because it had been a potential bias to the jury hearing the case. He elaborated that the money was in the principal of the Permanent Fund, but it was not included in the percent of market value (POMV) or dividend calculation. The payments out of the Earnings Reserve Account (ERA) for PFDs through FY 18 were \$24.4 billion. The POMV payments out of the ERA from FY 19 through FY 23 were \$15.9 billion. He relayed the use of the fund since the implementation of the POMV had been at a higher level than it had been historically.

[1:47:22 PM](#)

Mr. Mitchell addressed the responsibility of managing and investing for all generations on slide 6 titled "Investing for the Long-Term." He stated it was a concept that he may have ignored more than he should have because he had been focused on trying to provide a picture of the highest ability to pay and the best credit he could portray to rating agencies or investors. He stated that now, reflecting on the construct of the Permanent Fund and

surrounding statutes, it was about much more than the ability to pay in the current year; it was about being able to pay in the current years, 10 years, 20 years, and so on. The ability to pay at present was based on what the people had done in the past to set aside the money in order to have a resource providing for the ongoing transfers to the state. He noted it was one of the most important concepts that had come to the forefront for him in his new role.

Mr. Mitchell continued to review slide 6. The statute specified the fund's goal was to protect principal while maximizing total return. He elaborated that the fund's asset allocation was not designed to hit home runs, but to hit consistent base hits. The corporation had an investment staff focused on maximizing return in addition to a risk staff focused on ensuring investments were risk adjusted and reasonable. He clarified that the fund's investment performance was not a static target. The corporation targeted a return that would pay for the POMV transfer of 5 percent in addition to the inflation impacts of the prior year. He explained the target would be lower in years when inflation was low whereas the target was much higher in years when inflation was high. For example, inflation had been 8 or 9 percent the previous year; therefore, the targeted return had been 13 or 14 percent versus 7 percent in years with 2 percent inflation. He added that in order for the fund to maintain its ability to provide value to the state, it had to be inflation proofed. Otherwise, a dollar provided in the present day would not be worth the same amount in five years due to the eroding impact of inflation.

[1:51:05 PM](#)

Representative Stapp asked about the CPI [Consumer Price Index] + 5 percent target. It was his understanding the corporation was adjusting its inflation proofing to the actualized CPI annually.

Mr. Mitchell replied in essence it was true. There was a formula in statute defining how the inflation rate was determined. The amount was based on the prior year's inflation.

Representative Galvin thought about the board's appetite metric. She wondered if the current board had given any directive advocating for or against the POMV budget policy.

She understood the previous board and executive director had some outward communications regarding budget policy pertaining to POMV.

Mr. Mitchell answered that the board resolutions supportive of the POMV concept remained in place and the trustee papers describing the concerns of the board remained in place. He stated there was a bit of a disconnect in that APFC was not mandated to provide a strategy to generate a POMV payment. The APFC mandate was to keep the principal safe and maximize return. He elaborated that APFC did not just ignore the calls coming on the fund, but there was a bit of tension there. The board did not want make investment decisions based on a need to transfer monies to the state. The corporation made investment decisions based on the ability to maximize returns within its portfolio benchmarks. The corporation had to manage for the calls within the template even though it was not specifically mandated.

Representative Galvin appreciated the answer. She stated it was sometimes difficult to delineate the line between investment strategy and budget policy. She would appreciate it if Mr. Mitchell would share any nuances or policy directives the legislature should be aware of. She knew it was something that was strongly voiced.

[1:55:04 PM](#)

Mr. Mitchell discussed slide 7 titled "Diversified Portfolio." He stated that Alaska had a relatively small gross domestic product (GDP) - in the mid-\$50 billion range - in comparison to other states. The corporation had investments around the world in over 100 countries and 3,000 distinct entities primarily focused on North America and the United States to provide revenue back to Alaska. He highlighted an arrow on the map pointing to Alaska reflecting \$540 million partially managed by a firm located in Alaska in addition to funds that were part of a private equity strategy implemented in recent years with some investments located in Alaska.

Representative Hannan looked at the map on slide 7 and observed that the United Kingdom had 3 percent of the portfolio. She asked if there was a particular investment type the fund made in the U.K.

JIM PARISE, DEPUTY CHIEF INVESTMENT OFFICER, ALASKA PERMANENT FUND CORPORATION, answered that there were many financial partners in the U.K. The fund invested in large banks, which accounted for a large part of the fund's index. Additionally, the fund had some real estate holdings in the U.K. He stated it was a pretty sophisticated financial system in the U.K.

Co-Chair Johnson remarked there had been a bill that would require APFC to take the environmental social governance (ESG) perspective into account when making investments. She asked how it impacted the way the investments were pursued. She asked if it was straight out financial.

Mr. Mitchell replied that the less controls placed on managers making investment decisions the better. He noted that there were exceptions. He highlighted the current situation with Russia and explained the fund would not want to make additional investments there at a time when Russia was taking actions the world and the U.S. in particular did not condone. There were cases where it made some sense not to have investment because of social or other risks. He shared that he had been on the APFC board for a short period of time and recalled a presentation from a board advisor that went through some of the investment/divestment choices made over the past 20 years based on ESG type criteria including tobacco, oil companies, and other industries. The analysis had used CALPERS [the California retirement system] and indicated the system had foregone a significant amount of revenue of around \$1 billion as a result of the investment sectors outperforming (in part perhaps because CALPERS left the sector). He highlighted that when an investor was no longer an equity participant in a company, their ability to influence the company was diminished. He used divestment in oil and gas companies as an example. He remarked he did not know how the action could be reconciled when the State of Alaska received a large portion of its money from the oil and gas industry. He elaborated that suggesting the state should divest from the oil and gas industry would have resulted in negative performance over the past couple of years due to the outperformance of the sector.

Mr. Mitchell elaborated that APFC had an awareness of the ESG criteria because it was something the market was trending towards and ratings agencies had developed a subsection of their report on ESG criteria. To the extent

it was creating an opportunity, APFC would want to take advantage of somebody's positioning, but otherwise the APFC board would not advocate for limiting investment decisions based on somebody's analysis of ESG criteria.

2:02:09 PM

Mr. Parise expounded that in terms of investments, the Permanent Fund was a total return fund. He elaborated that if APFC was told it had to do something else, it would; however, APFC only looked for the best investment and was agnostic as to where it came from. He provided a green bond as an example where ESG had been beneficial to the fund. He explained that people were willing to take less yield on a bond because it had the ESG high score. He detailed that APFC did not buy green bonds, but would sell them. He believed the purchase of the bonds did stakeholders a disservice because they were buying based on the value someone placed on ESG. He reiterated that APFC investment managers only invested in what made sense for the portfolio. The fund worked to beat indexes; if its benchmark did not have any ESG component, the fund would not invest in ESG.

Mr. Mitchell moved to slide 8 titled "Asset Allocation: APFC's Investment Policy." The slide showed the progression of the sophistication of the fund's asset allocation. In 1980 the fund was entirely fixed income and over time the asset allocation had become much more diverse. He noted that Mr. Parise would provide details on the various sectors later in the presentation.

Mr. Mitchell moved to a bar chart showing real return comprised of 10-year historical lookbacks. The yellow dots reflected the return objective of CPI + 5. He highlighted the fund had exceeded its return objective for the past four 10-year lookbacks, it had failed the mean for the 10 years prior to that, and had met the mean for the 6 years prior to that. The chart reflected the cyclicity of markets and the high standard to reach the 5 percent POMV payout. He noted that based on historical experience there would be 10-year periods of time where APFC did not achieve CPI + 5 and it would require a significant amount of discipline by policy makers and investment staff to ensure there was a consistency of course during good times and bad. He explained that for long-term expectations like 30-

year time horizons, the likelihood of hitting a return objective of CPI + 5 was much higher.

2:05:36 PM

Representative Josephson asked if the graph on slide 9 included the \$12 billion in special appropriations over time. He had seen \$8 billion of the special appropriations deposited during his time with the legislature, once when there had been an inadvertent failure to veto \$4 billion. He surmised the special appropriations and inflation proofing had helped achieve long-term objectives.

Mr. Mitchell agreed it had helped the intergenerational value concept. He noted slide 9 was not oriented towards the concept; it showed the real return compared to the inflation objective. The presentation also included a later slide showing the [special appropriation] deposits over time.

Mr. Parise addressed slide 10 titled "Fund Performance vs Benchmarks." He intended to provide a high level overview of investments made at APFC, how the investment team thought about things, and what it was trying to achieve. He relayed the fund had three benchmarks. The first was the return objective, which APFC tried to achieve through the asset allocation of the board. The fund used the investment consultant Callan who talked with the board in coordination with staff to come up with an asset allocation that was meant to try to beat the return objective. He clarified it was not an actual benchmark the investment staff tried to manage to because there was no index guaranteeing CPI + 5. The corporation had to come up with a way to stay within the board's asset allocation and meet the return objective.

Mr. Parise explained there were two benchmarks the investment staff and board looked at. The first was the passive index made up of 60 percent stocks, 20 percent bonds, and 10 percent real assets such as real estate and TIPS [treasury inflation-protected securities]. He explained if managers did nothing else, the passive index was what the fund would achieve. The fund managers had added more sophisticated investments including private equity, private credit, and infrastructure. The chart reflected that adding the additional complexity to the portfolio was worth it over time because the returns beat the passive index. The second benchmark the fund was

measured against was the performance benchmark that combined all of the asset classes. Each benchmark within the asset classes was weighted to the size of the portfolio and asset classes within the portfolio. The benchmark indicated whether the managers and chief investment officer (CIO) were adding any value. The numbers on slide 10 showed the answer was yes.

Mr. Parise elaborated on slide 10. He explained that the board provided the asset allocation. For instance, directing the fund to have 39 percent in equities. The CIO had a band in which to underweight or overweight equities; it was the CIO's job to determine what they thought would happen. He clarified that the managers did not make large positions/bets versus the benchmark because they were extremely prudent and did not believe they had a way of beating the market; however, there were times small adjustments could be made to the portfolio in an effort to beat the benchmark. He highlighted that the proudest year of performance for investment staff was the previous year, FY 22. He looked at the passive portfolio showing equity had fallen off a cliff; it had been a nasty year. The fund beat its performance benchmark and passive benchmark pretty handily in a down year. He stated it was very easy to get panicked and make bad decisions when the market was going down; however, the fund and CIO had a disciplined and methodical process. He expounded that FY 22 followed a year where indexes had been up 27 percent and the fund outperformed by 2 percentage points.

Mr. Parise continued to address slide 10. The chart included FY 22, 3-year, 5-year, 10-year, and 30-year. He pointed out that of the past five years the fund had outperformed three years. In the other two years, the fund had underperformed by 5 basis points in one year and 70 basis points in the other. However, when the fund won, it won pretty big. He explained that if there was low hanging fruit or dislocation in the market, the fund tried to take advantage of the situation, but it did not occur very often.

[2:12:01 PM](#)

Representative Stapp asked increasing diversification of the asset allocation (i.e., private equity, private income, and infrastructure) made it easier for the fund to mitigate risk.

Mr. Parise agreed diversification across asset classes gave the fund managers more levers to use. One of the things the corporation considered when deciding whether to add an asset class was whether it had the resources, bandwidth, and a possible edge and that there was not someone out there that was more sophisticated that would hurt the fund if it invested in the asset class. The fund took adding an asset class or securities it had not previously owned pretty seriously. He explained the fund needed to ensure it had everything in place and there would not be unintended consequences of owning the asset.

Mr. Parise advanced to slide 11 titled "Benchmarks - Internal Fixed Income Example." He described a benchmark as the standard being measured against. The fixed income composite benchmark reflected how the overall fixed income category performed in a given time period. The slide broke out the underlying [fixed income] assets and portfolios managed by APFC and compiled them into a total based on their weighting in the portfolio. He relayed there was a team of seven fixed income managers at APFC who were each responsible for different portfolios and were tasked with beating their benchmark within a risk parameter set by the board and it generally included what was in the index only. For example, the corporate bond index was rules-based and included any bond with an issue size of \$350 million or more that was 18 months or longer and was investment grade. The fund was allowed to buy any of those bonds and its job was to select the best bonds to beat the index.

Mr. Parise continued to explain slide 11. The goal for each of the portfolio components was to outperform its benchmark. He used the global rates component as an example and noted it underperformed its benchmark. He detailed that if global rates was underweighted versus the benchmark and overweighted a different component, it was still possible to beat the benchmark. The strategy came down to asset allocation within fixed income in order to beat the benchmark. He used the U.S. corporate allocation as another example and explained that within the allocation, APFC could decide it wanted to own more banks than utilities. It could drill down to selecting specific banks, different investment time periods, specific coupons, etcetera. The fund managers' job was to figure out the best bonds to invest in. The selection included a disciplined thought process and robust portfolio analytics that allowed

managers to dissect the portfolios. The method was not limited to fixed income and included the fund's equity program as well. The goal was to grind out performance at all times and not take big bets.

[2:16:28 PM](#)

Representative Hannan asked what TIPS were.

Mr. Parise replied that TIPS are inflation adjusted treasury securities at the real rate.

Representative Hannan asked if TIPS were credit securities.

Mr. Parise answered that TIPS are not credit securities and are guaranteed by the federal government. He elaborated that TIPS were indexed to CPI. The current yield for a five-year TIP was about 1.36 percent, but the number adjusts with inflation.

Mr. Parise turned to slide 12 titled "Focus on Increasing Internal Management." He relayed that over time APFC's internal management had become more sophisticated. The fund's asset allocation included public equities, fixed income, private equity, private income, absolute return (hedge funds), risk parity, cash, and real estate. The corporation was working to determine where it could begin bringing some of the assets under internal management. He explained that fees alone were not a reason to make the change. He stated it was not prudent to fire external managers merely because they had high fees; there was likely a reason they had high fees. He detailed that APFC had to know it had the bandwidth, skill, or some sort of edge that allowed in-house managers to beat a benchmark or external managers. He elaborated that all fixed income management had been brought in-house in 2022.

Mr. Parise elaborated on slide 12. He relayed that APFC had brought some of its private equity portfolio under in-house management in 2013. The fund would not bring the entire asset class under internal management. He noted that private equity involved investing in private companies. He expounded that the investment was extremely labor intensive, time sensitive, and required analytics and "an army" of analysts to decide what was a good investment. The fund could do co-investments in private equity where it hired a manager to buy numerous companies. He explained the

external manager may see a company it wanted to invest in that exceeded its \$100 million fund. Under the scenario, the manager may only be able to contribute \$20 million and may ask APFC if it would be willing to invest \$100 million. He furthered that on top of the due diligence performed on the asset by the external manager, APFC would do its own review in addition to getting advice from its third-party consultant and would then decide whether or not to co-invest. He explained there was no fee and no carry in the co-investment, meaning it diluted the overall fee APFC paid to the external manager. He noted that the term "carry" meant that typically when a private equity manager performed well, APFC had to pay them year after year. Under the co-investment scenario, there was no carry fee. Additionally, it enabled APFC to move the portfolio around. For example, if the proposed investment was in a software company and APFC's private equity portfolio was underweight in software, the investment enabled APFC to put a considerable amount of money in software immediately.

[2:20:37 PM](#)

Co-Chair Edgmon recalled a recent conversation where the committee had been told that every barrel of oil was not equal in terms of valuation, whether it came from state or federal land, and other factors. He thought of the notion that every dollar in the ERA was not necessarily created equal in the sense of unrealized and realized gains and other. He believed the topic was worthy of discussion at some point. He stated there were some profound implications in having a given amount in the ERA, while much of the funding was tied up and much was in a more available liquid state. He spoke about oil price volatility in the coming years and considered it may be necessary to get into understanding the topic more. He thought it was fascinating to know there was so much going on behind the scenes at APFC in the fund management. He thanked Mr. Parise for the detail and noted it was an incredibly important point and one that many did not understand.

[2:22:42 PM](#)

Representative Ortiz asked when the ERA had been created.

Mr. Mitchell answered it had to have been the early 1980s before 1983. He noted the first PFD had been a \$1,000 [per

person] transfer out of the general fund. He would follow up.

Representative Ortiz asked about a scenario where the split fund was eliminated and replaced with one combined fund the fixed POMV model could draw from. He asked if it would impact the fund's portfolio in a good or bad way.

Mr. Parise replied from the perspective of investors they did not care about the ERA. He elaborated it was not discussed or thought about by fund managers. The investors managed for total return versus the benchmarks.

Mr. Mitchell responded, "For the rest of us, yes, it would be very helpful." He referred back to his explanation of tension that existed because APFC had a specific mandate in its statutes that ignored the needs of the state, but as good residents, APFC wanted to be cognizant of the state's needs and expectations of the legislature and others to provide on an annual basis. He explained that Mr. Parise was investing without regard to that need; however, the CIO through coordination with the chief financial officer (CFO) was setting money aside to meet the state's cash calls based on a schedule worked out with the Treasury Division [within DOR].

[2:25:37 PM](#)

Mr. Parise agreed. He confirmed that when the investment managers knew there was cash needed, they managed for that need. He clarified that investors were not managing for an ERA, they were managing against the benchmarks. When managers knew funding was needed, they moved the portfolio around and many times it was used as an opportunity to rebalance the portfolio. For example, if managers knew \$400 million was going to the state, they moved things around to make refinements to the portfolio.

Representative Ortiz stated that theoretically the legislature could draw the entire amount in the ERA if it was crazy enough to do so. He thought the absence of that potential could provide more freedom for APFC to be more profits or earnings driven.

Mr. Parise agreed that on the margins it was likely true; however, the fund had enough to sell and enough liquidity to do what it needed.

Representative Hannan referenced slide 8 regarding APFC's asset allocations. She observed that at one point the asset allocations APFC managers were allowed to make was driven by specific policy. She asked if the asset allocations were driven by a policy set by the board. She observed that APFC currently invested in all asset classes. She asked if there was policy that specified how much of the portfolio was invested in each asset class. For example, no more than 10 percent in real estate and no more than 20 percent in bonds. Alternatively, she wondered if the asset allocation policy decisions were no longer driving the allocations.

[2:28:15 PM](#)

Mr. Parise answered that the board set the asset allocations with bands, which gave fund managers the freedom to move where it saw fit.

Mr. Mitchell added that the board set the allocation on an annual basis.

Mr. Parise turned to slide 13 titled "APFC Performance Relative to Large Public Funds." He highlighted that APFC performance had been in the top decile in the last year, last three years, and last five years. He noted the performance was compared to some large funds with higher allocations to private equity, meaning they had riskier portfolios. He elaborated that APFC's success had been with less risk than some of the largest public funds such as CALPERS and CALSTRS [California State Teachers' Retirement System]. The numbers indicated that the fund's performance had been doing very well over the past few years with a consistent, disciplined process.

Mr. Parise moved to slide 14 titled "Tenured and Seasoned Investment Leadership." The slide showed investment managers and leadership who had been managing the APFC portfolios for a long time.

Representative Josephson asked if the people listed on slide 14 were the individuals who needed to arrive in the office at 4:00 a.m.

Mr. Parise answered, "That's me." He relayed that generally everyone was at work around 6:00 a.m. or 7:00 a.m. He noted that private market managers did not necessarily need to

come in as early, but public markets (stocks and bonds) managers had to be there when the market opened.

Mr. Mitchell addressed slide 16 titled "Financial Resource for Alaska." The slide addressed the state's reliance on the revenue stream from the POMV and APFC's work to be a good citizen by providing the predictable stream of revenue even though it was not necessarily the mandates provided by statutes. He elaborated that Mr. Parise had a mission driven job and needed to be able to ignore the noise of suggestions that something happen with the ERA. He explained Mr. Parise should not spend his energy worrying about the scenario and considering how he would get out of positions to provide extra cash. The goal was for predictableness and reliability. The fiduciaries for the fund were the Board of Trustees and they were responsible for setting the asset allocation. The asset allocation included bands, meaning that as allocations could go up and down in value without automatically being out of compliance. The investment policy was revisited annually and had a three-year prospective outlook that could evolve from year to year.

Mr. Mitchell discussed state revenue on slide 17. The slide included a bar chart showing the importance of the revenue flowing from the POMV. He explained that when the POMV was instituted in FY 19 it had a hugely calming effect on the state's finances and credit ratings. He noted there were considerably larger UGF revenues from petroleum revenue in FY 14, whereas FY 15 through FY 18 had been rough years for the state with large draws on the CBR Fund. There had not been many options people could agree upon and the POMV became a solution that worked from the perspective of meeting the state's needs while ensuring the fund met the statutory and constitutional mandates of maintaining the intergenerational value. The transfers in FY 20 and FY 21 were the largest component of state revenue in those years. He added that even in FY 22, petroleum revenue accounted for the largest single revenue source. He highlighted the predictability of the POMV on a year to year basis. He stated that the FY 23 payment was in process with about half yet to be transferred. He explained that the FY 24 payment was already known because the POMV calculation was 5 percent of the average of the last five complete fiscal years.

[2:34:42 PM](#)

Mr. Mitchell turned to a bar chart on slide 18 and discussed principal contributions and intergenerational benefit. He believed the chart illustrated the sacrifice of the 45 or so past generations of Alaskans to provide the resource now existing in the Permanent Fund. He detailed that in each of the years shown, the money could have been used for schools, capital projects, or other. He highlighted 1986 and 1987 when the bottom had fallen out of the Alaskan economy, there were still savings put away for the state's future. He remarked it was extraordinary to have the dedicated and statutory royalty revenues, the deposits from the ERA and general fund, the Amerada Hess settlement money, inflation proofing from the ERA, and special deposits from the ERA in 2020 and 2022. He noted the bar for 2023 was not yet complete. He added there was a makeup in 2023 of contributions from the state to provide for the statutory royalty revenues of some of the past years that had not received full contributions during the 2016 to 2018 timeframe.

[2:36:22 PM](#)

Mr. Mitchell addressed the ERA with a graph on slide 19. He pointed to the red line showing the net impact of contributions and withdrawals [from FY 14 to FY 22]; the line generally ascended and became choppier. He looked at the blue bar in FY 22 [FY 20] reflecting statutory net income money into the ERA and the brown bar reflecting the POMV transfer out. He noted the POMV transfer out was about equal to the statutory net income but adding the outflow of inflation proofing and special appropriations resulted in a dip in value. There was an increase in FY 21 with the bull market resulting in a 29 percent return for the fund. In FY 22, there was an outflow as the POMV and inflation proofing exceeded statutory net income for the year.

Mr. Mitchell relayed that statutory net income in the current year was surprisingly low; it was driven entirely by markets. He highlighted it had gone from \$3.5 billion in FY 14 to \$2.9 billion in FY 15 and \$2.2 billion in FY 16. The decrease had been followed by a run of fairly extraordinary statutory net income at \$6.3 billion in FY 18, \$3.3 billion in FY 19, \$3.1 billion in FY 20, and \$7.6 billion in FY 21. He noted the bull market in 2021 resulted in the high number in FY 21 with some residual impact in FY 22 resulting in statutory net income of \$4.5 billion. He

explained that FY 23 would be closer to \$2 billion. He explained the \$2 billion would essentially replace the \$6.3 billion in the statutory formula for the PFD. He elaborated that if the \$2 billion trend continued into the future it would have a stark impact on the formula.

Mr. Mitchell discussed the effective POMV rate shown on the bottom line of a table on slide 19. He explained that the fund had been ascending in value. He detailed when there was an increasing fund value and a historical average was taken, it meant less than 5 percent would be taken from the present day balance; therefore, the POMV draw had been less than 5 percent of the current fund balances. He highlighted the 4.04 percent POMV draw in FY 22 and 4.52 percent POMV draw in FY 20. He relayed the opposite would be true for a trend of fund declines; the draws would be much higher than 5 percent.

Representative Stapp asked if there were failure mechanisms in the current POMV formula. He asked if it would create a problem with the POMV draw if there were several years of declines in the fund combined with high inflation.

Mr. Mitchell responded that the scenario would create a problem and there was no safety feature. He elaborated that the principal of the fund was protected by the [state] constitution and could not be spent. The ERA housed the realized earnings of the fund (i.e., interest income, dividends, rentals, and realized gains), which could be spent. He explained if there was a period of low statutory net income years combined with high inflation, there was a significant probability of insufficiency in the ERA. He informed members that the Legislative Finance Division (LFD) had created a probabilistic model that had recently been presented in the Senate Finance Committee. The division had not pulled all the levers on the model; it included a static inflation assumption based on Callan's inflation projections, which were relatively low at 2.5 percent. He explained that a higher inflation level in the next couple of years would have a much more drastic impact on the durability of the ERA. The model also included a 5.1 percent statutory net income variable, whereas the actual current fiscal year number was about half of that amount. He believed the LFD presentation had 10 percent probability of an insufficient balance in 2027. He explained that a worse case scenario would pull that number forward to 2025

and the legislature would be faced with struggling over how to provide the 2026 POMV.

2:42:26 PM

Co-Chair Johnson asked for the projected ERA balance at the end of FY 23.

Mr. Mitchell turned to slide 20 and shared that the ERA balance was currently \$13.5 billion from a financial statement perspective. He relayed there were a number of nuances that made the balance much more austere. First, there was a \$4.2 billion inflation proofing transfer scheduled to be made from the ERA at the end of FY 23. Additionally, the FY 24 POMV payment was \$3.5 billion. Theoretically, the combined \$7.7 billion would be transferred out of the ERA on July 1, 2023. It was certain the \$4.2 billion would be transferred at that time in addition to a portion of the \$3.5 billion. The \$3.8 billion available for appropriation included the \$1 billion in realized statutory net income in FY 23; if there was an additional \$1 billion it would bring the number to \$4.8 billion.

Mr. Mitchell looked at the \$2 billion in unrealized gains associated with the ERA on slide 20. He explained that unrealized gains were divided between the two accounts [principal and ERA] on a pro rata basis, meaning balance was key to where the unrealized gains resided. He elaborated that as the inflation proofing transferred to the fund principal and the POMV draw was made for the state's use, about \$1.4 billion of the \$2 billion would move to the unrealized gains in the principal. The remaining amount would move to principal if the last \$3.8 billion was spent. He relayed it was more of a cushion than a number to be relied on for purposes of the balance. He clarified that if the gains were realized they would flow into the ERA. He noted that some of the asset allocations such as private equity and real estate were less liquid than public market securities or equities. He detailed that money was anticipated to be in a private equity transaction for ten years. Typically, money was invested in the first two to four years, some money started to come back in the following few years, and investors began to exit in the last seven to ten years. He explained it was a long play that did not lend itself to much nimbleness on the ability to realize unrealized gains.

Mr. Mitchell shared that APFC did not know what the future held and they were optimistic things played out better than the scenario he had just described. However, there was potential that at the end of the fiscal year there was a \$4.8 billion balance that would be mostly used to cover the FY 25 POMV draw and inflation proofing.

[2:46:30 PM](#)

Representative Stapp saw a potential risk if there was a relatively bad year combined with high inflation. He thought the 10 percent [probability of an insufficient balance] scenario may be very bad if the state could not have a POMV draw because the funds were allocated for inflation proofing. He asked if Mr. Mitchell had an estimate on how realistic the scenario was.

Mr. Mitchell answered in the negative. He stated the corporation was not making bets on the market, it was implementing strategies. He explained that APFC could project ranges for the next six months to 1.5 years that it hoped to be within, but they could not predict exactly what would happen.

Representative Stapp made clarifying remarks about his statement. He noted that APFC was doing a great job.

[2:48:12 PM](#)

Representative Josephson remarked that as the fund corpus grew, the amount of inflation proofing grew. He asked if there would ever be a time when APFC would advise against fully funding inflation proofing. He stated his understanding that inflation proofing was subject to appropriation by the legislature. He noted the legislature had been very good about making the payment historically, but he believed it was almost advisory.

Mr. Mitchell answered there were very strong beliefs surrounding the topic. Additionally, there were papers and a resolution around the ERA variability. He believed there was a recommendation for a minimum balance of four times the POMV payment and that there should be consideration of foregoing inflation proofing during times of low earnings with the expectation of making up the funds when earnings improved. He noted that discipline was very difficult. He

relayed it would always be the corporation's prerogative that inflation proofing should be pursued and enacted to the extent it did not lead to an inability to pay. He explained it maintained the compact with past and future generations. He remarked that in some ways the fall set the stage for a discussion about adjusting the two account system to a one account system. The presentation included a couple of slides on the topic.

Representative Josephson considered the past supplemental appropriations [into the fund principal] that had been sizeable. He asked if the past appropriations could effectively be considered as "credit" towards inflation proofing, enabling the legislature to suspend a year of inflation proofing. He asked if the description and words assigned to the actions taken mattered.

Mr. Mitchell answered there were strong beliefs about that as well. He aligned his views with the views of the APFC Board of Trustees. He defaulted to inflation proofing as a primary tenet of the compact of the Permanent Fund. He elaborated it should be given every consideration and the potential of not appropriating should not be taken lightly, despite past special appropriations. He highlighted special appropriations made in 1986 or 1987 from the general fund to the Permanent Fund. He stated it had not been designed as inflation proofing; it had been designed as an additional deposit to the fund. He thought it mattered how the appropriations were made when considering their purpose. He stated the fund had been growing, not merely maintained, over the years. He explained that it was a matter of considering whether it was the intent of a given legislature to grow the fund for the future or maintain the fund for the future. He stated the concepts were two distinct things.

[2:52:51 PM](#)

Mr. Mitchell highlighted an illustration on slide 21 showing the complexity of the two account system [the ERA and fund principal]. He reviewed the illustration showing money coming into the principal from royalty revenue, which was constitutionally protected. He detailed that invested income flowed to the ERA as it was realized. He highlighted the concept of unrealized gains, which were part of the financial and accounting world and not currently incorporated into statute. He remarked on unrealized gains

that resided in the two funds and could cause confusion about the real fund balance. He relayed there was a tension between maintaining an adequate balance and not having a balance that became too excessive and was relied upon beyond the ongoing ability of the fund to provide for each generation's needs with the POMV. He characterized the two fund structure as overly complex, which created many headaches for the CFO and people in general who were trying to understand how the Permanent Fund worked, how money flowed in the accounts, and what the balance was.

Mr. Mitchell turned to slide 23 showing a simplified system that APFC would advocate for where contributions came into the Permanent Fund and the fund paid out a historical POMV. He explained the structure was more in line with a classic endowment. The simplified structure eliminated the worry for those making decisions about whether they were doing the right thing for their generation that some future generation would take as theirs or whether they were taking what some past generation set aside in part for the present generation, but not all. The simplified system eliminated the tension associated with the balancing act between the ERA and keeping the other aforementioned considerations in mind. The change meant there would be a predictable payout. He recognized it was a heavy lift that would require a constitutional amendment. The board had been advocating for the change since 2003.

Mr. Mitchell looked briefly at slide 22 pertaining to the POMV. The slide highlighted the APFC board resolutions from 2003 and 2004 advocating for an amendment to the constitution:

Percent of Market Value (POMV)

- Supporting a constitutional amendment to limit the annual Fund payout to not more than a 5% POMV averaged over a period of 5 years.
- Implementation of a constitutional POMV spending limit for the Fund, has the accompanying benefit of assuring permanent inflation proofing of the Fund.

Mr. Mitchell highlighted other board resolutions on slide 24 that could all be found on the APFC website. He stated there had been significant thought put in by the board, consultants, and staff to set the framework for how the

fund operated and trying to live up to the standards of those who created it. Slide 25 showed an example of the corporation's homepage and documents that could be found on the website.

[2:56:47 PM](#)

Representative Hannan looked at slide 23 and asked for verification that Mr. Mitchell had stated that the APFC board had advocated since 2003 for a model that eliminated the ERA and included an endowment fund only.

Mr. Mitchell agreed.

Representative Hannan asked if the idea had ever gotten political traction at the legislature.

Mr. Mitchell answered there had been effort and it was a very difficult discussion. He relayed that a joint resolution was required for a constitutional amendment. He recalled former Representative Jonathan Kreiss-Tompkins advocated for the structure shift, but he did not know how much traction the effort had received. He stated that in some ways being able to see the floor of the ERA at present gave some additional weight to the conversation about the shortcomings of the current structure and what would happen if there were not sufficient realized earnings in the ERA to provide for the POMV. He stated it would be a dire situation. He thought perhaps people may be willing to reconsider the potential of making a run at the change. He considered that legislators in the future may look back and think about being present when the change was made. He thought of legislators who had been present when the Permanent Fund had been created and considered the historic nature of the times. He explained that the change [to a single fund system] would ensure the discipline of the past was maintained in perpetuity.

[2:59:37 PM](#)

Representative Stapp thanked Mr. Mitchell for reminding legislators for the incredible weight of their decisions.

Co-Chair Johnson requested [asset allocation] percentages on the smaller pie charts on slide 8. She thanked the presenters and reviewed the schedule for the following meeting.

#

ADJOURNMENT

3:01:01 PM

The meeting was adjourned at 3:00 p.m.