

Alaska Permanent Fund Corporation

**RESOLUTION OF THE BOARD OF TRUSTEES OF THE ALASKA PERMANENT FUND CORPORATION
OFFERING ALTERNATE PROPOSALS TO SUPPORT AN ANNUAL PERCENT OF MARKET VALUE
DRAW FROM THE PERMANENT FUND
RESOLUTION 20-01**

With the enactment of SB 26, Chapter 16 SLA 18 on July 1, 2018, an essential step was taken to codify a set of rules to establish a sustainable annual draw from the realized earnings of the Alaska Permanent Fund (Fund). The Board of Trustees believes additional measures would enhance the sustainable use of Fund earnings for the benefit of all generations of Alaskans that warrant consideration by the Alaska Legislature and the Administration, including:

1. Transform, by constitutional or statutory amendment, the Alaska Permanent Fund and Earnings Reserve Account into a single fund and limit the annual draw to the fund's long-term real return:

- a. Constitutional Amendment:** On three prior occasions the Board has adopted a resolution (Resolutions 00-13, 03-05, and 04-09) to collapse the Earnings Reserve Account into the Principal of the Fund and limit the annual draw from the combined Fund to no more than five percent of the average fiscal year-end market value of the fund over the immediately preceding five years. These resolutions explained that limiting the Fund's annual draw to the average real return of the Fund was both: (1) a common practice among large endowment funds, and (2) an effective way to balance the goal of maximizing the availability of income with the long-term goal of protecting the purchasing power of the Fund. Constitutional amendments to advance this change were considered by the Alaska Legislature during the Twenty-Second and Twenty-Third Alaska Legislatures, and are currently being considered by the Thirty-First session of the Alaska Legislature. To date, none of these resolutions have received sufficient Legislative support to advance to a general election for consideration by Alaska voters. The Board, through this Resolution, expresses its continued support of a constitutional amendment along the parameters outlined in its three prior resolutions on this topic.
- b. Statutory Amendment:** The Board has also discussed and supports the development of a legislative proposal that would amend existing law to transform the current two-fund structure (i.e. Principal and ERA) into a single fund with an annual appropriation to the General Fund based on the average long-term real return of the Fund. Because the constitutionally dedicated royalty deposits and appropriations to the Principal of the Fund are not subject to appropriation (i.e., permanent dedications), an annual appropriation would be prohibited if it would cause the value of the Fund to drop below the historic dollar value of these dedicated deposits. By collapsing the ERA and Principal into a single fund and limiting the annual draw to the Fund's real return, inflation-

proofing the Fund on an annual basis via annual appropriation would no longer be necessary. Importantly, this single fund transformation, based on the words contained in article IX, section 15 of the Alaska Constitution, appears supported by the rules of construction in section 4 of the Uniform Prudent Management of Institutional Funds Act, which Alaska enacted in 2010. The Board, through this Resolution, expresses its support for and directs APFC Staff to draft a legislative proposal and seek input from the Department of Law before submitting this proposal to the Administration and Legislature for their consideration.

- 2. Adjustments to the existing rules-based system governing fund transfers into and out of the Principal and ERA, if the ERA and Principal are not combined:** If sufficient support for a constitutional or statutory amendment cannot be garnered to transform the Principal and ERA into a single fund with a limited annual draw, the Board supports the following additions to the existing rules-based system to ensure the ERA balance is sufficient to meet the annual POMV draw enacted by the Legislature in SB 26:
 - a. Periodic Review of Fund Return Assumption:** Because the POMV draw from the ERA established in SB 26 is based on the assumption that the Fund expects to generate an average real return of 5%, if the Fund's real return falls below 5% for an extended period of time, the ERA will run dry (i.e. ERA Shortfall). The Board recommends having a mechanism built into state law that would require APFC to revisit this return assumption every few years and provide the Legislature with a report as to whether a 5% POMV is projected to be sustainable, both in terms of the expectation of the Fund to generate a 5% real return and the ERA's ability to support the POMV draw based upon its current and projected balance.
 - b. ERA Balance Buffer:** In modeling and analyzing the long-term durability of the ERA to support the POMV draw, it is clear that during market environments when realized gains from the Principal remain low for a prolonged period of time, without a buffer of funds in the ERA, the risk of ERA Shortfalls become meaningful. To hedge this risk, the Board supports a change to the existing rules-based system to maintain a balance in the ERA of at least four times the expected annual POMV draw ("4X Buffer"). This would include a rules-based approach that suspends inflation proofing when the ERA balance is below the 4X Buffer, and to make up missed inflation proofing payments when the ERA balance exceeds the 4X Buffer. This set of rules is projected to result in similar inflation proofing outcomes as the current annual rule, but significantly decrease the chance the POMV draw cannot be made in any given year.

To be clear, the Board continues to support the consistent inflation-proofing of the Principal of the Fund as set forth in Board Resolutions 17-01 and 18-04. However, if the Legislature can both maintain the long-term durability of the ERA to support the SB 26 annual POMV draw and honor its commitment to inflation-proof the Principal of the Fund over the long-term, the harm

to the Principal of the Fund will be mitigated. The Board is also evaluating and discussing with the Department of Law a legislative proposal to re-define “net income” so that the annual inflation-proofing transfer would happen every year automatically. Should this legislative proposal receive support, it could be designed to trigger the suspension of inflation-proofing when the ERA balance is too low and trigger inflation-proofing catch-up payments when the balance of the ERA recovers; all without the need for annual appropriation to support these events.

Based on analysis completed by APFC Staff and the General Consultant at the request of the Board, the combination of these two protective measures will enhance the ability of the ERA to weather most foreseeable market environments and sustainably generate the 5% POMV draw set forth in SB 26.

NOW THEREFORE BE IT RESOLVED that the Trustees direct the Executive Director to distribute this Resolution to the Members of the 31st Alaska State Legislature and offer to have the Board, Staff, and the General Consultant testify in support of the Legislative initiatives set forth in this Resolution.

PASSED AND APPROVED by the Board of Trustees of the Alaska Permanent Fund Corporation, this 5th day of March, 2020.

/s/
Craig Richards
Chairman, Board of Trustees
Alaska Permanent Fund Corporation

ATTEST:

/s/
Angela M. Rodell, Corporate Secretary