



Board of Trustees

Special Meeting

October 17, 2018

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01_Special Meeting Agenda

SPECIAL MEETING OF THE BOARD OF TRUSTEES **October 17, 2018**

Alaska Housing Finance Corporation
4300 Boniface Parkway, Anchorage, AK 99504

Webinar Access (click link to join webinar)

Join via WebEx and enjoy the ability to listen on your computer and follow presentations:

<https://alaskapfc.webex.com/join/apfc>

Teleconference Access

Call-in toll-free number: 1-844-740-1264 / Access Code (Meeting Number): 809 584 681

AGENDA

WEDNESDAY, OCTOBER 17, 2018

- | | |
|-----------|--|
| 2:00 p.m. | CALL TO ORDER |
| | ROLL CALL (Action) |
| | APPROVAL OF AGENDA (Action) |
| | OPPORTUNITY FOR PUBLIC PARTICIPATION |
| 2:05 p.m. | INCENTIVE COMPENSATION PLAN POLICY (Information)
Angela Rodell, Chief Executive Officer |
| 2:50 p.m. | LEGISLATIVE INITIATIVES (Action)
Pauly Swanson, Communications Manager |
| 4:45 p.m. | OTHER MATTERS / FUTURE AGENDA ITEMS / TRUSTEE COMMENTS |
| 5:00 p.m. | ADJOURNMENT |

NOTE: TIMES MAY VARY

<i>(Please telephone Danielle Graham at 907.796.1519 with agenda questions.)</i>

02_APFC Incentive Compensation Memo

SUBJECT: Incentive Compensation Structure ACTION:

DATE: October 17, 2018

INFORMATION: X

BACKGROUND:

Since 2011, the Board, through the adoption of its Personnel Management Program, has had a compensation philosophy as follows:

“APFC strives for a compensation program that competes well in the market and motivates all employees to bring their best efforts to the scope of their job responsibilities. The program provides a systematic means of tracking, measuring, and compensating employees and allows flexibility for APFC to act quickly.”

This is a compensation philosophy that recognizes all employees are valued and that individually and collectively that value needs to be compensated for fairly. Compensation should reflect our mission, vision and values and incentivize the behaviors we want to see as an organization.

APFC Mission

To manage and invest the assets of the Permanent Fund and other funds designated by law.

APFC Vision

Our vision is to deliver sustained compelling investment returns as the United States' *leading sovereign endowment manager*, benefitting all current and future generations of Alaskans.

Strategic Priorities – From 2017-2021 Strategic Plan

Priority #3: Develop best-in-class investment management capabilities, partnerships, and geographic reach to maximize investment returns

Priority #4: Enhance talent and staff across APFC

Goals – From 2017-2021 Strategic Plan

Designed to help fulfill above Strategic Priorities

Goal #5: Implement a competitive incentive compensation program by October 2019

STATUS:

In March of 2017, APFC, at the request of the Board of Trustees, hired McLagan to undertake a compensation review and develop an incentive compensation plan for APFC. At the December 2017 Board meeting, the Board of Trustees adopted updated base salary pay bands for each position as a result of that review. The adjustments warranted by the new base salary bands have been made and were incorporated into the FY19 budget request for APFC. In May of

2018, the Board adopted the basic parameters of an incentive compensation policy including the definition of Plan Participants.

The purpose of this agenda item is to continue the discussion of the September 2018 policy proposal and take any additional edits so that a final draft can be presented and adopted at the December 2018 meeting. This is a plan designed to attract and retain talent, recognize our value of being good stewards of resources, recognize our passion for investing for Alaskans, encourage teamwork and collaboration and ultimately deliver best in class results across all operational areas of APFC.

02a_Trustee Fisher Incentive Compensation Summary



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Revenue

COMMISSIONER'S OFFICE

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September 25, 2018

Trustees,

During our discussion on the incentive compensation plan in the last Board meeting, I expressed concern about increased risk taking that might be induced by the addition of the incentive compensation plan. At that time, I took the action to review the incentive compensation plans of CalPRS, CalTRS and the State of Wisconsin as provided by staff following the meeting. This document represents a summary of my thoughts.

Summary: The attached grid represents a summary of the material terms of all four Incentive Compensation Plans. With the exception of "Governance" and "Discretion," the APFC Incentive Comp Plan is generally in line with these other plans.

Governance: Under the APFC plan, the Executive Director administers the plan with "full discretion to conclusively decide all questions or matters..." (p.19) The other plans contemplate a greater involvement by the Board and one or more Committees.

- CalPRS: Performance, Compensation and Talent Management Committee
- CalSTRS: Compensation Committee
- Wisconsin includes two committees: Compensation Committee and a Benchmark Committee. "The incentive compensation plan is rigorously managed" by the Comp Committee. (P.1 *Emphasis added.*)

These Committees appear primarily focused on the following oversight:

- Performance Standards and Award Targets
- Benchmarks
- Managing Risk

(I did not review charter documents for these committees.)

Discretion: While the APFC plan provides that no incentive compensation will be paid "for the Fund for which a Participant is eligible is negative," or to employees that are not in "good standing," the other plans reserve discretion to alter or eliminate the incentive compensation based on a wider range of results, including:

- Non-adherence to risk management principles, etc. or adverse risk outcomes will reduce or eliminate incentive awards for involved individuals
- Ethics violations
- Reputational risks

This additional discretion appears to be an important tool to manage a broader range of potential abuses that may arise over time.

Further, I found the APFC Incentive Comp Plan to be shorter and simpler than the other plans, but less defined and somewhat more confusing.

Recommendation: I recommend that the Board not adopt an incentive Compensation Plan unless and until we are prepared to provide Board level oversight through one or more Board Committees focused on performance and compensation. As part of the process of establishing these Committees, the Board should review charter documents from other similar organizations. Committee oversight would likely include:

- Reviewing and approving targets
- Reviewing and approving Benchmarks
- Reviewing and approving Risk Management controls, including the appropriateness of risk control ranges in the context of the incentive comp plan.

Additional Comments: Further, there are additional differences between plans in other respects that do not rise to the same level of concern but are nevertheless worthy of consideration. Below are a summary of a number of elements that might be useful to consider including within our plan:

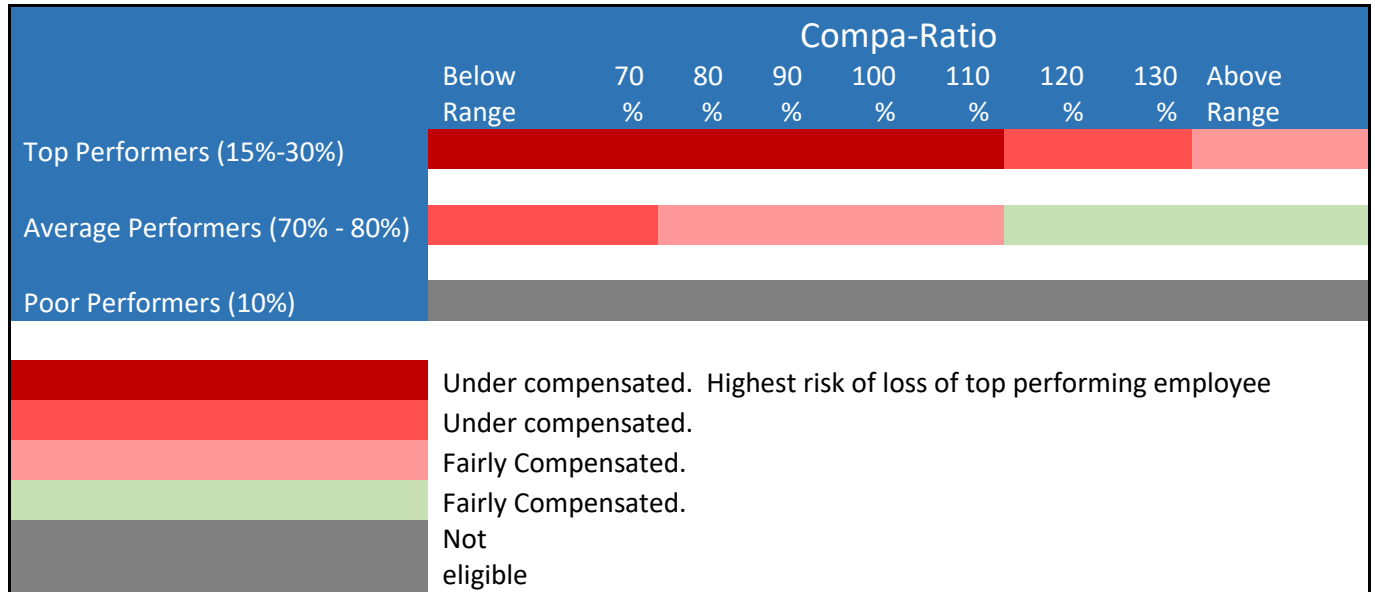
- Top Quartile Performance. The Wisconsin Plan explicitly attempts to align 100% incentive upon achieving “top-quartile” performance.
- Eligibility. The CalSTRS plan included Tenure as part of the eligibility criteria. An employee wasn’t fully eligible until after 3 years of employment.
- Qualitative element. All of the other plans incorporate some qualitative component to the incentive compensation.

In the past, I have urged that our compensation plan – including the incentive comp plan – be targeted on reward and retaining the key contributors that are driving APFC success. The lack of a Qualitative overlay to the plan makes this difficult. I recommend we adjusted the plan to ensure that our “Top Performers” are well compensated when compared to peers. This may mean that average performers may not be as well compensated – and as a result, we may experience some attrition among average performers. Appendix 1 can be a guide when considering allocating scarce compensation among staff.

Summary of Key Terms:

Category	APFC Proposal	CalPERS	CalSTRS	Wisconsin
Governance	Executive Director Administers Plan with "full discretion to conclusively decide all questions or matters..." (p.19)	Performance, Compensation and Talent Management Committee Oversight (PCTMC)	Compensation Committee Oversight	"The incentive compensation plan is rigorously managed" by the Compensation Committee. P.1 Wisconsin also utilizes a Benchmark Committee (p.8)
Risk Management	All plans are designed around the general philosophy that providing for extended investment performance period allows additional time for adverse risk outcomes to be identified before incentive awards are paid.			
	80% weighted to 5 yr performance 20% weighted to 1 yr performance	5 years 3 years public assets at portfolio level (See Appendix 2 - Page 20)	3 yrs	Generally: 85% weighted to 5 yr performance 15% weighted to 1 yr performance Multi-Asset Strategy: 75% weighted to 5 yr performance 25% weighted to 1 yr performance
Discretion	Silent	Non-adherence to risk management principles, etc. or adverse risk outcomes will reduce or eliminate incentive awards	Upon the occurrence of a defined "Trigger" the plan and reduce, eliminate or defer the award (p.16): -Poor Returns -Ethics violations Triggers -Reputational Risk Triggers	Variation from established risk guidelines will result in reduced or forfeiture of award. (p.12)
Quantitative	Above defined benchmark levels	Above defined benchmark levels	Above defined benchmark levels	100% achievement aligned with top quartile performance (p. 5, 9) Depending on position, includes: - Portfolio Component (e.g. Small Cap) - Asset Class Component (e.g. Public Equities) - Fund Performance (See Page 7)
Incentive Targets	Vary based on expected volatility While all plans follow a similar pattern, there are differences in the thresholds	Vary based on expected volatility	Vary based on expected volatility above benchmark performance necessary to earn an incentive compensation.	Vary based on expected volatility.
Qualitative Awards	None	Yes	Based on discretionary assessment of performance. 20-30% of total Award (see p. 10, 12)	Based on discretionary assessment of performance. 10% - 30% of total award (See p. 7)
Eligibility	Good Standing ("not being disciplined and/or ... not on a performance improvement plan" p.19)		Full Eligibility includes tenure (fully eligible after 3 years p.8)	Overall satisfactory Performance
Authority	Deemed part of authority to determine compensation.		Deemed part of authority to determine compensation.	Incentive Plan is authorized in Statute
Errors	Silent	Silent	Silent	Right to recover awards given in error

Appendix 1



1.3. Total Fund Performance

Risk-based Incentive Strategies

Expanding the incentive curve and changing its slope are fully consistent with "best practice" risk-based incentive strategies, offering "belt and suspenders" to other actions that the PCTMC has approved or will consider for future implementation

Suggested Action for FY16-17(Recap)

Best Practice Strategy	CalPERS's Approach	FY16-17	Future Consideration
1) Those with risk oversight responsibilities should not be paid under the same programs as those they oversee	Carve-out of COIO and CFO and their teams	✓	
2) Multiple metrics	CEO and CIO will earn incentives based on four to five performance categories; other participants will earn incentives across two to five performance categories	✓	
3) Risk-based incentive metrics	Non-adherence to risk management principles, etc. or adverse risk outcomes will reduce or eliminate incentive awards for involved individuals	✓	
4) Extend performance period, allowing more time for adverse risk outcomes to become known	Move from three-years to five years for Total Fund and Asset class level incentives	✓	
5) Reduce performance leverage/acceleration	Expand performance range, reducing slope	✓	
6) Effective use of discretion to avoid unintended windfalls or incentive outcomes that contradict risk outcomes/considerations	Authorize CEO and CIO (with CEO approval) to make discretionary adjustments to incentive awards	✓	
7) Deemphasize value of variable compensation in relation to total compensation	Maintain total compensation levels but rebalance fixed and variable, deemphasizing performance-based pay in total compensation (e.g., "rebalancing" strategy)		✓
8) Deferred compensation with claw backs for adverse risk outcomes	Incremental long-term incentive plan where account balances are adjusted for Total Fund performance and subject to cancellation for non-adherence, etc.		✓

Appendix3

Quantitative Measures - Performance-Award Scales ¹					
% of Maximum Incentive Earned	Performance Standards		% of Maximum Incentive Earned	Performance Standards	
	Minimum ²	Maximum ²		Minimum ²	Maximum ²
	10%	100%		10%	100%
Core Trust Fund (Net of Fees)	(bps)	(bps)	Public Equities (Net of Fees 2013 and after)	(bps)	(bps)
	>=1	.. 48			
Core Trust Fund (Net of Fees 2013 and after)	>=1	.. 60	Large Cap Global 2010	>=1	.. 75
Asset Class (Net of Fees 2013 and after)			Large Cap Global 2011	>=1	.. 100
Public Equity	>=1	.. 45	Large Cap Global 2012	>=1	.. 120
Public Equity 2013 and after	>=1	.. 80	Large Cap Global 2013 and after	>=1	.. 200
Fixed Income	>=1	.. 24	Health Care 2008	>=1	.. 140
Fixed Income 2013 and after	>=1	.. 40	Health Care 2013 and after	>=1	.. 200
Real Estate	>=1	.. 150	International	>=1	.. 120
Real Estate 2013 and after	>=1	.. 200	Small Cap 2009 and after	>=1	.. 180
Private Equity	>=1	.. 150	Small Cap Diversified	>=1	.. 180
Private Equity 2013 and after	>=1	.. 200	Small Cap Diversified 2013 and after	>=1	.. 200
Internal Equity 2014 and after	>=1	.. 100	Utilities	>=1	.. 105
Internal Equity 2016 and after	>=1	.. 200	Utilities 2013 and after	>=1	.. 200
Internal Fixed Income 2014 and after	>=1	.. 18	Consumer Staples	>=1	.. 130
Internal Fixed Income 2016 and after	>=1	.. 25	Consumer Staples 2013 and after	>=1	.. 200
Multi-Asset Strategy (Net of Fees 2013 and after)			Telecommunications	>=1	.. 125
Risk Arbitrage	>=1	.. 100	Telecommunications 2013 and after	>=1	.. 200
Risk Arbitrage 2015 ⁴	>=1	.. 275	Energy	>=1	.. 140
SWIB Alpha Portfolio 2016 and after	>=1	.. 275	Energy 2013 and after	>=1	.. 200
Global Securities Portfolio 2016 and after	>=1	.. 145	Financials	>=1	.. 140
Public Fixed Income (Net of Fees 2013 and after)			Financials 2013 and after	>=1	.. 200
Government Credit	>=1	.. 20	Materials	>=1	.. 145
Government Credit 2013 and after	>=1	.. 40	Materials 2013 and after	>=1	.. 200
Global	>=1	.. 30	Consumer Discretionary	>=1	.. 150
Global 2013 and after	>=1	.. 40	Consumer Discretionary 2013 and after	>=1	.. 200
Global Bond Analyst Ex-Credit 2014 and after	>=1	.. 30	Industrials	>=1	.. 150
State Investment Fund 2008 and after	>=1	.. 10	Industrials 2013 and after	>=1	.. 200
Short Term Credit Portfolio 2015 and after	>=1	.. 11	Technology	>=1	.. 170
Private Markets and Funds Alpha (Net of Fees 2013 and after unless noted)			Technology 2013 and after	>=1	.. 200
Combined Real Estate Equity	>=1	.. 150	Shareholder Opportunity	>=1	.. 200
Combined Real Estate Equity 2013 and after ³	>=1	.. 200	Consolidated Global Sector 2014 and after	>=1	.. 100
Real Estate Funds	>=1	.. 150	Consolidated Global Sector 2016 and after	>=1	.. 200
Real Estate Separate Accounts	>=1	.. 150			
Real Estate Transition Portfolio	>=1	.. 150			
NML Real Estate Mortgages	>=1	.. 30			
Current Return	>=1	.. 90			
Current Return 2013 and after	>=1	.. 120			
Private Equity	>=1	.. 150			
Private Equity 2013 and after	>=1	.. 200			
Private Equity April 2016 and after	>=1	.. 250			
Wisconsin Private Equity	>=1	.. 150			
Wisconsin Private Equity 2013 and after	>=1	.. 200			
Private Equity Legacy	>=1	.. 150			
Private Equity Legacy 2013 and after	>=1	.. 200			
Wisconsin Private Debt	>=1	.. 30			
Wisconsin Private Debt 2013 and after	>=1	.. 40			
Private Debt 2015 and after	>=1	.. 40			
Private Equity Co-Investments 2016 and after	>=1	.. 300			
Hedge Fund Consolidation 2016 and after	>=1	.. 275			
External Managers Consolidation 2016 and after	>=1	.. 125			
Risk Parity 2016 and after	>=1	.. 175			
Venture Capital Portfolio 2016 and after	>=1	.. 300			

¹ In cases when the scale of a portfolio or other scaled component moves from one basis point maximum to a different basis point maximum, a time weighted average of the components will be calculated and applied. In addition, if it is necessary to blend basis point scales for the same time period, that will be done on a dollar weighted basis.

² Intermediate points are interpolated.

³ 2013 Net ODCE less 40 bps
2014 Net ODCE less 30 bps
2015 Net ODCE less 20 bps
2016 Net ODCE less 10 bps
2017 Net ODCE

⁴ See March 11, 2015 Compensation Committee/Board Materials and SIS's February 6, 2015 memo. Tentative start date of this hurdle is end of Q1 2015; ultimately, it is to coincide with the completion of the alpha/beta overlay. November 2015 update: alpha/beta overlay completed as expected end of March 2015.

02b_APFC Incentive Comp Policy

Alaska Permanent Fund Corporation ("APFC")
Incentive Compensation Plan - Investment Staff

AUTHORITY

On May 24, 2018, the Board of Trustees of the Alaska Permanent Fund Corporation (the "Board") adopted Resolution 18-02, which modified the compensation for the Investment Staff and Chief Investment Officer ("CIO") to provide for a base salary plus an annual incentive compensation targeted at the median total cash compensation provided to the APFC peer equivalent. This document specifies the policies and procedures related to the administration of this modified compensation plan ("Plan") for the Investment Staff and CIO ("Participants").

OBJECTIVES

As outlined by the Board in Resolution 18-02, the modified compensation plan is designed to:

1. Help attract and retain world class investment professionals;
2. Help APFC earn the highest possible investment returns at a reasonable cost and at controlled levels of risk;
3. Reward long-term investment performance that reflects the Alaska Permanent Fund's aspiration to achieve above-benchmark, net of fees performance (as measured in basis points and the corresponding dollars of excess value added);
4. Motivate Participants to make sound decisions for the Fund, including implementation decisions related to asset allocation;
5. Foster a collaborative approach to investing APFC's assets under management; and
6. Reward measurable and achievable performance.

ADMINISTRATION AND MANAGEMENT

Because the funds needed to implement this annual compensation plan are contingent upon an annual appropriation by the Legislature, the policies and procedures described in this document are not a contract, guarantee of payment, guarantee of participation in the incentive plan in subsequent years, or guarantee employment among APFC and the Participants. Notwithstanding any other provision in this Plan and regardless of any incentive compensation award calculations hereunder, no incentive compensation award shall be made unless amounts have been included in a Board approved budget, appropriated by the Alaska Legislature and signed into law by the Governor of Alaska.

The Executive Director will implement and administer this Plan and may delegate certain administrative responsibilities to other senior managers at APFC, including the Director of Human Resources.

Participants may present questions related to the Plan to the Director of Human Resources. Under the Executive Director's direction, the Director of Human Resources will work with the appropriate persons to answer such

questions. The Executive Director will have full discretion to conclusively decide all questions or matters relating to the interpretation of the provisions and administration of this Plan.

Amendments or changes to the Plan may be proposed by the Executive Director but must be approved by the Board.

As provided in Resolution 18-02, positions at APFC eligible to participate in the Plan are regular, full- time positions classified by the State of Alaska as Chief Investment Officer, Investment Officer or Investment Associate.

By December of each year, the Executive Director will consult with the Board to confirm any new APFC investment positions that will be eligible to participate in the Plan during the next fiscal year.

For all Participants, an incentive compensation award is contingent on a Participant be in good standing on the day of payment. "Employment in good standing" means the Participant is not being disciplined and/or the Participant is not on a performance improvement plan.

INCENTIVE COMPENSATION POOL

For budgeting purposes, the annual total Plan Participants' incentive compensation pool is equal to 50% of the prior fiscal year's total base salaries of the Plan Participants.

AVAILABILITY OF QUANTITATIVE INCENTIVE POOL FOR DISTRIBUTION

The annual award of incentive compensation to Plan Participants is contingent on the Fund exceeding its short term and long term policy benchmarks, net of fees, as defined by the Investment Policy adopted by the Board and associated Investment Guidelines.

AWARDS TO INDIVIDUALS

Contingent upon funding and the Fund achieving its short term and long term policy benchmarks, the award of incentive compensation to individual Plan Participants, with weights varying by responsibilities, is provided in the chart below:

Title	Total Fund Weight	Asset Class Weight	Percent of Salary Eligible
Chief Investment Officer	100%	0%	50%
Director – Asset Class	50%	50%	50%
Senior Portfolio Manager	45%	55%	50%
Portfolio Manager	40%	60%	35%
Senior Portfolio Analyst	35%	65%	25%
Analyst	25%	75%	15%

The following performance bands, weighted 80% to five-year performance and 20% weighted to one-year performance, will be applied to determine the percentages of "Total Fund Weight" and "Asset Class Weight" that each Plain Participant will be awarded:

	Outperformance	Credit
Total Fund	100 bp or more 50 bp 0 bp	100% 50% 0%
Public Equities	100 bp or more 50 bp 0 bp	100% 50% 0%
Fixed Income Plus	50 bp or more 25 bp 0 bp	100% 50% 0%
Private Equity & Special Opportunities	200 bp or more 100 bp 0 bp	100% 50% 0%
Real Estate, Infrastructure & Private Income	100 bp or more 50 bp 0 bp	100% 50% 0%
Absolute Return	50 bp or more 25 bp 0 bp	100% 50% 0%
Asset Allocation	50 bp or more 25 bp 0 bp	100% 50% 0%

- Intermediate points will be interpolated

If with respect to any performance year the absolute investment return, gross of fees, for the Fund for which a Participant is eligible is negative no payment of incentive compensation will be paid.

The following examples are for Illustrative Purposes:

Example A

Director – Private Equity

Base Salary = \$200,000

Max Bonus Award = \$100,000 (50% of \$200,000)

Assume the following performance:

	Short Term	Long Term
Total Fund Performance	75 bp	150 bp
PESO Asset Class Performance	300 bp	100 bp

Calculation:

	Short Term	Long Term
Total Fund Performance	$(0.75 \times 20 \times .50) = 7.5$	$(1.00 \times 80 \times .50) = 40$
Asset Class Performance	$(1.00 \times 20 \times .50) = 10$	$(0.50 \times 80 \times .50) = 20$
Total Points	17.5	60

Total Points = 77.5 out of possible 100

Total Bonus = $77.5\% \times \$100,000 = \$77,500$

Total Cash Compensation =\$277,500

Example B:

Analyst – Private Equity

Base Salary = \$80,000

Max Bonus Award = \$12,000 (15% of \$80,000)

Assume the following performance:

	Short Term	Long Term
Total Fund Performance	75 bp	150 bp
PESO Asset Class Performance	300 bp	100 bp

Calculation:

	Short Term	Long Term
Total Fund Performance	$(0.75*20*.25) = 3.75$	$(1.00*80*.25) = 20$
Asset Class Performance	$(1.00*20*.75) = 15$	$(0.50*80*.75) = 30$
Total Points	18.75	50

Total Points = 68.75 out of possible 100

Total Bonus = 68.75%*\$12,000 = \$8,250

Total Cash Compensation =\$88,250

PROCESS FOR THE DIRECTOR OF HUMAN RESOURCES

The Director of Human Resources, in consultation with the Executive Director and each Participant's manager, will determine the amount of each of Participant's incentive compensation award pursuant to the Plan.

AWARD LIMITS

The maximum incentive award that may be awarded to an individual employee shall not exceed 1.50 times an individual's previous year's total compensation.

AWARD AND PAYMENT DATES

Incentive compensation awards will be determined and authorized as soon as practical following the close of each fiscal year. Contingent upon having access to the Fund performance information needed to complete the calculation, annual incentive awards for the prior year should be completed during the first six months of each fiscal year.

APFC and the State of Alaska shall be entitled to withhold or deduct, as applicable, from the amount of any payment under this Plan or any other compensation due to the Participant, all federal, state, city and other taxes and all other amounts, as applicable.

PRO-RATA PERFORMANCE AWARDS

Individuals who begin employment or who are appointed or transferred to positions eligible under this Plan, after the start of the fiscal year, may still receive a portion of the total potential incentive compensation amount, to be determined by the Executive Director, based upon the percentage of the fiscal year that they were employed in the position eligible for incentive compensation under the Plan. Individuals must be in an eligible position for at least one calendar quarter to participate in the Plan.

ELIGIBILITY UPON TERMINATION

Employment at APFC, in good standing on the day of payment, is a pre-requisite for receiving any approved incentive compensation payment. In the case of retirement, disability or death of a Participant occurring during the fiscal year, the potential incentive amount may be paid to the Participant, the amount to be determined by the Executive Director, based on the time worked during the fiscal year (using exact office dates, not payroll dates). These payments will be made at the same time as any other incentive compensation award.

GOVERNING LAW

The Policy shall be construed and interpreted according to the laws of the State of Alaska to the extent such laws are not preempted by federal law.

03_Legislative Initiatives Memo

SUBJECT: Legislative Initiatives

ACTION: X

DATE: October 17, 2018

INFORMATION: _____

Outlined below are three issues the Corporation has identified that would require legislation to address. The goal of this agenda item is to generally discuss each of these issues and solicit feedback from the Board on which issues, if any along with any others not listed below, you would support advancing to the Legislature for consideration in the upcoming legislative session:

1. Procurement

- a. **Issue**-When APFC staff is making an investment using permanent fund (Fund) assets (i.e. exercising its investment powers) the state procurement code does not apply to such investments. That said, to complete the investment due diligence process and then monitor investments, APFC typically contracts with vendors to assist them in this process and the state procurement does apply to these contracts. Because these investments opportunities must often be completed within a relatively short time frame and often involve proprietary information, application of the state procurement code (with built in timelines and the public process/transparency process) hinders APFC's ability to quickly and efficiently contract with vendors needed to assist APFC staff when directly investing Fund assets.
- b. **Proposed Solution**-request an exemption from the state procurement code for APFC contracts where the work to be performed is related to the investment and monitoring of assets managed by APFC.
- c. **Proposed sample language**-
"AS 36.30.850(b) is proposed to be amended by adding a new subsection to read:
(49) a contract of the Alaska Permanent Fund Corporation to provide investment related services for assets managed by the Alaska Permanent Fund Corporation."

2. Inflation Proofing

- a. **Issue**-The passage of SB 26 preserved in laws the existing language for inflation proofing the Fund and the FY19 Operating Budget included an estimated amount for inflation proofing the current year. Inflation proofing was not appropriated for FY16, FY17 or FY18. Any amount for FY20 and beyond is subject to appropriation and continues to be a risk for the Fund. Given the Trustees' stated goal to preserve the

purchasing power of the Fund for future generations, a more permanent, long-term solution may be in order.

- b. **Proposed Solution**-While there are numerous ways to achieve this goal, a simple solution would be to modify the current method of calculating annual net income of the Fund to hold the corpus of the Fund harmless from the effects of inflation just like we currently use realized gains to offset realized losses.

- c. **Proposed sample language-**

“AS 37.13.140 is proposed to be amended to read:

Net income of the fund shall be computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding: **(1) any unrealized gains and losses; and (2) an amount to be transferred annually to the principal of the fund to offset the impacts of inflation.**”

3. **Corporation Budget (AS 37.13.150)**

- a. **Issue**-Under existing law APFC must seek an annual appropriation of Fund earnings to cover both the costs of operating the corporation and the costs associated with external managers that are not paid out of the investment proceeds that we have hired them to manage (i.e. public equity managers). APFC continues to believe it is time to find a new budget paradigm that will allow the Fund and its managers to continue operating. Two proposed solutions are outlined below:

- b. **Preferred Proposed Solution**-The most effective solution would be to request a change to APFC’s investment authority so that *all* investment related costs could be financed with Fund assets (i.e. be a direct cost of the investment) rather than being funded with Fund earnings through an annual appropriation. To be clear, this is already how our private market investments are structured. This proposed change would include both costs associated with external managers (i.e. public equity managers), as well as the costs of operating the corporation (i.e. APFC operating budget). All of these investment costs would be tracked and reported to ensure transparency on how much was spent while investing the assets of the Fund.

- c. **Proposed Sample Language-**

“AS 37.13.120(a) is proposed to be amended to read:

(a)The board shall adopt regulations specifically designating the types of income producing investments eligible for investment of fund assets, **including the internal and external costs associated with making and managing these investments.**

AS 37.13.150 is proposed to be repealed.”

d. **Alternate Proposed Solution**-If the Board, Administration, or Legislature prefers the status quo (i.e. Fund earnings and annual appropriation used to cover APFC's internal and external budget (except private market investments)), we could request the Legislature approve APFC's budget two fiscal years in advance. For example, while the Legislature is working on the FY20 budget for state government APFC would request an appropriation for FY21. So, if come June 30, 2019 the Legislature has not yet approved a budget for FY20, APFC will avoid being swept up in a potential government shutdown because APFC's FY21 budget will have been approved in the FY20 budget.

e. **Proposed Sample Language-**

"AS 37.13.150 is proposed to be amended to read:

The revenue generated by the fund's investments must be identified as the source of the operating budget of the corporation **and should be included in the state's operating budget two fiscal years in advance of the fiscal year in which the operating budget is being considered** [in the state's operating budget under AS 37.07 (Executive Budget Act)]. **The operating budget of the corporation shall be developed and approved by the board and is exempt from the Executive Budget Act under AS 37.07.** The unexpended balance of the corporation's annual operating budget does not lapse at the end of the fiscal year but shall treated as income under AS 37.13.140.

03a_Fund Transfers Resolution 18-04

Alaska Permanent Fund Corporation

RESOLUTION OF THE BOARD OF TRUSTEES OF THE ALASKA PERMANENT FUND CORPORATION RELATING TO A SUSTAINABLE RULES BASED LEGAL FRAMEWORK FOR FUND TRANSFERS

RESOLUTION 18-04

In 2018 the Alaska Legislature passed and the Governor signed into law SB 26, Chapter 16 SLA 18, an important first step in codifying a set of rules to establish a sustainable annual draw from the earnings of the Permanent Fund. The Alaska Permanent Fund Corporation Board of Trustees (Board) provides the following guidance on a rules based framework around fund transfers to help ensure the long-term success and sustainability of using Permanent Fund earnings for the benefit of all generations of Alaskans:

- 1. Adherence to a Rules Based System for Fund Transfers:** Resolution 18-01 of the Board states the importance of following a rules-based legal framework for withdrawals and savings into the principal and Earnings Reserve Account of the Permanent Fund. That rules-based framework includes adhering to the formulaic calculations provided for in statute for transfers into and out of the Permanent Fund, such as dividends, royalty deposits, and inflation proofing. As explained in the Resolution 18-01, adherence to the rules increases the likelihood that systematic draws from the Permanent Fund will be sustainable over time and will allow for more prudent investment of the Permanent Fund due to the predictability of liquidity needs.
- 2. Ensure Sustainability:** Any rules-based system for drawing from the Permanent Fund (to support government spending or for dividends) should be sustainable, meaning the formulaic system for withdrawals should be projected to result in the Permanent Fund growing annually by at least the rate of inflation. Under the statutory framework currently in place, sustainability also requires annual formulaic withdrawals from the Earnings Reserve Account at an amount that the long-term balance of the account is able to fund. The Board has long supported the percent of market value (POMV) concept, including a constitutional amendment that would ensure no more than a sustainable amount was taken from the annual earnings of the Permanent Fund (Resolutions 00-13, 03-05 and 04-09). SB 26 institutes an annual POMV draw from the Earnings Reserve Account to the general fund that is based on 5.25 percent (going to 5.0 percent in fiscal year 2022) of the average market value of the Permanent Fund for the first five of the preceding six fiscal years. Current market projections applied to the asset allocation of the Permanent Fund suggest annual draws as set forth in SB 26 are sustainable over the long-term. That said, the Board recommends instituting a process that would require periodic review of these assumptions as market conditions change so that a timely reduction to the annual draw could be effectuated if necessary to maintain the long-term sustainability of the Earnings Reserve Account.
- 3. Automatic Inflation Proofing:** To ensure that the purchasing power of the principal is maintained as set forth in Alaska Statutes 37.13.020 and 37.13.120(a), an annual transfer of realized income from the Earnings Reserve Account to the non-spendable principal of the fund must occur. The Board has expressed its supports for ensuring that this annual inflation proofing transfer take place (Resolution 17-01). Traditionally inflation proofing happened through an annual appropriation by the Legislature consistent with the provisions of Alaska Statute 37.13.145(c), but for fiscal years 2016, 2017 and 2018 the transfers were not made. The Board believes that the inflation-proofing transfer should become a guaranteed annual event rather than a discretionary transfer that is subject to appropriation. To achieve this goal, the Board supports passage of

legislation that would define net income to require realized gains that are accumulated throughout the fiscal year be used to offset the impact of inflation on the principal of the fund with the remainder of net realized gains being accounted for in the Earnings Reserve Account.

4. **Promote Real Growth When Possible:** While providing for a sustainable draw by preserving the purchasing power of the fund and ensuring a durable Earnings Reserve Account is a primary goal of the Board, recognizing and executing on opportunities to grow the real value of the fund is also important. Real growth will not only result in more income and thus higher sustainable draws for dividends and governmental expenditures in the future, it is necessary to preserve intergenerational wealth as Alaska continues extraction of its finite natural resources. Thus the Board supports thoughtful strategies to grow the fund on a real, and not just nominal, basis. For instance, the Board encourages a revisitation of the dialogue during the debate on SB 26 about instituting a mechanism to reduce the annual draw on the fund during years when state revenues are sufficient to fund government services. In addition to reducing draws during years where oil and gas revenues are high, real growth could also be achieved by increasing the amount of royalties that are annually deposited into the principal of the fund. Setting up the rules for when and how Permanent Fund earnings and oil and gas revenues should be used to promote real growth should occur in the near term while oil and gas revenues are still substantial enough to provide meaningful options for real growth of the fund.

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 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 day of _____, 2018.

/s/

Craig Richards
Chairman, Board of Trustees

Alaska Permanent Fund Corporation

ATTEST:

/s/

Angela M. Rodell, Corporate Secretary