

To: Chris Cooke, Chair
Through: Mike Abbott, Chief Executive Officer
From: Carol Howarth, Chief Financial Officer
Date: March 23, 2021
Re: Finance Committee Report 3/5/21

REQUESTED MOTION:

The Board of Trustees approves the designation of up to \$120,280,300 of Alaska Mental Health Trust earnings as principal for the purpose of inflation proofing. The Board of Trustees authorizes the Chief Financial Officer to designate \$50,000,000 as soon as practicable, and designate, before the close of FY21, the amount necessary to achieve the total designation that will maintain a year end FY21 budget reserve balance of at least 400% of the FY21 payout, or \$96,628,400.

Meeting Summary:

There has been one meeting of the Finance Committee since the last board report, occurring on March 5, 2021. The meeting was attended via the online WebEx platform by trustees Chris Cooke (designated chair), Vernè Boerner, Rhonda Boyles, Chris Cooke, Annette Gwalthney-Jones, Brent Fisher and John Sturgeon. Anita Halterman was excused from the meeting.

The meeting of the Finance Committee was called to order by Chairman Cooke at 1:30 pm to address a motion recommending a formal designation and transfer of budget reserves to principal for the purpose of inflation proofing.

Motion: The Finance Committee recommends that the board of trustees approve the transfer of \$120,280,300 from the Alaska Mental Health Trust Authority budget reserve account to the Alaska Mental Health Trust Authority principal account managed by the Alaska Permanent Fund Corporation.

The motion was presented by Trustee Boyles and seconded by Trustee Sturgeon.

Mike Abbott provided an overview of past inflation proofing discussions, highlighting that Trustees had the authority by statute and by the Asset Management Policy Statement to use budget reserves for the purpose of inflation proofing when reserves exceed 400% of approved spending. He noted that the Trust was in a strong financial position. He also noted that the Governor has proposed use of an additional \$16MM of Trust Reserves in the near term, and another \$50MM in subsequent years.

It was noted by both Chair Cooke and Mr. Abbott, and observed by other Trustees, that at the Senate Finance Committee presentation, senators had expressed a level of concern that the Trust had not been more consistent with the annual transfer of funds to principal for the purpose of inflation proofing.

Carol Howarth explained that Trustees had a choice in the method of protecting Trust purchasing power. They could use the endowment method, where purchasing power would be protected by following the Trust's spending and reserve discipline. Or, following the traditional principal & interest model, a permanent designation of funds, as proposed in the motion, could be used for inflation proofing. She noted that using the endowment model at the end of FY20 there was a shortfall of \$33.6MM and that as of December 2020, with the market recovery, there was a \$23.5MM surplus. Under the principal & interest model, a designation of \$107MM was required to protect the purchasing power of the Trust Fund at the end of FY20 and that amount had increased to \$120MM by December 2020.

The Trustees commented and asked a number of questions for clarification.

Trustee Boyles asked for perspective on the history of using the endowment method. Ms. Howarth explained that up to 2009, earnings in excess of 400% were transferred. In 2009 there was a shift towards the endowment model: spending based on net asset value to support long-term beneficiary needs and reserves leveling out near-term needs. She noted that the Governor's proposed additional spending exceeded the Trust's 4.25% spending policy.

Trustee Sturgeon's comments focused the message from members of the Senate Finance Committee regarding inflation proofing, and on being proactive in communicating the Trust's intent. His questions centered on the impact of inflation proofing on available reserves should there be a large market decline. Mr. Abbott assured Trustees that under a market decline, there would be reserves available to support spending.

Trustee Gwalthney-Jones question involved assurance that Budget Reserve commitments were considered.

Trustee Fisher requested three tables showing the inflation proofing effects over time 1) principal, 2) reserves, and 3) a combined chart. There was assent that this could be made available before final board action.

Trustee Cooke asked if it was a recommendation to set up a regular practice of inflation proofing. Mr. Abbott assented that he would like Trustees to consider it. Trustee Cooke expressed that the action would not eliminate all reserves, and the Trust would still get benefit of annual withdrawal from reserves; if taken and spent in other ways, it would affect the income and spending; and the Senate Finance Committee wanted the Trust to proceed with inflation proofing. The inflation proofing action would ensure the sustainability and permanence of the fund, side-step legal issues, and avoid a confrontation.

Trustee Boerner noted that Trustees had been raising the topic of inflation proofing but not acting on it, and requested that Mr. Abbott provide Trustees with perspective. Mr. Abbott discussed the history, noting that in May the target had been below 400% and has since recovered. Trustee Boerner noted that inflation proofing had been a consideration for awhile and this was the right time to inflation proof.

Trustee Boyles commented that from listening to the Senate Finance Committee discussion, she questioned legislators' understanding of the Trust and the role of the Trust, and commented on the importance of inflation proofing. Trustees Boyles and Sturgeon commented that Trust's policy adherence kept Trust spending within its means, contrasting the Trust with the State of Alaska. There was general agreement by all Trustees.

Trustee Sturgeon called the question. The motion passed unanimously.

Chair Cooke expressed his desire to have a special board meeting at the end of March and instructed Mr. Abbott and Ms. Smith to take action to schedule the meeting.

The Finance Committee adjourned at 2:22 pm. The next scheduled meeting of the Finance Committee is ***April 21, 2021.***

Board to Action 3/30/21