

**ALASKA MENTAL HEALTH TRUST AUTHORITY
AUDIT & RISK COMMITTEE
April 25, 2024
12:15 p.m.**

**Hybrid Meeting:
Alaska Mental Health Trust Authority
3745 Community Park Loop, #200
Anchorage, Alaska 99508**

Trustees Present:

Anita Halterman, Chair (Virtual)
Kevin Fimon
Agnes Moran (Virtual)
John Sturgeon
John Morris
Rhonda Boyles

Trust Staff Present:

Steve Williams
Katie Baldwin-Johnson
Miri Smith-Coolidge
Michael Baldwin
Julee Farley
Allison Biastock
Valette Keller
Kelda Barstad
Luke Lind
Debbie DeLong
Carrie Predeger
Janie Ferguson
Eliza Muse
Eric Boyer
Heather Phelps
Janie Ferguson
Tina Volker-Ross
Kat Roch

Trustee Land Office staff present:

Jusdi Warner
Sarah Morrison
Jeff Green
Tracy Salinas
Blain Alfonso
Peter Mueller
Mariana Sanchez
Heather Weatherall

Also participating:

Ann Ringstad; Brenda Moore; Lisa Cauble; Paul Cornils; Philip Licht; Stephanie Kings; Kathi

Trawver; John Springsteen; Patrick Reinhart; Justin Slaughter; Alyssa Bish; Jena Crafton; Rod Shipley; Tony Newman; Stephanie Wheeler; Stephanie Hopkins; Valerie Mertz.

PROCEEDINGS

CALL TO ORDER

CHAIR FIMON called the meeting to order and began with a roll call. He asked for any announcements. There being none, he called for a motion to approve the agenda.

APPROVAL OF THE AGENDA

MOTION: A motion to approve the agenda was made by TRUSTEE STURGEON; seconded by TRUSTEE MORRIS.

After the roll-call vote, the MOTION was APPROVED. (Trustee Moran, yes; Trustee Halterman, yes; Trustee Sturgeon, yes; Trustee Morris, yes; Trustee Boyles, yes; Chair Fimon, yes.)

CHAIR FIMON asked for any ethics disclosures. Seeing and hearing none, he asked for a motion to approve the minutes.

APPROVAL OF MINUTES

MOTION: A motion to approve the minutes from January 5, 2024, was made by TRUSTEE STURGEON; seconded by TRUSTEE MORRIS.

After the roll-call vote, the MOTION was APPROVED. (Trustee Halterman, yes; Trustee Moran, yes; Trustee Sturgeon, yes; Trustee Morris, yes; Trustee Boyles, yes; Chair Fimon, yes.)

CHAIR FIMON asked CFO Farley to talk about the APFC Trustees' paper.

ALASKA PERMANENT FUND CORPORATION TRUSTEES' PAPER VOLUME 10

CFO FARLEY stated that the Alaska Permanent Fund Corporation is our primary asset manager, managing the majority of our assets. She continued that anytime they have noteworthy news, we like to track that because it may apply to our investments. They have been in the news since the beginning of the legislative session where they were presenting financial information that they have been making public over the last 10, 15, and I think sometimes every 20 years, regarding some very specific accounting technicalities relating to their two-account structure that could impose restrictions on their ability to have future payouts. At a recent meeting, the trustees voted to release APFC Trustee Paper No. 10, a very informative document. This is provided on an informational basis only to keep trustees informed of any notifications on the accounting structure. The Permanent Fund Corporation handles the accounting for our investments that are in the dashboard that trustees see monthly. She introduced Valerie Mertz, long-term CFO at the Alaska Permanent Fund Corporation, to provide us APFC's perspective of the two-account structure.

MS. MERTZ stated that the Permanent Fund Board of Trustees recently published Trustee Paper No. 10 which is titled "A Rules-Based Permanent Endowment Model for Alaska." The Board of Trustees has long been focused on the stability of the Fund's two-account structure. Beginning in the early 2000s, there have been a series of Board resolutions addressing the issue. Recently, the State's reliance on the POMV transfers to balance the State's budget, combined with a market

environment where we have historically low realized earnings balances, heightened the attention on this issue. The trustees published Paper No. 10 in an effort to educate stakeholders about the inherent problems with this two-account structure and the real risk of depleting the earnings reserve account. The paper was authored by Dr. Malan Rietveld, an internationally recognized expert on sovereign wealth funds. At a high level, the paper suggests four approaches to addressing the issues with the stability of the two-account structure. The first would be to combine the principal and the earnings reserve under a permanent endowment model through modifications to the statute. The statute created the two-account structure, so there is thought that statutes could undo it. The second would be to temporarily, in certain circumstances, suspend inflation-proofing when the earnings or their balance falls below a set minimum level. The third would be to establish a policy of realizing gains when necessary to bolster the realized earnings that are available for appropriation. The fourth would be to amend the State Constitution to establish a single account endowment. Each one of these approaches has drawbacks and challenges. The one that is consistent with the Board's views over the last two decades is amendment to the Constitution to eliminate the concept of principal and earnings reserve. She explained that the statute requires that we account for the Mental Health Trust Fund investments in the same way as we do for the Permanent Fund. There are contributions that flow into the principal of the Fund, which are invested, and over time they generate unrealized gains. They also generate earnings in the form of cash, income, and realized gains as the investments are sold, which flow into the earnings reserve. Like the principal, those earnings are invested and generate realized income, as well as unrealized gains. It is the realized income in the earnings reserve account that is available for appropriation. The big ones transfer to the General Fund for the POMV draw, back to principal for inflation-proofing, and then a small amount to pay for APFC operating expenses. If the inflows to the earnings reserve do not keep pace with those outflows, eventually the balance that is available for appropriation will be depleted; and this is the risk that is really the focus of Trustee Paper No. 10. A single account endowment would look like the principal and earnings reserve have been combined into the Alaska Permanent Fund, and contributions flow directly into the Fund. The investment of the Fund generate earnings, both realized and unrealized, which over time serves to increase the value of the Fund. Outflows are limited to the transfers, the General Fund, and the corporate operating expenses of APFC. There is no longer the inflation-proofing back to principal since principal no longer exists. Under this contract, the risk of not meeting the outflow requirements is eliminated since the earnings reserve limiter is no longer there. Inflation-proofing is accomplished organically by insuring that over the long term, the outflows plus inflation do not exceed the inflows.

CHAIR FIMON asked about the downside of a particular slide. He asked if we changed to that, if there is some risk of taking too much.

MS. MERTZ replied that that is a consideration. If we review the information that the trustees have put out over time, along with the constitutional amendment, there would be some sort of a limiter on the draw; there is a provision for a review periodically to make sure that the real value of those contributions is not eroded. Without the earnings reserve limit, on the one hand, the real return would have to be monitored over time to make sure that too much is not drawn.

CHAIR FIMON remarked that it might be really interesting on a potential year where there are very little earnings.

MS. MERTZ stated that all of this is intended to be viewed over the very, very long term. It is not something to be shifted and changed from year to year.

CHAIR FIMON asked if there were any questions online. Seeing none, he asked Ms. Mertz to continue.

MS. MERTZ looked at the two-account structure as it relates to the Permanent Fund first. As a reminder, the principal of the Permanent Fund was established through a constitutional amendment, which requires that at least 25 percent of the mineral royalties be placed in a fund that is used only for income-producing investments. Therefore, the principal is not available to be appropriated. Subsequent to the establishment of the Fund, the earnings reserve account was established in statute. The purpose of the earnings reserve account was to receive and distribute the realized earnings of the Fund. The amount of the Fund available for appropriation within the earnings reserve is limited to the uncommitted realized earnings. The values on Slide 8 show the various components of the Fund on the right at the end of February, which had a net value of \$78 billion. Shown on the left are contributions in the form of mineral royalties, inflation-proofing, a handful of special appropriations to principal for a total of \$56.8 billion. There is an allocation of unrealized gains of 11.9 billion. This is one of those special accounting rules that was referred to earlier. The Attorney General Opinion requires us to allocate the unrealized gains at the end of every period between principal and earnings reserve, which is done on a monthly basis, both for the Permanent Fund and for the Trust. There have been amounts within the earnings reserve which we call “committed.” They have been set aside: 3.7 billion for the FY25 transfer to the General Fund; 1.4 billion for the FY24 inflation-proofing that will happen at the end of the year; which leaves uncommitted realized earnings of 2.6 billion. The allocation of unrealized gains is 1.6 billion based on the earnings reserve balance relative to the total fund. She continued that next we will look at all of those balances that are considered to be spendable. The spendable balance of the Fund or the amount available for appropriation is the cumulative net realized earnings. At the end of February, that was 2.6 billion. We are projecting at this point for that balance to grow by the end of the year to 3.9 billion. We have already set aside those amounts that we talked about which are accounted for and covered, and taken out of that balance. The cause for concern regarding the durability of the earnings reserve is that the annual outflows for the POMV transfer and inflation-proofing that now total more than \$5 billion realized earnings for the last couple of years have been well below that mark. The buffer in the earnings reserve account has been eroding. Under the two-account structure, without a buffer in the earnings reserve, we could get to the point where we are limited just to current-year earnings to cover any outflow requirements. As discussed, the Constitution protects the principal from being spent by requiring that it be only used for income-producing investments. Also not spendable is the committed portion of the earnings reserve account. Those are the amounts that were talked about earlier that have been set aside: They are already appropriated, or it is highly likely that they will be appropriated, and they are able to be quantified. At the end of February, that total, 5.1 billion, was the amount for the General Fund transfer and for inflation-proofing. Also not spendable are the unrealized gains across both of the accounts. Gains need to be realized in order to be spent.

CHAIR FIMON asked if there were any questions online. Hearing none, he stated that the Trust is pretty much aligned, if not fully aligned, with exactly whatever the rules are through the Permanent Fund. The structure cannot be changed unless it all clearly happens through the Permanent Fund.

MS. MERTZ replied, yes, absolutely. That happens in a couple of different ways in the statute. First is a statute that requires that the principal of the Trust be retained perpetually for investment by APFC. By definition, the Trust also has the concept of principal that is not available. The second piece of that is also in the statute that requires us to account for the Trust’s investments in

the same way as we account for ours.

CHAIR FIMON remarked that the reality of what unrealized gains could be down in the future was probably super hard to project, and sometimes you are the victim of your own success.

MS. MERTZ stated that regarding the portfolio, all of these statutes are very, very old. And the portfolio looked very different early on. The impact at one time was completely just fixed income; bonds that were generating regular interest income all the time. The realized earnings component was much more significant than the unrealized. Part of our issue is we now are operating under modern portfolio theory with not so modern statutory requirements. At the end of February, the Trust Fund was worth 707.5 million. The components of that are 544.6 million in contributions to principal. Allocated to that balance, over 93.7 million in unrealized gains. The various components of the Trust Fund's earnings: there were 27.9 million in realized earnings that had been generated by the investments of the Trust Fund that had not been drawn. In the past, we had deposits that were identified as earnings by the Trust, and so we have accounted for them as earnings even though they were not generated from within the Trust Fund. A total of realized earnings of 59.1 million. Then allocated to those earnings was 10.1 million in unrealized gains. The spendable portion of the Trust Fund balance consists of the two pieces of realized earnings, about 27.9 that has been generated by the investments, and then the 31.2 that has been deposited from outside of the Trust Fund. Alaska Statute 37.14.035 requires that the principal of the Trust Fund be retained perpetually for investment by APFC, so it is, therefore, not spendable. Similar to the Permanent Fund, unrealized gains across the portfolio are not spendable until they are actually realized. The Trust is in the same situation as the Permanent Fund in that outflows are limited to the balance of realized earnings. At the end of February, the Fund had cumulative realized earnings of 711.9 million, and cumulative draws of 684 million, which leaves the balance of net realized earnings. During FY19 through '23, the Trust drew from realized earnings a total of 217 million; 99 million of that was in the form of draws to the Trust Authority, and 118 million represented transfers from earnings to principal that was done at the direction of the Trust Board. During that same time, when 217 million was being drawn, realized earnings flowing in totaled about 185 million. Similar to the Permanent Fund over this more recent period of time, the draws have exceeded the earnings. This highlights the fact that many of the same concepts the Permanent Fund trustees brought forth in Trustee Paper No. 10 regarding the Permanent Fund are also applicable to the Trust Fund, and it highlights why our trustees feel it is important to be focused on these issues, particularly right now.

CHAIR FIMON asked Ms. Mertz if she gets a sense that there is maybe more hesitancy, in light of what has been focused on these last couple of years, for anyone to do inflation-proofing unless maybe they are forced to.

MS. MERTZ replied that we feel that inflation-proofing is very important, and in the two-account structure, unless the principal balance is replenished, it will be eaten away by inflation. Also, under the two-account structure, at any time that money is transferred out of realized earnings, that is making it less durable. It is a tricky balance. There is conversation even within the '25 budget discussion that inflation-proofing was in, and then it was out, and then it was in. It is something that everyone is struggling with. It reinforces the importance of really considering changing the fundamental structure of the way that we are accounting for everything.

MS. FARLEY stated that the inflation-proofing that has been done by the Trust and by the Permanent Fund trustees under the proposed endowment model would cease. And the way that the funds would be inflation-proofed is through long-term returns. It was shown in yesterday's

Finance Committee packet. Since inception, the return on the Alaska Permanent Fund Corporation has been 7.7 percent, and over that same period, since our funds are managed by the Permanent Fund Corporation, inflation has been 2.5 percent. Their long-term returns are more than keeping up with inflation. The returns keep up with inflation, and they also fund our payout. But through the endowment model, there would be no need to designate an inflation-proofing amount annually because that would be realized through the long-term investment returns.

CHAIR FIMON noted that that was a very good point, and asked for any questions.

TRUSTEE BOYLES asked if there is ever going to be a change in the Permanent Fund structure.

MS. MERTZ answered that we hope so. A Constitutional amendment is a heavy lift. It takes approval by the Legislature, and then it goes out to a vote of the people who have to support it. If the current market environment does not improve, we may be forced to do something. Once that realized earnings balance goes to zero, there just is not anymore. It has been talked about at all levels, but only recently that there has been any real risk of what we have been talking about because of the change to the way the draws are being calculated and that our accounting has not kept pace with the modernization of our portfolio.

MS. FARLEY added, one additional point is that the Trust has reserves managed by the Alaska Permanent Fund Corporation, and we also have a separate reserve account managed by the Department of Revenue. It could be that if this two-account structure takes a couple of years to get resolved, we could be looking to take our annual payout from the reserves managed by the Department of Revenue. That has never been done before. We have always pulled from the Alaska Permanent Fund Corporation managed reserves. That reserve account held at the Department of Revenue has been invested and has done well recently with the index returns; but we have taken about 18 million out of that account over the last number of years to fund some development projects. She wanted to remind trustees that that balance might also need to be used in the future to fund annual revenues of the Trust.

CHAIR FIMON noted that the conversation and the reason why this was brought forward for this meeting is the awareness that this was kind of happening even beyond the headlines, and to understand what the APFC is probably facing and what they are thinking.

TRUSTEE MORAN asked until this issue is resolved at the Alaska Permanent Fund level, if the Trust should be changing the methodology on how we are doing our draws.

MS. MERTZ replied that that is not something that she felt super comfortable with weighing in on; that is a policy call for the Trust. She stated that her goal today was just to give some information so that trustees would have more information to make those decisions. The buffer in your earnings account is something that should be monitored, and it should be considered when you are making those decisions; particularly, if they are outside of the normal regular annual draws.

MR. WILLIAMS stated the question of should we be looking at our payout and how that is calculated and whatnot is that we had planned to put out an RFP to have an entity similar to what Callan did three years or so ago, to look at all of it, including the percentage of payout, which has been rated with us by others.

MS. FARLEY stated that she does monitor that earnings reserve balance, and she will likely include some numbers and a refresher on this whenever she proposes the annual payout.

CHAIR FIMON thanked Ms. Farley and Ms. Mertz for the work on the presentation.

TRUSTEE HALTERMAN stated that she had two motions.

MOTION: A motion that the AMHTA Audit & Risk Committee require the CEO to work with the Department of Law to schedule a training for the Board starting with the statutory plan that the Board is required to follow for the administration of the Trust. The training should include all applicable requirements contained in Alaska Statute Titles 44 and 37, as well as applicable regulations, the life settlement, and any other topics that the Department of Law believes will benefit and educate trustees on their duties. The motion was made by TRUSTEE HALTERMAN; seconded by TRUSTEE STURGEON.

TRUSTEE HALTERMAN stated that this is in response to multiple trustees' requests to receive clarification for certain statutory provisions that govern our work. And so trustees have been asking for this kind of training, and this just officializes a motion to make that happen.

TRUSTEE MORAN asked why it requires a motion.

TRUSTEE HALTERMAN responded that there have been multiple requests, but to date we have not received any training. This particular motion just formalizes a request for our CEO to work with the Department of Law, and to give the Department of Law some directions from the Board. She continued that she cannot call for this kind of training without the support of the Board. This motion gives the Board the opportunity to weigh in on making that request so that Law can engage with us.

TRUSTEE BOYLES asked if we should suggest this training be scheduled before we proceed further on the governance rule changes or clarification of the governance.

TRUSTEE HALTERMAN stated that she would prefer it be before. But given the time constraints, she is not positive that all of the training will happen before the governance, but applicable, appropriate training should be done before we finalize governance work. She asked Mr. Williams to set her up for additional governance training as the Chair. She would encourage that each respective committee chair be offered the same kind of governance training, just to insure that we understand our duties, our respective roles, and the process.

CHAIR FIMON stated that he does not sense any disagreement with doing training whether or not it rises to the level of a motion. The motion has been made, seconded, and if there is no further discussion, he called for the vote.

After the roll-call vote, the MOTION was APPROVED. (Trustee Morris, yes; Trustee Moran, yes; Trustee Halterman, yes; Trustee Boyles, yes; Trustee Sturgeon, yes; Chair Fimon, yes.)

TRUSTEE HALTERMAN stated that the second motion has to do with the Alaska Mental Health Trust Authority employee grievance process. She framed it with a statement that she reviewed the Employee Grievance Policy in our personnel policy, and she does not find it workable for when an employee has an issue with our CEO. She stated clearly that she has not

received any complaints about the CEO, but that the current policy is lacking in this regard.

MOTION: A motion that the AMHTA Audit & Risk Committee requests that the Department of Law review the Alaska Mental Health Trust Authority Employee Grievance Policy and provide recommendations to the Board of Trustees on how to improve that policy. The report should include to whom the employee should report on issues about the CEO, and the proper procedure for investigation and resolution of those issues. The motion was made by TRUSTEE HALTERMAN; seconded by TRUSTEE STURGEON.

CHAIR FIMON asked if there was any discussion.

TRUSTEE MORAN stated that she is in full support of grievance procedures, just as to transparency of the process. She continued that they have them internally at her organization, and they are used. But the value comes from who is sitting in which chair.

TRUSTEE BOYLES asked if this part of our governance work, or if it is going to be separate from that.

TRUSTEE HALTERMAN responded that this particular motion opens the opportunity for the Board to give instruction to legal counsel to give us guidance so that we can begin to move forward on a meaningful policy. The policy that we have right now does not address a CEO grievance process in a meaningful way. Therefore, getting some guidance from Law will set the foundation so that we have an understanding of what applicable policies might work, and then gives us some advice so that we can then make some informed decisions about implementing a proper policy to insure that if an issue arises, we have a process in place. It lays the foundation for Legal to weigh in.

CHAIR FIMON asked if there were any other comments, suggestions about it from board members.

MR. WILLIAMS stated that he welcomed the opportunity to look at the process and to improve it, and having Legal looking at it is good. He wanted to make sure that everyone is clear that we do have a grievance process.

CHAIR FIMON stated that he did not want to speak for Trustee Halterman, but he thinks that the culmination of a few of these motions has kind of come from this past year and a half of trying to go through governance and trying to understand the review process. If it brings the clarity and brings what is already in print to us, he thinks it is a good thing, and will be in support of the motion. He then called for the vote.

After the roll-call vote, the MOTION was APPROVED. (Trustee Morris, yes; Trustee Boyles, yes; Trustee Sturgeon, yes; Trustee Moran, yes; Trustee Halterman, yes; Chair Fimon, yes.)

CHAIR FIMON called for a motion to adjourn.

MOTION: A motion to adjourn the Audit & Risk Committee meeting was made by TRUSTEE MORRIS; seconded by TRUSTEE STURGEON.

After the roll-call vote, the MOTION was APPROVED. (Trustee Halterman, yes; Trustee Moran, yes; Trustee Sturgeon, yes; Trustee Boyles, yes; Trustee Morris, yes; Chair Fimon, yes.)

(AMHTA Audit & Risk Committee meeting adjourned at 1:10 p.m.)