

*Exxon Valdez* Oil Spill Trustee Council



Investment Policy

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## 1. Joint Trust Funds

In 1991, the State of Alaska and the United States received approximately \$900,000,000 in joint trust funds, as settlement of natural resource damage claims stemming from the 1989 *Exxon Valdez* oil spill (EVOS). The Memorandum of Agreement and Consent Decree (MOA) entered into by the State of Alaska and the United States in Civil Action No. A91-081, governs the use of the natural resource damages, paid by Exxon. The State and Federal Governments act as co-trustees in the collection and joint use of all natural resource damage recoveries for the benefit of natural resources injured, lost or destroyed as a result of EVOS. The terms of the settlement are contained in the Agreements and Consent Decrees entered into by the State of Alaska and Exxon Corporation in Civil Action No. A91-083, and United States of America and Exxon Corporation in Civil Action No. A91-082. The United States Congress in Public Law (PL) 102-229 recognized the MOA and Consent Decree. Alaska State Legislature recognized the MOA and Consent Decree in AS 37.14.400. The *Exxon Valdez* Oil Spill Trustee Council (Council) has the responsibility for the general management of these joint trust funds.

## 2. Investment Fund

Initially, the joint trust funds were invested in the Court Registry Investment System (CRIS). However, in 1999 Congress enacted PL 106-113. *Attached*. This law allowed the joint trust funds to be deposited in the United States Department of the Interior's Natural Resource Damage Assessment and Restoration Fund and/or accounts outside the United States Treasury. The law requires that the funds are invested only in income-producing obligations and other instruments or securities that have been determined unanimously by the Council to have a high degree of reliability and security. In addition, the law requires the funds to be managed and allocated consistent with the Resolution adopted by the Council on March 1, 1999, establishing a Restoration Reserve. *Attached*. Under the terms of PL 106-113 and after an extensive review process by a group of Alaskan and national investment experts, the Council chose the Alaska Department of Revenue, Division of Treasury (ADOR) to manage and invest the funds on behalf of the Council. The joint trust funds are invested in the ADOR EVOS Investment Fund (Fund). As specified in the March 1, 1999, Council Resolution concerning the Restoration Reserve, the Fund is divided into two sub-accounts: Research and Habitat Protection.

## 3. Council Responsibilities

The statutory responsibility of the Council is to invest Fund monies in income-producing obligations and other instruments or securities that have a high degree of reliability and security. Although it is a matter of debate whether the Fund is a true trust or simply a misnomer for public money restricted to a particular use, the statutory responsibilities of the Council in the management of the Fund may be considered through analogy to some aspects of the Restatement (Third) of Trusts. When investing trust property, the trustee has a duty to conform to the terms of the trust, and to conform to applicable law in the absence of provisions in the trust. In the absence of contrary law or trust provisions it imposes the standard of the "prudent investor" which

*“ . . . requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.”* Restatement (Third) of Trusts, §277

To support the Council’s duties, the purpose of this policy is to provide general guidelines for the proper management of the Council’s investment decisions. The Council shall establish policy, set direction, and provide oversight and stewardship for the prudent investment and management of the Fund. In doing so, the Council will follow a procedurally prudent process when investing the Fund assets; prepare written investment policies; choose an appropriate asset allocation strategy with regard to the appropriate and intended use of the Fund; control investment expenses; monitor the activities of all investment managers and investment consultants; and avoid conflicts of interest and use “prudent experts” to make investment decisions.

#### 4. Standard of Prudence

The standard of the “prudent investor” has been interpreted as approving a portfolio theory of investments but does not impose a duty to maximize income. Indeed, the standard for typical trusts gives primary emphasis to preservation of the trust estate, while receiving a *reasonable* amount of income without taking undue risks. Only where all else is equal should the trustee choose the investment that produces the greater return. With regard to the Fund, which does not require preservation of the Fund, the trust must be invested in such a way that the purpose of the trust is served. It is therefore imperative that investment policies and asset allocation strategies adopted by the Council reflect the underlying purposes and intent of the Fund.

Prudence is based on the conduct of the Council in managing the assets, and is evaluated by the process through which risk is managed, assets are allocated, custodians and managers are chosen, and results are supervised and monitored. A standard of prudence places the emphasis on responsibilities related to the investment portfolio and its purpose, rather than on investment performance. The Council is not an investment manager or investment specialist and is not responsible for the ultimate investment results. Although it is not possible to guarantee investment success, following the process outlined herein will significantly improve the odds of structuring an investment portfolio which will stand up to public scrutiny and will serve the Fund’s purposes.

#### 5. Indemnification

State law, found at AS 37.10.071(e), provides that the State shall indemnify fiduciaries or an officer or employee of the State against liability, under AS 37.10.071(d), for breach of a statutory duty in exercising investment, custodial, or depository powers or duties to the extent that the alleged act or omission was performed in good faith and was prudent under the applicable standard of prudence. However, actions which do not fall within the area of good faith and prudent practices are not statutorily entitled to indemnification. Indemnification language consistent with AS 37.10.071(e), as well

as the desire of State trustees to hold retained investment managers and other retained fiduciaries to high standards, are included in contract language with such retained consultants.

## 6. Trustee Council Activities

In establishing policy, setting direction and providing oversight and stewardship for the prudent investment and management of the Fund, the Council will: adopt an appropriate asset allocation strategy; maintain one or more consultants, bank custodians, external investment managers, and legal counsel who may include the Alaska Department of Law and the United States Department of Justice; control investment and administrative expenses and incur only those costs that are reasonable in amount and appropriate to the investment responsibilities of the co-trusteeship; make financial and investment policies and performance available to the public; avoid conflicts of interest; and conform to the fundamental fiduciary duties of loyalty and impartiality.

## 7. Executive Director/Council Staff Activities

The Executive Director of the Council shall engage experts and contract for investment services, as the Council deems appropriate. This may involve entering into ‘reimbursable services agreements’ (RSA) with State and/or Federal agencies (e.g., the Alaska Department of Revenue and/or the United States Department of the Interior) for personnel services costs and associated contractual costs. In addition, to support the Council’s management of the Fund, the Executive Director/Council staff will: make recommendations concerning policies, investment strategies, and procedures in consultation with the Investment Working Group (IWG, see below); advise the Council regarding the selection of custodians, an investment consultant, and investment managers in consultation with the IWG; account for and report on the investment activity of all funds under the investment responsibility of the Council; and advise the Council on the evaluation of investment policies and performance of the portfolios in consultation with the IWG.

## 8. Investment Working Group Membership

The Council has broad authority to engage experts and to delegate its investment responsibilities, as it deems appropriate. The Council, when formulating investment policies, will review the recommendations from the Executive Director. The Executive Director will consult with the IWG and such other consultants as the Council may retain from time to time. The IWG consists of at least one Council member or designee, as determined by the Council, and appropriate state and federal officials and at least two investment experts from ADOR, who are selected by the Executive Director. At least two members of the IWG must have experience and expertise in financial management and the management of institutional investment portfolios.

## 9. Investment Working Group Activities

The IWG may engage in a variety of activities to serve the Executive Director and Council, including: reviewing investment policies, strategies and procedures; making recommendations to the Executive Director concerning policies, investment strategies and procedures; providing advice as requested by

the Executive Director, which may include the selection of custodians, an investment consultant, and investment managers; brief the Council at the Executive Director's request and/or at the request of a member of the IWG; act as "prudent expert" on behalf of the Executive Director; develop and recommend investment policies and strategies to the Executive Director; develop and recommend internal control systems and procedures to the Executive Director to ensure all investment assets are safeguarded; recommend to the Executive Director information systems adequate to fulfill the accounting, monitoring, investing, cash management and other information needs of the Council; and advise the Executive Director on the evaluation of investment policies and performance of the portfolios.

## 10. Investment Consultants

The Council selects investment consultants to provide advice on specific investment classes, including debt and equity securities, alternative investments, and other areas where focused attention is needed. Investment consultants do not accept discretionary decision-making authority on behalf of Council. Investment consultants function in a research, evaluation, education and due diligence capacity for Council and are fiduciarily responsible for the quality of the service delivered. Their activities may include: recommending strategic procedures and processes; identifying problems, issues and opportunities and making recommendations; upon the request of the Council, preparing an asset allocation study together with alternatives; assisting with manager structure, selection, monitoring and evaluation, if the manager is a third-party; monitoring and evaluating the overall performance of the portfolio; carrying out special projects at the request of Council; and providing continuing education to the Council and staff, as appropriate.

## 11. Investment Managers

The Council selects investment managers to carry out the "prudent expert" role of the Council; to develop a portfolio strategy within the specific mandate and asset size determined by the Council; to manage, purchase and sell assets for the portfolio; and to act as a fiduciary for assets under its management.

## 12. Delegation of Authority

The Council, through the appropriate state and/or federal agencies, may contract for investment, custodial or depository services on a discretionary or non-discretionary basis to the State and Federal governments and their employees, or to independent investment management firms, banks, financial institutions, or trust companies by designation through appointments, contracts, or letters of authority.

## 13. Code of Ethics and Conflicts of Interest

The State trustees and employees of the Trustee Council Office are subject to the Alaska Executive Branch Ethics Act (AS 39.52). In general, the State law provides that high moral and ethical standards are essential for the conduct of free government and that a Code of Ethics for the guidance of public officers will discourage those officers from acting upon personal or financial interests in the performance of

their public responsibilities, and will improve standards for public service and promote and strengthen faith and confidence in public officers.

The State Code of Ethics provides that any effort to benefit a personal or financial interest through official action is a violation. The Code details specific prohibitions pertaining to the abuse of official position, acceptance of gifts, improper use of disclosure of information and improper influence. By law, the State trustees are subject to conflict of interest disclosure requirements of AS 39.50 which includes the delivery of annual reports on financial and business interests to the Alaska Public Officers Commission.

All federal government employees are subject to the standards of conduct provided by the Ethics in Government Act of 1978, Public Law 95-521, as amended, including the Ethics Reform Action of 1989, Public Law 101-194. The statutory prohibitions are found in Title 18 of the United States Code, Sections 201 through 209, which include representational activities, conflict of interest, and dual compensation. Standards of conduct for all government employees are also delineated by Executive Order 12674, as amended by Executive Order 12731. The federal standards of conduct are further delineated in the regulations of the Federal Register, and include acceptance of gifts from outside sources; gifts between employees; gifts from foreign sources; acceptance of travel and related expenses; outside work; honoraria; outside activities; political activity; lobbying; procurement; misuse of government time, equipment, and information; nepotism; negotiating for non-federal employment; post employment; disclosure of financial interests; and penalties. The Department of the Interior, Commerce and Agriculture have additional ethics standards and requirements for all of their employees, including annual training and financial disclosure statements for specific persons, which include members of the Trustee Council.

## 14. General Investment Objective

The general investment objective for the Fund is to equal or exceed target returns over time while limiting total risk to that which is appropriate to the investment goals and time horizon.

## 15. Individual Account Objectives

The objectives of the individual accounts may shift with unanimous Council action. Such action would supersede these policies and require their update. As of the date of the adoption of this policy, the account objectives for the Fund's sub-accounts are as follows:

**A. Research Sub-Account:** As forecast in the annually-updated Trustee Council Long Term Spending Scenario, liquidity, and future income to support administrative expenses, projects, and long-term programs. The expenditures in this area as noted in the Scenario, if continued to be supported by the Council, are somewhat predictable over the future term and thus there is advance notice of the general amount of liquidity required for funding released on an annual cycle in approximately mid-September and a potential investment horizon ending in 2033.

**B. Habitat Sub-Account:** income for on-going habitat protection purposes, including the acquisition of lands, or conservation easements. Future land purchases are subject to ongoing negotiations and the timeline of their corresponding investments cannot be determined until such negotiations are concluded. There is typically at least a six-month period of notice of a need for liquidity and may occur at any time during the year. The investment horizon for these funds will likely not exceed 2029.

## 16. Annual Asset Allocation by Council

The Council recognizes that strategic asset allocation is the single most important policy decision affecting portfolio return and risk. At least annually, the Council will evaluate its current strategic asset allocation policies. The current policies will be compared with potential alternative policies on a consistent basis. This evaluation may include recommendations by the Executive Director based upon the IWG, comparisons with alternative policies; the status of the Fund; actual historic and future expected performance, risk, and return; time horizons, and Council funding priorities. Any changes to asset allocations will be approved electronically by the Council as described in the General Operating Procedures.

The specific status of the Joint Trust Fund, including funding status, earnings assumptions, liquidity requirements, and expected growth may be considered. The Council's investment consultant may use a "mean variance" optimization approach to evaluate the current and alternative policies. The specific inputs to the modeling process may be defined and contrasted with actual historic results. The implications for expected return and risk may be considered over multiple time horizons. The development of optimized asset allocations may include estimates of risk (standard deviation of returns for each asset class), the modeled return for each asset class, and the correlations of each asset class with other asset classes. The strategic analysis may include those asset classes for which the Council believes reasonable inputs are available. Asset subsets where meaningful historic data are not available may not be considered as a part of the strategic asset allocation analysis. Such subsets or categories, however, may be included as part of an appropriate broad asset category.

## 17. Review of Investment Manager Performance

The Council may review its investment management, in consultation with the Executive Director, IWG, Council staff, and investment consultants. If the Council determines a new investment manager is necessary, a rigorous, objective due diligence process will be utilized in the selection of any investment managers retained by the Council. Such review may include an analysis by an investment consultant of the Council's choosing and recommendations by the Executive Director and IWG.

## 18. Securities Lending

The Council may delegate to the ADOR the authority to enter into a securities lending arrangement with an agent(s) when the ADOR concludes that such an arrangement would benefit the Fund. The ADOR will



use the same skill and due diligence in the evaluation and selection of such agent(s) as utilized in the selection of money managers.

## 19. Rebalancing Guidelines

The Council may periodically instruct staff to shift and/or limit staff's authority to shift assets within asset classes and/or among asset classes. Unless restricted by Council action, the Executive Director or an appropriate designee shall have discretion to move assets among investment managers and asset categories provided that the actual asset allocation is within the variability bands of the Council's strategic asset allocation policy.

Links in Document:

Public Law 106-113

Resolution 99-03-01 Regarding Restoration Reserve and Long-Term Restoration Needs