


## **POSSIBLE MOTION**

**I MOVE TO** approve Ordinance 2015-38 on second and final reading.

# Memo

**To:** Mayor McConnell and Members of the Assembly

**From:** Jay Sweeney, Chief Finance and Administrative Officer 

**Date:** June 17, 2015

**Re:** Request To List Exchange Traded Funds (ETFs) as a Suitable and Authorized Investment for the Sitka Permanent Fund

---

The investment policy for the Sitka Permanent Fund has allowed investment in equity mutual funds since 1994. The investments in mutual funds have been the reason the Permanent Fund has still grown in value during an extended low interest rate environment, while still distributing 5% of its value to the General Fund each year.

Recently, following a recommendation by the Investment Advisory Committee, the Assembly voted to allow the Administrator to enter into a contract with Alaska Permanent Capital Management, LLC for external investment of the Permanent Fund.

In preparing to assume responsibility for external management of the Permanent Fund, Alaska Permanent Capital has reviewed Sitka's Investment Policy, contained in SGC Chapter 4.28, and has recommended that exchange traded funds (ETFs) be added as an additional authorized investment for the Permanent Fund.

Exchange traded funds closely resemble traditional mutual funds, with one key difference. That difference is that exchange traded funds have prices, like individual securities, which fluctuate throughout the trading day. Traditional mutual funds, in contrast, have a net asset value (NAV) price which is calculated at the end of the trading day. Thus, if an investor were to purchase or sell an ETF, the investor would know the exact purchase or selling price at the time of the transaction. The price for the purchase or sale of a mutual fund, on the other hand, is not known and finalized until the end of the day.

Alaska Permanent Capital has recommended ETFs be added as authorized investments for a specific reason. That reason is that the fees associated with ETFs are far lower than those associated with traditional mutual funds. This reduction in fees, through the reduction and elimination of loads and management fees, will help to increase the return Sitka obtains through its investment in equities.

At the time of the creation of the Sitka Investment Policy in 1994, exchange traded funds were almost completely unknown; only one such fund existed. Thus, at that time, they were considered a non-mainstream investment. Since 1994, however, ETFs have become commonplace and are now seen as an essential and integral part of a diversified investment portfolio. Or, in other words, Sitka's investment policy needs to be updated and modernized in regards to exchange traded funds.

As a last point, exchange traded funds are authorized investments for the mutual funds of other municipalities in Alaska, so Sitka will be following the lead of other communities in allowing investment in them.

An explanation of ETFs from Alaska Permanent  
Capital Management (external managers of the  
Sitka Permanent Fund)

## Why ETFs

### *Key Points*

- **Exchange Traded Funds (ETFs) are a pooled investment vehicle (similar to a mutual fund) that has been developed over the past two decades and are now widely used among investors.**
- **ETFs can offer broad and diversified exposure to entire asset classes (sometimes 1,000's of individual holdings) at minimal costs.**
- **Because ETFs trade throughout the day, they provide APCM with greater flexibility when making adjustments to client portfolios.**

### *Detailed Explanation*

ETFs, or Exchange Traded Funds, are investment vehicles that typically provide broad market exposure to a particular asset class or index. They have become quite popular among both individual and institutional investors over the past 10 years. The first ETF was created by a subsidiary of State Street Bank in 1993 and began trading with just \$6.5 million in assets. Over the past two decades the market place for exchange traded products has seen massive growth and now includes more than 1,600 different funds with over \$2 trillion in assets.

ETFs are similar to traditional mutual funds, but there are several key differences which makes them appealing. As with mutual funds, ETFs hold a collection of different securities and each fund has a specified benchmark that it is supposed to track. Unlike a mutual fund, ETFs trade intraday similar to the shares of an individual company (i.e. Apple or McDonalds). The price of an ETF fluctuates with the market throughout the day and an ETF can be bought or sold whenever the market is open through a regular brokerage account. Mutual funds on the other hand are priced once per day after market close and are offered to investors to buy or sell at one single price which is referred to as the net asset value, or NAV. The intraday trading feature of ETFs provides APCM with greater flexibility when rebalancing the portfolio or implementing tactical tilts.

While an ETF can be either passively or actively managed, the vast majority are passive index funds. When a funds is "actively managed" a portfolio manager selects individual holdings in the fund with the intent of trying to beat a specified index. While this may sound alluring, management fees for active funds are often sustainably higher and there is a large collection of research that shows active managers do not consistently outperform their specified index. Passively managed ETFs simply attempt to replicate the market or index and as a result offer broad diversified exposure with very low expense ratios. This aligns well the investment philosophy of APCM which seeks to minimize the fees and expenses paid by our clients.

As assets in the ETF industry have grown, so too has the amount and complexity of the products available. APCM continually researches trends in the ETF industry and conducts a comprehensive annual review that looks at all of the funds currently held in client accounts and compares them to other offerings in the market. The firm uses a combination of in-house research as well as data provided by an independent evaluator to ensure the funds it utilizes are liquid and provide the correct exposure to each asset class.

CITY AND BOROUGH OF SITKA

ORDINANCE NO. 2015-38

AN ORDINANCE OF THE CITY AND BOROUGH OF SITKA AMENDING SITKA GENERAL CODE SECTION 4.28.110 "SUITABLE AND AUTHORIZED INVESTMENTS FOR THE PERMANENT FUND" BY ADDING EXCHANGE TRADED FUNDS AS AN AUTHORIZED INVESTMENT FOR THE SITKA PERMANENT FUND

1. CLASSIFICATION. This ordinance is of a permanent nature and is intended to become a part of the Sitka General Code.

2. SEVERABILITY. If any provision of this ordinance or any application to any person or circumstance is held invalid, the remainder of this ordinance and application to any person or circumstance shall not be affected.

3. PURPOSE. The purpose of this ordinance is to add Exchange Traded Funds (ETFs) as authorized investments for the Sitka Permanent Fund.

4. ENACTMENT, NOW, THEREFORE, BE IT ENACTED by the Assembly of the City and Borough of Sitka that SGC Section 4.28.110 is amended to read as follows (new language underlined):

Chapter 4.28
Investment Policy

\*\*\*

4.28.110 Suitable and authorized investments for the permanent fund.

A. Authorized investments in the permanent fund are as follows:

- 1. The authorized investments listed in Section 4.28.060B for pooled investments.
2. Mutual funds which are invested in corporate equity securities. The equity securities within the mutual funds will be broadly diversified across all sectors.
3. Exchange Traded Funds (ETFs).

\*\*\*

5. EFFECTIVE DATE. This ordinance shall become effective the day after the day of its passage.

PASSED, APPROVED, AND ADOPTED by the Assembly of the City and Borough of Sitka, Alaska this 14th day of July, 2015.

Mim McConnell, Mayor

ATTEST:

Sara Peterson
Municipal Clerk