7:05 p.m
[Mr. Hutton in the chair]

MR. VANDERBURG: Well, thank you ever so much, everyone, for attending. It's my pleasure to introduce to you the members of the Alberta Heritage Savings Trust Fund Committee, but first I'd like to introduce the minister, Greg Melchin. Thank you very much for coming here this evening, Greg.

MR. MELCHIN: Thank you, George. I appreciate it.

MR. VANDERBURG: The purpose of the meeting tonight is to provide an update on the management of the fund. Normally we have more members – this is an all-party committee – but some of the members weren't able to make it here this evening. But there's no doubt we have the best of the crew here tonight, so I thank you.

Drew Hutton is the chair, and he's the MLA for Edmonton-Glenora. Richard Marz is the Member for Olds-Didsbury-Three Hills, and of course, Mel Knight, a former citizen of Whitecourt – I always have to say that – and MLA for Grande Prairie-Smoky. Welcome, gentlemen.

We have others here in attendance: Paul Pugh, the chief investment officer, investment management division, Alberta Revenue; Peter Orcheson, senior manager, investment management division, Alberta Revenue; Gordon Vincent, director, Revenue communications; and Elaine Chance, public affairs officer, Revenue communications. Why are you guys standing at the back?

MR. VINCENT: It's very close to the phone.

MR. VANDERBURG: Oh, okay.

And some very special people that do all the backroom work. They set up here for communications. Corinne Dacyshyn – where are you Corinne? Thank you. Carol Holowach; thank you, Carol. Michelle Grove; thank you. Stan Konig; thanks, Stan.

At this time, before we get going, I'd like to ask Mayor Brady Whittaker to say some welcoming words.

MR. WHITTAKER: Well, I'd be more than happy to say some welcoming words. Welcome to all of you from outside of Whitecourt to our community. It's a great pleasure to have you, especially tonight for this informative talk. Since George has become our MLA, I'm not sure that we've had so many visitors from the Leg., and we're very, very thankful and appreciate you all coming to Whitecourt and welcome you to come back anytime, not just for a formal session. You're all more than welcome to come at anytime as my guest. I understand a number of you got a tour of the community today and part of the constituency. I hope you enjoyed yourselves. We look forward to this informative session tonight and ask that all of us participate as much as we can. So thank you and welcome once again.

MR. VANDERBURG: Thank you, Brady.

At this time I'll turn the microphone over to the chairman, Drew Hutton. Thank you.

THE CHAIRMAN: Thank you, George. Yes, as the mayor mentioned, we enjoyed a tour of the mill today. We were fortunate enough to see where the 10 millionth seedling was planted, and we enjoyed that as a committee.

I also want to take a moment to thank George and Elizabeth for hosting us today. We thoroughly enjoyed it.

George and Mel and I are on the same floor of the Legislature Annex. We're three of the rookies, and we share a floor. We've become pretty close and tight in the last seven months, and it's great to come out to Whitecourt. Richard has been around a few more years than us, and we depend on his expertise, somebody who's been through a term. We're still rookies, and we're still trying to find our way at times, so if we fumble a little bit, please have a little patience with us. Thank you.

Our presentation this evening will be in two parts. Several members of the committee will review the history, mission, structure, and governance of the heritage fund. Paul Pugh, who George introduced, will then discuss the operations and performance of the fund, and we'll have a question and answer session following the presentation.

Greg, our Minister of Revenue, who is responsible from the government's standpoint, was kind enough to come down here, and I want to thank Greg for taking the time out. Greg was in Peace River today, and I think you're off to Grande Prairie tomorrow. Are you, Mr. Minister?

MR. MELCHIN: I'm going to Grande Prairie tonight.

THE CHAIRMAN: Tonight. Oh, there you go.

I'll turn the meeting over to Richard now to start the presentation on the fund.

MR. MARZ: Thanks, Chairman Drew. I'd also like to add my thanks to all of you for coming tonight, as well as to your MLA, George, for the wonderful tour this afternoon and for the very informative time and for the hospitality shown by your community to the committee.

I'm not too sure what to make out of the hospitality shown tonight, because part of the greeting crew was entailing hugs, and I never got one. I'm not sure what to make out of that, but perhaps I'll get one before I leave.

MR. VANDERBURG: I'll introduce you to my mom when we leave.

MR. MARZ: I'm looking forward to it.

The heritage trust fund was started back in 1976, and it's been a very unique aspect of Alberta's financial situation. No other province in Canada has such a fund, so we are the envy in Canada in that perspective.

From 1976 to 1983 the fund grew with 30 percent of all oil and gas revenue going into the fund. It reached its peak at just over $12 billion in 1987, and it's remained at that value ever since, or roughly around that value.

From 1982 to the present all the income from the fund was transferred into the general revenue fund to meet the financial priorities of this province. Further, spending on capital projects ended in 1985. The bulk of the fund's investments up to 1996 were a fixed income instrument, such as bonds and money market securities.

An obvious question raised by the chart you see in front of you is: why has the fund not grown since 1987? The value of capital projects are not included, and after 1987 nearly every dollar of income generated by the fund was taken out of the fund and used within the general revenue fund. Those dollars were used to support programs in various sectors such as health, education, and infrastructure, which are priorities identified by Albertans. The only exceptions were in 1997, 1998, and the year 2000, when $176 million, $25 million, and $230 million, respectively, were retained in the fund for inflation-proofing.

The income profile of the fund will be discussed by my colleague Mel Knight, and he'll be dealing with that in the next slide. Mel.

MR. KNIGHT: Thank you, Richard, and again good evening. It's nice to see you. It's always nice to come back to Whitecourt, and I thank George very much for the hospitality. I don't know, Brady, about that invitation. Did you say that we're welcome to be your guest anytime? I go back and forth a lot. I'm wondering about lunch. You know, I have to go through here at least once a week. Anyway, I wanted to thank you very much. I'll carry on here.

The slide that we have here now will kind of point out a bit what happened as far as the income from the heritage trust fund. As indicated, you can see the substantial contribution of the heritage trust fund to the province's revenue. From 1977 to 1986 the income grew dramatically. This reflected the growth of the fund and the fact that interest rates were substantially higher in that period of time. The income of the fund has declined, reflecting the fact that the fund has not grown, and interest rates have declined as well. In fact, interest rates peaked in 1981 with federal government bonds yielding 15.2 percent. They then declined to 9.8 percent by 1991 and then further declined to the current levels of less than 6 percent. As most of the fund was invested in interest-paying securities, the securities matured and rolled over at continually lower interest rates. The result was a continual decline in the income. The total investment income over the period, however, has been substantial, amounting to over $25 billion.

This income does not include the impact of legacy investments, which continue to make social and economic contributions. One example is the medical research fund. This fund was started in 1980 with a $300 million contribution by the heritage fund. On June 30 of 2001 the value was $968 million. Not only does this provide an immediate impact in terms of the advances in medical science, but it also has provided a competitive edge in the biotech industry.

By 1996, however, concerns were raised about the sustainability of investment income. Many people were wondering whether we should sell off the fund and just pay down the debt of the province or, if it was decided to keep the fund, how it would be managed in the future. George VanderBurg, my colleague, will discuss how these issues were resolved.

7:15

MR. VANDERBURG: Well, thank you, Mel. A key factor in the resolution of those issues was a broad consultative process. As a result of that process, it was decided to retain the fund but manage it on a new basis. The mission of the fund would be to focus on maximizing the financial return. This would allow for current and future generations of Albertans to gain the maximum benefit of the fund. In addition, provisions are in place to allow the fund to grow.

As mentioned previously, in 1997, 1998, and 2000, due to the strong fiscal position of the province in each of those years, $176 million, $25 million, and $230 million were retained in the fund respectively.

Finally, the new legislation and business plan for the fund called for professional investment management. It was decided that policy investments would be sold and the fund would be managed on the same basis as an institutional endowment fund.

The issue in 1996 was: how do we get from an income-oriented fund to a fund that would give us an opportunity to maximize the potential financial return on the fund?

Drew, I'll turn it over to you.

THE CHAIRMAN: Thanks, George. The heritage trust fund in 1996 was largely made up of fixed income securities and short-term investments. The emphasis was maximizing short-term income to meet the fiscal needs of the province. A program was implemented to gradually shift the fund to what is called the endowment portfolio.

What do we mean by an endowment fund? Well, endowment funds are very common within institutions like universities. As mentioned earlier, an endowment approach is used to fund medical research in Alberta, which is nearly a billion dollars. Capital is put aside and invested, and the investment income is used to fund expenditures on an annual basis. The higher the return, obviously, the higher the spending that the endowment fund can support. There are many times when investment income is not as great due to the performance of capital markets. However, an important rule in the management of an endowment fund is not to spend the underlying capital.

Two portfolios were created: the transition portfolio and the endowment portfolio. The transition portfolio would gradually decline with $1.2 billion to $3.6 billion being transferred to the endowment portfolio each year. Transfers recently have been in the range of $300 million per month. We now have over two-thirds of the funds through the transition. We'll probably complete the transition in August of next year.

How has the endowment portfolio been structured to meet the goal of maximizing long-term returns? The short answer is equity investments. Over longer periods equities have outperformed bonds, but they can be more volatile, and certainly over the last few months we've seen evidence of the volatility. I know my portfolio has. This volatility is having an impact on the fund's current income given that the transition is almost complete. When we come to discussing the future, a major issue for the fund will be managing the volatility of the income.

One of the keys to the new heritage fund is transparency. Every quarter an investment report is provided on the fund both in hard copy and on the Internet. Copies are available out at the front door. We would be happy to put any of you on the mailing list for later. In addition, the annual report is prepared and published within three months of the end of the province's fiscal year, which is March 31.

Another key is accountability. We have clearly defined benchmarks that we can use to measure the performance of the fund. In addition, we have adopted a well-defined standard of care in the management of investments, the prudent person rule, which is the basis for the investment management industry. We have instituted a public meeting such as this to discuss the fund and its performance.

Finally, the fund's performance is reviewed quarterly by the committee of the Legislature, of which we're the members, and the Investment Operations Committee, which is composed of private-sector individuals with financial and investment experience.

I would like to call on Paul Pugh now to discuss the actual operation of the fund. Thanks, Paul.

MR. PUGH: Thank you, Drew, and to the committee. We're pleased to be here tonight, and we'll try and give you a broad outline of how we manage the fund on a day-to-day basis. I am the chief investment officer, the portfolio manager for the fund.

What we want to talk about tonight are the following: the decision-making for the fund; the investment philosophy that guides the fund and, really, the operations of the investment management division of Alberta Revenue; the structure of the fund; our investment policies, performance benchmarks, the actual performance of the fund; and what we're looking at for the fund in the future. I will do part of the presentation, and Peter Orcheson, who's a senior manager and works in our equity area, will take over for the ending part of the discussion. We'll give him the performance part. A good manager always has a victim in the background.

Decision-making for the fund. If we talk about the investment management division, we're one of the largest investment organizations in Canada. We manage roughly $12 billion from the heritage fund, but we also manage the medical research fund, and we manage about $18 billion for the public-sector pension plans. So, in all, we manage about $37 billion for the government and government-related entities, public-sector pension plans. That makes us the fifth largest investment organization of this type in Canada.

We have 44 employees. That's actually slightly misleading. There are 42 and two students that come in one day a week, that we try and use as a co-op program. We have 20 chartered financial analysts. A chartered financial analyst is the equivalent to a chartered accountant's designation. It's the professional standard for investment professionals in the industry. We have 20 with CFAs, eight writing their CFA exams now. They'll be starting to study just about anytime now because the exams are in June and the course material comes out in about December. I'm glad I don't have to write the exams anymore. I did them a few years ago. They're getting tougher and tougher.

We have an average experience in the department of about 11 years. We have some junior staff and some older people like myself who have quite a bit of experience, and we're bringing up a team of younger people, who can gain from that experience and who will be, if you will, succession for the future.

One of the things that we will note: because we are such a large organization – we have a large asset base, $37 billion, $38 billion dollars – we do use external managers, and I'll touch on that a little later. We don't do all the investments directly in-house.

Our philosophy in managing the assets is that we are very conservative investors. We're very risk aware. We try and understand where the potential risks and pitfalls are in the portfolio. To manage some of that risk, we use diversification. We diversify against asset classes we hold, and we'll demonstrate that a little further in the presentation. We hold bonds. We hold equities. We hold Canadian, U.S., and foreign equities, real estate, and mortgages. So we can diversify some of the risks to different asset classes. We're disciplined. We try and add value on an incremental basis. We don't go for, if you will, the home runs; we go for the base hits. We try and add value incrementally through good security selection and by varying our asset mix on the margin, and we'll talk about that a little bit further on.

We're long-term investors. We're not looking for the heritage fund to be in the *Globe and Mail* monthly performance numbers in the mutual funds so that you choose the fund of the month. The heritage fund is there for the long term. We invest for the long term. We don't look for month-to-month gains but gains over the long term.

One of the things that is important: cost matters. Because we're a $38 billion organization, we have some efficiencies in our organization that come naturally from being a large manager of funds. We manage the funds for the heritage fund roughly under 10 basis points. That's one-tenth of 1 percent. Let's compare that to what most people pay in their mutual fund, which is 2 percent plus in most cases. For other institutional pension funds they may pay up around 25 basis points, or a quarter of 1 percent. You're saving, let's say, one-tenth of 1 percent per year for the long term. That adds up over time. So we are a cost-effective organization.

7:25

One other thing. Our philosophy is: do what you can do, and for what you can't do, hire somebody that can do it. That's why we use external managers. We don't do the investing directly in the United States. We have managers who are expert in the States. We hire them in New York, Boston. We hire European managers out of London and Far Eastern managers out of Australia, Hong Kong. We want the best for the fund. We can't provide a lot of those services in-house. It's very difficult to manage equities in Hong Kong from Edmonton. It's just not practical, so we hire other people to do it. We try and do what we can do and what we're good at, and what we don't think we're good at, we hire other people to do.

Let's look at the investments in the fund as at June 30. As the chairman mentioned, we have the transition portfolio and the endowment portfolio. The transition portfolio is $3.8 billion; the endowment portfolio is $8.2 billion. As was mentioned, $300 million is being transferred each month from the transition portfolio to the endowment portfolio. So the focus is now to the longer term and on maximizing gains, not pure income. I don't know if you can see it on the chart here, but the transition portfolio is basically fixed income investments, whereas the endowment portfolio is a more balanced traditional portfolio which has equities and bonds. Canadian equities represent about 25 percent of the portfolio, international equities about 15 percent, U.S. 16 percent, and our bond portfolio about 39 percent. In roughly a year's time you will only have the endowment portfolio left, and the endowment portfolio will have that characteristic of being a diversified, balanced portfolio with a significant equity exposure, and as I mentioned, we'll use external managers to manage international equities and U.S. equities.

As I've mentioned, the portfolio, or the heritage fund, has been transitioned to a more balanced portfolio which will have a lot of equity exposure. Just to give you an idea of the difference. I don't know if you can see the bottom red line there. If you had invested a dollar in the bond market in 1924, you would have $90 now. If you had invested a dollar in the equity markets, you would have over $2,000. That's when I come back to the point we made before: long-term equities will outperform over the long term. Now, the natural comment of the audience should be, "Well, if you looked at my equity portfolio in the last year . . ." If Peter could put up the next slide, we'll show you. The red line shows you the volatility year to year of equity returns, and the blue line shows you the volatility of bond returns. If you look at, roughly, up to 1980, the volatility in bond returns was fairly stable. It was only when we got to the period of the '80s that we had, as some of you can remember, Canada savings bonds at 18 percent versus – what? – 1 and three-quarters percent this year. That's where that volatility comes from, the '80s and the '90s, high inflation. Historically equities have been more volatile, but if you go back to the first chart, they've given you the higher return.

What does this mean for the fund? As we go forward, the volatility in the fund is going to increase because we're going to have the higher equity weighting, and that has definitely been the case in the last 18 months.

To further focus on that, here is our investment policy. Each of our funds - and the heritage fund is a good example – has a range of the different assets we can invest in. This is where we control some of the risk in the portfolio, in that fixed income can only vary between 25 and 45 percent of the portfolio; equities, if you can see it, vary between 55 and 75 percent of the portfolio. We have what we call a policy allocation which says that 35 percent of the portfolio should be in fixed income, 65 percent in equities. On that policy allocation we will vary it plus or minus 2 percent. We may be up 2 percent in total equities or down 2 percent in total equities, depending on our view of the market. Although we've got these broader ranges, we actually manage the fund within fairly narrow ranges, close to this policy allocation. That's one way we control risk. At the same time, because of the equity weighting, we will see, as we have in the last months, greater volatility in the heritage fund investment performance.

Some other investment policies that we have – and I've touched on them briefly. We diversify by strategies and by managers. For instance, we will hire a growth equity manager versus a value equity manager. We'll have indexed portfolios. Part of our portfolios, Canadian equities, will be indexed to the Toronto Stock Exchange 300 index. We'll have part indexed to the Standard and Poor's 500 index. So we control risk but also diversify the portfolio by using different managers, using different mandates, varying the active component of the portfolio and the passive or the indexed component of the portfolio.

We put limits in our portfolios on the quality and quantity of our assets. For instance, we can only hold a certain percentage of the portfolio in triple B bonds in our bond portfolio, we'll put limits on how much we can deviate on the Toronto Stock Exchange index for holding one stock in the portfolio that's on the index, and for our managers that we hire, we'll limit their discretion to do things. For instance, our foreign managers will be limited as to how much foreign currency risk they can take in the portfolio and how much volatility they can take in their stock, and we'll limit the number of names in the portfolio and/or the percentage that they can have in the portfolio in one particular name.

All our fund managers have benchmarks that they are measured against. So if we hire a U.S. manager, he has a benchmark, let's say, of the Standard and Poor's 500 index, and we say: that's the benchmark; you have to beat that benchmark. We'll also say: you have to beat the benchmark by 100 basis points, or 1 percent, or 150 basis points, 1 and a half percent, over a four-year rolling period, et cetera. So we try and add value to the portfolio by hiring managers but also giving them targets that they have to work to. We also have to work to targets for our own in-house portfolios.

So that gives you a broad overview. What I'm going to do now is turn it over to Peter, who's going to talk about the benchmarks in the portfolio and the performance.

MR. ORCHESON: Thank you very much, Paul. Actually, it's interesting: I noticed that Paul described me as his, I believe, guinea pig. When he was looking for someone to discuss performance, I noticed around the office that most people took a giant step backwards, but I stood forward because I know that over the longer term our investments have done well and at the same time we're looking forward to a more normal period and more reasonable period to do investing.

Before I get into the returns, I'd like to discuss benchmarks briefly. First of all, we have three benchmarks for the heritage fund. The first is a relative return benchmark, which essentially compares how other managers have done in the investment business. The second is the cost of debt. A reasonable argument could be made that since the province has debt, you could simply liquidate the heritage fund and pay off that debt. If our assets are earning a greater return, clearly it makes sense to maintain the fund. Lastly and we in the investment group believe most importantly, the policy benchmark return.

7:35

Just to get into that policy benchmark return for a second, policy benchmark return is defined as the market return times the long-run asset allocation to that particular investment. For example, on the Canadian side the market return could be defined as the return on the TSE 300 index. In fact, that is the benchmark that we choose on the Canadian side. Outside of Canada we use the S and P 500, and we use the Morgan Stanley EFI index. What we do is we take a look at our allocation to each of those particular asset classes and multiply it by the market return. That gives you a policy benchmark return, and from an investment perspective what we try to do is we try to beat that return: add value, add basis points, add a percent on top of that.

Investment managers spend a lot of time worrying about benchmarks, and you can certainly think of some reasons why. First of all, it's how people in the investment business typically get paid. You know, when we're looking at an appropriate benchmark, we want something that's reasonable and consistent. I mean, it's a clear picture of what we do because we are trying to add value. If the particular benchmark is a bit nebulous, hard to measure, it becomes difficult for the manager on a day-to-day basis. When we take a look at the various benchmarks that we have here, the relative return, if you look at how other managers have done, typically what the surveys do is they order them and they pick the manager that's in the middle. So have you been able to beat the median manager? Well, at the start of the period you don't know who the median manager is going to be, so it's not really reasonable and certainly not investable a priori.

Cost of debt. I think that's reasonable, certainly over a long term. As I mentioned, you would like to outperform the cost of debt. Otherwise, there's no point in keeping the fund or at least not all of it. It would make sense to liquidate part of it and pay off the debt.

Again, on the policy benchmark side we tend to favour this because it is investable. I know myself, I work on a Canadian equity product, and our benchmark is the TSE 300. It's a measurable index. We get data on the TSE 300 every month. We know exactly what's in the index, and it actually defines an investment opportunity set, if you will. You know, I look after some of the sectors. I simply look at the stocks that are in there, evaluate them on several criteria, and try to pick the best ones.

Again, we do favour the policy benchmark return. It's a much more accurate estimate of sort of what we do on a day-to-day basis, but you know, we do look at all three, and on the next chart we'll sort of get into how we've been doing. I mean, the last year has not been a particularly favourable year for ourselves or generally in the investment management industry. However, I would like to stress that there are some positive points to the story.

The endowment portfolio, which of course we are moving into. We'll have all that money invested by I believe it's August of '02. Performance on the portfolio was a poor minus 7.1 percent, but at the same time management value added was about 100 basis points. In markets like this it's very difficult to generate positive returns, but you're at least generating a better return than you would have had if you were purely in the indices.

On the median manager side, minus 2.9 percent. It's difficult to know exactly how they're invested. You know, the median manager probably had a higher portion of fixed-income securities than we had. Over the longer term we do feel that the equities will outperform. Certainly historically they have, so in the short term we've got to live with a little bit of that volatility.

On the total fund, including the transition portfolio, we're down 1.2 percent. The borrowing cost return for the one-year period was 8.3 percent, so we didn't necessarily stack up very well on that criteria, but again I stress that's not something we manage to on a sort of day-to-day basis.

In terms of the four-year number, quite a positive number. There's 7.1 percent on an annual basis versus a policy benchmark return of 6.7 percent, for value added of about 40 basis points a year. On $12 billion that's quite a bit of money. The Royal Trust median, 8 percent. Total fund return, 5.2 percent versus a borrowing cost return of 6.9 percent. Actually, I think this is the first period that we have a four-year number that's below that borrowing cost return, simply because of the situation in the markets for the last year, but we're expecting things to turn around here, certainly over the next year or two. So that's it on performance.

In terms of the future of the fund, transition, again, nearly complete, so the endowment portfolio is dominating the performance, and we are living through some volatility at this current time. This market volatility is reflected in the income that is being transferred to the general revenue fund. Over time we expect that the income we showed on the slide will move to a more sustainable level but, again, a pretty solid level.

In terms of future management of the fund, we recognize that we don't really want to dip too heavily into the principal. The degree to which those future income levels are able to grow is going to be dependent on the degree to which the fund itself will grow. So that concludes my portion.

I'd like to now turn the presentation back over to Drew Hutton.

THE CHAIRMAN: Thank you very much, Peter and Paul, for taking the time to go through that.

The Alberta way is added value, as Peter mentioned, and tonight we are fortunate to have the Minister of Revenue coming down to attend the meeting. The reason I say added value is that Minister Melchin is also the chair of the Future Summit that's taking place. We're consulting with all Albertans on the future of Alberta in the long term. So we really appreciate you coming down, Mr. Minister. Folks, when you're leaving – I believe, Corinne, you've left some of the Future Summit brochures on the front desk.

I'd ask that the minister come up and sit at the front. We're going to turn this meeting over to you folks to ask questions. I'm going to move over to the middle chair because there's no more need for the screen. If Greg wouldn't mind coming up to the front.

So if you wouldn't mind, if you have a question, just step to the microphone, state your name and your question, and hopefully one of us will be able to answer it. If not, Paul and Peter are here to answer them. Don't stampede.

MR. MELCHIN: No one likes to go to the microphone.

THE CHAIRMAN: I know. Nobody likes to go to the microphone.

No questions? Yes, Brady.

MR. WHITTAKER: I guess the first question that comes to mind, as Peter and Paul were identifying, is the growth of this fund. If it does not exceed what you could be gaining, why aren't we paying down the debt? It clearly shows in the slides that it's close, and I know that hasn't been the case for years. But are we as a province entertaining more money from the fund going to pay down the debt?

MR. MARZ: Well, if I may. We have the minister here, so if I deviate from the plan, he can correct. Certainly, as was pointed out, hindsight is 20/20, and we're dealing with a very short-term downward fluctuation in the market, which is an extremely uncommon thing, so I'm not too sure it would be prudent to react this quickly to that downward trend when the historical performance of the fund has been on the positive side.

7:45

MR. VANDERBURG: I think too, Mayor Brady, that the debentures are timed, as are your debentures in the town of Whitecourt, so that only at certain times we can make complete payment on those debentures. They come due at different times. Mr. Minister, you can help me out. I don't know the exact timing of them, but we have met or exceeded all our debenture payments to date.

MR. MELCHIN: A couple of things I will comment on. Last year we applied $6 billion of our surplus towards repayment of the debt, but we didn't have enough debt matured of that $6 billion. We actually have about $3 billion invested short term waiting for some of the debt to mature. So you could try and request or try and buy back that debt, but you'd pay a high premium to do that because that's widely disbursed. Those bonds are owned by individuals throughout – who knows where they're all owned. They're certainly widely disbursed, and to retrieve that, you would pay a high premium. Some of it doesn't mature until the period of 2013-15, somewhere in that range, so part of the problem is we couldn't even retire it as fast as some of the earnings.

One comment I'd like to make about this committee. I'm actually not a member of this committee. For your understanding, there's all-party oversight of the Alberta heritage savings trust fund to bring awareness to Albertans, so that's why they're here. It's not to be part of the on-going administration of the fund, of which the department that I'm over, with Paul Pugh, has the responsibility. So I'm here as a guest. It's just that we're fortunate enough that we could be able to do just that, although I'm thrilled to have the opportunity to hear the comments about what you might see.

The other comment I would say with respect to the fund and its purpose is that if we could not obtain exactly what you mentioned, if we could not obtain results of returns higher than the cost of our debt, I would think that we'd be looking towards exercising some of those options. But like many of you, if your investment policy is to buy high and sell low, it's not a very good strategy. In the marketplace where we're right now, at a low point in a one-year cycle or even two years, it's thrown off the four-year kind of number because that's not a long enough term to look at performance. You need to be looking at five, 10, 15 years' performance as to seeing the trends, and you get a high distortion from this last decline in the marketplace, probably the better time to be buying, when it's now lower, than thinking conversely.

THE CHAIRMAN: Thank you, Mr. Minister. Just to add another couple of points to the minister's comments. Although George, Mel, and I are rookies, the original plan of the Klein government, Greg and Richard, was to retire the debt in 2017. Correct? We're well ahead of that right now, and that's why some of this time-sensitive debt – that was one of the things we were dealing with when we were going for 2017, that there would be these penalties.

To reiterate what Greg said, this is your meeting to give input to us, and we in turn would be giving this input to the government as recommendations. This is one of the times when you have an opportunity to provide input, or if you so choose, you can e-mail through our web pages. Corinne, is it on any of the printed material? Our web page: is it just the Leg. Assembly?

MRS. DACYSHYN: Yes, that's correct.

THE CHAIRMAN: If you feel afterwards that you have any questions or concerns with regards to the fund, log on to the Leg. Assembly and you can provide input.

Feel free to get up and ask questions or give comments.

MR. STEPHENSON: I'll ask questions. My name is Arni Stephenson, and it's a bit of an honour for me to be here tonight. It's the first one of these meetings I've attended. I was always told that if you don't ask, you don't get an answer and that no questions are stupid, so I'm going to ask.

THE CHAIRMAN: And you're correct.

MR. STEPHENSON: Is it possible for Albertans to access any of these funds for expansion or growth of companies? We've heard about the investment portfolios and the moneys here and there, Alberta money. Is it possible for private enterprise to access the funds for growth within the province itself? If it is, how does one go about that?

THE CHAIRMAN: Clearly, if it's a direct funding of private-sector enterprises, Arni, the Klein government made the decision many years ago to be out of the business of being in business.

From a venture capital standpoint I'd have to defer that to Paul or Peter or the minister.

MR. KNIGHT: Could I make a comment?

THE CHAIRMAN: Sure. Go ahead, Mel.

MR. KNIGHT: I think one of the things that was quite clearly demonstrated was, for instance, in the endowment with respect to the medical community and the research and development in that area. That is worth today nearly a billion dollars. That part of the heritage trust fund is used, you know, with respect to increasing research and development and putting the province of Alberta in the forefront in many fields like that, but that's not, I don't think, answering your question with respect to private enterprise. That is private business that we support through this program, but it's not the type of thing if you, for instance, wanted to set up a situation where you were doing something in particular with bison genetics or something like that. It may or may not play into that type of thing.

So probably for a private enterprise it would be difficult to access directly, although in the province of Alberta there are a number of places you can go as a private entrepreneur to achieve your result, and Alberta Opportunity Company is certainly one of them.

MR. PUGH: If I can make some comments. As was mentioned, the decision has been made that the government would not be in the business of business, so the heritage fund does not direct investments to specific investments or locations within Alberta. We do, as general policy, invest in things like real estate. We own quite a bit of real estate in Calgary and Edmonton. We do invest in venture capital, but it's done, if you will, indirectly. We hire venture capital managers, and they make the decisions on which companies they're going to invest in. We have some venture capital companies that are domiciled in Montreal who invest in Alberta. We have some Alberta venture capital funds that are domiciled in Calgary that invest in Ontario and Quebec.

So we do have vehicles available for Alberta entrepreneurs to invest in venture capital situations or for venture capitalists to invest in them, but we do not and our policies do not allow us to invest directly in a company in Alberta that is in a venture capital mode, if you will. It has to go through venture capital managers of different funds. It's part of our policies, and that gets back to not having specific investments and to getting out of the business of being in business.

MR. VANDERBURG: But saying that, we have an investment. Someone in the hall had asked me: do we still own that grain elevator out there in Prince Rupert? There was an investment made some time ago, and we are still in that type of business. Paul, maybe you can explain that. It was asked if I would bring it up, because this person didn't want to.

MR. PUGH: Yeah. We do have and we have had an investment in the Prince Rupert grain elevator, and that has not been one of our highlights. It is in the heritage fund. It's one of the, if you will, legacy investments from the pre-Klein era, when there was the focused investment that was to generate economic activity. The Prince Rupert grain elevator is still in the portfolio. They have at various times met their obligations, at various times not met their obligations. There have been discussions about selling the grain elevator back to the principals all through, well, a good part of last year, but that fell through. It's still in the portfolio, and it's been written down substantially in value because of the problems of getting the due interest from the principals.

7:55

MR. MELCHIN: I want to supplement a little bit about the option for investing specifically in loans or equity of Alberta companies. You may recall that quite a few loans were actually put out to Alberta companies in the '80s. You know, there was $2.5 billion that was written off over a period of time of a number of different loans on diversification. They did generate a huge amount, actually, of spin-off activities, so it's not exactly lost to the economy as a whole. But for the heritage fund mandate, when we asked Albertans what they wanted for its purpose for the long term, they wanted to see that it was there with managed, maximized returns for Albertans for the long term, not to be specifically used to get into the business of being a pure venture capitalist and picking winners and losers in the business market, but more like a pension fund might be administered.

MR. HORNE: My name is George Horne. I was going to ask a question in terms of the investment people here. We've heard about the returns on the market not being very attractive in the last 12 to 18 months. I wonder if they'd like to comment in terms of what they see in the next 24 months in terms of their expectations, say, for the TSE and also for long-term bond rates.

THE CHAIRMAN: Thank you, George.

Paul.

MR. PUGH: Can we turn *Hansard* off? [some laughter]

MR. WHITTAKER: Please be specific.

MR. PUGH: The markets have been very volatile. The TSE was at 11,000 18 months ago or just over a year ago. It's now at roughly 7,000. So that's over a 30 percent decline in the markets. Our view of life has been completely changed since September 11. We did believe that we were going to see a recession and that it was going to be a shallow recession. September 11 has changed the world and the world we live in, and investment markets are no different.

What we've done with our portfolios and with the heritage fund. If you remember, in my presentation I said that we're usually plus or minus our policy benchmark. We've neutralized that. We are at the policy benchmark, because we're having a hard time judging the impact of what we saw was a slowing in the economy and what the impact would be of September 11. That's going to have severe dislocations. There are going to be added costs – we've seen it already within Canada: border crossings, security costs, et cetera – that may not be passed on easily to the consuming public. The consumer has pulled in its horns as well.

So our view on markets is they're going to be over the next year fairly volatile. We'll probably see low interest rates. We'll probably see rates drop further. We saw the federal reserve knock rates down by 50 basis points yesterday to 2 percent. We may see another cut. We'll see the Bank of Canada probably cut rates further. Long-term interest rates are now down. Thirty-year Canada bonds are down 5.3 percent. I don't think most people in this room can remember when they've been that low before, especially in the short term of the market. We would see rates coming down further and then probably moving back up as the economy recovers. We do not see a huge recovery in the economy. We'll probably see another six, possibly nine months of very weak recessionary activity and then the markets recovering. Next year, if we get 8 percent out of the TSE, I think we'll be doing very well. If we get coupon plus a little bit in the bond market, which could be 5 or 6 percent, I think we'll be doing very well. But we're going to have a lot of volatility through that period. It's all going to be dependent on what happens in the United States. They will be the ones to either get us out of the recession or drag us further into a recession. I think what we're looking at is a very uncertain period over the next year and especially over the next six months.

Was that specific enough?

MR. WHITTAKER: I was looking for companies to invest in.

Thank you.

THE CHAIRMAN: Thanks, Paul. One of the things that came up a couple of times today in our travels was talk of inflation-proofing the fund. Paul or the minister, would you mind commenting on why it hasn't been in the past, or is there any plan in the future?

MR. MELCHIN: I would say that what they would mean by inflation-proofing is let the fund grow by certainly the rate of inflation at least so that it retains some of the earnings inside of the fund so that it grows. That would mean that in 1985, when it got close to $12 billion, that fund in 1985 in relative terms was worth a lot more than $12 billion in 2001, and $12 billion in 2020 will be really substantially of less value. So by default in some respects we're declining the value of the heritage fund if we don't allow it to at least grow by inflationary amounts.

What we have been doing as a policy – and that's why you've seen some reinvestment over the past few years. There's been a high priority of repaying the debt, so the investment income has really all gone back into general revenue funds to service and to ensure that there's a surplus to pay down debt. So the fund may not be growing, but we're starting to see a decline in the debt in paying less in interest costs. In some respects that's another way of inflation-proofing it, though the fund in isolation of the debt isn't itself inflation-proofed.

Over the long term this all-party committee is structured to create awareness about the fund. I'd be surprised or quite amazed, actually, how few people in Alberta realize that there's actually $12 billion there. Many people's reaction might be: oh, it's all been frittered away on bad loans or to other provinces or companies and it's lost. But it's not. It's like any mutual fund, pension fund, in a very diversified portfolio and very liquid, for that matter. I mean, it would take some time to have to liquidate $12 billion, but it's a fund of real value and has potential for a lot of options in the future.

So getting that message out and starting to ask the questions of why we are saving, for what purpose, are some things that we really want to look at and examine. Should we save to have a larger amount of savings? If so, who are the beneficiaries? What do you use the income for? We're undertaking that as a commitment certainly now and on the side of our Revenue department, and we'll be coming back to this all-party committee to kind of judge and work through some of those questions so that they can get some feedback from these meetings plus work through identifying the need to save. That will help us identify what we should do with the fund and how large and what the investment return of it should be used for.

MR. VANDERBURG: Mr. Minister, can you expand on the loans that we've made to other provinces? One of the things that I found when I was knocking on doors this last spring was that people were saying: "Well, you guys stop lending money to Quebec; they're never making their payments to us," and "You know, those maritime provinces never pay their debts. What's happening with this?" I think there is that common thinking out there that we have lent money to other provinces and are not getting a fair return or any return at all.

MR. MELCHIN: It is true. Most of those loans made to other provinces, specific loans to provinces, not just buying their debentures that are floated in every issue every year when you're issuing debt – there were a number of specific loans to provinces made in the late '70s, early '80s. All of those loans have been repaid. The last of those loans to the provinces was repaid last December. So at that stage they were completely, fully repaid, all interest. The good news really for Albertans is that at that stage interest rates were quite high, there was a very strong return, and the province did very well on all those loans. There was nothing ever written off. They were fully repaid, all interest collected, and returned a very solid investment for the province.

MR. MARZ: If I could add to that, Mr. Minister. The bad news is that since they've been repaid at the higher interest rates, we don't have the opportunity today to reinvest that at those comparable interest rates.

MR. MELCHIN: I think we all would have loved to have had a lot of money tied up in interest-bearing when it was 18 to 20 percent. We're all in that boat. A lot of it has matured by now, and we wish we still had a lot more for longer terms.

8:05

THE CHAIRMAN: Any further questions?

DR. DANYLUK: My name is Ross Danyluk, and I'd like to pose a question. The heritage trust fund comprises two portfolios, the endowment and the transition. Correct? I read in the pamphlet – it's a well-written pamphlet – that the transition portfolio's objective, as you explained earlier, is to support the government's fiscal plan. Is that still its mandate at this point? Is that correct?

THE CHAIRMAN: Yes.

DR. DANYLUK: With that in mind, if we're looking at transferring all of the transition portfolio over to the endowment portfolio by 2005 – and it seems to be highlighting in this pamphlet that the transition will be completed earlier, as you were saying, by August – can you please explain what the advantage is of fast-tracking that transfer and that transition when it does add right now to the government's fiscal issues? What's the advantage of this, please?

Thank you.

THE CHAIRMAN: Please, Paul.

MR. PUGH: You're correct in your characterization of what we're up to. To put it simply, we hope to be buying low; i.e., we're transitioning the portfolio into equity investments. We've hurried up the transition to gain the advantage of buying in the equity markets when they're at a low level. That's one thing.

If you remember the chart I put up on the endowment portfolio's asset mix, 35 percent of the portfolio is in fixed income securities, so not all of that transition is going to equities. Thirty-five percent of that move over is still going to be in fixed income investments. Part of it will be going over, roughly 7 percent, into real estate. Another part, roughly 1 percent, will go over into mortgages. So it's not pure fixed income into total equity. It's a very low-term fixed income investment into a broader category of fixed income and equities. We're still going to be supporting the government's short-term needs, but it'll be at a lower level from the point of view that we'll have equities in the portfolio for long-term growth in the fund and long-term growth, hopefully, in the province's revenues.

THE CHAIRMAN: Thank you. A good question.

Any further questions? As Arni said earlier, there are no bad or dumb questions, but if you are not comfortable coming to the mike, again feel free to provide input through the Internet. There's a great MLA in Whitecourt, who would be more than happy to field any of your questions after the meeting or in the near future, and we'd be happy to bring them forward at our next meeting of this group.

At this time I'd like to thank you all very, very much for taking the time out of your evening and coming down and hearing a little bit about the fund. Please tell two friends.

Also, the Future Summit is another avenue for you to use to get information out to us, to tell us what to do in the long term with regards to not only the fund but the government, and I think I'm speaking for my colleagues when I say that.

Thank you, Mr. Minister, for coming down and to the support staff for coming down here and doing an excellent job. Thank you very much.

MR. VANDERBURG: I guess I'll just further add. To Mayor Brady and Councillor Deb Edney and the other elected officials here from Onoway, Yellowhead county, Woodlands county, Mayerthorpe, thank you very much for attending. The citizens of Whitecourt-Ste. Anne have been interested, Mr. Minister, on the performance of this fund, and I think it shows by the attendance here tonight. I'm very, very proud to host this in my constituency.

Thank you.

[The committee adjourned at 8:10 p.m.]