

**Title:** Thursday, September 13, 2007 Heritage Savings Trust Fund Committee

Date: 07/09/13

Time: 2 p.m.

[Mr. Johnston in the chair]

**The Chair:** Thanks, everyone, for coming. We'll just go around the room and have everyone identify themselves. I'm Art Johnston, the new chair. Anyway, we got through the first meeting initially, and it was great. You really helped me, so thanks. Now we're professionals.

**Mr. Rogers:** George Rogers, deputy chair, the Member for Leduc-Beaumont-Devon. I'm very pleased to be here.

**Mrs. Mather:** Weslyn Mather, Edmonton-Mill Woods.

**Mr. Epp:** Lowell Epp, Alberta Finance.

**Mr. Brown:** Aaron Brown, Alberta Finance.

**Ms Hay:** Sandie Hay, Alberta Finance.

**Mr. Pappas:** Dave Pappas, Finance.

**Mr. Berezowsky:** Mike Berezowsky, Finance.

**Ms Sales:** Tracey Sales, communications consultant with the Clerk's office.

**Ms Sorensen:** Rhonda Sorensen, manager of communications with the Legislative Assembly Office.

**Ms LaFave:** Betty LaFave, office of the Auditor General.

**Mr. Stratton:** Doug Stratton, Finance.

**Mr. Bhatia:** Robert Bhatia, Deputy Minister of Finance.

**Mr. Mar:** Gary Mar, MLA for Calgary-Mackay.

**Ms Gravel:** Micheline Gravel, acting committee clerk.

**The Chair:** First one. So we've got a first and second here.

Thanks again for coming. We've got a few people missing. I'm not sure what the story is there, but we'll carry on.

Your packages were made available on Friday, September 7. I assume that everyone would have received their package. We need approval of the agenda. If we can have someone move that. Okay. Moved by Weslyn that the agenda for the September 13, 2007, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be adopted as circulated. We don't need a seconder for that. All in favour?

**Hon. Members:** Agreed.

**The Chair:** Okay. Then we'll need approval of the minutes from the June 12, 2007, meeting.

**Mr. Rogers:** Mr. Chairman, I'll move the approval of the minutes of the June 12, 2007, meeting as circulated.

**The Chair:** Thank you. Moved by George Rogers that the minutes of the June 12, 2007, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be adopted as circulated. All in favour?

**Hon. Members:** Agreed.

**The Chair:** Carried.

Any business arising from the minutes of the previous meeting? Okay.

In response to a request by the committee a detailed list of investments was made available to all committee members on July 17, 2007. Any comments there? I'm supposed to say that that's for information purposes only.

**Mr. Rogers:** It's good information, Mr. Chair.

**The Chair:** Okay. The 2007-08 first-quarter update, the quarterly report, was made available to committee members on the website, and I would now ask representatives from the Department of Finance to speak to this item.

**Mr. Bhatia:** Thank you, Mr. Chairman. In the absence of the Minister of Finance, who sends his regrets, I'll give the committee an overview of the quarter if that's acceptable to you.

**The Chair:** Yes, it is.

**Mr. Bhatia:** I'll also, a little later on, talk a bit about the progress with respect to the corporatization of Alberta Investment Management and the Financial Investment and Planning Advisory Commission, which I know will be of interest to the committee.

With respect to the quarter ended June 30, the fair value of the heritage fund was \$16.3 billion at June 30 as compared to \$16.6 billion at the beginning of the fiscal year. A number of transactions were made during the quarter that produced realized capital gains. As legislated, realized investment income less the amounts retained for inflation-proofing is transferred to the general revenue fund.

Income earned by the heritage fund does not include changes in fair value as this is unrealized income. Realized income of \$457 million was transferred in the first quarter, which exceeded the market value return of \$155 million and therefore accounts for the drop in the fund's fair value. The heritage fund posted a 0.9 per cent return in the first quarter compared to a negative 2.2 per cent return in the first quarter of 2006-07. On a five-year annualized basis the fund's return at June 30 was 10 per cent.

In order to measure the performance of the fund's active management, the fund's actual return is compared to the policy benchmark return. For the three months ended June 30 the fund's overall actual return of 0.9 per cent exceeded the policy benchmark return of 0.6 per cent by 0.3 per cent.

On page 5 of the report you'll find a market summary. To go over it briefly, in Canada the Standard & Poor's/Toronto Stock Exchange composite index increased by 6.3 per cent during the quarter compared to a negative 3.5 per cent in the same period last year. Looking at American markets, the Standard & Poor's 1500 index increased by 6.3 per cent in U.S. dollars compared to 1.7 per cent last year. However, the continued strength of the Canadian dollar is producing negative effects on equities valued in U.S. currency. When translated into Canadian dollars, the Standard & Poor's 1500 decreased by 1.7 per cent during the quarter. The Morgan Stanley capital international Europe Australasia, and Far East index increased by 5.9 per cent during the quarter. Again, though, the strong Canadian dollar had a negative effect when the values of assets are translated into Canadian currency. During the quarter the Canadian dollar rose 10 cents against the euro. As a result, the index declined by 1.9 per cent in Canadian dollars.

Turning to investment income, the first-quarter update forecasts

that the heritage fund will earn \$1.34 billion in 2007-08, up \$120 million from the budgeted amount. As of June 30 the fund had earned \$543 million. Inflation-proofing is now forecast to be \$346 million for the current fiscal year, up from \$284 million at budget.

I'll now turn briefly to a couple of things noted in the fiscal update as well as the heritage fund update. The first-quarter fiscal update announced that the government has committed \$192 million of new capital to the heritage fund under the surplus allocation policy announced in the budget. The policy requires that any unanticipated in-year surplus be divided one-third to savings and two-thirds to physical capital investment.

During August the Minister of Finance established the Financial Investment and Planning Advisory Commission to review the province's savings and investments, including the heritage fund. The five-member commission is led by Dr. Jack Mintz, who is the former CEO and president of the C.D. Howe Institute and who will be chairing the University of Calgary's new school of public policy. The commission is considering a number of questions about the heritage fund such as: do the purposes and goals of the fund need to be changed or refined? Are the broad investment and spending objectives consistent with the long-term objectives of Albertans? Should the real value of the fund be preserved? Should it grow? Should a portion of the fund be earmarked for investing in Alberta?

The commission's report is expected by November 30. Also in August the chair and vice-chair of the Alberta Investment Management Corporation's first board of directors were named. Charlie Baillie was selected as chair. He is the former chairman and CEO of TD Bank Financial Group. George Gosbee, who was named vice-chair, is chairman, president, and CEO of Calgary's Tristone Capital, the investment banking firm that he founded. Alberta Finance is proud to have been able to recruit them for the inaugural board. They bring a wealth of experience in the investment industry and corporate governance.

Finance is still in the process of selecting the remaining board members so that they can have their first meeting this fall. As planned, AIMCO is expected to be operating as a provincial corporation in the new year.

That concludes my opening comments. We'd be pleased to answer your questions now.

2:10

**The Chair:** Do we have questions? Mr. Rogers.

**Mr. Rogers:** Thank you, Mr. Chairman, and Mr. Bhatia, I thank you for that update. I listened with great interest as you talked about the summaries on page 5 and, in particular, the impact that the growth in the value of the Canadian dollar is having on our returns from U.S. dollar based investments. I noted today that the dollar is at a 30-year high. I believe it's hit – I don't know if it's still there – the 97-cent mark, and there was some suggestion that we might be heading to parity. Apparently the last time was 1976. My question to you would be: does this trend signal a natural decision to review, possibly with a view to reducing some of our U.S. dollar investments, whether or not there is any indication that this trend towards parity will continue? I am wondering if we may not even pass the U.S. dollar at some point if this trend continues.

**Mr. Bhatia:** I'll make a few comments, and then I'll ask Doug Stratton to supplement. First of all, there are really two different kinds of decisions that we make and that we need to make. One is about the choice of asset class, the choice of type of investment that we make. Clearly, we make a choice to invest in the U.S. equities market, for example, because it is the world's premier capital market

and provides investment opportunities that aren't available anywhere else. That's one decision. Then the next decision that we make is whether once invested in the U.S. market, do we leave that investment in U.S. dollars, or do we swap it back into Canadian dollars?

We make decisions with a long-term time horizon based on our analysis of the fundamental nature of the markets and our long-term objectives. Our policy has been to not hedge that exposure in particular and several of the other international exposures that we have. That's based on very long-term considerations, not on short-term events in the marketplace. So a change in the exchange rate, to us, doesn't necessarily signal a time to be changing that policy.

I'll ask Doug to add any comments that he may have.

**Mr. Stratton:** Currency markets by their nature are very volatile. We see that again in the recent quarter. The Canadian dollar appreciated about 8 per cent against the U.S. dollar. Hence, that would affect performance, and it would affect performance for those investments directly exposed to the U.S. dollar. On page 7 of the quarterly report we can see the asset mix of the fund. To give you a sense of where the exposures are on currencies, it would be in the U.S. equities and the non North American equities and in the private equities.

The other pools are hedged to the extent possible or practical. For example, the Timberland pool is hedged to the extent practical, which at this point is about 75 per cent of its current value. The same can be said about absolute return strategies. Often those are very much U.S.-centric strategies, and they are hedged into Canadian dollars.

**Mr. Rogers:** Thank you.

**Mr. Mar:** I have a number of questions, but they might be best directed at Mr. Mintz's committee because some of the issues that have been posed to that committee are quite interesting to me. What is the purpose of the fund? Should the asset mix be changed? And so on. I'll try and restrict my questions to things that are perhaps more immediate to this report.

I noted the benchmarks on page 7 comparing the heritage fund to a number of other what we would call market returns and that on its face it appears good that we're beating the market, in some cases marginally and in some cases by more than a mere margin. I'm wondering about whether or not we do any benchmarking against other sorts of pools of capital that might be perhaps more comparable. I'm thinking about the Alaska permanent fund, as an example, or a corresponding pool of money that they have in the Norwegian jurisdiction. I wonder if we have any sort of sense of what kind of rates of return those capital pools generate.

One other question that I have is about AIM and how that's going. Do I understand correctly that the real estate holdings in here will be rolled into AIM? In the future how will those dollars and assets be accounted for? Will it come through this committee, or will it have a separate corporate life, separate and apart from the heritage fund?

I'm wondering about our investments in U.S. equity markets and whether or not the challenges in the subprime mortgage market are going to have an impact on our asset values that are expressed in U.S. investments. On its face it doesn't appear to me that the U.S. subprime market is that large. It's maybe \$50 billion or \$80 billion in a lending pool of perhaps trillions of dollars, yet the difficulty appears to be trying to identify who is holding the bag on those potentially bad loans. I'm wondering if we have any sense of our exposure to some of the downturn that has appeared in U.S. equity markets as a consequence of the subprime mortgage problem.

**Mr. Bhatia:** Thank you. I'll answer some parts of those, and then again I'll ask Doug Stratton to provide some additional comments.

With respect to how AIMCO fits into the assets that you see before you here, AIMCO will be the investment service provider for the heritage fund and for other government funds and pension funds. What that means is that the actual individual investment holdings and investment decisions will be made by AIMCO, just as they are made by our staff in the Finance department's investment area today. The overall policy will continue to be set outside of AIMCO, either by the existing mechanisms that we have or if those evolve as a result of the FIPAC panel's review. So investments in the heritage fund are among those invested and administered by AIMCO.

With respect to comparisons to other investment funds, yes, we do look at other investment funds to see how the heritage fund and others that we administer compare to outside funds. We have to be rather careful in comparisons with other funds because they have different investment objectives, and therefore their investment results can differ simply because the policy choices that another fund would make would be different than, say, one of our funds. For example, a pension fund might not choose the same mix of investments as, say, the heritage fund does. Notwithstanding that, for example, in the 2006-07 fiscal year the heritage fund had a return of 12.4 per cent. The Canada Pension Plan Investment Board returned 12.9 per cent. Our own local authorities pension plan returned 12.3 per cent. So it gives you a bit of an idea.

2:20

If we look over the calendar year 2006, the heritage fund had a return of 14.8 per cent. For the same period the Ontario Teachers' Pension Plan, which is perennially viewed as probably the premier investment fund in the country, earned 13.2 per cent. On the other hand, the Caisse de dépôt in Quebec earned 14.6 per cent. OMERS, the Ontario municipal plan, earned as high as 16.4 per cent. We do look at those comparisons, but there are enough differences between the funds that direct and simple comparisons aren't easy.

With respect to the impact of the subprime situation in the United States I'll let Doug Stratton talk about that.

**Mr. Stratton:** Thank you, Robert. The subprime mortgage situation in the United States certainly has had an impact broadly across the market, and the heritage fund would not be unaffected by that. It's a little too early to say at this point exactly how the next quarter's performance numbers are going to shake out. We do know a few things. For example, the Canadian equity market in the early part of August did fall off quite substantially but then recovered very sharply thereafter, so it's moderately up for the period from June to today.

The other point I wanted to make is that this type of situation in the market, because it affects a number of different asset classes, really does underscore the importance of being very diversified in your investments, diversified not only in a number of different asset classes but within those asset classes being properly diversified.

One thing I do want to point out is the credit exposure. The subprime mortgage situation has also caused credit spreads to widen, and by that I mean the cost that a borrower needs to pay above government benchmarks. So the costs that borrowers need to pay have increased and in some cases quite substantially. Since we're often a lender, essentially, into the market, we'll see some marked market adjustments in our credit exposure.

Again, it's very early to say. We haven't seen, you know, the full quarter end numbers as yet.

**The Chair:** Thank you.

Any further questions?

We have two new members that just arrived. Identify yourselves for the record, please.

**Mr. MacDonald:** My name is Hugh MacDonald, from Edmonton-Gold Bar. Mr. Chairman, at the appropriate time I have a question regarding timberland.

**The Chair:** Okay.

**Mr. Griffiths:** Doug Griffiths, MLA for Battle River-Wainwright.

**The Chair:** Go ahead, Mr. MacDonald.

**Mr. MacDonald:** Thank you, Mr. Chairman. The timberland investment: as I understand it, the entire holding is located on Vancouver Island. Correct?

**Mr. Stratton:** Predominantly it's situated on Vancouver Island. I think there are some pieces that are outside of Vancouver Island.

**Mr. MacDonald:** What effect, if any, is there on these holdings and on the value of this property through the infestation of the mountain pine beetle in British Columbia?

**Mr. Stratton:** In that particular case, because of the species involved, there's no pine in those holdings and hence no pine beetle.

**Mr. MacDonald:** Okay. Glad to hear that. Thank you.

**The Chair:** Any further questions?

If no further questions, then I would like to have a motion to receive the quarterly report. Moved by Mr. Griffiths. All in favour of the motion?

**Hon. Members:** Agreed.

**The Chair:** Opposed? Carried.

Okay. The annual public meeting in Red Deer. Since the committee last met, there have been developments with respect to the date of the annual public meeting. It was tentatively scheduled to be held in Red Deer on Wednesday, October 10, and in order to finalize arrangements for this meeting and proceed with the related advertising for the event, I would be looking for the following: a motion to set the date of the annual public meeting. That motion would include October 10, 2007, at 7 p.m.

**Mrs. Mather:** I'll make that motion.

**The Chair:** So it's moved by Mrs. Mather that the Standing Committee on the Alberta Heritage Savings Trust Fund holds its annual public general meeting on Wednesday, October 10, 2007, at 7 p.m.

All in favour? Opposed? Okay.

Jody Rempel will be confirming the final details for the annual public meeting. It will include a dinner prior to the meeting. A complete itinerary will be provided to all members, the minister, and technical support staff, and that'll be the week prior to the meeting, so the first week of October.

The next item: Draft Communications Action Plan for the 2007 Annual Public Meeting. Members have received a copy of the draft communications action plan as part of their meeting materials as well as copies of the draft media advisory, news release, and

postcard. At this time I'll turn it over to Tracey Sales to address this item.

**Ms Sales:** Thank you, Mr. Chair. As previously noted, your package includes the public meeting action plan and supporting documents. Just a note on those documents. The items in your package have been reviewed by Alberta Finance communications, and some of the financial information has been updated since the package was provided to the committee.

Basically, the suggested initiatives included in the public meeting action plan were all referred to in the approved communications plan presented at the last meeting, so I'll just quickly walk through the initiatives specific to the public meeting. There will be an ad to run within Red Deer and the surrounding area newspapers within a hundred-kilometre radius the week of September 29 to October 5. A media advisory inviting the media to attend the meeting as well as a news release will be distributed to all Alberta media by September 24. A postcard for the direct mail campaign, which targets Red Deer and the surrounding area within a hundred-kilometre radius, will be distributed the last week of September, the first week of October. The updated stat cards will be printed and copies will be sent to all MLA constituency offices and handed out at this public meeting. As well, there is a sample questionnaire in your package, and that will be handed out after the public meeting.

The plan also refers to a website posting promoting the meeting and an online media kit, including items such as the media advisory, the news release, the stat card. These items will all be given by LAO communications to Finance communications staff to post on the heritage fund website as well.

That about wraps it up unless there are questions.

**The Chair:** Okay. Thank you, Tracey. Are there any questions from anyone for Tracey? One question here.

**Mr. Rogers:** Thank you, Mr. Chairman. Just one question of Tracey. Tracey, you mentioned media news releases. We will have advertisements in the local papers in and around Red Deer, but will those be the only ads other than the news releases to the other media? I could be wrong, but I seem to recall that we did ads in the major papers of Edmonton and Calgary as well last time. Somebody can help me with that. I could be wrong.

**Ms Sales:** Okay. Actually, the initiatives that we set out just included a targeted ad campaign to the Red Deer area and the surrounding within a hundred-kilometre radius simply because those would be the people most likely to attend the public meeting. The media advisory and the news release will go out to all Alberta media, but the ad campaign was going to just be targeted to the local area.

**Mr. Rogers:** Thank you.

**The Chair:** Thank you, Tracey. No further questions for Tracey? Okay. I need a motion to approve the committee's 2007 annual public meeting communications plan.

Mr. Griffiths. All those in favour?

**Hon. Members:** Agreed.

**The Chair:** Opposed? Thank you.

The heritage savings trust fund website. We have an update on the website hits. In your meeting information you should have received a memo from August 30, 2007, from Mike Berezowsky. Mike, do you have any additional comments you'd like to make?

**Mr. Berezowsky:** No comments to add.

**The Chair:** No comments. Any questions at all for Mike? No? Thank you.

The 2007 report of the Standing Committee on the Alberta Heritage Savings Trust Fund. As members are aware, this committee must report annually to the Legislature. This report will be tabled by the chair in the Legislature during the next session. The draft of this report was sent to members for review on September 7, and I would ask if members have any comments before I ask for a motion to approve. Mr. Rogers.

2:30

**Mr. Rogers:** Thank you, Mr. Chairman. Just for starters. Now, I realize that we've changed membership since we've started for this session, but I'm noticing that it's still showing the previous chair, and I'm just wondering if the staff can help us. If this chair is going to deliver a report to the Legislative Assembly, I would hope that the report would refer to the fact that he is the chair. Maybe someone could help me with that, please.

**The Chair:** I did ask that question also, George, and I was told that that would be changed.

**Mr. Rogers:** Okay.

**The Chair:** Any other questions?

**Mr. MacDonald:** That should be changed straightaway, Mr. Chair.

**The Chair:** Yes. I had asked that that be changed. Thank you, Mr. MacDonald.

We have a motion to approve the 2007 annual report of the committee.

**Mr. Rogers:** With the noted change, Mr. Chairman, I'm willing to make that motion if the report refers to all current committee members, including the chair.

**The Chair:** Thank you, Mr. Rogers. All those in favour?

**Hon. Members:** Agreed.

**The Chair:** Opposed?

Moved by Mr. Rogers that the Standing Committee on the Alberta Heritage Savings Trust Fund approve the draft 2007 report of the committee as revised.

Other business. Are there any other items for discussion? Okay.

Following our meeting in Red Deer the next meeting will be at the call of the chair, but it will probably be in January or February. Any comments, questions, or concerns about that?

That being the case, I will adjourn.

**Mr. Rogers:** You need a motion.

**The Chair:** Sorry. A motion to adjourn, of course.

**Mr. Rogers:** I'll move that, Mr. Chairman.

**The Chair:** Thank you, Mr. Rogers. Moved by Mr. Rogers that the meeting be adjourned.

[The committee adjourned at 2:32 p.m.]