[Mr. Hutton in the chair]

THE CHAIR: Good morning, everyone. Welcome to the Standing Committee on the Alberta Heritage Savings Trust Fund. I'm glad to see all of your smiling and shiny faces. I'd like to go around the room and have everybody from Revenue and the Auditor General's office introduce themselves, please, and committee members. I'll start with you, Karen.

MRS. SAWCHUK: Karen Sawchuk, committee clerk.

[The following members introduced themselves: Mr. Bonner, Mr. Broda, Ms Carlson, Mr. Hutton, and Mr. VanderBurg]

[The following staff of the Department of Revenue introduced themselves: Mr. Bhatia, Ms Forbes, Ms Housdorff, Mr. Kanashiro, Mr. Orcheson, Mr. Parihar, Mr. Shepherd, and Mr. Stratton]

[Mr. Pappas, from the Department of Finance, introduced himself]

MR. MELCHIN: Greg Melchin, Calgary-North West and Minister of Revenue.

THE CHAIR: I'd like to move quickly to approve the agenda. Are there any additions, deletions? Everybody satisfied? Okay. Dave. Second? Bill. Any opposed? Thanks.

Approval of minutes from September 23, 2002. Motion to accept? Any deletions? Names spelt right? Moved by Debby. Second? I don't need one? Okay. Any opposed? Thank you.

I know that the minister has to move on to a meeting, so if you would be so kind, Minister, we're going to move to item Second Quarter Update and to 5 and 6 rather quickly. Thank you, Minister.

MR. MELCHIN: Thank you. We're looking forward, actually, to coming to this committee with the third quarter in probably the near future as well since that's to be finalized pretty quick here. It'll be nice to see the markets improving so that we can count the tremendous things that are happening in the marketplace versus having to come forward in a difficult time. As everybody would know, that quarter ending September 30 was one of the very substantial declines historically in the markets. They've been tracking down over the past couple of years, and certainly that second quarter that we had ending September 30 reflects that in it. The declines have been worldwide. It has not been just with respect to Canadian markets. In fact, the U.S. had even higher declines than they did in the Canadian markets.

Really, it gets into important decisions around here when we get into the business plan and the next step, making sure we're clear about the diversification, how we ensure that we maximize returns on a long-term basis and are clear about the investment policies. I would say that we are fortunate to have a great team of professionals who know the industry well, have served us well, and continue to perform and do great work despite that they haven't yet figured out, or maybe the committee hasn't yet figured out, how to control the markets. So we're looking to the advice of this committee on how they can see they can manage the markets so that they continually climb versus decline. If you've got the answer to that part, we'd like to hear it.

Let's maybe just take a few highlights out of it. You've got your second quarter, September 30. The fair value of the fund, as was previously reported, had declined to $11.1 billion. That was down from $11.8 billion at the end of June and down from about $12.3 billion, $12.4 billion at March 3l. So those six months' losses from equity investments of $820 million were partly offset by income from bonds and notes, short-term paper of $144 million, and real estate income of $16 million, for a net loss of $576 million. The fund is forecast to have a net loss of $627 million this fiscal year. That was the forecast presented at the end of the second quarter. We made a provision for write-downs that's included in that number of $342 million, reflecting that in some of the markets, when you look at the asset classes, there are substantial declines in some areas. So we have taken a provision for a write-down in some of those equity markets.

I'd like to also point out our benchmarks. When you look at the fund managers, this is part of the basis of evaluating performance, not the only, but it's one indicator that we have actually performed 30 basis points better than the TSX as well as the S&P 500 as well as the MSCI EAFE index. All of those indices had substantial declines in that same quarter, and part of our fund managers' objective is to have benchmarks to outperform the markets in which we participate, in which we invest. The fund posted a negative rate of return of 6.5 percent this quarter and negative 11 percent over six months but has generated a positive annualized return over the past four years. It's important to note that over the past ten years the fund has still earned $8.7 billion in investment income for Albertans.

When we look at this quarter, I think it's indicative that this fund as well as most funds that are diversified portfolios – pension funds would be included in that category, the heritage fund, and most large funds who have diversified portfolios – will be down through this period of time. I would like to highlight, though, that the objective of the heritage fund has been and continues to be to maximize a long term. In fact, if you're trying to look at one of the risk-mitigating factors, it's the long-term investment strategy that if you are prepared to look long term, the risk is really quite mitigated. You know that from year to year the swings can be quite volatile with equities, yet the returns on a long term do tend to outperform the other alternatives, be it fixed income – certainly, they outperform the money markets, and they will outperform even real estate on a long-term basis.

10:40

I think I'll wait till the business plan to go through the benchmarks that we've got in the asset mix.

The heritage fund has been structured for a long-term investment, and as you know, just to reiterate, back in '97 from a follow-up of work done in 1995 it was chosen to diversify and work to a long-term strategy which would include a blended portfolio of equities, fixed income. We have performed very well on the fixed income portfolio component of it. Our real estate has produced positive returns. Each of those will have varying returns over time, and that's why you want a mix and not just all in one asset class.

We certainly have members of the investment management division here that would be happy to entertain and answer questions with respect to particularly the second quarter.

MR. VANDERBURG: Minister, you talk about the fund's real estate portfolio, and really I think it's underperformed for where it should be, and I think we're underinvested in the Alberta market. When I hear private investors across this country investing in the hot real estate market in Alberta – and I don't think that's a short-term investment; I think it's a long-term investment – I think we've underperformed in our real estate market. You've said that you think we're doing okay, but I think we've underperformed, and I think we could weigh ourselves heavier in Alberta investments. You know, to have two-thirds of our real estate investment in Ontario and one-third in Alberta – and here this government is out promoting the Alberta advantage and how hot an economy we have and how stable an economy we have and all the great things we have in Alberta, yet our own real estate portfolio is only one-third invested in Alberta. I question that.

THE CHAIR: Peter?

MR. ORCHESON: Sure. I can take that question. The underperformance is largely due to a difference in quality versus the real estate index. We're invested in the bluest of the blue-chip projects within Canada, and these include, you know, shopping malls in the east as well as other high-quality office properties across the country, including Calgary. I mean, I think it makes sense to look at each project as it is, each investment on its merits. I hear what you're saying. Alberta real estate has done quite well. We do have a position here, but over the long term I think it makes sense to be geographically diversified.

THE CHAIR: Thank you, Peter.

MR. ORCHESON: Actually, I could even defer the question to Dan Kanashiro here because he actually is the real estate manager.

THE CHAIR: Okay.

MR. KANASHIRO: Partly you're correct in that everyone is looking for properties in Alberta, and there are very few properties for sale over the last five or seven years in Calgary or Edmonton. That's been part of our problem. However, prior to 1998 we were somewhat overweighted in Alberta. We determined that the larger growth area in Toronto was where we had to put some money, and we have done so now. We've bought three large shopping centres in the metro Toronto area. Now the portfolio should be swinging back to the other parts of the country, so we will be diversifying this. Last year we bought one-half of a building in Ottawa, and we have purchased a couple of apartment buildings.

So these will be spread out across the country as the opportunities arise, but as I said, it's been very difficult to buy properties in Calgary and also in Vancouver. We have very little weighting in Vancouver. We've wanted to buy buildings in Vancouver for 10 years, but we haven't been able to. These are things that are sort of works in progress. You can't buy something when there's nothing for sale, and this is what happens in real estate, unfortunately. Sometimes you get tilted, and your portfolio may not be exactly the way you want to have it balanced.

MR. VANDERBURG: So you're telling me that there's not enough for sale in the Alberta market and that's why we're not in it?

MR. KANASHIRO: No. The type of quality of buildings we're looking for are primarily office buildings. We can buy shopping centres. We're not doing that. We've determined that if you want shopping centres, you'd better have them in the highest growth areas. So it's part of the whole strategy of what type of property you want to buy and in which cities, and it has to come available in that city, of course, and at the right price. So quite often what happens is that we see the buildings but the pricing is too high. I mean, the yield is too low, and we don't want to diminish our returns on the total portfolio. So we have to pass on some of these deals, yes.

MR. MELCHIN: I would say that we're not into residential real estate in that respect. If you're looking for a triple A class office building, there really aren't that many of them. If you're going at some of the very prime pieces of real estate in commercial real estate, they aren't all on the market at any one given time. So I would concur that part of the strategy has been: how do you select very prime, potentially very long-term pieces of real estate? Those ones are the same properties that many companies have gone at and/or have held for a long period of time. It is true; you'll see in the residential markets that there's been a heated market that's come up from people moving in, but that's not the marketplace in which we've invested.

THE CHAIR: Bill Bonner.

MR. BONNER: Thank you, Mr. Chairman. In the second-quarter update I'm looking on page 1, and I see that we now have holdings in the absolute return strategies, and to my knowledge this is a first for the heritage fund. I look at page 18 of the second-quarter update, where it does give us some explanation, and it sets there an "objective of providing investment returns higher than the Consumer Price Index (CPI) plus 6%." Additionally, the second-quarter update indicates that this pool uses external managers and that these managers "are expected to produce positive absolute returns in excess of the rate of inflation with low volatility." So I was wondering if I could get an answer to what an absolute return strategy is and how this new strategy will affect the bottom line of the heritage fund.

MR. MELCHIN: Peter, do you want to lead that?

MR. ORCHESON: There are many types of absolute return strategies. A couple which I think would be more common or certainly more well heard of would be something along the lines of a long/short portfolio in equities so that the manager's views towards, you know, a particular universe of stocks – he can go long the ones he likes and short the ones he doesn't like. This is different from most managers, who are purely long, and if they don't like a stock, they simply don't hold it. These funds in the last few years have done extremely well in down markets simply for the fact that they were able to short some of the worst performing stocks.

Now, how this affects the overall bottom line of the fund. This is one of a group of investments that we call alternate investments, including real estate and private equities, and we feel that over a longer period of time we can produce a better risk/return profile for the fund and essentially really not increase the risk but add 20 or 25 basis points to the bottom line, say, over a four-year period.

10:50

MR. BONNER: Now, then, why are external managers being used to manage the absolute return strategies given that they have more expensive fees than internal managers?

MR. ORCHESON: Well, we have to strike a balance between our internal competencies and, you know, the cost of hiring external managers. We certainly do have internal products, and as you point out, it is less expensive. But in the kinds of markets that we face right now, if you're paying away our external managers, across the board the cost would be something along the lines of probably under 40 basis points. With the volatility that you see in today's markets, you can get paid back in one day of having the best managers looking after your fund.

I think that in the past we've given the example that, you know, we don't invest in Japanese equities. We're just too far away from the information flow. By the same token, on absolute return strategies it's not something we've managed before. It's not to say that we couldn't down the road, but we've got to get our competencies up. Trust me; people inside IMD would love to have all the money in-house, but we have to strike the balance because it's important for the performance of the fund.

MR. BONNER: Given that the third quarter has just finished, have you had any indicator as to how these strategies have done during the third quarter?

MR. ORCHESON: I don't have an update on each of the pools. Well, I know that overall the fund has done quite well in the third quarter. We're looking at up, on the whole, about 4.75 percent, but even on the real estate and the private equity and the absolute return strategies we need a period of time in which to evaluate the managers. I'd prefer not to look at quarterly moves. I mean, we're attempting to add value over the long term here.

MR. PARIHAR: Mr. Chairman, if I can supplement that, for absolute return strategies we use a fund of fund approach where we engage a fund manager who in turn hires a number of fund managers. So we have two fund of fund managers, and each one of them would have about 25 to 30 underlying managers. Each of those 30 managers would have different strategies, and that then gives you the diversification you need to provide the absolute return at the lowest possible risk there. So for the third quarter we don't have numbers I can share with you, but I know that we had a positive return.

THE CHAIR: Thank you, Jai.

Any further questions? Debby.

MS CARLSON: Thanks. I'd just like to do a bit of a follow-up there. I have to say that when my broker says trust me, I start to get a little nervous.

When we take a look at this fund, where administrative expenses have gone up in this last quarter and we're in a negative rate of return, I think it's a little tough to explain to the average Albertan how we're paying people more money to lose even more of our money than they did the quarter before. So I'd like to focus a little bit more on the administrative expenses, and I think we need a little more detail in the information here in terms of what your plans are now to minimize them, an explanation that people can readily understand about how fund managers' fees are tied not to performance but to other factors. I don't actually see here any kind of benchmarking for administrative expenses. So if you could elaborate on that for me.

MR. ORCHESON: Well, perhaps I should choose my words more carefully. I agree; it's been a difficult period, and we've had negative returns. But, by the same token, we pay our managers what we pay them because we feel that they can outperform the various benchmarks that they're in and they've done an excellent job. With respect to the fees, you know, we're running probably somewhere around 12 to 14 basis points annually. It has gone up. It's understandable that it would go up as we transition from essentially a fixed-income portfolio into a balanced portfolio that has 65 percent in equities. In-house we manage all the fixed-income; externally we have diversification among managers.

I don't have a fee benchmark per se, but I think we all know that the kinds of fees we pay on our retail mutual funds are something around 2 percent, and as an institutional investor we're paying across the board, you know, fees of 12 or 14. That's not expensive by any stretch, and part of that is just that given our size we get a very good deal when we go out and hire managers.

We should be able to provide more down the road, I guess, on the fees and exactly on the breakdown. The usual payment for the manager is based on assets under management. Now, there are incentive fees paid to some of the managers in absolute return, but when it comes down to it, we evaluate over time, and if they haven't added value beyond what we've paid them in fees, they're probably not going to be a manager for very long.

MR. MELCHIN: I would like to say that, you know, some of the historical numbers that you're comparing, your administrative breakdowns – and Peter touched on it. It has been transitioning from a fixed income, a lot lower cost structure and a lot easier to manage internally. When you get into different forms, especially when you get into the equities in international markets – not just Canadian but U.S., European, Far East, and the like – you need to go outside and provide some of that expertise other than just right here. The absolute return strategies, real estate, all of them will come with a higher complexity and cost to administer than fixed income.

If you're looking at the expense, the expense structure is going up, correct, but the expectation of minimizing risk and maximizing return is also going up. The judgment of that on a quarterly basis is almost impossible to prove because any one quarter of the markets can be so volatile. So, yes, in that quarter markets went down and we lost more while our expenses went up, whereas you're trying to maximize a long-term return and minimize that risk at the same time. That's why the blend of strategies, the blend of managers, the blend of even absolute return strategies and real estate add to cost structures.

Yet even with all of that, our comparables – you take the Ontario teachers' fund and others that are public-sector types of funds. They are even more diversified and more complex in some of their strategies than us, and their cost structures are yet still higher. So that's part of the asset mix, and we look at: if we continue to diversify, which would help minimize risk and really be a chance to maximize return, you are going to increase some cost structures to do it. If we don't go with that asset class, then we could minimize the cost, but our return is going to be down.

THE CHAIR: You want a supplement?

MS CARLSON: Actually on another issue. Do you want me to wait to bring it up?

THE CHAIR: No. Go ahead. Then Bill can follow, if you don't mind, Bill.

MS CARLSON: I'd like to talk about the Ridley Grain terminal. We have a lot of deferred interest income again. I think that the last two times I asked questions about this, you said that there were some negotiations in process. Could you update us on what's happening there? Really, what I want to know is: are we ever going to recover anything there, or is the province perhaps thinking of putting more money in to upgrade it to a point where it becomes viable? If you could comment, that'd be helpful.

MR. MELCHIN: We have had discussions with the owners of the Ridley Grain terminal and with others about: could we exit; could they buy out our investment? At this stage there is no specific ongoing dialogue. We have not been able to reach any agreements at this stage, and a lot of it's due to some of the market constraints that they're facing themselves of being unable to maybe capitalize or go forward. That doesn't say that those are ended, but we have no specific offers on the table at this stage to address or even to bring forward.

11:00

I guess one thing that's been a challenge is that the capacities for throughput both at the Vancouver and Prince Rupert terminals actually are much greater than the export amounts of grain that we're putting out at this stage. This last year was very low. I forget the total grain production volumes that they were saying. We were fortunate, you know, in a bad situation with grain volumes substantially down across the prairies, that the Vancouver port was on strike, so the throughput in the fall went through Prince Rupert. In that respect we were very fortunate. I don't know what that will yet mean for us as far as recovering some interest and some payments on it because that hasn't been finalized. In a low-volume year at least that terminal has had some volume come through it, which is going to benefit us this year. The agricultural community hopefully is going to have higher crop yields. That's the viability of it. It's an excellent port. It isn't so much having to inject more dollars to improve it; it's an excellent facility. It's just that there isn't enough grain moving out of Canada. Our yields were far too low this past year, so we need to get back to some higher grains, better yields. Hopefully, the drought will end.

THE CHAIR: Thank you, Mr. Minister.
Bill.

MR. BONNER: Thank you. On page 3 it indicates that $180 million was transferred back into the fund from the general revenue fund. If the markets recover significantly over the last two quarters, is there a possibility that these moneys will again be transferred back to the general revenue fund?

MR. MELCHIN: I think this is just the receivable. I'm going to have to go back and read the context of the paragraph there. I think that's just a receivable. It's a timing question.
Jai, you might supplement.

MR. PARIHAR: Yes, if I can supplement. Based on the income forecast in the budget, we do the transfer from the heritage fund to the general revenue fund. So early on in the first quarter $180 million was transferred from the heritage fund to the general revenue fund. Given that the income is going to be negative this year, this money is payable back to the heritage fund, and the heritage fund will receive this money back next month or by the end of the fiscal year.

THE CHAIR: Thank you.

MR. VANDERBURG: I don't know if it's just my opinion on the Ridley Grain terminal, but I'd like to hear your comments, Mr. Minister. I think that the closer we get to the date of maturity on that note, the more valuable that terminal really is to us. You know, I think that maybe some companies would have liked to negotiate their way into that terminal at a discount price, but it's my opinion that the longer we hold that terminal, the closer we'll get to the value of our loan on it. I'd just like your opinion on that.

MR. MELCHIN: We have talked with the owners with respect to that, and they are fully aware of that. Even in any discussions we've had at this stage as to any offers to buy out the loan, they start acknowledging exactly that. Our provision is to exercise more default. Once it matures, it's all due: interest that's been foregone and everything. So the number gets onerous for them to have not paid the interest when it finally matures. The closer we get to that, we either have a stronger likelihood of collecting substantially all or a good portion or higher values than we even have on our books or we are at least going to have the asset, one or the other. We'll have more control of the property.

So, yes, there's a great chance. It isn't so much that we have to, I would say, rush to divest ourselves of the loan at all costs. I think it is important to look at that the long term could actually work out very favourably for us and so not to panic in accepting anything. We'll try and get the best offer we can, and we'll continue to talk with them. At this stage there are no offers on the table, but the long term could hold up to be very promising for us. That port is a great port. From B.C.'s perspective – we've talked with them about it – it's an important port for them. They want to see that that port is viable and has a future for them. So I would say that there are great possibilities for Prince Rupert to be a very viable port in the years ahead.

MR. VANDERBURG: As far as Northern Alberta, you know, the perspective from the forest industry, mining industry is that it could be a very valuable port in the future. I wouldn't like to see us stick more money into it now when we don't really have that opportunity of ownership. In 2015 or '14 or whenever that note matures, we may take an aggressive attitude to invest some more money into that and make it an important port for our forest industry and our mining industry. The Northern Alberta Development Council has been spending a lot of time looking at a northern transportation route, and all of that seems to tie into that port.

So, you know, I'm concerned about our investment there and our lack of return, but I'm concerned that we jump at the first offer too.

THE CHAIR: Thank you.
No further questions? Then I trust we've dealt with this issue, and I'm looking to have a motion that

> the Standing Committee on the Alberta Heritage Savings Trust Fund receive the second-quarter investment report as distributed.

Rob Lougheed. Any opposed? Thank you.
Now we'll move on to the business plan for 2003 to 2006. Would you like to take that, Mr. Minister?

MR. MELCHIN: Thank you. With respect to the business plan this is a draft business plan at this stage. I think it's really critical for us to be understanding and supportive at least, you know, of the asset mix and objectives of the heritage fund, because they come with different attributes of results and with risk. I want to reiterate that the heritage fund, created in 1976, has already been in existence for 26, 27 years. We know that Albertans value the fund. Even in our recent survey that we put out in the fall, we knew even before that there's always been a view that a good portion of that fund ought to be held for the future. The perspective of this fund existing well into the future if not perpetually is there, so it does have a life beyond really the immediacy.

The principal should be there and quite likely will be there for I don't know how long but certainly for a long-term investment opportunity. If you can invest for a long term – this fund is here for those periods of time – then it opens up a lot of other alternatives for investment, and that's why it was restructured back in '96-97 so that it would take a long-term investment perspective with it rather than just a fixed income, which would have been much more short-term in nature. In that respect, I would still recommend that it's very prudent that we look toward a diversified portfolio to manage the risk because we know that there will be volatility from year to year. We've just suffered one of the real examples of it in the last year to two years of the downside of the volatility. The volatility also swings back up, so if you're there for the long term, you have to look beyond: is our investment strategy a quarterly aspect or an annual or is it even a three-year business plan kind of question, or is it a 10- to 20-year? This investment strategy is much longer focused – i.e., 10, 20 plus years – than a one- to five-year approach.

With that in mind, it's with the continual refinement of that strategy that some of the changes are being brought forward. The changes in the business plan from last year incorporate three key things. We want to increase the investments in private equities and absolute return strategies, reduce the Canadian equity investment to accommodate the increase in those, and increase the foreign investment limit from 40 to 50 percent of the market value. I thought I'd just touch a bit on that.

11:10

Private and absolute return strategies: we want to increase both of those up to 5 percent. One was at 2 percent and the other at 3 percent. We want to increase over the next three years private equity and absolute return strategies to comprise 5 percent each of the portfolio. That would end up being 10 percent in total. That incremental increase of 5 percent would be reduced from the Canadian content in Canadian equities. We already have a fairly large exposure to the Canadian market. The Canadian market is really, you know, a 2 percent capitalization question in the world, and we have a large percentage of our fund already in Canada, so if we're refining that, it was felt that the best place to pull those funds out of would not be fixed income or the other areas but out of the Canadian equities. Now, absolute return strategies can also incorporate equities, may have a Canadian component of equities in it, depending on the fund managers we use.

We also are looking to increase the foreign investment limit from 40 to 50 percent of market value. The heritage fund doesn't have a foreign property rules limit, unlike, you know, a pension fund would. So we're under no constraints as to where the funds are invested other than to look for what are the best long-term operating strategies for us. That's not to say that we will, but we want to at least have the latitude within the fund and flexibility.

I'll have you refer to page 7 of the draft report, where you get the asset mix, the benchmark. You look at the left-hand column. Strategies/Outputs has an asset class, and there's a range of securities and equities and real estate and absolute returns. There's a range because you're moving and investing and trading continually in those, trying to outperform the market. You're constantly rebalancing your portfolio, so you need a range of latitude to be in, though our benchmark is to be in money markets at 2 percent, bonds at 33, so a total fixed-income component of 35 percent. That still is the same. Canadian equities would now be at a benchmark of 15 percent, down from 20, U.S. at 15 percent, other international at 15 percent. Those are the same. Private equities would now be 5 percent. Total equities would still be at about 50 percent, real estate at 10 percent – no change there – and the absolute return strategies at 5 percent.

The rest of the business plan that we have is similar to the past year's. Those are the key changes in content. Clearly, for discussion I'd be happy to entertain any questions and clarify more of the information on that as members have questions.

THE CHAIR: Thank you, Mr. Minister. We'll start with our list, but if you are called out, I'm sure that your deputy minister and your CIO will be able to handle the questions.

We'll start with Debby.

MS CARLSON: Thanks, Drew. Thanks for that background. I look at the three-year business plan from the perspective that you've just done a survey on how the fund should be managed. We haven't seen those results. We do see some changes happening in the next three years in accordance with your goals and strategies. I'd like to know how much of what you heard in the survey has been incorporated in that. Or is it possible that we can expect some fairly significant changes coming out in the next quarter or whenever it is you announce the results? That's my first question. I have a follow-up.

MR. MELCHIN: A very good question in light of that survey. Without pre-empting what's going ahead with the announcement of the survey, I will say that we've always known that there's a component – and the survey does reconfirm that – an interest to retain the heritage fund. I would say that the survey has also said that Albertans support a variety of reasons why we should save. But we don't intend to make any changes instantly, even with those survey results, in this year's business plan. Any changes that would be anticipated, I think, or fall out of that survey would come into the next year's plan. It is too late in this year's business planning cycle to work that in. So there'll be time for this committee to get the full results of the survey. I think that would be a very good discussion that we should have: here are the results of the survey, and when we're preparing for next year's business plan, how would that impact it?

MS CARLSON: Thank you.

So when you talk about a diversified portfolio and an increased investment in private equities, what comes to mind for me is that you may be once again looking at some kind of venture capital fund or that kind of investment. Can you comment on that?

MR. MELCHIN: You know, venture capital is very much part of private equity components, so maybe we'll speak to how we're managing the private equities.

MR. KANASHIRO: I'll answer that question. The list, I believe, that's been circulated to you has indicated what we currently have, but you should keep this in perspective. The total private equity investment right now is less than 1 percent. It's only about .8 percent, so it's not a huge commitment. We have made some commitments in addition to that where their managers will draw down the money as they make the investments. Of the $84 million that's been drawn down, we have commitments of an additional approximately $90 million on top of that that will be drawn down, we estimate, over the next two to three years.

This request to increase this is based on hiring additional managers. We currently have about 13 managers investing on our behalf. We're not making the investments in these companies on our own. They're specialized in their particular areas, whether they're buyout managers or whether they're venture capital managers. To date the buyout managers have been performing pretty much as expected, somewhere between 15 percent and 20 percent returns. The venture capital managers haven't performed as well, but their market has been pretty disastrous over the last two years. We have two venture capital and approximately 13 mid-cap managers, or buyout managers. Now, the increase will mean that we are just going to add a few other managers and commit more moneys to this sector, primarily in Canada.

MR. VANDERBURG: While I agree, you know, that increasing the foreign investment is a good idea, foreign investment in the past has created some controversy and some bad press for the Alberta government: an oil company that may be doing questionable things or, like Member Bonner had talked about, companies lacking ethics, you know, using maybe child labour or something like that. What kind of assurance can you give us, the investors, that we're not going to get into those kinds of situations? I don't mind us investing more in foreign investments, but I want to know that we can stand proud of the companies we invest in. Are there some kinds of checks and balances on our new investments that will be done?

11:20

MR. MELCHIN: I guess I'd first say that with respect to when you are investing, we have that risk. For example, some were brought in and questioned about investments in Talisman, a Canadian company, versus anywhere else in the world, so it's one right here at home that has had questions.

Our policy has not been to go to, say, an ethical investment policy, because even that gets very subjective as to what is and what is not. The marketplace has through securities regulations a very high ethical standard that has to be met, and I think that has to be known to begin with. When you extract out of, say, the S & P 500 or even those that are listed on the TSX, you're already listing and investing in some of the large blue-chip types of companies, those that have built reputations, have been successful, have served customers well throughout this country and the world and have had that satisfaction. That's why they've been successful. Those are by nature the types of investments that we go into.

Will some of them make mistakes? Yeah. You know, we've seen some of it this past year, the Enrons of the world. Yet there's no prevention of it. Even under any policy there's absolutely no guarantee that you can ever prevent fraud, for example. People are going to be dishonest. There's no way to prevent it. You can take a lot of measures to try and be prudent in your strategies of investment, but we are subject, because of a diversification of a portfolio, to one company having done some very dishonest and irreparable kinds of activities.

That said, I would say that the marketplaces do react and judge those companies quickly and harshly, so you do have a mechanism to prevent those in the future. The markets are also reacting, maybe overly so. The Sarbanes-Oxley Act requires a whole level of other governance. There's another tremendous review being handled on all the securities regulators around the world with respect to corporate governance. Those are the right questions that we ought to keep driving towards, ensuring that there are the right governance structures in place to protect all investors, of which we're one and a large one, to protect us all.

So I don't know how to give you the comfort level that we want – by the nature of our investments we already take the larger, more blue-chip kinds of companies – other than, I guess, you could then focus in on a little bit of our own private equity strategies, which has got another level of a kind of company. I don't know if that satisfies you. We can't take away all that risk though.

MR. LOUGHEED: We had a bit of a discussion a little while ago about Ridley Grain. In your strategies and outputs here you talk about reducing the heritage fund's investment in project loans. In light of our other discussion there – and I guess that another few million dollars beyond Ridley is all that is left in these project loans, and maybe there'd be a more opportune time to get out of those, to reduce that investment – I wonder if you'd comment a little further on your strategy, why that would be in there, with respect to it in light of our discussion on Ridley Grain.

As well, you had made mention, or somebody had, of the Ontario teachers' investment strategies, and unless I'm misinterpreting what you refer to as project loans – or maybe the teachers' fund just takes an outright ownership position in things like a generating facility, for example – can you clarify a little bit the difference in strategy there?

MR. MELCHIN: Our project loans have been by policy of this government since '93, really, that we get out of the business of being in business; i.e., our strategies are not designed, even in the private equities, so that we are sitting around the table picking investments of each individual company. We'll choose to invest in indices – i.e., the TSX, the U.S. indices – and we go to fund managers even for private equities so that we're not around this table trying to pick, by reasons of favoritism or preferential terms or otherwise, investments in special loans. It's been the policy to get out of some of the special types of project loans that were put in place for reasons other than just to maximize return. They had some reasons – the Ridley Grain terminal being a very good one in particular – of some economic drivers and benefit to the long-term position of the province potentially beyond the value of that loan. So we want to get out of project loans, but our intent is to have specific diversification kinds of loans. That isn't the intent, though we will invest in industry; we will invest in indexes; we will buy real estate; we will put funds into private equities.

I don't know if anybody else wants to supplement on our strategy on the private equities component. That's the only one that would really get closer to it. Our equities in the public markets are clearly not of this nature at all; they're far more liquid.

MR. ORCHESON: Right. Maybe we can just pass the question on to Dan.

MR. KANASHIRO: On the private equity our managers make all the selections. We don't know beforehand what they're going to invest in, what they're considering. As a limited partner you can't get involved in the investment process by law or else you lose your limited liability status. This is the reason why we have managers working pretty much independently, and they can select the best investments for the best investment results. We don't put on any kinds of qualifications. They are aware of our sensitivities though, sometimes, and they will try to avoid it if there are conflicts with the Alberta government or things like that.

THE CHAIR: Thank you, Dan.

MR. MELCHIN: I apologize, but I'm going to have to leave. Unfortunately, even after we scheduled this, another meeting got placed on top of this that I need to go to. I don't know if there are any questions that I should answer before anybody goes. Robert is going to be still here and Jai and certainly all the level of expertise. Feel free to question them as you need.

THE CHAIR: You have to run, Minister. If we can't answer the question, we'll get it written and forward it to your department.

But quickly, Deb, you've got . . .

MS CARLSON: No. That's okay. I'll get it in writing. I'll put it on the record. Thanks.

MR. BONNER: I can do the same, Greg.

MR. MELCHIN: All right. Thanks.

THE CHAIR: Thank you, Minister.

MS CARLSON: I'll put my question on record now.

THE CHAIR: Oh. You want to put it on record. Okay; go, please, Deb.

MS CARLSON: Perhaps the second part of it someone here could answer. I specifically want to know if the government is looking at a direction with a part of any of this fund, as an outcome of the surveys, looking at investing in venture capital funds again as either the key funder or a mix of funding. So that's the one I'd like to get a response from the minister on in writing, a policy question.

But then also in terms of the response that was given with private equities investments, definitely you can give some direction to your managers in terms of weighting or industries. Will that happen on the private equity side in the future?

MR. KANASHIRO: When we make the original commitments, this is a time in which we sort of discuss with the managers what their intended target industries are and their specialities. Usually we choose them because of their specialities in certain industries that we want. But once the fund is completed and they've raised all the money from their limited partners, the limited partners after that don't have any say in the investment process.

The second part of your question, whether we will dominate: we don't do that. Our investment policies don't allow us to be the largest investor, for example, or to be the only investor or things like that. We have to invest along with other people that have made their decision to invest in this manager independently of us. So that's sort of a check and balance that's in place, and it's been in there for 10 years, 15 years almost.

MS CARLSON: And will you notify us if there's a change in that strategy?

MR. KANASHIRO: If there are changes in policies, yes, but it would have to be approved by our committee's investment operations committee.

11:30

THE CHAIR: Bill.

MR. BONNER: Thank you, Drew. I'm looking at page 3 of the business plan, the second bullet under Fiscal Context. At the end of the last sentence it indicates that the Minister of Revenue "has discretion in retaining income to protect the real value of the Heritage Fund." My question to the minister – and he can get back to me later if that is necessary – is: since we are well ahead of the debt elimination schedule, has the minister considered inflation-proofing the heritage fund, and if he has considered that, could this strategy also be reflected in the business plans?

THE CHAIR: Are we capable of answering that question, Robert, or do you want to leave that to the minister?

MR. BHATIA: I can give an answer, and if the member wants to follow up, then that's fine too.

THE CHAIR: That would be great. Go ahead, Robert.

MR. BHATIA: What's described here is the legislative provision. As I think you're generally aware, the government's policy has been to focus on debt retirement, so under that policy surplus funds have been directed to debt retirement rather than inflation-proofing the fund. If you like, the minister can supplement on sort of future plans in that regard.

MR. VANDERBURG: On that note, in the September 23 meeting I had asked that we have a full discussion on inflation-proofing in one of our future meetings, and that was in the minutes. So I do see a future item, you know, maybe being dedicated to this discussion because I think it's of concern.

THE CHAIR: As chair it was reflected in the meetings, and we didn't know that the Member for Whitecourt-Ste. Anne was going to be here today. Because he had raised it at the meeting, we had removed it from the agenda, so that is one that will be brought forward at the next meeting.

No further questions on this? Go ahead, George.

MR. VANDERBURG: Just one question, and, Robert, maybe you can help me with it. The plan from the Alberta government – we're hearing more about P3 investments, and I heard this morning one of the staff talking about lack of investments in Alberta. Is this something that maybe we should be looking at ourselves as kind of an Alberta strategy? Maybe we should be the owner of a courthouse or a school or a hospital rather than the private sector going out there and returning 12 or 13 percent to their investors. Has there been any thought given to that or talk about us being involved in the P3 models?

MR. BHATIA: I can comment at least briefly on that. As a general investment opportunity we are looking at ways that we can participate in P3-type projects across the country. Typically the way we would likely do that is by partnering with other major funds because there's a lot of expertise required to evaluate those opportunities and we won't be able to develop that expertise quickly.

With respect to projects in Alberta I think there may need to be more of a policy discussion at some point on that because we have to be very sure that we are making any investment purely from a financial and investment perspective and not bringing in elements of government policy to the investment decision.

MR. VANDERBURG: Fair enough discussion, but I think that it warrants full investigation into opportunities right here in Alberta, where the government of Alberta is the anchor tenant. I mean, what more security could we ever want? I'd like to see you and the staff have some kind of discussion on that because, you know, with the triple A credit rating that we have to invest in our own facilities, what a great opportunity. Rather than looking at New Brunswick or Ontario or Quebec, let's look right here at home.

THE CHAIR: Having no further questions, under point 5 I would be receptive to a motion that

> the Standing Committee on the Alberta Heritage Savings Trust Fund approve the business plan for 2003-2006 as circulated.

MR. BRODA: A draft motion?

THE CHAIR: A draft motion, yes. Thank you, Dave Broda. Any opposed?

Moving on to item 6, this was something the minister was going to address, but I believe, Jai, that you can deal with item (a), Listing of Fund Managers and Portfolio of Companies Invested in for Private Equities.

MR. PARIHAR: Yes, Mr. Chairman. We have circulated a list of investment managers which we have used for private equities.

THE CHAIR: We don't have it here.

MS HOUSDORFF: It's in the binder, at the back of the potential questions.

THE CHAIR: If you don't have the letter . . .

MRS. SAWCHUK: Mr. Chair, the only memo that we received was the one from communications.

MS HOUSDORFF: Okay. I'm sorry.

THE CHAIR: Okay. We're going to make a copy. Why don't we move to item (b) and come back to item (a), if that's all right for the committee.

So item (b), Information on the Alberta Heritage Savings Trust Fund Web Site. Cathy, would you care to take that one?

MS HOUSDORFF: Thank you, Mr. Chairman. Actually, Tammy Forbes has compiled all the information, so I'll ask her to speak to this.

MS FORBES: Good morning. At the meeting of September 23 Ms Carlson did pose the question regarding the heritage fund web site and the number of hits, so I've asked our web co-ordinator to compile that information. I believe that everyone does have that. The hits are from June of 2001 until January of this year.

As you can see from the memo and the numbers, the heritage fund URL became active in October of 2001, and since then the hits have increased significantly and have been consistent through those months. There is a variation, given any announcement or project that would focus on the heritage fund – and it has been in the news quite a bit in the last year and a half – ranging from the annual general meeting to any of the quarterlies and the annual reports. As I pretty much keep the information updated on the site as things become new and relevant, I can tell you that there have been a number of inquiries from various stakeholders in Alberta – be it teachers, students, other investment stakeholders, other provinces – looking for information on the fund, and when they are directed to the fund's web site, they find that the information is very helpful. It's certainly a tool in beginning their search or getting information on it. So we feel that it is certainly a valuable tool in that regard.

THE CHAIR: Dave Broda, a question?

MR. BRODA: Yes. Thank you very much. I'm looking at page 2 of your letter, Cathy or whoever can answer that. When you're looking at the number of hits, they're pretty well consistent, as you indicated. What happened in October/November with such a high? Is that a hit, or what happened there?

MS HOUSDORFF: That was a big hit. That coincides with the heritage fund provincewide survey that we conducted from October 28 to November 22, so significant interest at that point.

THE CHAIR: Debby.

MS CARLSON: Thank you. This is very helpful. Could we have this as part of the regular quarterly report?

MS FORBES: Certainly.

MS CARLSON: Great. To have the perspective of a year or a year and a half comparison is very helpful. Thank you.

THE CHAIR: Noted, and thank you.

Now can we move back to item (a)? The copies have been handed out, and if you would like to now carry on, Jai, that would be terrific.

MR. PARIHAR: Yes, Mr. Chairman. What I've got here is an appendix to the letter, appendix 1, which lists the geographic distribution of our private equity investments. Appendix 2 is the listing of managers we use for private equity. As requested by the committee, we have provided this information. I'd be happy to answer any questions on that.

11:40

THE CHAIR: Thank you. I'll give people a moment to look at it, and then if there are any questions.

MS CARLSON: Well, it doesn't actually answer the question in terms of listing the fund managers and the portfolios of companies.

MR. KANASHIRO: You wanted the list of each of the companies that the managers made investments in? Is that what I'm hearing?

MS CARLSON: Well, we were more interested in who the fund managers were. I mean, this gives us a geographic distribution, but . . .

THE CHAIR: There's a back to it, on the flip side.

MS CARLSON: Okay. Thank you.

THE CHAIR: We're okay.

Thank you very much. That's follow-up from the meeting of September 23.

Now we'll move on to item 7, which is Report on the Annual Public Meeting. First of all, as chair once again on the record I want to thank Richard. He delivered a great day. We had a great tour of Olds College. Also, Banner Pharmacaps was a very informative tour, and the meeting went very, very well.

I'd also like to acknowledge those members that did attend. Debby Carlson, Richard Marz, George VanderBurg, and Richard Magnus attended as well as the minister and his staff. Thank you very much for your support. You handled the meeting very well. Over 42 members of the public attended. It doesn't quite reach the level of all the relatives that George VanderBurg had at Whitecourt-Ste. Anne, but it was an excellent turnout.

I also want to thank *Hansard* staff and the people that handled the communications that evening. If anyone requires additional copies of the public meeting, please contact the committee clerk, and we'd be more than happy to get them to you.

With that, I will just let you know that we'll call the next meeting once we've got the third quarter, and included in that will be a discussion on the inflation-proofing.

Now I'd ask for a motion to adjourn.

MR. VANDERBURG: So moved.

THE CHAIR: Thank you, all. Have a great day.

[The committee adjourned at 11:43 a.m.]