[Chairman: Mr. Pashak] [8:30 a.m.]

MR. CHAIRMAN: It's 8:30, so I'd like to call this meeting of the Public Accounts Committee to order. The first item of business on our agenda is to approve the minutes of the May 16, 1990, committee meeting as distributed. Do I have a motion? From Mrs. Black. Are we agreed to adopt the minutes as distributed? Agreed. The minutes are adopted.

I'd like to welcome the Treasurer this morning and invite him to introduce his department members and perhaps make a brief opening statement if he should care to.

MR. JOHNSTON: Mr. Chairman, thank you very much. It's a great way to start a Wednesday, to come and visit with the Public Accounts Committee and talk about the romance of the public accounts disclosure. Today I have my two top senior specialists, Al O'Brien and Allister McPherson respectively, the deputy ministers of the department of the Treasury, Al O'Brien on the budget expenditure control side and Allister, as you well know, on the finance side, dealing with the revenue, the Heritage Savings Trust Fund in particular and the management of the assets and liabilities.

Well, with so much information – and you've had an opportunity already to meet with Don Salmon and he's told you all the tough questions to ask, so I'm sure you're well prepared for the discussions today. Let me only say by opening comments that I must say that if you look at the information that's provided through the public accounts, you'll see that Mr. Salmon has provided us with what is described as a clean opinion. In his professional judgment he said that, you know, considering the size of the transactions and the complexity of the government of Alberta, on balance it's been pretty well presented, and it's fair, it's accurate, it's consistent, and there's nothing in his work that would suggest that there's been wrongdoing, there's been anything that's questionable, there's been, I don't think, a significant amount of default or defrauding of the government's position; the assets are controlled: all those things are reflected in the statement of the Auditor General, and I'm sure you've gone through that already.

Secondly, the consolidated financial statements of the government of Alberta reflect, I think you would say, despite a difference of opinion with respect to universities and colleges perhaps, that the entities which are controlled by the province are consolidated. They're brought together; they reflect the consolidation of the assets and liabilities, revenues and expenditures wherever possible, with the possible exception, as you are probably aware, of three entities which are treated somewhat differently. They simply don't consolidate on a line-by-line basis; they consolidate on an equity basis. That would include Alberta Government Telephones, Workers' Compensation Board, and the Treasury Branches. Those are consolidated on a so-called equity basis: take the net and bring it into the calculation of the bottom line, if you like, or the consolidated surpluses of the province of Alberta. But wherever else, the consolidation takes place, and why that's important is because in the case of the Heritage Savings Trust Fund, although we have had a debate about the so-called deemed assets, it really becomes irrelevant when consolidation takes place, because those are not consolidated for purposes of consistency or disclosure. They're consolidated on the same basis with other fixed assets of the government; that is, on an expenditure basis. So if you looked at the consolidated statement that Mr. Salmon has presented, it's a so-called unqualified opinion or full, clean opinion with respect to the way in which the financial statements are presented.

Now, within the financial statements, of course, there are a lot of transactions. There are a lot of issues which still remain to be subject to this committee's debate on the public policy questions. I would imagine that over the course of the next few minutes, we'll have some discussion about the public policy item. I'll be glad wherever possible to provide our views, our understanding, and I guess our outline as to where we may be going. I would be surprised if we didn't deal with such things as pension liabilities, perhaps even touch on the deemed assets of the Heritage Savings Trust Fund. Those are some of the items, obviously, which will be discussed as the big issue, but outside of that, as I look at the disclosure here of the financial information, there really isn't a whole lot that would be so-called contentious. Yes, there's always the question of whether or not the electronic data processing system was perfect and whether it needs to be updated or continue to be changed. A variety of those so-called, what I consider to be, smaller issues are always before us, and generally they pale in materiality because they're really not large dollar amounts. Even if there was a potential for a loss, it really isn't significant or large in the context of the overall expenditures of the government or revenues of the government.

That's where I'll end right now, Mr. Chairman. I appreciate the opportunity of being here. I will try wherever possible to answer questions and, of course, call on the assistance of my two able colleagues where necessary to shore me up, stand me up, and reinforce what I may or may not say. So I appreciate the chance of being here.

MR. CHAIRMAN: Thank you very much, hon. minister. I'd just point out that we do try to keep the policy questions out of the discussion as much as we can, because that just duplicates what goes on in the Assembly. We try to get to actual items either in public accounts documents themselves or observations that are made in the Auditor General's report.

If I may, I'd like Mr. Moore to take the Chair for a moment because I'd like to take the prerogative of the Chair to ask the first set of questions.

[Mr. Moore in the Chair]

MR. PASHAK: I'd like to ask my first question with respect to page 2.36 of the public accounts document, which is a listing of loan guarantees. When we had the minister of economic development before the committee, he indicated that he approved many of these loans, or at least his department did, and that once the loans were approved, they became the responsibility of the Treasurer to monitor their performance. I wonder if the Treasurer could just give us – I'll make the first question rather broad – some idea of what his department does with respect to these loan guarantees in terms of monitoring, in terms of getting collateral. My guess would be that these are all high-risk loans or the bank would make them in the first place. They're only making these loans because they're getting a guarantee from the province that if there should be a failure or something, the province would step in. Can you just explain in some broad terms your responsibility?

MR. JOHNSTON: With respect to the guarantees, first of all, the use of guarantees is an interference in the marketplace. We stipulate that. We understand that. It does provide an extra opportunity for an entity to have a slightly better marginal rate of return or lower borrowing cost because the guarantee is in place. It was an explicit policy of the government going back to

1985 when we introduced the white paper on economic development, an industrial policy paper essentially. In it we outlined quite specifically that we had to be involved in the game of attracting industry to the province. It was a relatively mild form of interference, but it is quite commonly found among other governments, the point being that if the government of Alberta wasn't involved and other governments were, then you found yourself in some sort of a whipsaw between investment decisions of the private sector. We found that the guarantees were probably as inoffensive as any.

Other provinces, for example, used other forms of direct incentives such as grants, such as equity investments, or the kinds of transfers to the particular industry to attract them to the jurisdiction. This wasn't just unique to Alberta or Canada; this was in fact quite commonly found in the United States' jurisdictions, where some states, in fact, had swat teams going out and buying away industries to bring them to their own country, their own states – Massachusetts is classic – et cetera. But the point is that unless you have some way to bring a new industry to your province, the natural evolution is slow. That is to say, the small entrepreneur building slowly will develop a business, but it takes some time for him to reach the so-called, although I hate the term, critical mass before he starts to be a significant performer in terms of macroeconomic contributions. So the guarantee, as we see it, is one of the less offensive ways in which we interfere with private-sector decisions but nonetheless does provide an opportunity for the private sector to choose Alberta on an equal basis, because other provinces are offering similar kinds of incentives.

Now, the process with respect to the guarantees is the kind of process that you would expect, but I will very briefly provide an outline which may satisfy some of your questions. I'd be glad to provide more detail as to how the credit decision is made. First of all, the project itself must be evaluated and it must be one which fits with the overall direction of the government, wherein enhancement of resources takes place, additional gross domestic product is provided to the province, jobs are generated, and new investment flows. It probably is one which enhances and complements existing developments which are under way and enhances and complements the normal exploitation of resources, which are in fact part of the program of development of the province, and thirdly, would have to be on some basis, quite generally a reasonable basis, for investment for the guarantee to be offered. And if it's not reasonable, then that must be factored into the decision itself. We also take, obviously, if the guarantee is provided, a good security. We would take whatever security is available. We would, for example, take a charge against assets; we would ensure that personal covenants are in place: those kinds of traditional forms of protection would be provided to the province.

Usually the guarantee affords the investor a marginal rate of return, which is about equal to our borrowing cost. As you know, the province of Alberta borrows on the capital markets at a fairly reasonable rate. Our rate is probably as good as any province's, certainly, and in terms of world capital plays, our borrowing is as good as many sovereigns'. We place a very high priority on protecting our borrowing rate. Our position in the capital markets is one of the major objectives of Treasury, to ensure that we don't abuse the capital market response to our borrowings and that the credit of the province of Alberta is maintained at all times. So it is a conditioning factor in the way in which the guarantee is structured, and we will not, for example, allow a borrower to simply shop our guarantee anywhere he wants. We set up the guarantee so that we know exactly with whom we're going to be doing a one-off transaction, who is the banker that's at the other end of the transaction.

Once we provide the assistance to the individual – that is, to provide the comfort of a lower rate of borrowing cost – then, of course, we take the guarantees; we take the securities I've indicated. At the same time, I should note that for this we receive a fee. The fee may vary from an up-front position fee or it may in fact be a continuing fee which accrues to the province based on the amortization schedule or the repayment schedule of the liability, and it may raise about a half a percent, for example, for the province.

So what do we have? We have a company, for example, in many cases an industrial company in the case of the forestry sector, who sees that they can achieve some savings by the guarantee. And remember that industrials, even if you're a strong industrial company borrowing on the capital markets, would still pay a higher price than the province of Alberta. For a while there the capital market's response to industrial bonds was not very positive because of the so-called event risk, and therefore industrials were paying a higher spread above treasuries, which obviously cost them more money. Therefore, our guarantee was a comfort to them in terms of the actual cost of the project, and it allowed the project on a simple present-value basis or capital investment decision to proceed.

Secondly, many of these companies are companies that probably never will default. For example, if you gave a guarantee to, say, Imperial Oil – which we have done because of some of the heavy or bigger developments – or some of the larger developments of that order, they simply never default. Therefore, your event risk is small in terms of the risk that the province is taking, and it does provide, thirdly, some signal of comfort to the entities, to the investors themselves. They look at the province; they say, "Well, I guess this does fit with the overall economic objectives of the government. It is the kind of resource development which is positive both to the private sector in terms of market analysis, market decisions, and is in fact complementary to the government itself." So you can find an investment play taking place. But it is an extra bit of advantage to the private sector. As I say, they can borrow cheaply, it's a signal of good faith, and it allows them to transfer a part of the risk, at least, to us, no question about it.

With respect to smaller guarantees, we have a range of smaller guarantees which may from time to time provide some comfort. Now, these are generally higher risk guarantees wherein the province says quite clearly and makes an overt decision that we will take this additional risk because this is the kind of risk the government should be taking to ensure that this particular kind of development does take place in your province. It may be something of a high-technology nature. It may be something in biotechnology, for example, where the actual bringing together of an idea to maturity does take some time and institutions outside of venture capital firms are reluctant to take a position with these entities, or the venture capital firm has already taken a position and now finds itself not desirous of expanding its investment, and there is some judgment by consultants, by department officials, or by the government itself that this entity or this place is such that it's at a very critical stage in its development and needs a touch more comfort to get it over this big hump, in which case the guarantee would be provided. Obviously, the financial institution receives additional comfort from the province. Those are obviously plus or minus. We've had some pluses; we've had many minuses, but that's the way the game is played. If you don't take the risk, obviously you can't achieve anything. We think that in terms of exploitation of some of the opportunities, we need to have the government guarantee to ensure that the private-sector response is positive.

Then there are the other kinds of guarantees. Remember that the largest form of guarantees that the government has outstanding at the present time – I can't give you the exact numbers, but I'm sure you have them – is with respect to the farm guarantees, agriculture guarantees. Here again, under the farm credit stability program, for example, we use the borrowing power of the province to secure long-term financing for the farm sector, something up to 20 years, for example, at 9 percent money. I think in today's marketplace that 9 percent money is absolutely a major boon to the farming community, to borrow at 9 percent where mortgage costs would be – I don't know; what do you think? – 16 percent, perhaps, on a normal transaction. I think FBDB is charging something like 15 percent. Obviously the farming sector receives a major benefit from this guarantee and the financing provided to farmers. But a large part of our guarantee flows through to the financial institution because we want to backstop the decision of the financial institution to provide the credit. That accounts for a significant amount. I think the last numbers I looked at, simply to bring it up to date – I understand that we're dealing with March 31, '89 – runs somewhere close to $2.3 billion, I think.

As well, we have guarantees on the small business loan fund, which is around the $700 million, which are being repaid rapidly.

Still further, of course, one of the major guarantee forms of the province is in student loans. Now, obviously, the economics of that are quite clear. Students simply haven't got the creditworthiness to acquire long-term liabilities from financial institutions based on the best guess if you're going to graduate and get a job sometime. Therefore, the guarantee is a significant part of the educational system, allowing our youth to have an opportunity to bring their intelligence and education skills back to the province to exploit opportunities here and to contribute in high-paying, meaningful jobs to the province's overall well-being. So we have a very large exposure there as well. By the way, that's where some of the losses do take place with respect to guarantees.

Finally, let me talk about the export guarantee. Export guarantees are one of the mechanisms which I think work successfully for a small trading business. Many businesses who want to expand into other markets where the jobs and the value are added and contribute to the Alberta economy and want to expand into the United States market as a result of the opportunities afforded through free trade, for example, will come to the province and say: "You know, we have to run up the inventories to satisfy a long-term contract, and we have to invest $2 million, $3 million, $5 million, perhaps, to expand inventories; working capital is a tough cost for us right now. Current borrowing costs in the province of Alberta may well be up around the 17 or 18 percent. We simply haven't got the economic clout with the bank to secure that kind of financing against that contract. How would you like to provide us with one of your export guarantees?" On the basis of the contract, we'll provide export guarantee funding, usually 85 percent of the contract. We provide the comfort to the financial institution, the financial institution accordingly reduces the rate to the consumer, to the individual, and then once the contract is fulfilled, obviously the guarantee ends. We take all the precautions against security, check the contracts, have a look at the finances, essentially, of the entity.

As you say, this has really allowed small business in Alberta to expand into those markets in a very significant way. I think this is probably one of the most successful guarantee programs which any province has operated, and to date the losses on this side have been relatively insignificant. I would say that the success rate with respect to this guarantee program must be of the order of 95-plus percent. It's the kind of guarantee that in a general sense, then, allows the small business to expand, say, $5 million to $7 million into the American markets or other markets, where the technology, the manufacturing prowess of a company here in Albertan can be expanded and exploited, and the government's creditworthiness is used to protect the interests of the investor and the financial institution.

Well, that's a general outline of how the policy works. I can tell you we take . . . I could go on for a few more minutes if you wish, but I'm sure you have other questions, Mr. Pashak, that you'd like to ask me, and I'd be glad to be just as thorough in the next question.

MR. PASHAK: I'll try to make the other question a little more specific.

I'd like to draw your attention to a loan guarantee that was made to Alert Disaster Control Inc. Now, I don't know whether it'd be unfair to expect you to be familiar with the details of all the loan guarantees, but in this particular case I think there is a significant danger of default on this particular loan. What steps would you take to ensure that the interests of the province are protected to the greatest extent possible in this particular case?

MR. JOHNSTON: I should say that this was a touch risky, in my judgment, and was done at a time when perhaps we could have been more vigilant.

But, you know, the trading into international markets is not just the trading in commodities. One of the major trading opportunities for a province such as Alberta is the trade in intellectual property or technology in particular. Generally in our advanced educational institutions, because of the tremendous contribution the province has made to the success of the financial institutions, because the technology is being exploited not just for the benefit of Alberta but is, in fact, a major tradable commodity, many institutions have been successful in attracting foreign students here to learn about the technology, whether it's in the universities or in agricultural or engineering technology or computer technology. In all of these areas there has been a major worldwide attraction for the opportunities to learn from Albertans. It's a two-way flow obviously, the flow not just being that of providing educational abilities or instruction to, in this case, people away from the province, offshore from the province, but there is a linkage with respect to this kind of connection, a linkage which ultimately could lead to an expansion of trade with a major area.

Now, you know that the world is essentially broken into three trading units: the so-called Asian trading unit, the EC-12 trading unit, and the North America trading unit. So obviously in terms of our strategy we were attempting to position ourselves to take advantage of a major connection with the Asian market trading opportunities; therefore, because we had a card and the Southern Alberta Institute of Technology had a card to play with respect to a need that was seen on the offshore drilling and oil exploitation in a Far Eastern country, the demand for that training was such that we thought, SAIT certainly thought, that they would commit some dollars to the project. It's essentially an offshore platform which is used to train students. SAIT committed dollars to it, and to backstop the opportunity, the province of Alberta provided a guarantee against which we have secured a charge against a floating asset. Now, some people suggest we should bundle up our friends in the opposition and send them over there, but I would never suggest that. We do have security against this asset, and as a matter of fact we have had an independent CA consulting firm have a look at the asset to see what kind of form it's in, whether it's salable. We expect we'll have to foreclose on the guarantee, take back the security. You have to judge whether or not you've got anything you really want to secure, because you could end up with a long-term liability.

But that's how it developed, and that's the reason for it. Sure, people who do things and who take risks sometimes have to pay up.

MR. PASHAK: One final question, hon. cabinet minister. You indicated that many of these loans are made for development purposes. In that context, how does providing a loan guarantee to the Calgary Stampeder Football Club bring new business to the province?

MR. JOHNSTON: Well, outside of the fact that I support the Calgary Stampeders . . . Obviously, this is one of the areas where it was felt that on a broad base there was a lot to be achieved by having the sports industry expand in the province of Alberta as opposed to having the sports industry fail in the province of Alberta. I think this is not unique. Many other governments, including municipal governments, have taken some action to ensure that sports activity – which provides release to some of the pressures we face on Wednesday mornings or Monday to Friday, which develops interests in the community, which provides esprit de corps, if you like, as you saw in the winning of the Stanley Cup how excited the community was. Winning the Grey Cup is similar, emblematic to a community, its success, and provides not only a tourism attraction but provides some sort of community spirit, community heart.

The history, as you well know more than I, of the Canadian Football League is such that it's an important institution. The Grey Cup goes back a long time. Obviously these teams come and go in terms of their popularity and their financial ability, and along with other governments we thought that this was one way we could ensure that the Calgary Stampeders continued in the province. We have also an exposure, I believe – I don't know if it's been triggered – to the Edmonton Eskimos, and other municipalities, for example, have provided advantages to other communities.

So it's an industry. It generates jobs. It has a community spirit. It diversifies the economy. It satisfies those tests generally.

MR. PASHAK: Thank you.

[Mr. Pashak in the Chair]

MR. CHAIRMAN: Thank you, Mr. Moore.
Mrs. Black.

MRS. BLACK: Thank you, Mr. Chairman. I'd like to welcome the Provincial Treasurer and his department this morning. I guess I'll go back to a more specific question. I'd like to go back to the first recommendation in the Auditor General's report. He expresses his concern with the government's exclusion of our pension liabilities from its financial net worth, adding it on, instead, as a footnote to the financial statements. While considering this note an accurate indication of the province's pension obligations, the Auditor General remained concerned that the note does not sufficiently indicate short-term and long-term cash requirements of the province. This is the second year that the Auditor General has made this notation in his report, and I was wondering: how does the Provincial Treasurer respond to this concern?

MR. JOHNSTON: Well, Mr. Salmon and I have extensive discussions about these kinds of issues. Let me begin by saying, first of all, that Mr. Salmon has not provided any qualifications in his audited statement. Therefore, you can conclude that we are not inconsistent with disclosure or not so-called offside – at least to this point, I guess, Mr. Salmon. Now, we may have to fight this one out. But there is nothing wrong with the disclosure that the province has presented. We do disclose the liability of the pension fund at least to the extent that we can calculate that exposure or, in fact, to the extent that that exposure is a real exposure. But the disclosure has been consistent with our disclosure in previous years. We maintain a very complete and detailed provision of information in the financial statements, the balance sheet of the entity, and it's clear that the liability is set out.

Now, the second point you should note is that there is not at this point a so-called postulate. There may be some strong views; there may be some good so-called theory. It's not really a theory but a collection of principles which reflect disclosure of financial information. But at this point, at least, something called PSAAC – I never know what it stands for, but it's got a lot of weight; it's close to God, I guess, but it's a little off – tries to disclose or form some minimum standards for us. To date we have followed those standards. That is to say, the disclosure we have provided is accurate. So on the disclosure side, don't be fooled by those people who say we're not providing the information or that we're doing something untoward with respect to the way in which the financial assets and liabilities of the pension fund are provided.

Now, some provinces have looked at the liability. They have said, "Well, we've got to fix this liability; we can't have it expanding." They have taken it upon themselves to amortize in some fashion, some calculation, the liability over a period of years, which reflects right on the deficit, which shows up as a disclosed liability. We haven't come to that conclusion yet, but it may well be one of the options we'll have to deal with at some point. Let's remember that the disclosure currently is based on an actuarial assumption, and that actuarial assumption certainly in my view is subject to some review and criticism and, I would suggest, recalibration: In that, for example, the actuary – and I'm not suggesting he's doing anything unprofessional, but he's simply looking at the history – reflects in the long-term liability, that is the calculation of the long-term liability, a so-called indexing factor sometimes referred to as the cost-of-living adjustment or the COLA clause.

The COLA clause, in fact, has not been reflected legally or by contract in any of our pension obligations. However, the province traditionally, going back as far as I can remember – and that's probably as far as there was any record – has put in place an adjustment for cost of living, a CPI adjustment. In some cases it was done annually, and I recall one case when it was done twice in the year. To some extent it has been close to 75 percent of the CPI. Recently it's been far below that and, of course, requires that it's done each year on a unique decision. It's not a commitment to do it the next year, but we have in fact continued to provide the COLA adjustments.

So in calculating the future obligations of the province under pension arrangements, the actuary has in fact included in his forecast costs this so-called COLA, and therefore you've expanded the obligations of the province – the point being that no one's paid for that COLA benefit. The people who are participating in the plan either now or in the future, or presently are in the plan as a retiree, in fact didn't pay for that COLA benefit, and therefore your contributions to the fund were far below the benefits you're now receiving. You can expect, therefore, that the increased liability was just that. It increased quite rapidly as we're beginning to kick in the COLA adjustment.

Other increases on the benefit side have been traditional in pension policy – increases which provided fairly elaborate retirement options, pensions which provided other kinds of benefits which were not paid for specifically – and to some extent I think it's fair to say, looking back on the past decade or so, that the pension benefits were seen as part of a compensation package, and as opposed to charging the beneficiary for the benefit under the plan, you simply provided them with a gratuitous benefit, which started to cost money then and, as you run through the system, costs more money ultimately. What I can say is that I'm in the process now of reviewing pension liabilities, and I would imagine I will discuss with my caucus very soon some way in which we can deal with this problem. We recognize it, we understand it as fully as anyone else, and we're in the process of reviewing the policy.

But as between Mr. Salmon and I, it's a long debate about how you disclose this liability. I think, Mr. Salmon, it's safe to say that we are now following the so-called minimum standards with respect to disclosure, minimum in the sense that Mr. Salmon would like to see the items brought into the balance sheet more fully. We are saying that we're following the standards quite clearly and providing full disclosure in a footnote to the balance sheet, which is consistent with our disclosure historically, which is consistent with the majority of the provinces, and I should note that the so-called accounting rules really do not in any event apply to governments.

MR. CHAIRMAN: Thank you very much.

Hon. Treasurer, we've got a long list of people that would like to put questions to you today. Even if the questions are asked rather broadly, if you could interpret them in the narrowest possible way so that we could get more people in, I think the members of the committee would . . .

MR. JOHNSTON: Mr. Chairman, I'm always being criticized by the opposition for not providing complete information, and here's a chance. I'm just doing my job.

MR. CHAIRMAN: Well, it's not just the opposition that's asking questions this morning.

MRS. BLACK: I'll keep my supplemental brief, then, Mr. Chairman.

Right below the recommendation, Provincial Treasurer, the Auditor General recommends that the provincially-owned universities and colleges be included in the province as financial consolidated statements. I'm wondering, what would be the overall effect to the consolidated statement? Have we done a comparison as to what the overall effect would be if in fact we did incorporate them into the consolidation?

MR. JOHNSTON: Well, sure. You see, this is hinging on a de jure determination as opposed to a de facto determination of how these entities operate. Mr. Pashak, I'll try and be as brief as possible here. Like many things that happen in constitutional history or the way in which institutions evolve and emerge, you find that there is a tradition, a certain history that develops, which sets out the precedent. I think it's safe to say with respect to advanced educational institutions and universities that these are board-operated institutions which essentially receive bulk bucks from the government on a global transfer, and they have the responsibility as an independent board to allocate those dollars. They're outside the Financial Administration Act, I think it's safe to say, in all cases and, therefore, outside the adminstration tests or controls of the province of Alberta.

Now, when the Act was originally structured, these seemed to be emanations, if you like, of the province of Alberta. I think the history and precedent show now that these are autonomous bodies. Therefore, because they are autonomous, are board governed, have their own financial system, have their own financial administration, operate independent and separate from the government except with respect to one or two items, particularly financing, it's our view that these should not be consolidated for purposes of the General Revenue Fund. I think that's a view which is shared by the institutions as well. They would rather be independent, have their own disclosure, be accountable, even if it's the case of making a bad decision with respect to an offshore training program. They want to be accountable themselves, and that's the way in fact the democratic process operates.

So the Auditor and I continue to discuss this issue. He suggests that we should consolidate all these entities back into the General Revenue Fund, the consolidated statements of the government, and we continue to recognize the independence and the autonomy of these boards. Yes, it's not altogether 100 percent clear, but we recognize it.

Now, just remember that there are a variety of other assets that probably would have to be accounted for somewhere along the line which have been paid for by the province. That is, the capital buildings, for example, have been paid for by the province. Up to about three or four years ago these were essentially written off as capital expenditures each year; therefore, we may have to go back and recalculate some of the assets which the province owns for this to take place. But I think this is an appropriate disclosure. Again, I note that Mr. Salmon has not qualified his financial statements, but this is one of the continuing items which we have some delight in discussing from time to time, sharing views about different approaches to it. But I think with respect to the history of the universities, hospitals, and colleges in this province, this is a reflection of the de facto way in which they operate. It may be subject to some de jure test; nonetheless I think it's consistent, and that's the way we would continue to do it the future.

MR. CHAIRMAN: Mr. Chumir.

MR. CHUMIR: Thank you, Mr. Chairman. I welcome the minister and his staff here.

MR. JOHNSTON: Sheldon, how are you?

MR. CHUMIR: Just terrific, Mr. Minister. Thank you.

I would like to refer – surprise, surprise – to page 2.36. As well, I'd like to bring the minister's attention to an item relating to a loan guarantee to Gainers Properties Inc. – is that name familiar to the minister; that's not my first question – stated to be $58,872,000 as of March 31, 1989. Now, with respect to the granting of these loans, in the beginning of his comments the minister stated that one of their criteria is that new investment should flow. The press release issued by the government on March 3, 1988, indicated that this guarantee and some other assistance was to fund the expansion and improvement of the Edmonton plant and a new southern Alberta plant. We know since then that the loan was primarily to cover existing bank indebtedness at Lloyds Bank. Indeed, on March 31, '88, these public accounts show that there was a complete indebtedness, that the full guarantee of $55 million was being taken up and the full $55 million was in respect of this bank guarantee at that time.

So I'm wondering whether the minister would be able to tell us, at the time in which the guarantee was given, how much the bank loan was at that particular point in time and how much was left over for other activities, and how that fits into that principle he set out that new investments should flow from these guarantees.

MR. JOHNSTON: Well, I'd be glad to go back on the guarantee again, but Mr. Pashak may get a little twitchy over there. Let me try to outline this decision in a broad way. Gainers obviously has already been a subject of a lot of discussion and consideration in the Legislature, so I probably haven't much more that would be new information. But what we did is simply provide a guarantee to a company that was going through a difficult period because it was important to the economic profile of the province.

I think even the Member for Calgary-Buffalo, Mr. Urbanite, would agree that the agricultural industry is a significant strength of the province, and as I indicated earlier, agriculture was subject to the frailties of treasuries of other provinces. If you look at the numbers of hogs being produced in Canada going back to 1950 and, say, 1986, you would find a major shift in hog production away from western Canada towards Quebec and perhaps even Ontario – unnatural in its fundamental economics, as Ricardo would say, and driven essentially by the decisions of treasuries to seduce investment in their province based on subsidies. So you can't have an industry which is predictable and important to the producers in this province swept away by subsidies.

Now, when an industry of this size is under financial stress, one of the places you look to is other investment or the existing shareholders. Obviously, if that doesn't turn well, you look on a broader economic base to see if there's an opportunity for the province to play a role. In this case it was the judgment of government that the province should play a role to stabilize this entity, divorcing itself from the personalities who were involved but aligning itself with both the producers and the employees of the entity as the major reason for providing that guarantee. It was done on that basis. It was done to protect the industry, to protect the jobs and protect the producers, and that's exactly what it did.

There were discussions about future investment. One of the conditions was that we provide an additional comfort through a long-term loan which was interest free for a while, which started to accumulate interest after, I think, the first year and half, which had a bullet payment on it. Of course, in both cases we had full security against the assets, and that was contingent upon a decision to expand the plants so that our hogs were sold in a different form. One of the expansions did take place in Saskatchewan, which was similarly funded by the Saskatchewan government through a company called Saskatchewan Economic Development Corporation, and there was a commitment to attempt one in southern Alberta. The latter commitment failed, and obviously that's caused some concerns about how the government operated.

Well, we operated to expand, we took the risk, we saved the jobs, we assisted the producer, and now we have the company. It's as simple as that. It was important in terms of the economy, it did drive jobs, there was an intention to drive new investments, and in fact the producers, as it now turns out, are well protected because the company is continuing to operate. I would imagine at some point we'll move it back into the hands of the private sector.

MR. CHUMIR: I thought the question was primarily: how much was the bank loan at the time the guarantee was given?

MR. JOHNSTON: Fifty-five.

MR. CHUMIR: The bank loan was at $55 million at that point of time? Okay. Thank you.

Now, we see from the public accounts that this amount has grown to $58 million-plus. I'm wondering whether the minister could tell us generally, with specifics, about the deal the government made re payment of interest, since the press release only indicated a $55 million guarantee, not $55 million of interest. What is the deal with respect to interest, including rates and when it's payable and how much we had actually paid? This is an accrued amount, the $58 million.

MR. CHAIRMAN: I think you're working in a number of questions there. Just leave it in the broad . . .

MR. CHUMIR: Well, I'm trying to give examples of the type of information I want on a broad basis, including how much has been paid . . .

MR. CHAIRMAN: Describe how the interest on the part of this debt is treated.

MR. JOHNSTON: Well, I don't know where to start on all these questions. I may have to go for 20 minutes here.

MR. CHAIRMAN: Broadly explain how the interest debt is handled.

MR. JOHNSTON: I can tell you the following: number one, the loan was $55 million, and at the time the guarantee was provided the loan was $55 million. There is an agreement to pay interest on principal on, I think, an annual basis, if my memory is accurate. Obviously, the difference between $55 million and $58 million at the time of the year-end deals with the arbitrariness of repayment dates and annual fiscal year-ends, and because the fiscal year-end does not align itself with the interest payment, there is an accrued interest calculation. Of course, our guarantee covers the principal plus accrued interest.

MR. CHUMIR: When and what rates, Mr. Minister. Would the minister undertake to provide that?

MR. JOHNSTON: No.

MR. CHUMIR: No. He's said no before.

MR. JOHNSTON: Nice try, Sheldon.

MR. CHUMIR: My final question is with respect to another principle the minister outlined, that they take good security and ensure that personal covenants are in place. We're all aware the personal covenant of Mr. Pocklington was not taken with respect to this loan, and I'm wondering whether perhaps he might elucidate as to why that was the case and just what is the principle or the rule within the minister's department as to when personal covenants are required.

MR. JOHNSTON: Well, I'm surprised, Mr. Chairman, the member has that information, because it's not my information.

MR. CHAIRMAN: Mrs. Laing.

MRS. B. LAING: Thank you. Page 5.27 of the Alberta Heritage Savings Trust Fund balance sheet shows as of March 31, 1989, an increase in cash and other short-term investments. Is this part of a deliberate strategy?

MR. JOHNSTON: The Heritage Savings Trust Fund, of course, is now in almost a holding pattern. The member knows the history of it as well as anyone. Since we're using the income stream of the entity to transfer to the General Revenue Fund to assist us in maintaining our first-rate expenditures in Health and Education, we are therefore attempting to maximize the return on the heritage fund. It is a strategy essentially to convert as much of the fund as possible into liquid form. That means that since April 1987, in particular, the rate of return on money market instruments has been quite high. Today, for example, I know it's out of scope a bit, but the T-bill rate – I don't know what it is today, Allister – of 13.7, say, is a fairly high rate of return for a cash option, and therefore we have continued to have a more liquid profile of the heritage fund than a less liquid profile. Assuming that the so-called short end of the yield curve is yielding more than the longer term of the yield curve, we've been investing in short-term securities, maintaining cash assets, because that's where the rate of return is highest at the present time.

At the same time, the member should be aware that we are using part of the liquidity of the Heritage Savings Trust Fund to provide, on a regular interest basis, advances to the General Revenue Fund or to other funds in particular to help us buffer the demands in the capital market with the frailties of the capital market. That is to say, if you need to borrow money at some point and the capital market is moving against you for a variety of reasons, you can always borrow from the heritage fund at a market rate and then replace it once it's refunded off the long-term market onto capital markets.

We have used, for example, some of the liquidity of the heritage fund to fund – correct me here, Allister – certainly the small business fund, the 9 percent loan fund, and in part the Farm Credit Stability Fund. What we have done is used the liquidity there to match certain repayments of duration going from three to five years going out, which again provides a fairly nice yield back to the heritage fund. But you're right. It's a very good question, very perceptive in seeing that change, and we'll probably continue to maintain it in liquidity form.

MRS. B. LAING: Thank you very much.

MR. CHAIRMAN: Mr. Lund.

MR. LUND: Thank you, Mr. Chairman. Good morning, gentlemen. I've got a question on the Treasury Branches and their loan loss provisions. I notice in the Auditor General's report, under Audit Observations, that the loan loss provisions have been mentioned in previous years and again this year. As a matter of fact, recommendation 6 on page 11 states that "It is recommended that the systems used by Treasury Branches to estimate loan loss provisions be improved." Now, I'm wondering, what has the Provincial Treasurer done to accomplish this improvement in the Treasury Branch loan loss provisions?

MR. JOHNSTON: Well, we always take advice from the Auditor, and if you look at the advice, it says: improve the loan loss controls. I think Mr. Salmon would agree that post March 31, '89, we've done just that. It's not a surprise to anyone that the Treasury Branches suffer losses. It's not a surprise to anyone in the financial institution business to know that western Canada is probably a high-risk area, starting with possibly '83, growing sharply in '86, and similar to other financial institutions, the Treasury Branch is experiencing losses. I had the same concern as Mr. Salmon about the losses in the Treasury Branch, because of course these losses, if they were significant, could cause a major erosion of the assets of the depositors and, therefore, because the province provides a full guarantee would transfer back to the province.

We'd already been through a massive review of financial institutions in western Canada. I'm not going to enumerate the two banks and the credit unions and the trust companies – we are all familiar with those – but we did have some experience as to what was happening in these institutions. Nonetheless, we knew all along that the Treasury Branches were operated more effectively and I think were more careful in the kinds of credit they did grant, recognizing, however, that they were driven by an Alberta economy and by the necessity to protect both farmers and small businessmen and individuals in this province; that is, to take a little greater risk at a time when the economy was going against us to ensure that access to borrowing was provided to some of those major groups. The Treasury Branch over its 50-year history has done just that. It's a major buffer against large financial institutions. It could be seen to be a populist response, which I agree with.

Similarly, with the Auditor we had a very extensive review done of the loan loss calculations in the Treasury Branch. It's true that the losses of the Treasury Branches over the past three years have been something like close to $140 million – Allister, Mr. Salmon? – someplace in there. A lot of that has been from write-offs of assets which were foreclosed or where loans or mortgages were foreclosed, and obviously we'd take the asset back and sell it off. But we had an external consultant in who went back to every one of the files we have established, and each file was reviewed independently and an assessment was made of the kinds of risks you're looking at. As well, of course, we're concerned about matching assets with liabilities. We are quite satisfied now, and I think post March 31, '89, we are very satisfied about the kinds of risks we're taking in the provision for loan losses themselves. I would expect – I'm not too sure what's going to happen this year – you'll see the Treasury Branches getting either close to break-even or generating profitability. The judgment hinges on Mr. Salmon's wisdom or arbitrariness, depending on whose side of the issue you're on. I think the loan loss provisions have been well covered. We've taken provision for all those files where we see the loan losses, and that's why the Treasury Branches have shown a loss to date.

Of course, every system can be improved. We accept the advice of the Auditor, and we're doing just that, improving the system, as I've said. The confidence level in our provision for loan losses is running higher every year.

MR. CHAIRMAN: Do you have a supplemental?

MR. LUND: Thank you. I'm not sure from what you said if the losses the Treasury Branches have been suffering over the last years is partly because of the inadequate system to estimate these, or is it because they were taking some extra risks that maybe some of the other institutions were not taking?

MR. JOHNSTON: I think it's a bit of both. I guess there are three problems here. One is the fact that Treasury Branches are Alberta based, they haven't got a diversified portfolio, and therefore their risk is focused in Alberta. With that kind of narrow base, I think it's surprising the Treasury Branches have done as well as they have, both because of the lack of diversity of their portfolio assets and because they have taken, I think, more strident risks with respect to the chances that afford the investor in Alberta: the small businessmen, the farmer, or the individual. They've taken a more aggressive stance there as well. So on that side, you can expect that the expected loss or the expected cost of losses is going to be higher. The probability times the total loss potential will be higher in the case of Treasury Branches than it would be in a institution which was balanced in its portfolio across Canada.

The second question is one of judgment. It's always a judgment in these things: at what point does a loan become either a direct write-off or a provision? Now, generally institutions use something called the accrued interest test, I guess, wherein if the company is not paying interest or not making amortized payments - I'm not too sure what the trick is with respect to the Treasury Branch, but let's say that they don't make payments for six months - then the loan starts to become an accrued interest loan, and therefore it has a second category in terms of its evaluation. Then, finally, there are going to be those loans which are absolute losses, where the direct write-off must take place. Those are pretty easy ones to judge.

In between there, there are some people who suggest that we should have a general provision for loan losses. That is to say, although you can't identify the specific file or specific loan, you should in a general sense provide some sort of percentage of all the loans that are outstanding by categories, assign some probability of a loan loss taking place, and make a provision in your accounts for that loss. Well, that is one way of doing it. I can tell you that the way in which the banks calculate a loan loss is a checkered history. They built up reserves. They used long-term averages. They did a variety of things to provide for those loan losses. We think that the Treasury Branches, and we're sure of that right now, are taking adequate provision for losses. We've done a file-by-file analysis of the existing write-offs, we're in the process of disposing of real estate which we foreclosed, and we're looking at those kinds of soft loans which may require some sort of corrective action as well.

So I think this year, after taking overt action clearly in 1987-88, we have a very good handle on the way in which these loan losses should be disposed, the values, and how to calculate them.

MR. LUND: Thank you, Mr. Chairman.

MR. CHAIRMAN: Thank you.
Mr. Hawkesworth.

MR. HAWKESWORTH: Thank you, Mr. Chairman. Welcome to the Provincial Treasurer this morning. I take it from the long list of committee members wanting to get in this morning that may not get the opportunity, perhaps we could request before the end of the meeting this morning that the Chairman arrange a second appearance of the Provincial Treasurer so that all members of the committee who have questions today and don't get in may have an opportunity to put those to the Provincial Treasurer.

In his remarks in answer to your questions, Mr. Chairman, the Provincial Treasurer indicated that guarantees seem to be the mildest form of involvement by the provincial government, as inoffensive as any, I think, if I heard him correctly, the least offensive form of providing support to companies. But I'm sure the Provincial Treasurer would agree that from the credit granter's point of view, they're exactly the same as providing a direct loan. My first question to the Provincial Treasurer in regard to guarantees is whether he agrees that the granting of guarantees is the same as a direct loan in that both of them are in effect an extension of credit?

MR. JOHNSTON: No.

MR. HAWKESWORTH: The Provincial Treasurer doesn't consider them the same. That I find quite astounding, Mr. Chairman, because exactly the same obtains in terms of extending credit to the recipient company, and certainly others in government service consider them to be the same. Is that the reason why he uses a guarantee rather than . . . I'll leave that, Mr. Chairman.

I guess the other form of extending a credit is through direct loans, and I'd like to ask the Provincial Treasurer in regards to the Treasury Branches, which is the other means that this government uses to extend credit to borrowers: why is it that Treasury Branches are used to make major loan commitments to industries not deemed creditworthy by commercial banks? Why is that the case in terms of the structure and the purpose of the Treasury Branches?

MR. JOHNSTON: Just so I understand the question, Mr. Chairman, is Mr. Hawkesworth asking me: is it a fact the Treasury Branches take greater risks for Alberta-based companies?

MR. CHAIRMAN: Do you want to restate your question?

MR. HAWKESWORTH: Okay. Among other things they take risks that other commercial banks do not take in that they deem certain companies not creditworthy and the provincial government extends loans to them where other commercial banks do not.

MR. JOHNSTON: That's right. That's precisely the strength of Treasury Branches, and I hope that you would disagree with the Treasury Branches' position, because guess what? Very few Albertans disagree with the risks that are being taken by Treasury Branches.

Now, I'm not too certain if you're taking a position or if you're simply asking for an explanation. I hope it's the latter.

MR. CHAIRMAN: We have a policy debate here, hon. Treasurer.

MR. JOHNSTON: Because I know this is quite an interesting view, and I will take it as a neutral question as opposed . . .

MR. CHAIRMAN: I think your answer is that you're taking a position – I mean, your answer in effect . . . Well, I'm going to have to restate the . . .

MR. JOHNSTON: I haven't answered yet.

MR. CHAIRMAN: Okay.

MR. JOHNSTON: But I will, if you give me a chance.

Yes, it is clear that the Treasury Branches are in the process of evaluating investments in Alberta in a different way, which in its fundamental form can only be equated to a different view of the risk. That's exactly and precisely why Treasury Branches operate in the province of Alberta, because it's that risk calculation, which varies from day to day, from week to week, from year to year, from bank to bank, that in fact is the strength of the Treasury Branch.

Now, many people here would know of the times when the central banks started to tighten up, and certainly that happened in 1986. Clearly the policies of the central banks, despite the protestations to the opposite, were: stop lending in Alberta. They said that the risk in Alberta for the central banks was far too high; we don't need that business; let's be very careful; let's start to call the loans; let's start to squeeze the industries; let's start to recall the cash, and let's not put out anymore money in Alberta.

Now, Mr. Hawkesworth comes from Calgary. I'm sure he's talked to many people in the oil business who experienced that very phenomenon. Energy was soft, cash flows were down, reserve calculations were down, debt continued to rise, and the poor old people in the financial industries said nothing that would comfort the oil and gas sector. Therefore, they started to withdraw money, put the squeeze on, force receivership, force liquidations, and therefore cause an erosion of the economic growth and strength of this province.

In my mind the Treasury Branches buffer that very centralized notion that takes place in banking institutions, and I'd love to debate that issue with the central bankers, particularly those big five banks. When they come to visit me, they know that the Treasury Branch is probably the second largest bank, if not the largest bank, operating in Alberta. Our growth is secure, our deposits are rampant, and people love the comfort and guarantee of the province. But at the same time, as I said to my colleague, we like to have the Treasury Branches taking a touch more risk, specifically with respect to small businesses, to farmers, to those people who are struggling to get some kind of a credit line over the course of their business cycle. It is that business cycle that drives the decisions by the big banks, and those big banks from time to time put the screws on dollars flowing to Alberta. The Treasury Branches are countercyclical to that trend and are an important policy of the province, to ensure that they stay in place and provide the needed capital to the small business investor.

Therefore, at the bottom line it is in fact precise to say that if you were to evaluate or to compare the risk equation – which is made up not just of the items I talked about, geography or economic cycle, but a variety of others, including the credit worthiness and cash flow availability – and evaluate the risk-taking decisions of the Treasury Branches and put them parallel with the financial institutions that I referred to, what obtains specifically is that the Treasury Branches do take greater risks. And I'm very pleased that they do that, because it provides comfort and security to the sustained economic growth of this province, access to capital by small businessmen and the farmers. That's what it's all about, and that's why the history has been 50 years of success.

MR. HAWKESWORTH: Well, Mr. Chairman, it's certainly understandable in terms of small business and especially in smaller communities in rural Alberta that don't have access to capital. I guess my concern is that major commitments are being given to major companies that are not deemed creditworthy by commercial banks, and the question then comes into play in terms of prudent management of the province's financial resources. I notice with the Treasury Branches that there is no structure similar to that of other financial institutions in Canada in the sense that there's no board of directors guiding and reviewing policy and reviewing these kinds of loans. I'd like to ask the Provincial Treasurer: given that there is no accountable board of directors in terms of the lending policies of the Treasury Branches, why is it that those changes or those structures have not been put in place to provide sort of an arm's-length relationship with the provincial government and thereby pursue the kinds of policies he's talked about in an accountable sort of way? There's no clear accountability mechanism within Treasury Branches to ensure that these policies are prudently administered. Given the statements he's made that he's willing to take all sorts of risks regardless of the consequences, who then is accountable for lending within the Treasury Branches?

MR. JOHNSTON: Well, the member is making some very broad generalizations which are not substantiated by fact. We are talking about degrees of risk, which is a fair assessment. I've explained that already, Mr. Chairman, and I can say as well that we're looking at a variety of ways in which we can improve the operations of the Treasury Branch. The facile assumption that a board will solve all the problems of the Treasury Branch is just that, but it is possibly one of the recommendations which we would consider. I know the member has made it before, but let me make it clear that if we ever move to a board, it wouldn't be his idea, I can assure you. What is needed is a more comprehensive review of the Treasury Branches, and that is ongoing right now.

The most significant fact that a financial institution faces is the so-called asset/liability management. This game is a spread game, as the member well knows. If you make a loan at a price above what it would cost you to borrow it, you make money. That spread factor is essentially the evaluation of risk and depends upon the availability of dollars to loan out. Now, the Treasury Branches have a vast availability of dollars to loan out because of the confidence that Albertans place in the Treasury Branches. On the other side, as I've indicated, given the focus of their activities – that is, the fact that their investment base is not diversified outside the province for constitutional purposes – and given the fact that they have taken risks to ensure that small businesses grow, that jobs are generated, that farmers are helped, that individuals are provided access to banking services with their own money, then in fact the losses have been really not all that great for that very reason.

Thirdly, to suggest that they are taking unnecessary risks with respect to – I guess I can only read into it – some large entities is in fact just not accurate. He just doesn't have the facts, and this just isn't the case. What I can say is that there are cases, and I can plot several of them just off the top of my head, where an individual could not borrow money at a chartered bank, turned to the Treasury Branches, and said: "Gosh, I've got a heck of a good idea. I'm hard working, I've got a good record, but damn it all, those big institutions won't give me the money." The Treasury Branch may in fact provide an individual like that with a $10,000 or $15,000 or maybe $50,000 loan. Guess what? The idea grows; the company prospers. Soon the idea, not unlike other ideas in Alberta, becomes a national idea which is attractive, which has a marginal rate of return that allows a company to expand, to generate jobs and reinvest in the province. It happens to grow, Mr. Chairman. In some cases these small companies that start out with a very few dollars outgrow the financial capability of the Treasury Branches, because we've been very precise in our constitutional base to ensure that they operate entirely within the provincial jurisdiction.

Now, as members have heard me say time and time again, the financial markets are changing rapidly, and therefore the Treasury Branch is attempting to keep contemporary. I mean, we have electronic cards, we have electronic banking, and as a matter of fact we're one of the few, if not the first, banks in Alberta to have home banking services, a debit card at home, if you want to use it; very high tech. But it's for some of those transactions which are worldwide in nature, where the diversity of the company's operations are such that they expand amazingly outside the province's borders, that you have to have a larger financial institution to deal with the clearing question. Therefore, in some cases when the entity becomes very large, it does outgrow the Treasury Branches. And the Treasury Branch, by specific policy, says: "You know, I think you'd be better suited to a larger financial institution where you have a national, worldwide opportunity for banking services. You deal with more complex kinds of transactions that aren't available to the Treasury Branch. In fact, we want to use the deposit and the resources which we would otherwise devote to you, valuable client as you are to us, to other small businesses to encourage them to do the very same thing."

So I think it just isn't accurate that we are taking unnecessary risk with large clients; in fact, just the contrary is true. Over the past couple of years we have moved back from some very large clients, freeing up people and resources to allow small businesses to have access to those funds and allowing them to grow. In fact, if you look at the record of the risks and the losses with respect to large companies, it's absolutely not out of proportion with other forms of losses which the Treasury Branch may experience.

Let me come back, though, to the need for structural changes. We have had the Treasury Branches working with Allister and myself and the consultants that I've indicated over the past year and a half to two years. We're in the process of revitalizing, reviewing, rethinking some of ways in which Treasury Branch operates. It's going to maintain its profitability, it's going to maintain its uniqueness in Canada as a financial institution, and it's going to do things better than it has done in the past. That's our commitment; that's what's happening.

I should say that Ontario sent one of its ministers out here to view the Treasury Branch operation because they were so intrigued with the way in which the Treasury Branches were operating. They saw it as a major opportunity to balance countercyclical policies. They saw it as being a superb example of how provinces can use their own resources – of the small businessmen, of the people – to build a significant financial institution, and they saw the strength and success of those Treasury Branches.

Let's talk about the success story. Let's not be doomsayers about the Treasury Branch, a remarkable success story.

MR. HAWKESWORTH: Did I hear the Provincial Treasurer, who is a chartered accountant, say that the profitability of Treasury Branches . . . That $149 million deficit: did he call that profitable?

MR. CHAIRMAN: This actually becomes another question. But I think he's just saying: in your remarks did you use the word profitability in association with the recent operation of the Treasury . . . He's just wondering if he heard the word profitability correctly.

MR. JOHNSTON: Glad to make it a specific item here. First of all, the Treasury Branches have been profitable except for the year – what is it, Allister? – '86, '87, those two years where the recession was involved, and that generated the losses which are there. But remember this: when the Treasury Branches were profitable, they transferred one-half of their profits to the General Revenue Fund because they wanted to be so-called tax equivalent. I don't agree with that. I think if the Treasury Branch makes profits, they keep it for themselves and reinvest it and expand.

But I am saying that we recognize that the losses were there. We're doing the best that we can to rethink and to develop a more specific business plan for the Treasury Branches, which will return them to profitability, and I think the Treasury Branches will in fact be profitable this year.

MR. CHAIRMAN: Thank you, hon. Treasurer.
Mr. Severtson.

MR. SEVERTSON: Thank you, Mr. Chairman. On page 3.133, vote 3.5.2, it shows an overexpenditure of $10 million on the trust companies. Could the Treasurer explain that overexpenditure and perhaps even explain the expenditures on trust companies?

MR. JOHNSTON: My goodness, Mr. Chairman. Someone's been thorough in their homework. What page is it again?

MR. SEVERTSON: Page 3.133, vote 3.5.2.

MR. JOHNSTON: I might leave that one to the experts. I'm just going to have a coffee.

MR. O'BRIEN: The vote reference was?

MR. SEVERTSON: Vote 3.5.2.

MR. O'BRIEN: Oh, okay.

MR. CHAIRMAN: We're dealing with the public accounts for '88-89, right? Three point one three?

MR. SEVERTSON: The page number is 3.133, and the vote is 3.5.2.

MR. O'BRIEN: That's the vote that pays for the Code inquiry, and that overexpenditure was the subject of a special warrant.

MR. SEVERTSON: So it all relates to the Code inquiry, that whole expenditure?

MR. O'BRIEN: Yes.

MR. McPHERSON: No, not the $16 million. The large part of the increase, if not all of the increase, would have related to the Code inquiry.

MR. SEVERTSON: Okay. What was the other expenditure in that account for then?

MR. McPHERSON: Mr. Chairman, the main part of that would be, first of all, the administration associated with the Trust Companies Act, and I believe the estimates also included, from memory, some dollars related to the Principal Group affair.

MR. SEVERTSON: Okay. I'll go to a different area of the same page, vote 2.2.2., Farm Fuel Distribution. It was also an increase. Was that just underestimating the amount of volume?

MR. McPHERSON: Yes, Mr. Chairman. That was volume increases in the consumption of fuel.

MR. SEVERTSON: Okay; fine. Thank you.

MR. CHAIRMAN: Thank you.
Ms Laing.

MS M. LAING: I would like to refer to recommendation 7 on page 12 of the Auditor General's report, in which it is recommended that there be an identification system that looks to all the "loans and commitments that share common collateral or earnings"; that would be a singular owner or company. I'm wondering if that has been put in place.

MR. JOHNSTON: Well, Mr. Chairman, as I've indicated before, I don't know of any financial institution or, for that matter, any financial information system, management information system, that isn't always capable of some improvement. We admit that in the case of some of the internal information systems the Treasury Branch has been operating, there are technology changes which would more adequately provide information to the decision-makers of the Treasury Branch. I have had the same concern as the Auditor has that management information systems were not flowing to the decision-makers, and in fact there needs to be some major improvement in the way in which that happens. That's part of the business plan that I talked about, whereby the revitalization was to take place and new management information systems were to ensure that the integration of information was done. That has taken place, and we have this so-called Synergy banking system. I hate the word Synergy because it's a 1960s term, but anyway we do have something called the Synergy banking system which in fact is going to do just that. There's a customer number; there have been ways to collate the information. And with all systems, every time you talk to a new computer system salesman, he's got a better idea. We agree that some of these things can be improved.

Our focus has been on the management information systems to ensure that decision-makers are getting, on a regular basis, updated daily information; that at the end of the day they know where they stand with their asset and liability exposure; that they can match the assets, the liabilities; that they know where the spread is at the particular time; and that they have much better information. Part of that, of course, deals with the credit risk, which is essentially this issue. In terms of evaluation of credit I guess what they suggest is that at some point there may have been a duplication of credit provided. Now, that's either a mistake, it's sloppiness, it's a misrepresentation by the person borrowing the money, or all three. That happens, I agree, but if you have a better management information system, you will be able to avoid that to the extent humanly possible or systemwise possible. We're in the process, as I say, of ensuring that a much better system is in place. It's part of the long-term strategy.

MR. CHAIRMAN: So I take it, if I may, just by way of clarification, that your answer is yes, you're moving in the direction of implementing this . . .

MR. JOHNSTON: I think the Auditor would agree with that.

MS M. LAING: That's good to hear. I'm wondering, in the context of having this integrated system where you would be able to track the loan application and loan guarantee applications from a single owner or collateral base, would you then put some guidelines in place as you do in terms of risk categories? Would you also have the same kind of guidelines in place in regard to owners in common or collateral flowing from a common source?

MR. JOHNSTON: Well, sure. You know, an entity such as the Treasury Branch develops certain processes and certain procedures. Our procedures are much the same in terms of the overall evaluation and securing of our position, securing of our loan, as other financial institutions would achieve. On a straight credit-granting basis, obviously collateral is important, the security within the entity is important, the collateral provided by the person himself outside of the organization or structure he's operating is important, and the creditworthiness of the individual is important. But, in particular, these decisions essentially impinge on the cash flow of the entity. No matter how you cut it, you've got to be able to pay the loan back, and that's what the credit judgment's about.

Now, in some cases the risk is that even though the asset isn't there, the person is going to pay the loan back. So in terms of repayability, you have to assign some value to it. The best criteria of judgment of the repayability of a loan is the cash flow, having a history of profitability or cash flow – sometimes they're not necessarily the same thing, but certainly cash flow – and showing, as you work out over the next decade or whatever the amortization period, that the present value of the capital investment decision is less than the present value of the income generated by that asset. I mean, that's a simple capital investment decision. If the present value of the income stream is greater than the present value of the asset, you invest. If the present value of the income stream is greater than the cost of amortization and principal, you provide the loan. You have certain heuristics or rules of thumb which say that if the interest covered is one and a half, two and a half, three and a half times – depending on the industry, depending on the economic situation, depending on the management ability – then you provide the loan. Those kinds of decisions are intrinsic, or fundamental, to a credit-granting institution such as the Treasury Branch.

What we're doing here is taking it from the individual judgment and putting it onto some kind of a management information system so that at the end of the day you can tell what your exposure has been on certain kinds of loans; you can tell how you've matched off your assets and liabilities, because that's the business you're in; and you can tell what kind of exposure you may have on certain loans on a very updated basis as opposed to waiting for somebody to get home from vacation, where in fact the file is sitting on the desk and maybe the clock is running against you – you always have that risk.

In terms of taking asset security, obviously you do title searches, you have disclosure affidavits, statements of disclosure, and wherever possible, you would take a personal guarantee.

MR. CHAIRMAN: Thank you. Final supplementary.

MS M. LAING: Well, I guess I'm wanting to get something more specific. You try, in terms of limiting credit risk, by not lending all your money to, say, somebody growing beans or mushrooms, because there would be a limited possibility of recovery from that particular area if in fact everybody in Alberta was growing beans and mushrooms. The concern that I raise then: in terms of the assets, the collateral of a particular company or individual that is, in fact, applying for loans for a series of developments or investments but has a common pool of collateral, will you then make a commitment to put in place guidelines to say only that there will be some limitation there? You know, I think a nice theoretical statement about balancing this and that . . . But I'm wanting specifics in regard to companies. I think when we look at Peter Pocklington and Gainers, we see some questioning about: were there guidelines in place that could have prevented the kind of losses that we now have experienced? That's what I'm asking.

MR. JOHNSTON: Well, what losses are you talking about?

MS M. LAING: That he was not able to repay.

MR. JOHNSTON: Well, that's absolutely false. So either you know what you're talking about or don't raise that kind of a position, because you don't know what you're talking about.

MR. CHAIRMAN: I'll assume that's the answer to the question. I've got a chance to . . .

MS M. LAING: Then why did you take him over? Like, come on.

MR. JOHNSTON: You don't know what you're talking about.

MS M. LAING: I suggest possibly you don't.

MR. CHAIRMAN: What we're getting into is a debate back and forth across the Chamber. If we could at least come through the Chair, I'll give the Treasurer a chance to make his position clear with respect to this issue.

MR. JOHNSTON: I'm not going to talk about individual credit files in the Treasury Branches; I've made that clear before. That's not my responsibility, and obviously it's not the way in which we operate the Treasury Branches, because we want to maintain confidentiality. We want to know that an individual who deals with the Treasury Branch, whether you've got a $100 credit account there or a $2,000 personal loan, has confidentiality. This is not a frivolous position. We're very serious about it, and we may have to take some hammering, because obviously the odd time you get into a position where you can't tell what's happening. Of course, that is the important principle: confidentiality about an individual's assets, liabilities, and business practices must be absolutely sacred.

But I was trying to deal more broadly with the way in which these operations take place. The only thing I didn't note is that from time to time if the Treasury Branch is called upon to be involved in a very large loan – let's say a $10 million, $15 million, or $20 million loan – it may turn to other financial institutions who are familiar with the credit and say, "Do you want to participate in this loan with us?" This is quite common in the private sector, in financial institutions in particular. You may broker off part of the risk or part of the loan with another institution, and that's done all the time. Therefore, you limit your exposure to any particular asset or client or credit risk, and you share it with other institutions. That's done all the time, and that's the way the Treasury Branch operates as well.

MR. CHAIRMAN: Thank you, hon. Treasurer. Just in light of the hour, I'd like on behalf of the committee to thank you and your staff for appearing here today. We certainly appreciated the comprehensiveness of your answers. We wish we had more time to spend with you, and I hope you're delighted with the fact that we provided you with such an attentive captive audience.

MR. JOHNSTON: It was a very good time, Mr. Chairman. I appreciate the morning. Thank you so much for the invitation.

MR. CHAIRMAN: To the committee, we do not have time to get into other business. There are some items before the committee. I suspect that next week when we meet with the Minister of Energy, the Hon. Rick Orman, we may have some time to deal with other business.

I'd recognize Mr. Moore.

MR. MOORE: I move to adjourn.

MR. CHAIRMAN: Motion to adjourn. Those in favour?

HON. MEMBERS: Agreed.

[The committee adjourned at 9:59 a.m.]