1:06 p.m. **Monday, December 15, 1997**

[Mr. Pham in the chair]

THE CHAIRMAN: I would like to call the meeting to order now. First, I need a motion to approve the agenda as presented to us. Okay, Mr. Shariff. Anyone opposed? So carried.

The next item on our agenda is the presentation of the Alberta heritage savings trust fund's three-year business plan starting from 1998. It is the annual thing that the committee does every year: get together and approve the business plan.

I will turn it over to the Treasurer to give us the presentation. I also would ask you, sir, to introduce the people that you have with you so that *Hansard* can record them.

MR. DAY: With me today is Al O'Brien, Alex Fowlie, Robert Bhatia, James Forrest, and Laurence Waring. Laurence is the investment liaison officer.

Mr. Chairman, I was asked some questions by Debby Carlson when I met with you about a week or so ago. There was a request for a summary of the application of project cash to the Al-Pac loan and the relevant excerpt from the agreement, and also a schedule showing the anticipated repayment of provincial corporation debentures and an estimate of the premium over the book value at the time of payment. I have that information here for you today.

THE CHAIRMAN: Thank you. I would ask Diane to make copies and distribute them to all the members.

MR. DAY: Okay. Mr. Chairman, the business plan of course being a three-year business plan does not have significant changes in terms of the overall plan, and I would hope that members have had the opportunity to peruse it, given that the plan did receive approval about this time last year, I believe. There are, however, some items of interest from our Investment Operations Committee. As you know, the Investment Operations Committee reviews and recommends the business plan to the Treasurer and then on to this particular committee. I'd like to just get to those in a minute.

I don't have to remind members here, but just for the sake of putting it on the record, the heritage fund has been divided into two separate portfolios, as we know, which has approval of this table and our larger legislative table. Starting in '96-97, a minimum of $1.2 billion in assets needs to be transferred annually from the transition portfolio to the endowment portfolio and by the year 2005 all assets transferred there. As of September 30, 1997, the fair value of the transition portfolio stood at $9.727 billion, and the market value of the endowment portfolio was $2.494 billion. So that particular transition, the moving of those funds, continues to happen at a pace approved by this committee.

The Investment Operations Committee, in looking at the fund and looking at the portfolios, has recommended some changes to the endowment portfolio's investment policy, and having looked at those and gone over those, I find myself favourably inclined to those particular recommendations and certainly would hope that this committee does also. If I can just touch on what those would be. An overview executive summary was presented to you; also, the detailed amounts beginning, if you look, on page 10 of the document provide the basis for that.

The main areas for consideration. The foreign investment constraint in the regulations is recommended now to be removed and the foreign equity exposure to be set as part of that investment policy. With the removal of that constraint, the recommendation is that the foreign equity benchmark be increased from 15 percent to 30 percent. I know that Mr. Shariff, for one, had looked at and recommended that some time ago, so he was well ahead of us in our thinking there. Increasing that foreign equity exposure will increase the diversification in the overall risk management characteristics of the portfolio. That'll help to offset some of the increased volatility that results from a higher equity weighting. I would see this as a positive move and will build and add to the long-term returns and the strength of the fund in general. With that there would be an accompanying policy allocation to equities from 50 percent to 60 percent, again increasing the potential long-run rate of the return and, I think, enhancing the possibility of realizing that 5 percent real rate of return expectation. There has been some analysis done in terms of what would be the income on the short term, and all analysis would indicate that that would be a minimal effect.

Then there are recommendations related to narrowing the policy allocation target for each of the asset classes. Doing that helps to control the portfolio's exposure to a number of risks associated with these asset mix shifts and just builds a more disciplined structure so that that asset mix just doesn't drift with the market, so to speak. Those are outlined for you also on page 10.

What we're looking at in terms of the asset class is the cash and the short term. The current policy benchmark is 3 percent; that would remain at 3 percent. The fixed income: the current policy benchmark being 47 percent, narrowing to 37 percent. Canadian equities: the current policy benchmark at 30 percent, recommended to 25 percent. Foreign equity: as I've just suggested, moving from 15 percent to 30 percent. Real estate: staying at 5 percent.

Again, for the reasons mentioned, I believe, Mr. Chairman, that this will strengthen the long-term viability of the fund and will be seen as a positive move. These types of considerations that are done by the investment committee are done after consultation and measuring up of the markets, still guided by the prudent investment guidelines to which this fund is subjected so that unnecessary risk is not applied to these dollars, which are the dollars of Albertans.

That's a summation of what the recommendations are, Mr. Chairman. I'd certainly be willing to take questions on those and would hope that this committee would also join in seeing that this would be a positive move.

Thank you.

THE CHAIRMAN: Thank you.

Mr. Zwozdesky.

MR. ZWOZDESKY: Thank you. Welcome, Mr. Treasurer, to you and your staff. It's a pleasure to see you again, as always, and it's a pleasure to meet in this committee.

I have a couple of general questions, if you might permit them, Mr. Chairman, very brief, and then I'll get into the specifics. I'm just wanting to know whether or not it's possible at this stage that anything our committee might discuss or perhaps recommend will be reflected by way of any changes to the draft plan. Or is this set in stone now and we're just reviewing it?

MR. DAY: The purpose of the committee is to approve the business plan. If it was agreed in the committee that there was something substantial that needed to be addressed, then I would want to be aware of that and give that some consideration.

1:16

MR. ZWOZDESKY: Okay. I want to just pick up on the first point that you really got into, and that's with respect to the increase in the limit for foreign equities. Is it 15 or 20 percent up to 30?

MR. DAY: Fifteen to 30, yeah.

MR. ZWOZDESKY: I guess the question really is: why has that limit on investment in foreign assets been deleted from the regulations? As I understand it, we've had regulations governing this in the past, and while I can appreciate the need and the rationale behind the projected increase, my question is more with respect to why that has been deleted from the regulations. Is there someone with an answer to that?

MR. BHATIA: The decision was made last year to include the limitation on foreign investments in regulations approved by the Lieutenant Governor in Council, and those regulations were put there initially with a view to constraining the heritage fund on its foreign investments in a way similar to the way pension plans are constrained on their foreign investments. Although there was no other external requirement, like the Income Tax Act in the case of pension plans, to impose that restriction, the decision made at the time was that the fund starting off should have that restriction.

With the input from the Investment Operations Committee, their view was that since there is no income tax imperative or anything like that on foreign investments, it was more appropriate to set the limit on foreign investments by investment policy as opposed to by a regulation per se. So in reflecting their recommendations in this proposed business plan, we suggested that the regulation simply be eliminated but that by policy we establish a limit on foreign investments.

MR. ZWOZDESKY: Well, I would hope that you and the Treasurer and others would agree that we should have some mechanisms by which to gather the information that's sort of required as people try to understand what the heritage fund is doing for us. I thought the regulations were there to help effect that. If not the regulations, then is this now, coming out of your answer, going to be something that is buried in policy? If that's the case, will we then be able to see what these investment policies and investment policy statements, in particular, are going to be? Is that how you're going to offset the deregulation: by still trying to maintain some openness and accountability and transparency? Otherwise, there's a perceived danger, I think, that we're moving away from regulation and openness here. The regulations, in other words, were one sort of checkpoint. I appreciate there was a little bit of administration involved in going through an order in council to change it or to up it or whatever, but it just seems that we've gone so completely to the end, and I'm just wondering: how do we account to Albertans for that move, and will it be through the policies?

MR. DAY: Is there an area of the investment policy which you think is not abundantly clear or up front to the public? As an example, in terms of the Investment Operations Committee and their recommendations, there is some clear indication in the business plan of what the current policy is and what the proposed policy changes would be. I wonder if there's somewhere that we can make that more clear. Is there somewhere where it's being obscured, in your view?

MR. ZWOZDESKY: Well, I guess that's the point. We're trying to keep it up front and open, yet by removing it here, Stock, I would suggest that it would look like there may be things that could happen that the public wouldn't otherwise know about. The way the system is set up at the moment, we do have some greater accountability as a committee, as a Treasury Department, and as a government to the shareholders, to Albertans, but this move goes sort of to the opposite end of the scale.

MR. O'BRIEN: If I could comment. I don't believe it goes to the opposite end of the scale. It really is a question of whether the Lieutenant Governor in Council, the cabinet, should make the decision or whether it should be a decision that's made in the business plan, which is approved by this committee and then ultimately by the Legislature. It's really a question of whether it should be a rule in regulation or a policy in a business plan approved by the Legislative Assembly.

MR. DAY: You know, if you think it needs addressing further, Gene, these foreign limits, for instance, could be explicitly included in the business plan which goes to the Legislature.

MR. ZWOZDESKY: No. I accept Mr. O'Brien's clarification and your comment, but as I look at this, Stock, what I'm hoping is that if Mr. Bhatia's case is correct - and I'm sure it is - will we then see these policy statements from the transition and endowment portfolios becoming public instruments so that we can ensure the continuance of transparency? That's really the issue.

MR. DAY: Well, on the foreign limits I think that isn't difficult.

MR. ZWOZDESKY: Good.

MR. DAY: I'd have to do some checking to see in terms of past precedent if there might be some difficulties in some of these overall policy considerations here, you know, if you'd allow me to look at that and see if we're running into any complications there.

MR. ZWOZDESKY: I guess, Stock, to sort of try and help out, the T in your OATH, which I'll remind you of again - the openness, accountability, transparency, and honesty - is the transparency. If there's a perception in the public's mind that something may be taken away, on the one hand, can you show us some replacement for that transparency through the public disclosure of the policy statements? I don't think that would hurt. In fact, I think it would help.

MR. DAY: No, that's a fair question. If I can take a look in terms of what's involved there and what we've run up against, let me do that.

MR. ZWOZDESKY: Thank you.

MR. DOERKSEN: If I can just follow that briefly. I think the question in my mind, if I follow you, is: isn't there greater accountability with a regulation than there might be with a policy? A policy statement is one thing; if it's in regulation, there's a little more force of the law behind it. That would be my reading of it. That's a comment.

A question I had, moving to the suggested 30 percent on the foreign investments. In your presentation on page 6 it's noted that private- and public-sector pension funds have a 20 percent limit, yet we're proposing to go above and beyond that. I've got to ask why. Why do we want to take on, presumably, a higher risk than pension plans?

MR. DAY: Well, keeping in mind that all investments are carefully restrained overall by prudent investment policies, this is not a high-risk fund. If you look at real estate alone, you're looking at about 3 percent, I think. Keeping that in mind and the fact, as you know, that in terms of just the Canadian market there are more and more dollars chasing fewer and fewer products – and that's going to have some dire effects – it allows for that greater ability. Going to the 30 percent should not be a cause of unnecessary risk, because the investment managers are guided by these other prudent investment policies. It just allows for more fluidity and more of an opportunity to maximize the asset and the return. I don't know if there are some other areas that you want to comment on, either Robert or Laurence, from an investment point of view.

MR. DOERKSEN: Just before you begin. Maybe I don't quite understand it. The way I read it, the recommended policy benchmarks allow us to go to 30 percent of our endowment portfolio in the foreign equity component. If I read the comment on page 6, private- and public-sector pension funds only allow a 20 percent maximum exposure.

MR. WARING: I'll clarify that. The 20 percent limit for a pension fund is not a pension legislation restriction. That's a federal income tax restriction, and it has to do with managing the flow of capital in and out of the country. It hasn't anything to do with prudent management of a pension fund. In fact, if you were to poll pension funds in Canada, there's a number of associations that are on record that represent pension funds in Canada who would say that's a rule that should be ended, that it isn't prudent in managing a Canadian-based pension fund to have that restriction because the Canadian equity market is only 3 percent of the world equity market. To actually invest the bulk of your equity assets in that asset class is actually riskier. So that's the argument.

1:26

MR. DOERKSEN: Okay. I appreciate that explanation. That explains a lot to me.

The other question I have – may I, Mr. Chairman? On the second page in the summary you gave to us, you have current policy, minimums and maximums, and then it has proposed policy, minimums and maximums. Why do we set a limit on minimums? Why do we have anything on the minimum side?

MR. DAY: Good question.

MR. WARING: What you're trying to do is set an asset mix policy as a long-term strategy, and you're trying to impose a discipline on that. For example, you would have minimums and maximums. Let's say that you went into a situation where a market did extremely well in one asset class. Let's say equities go up 40 percent in one year. What this does is it forces you to rebalance, rebalance away from an asset class that may have done extraordinarily well and rebalance toward an asset class that may have not done as well. That's actually a positive discipline if it's done consistently over time. So what we're trying to do here is avoid the portfolios that stand at any point in time to reflect the flavour of the day. It's a discipline. It's a way of maintaining the integrity of the long-term asset mix.

THE CHAIRMAN: Actually, if I may, that's a complicated explanation. The simple explanation is that if you take a look at it, if you only accept the maximum of the two portfolios, then automatically when you reach the maximum of one portfolio, you're at the minimum level on the other. So, in fact, if you set the maximum, then that should be sufficient.

MR. DOERKSEN: All right. Those are both complicated explanations, but I think I understood both of them.

I'll pass to the next one, Mr. Chairman.

THE CHAIRMAN: Mr. Shariff.

MR. SHARIFF: Yeah. I have a couple of questions. First of all, I'm glad to see the proposal that's coming forward. I think it's a move in the right direction. I presume that that may go through. Well, let's hope that it goes through today at this meeting. If that does happen, I just wanted to know from you if that would necessitate any change in terms of a policy for how you would monitor it. I look at page 8, and you do have your strategies and outputs that indicate that it has to be – bullet 2 – governed by an accrediting agency or, in the absence of that, by Alberta Treasury. When it comes to foreign investments, will Alberta Treasury be able to provide the necessary accreditation information if it's not recognized appropriately by our body? Does that need to be looked into? Then I have another question, but if you want to respond to that one first.

MR. DAY: Okay. I'm on a different page here.

MR. SHARIFF: I'm looking at this goal 1.

MR. DAY: Yes. Okay.

MR. BHATIA: Perhaps I could just clarify one thing. That goal is with respect to the transition portfolio. The evaluation that you were referring to is an evaluation of our investments in Canadian bonds and similar instruments, whereas the proposals that we've been talking about otherwise are with respect to the endowment portfolio. With the exception of some investments in the United States, these foreign investments are managed on our behalf by external investment managers with expertise in particular markets. So we would not be making evaluations of individual firms, for example in European investments.

MR. DAY: In terms of being able to benchmark though – and I think that's what you're concerned about, Shiraz – the benchmark indices would remain, and on a foreign equity the Morgan Stanley capital index is what's used to benchmark those. That would continue to be the case.

MR. SHARIFF: Okay. So it can be measured by a set standard.

MR. DAY: Right.

MR. SHARIFF: Okay.

Having dealt with that one, my second point is with regard to this request for an increase and decrease in certain investment classes. I'm just wondering. With regard to the volatility that happens in the markets that we read about in papers from time to time, would there be any merit to having some variance option so that you have a little flexibility in the event that you need to shift from, you know, whatever is allocated, go 10 percent below or above it, so you can play around without having to come back to this committee given the sensitivity of times in the market?

MR. DAY: Laurence, do you want to respond to that?

MR. WARING: The 20 percent range that we're proposing is actually a good range. It certainly gives a fair degree of discretion to ourselves as fund manager, and we're comfortable with that.

MR. SHARIFF: Okay. Thank you.

MR. ZWOZDESKY: I just want to pick up again on the increase in the foreign equity benchmarks from 15 to 30 percent. I can appreciate why we're doing that. I can appreciate that there's more money to be made out there in the foreign equity markets, and I can support that. I wanted to know with respect to the projected mix of investments if there is some sort of a strategy, if you will, or a formula. How was it that you determined the projected mix of investments on a per country basis or a per continent basis? What is the criteria that you use there?

MR. DAY: I can get Laurence to speak to the actual mix. In terms of emphasizing the prudent approach, these are the large cap investments which historically provide a great degree of stability along with a return that is not extremely high risk. A GE for instance – I put that out as an example – is not running around in the niche high-risk areas. The large cap funds historically have the strength and the foundation that would put you at a lower risk. In terms of a percentage and how it's actually chosen, maybe Laurence or Robert could comment on that.

MR. WARING: Just to carry through on that. The key is to maintain a diversified portfolio. We have a number of managers that we've hired, some with regional mandates, and we give a certain allocation to that. Then there are also a number of managers that have global mandates that in fact will make the decision to tilt us one way or the other, given that they're in a much better position. They have the expertise and the sort of position in the marketplace to make those calls. But we apply to all our managers' ranges and constraints, as we have here, so that at the end of the day you have a consistent quality diversified portfolio.

MR. ZWOZDESKY: Are those sort of the major criteria that you use in determining? And you have some system of monitoring or controlling or supervising?

MR. WARING: Yes. All of our managers funnel through a single custodian. We have a direct access to the information that comes out of the custodian so that at any point in time we can monitor what a specific manager is doing and what the portfolio in aggregate is doing. So we do monitor the bets. Managers come in at least two or three times a year, face-to-face meetings. On a month-by-month basis we do receive information both from the manager and from the custodian in terms of their performance.

MR. ZWOZDESKY: And the criteria as spelt out: is that in writing?

MR. WARING: In fact, we're working on a formal review of that with the operating committee. That's one of the tasks of the operating committee.

MR. ZWOZDESKY: I wonder if the Treasurer would allow that to be shared with the committee.

MR. DAY: Sure.

MR. O'BRIEN: I think that would be the intention. One of the plans of the Investment Operations Committee is to formalize the criteria that will be used in appointing external managers, and that would definitely be public.

MR. ZWOZDESKY: Just a final brief comment, Mr. Chairman, if you will allow, please. I think we're all aware of something that Mr. Shariff pointed out earlier, and that's the volatility of all the markets. In particular, I'd be interested to know how much or how little is going and against what sort of criteria it is going to, for example, the Far East markets, where there's a great volatility at the moment? I don't think a day goes by when we're not reading something about it, and it would be very prudent, obviously, for us to be very wary of that and what the external managers are doing as they invest in equity pools over there.

1:36

MR. DAY: I think our exposure in those areas now is in a range of about 3 percent; is it not?

MR. WARING: In terms of our weighting, we're actually below or at the market weighting in specific markets, but in the case of the Pacific basin, Japan is a big chunk of it. Outside of Japan I think it's in the 3 to 6 percent range.

THE CHAIRMAN: Thank you.

MR. DOERKSEN: I refer to the first two goals in your business plan. The first goal reflects on the transition portfolio, and one of the outcomes is "a higher return on assets than the cost of the province's debt." In goal 2 that's not mentioned. We get more specific in terms of "the expected real return of the investment policy," and we name the 5 and a half percent and 5 percent in there. But if I go back to the task force that looked at what we should do with the heritage savings trust fund, one of the indications in the report we sent to every household was the fact that the heritage fund actually earned more than the province's cost of debt. I think that we need to clearly specify in our outcomes that that objective remains, because if it doesn't and if we don't achieve a higher rate of return, they might have a different opinion as to what we do with the heritage savings trust fund. So if you could comment on that aspect, I'd appreciate it.

MR. DAY: Well, on the third quarter, that's an important comment. Naturally it's anticipated and hoped that we will continue, obviously, to lead the debt or stay ahead of that. By the third quarter we'll know if in fact we're doing that. That's something that's monitored on a quarterly basis, and by the third quarter we should have an indication of that. It's the goal. I can't carve in cement, nor could anybody around the world, that that will hold, but certainly we think the history of our investment policies here will prove that that's the case. We'll have those figures by the third quarter.

MR. DOERKSEN: Yeah. My suggestion was that it should be stated as an outcome in the business plan.

MR. O'BRIEN: For the endowment fund as well as the transition fund.

MR. DOERKSEN: For the endowment fund, yeah.

MR. DAY: That's a good comment. I suppose just because it's anticipated and understood, maybe it hasn't been stated there, but that's a good point. We can take a look at how that could be included.

THE CHAIRMAN: If I may add, I think it's very important for us to have it in there, because during the public meetings that we had, many people asked us why we don't sell off the fund to pay the interest. The answer that we provided was: because the fund is earning a better return than the interest rate that we are paying on the debt. So it's important to have that principle included in our plan.

MR. DAY: Okay. I appreciate that comment and advice.

MR. DOERKSEN: One brief editorial question, and this is really picky, Mr. Chairman. On page 10, if you look at your chart there, in the bottom right-hand corner it talks about the money market, 3 percent, 3 percent, 3 percent, and then it has bonds at 47 percent, then blank and blank. Should there not be something in there?

MR. WARING: Yeah. Actually, just looking at this, the 42 should move up and the 37 should move up so that they're opposite the 47 so that you can see the shift. My apologies. We'll correct that.

MR. DOERKSEN: So then the totals would be 45 and 40 percent.

MR. WARING: Yeah.

MR. DOERKSEN: Okay.
May I have one more question, Mr. Chairman?

THE CHAIRMAN: Yeah.

MR. DOERKSEN: Based on my foregoing comments with respect to earning a higher rate of return than our interest rate charges, there's nothing in here that I can see that indicates what our expectation of debt cost is going to be over the next 12 months.

MR. DAY: I could have brought my budget book and had that right at hand here. Actually, the figure that's coming to mind is just under a billion. I want to say $975 million, but the exact figures I don't have with me. It's right in that neighbourhood.

MR. DOERKSEN: Okay. If I might make a suggestion – maybe you're not comfortable with it – in our budget that we present in the springtime, we always put in our assumptions in terms of interest rates and oil prices and gas prices, et cetera, et cetera. Should we not do the same with respect to this in terms of the assumptions that we're making in this portfolio?

MR. BHATIA: The key assumptions are on page 13.

MR. DOERKSEN: I saw that, but it doesn't talk about debt cost, I guess, and maybe that's not significant.

MR. DAY: To have as information in there what the province's debt cost is?

MR. DOERKSEN: Yeah. Just for when we compare. If, for instance, you were to have an estimated debt cost of 6 percent in your assumptions, then I would look at your outcomes in goal 2 and see 5.5 percent; then I would start asking some questions.

MR. BHATIA: Yeah. The way our debt costs are presented on a forward-looking basis is normally just to project what we expect the accounting costs to be, the actual dollars costs, whereas these performance measures are reported, other than this one notation on page 10, on a backward-looking basis. We don't normally forecast the rate of return on the debt portfolio or on the heritage fund. Rather, what we do is structure the investments of the heritage fund in the transition portfolio so that they closely match the debt portfolio. Then the result of structuring the investments that way is that the return on the transition portfolio should be just about the same or slightly larger than the cost of the debt.

With respect to the endowment portfolio, the 5 and a half percent real return that's mentioned here is a long-term expectation of return. It's not a forecast for a particular year. So the information that you're looking for – I can appreciate why you would ask – would be quite a different type of information than we've attempted to provide. You can derive, I guess, something like that from looking at the assumptions, but it would be an unusual and possibly quite difficult exercise to actually project that rate of return on the overall portfolio.

MR. ZWOZDESKY: Can I just follow up on that question, Shiraz, because mine is directly related to that?

MR. SHARIFF: Sure.

MR. ZWOZDESKY: Would you mind, Mr. Chairman?

In that respect I'm interested to know what you might consider to be what I would term a reasonable spread for evaluating the performance between the market value rate of the return of the portfolio versus the market cost of the Canadian dollar portion of the province's debt. Last year wasn't our cost of carrying the Canadian dollar debt portion about 8.05 percent or thereabouts? That being the case, what would you consider the reasonable spread to be? In other words, what's the criteria you would set up for yourself for good performance?

MR. WARING: That's a tough one because this is a relatively unique experiment, I suppose. We want it to be positive. We're doing a lot of work trying to get the benchmarks and get a sensitivity for the benchmarks. At this point I don't think we have a firm number to say whether it should be 30 or 40 or 50 basic points.

MR. ZWOZDESKY: Yeah, but you must have something you're striving toward, I would hope. We know it has to be above the 8.05 percent, But what's acceptable? Is it 9 percent? Is it 10 percent?

MR. WARING: I think we'd have to come back to you with that.

MR. ZWOZDESKY: Can you undertake to provide that through the Treasurer?

1:46

MR. WARING: Yeah.

MR. BHATIA: I think that the starting point direct answer is that the benchmark we had proposed last year and that was approved last year and that we're proposing again this year is the cost of debt. So we hadn't set a higher threshold than the cost of debt to this point.

MR. ZWOZDESKY: But you will be looking at that or are looking at that right now, I gather.

MR. WARING: Yeah. I mean, we want to know that we're doing it on a prudent basis.

MR. ZWOZDESKY: So do I, of course.

MR. SHARIFF: I'd like to go back to the concept of this new policy that's being proposed for consideration. I'm wondering if we should have any time limit or at least a review period to come back to this committee, even if it's two or three years down the road, just a review as to whether these ratios that have been identified meet our needs or not.

MR. DAY: Well, I could commit even more than the two or three years, that annually we should review and report on that so that the committee can see progress or lack thereof.

MR. SHARIFF: Okay. Thank you.

Then, keeping in line with that, one of the issues that I had raised about a year ago was that this committee is expected to evaluate the performance of the fund and that for us as people who are not in the investment field to make sense of what the outcome is, we need to have reports in a readable format that makes sense to us. What I would, then, request is that we be furnished with, you know, whether it's for a quarterly period or an annual period, a benchmark to look at and compare with other investment portfolios investing in the same fields so that we have some idea of how we are managing and can therefore give some good evaluation feedback.

MR. DAY: I'll take that advice, and we'll work towards that. It's a complicated field, for sure, and we can do that, again, even in an annual way and work hard to make sure it's easily understandable. It's certainly something that I need. I can commit to doing that.

THE CHAIRMAN: Actually, if I can add to that, every year as a committee we have to meet to review the annual report. In that annual report I expect that you could indicate clearly whether the portfolio has met the benchmarks that we set out in the business plan, and at that time as committee members it is our job to make sure that the benchmark performance is being met.

Mr. Shariff, are you done?

MR. SHARIFF: I have had my two questions.

THE CHAIRMAN: Mr. Zwozdesky.

MR. ZWOZDESKY: Thank you. I was looking at last year's heritage savings trust fund business plan, which comprised part of Budget '97. I note here, where we talk about "Heritage Fund Income Forecasts and Underlying Assumptions," under item 2, which you'll find on page 381 of last year's plan, should you have it handy, you would find a description of income from equities, and the overall rates of return are spelled out here in terms of projections for Canadian equities, a separate listing for U.S. equities, and a separate entry, again, for international equities. Yet as I look at this year's business plan before us today, page 13, item 2 again, there's just a single-line entry for equities and the estimated income rates without any specificity. Well, I guess my question is this: why have you removed this specification of estimated income rates for Canadian equities, U.S. equities, and international equities in the current business plan?

MR. BHATIA: We decided that in fact those were too specific projections to make with any reasonable degree of accuracy. It was probably better overall to estimate an aggregate equity return realized to the heritage fund and not attempt to differentiate between the various markets.

MR. ZWOZDESKY: Were we fairly close? I use the term "we" loosely here. Were you fairly close with the business plan projections for '96-97? Did they close out fairly close to what was there?

THE CHAIRMAN: Mr. Zwozdesky, I think you are venturing very close to the point where you're trying to look at the year-end performance of the fund.

MR. ZWOZDESKY: Well, yeah; sorry.

THE CHAIRMAN: That question may be better left for the meeting where we review the annual report of the fund to see whether the mandate of the fund is being met. Right now we are working on a business plan for this year. I understand where you're coming from, but . . .

MR. ZWOZDESKY: You always understand where I'm coming from. It's an amazing talent you have.

I simply wanted to say – sorry to interrupt, Mr. Chairman – there is nothing here that I'm looking for other than to say that if we've been out by a lot, then I can understand the move to just consolidate and put in one figure. But if we're fairly accurate with it, again, it helps the reader understand and it adds to the credibility of the process and to the credibility of this fund, this committee, the Treasury Department, and government. So perhaps you would review it from that standpoint. It's meant to be a helpful suggestion.

THE CHAIRMAN: The way I see it is that when you put more restrictions in there, when you put more conditions on, then I think it takes away some of the flexibility of the fund manager. You know, if you have to have it that 90 percent goes to the U.S., 5 percent goes to Asia, with, for example, what happened in Asia over the past few months, obviously you see that it may be better if we have that flexibility. If you provide it with a good investment policy with a cap on top of everything there rather than trying to split it down through the markets, it may be better that way. But a lot of the questions on how the fund is performing and whether it reached the benchmark set out last year or not should be left for another meeting when we review the performance of the fund at the end of the year. Right now I don't think they may have this information ready yet.

MR. WARING: Well, the other thing is that the principal purpose of this table is to develop what we feel the income will be out of the fund. So we're making assumptions with how the portfolio turns over and what kinds of capital gains we'll realize, whereas looking at the forecast for markets, that includes unrealized gains as well. What we were trying to do here is to move to a basis where what we're trying to forecast here is what the income will be, not necessarily what we think markets would actually do or not do, because we may not realize the gains, especially on the increases.

MR. ZWOZDESKY: I appreciate the clarification, but the headline reads the same in last year's business plan and this year's, which is what led me to the question. I appreciate the clarification. I guess all I'm trying to do here is set up something that you might want to call a performance measure, because it's more easily and readily followed and understandable to the general public if it's spelled out with some detail. Again, the downside, if I can say it that way - and I don't mean to sound like it's doom and gloom because it's not intended that way - would suggest to the skeptics that we're trying to remove ourselves from some form of performance measure here by globalizing it. You've taken three things that are very easily trackable and reduced it to one global one, and I appreciate the explanation why. I'm simply suggesting that maybe you might want to review that again and put it out the way it was, because it seemed to me that it worked well the way it was.

THE CHAIRMAN: But at the end of the year when you measure the performance, do you measure whether they invested 2 percent in the U.S. market, 3 percent in Europe, or do you just measure the end result, whether they have earned the rate of return that they expected of it? Which one would you measure?

MR. ZWOZDESKY: Well, I want to know how we did in terms of Canadian equities. I want to know how we did in terms of U.S. equities and in terms of international ones and be able to explain that and account to the people who wish this same information.

MR. DAY: Mr. Chairman, I'll commit to reviewing the way the assumptions are presented and report back.

MR. ZWOZDESKY: There's a good man.

MR. DAY: With the chairman's guidance on that, I'll help the chairman out. I can commit to reviewing that.

THE CHAIRMAN: Okay. Thank you.
Any other questions from the committee?

MR. DOERKSEN: Just one more simple question. Robert, you referred to the fact that our benchmark is in fact the cost of our debt.

MR. BHATIA: For the transition portfolio; that's correct.

MR. DOERKSEN: For the transition portfolio. Is that stated anywhere?

MR. BHATIA: Yes, it is stated on page 8 in the right-hand column. It states that the primary performance measure is "the market value rate of return on the Transition Portfolio," and right below that, the benchmark is "the market cost of the Canadian dollar portion of the province's debt portfolio."

MR. DOERKSEN: Thank you. I'd missed that before.

1:56

THE CHAIRMAN: Mr. Zwozdesky.

MR. ZWOZDESKY: Thank you. Were you asking me to chair the meeting temporarily so you could ask your own questions?

THE CHAIRMAN: No. You can go ahead and ask your questions.

MR. ZWOZDESKY: I just thought I'd make that offer.

THE CHAIRMAN: Thank you. And I know where you're coming from when you ask that.

MR. ZWOZDESKY: I've chaired many, many meetings.
I don't think it would be fair, Mr. Treasurer, if we didn't at least touch on Al-Pac; do you?

MR. DAY: I anticipated you would. The question of fairness is not for me to deliberate on.

MR. ZWOZDESKY: It's a very simple, straightforward question.

MR. DAY: As always.

MR. ZWOZDESKY: The provision for loan impairment of $114.2 million, the interest reversal of the $17.1 million through September 30, '97, and the fact that we have continued deferrals of the accrued interest on the Al-Pac loans: this obviously has an impact on our work here. I'm not sure yet what that full impact will be and how it's going to be reflected, but my question is with respect to the $2.8 million per month that is accruing and whether or not it's now been deducted from income. Or has it been accounted for somehow else in terms of the projections that we're making for the fund through this business plan?

MR. BHATIA: That's one of the things that we will be fine-tuning as we finalize the income projection numbers. You'll note that it indicates that the investment income line is subject to some further revisions, so we'll be fine-tuning the best way to deal with that.

MR. ZWOZDESKY: Is that the superscript 1 on page 13?

MR. BHATIA: Right.

MR. ZWOZDESKY: Because I was looking at page 13 in that respect. What does superscript 1 say? I forget.

MR. BHATIA: Sorry. It says "unconsolidated," which is just simply to indicate that these numbers are presented on the basis that they would appear in the heritage fund annual report on a stand-alone basis as opposed to the government's consolidated accounts or the budget, which is presented on a consolidated basis. Then, secondly, it just says "subject to revision," and that's because we're still fine-tuning the numbers, and the final numbers that go into the budget documents may be slightly different.

MR. ZWOZDESKY: So what we're looking at approving today is subject to change still. Is that correct?

MR. BHATIA: With respect to these numbers, yes.

MR. ZWOZDESKY: Just that one line and then the bottom line?

MR. BHATIA: The interest rate assumptions and so on may vary just slightly. In particular, for example, in '97-98, when we have another month or two of actuals, that number may vary slightly. Yes, the income numbers could move up or down a bit.

MR. ZWOZDESKY: So, Mr. Chairman, should that information come back to this committee before it goes into final print in the budget? What do you think, Mr. Treasurer?

MR. DAY: That's not a problem. We should be able to accommodate that.

THE CHAIRMAN: Yeah, but this information may be sent to me, and then I will send it on to all the members of the committee. We don't have to meet together as a committee to get it.

MR. DAY: I'll get that information to you, Mr. Chairman.

THE CHAIRMAN: Mr. Zwozdesky.

MR. ZWOZDESKY: I have a few more, Hung, but you go ahead.

THE CHAIRMAN: Okay. I want to focus on page 13. For next year your assumption for our equity rate of return is 4.9 percent.

MR. DAY: Correct.

THE CHAIRMAN: And the bond rate of return is 5.5 percent for a five-year rate?

MR. DAY: That's right.

THE CHAIRMAN: How does this assumption compare with the other mutual funds out there of a similar size? As an investor in mutual funds, if I am being quoted and I expect a rate of return of 4.9 percent in the next year, then, I may find it really quite discouraging.

MR. WARING: One of the issues with this table is that it does not forecast or give you our expected rates of return. This table gives you our expected estimated income for the purposes of calculating how much income goes from the endowment back to the GRF. What we're looking at here is dividends and realized capital gains. We're not looking at unrealized market appreciation. Obviously, with equities a significant portion of your gain is that you buy a stock, you don't sell it, and it grows, it grows, it grows, whereas in the case of a bond, we're looking at the actual income that we're receiving, which largely comes from the interest side.

To reflect on previous comments, I can see how this table can be difficult. You're looking for a table that says that this is what you expect it to return, and you want to compare your returns and forecasts of returns, but really what you're looking at is something that's trying to calculate something different, which is just the realized income under the legislation or how we define income, which is what's actually received in the realized capital gains. So that's why these numbers for equities look low, because you've just got dividends in the portion of realized gains.

THE CHAIRMAN: That's why your note number 2 down there didn't make much sense to an average guy like me, but now you've explained it, and then it makes sense.

I expect that the average Albertan will also read this plan. Is there any way we can explain these things to them in an easier way so that they can understand it too? Last time when we had those public meetings and we read the act, we said that last year $176 million was put back into the fund. Some people mistakenly thought that the fund only earned $176 million. Many people were fairly mad. They said, "You have a $12.1 billion asset, and you can only earn $176 million?"

MR. DAY: Sounds like my investment manager.

THE CHAIRMAN: You know, people don't have a lot of time to go and read the details and try to figure out the numbers. They just skim through it, and they form their opinion based on that.

MR. WARING: That's a challenge for us, and we'll work on that, at least certainly this table. We've got to work better on it; I agree.

THE CHAIRMAN: Thank you.

Okay. Mr. Zwozdesky.

MR. ZWOZDESKY: Thank you. I want to visit the issue of the Alberta Social Housing Corporation and, more specifically, tie it in with the November 26, 1997, orders in council 563/97 and 564/97, which authorize the ASHC to borrow $130 million and $400 million from the general revenue fund. I think on December 9 the Alberta government borrowed $390 million in the Canadian bond market in the form of an 18.75-year amortizing debenture with a coupon interest rate of about 5.9 percent. The proceeds are being lent – basically, that's how it works – to the ASHC to be used by the corporation for early repayment of debentures previously issued by the corporation to the heritage fund. My question is: what is the schedule of debentures of the ASHC that will be retired over the course of the next three years as set out in this business plan?

MR. BHATIA: That was included in the information that the Treasurer just provided to Mr. Pham at the beginning of the meeting.

MR. DAY: Debby Carlson had asked for that specific breakdown. It's fairly detailed, but it is in the information that I submitted to the chair.

THE CHAIRMAN: Yes, it's a fairly thick document.

MR. ZWOZDESKY: The documents you presented at the beginning of the meeting?

MR. DAY: Correct.

MR. ZWOZDESKY: Okay. We haven't seen those yet.

MR. DAY: No. You haven't seen them yet.

THE CHAIRMAN: A lot of the questions that you are going to ask from your notes may already be included in here.

MR. ZWOZDESKY: Well, that's fine. The Treasurer can just tell us that, and we'll move along.

MR. DAY: Yeah. You haven't seen it yet, and that's what's submitted there.

MR. ZWOZDESKY: Do you know offhand then, Mr. Treasurer: does it also cover the impact we can expect from the early retirement of some of the ASHC debentures? Is that covered in there as well?

2:06

MR. BHATIA: What we've laid out for you are just the amounts to be repaid ahead of the scheduled maturity each year for the next three years and then what's left over after that. Just to answer your question, for ASHC it's $388 million in the current fiscal year, $232 million in the next fiscal year, $31 million in '99-2000. In 2000-2001 it will be $40 million, and beyond 2001 there's $144 million left.

MR. ZWOZDESKY: So the earlier retirement will free up assets. Is there a comment with respect to the income generated by ASHC to the transition portfolio and to our fund overall? Is there a comment in that respect in that set of documents? Do you recall?

MR. BHATIA: The specific question that was asked was: what was the premium of market value over book value that was expected? We've included that in there.

MR. ZWOZDESKY: So it's in there?

MR. BHATIA: Yeah.

MR. ZWOZDESKY: Just a short one here. My other question . . .

THE CHAIRMAN: The last one?

MR. DAY: To conclude . . .

MR. ZWOZDESKY: We have till 3 o'clock; right?

THE CHAIRMAN: Yes, you're right.

MR. DAY: My commitment was to hopefully be here – I thought an hour would suffice. I've been here longer, and I'm certainly willing to stay as long as I can, up until 2:30.

MR. ZWOZDESKY: Well, I'll just ask a couple of brief ones and then submit the rest in writing, if that'd be okay.

MR. DAY: Oh, that would be wonderful.

MR. ZWOZDESKY: Thank you. My question is with respect to the Investment Operations Committee. I wonder if you could just clarify for me again what the general role is and how that committee functions. As you're giving me a little bit of a clarification on that, can you tell me what the frequency of reporting is of Alberta Treasury and external managers to the Investment Operations Committee and what a typical report would contain?

MR. DAY: Well, in terms of the mandate of that committee, it's to

1. Review and recommend the Business Plan to the Provincial Treasurer for transmittal to Treasury Board and the Standing Committee.
2. Review and recommend the investment policy statements for the Endowment Portfolio and the Transition Portfolio to the Provincial Treasurer.
3. Review and approve the financial statements and recommend the annual report.
4. Approve the quarterly reports for transmittal to the Standing Committee.
5. Advise on the extent of use of external managers and the criteria for selection.

Those are the five stated purposes.
The second part of your question?

MR. ZWOZDESKY: It's with regard to the reporting of Alberta Treasury and external managers to that committee. How frequently is that reporting done, and what typically constitutes the type of reporting that is covered?

MR. BHATIA: First of all, the external managers report to Treasury, and then Treasury reports to the Investment Operations Committee. That reporting is quarterly, and it would include, for example, the performance of the various components of investment, the various types of equity pools and so on that we have, compared against their benchmark, as well as commentary on the reasons for the performance results, et cetera.

MR. ZWOZDESKY: Are those reports anything that we ever get to look at as a committee?

MR. BHATIA: No. They're reports internal to the minister.

MR. ZWOZDESKY: Would the minister be willing to share any of those at some point? Just a question.

MR. DAY: Well, I could clear those to make sure that there were no commercial agreements or anything that are in any way being unduly exposed. I could clear those to see what could be made available to the committee.

MR. ZWOZDESKY: I'll tell you that what's very difficult is to get a clear picture and an understanding of the breadth of work and the process involved with administering the heritage savings trust fund. While I don't want to get into micromanaging, as it's called, it is helpful as a committee member and as a member of the Legislature to be able to understand a little bit better how some of these committees work, committees that we, in a sense, kind of oversee but don't really have any direct authority or control over or access to.

THE CHAIRMAN: I have a suggestion for you, Gene. If you really want to get into the day-to-day operation of the fund, you can quit your job and apply to be a fund manager.

MR. ZWOZDESKY: Well, I may do that at some point too, but for the moment I'm enjoying this.

MR. DAY: We'd be happy to consider his résumé. I know it would be substantial.

MR. ZWOZDESKY: Thank you.

THE CHAIRMAN: I know him well, and I would write a good recommendation letter for you too.

MR. ZWOZDESKY: I appreciate that too. Thank you.
It's also difficult, Mr. Treasurer, as I'm sure you will appreciate, to receive a draft business plan as we did this morning at 11 o'clock and come in here prepared in less than two hours to really, you know, fine-tune it and ask all the questions that we'd like to ask. So anything you can provide that way is good, and I can assure you that it'll spin out well out there in the public sector.

THE CHAIRMAN: If I can comment on that. I would like to thank the Treasurer for his quick action, because I know that he had this business plan approved by Treasury Board just earlier this morning, and because of the conflict of schedules of many members of the committee, I requested to have this meeting at this hour. I know that you have done a lot of rescheduling of your schedule to accommodate us. So on that note I really appreciate your co-operation.

MR. DAY: Thank you, Mr. Chairman. We did work hard to do that. As we've indicated, the business plan itself was substantially the same, other than a few differences that have been noted. Of course, what I wanted you to have and focus on was the actual recommended changes to the plan, so we'll continue to try and strive to get information to you. There was a compressed scheduling problem.

THE CHAIRMAN: If I may add, the plan last year was approved unanimously.

MR. ZWOZDESKY: So my final question in respect of the time, then, is a very short one. You had indicated that the documents that you've provided to the chairman for envoyance to Debby Carlson contained information about the Alberta Social Housing Corporation. Can you tell me: does that same set of documents also contain information related to the Agriculture Financial Services Corporation?

MR. BHATIA: Yes, it does.

MR. ZWOZDESKY: I have similar questions there with respect to the income to the fund and what impact early repayment of the debentures may or may not have and so on.

MR. DAY: It includes that, Mr. Chairman. I think that when the member sees it, he'll be satisfied with those. If not, he can ask any questions back. But it does include that information.

THE CHAIRMAN: And with anything, if you have any questions that you haven't had answered by the Treasurer, then certainly you can send the question either directly to the Treasurer or to me, and I can pass it on to the Treasurer.

MR. ZWOZDESKY: With respect to your kind comment about unanimous approval, I see no reason why it can't be that way again, provided it's subject to the answers coming forward and the public disclosures that we discussed. I'm sure the Treasurer will do everything he can to ensure that.

THE CHAIRMAN: Thank you.

If I can sum up, then, today. There is the suggestion from Mr. Doerksen that we need to change goal 2 to include that the fund has to perform better than the interest rate that's being paid on the loan, also the mistake on page 10: bonds, 47 percent; next to it is 42 percent and then 37 next to that; then 45, 40 on the next line.

Okay. So I need a motion to move that the 1998 Alberta heritage savings trust fund business plan be adopted with the two changes as indicated by Mr. Doerksen.

MR. DOERKSEN: Yes. Mr. Chairman, before we address that question, I just wanted to go back to the first discussion we had with respect to the part about removing the constraints from regulation. Is that a really big problem, to keep them in regulation?

MR. O'BRIEN: No. I mean, if you wanted to put 30 percent into regulation or 35 or something instead of the 20, I don't think it's a big problem. It is a question of whether we want to regulate that by an order in council as opposed to a plan and a policy direction, but operationally it doesn't make any difference one way or the other.

2:16

MR. DOERKSEN: The reason I ask that is that we've talked several times about the discipline required in managing an investment portfolio and the fact that the reason we have these things is so they won't be exceeded, so we don't get into an out-of-balance kind of portfolio. So I'm wondering, just in terms of public image and everything, whether we couldn't just keep that in regulation as we are going to approve in the business plan.

MR. DAY: Mr. Chairman, if you and the committee feel that that gives an added sense of accountability, that could be accommodated.

MR. ZWOZDESKY: It's either that or give us the rules by which that particular aspect is governed; make that public.

THE CHAIRMAN: That is a comment on record. It doesn't affect the business plan per se.

MR. DOERKSEN: The only reason it would affect the business plan is that there's a statement made on page 2.

MR. O'BRIEN: So rather than saying "be deleted," it be would be: be raised.

THE CHAIRMAN: Yeah, be raised and be changed to 30 percent.

MR. DOERKSEN: Right.

THE CHAIRMAN: Okay. So I need a motion now.

MR. DAY: I think, Mr. Chairman, to accommodate that benchmark from last year on that 5 percent, then, if it's going to be regulation to allow the flexibility needed, it should be regulation or should read 35.

MR. BHATIA: The reason for that is that by March '99 the benchmark is 30 percent, as proposed here. So you need some flexibility to be able to go over the benchmark slightly and still not be offside the regulation.

MR. DAY: The benchmark stays at 30, but you need that variance if you're going to be up sometimes or slightly below. If it's regulation, then investment managers don't feel constrained at all, and we could run into some difficulty. The benchmark is clearly 30, with the regulation reading 35 to allow for that variance.

MR. SHARIFF: That was the point I had raised earlier on.

THE CHAIRMAN: Any objection to that?

HON. MEMBERS: No.

THE CHAIRMAN: Okay. We need a motion.

MR. DOERKSEN: On that basis, Mr. Chairman, I would move that

> we approve the business plan for the Alberta Heritage Savings Trust Fund for 1998 as amended.

THE CHAIRMAN: We had two minor changes suggested by Mr. Doerksen earlier.

Anybody opposed?

MR. ZWOZDESKY: As amended or whatever.

THE CHAIRMAN: As amended, yeah.

HON. MEMBERS: Agreed.

THE CHAIRMAN: Okay. Let the record show that the business plan is approved unanimously. Thank you.

MR. DAY: Mr. Chairman, I want to thank you and the members for your good input. As you can see, it does bring about positive changes to the plan. Also, thank you for passing on the public input. What you heard from the public is going to be reflected in some of these changes. That's very helpful to us. I appreciate that.

THE CHAIRMAN: Thank you, sir.

The next item on our agenda is Other Business. Last time there were questions about the committee's annual report to the Legislature and also the timing of our meeting to review the quarterly reports. Those issues that I am discussing with the Treasury Department will be included in the next meeting's agenda, but this meeting I wanted dedicated to the business plan.

As far as the date of the next meeting, we will meet before the Legislature sits again to review the annual report. We have to report to the Legislature. We also will try to co-ordinate it in such a way that if we have the information at hand, we may meet to review the third quarter performance as well. We definitely will meet before the start of the Assembly, before January 27.

MR. ZWOZDESKY: Mr. Chairman, would you mind asking the Treasurer if he could provide us with a copy of the third quarter report before it gets provided to the public, unlike what we just had with the second quarter?

THE CHAIRMAN: It's in the letter.

MR. ZWOZDESKY: Is it in the letter?

MRS. SHUMYLA: It's in that, yeah, and I gave you a copy of it.

AN HON. MEMBER: Second page.

MR. ZWOZDESKY: Okay. That would be excellent. Of the letter you just gave out?

MRS. SHUMYLA: Uh-huh.

MR. ZWOZDESKY: Is this the one?

MR. DOERKSEN: Yes, that paragraph.

MR. ZWOZDESKY: Oh, I see it. Okay. Yeah. Excellent. Thank you very much.

THE CHAIRMAN: Okay.

So is there anything that committee members would like me to include at the next meeting?

MR. SHARIFF: Are you setting the date right now, or will you be getting in touch with us?

THE CHAIRMAN: Diane will get in touch with you with regard to that.

MR. SHARIFF: Okay. That meeting will be to evaluate the annual report?

THE CHAIRMAN: No. To review the annual report that we are going to present to the Legislature.

MR. SHARIFF: Okay.

THE CHAIRMAN: Also, if we have the third quarter performance of the fund, we will review that information at that time too.

MR. SHARIFF: So we would receive that before the meeting?

THE CHAIRMAN: Yeah. Either shortly before the meeting or at that meeting, but that meeting will be held before the information is released to the public.

MR. SHARIFF: Okay.

THE CHAIRMAN: Okay.

Seeing no other questions, I need a motion to adjourn the meeting.

MR. ZWOZDESKY: So moved.

THE CHAIRMAN: Thank you. Any opposed? The motion is carried. The meeting is now adjourned.

[The committee adjourned at 2:23 p.m.]