Legislative Assembly of Alberta

The 30th Legislature
Fourth Session

Standing Committee
on the
Alberta Heritage Savings Trust Fund

Monday, March 27, 2023
9 a.m.

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Alberta Heritage Savings Trust Fund

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Allard, Tracy L., Grande Prairie (UC), Deputy Chair

Eggen, David, Edmonton-North West (NDP)
Gotfried, Richard, Calgary-Fish Creek (UC)
Gray, Christina, Edmonton-Mill Woods (NDP)
Hunter, Grant R., Taber-Warner (UC)
Issik, Whitney, Calgary-Glenmore (UC)
Phillips, Shannon, Lethbridge-West (NDP)
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Standing Committee on the Alberta Heritage Savings Trust Fund

Participants

Ministry of Treasury Board and Finance
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Stephen J. Thompson, Executive Director, Capital Markets

Alberta Investment Management Corporation
Amit Prakash, Chief Fiduciary Management Officer
Marlene Puffer, Chief Investment Officer

9 a.m. Monday, March 27, 2023

[Mr. Orr in the chair]

The Chair: Good morning, everyone. I'd like to call the meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund to order. Welcome, everybody. I hope you didn't have too much difficulty getting in past the road closures today. Welcome.

My name is Ron Orr, MLA for Lacombe-Ponoka and chair of this committee. I'd like to ask the members and the guests at the table to introduce themselves for the record, and then I will call on those joining by videoconference. We'll begin to my right, please.

Mrs. Allard: Good morning. My name is Tracy Allard. I'm the MLA for Grande Prairie and the deputy chair of this committee.

Mr. Smith: Good morning. My name is Mark Smith, and I'm the MLA for Drayton Valley-Devon.

Mr. Hunter: Grant Hunter, MLA for Taber-Warner.

Mr. Prakash: Amit Prakash, chief fiduciary management officer, AIMCo.

Dr. Puffer: Marlene Puffer, chief investment officer, AIMCo.

Mr. Thompson: Steve Thompson, executive director of capital markets for Treasury Board and Finance.

Ms Jones: Brittany Jones, senior manager of portfolio analytics and research in Treasury Board and Finance.

Mr. Robe-From: Nelson Robe-From, principal with the office of the Auditor General.

Ms Steenbergen: Good morning. Christina Steenbergen, supervisor of LAO communications.

Mr. Eggen: Good morning. I'm Dave Eggen, MLA for Edmonton-North West.

Ms Gray: Good morning, everyone. Christina Gray, MLA for Edmonton-Mill Woods.

Mr. Koenig: Good morning. I'm Trafton Koenig with the Parliamentary Counsel office.

Ms Robert: Good morning. Nancy Robert, clerk of *Journals* and committees.

Mr. Huffman: Good morning. Warren Huffman, committee clerk.

The Chair: We'll go to those joining virtually. We'll begin with Mr. Gotfried, please.

Mr. Gotfried: Richard Gotfried, MLA for Calgary-Fish Creek.

The Chair: Hon. Member Phillips.

Ms Phillips: Thank you, Mr. Chair. Shannon Phillips, MLA for Lethbridge-West.

The Chair: Hon. Ms Pon.

Ms Pon: Good morning, everyone. MLA for Calgary-Beddington.

The Chair: Wonderful. Thank you. I think that's everyone today.

For the record I will note one substitution today: Mr. Smith for hon. Ms Issik.

Just the usual few housekeeping items to address, please. Note that the microphones are operated by *Hansard* staff; you don't have to deal with them. Committee proceedings are live streamed on the Internet and broadcast on Alberta Assembly TV. Both the audio- and the videostreams and transcripts of meetings can be accessed via the Legislative Assembly website. Those participating by videoconference are encouraged to please turn on your camera while speaking and mute your microphone when you're not speaking. Members participating virtually who wish to be placed on the speakers list are asked to message the committee clerk, and members in the room are just asked to please signal the chair or the clerk. Please set your cellphones and other devices to silent.

I think today we should maybe just also recognize that this is a rather sombre day. I trust that most of you will be able to join the procession outside after we're done here. Yeah. We need to remember both the officers and families today.

A draft agenda was made available to all members. Does anyone have any changes or additions to the draft agenda?

Seeing none, would someone like to move that the Standing Committee on the Alberta Heritage Savings Trust Fund approve the draft agenda for today's meeting as distributed?

Mrs. Allard: So moved.

The Chair: So moved? Thank you very much, Member Allard.

That motion is carried. Pardon me. Getting ahead of myself here. Any discussions, questions, concerns?

Seeing none, that's carried. Thank you. [interjections] Oh. We did all of the questions, but all in favour, please say aye. I'll get into the motion here in a minute. Sorry. Any opposed? Online, all in favour? Any opposed? Hearing none, that motion is carried. Way ahead of myself.

Approval of the minutes. Next we have the draft minutes from our February 1, 2023, meeting. Do members note any errors or omissions?

If not, would someone like to make the motion that the minutes of the February 1, 2023, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be approved as distributed?

Mr. Hunter: So moved.

The Chair: Mr. Hunter, thank you.

Any discussion?

In the room, all in favour? Any opposed? Online, all in favour? Any opposed? A little harder for them online. That motion is carried. Thank you.

We'll move on, then, to the main part of our business here today, the Alberta heritage savings trust fund third-quarter report for '22-23, ending December 31, 2022. It was released by Treasury Board and Finance on February 28. Members were notified, and it was posted on the committee's internal website for members. The Alberta Heritage Savings Trust Fund Act mandates, of course, that the function of this committee is to receive and review quarterly reports on the operations and results of the heritage fund. We're pleased to have representatives from AIMCo and Treasury Board and Finance and the Auditor General's office. They've already introduced themselves. They're here to provide us with an overview of the report and answer any questions that members may have.

I'll turn the floor over to you folks, and you can begin when you're ready with whoever is going to start. Mr. Thompson, thank you.

Mr. Thompson: Thank you, Mr. Chair. Members of the committee, thank you. Good morning. I'm pleased to appear before you today to present the 2022-23 third-quarter results for the Alberta heritage savings trust fund on behalf of the Ministry of Treasury Board and Finance.

I would like to begin by reminding us all of the legislated mission of the fund, which continues to be to maximize long-term financial returns while balancing the risk of losses. The fund remains well positioned to meet these stated objectives. The fund returned 3.6 per cent over the third quarter, which is a welcome trend reversal for this fiscal year. As you are well aware, the first two quarters of this fiscal year were marked by significant challenges to global markets, and this is the first quarter with positive returns for the '22-23 fiscal year.

The third-quarter performance has nearly reversed the negative impact of the first two quarters, but year to date the fund is still down by approximately $244 million. The net asset value of the fund has rebounded to $18.6 billion at the end of December, which is almost back to the historic highs of $18.7 billion recorded on March 31, 2022. We have seen tremendous volatility this year in both equity and fixed-income markets, and that trend does not seem to be showing signs of easing. However, it should be noted that periods of volatility also provide opportunities for active managers such as AIMCo to add value.

The asset mix at the end of the third quarter was slightly underweight – fixed-income assets at 19.3 per cent and equities at 45.9 per cent – when compared against its long-term targets. To off-set this, inflation-sensitive and alternative assets were slightly overweight at 34.4 per cent. Our asset manager AIMCo is mandated to manage the assets of the portfolio within specified ranges around the long-term targets where opportunities exist to add value.

Inflation-sensitive and alternative assets currently include investments in real estate, infrastructure, and renewable resources. Fiscal year to date these assets have returned a combined 7.7 per cent for the fund. In comparison, over the same time frame fixed-income investments have fallen by 3.3 per cent, and equity investments are 5.1 per cent lower. Alternative assets perform well in an inflationary environment when compared to other asset classes as they produce cash flows more linked to that economic environment. Therefore, these assets being overweight has benefited the fund throughout the reporting period.

The volatility in rates continues to impact the equity and fixed-income market, and losses in these asset classes have had a direct impact on the investment income earned by the fund. However, the investment strategy for the heritage fund continues to be a focus on maximizing long-term returns and not reacting to short-term movements in valuations of markets. Performance is measured over the long term to capture changes in economic cycles. There may be times when long-term performance is higher or lower than target.

The fund has a target return of the Canadian consumer price index plus 450 basis points measured over a five-year rolling period. At the end of the quarter the target was 6.6 per cent. Over five years the fund has returned 6.0 per cent, which is lower than the target return as inflation has rapidly pushed up the real return target while also contributing to the headwinds faced by the global economy and financial markets. Over the last 10 years the heritage fund has earned a return of 8.5 per cent.

The fund also has an active management target to help evaluate the asset manager's value-added performance over time. Active management of the heritage fund has the benefit of limiting the potential losses the fund could incur and capitalizing on opportunities that are not available through a passive management approach. That target is that actual returns should be at least 1 per cent higher than the returns of the passively managed portfolio. Over five years the fund has returned .4 per cent, or 40 basis points, more than if it had been invested passively.

For the third quarter investment income was negative $244 million, as I've said, which includes $90 million in expenses. The main detractor from investment income has been the decline in global equity markets. Given the current level of Alberta CPI it is estimated that the fund will retain at least $600 million for inflation-proofing. If the income generated by the fund continues to be less than that amount, no transfers from the fund can take place as per the legislation. Overall, the fund remains well positioned for the current economic landscape.

Thank you. That concludes my remarks.

9:10

The Chair: Wonderful. Thank you.

We'll open the floor to committee members for any – oh, I'm sorry. Mr. Prakash, did you want to contribute? I really am not focused here today.

Mr. Prakash: Yes.

Mrs. Allard: It's Monday morning.

The Chair: Monday morning. Yeah.

Mr. Prakash: Good morning, all. It's a pleasure to be here. To echo Mr. Chair, it is indeed a sombre day today, and we acknowledge that.

I'll spend just a few minutes giving you an update on AIMCo, and then I'll turn it over to Dr. Puffer to give you an update on the heritage fund. Mr. Siddall couldn't join us this morning. He sends his regrets.

Last week we announced that Mr. Mark Wiseman, the chair of the board of directors of AIMCo, will be leaving at the end of his three-year term, a successful term, later this year. Mr. Wiseman oversaw the development or, I'd say, transformation of AIMCo over the last few years, providing stability, hiring the new CEO, overseeing the development of the corporate strategy, investment strategy, and, finally, enhancing the governance at AIMCo. Mr. Wiseman will remain in his capacity through the end of the year, ensuring seamless transition to the new board chair.

We are very pleased to announce that Dr. Marlene Puffer joined us as chief investment officer last month. She will introduce herself momentarily in addition to providing remarks on the heritage fund. With Dr. Puffer joining us, the executive team at AIMCo is fully in place now, so that's a huge positive relative to the transition path that we've been on over the last year, year and a half. A couple of other updates, and mostly these ones are directed towards building capabilities that we would deliver to the heritage fund and to our clients as we look forward the next 10-plus years.

Firstly, in that category and as described in our corporate strategy, we will be opening international offices in New York and Singapore. The key thrust of opening international offices similar to up here is to expand the investable universe, the opportunity set, that the heritage fund and our clients would have access to as we look forward. The initial focus will be on infrastructure, on private debt and loan, and illiquid assets more generally, but again, the thesis is to be able to access the best opportunities wherever they may lie.

Along the same dimensions, we've also commenced a review of our technology platform. The intent, again, there is to have a platform that is fit for purpose as we look many years out and one that is a lot more scalable, a lot more robust and transparent relative to the one that we've had given the opportunity set we had over the last few years.

Finally, for investment managers such as ourselves the development of talent and people is intrinsic to our success and to the services we provide to our clients. On that front, we're refreshing our talent and culture strategy, and the thrust of that strategy is to build results-oriented skill building, be succession ready, and, more broadly, more generally, future-proofing the organization as our needs expand.

With that, I conclude my prepared remarks, and I'll turn it over to Dr. Puffer.

Dr. Puffer: Thanks, Amit. Well, it is an honour to be here and to serve so many Albertans, having joined AIMCo all of eight weeks ago as chief investment officer. In addition to acknowledging the sombre nature of today and all the police services who are outside the door, I'd like to acknowledge my great-grandfather, William Franklin Puffer. He served in the very first Legislative Assembly of Alberta. That was in 1905. He was re-elected twice in the district of Lacombe, and he served until 1917. Your kids may have learned about him on a field trip to the historic McKay Avenue school, where there's an exhibit called Mr. Puffer Goes to Parliament. That's my great-grandfather. [some applause] Thank you. My dad is long gone, but this would blow his mind, that I am sitting here in this spot talking about his grandfather.

I'm really delighted to have joined the team at AIMCo. As Amit referred to, it's really an exciting time. The organization is implementing a number of important strategic initiatives, and these will ensure that the backbone of systems and technology and people are well aligned to ensure that we can deliver the strong, risk-adjusted returns that all of our clients need well into the future. It's really critical so that we can continue to be innovative as market conditions evolve, and we're making progress on the geographic expansion, as Amit mentioned, in New York and Singapore to facilitate this.

Of course, our investment focus is on the long term. Mr. Thompson gave a summary: 2022 was a challenging year in the markets. I am pleased to note that the heritage fund returned 3.6 per cent for the last quarter although the return remained slightly negative for the fiscal year through the end of 2022. It was above the benchmark return for that period, which was minus 1.7 per cent, and of course this is in the context of healthy, long-term returns over 10 years of 8 and a half per cent for the heritage fund.

The year 2023 has started off with a lot of turmoil in the banking sector. The direct exposure of AIMCo client portfolios to the affected financial institutions was immaterial, but the financial market volatility is certainly heightened, and the indirect impacts on financial markets and policy leaders are continuing to unfold.

Liquidity management in this kind of environment is paramount. The heritage fund liquidity needs are very well covered. In fact, we've recently completed a thorough review of how we define and manage liquidity across all of our clients, and one key change was to make the stress scenario – that's our focus of analysis and planning – to be more conservative. So you can be quite comfortable that we're covering that off very well.

The recent market conditions certainly highlight the importance of diversification, careful oversight, risk management, and the benefits of the private asset classes that Amit referred to. The diversification benefits and inflation-hedging characteristics of investments in the heritage fund's 35 per cent allocation to real estate, infrastructure, and renewable resources have really been evident. These asset classes have outperformed public markets in recent periods. Fiscal year to date, the fund's performance was ahead of the benchmark by .9 per cent, which came from multiple asset classes, including these.

These alternative asset classes will continue to be important contributors given that the remedies for high inflation are for inflation to drop the hard way, through aggressive Fed tightening, or the easier way, through below-trend growth. We need all the tools in the tool kit to get through this.

That concludes my opening remarks. Amit and I look forward to responding to your questions.

The Chair: Wonderful. Thank you, and welcome to the committee.

Dr. Puffer: Thank you.

The Chair: Okay. I think we're ready to move on, correct? I'm getting there.

Mrs. Allard: You're feeling tentative now.

The Chair: Yeah.

Members of the committee, time for questions. I have hon. Ms Gray on the list. Please proceed.

Ms Gray: Thank you very much. Thank you to the officials who are here. As others have, I would also just like to remark on the day that is today. I know we are all thinking about the service members who are outside.

Thank you for your opening comments. My question, to start us off, is around note 7 in the third-quarter report, just around investment expenses, because I was comparing the investment expenses in this third-quarter report to the ones from 2021 and 2020. It appears that we've got our first significant increase in investment expenses. Now, understanding that they are charged on a cost-recovery basis, can you please speak to why we are seeing an increase in the investment expenses?

9:20

Mr. Prakash: Thank you very much. On behalf of our clients we are focused on managing the expenses we incur in delivering the investment management services. One of the things we do to ensure that there is discipline around this process is that we compare ourselves with peers across the industry but particularly within the pension management industry. Within that, historically AIMCo has been at the lower end of the spectrum.

The first aspect is that many of the things we described in terms of opening offices internationally, looking at the technology platform, et cetera, are simply making investments into the future strength of the platform.

The second part of the overall investment expenses also relates to the mix of the assets that are managed internally as opposed to externally. Since we've started to onboard the client assets that came aboard over the last two years, with the addition of three new clients, that transition is still a work-in-progress and particularly on the illiquid side. So the benefit of the overall cost of the platform will start to accrue as some of those externally managed strategies start to be managed internally. That's number 2.

Then, thirdly, within the overall bucket of expenses, the third category tends to be performance expenses, and that, of course, goes up and down depending on the performance of the external manager.

That's sort of a broad-brush description of the changes in the expenses.

The Chair: A follow-up?

Ms Gray: Yeah. Thank you very much for that.

Understanding kind of the three factors you've described, I think it's a good thing that, if compared to peers, AIMCo is at the lower end. Do these increases in our investment expenses now put us more at parity? Are we still at the lower end when looking at this? Do you anticipate these expenses to continue to increase when it comes to the opening of international offices and some of that expansion as we go forward, or do you anticipate that investment expenses will be held at this new, higher level?

Mr. Prakash: We are still relatively below, which reflects equally the underinvestment, the fact that amongst our peers we are one of the ones with the least amount of international presence, for example. The other bit – fair to say: more philosophically – is shifting the focus to deliver the best net-of-cost, risk-adjusted returns to clients rather than simply focusing on a component, which is the cost, to the extent that opening an office, for example, in Singapore gives us better opportunities to access infrastructure transactions in Asia. The ability to impact the overall net return net of cost is the focus, and that, we believe, serves our clients collectively in the heritage fund well and is consistent with the mandate for the heritage fund as well.

The Chair: Thank you very much.
Next we have hon. Mrs. Allard.

Mrs. Allard: Thank you, Mr. Chair, and good morning, everyone. Again, I too want to echo the sombreness of the day, thinking of the two fallen officers and their families this morning.

Turning to the fund, I think I may know the answer to this question, but I want to ask it anyway. Last week the Legislature passed a bill that would allow the fund to retain all of its net investment income. I just wanted to know your best guess: had this rule been introduced since the start of the fund in 1976, could you provide an estimate on how much the expected net worth of the fund would be today? Further to that, if you can estimate for us: what would the expected annual investment income off this larger fund look like had we done that from the beginning?

Mr. Thompson: I'm happy to answer that one. We actually have done a bit of work in anticipation of that kind of question on the back of the changes to the heritage fund act. We do have a number, but there are a few caveats that I'd like to give before I actually throw a number at you.

To come to the value of the fund, we would look at keeping all of the income that had been drawn out in the fund, and then we assumed that those funds would earn a return as per the historic returns on the fund. That's actually not a very strong assumption. It's subject to a lot of caveats. You would invest in a much larger fund in a very different way than you would the current fund, for example. Assuming that the fund had earned the returns it has earned over the past few years and that all of the investment income that had been drawn out had been left in – we also have to assume that between 1976 and 1995 we actually spent money on capital projects out of the heritage fund; there were hospitals built and parks, I believe , and we assumed that those monies were still spent in that fashion – with all of those assumptions made, we come to a value at the end of 2022, March 31, 2022, of approximately $270 billion. That would be the value of the fund.

If we want to project earnings – and, again, these are subject to many caveats and many assumptions – the simplest estimate that I could give would be to say that if we look at our 10-year return on investment, our 8 and a half per cent over 10 years, which is what we've expected to earn, if we assume an 8 and a half per cent return on a fund valued at $270 billion, that would be about $23 billion in income.

Mrs. Allard: Thank you for that. I know that was probably a bit of an unfair question given all the caveats you had to provide there, and I can appreciate that. I tried to noodle through that myself and figure out what my estimation would be.

I'm just wondering. Further to that, given your comment around the fact that, you know, it's hard to know if we'd had a larger fund and we'd been investing in it all along, we would have invested differently and likely had, in theory, economies of scale and a higher outcome. That said, I'm wondering if you can provide your best estimate – again, this may be an unfair question – on how much faster you expect the fund to grow under the new rules compared to the previous legislation, which just allowed for us to inflation-proof the fund.

Mr. Thompson: Trying to predict the future has ruined many financial careers, so I'll be cautious in that answer. I think the simplest way to envision it is to simply look at the income that has been drawn out over the years and assume that it's not, so the fund will grow because money is not being drawn out of it.

In terms of higher rates of return, I would not hazard a guess. I don't know. My colleagues at AIMCo can chime in on this one. There will be a larger balance in the fund, going forward, as monies are not drawn out and assuming that the fiscal balance is still, you know, in surplus, so we will see growth through that.

In terms of additional income, yeah, there will be higher returns based on the higher principal value, but it's important to remember also that in years when there are losses, there will be higher losses. For example, if we were at $270 billion at the moment, our loss today would be somewhere in the range of 2 and a half to 3 billion dollars today. There will be faster growth, but primarily it will be from that addition of principal into the endowment.

You want to give a better strategy for a bigger fund?

Dr. Puffer: I would just add that, you know, compounding on more capital is a very powerful thing, as the numbers indicate. The order of magnitude, when you keep money in and invest it, builds quickly.

The Chair: Thank you.
I think we'll move online now. Next on the list we have hon. Ms Phillips. Please proceed.

9:30

Ms Phillips: Thank you, Mr. Chair. I have just a quick question for Finance. Years ago we heard – I think it was in either late '19 or early '20 – that there was a review of the investment mandate for the heritage fund, including exploring, you know, moving some from active management into more passive management, we heard at that time. We heard a couple of different reasons for that investment review and the investment mandate. Here we are at the end of the term, and we haven't seen any of the results of that work. I'm wondering if we are going to see the results of that work.

Mr. Thompson: Certainly. I'm happy to answer that. You're correct. That was a commitment made in the '19-20, I think, fiscal year. That work is under way. We have done an internal review of the investment policy. We have worked with AIMCo to look at the asset mix and try and define a new asset mix, going forward, or see if the asset mix is appropriate. None of that work is available to share at the moment. We're just in the closing phases of a request for proposal to hire an external consultant to lead us through another asset mix study. That will include considerations of the changes to the fund through the changes to the heritage fund act, so the fact that we will be contributing into the fund will likely have an impact on investment policy and asset mix going forward. Once the decisions are made and those changes are made to the policy, they will be available publicly.

The Chair: Wonderful. A follow-up?

Ms Phillips: Yeah. Sure. At that time, of course, it was a time when our passively managed investments were doing pretty well because equity markets were kind of on a tear at that time, so it was, I think, maybe increasingly fashionable to talk about: oh, well, maybe we can do some more passive management. Has that changed? Is that still in the mix on how we might approach the review? Are people thinking differently about that now? Can you talk a little bit about that?

Mr. Thompson: Certainly. As asset owners we look at the performance, and you're correct. There was quite a drive to consider passive management as part of the mix, and those are discussions that are always ongoing. You know, the fund's stated beliefs are that active management adds value. Those beliefs are still in place, and they're still within the policy. With a fund where we will not be drawing income out as much, unless in times of stress perhaps, we would think that active management would still benefit the fund. We've seen 40 basis points of that performance over the five-year term, so we still do believe in active management. There is a case for passive management in certain funds, but I don't think that our investment beliefs for the heritage fund will change.

The Chair: Great. Thank you. Great question.

We'll return to hon. Member Allard.

Mrs. Allard: Thank you, Mr. Chair. I'm just thinking about the volatility that we've been experiencing in the last several years. I mean, certainly, COVID, but even within the last year the war in Ukraine, persistent inflation, and then governments responding with ever-increasing interest rate hikes and then in the last month or so some banks in the States in trouble. My husband will tell you – he manages our portfolio – that it's been a very stressful time to be an investor. I'm sure you can appreciate that.

I'm just wondering. All of this considered, all of this volatility – I was impressed to see, given that volatility, how the fund had performed. On page 1 of the report you mentioned that you were under a 3.6 per cent return despite all of those factors in the quarter ending December 31, '22. I'm wondering if you can expand on what steps you took to achieve this gain despite the difficult circumstances and the many headwinds and then, secondarily to that, if you can comment on how the fund performed against major stock indexes like the S&P 500 or the Nasdaq.

Dr. Puffer: Certainly. It has been a stressful time to be an investor, without a doubt, and there are certainly many on the team who can attest to that. The key drivers of the 3.6 per cent return were, really, the allocation to equities and to the inflation-sensitive assets. Those two categories really did the job. Equities returned 6 per cent for that quarter, and they make up about 46 per cent of the heritage fund portfolio, so that was pretty powerful.

Inflation-sensitive and alternative assets, that include real estate, infrastructure, and the renewable resources portfolios, are about 34 per cent of this portfolio. The returns on these combined for the quarter was 1.85 per cent. These inflation-sensitive assets are positively exposed to an inflationary environment, and many of them have characteristics where they can directly pass on higher inflation to their customers. Think about, you know, in real estate: tenants pay more as inflation goes up as they renew their leases, as an example.

Over the last 18 months AIMCo has undertaken initiatives alongside the heritage fund that include a review of the private debt and loan allocations, public equity optimization, which is partly, coming back to the previous question, about active and passive and really making a conscious choice in the current market environment about where we think there's value to be added actively versus areas where – the U.S. S&P 500, big large-cap equities in the U.S., as an example, are a place where it's tougher to add value. We're being very thoughtful about that review to optimize the public equity portfolio, and we're looking at risk-target analysis to determine the right levels of risk appetite and how to implement that. These initiatives combined are really aimed at ensuring that the fund is positioned to provide diverse sources of return to aim to be sustainable in a variety of market environments.

In terms of the relationship to the indices, I can give you a few bits of data there. During that period the S&P 500 in Canadian dollars return was 6 per cent, so pretty much the same as the overall equity portfolio. The heritage fund overall returned 3.6 per cent. The MSCI world index in Canadian dollars returned 7 and a half per cent. This is a relevant index because it's the benchmark for the global equity allocation in the heritage fund.

It's difficult to draw direct comparisons between the S&P 500 or MSCI world index and the heritage fund because the heritage fund itself is more broadly diversified. It has stocks and bonds and these inflation-sensitive and alternative assets in it. Hopefully, that helps.

Mrs. Allard: Thank you.

Just a follow-up, Mr. Chair. You mentioned bonds, so I just wanted to ask. I hope this is a simple question. Can you do the same comparison, then, against the major bond indexes?

Dr. Puffer: Yes. Bond markets did not do so well during that period. The Canadian universe bond index return was just .1 per cent, just a bit above zero, and the Canadian all government bond index return was just a little below zero, at minus .2 per cent, during that time.

The Chair: Okay. Member Gray. Thank you.

Ms Gray: Thank you very much. Thank you for those answers. Those were really helpful. Welcome to Ms Puffer as incoming CIO. You said that you've been on the job for about eight weeks now, and I was just wondering if you could talk about joining AIMCo. With the change of CIO, how does that potentially change direction at AIMCo, or what kind of influence are you hoping to provide?

Dr. Puffer: That's a great question. Well, I've come in at a time when there's already been a well-articulated corporate strategy for the next five years and a well-articulated overarching investment strategy for the next five years, and Amit referenced the components of that that relate to global expansion of the team and the investment strategies, various aspects of talent, and so on. I did have a little bit of say in that strategy as it was being developed. It was approved at the board in December, and I was already in deep discussion. We had some conversations there, so I had a little bit of influence there.

An additional area is, you know, our focus on finding the middle way with regard to sustainable investing, ESG considerations, that sort of thing. It's a time where we are really, as a whole executive team, looking at the whole organization and making sure that all of the strategic initiatives are aligned with what we have planned to do in the overall long-term investment strategy.

With regard to specific areas of investment there are fantastic teams in place across each of the investment asset classes. We're optimizing, as we say, on the equity side and making some changes to be even more focused on where we want to be active, where we want to be passive. In fixed income we're being more deliberate about where active and passive management make sense. That includes separating out credit and government or interest rate exposure a little bit more clearly.

9:40

All of those areas are well under way, and they're all the areas that I will be focused on. I have a very broad background, very broad experience. I kind of grew up through the fixed-income part of the business and then, increasingly, derivatives and then, increasingly, all the alternative asset areas. So I've kind of touched all of these areas. I'll be focused across the board but particularly focused on areas of activity that relate to tying it all together as a total fund strategy.

Ms Gray: Fantastic. That's great. I appreciate that you've brought I believe it was, like, 25 years of experience.

Dr. Puffer: I stopped counting at 25.

Ms Gray: We can all stop counting. That sounds great.

No, I appreciate you joining AIMCo and the new view you have and the oversight role that you will play across the organization.

This is maybe not quite a follow-up, but risk management has been something that we've talked about quite a bit at this committee across the years. Certainly, in the quarter 3 report there's a great deal of information about the various risks that are currently being managed. I suppose my question is just: from your perspective, which risks do you think need to be top of mind as we continue in through this 2023 volatility and turmoil that we've seen so far?

Dr. Puffer: There are a lot of risks that we look at. I'll kind of list off a number of them, with a little comment on each, and then kind of tie it together for this current environment. We look at overall total fund risk, obviously, just absolute return: how much is that going to vary over time and in the future? We look at tracking or active risk relative to what the policy benchmark is for the fund and make a determined effort to target where that level is. We look, of course, at our exposures to countries and sectors to ensure that we are targeted about that. We look at individual exposures within portfolios, single-security exposures, and then, of course, there are total risk limits on the total portfolio itself. Of course, liquidity exposure and liquidity management is a really important risk, especially in this current environment, with volatility in the financial sector itself and with banks and their liquidity coming into question and really causing secondary and tertiary effects throughout the markets. So liquidity management, as I mentioned in my opening remarks, is really top of mind.

I've been very impressed, as a newbie in this particular organization, with how liquidity is being defined, because there are many ways to define what really constitutes liquid assets: things that we can sell very quickly or easily, things that we can use to pledge as collateral and borrow money against. There are many ways of defining what constitutes liquidity in addition to the obvious cash in the bank, so to speak, and it's a very sophisticated approach to the definition that's appropriately conservative. As I mentioned earlier, the assumptions of what scenario we're using as this stress environment to plan around have become more conservative with our latest review.

The Chair: Wonderful. Thank you.

We'll move on to hon. Mr. Hunter, please.

Mr. Hunter: Thank you, Mr. Chair. I also want to express my profound sadness for the families that are dealing with the slaying of the two officers. In our society it's unacceptable, and it's such a sad day.

I want to, first of all, welcome Marlene for the new office that you're holding. I want to actually ask a follow-up question to Ms Gray's first question that she asked. I'm just looking for clarity on this. On note 7 you talked about the expenses going up. Now, you had said something in there where you said that you do comparables with other organizations in terms of the cost of expense. My question is: do you do comparables in terms of rate of return as well in those same organizations?

Mr. Prakash: Yes, we do. Last year, perhaps as a follow-up to a similar question, we provided the comparison. I'm happy to do that as a follow-up as well.

Mr. Hunter: I'm just wondering: is that something that we would be able to have as a standing comparable metric, that we could have it at our meetings so that we can – I mean, when you present it after the fact, you know, it's good. We get that, but I think it would be helpful in a public forum to be able to get that. I know you guys do that. Your benchmarks are always aggressive, and I appreciate that. It's important to have that. But I think that it's also important to make sure that Albertans have the ability to see those comparables to other investment firms as well.

Mr. Prakash: If I may, just the only caution with that – we look at the data; we certainly do the comparisons. Part of the art, if you will, in that is across the plans, the asset allocation, you know, the mix is quite different, and benchmarks are different, et cetera. At one level it is helpful to compare at a headline level. As you get into the details, similar to Mr. Thompson's earlier response, there are a whole lot of caveats in the comparison. So we can certainly work with the team to see how best we could offer that.

Mr. Hunter: I think that that's a very good point. I imagine that when a regular Albertan would be taking a look at this, they might have to read through the caveats and look through the notes and make sure that they understand it, and it would be tough to do. But in terms of transparency I think that that's always the best approach in order to be able to provide that help for Albertans as we navigate a very tumultuous investment world. I do take my hat off to you. I know that these last few years that I've been on this committee and taking a look at what you've done, I take my hat off to the work that you guys have done. It's monumental.

I'll just leave it with that. I do have some other questions, but maybe I can turn it over to someone else.

The Chair: Yeah. It's a supplemental. Thank you. We'll come back to you.

Yes. We'll move on, then. Hon. Mr. Eggen.

Mr. Eggen: Thank you, Chair. I also want to express condolences to the families of Travis Jordan and Brett Ryan, colleagues, and friends on the occasion of the funeral service that will take place later today.

I just wanted to ask about inflation and interest rates. I mean, we're all feeling the effects of inflationary pressures. I'm just curious to know how the heritage fund and AIMCo have positioned themselves to perhaps take advantage of these higher interest rates. What part of the fund is most able to take advantage of, you know, higher interest rates and this inflationary economy which we are in right now?

Dr. Puffer: Certainly. The areas that I mentioned earlier are well positioned for both higher interest rates and higher levels of inflation, so those alternative asset categories of real estate and infrastructure and renewable resources. In addition, there's an allocation to the private debt and loan book, and that private debt and loan book is one that is geared off of floating interest rates. As interest rates move up, the rate of return directly goes up to earn that higher level of return plus a credit spread that is compensation for the exposure to underlying corporate risk that's undertaken. That area is one that is important in our geographic expansion. It's been primarily focused in Europe in the past, and we're in the process of adding additional exposure to that, primarily in larger capitalized companies in the United States. That area is an area where it's resilient to the economic outlook. Although we think that there's risk of inflation staying elevated and economic growth being lacklustre at best, this area is one where we really look carefully at what kind of companies we invest in, and their credit quality is very high. So it's quite a resilient part of the portfolio.

9:50

Mr. Eggen: Okay. Okay. Good. My follow-up to that is perhaps from a position of ignorance. I think also something that people are often curious about and always keeping to the idea of ethical and responsible investment, you know, making choices to take full advantage of inflationary pressures in an economy – I'm just hoping that there's analysis and care taken to not make an investment or investments of that type that would only exacerbate the problem. You know what I mean? Like, you're sort of taking advantage, you're doubling down on a weakness in the economy. How are you careful to make sure that doesn't just exacerbate the problem of inflation for the general population?

Dr. Puffer: If I may, do you mean that our investments may continue to stimulate inflation . . .

Mr. Eggen: Yeah. Somehow, like, to perpetuate or to make the inflationary pressures worse.

Dr. Puffer: Well, we have a lot of assets under management, but we're not that big to influence the overall economy is the first thing I will say.

You did also mention sustainable investment. Perhaps you're alluding there to the idea that we may be investing in areas where there are decisions to be made that may not be just for investment purposes. I will assure you that as we take into consideration all the aspects of any investment decision, it is really about maximizing the long-term risk-adjusted expected return. That is the goal. In an environment that is more inflationary than we've seen in the past, we're also particularly focused on income-generating assets where we can, you know, tangibly receive cash flows that help to off-set that risk.

Mr. Eggen: Thank you.

The Chair: Okay. Thank you. Very good.

We'll return to hon. Mr. Hunter.

Mr. Hunter: Thank you. I just want to, first of all, say thank you for focusing on the return on investment as this is our savings fund for future generations to be able to buy the hospitals and the schools and the roads that we need. That's extremely important in my mind.

But I do want to ask you some questions about the derivatives. On page 15 you talk about that. Can you expand on the types of interest rate derivatives you are using and how they help hedge your assets against interest rate risk?

Dr. Puffer: Certainly. You like to ask the tricky questions. First of all, the universe bond product description notes that we have an active duration risk control of plus or minus one year. What that basically means is that there's a certain sensitivity of the assets to interest rate movements, and we have a range within which we operate, okay? The investment team manages that portfolio within this risk control and within broader active risk thresholds – so lots of things are taken into consideration, in other words – and the main use of derivatives is to manage to make sure we're within that range. Primarily, it's used to be able to react to market movements and adjust kind of at the edges. These are vanilla, so quite simple, interest rate derivatives, and they swap fixed rates for floating rates. As an agreement that's quite straightforward and used very, very widely in the marketplace.

These combine with the underlying exposures to adjust the duration of the overall portfolio or that sensitivity to interest rates to where we want it. An interest rate swap that shortens duration exchanges fixed rates for floating rates; that kind of an interest rate swap gains in a rising interest rate environment and serves to off-set some losses in the portfolio when they occur.

That's how we use them, to adjust to make sure we're in the range we want to be in and to allow for certain adjustments in the risk profile of the portfolio.

Mr. Hunter: So if the interest rates continue to rise, how is that going to affect the net favourability of these contracts?

Dr. Puffer: It depends on the positioning on any given day. If interest rates continue to rise, then the assets held underneath will decline in value. The underlying exposure is that way. So that consists of multiple components. There's the cash, fixed-income holdings plus the derivatives contracts. That combination depends on how much we have in place of derivatives at that time. The derivatives contracts are used primarily to manage the exposure against the benchmark across the whole yield curve; in other words, at various maturities they will gain or lose value relative to interest rates depending on how much is in place at any given time.

The Chair: Okay. Thank you.

Anyone else? No?

Mr. Smith: Sure. I'll go.

The Chair: Okay. Member Smith, please.

Mr. Smith: Thank you very much. I'd like to talk about the ways you measure risk on the equity assets in the portfolio. What's the average beta of the equity assets in your portfolio? Do you have any targets on an acceptable range for this metric? And are there any other metrics that you use to determine risk? If so, can you talk about what they are and why they are effective, and can you talk . . .

Dr. Puffer: Certainly.

Mr. Smith: Okay. Go ahead.

Dr. Puffer: Currently the average beta of the public equity assets is very close to 1. In other words, the broad market index and the portfolio will behave approximately the same way when the broad market index moves, and it's within a tight range. We tend to manage it quite close to that, the reason being that it's to ensure that there's an agreed-to exposure to markets. If we managed that wildly differently, that would be a big active decision.

We target that metric, or the beta. Over the last year the team has been just a little bit pessimistic toward equities, and that has meant that the beta has been managed at a couple of decimal places below 1. It's not a huge active position that we tend to take, so about .98 has been where we've been positioned. The limit on active beta, or that difference between the portfolio and a beta of 1, is agreed to with clients. On the public equity products that agreed limit is 10 per cent, so between .9 and 1.1 is the full range if we wanted to use it, but we tend to stay fairly close to home in terms of our exposure to the equity market measured by beta.

Mr. Smith: Can you talk about the ways you hedge equity investments against inflation, currency, and interest rate risk?

Dr. Puffer: The public equity products are managed against their benchmark. Currency hedges can be used from time to time to reduce the size of active equity exposures. In other words, if we were overweight in the U.S. market relative to the benchmark, we may hedge that back to being the amount of U.S. equity that is in the benchmark. So we just hedge the piece that's different from what the underlying benchmark exposure is in equities for currency, and it depends on the team's views of relative value in currency. And then, of course, the currency exposures feed our country risk analysis, and I mentioned earlier in response to the previous question that country exposure, sector exposure are risks that we monitor carefully within our equity portfolio as well. We monitor and manage.

We also watch and manage the macroeconomic exposure to variables like inflation and interest rate risk within the equity portfolio because there is exposure to interest rate risk there, and these are managed with respect to the difference to the overall benchmark. When we manage the risk profile, we also often will use derivatives within the public equity portfolio to stay within ranges that we think are appropriate.

The Chair: Okay. Thank you.

Any further questions from any committee members?

Seeing none, I want to thank our guests for joining us today. I appreciate your effort to get here and your responses and your contribution. You're welcome to leave now or remain, as you choose. We'll give you a few moments, and then we'll get back to our business.

10:00

Dr. Puffer: Thank you very much.

The Chair: Thank you very much. Have a good day.

Members, we can now move on to a motion to receive the fund's 2022-23 third-quarter report. Would someone like to move that

> the Standing Committee on the Alberta Heritage Savings Trust Fund receive the '22-23 third-quarter report on the heritage savings trust fund.

Member Gray, please. Thank you. I appreciate that.

Any discussion, questions, comments?

Seeing none, in the room, all in favour? Any opposed? Online, all in favour? Any opposed? Thank you.

> That motion is carried.

Now we'll move on to a very important part of our business; the Alberta heritage savings trust fund must make an annual report to the Legislature each year.

Did I miss anything?

Ms Robert: Sorry. Can I just speak for one second?

The Chair: Sure.

Ms Robert: Thanks, Mr. Chair. I just wanted to make it clear that it's the committee's report to the Assembly on the fund.

The Chair: Yes. The committee's report.

Ms Robert: Okay.

The Chair: Did I say that, or no? Yeah. The standing committee must make a report to the Legislature. Correct? Yeah.

The next item on the agenda is that committee's report to the Legislature. As discussed at the last meeting, the committee is reverting to its reporting period from the calendar year to the fiscal year. We talked about that last meeting. Of course, the fiscal year is from April 1 to March 31, in accordance with section 6(4)(c) of the Alberta Heritage Savings Trust Fund Act. This year's report will cover 2022-23 fiscal year as well as January through March of '22 to ensure that there are no gaps in our reporting coverage.

A draft of that report was posted on the committee's internal website for you. This draft included information on all of the committee's activities during the reporting period up until today's meeting. The committee clerk will distribute a new draft of the report that will include the motions passed at today's meeting for members to review. Are there any questions or comments with regard to the report as it was made available to you?

Seeing none, there is a process followed by some other committees to approve committee reports that has authorized the chair to approve the final report after it has been distributed to committee members for their review. I'll open the floor for discussion or a possible motion in that regard. Basically, because we're not meeting again, to allow me to approve the final report, including today's meeting after it's been made available to you for a while.

A question?

Ms Gray: Mr. Chair, yeah, just to clarify. So the change to the report would just be to include, like, the motions passed at today's meeting? That's the only change?

The Chair: Right. Yup.

Ms Gray: I would be happy to make the motion that you should be able to approve the final report.

The Chair: Okay. Thank you.

Member Gray has moved that motion for us. I'll just read out a proposed motion, that

> the Standing Committee on the Alberta Heritage Savings Trust Fund authorize the chair to approve the standing committee report to the Legislature on the Alberta heritage savings trust fund annual report '22-23 after it has been circulated to committee members for review.

Any questions? The motion has been made.

Seeing none, in the room, all in favour? Any opposed? Online, all in favour? Any opposed? Seeing none,

> that motion is carried.

Thank you.

One last piece here, a process for approval of today's meeting minutes. We're referring now just to the minutes of today's meeting. As this may be the final meeting of the committee prior to dissolution of the 30th Legislature, the committee should consider how it will approve the minutes of today's meeting, similar to the approval of the annual report. The committee could choose to authorize the chair to approve the minutes of this meeting after they have been circulated or distributed to committee members for their review. I'll open the floor for discussion and a possible motion on that particular piece. No questions?

Member Hunter has made the motion. I'll suggest some wording: that

> the Standing Committee on the Alberta Heritage Savings Trust Fund authorize the chair to approve the minutes of the March 27, '23, meeting of the committee after they have been circulated to committee members for review.

Any discussion, comments, questions on that?

Seeing none, in the room, all in favour? Any opposed? Online, all in favour? Any opposed?

> That motion is carried.

Thank you, all. Any other business or discussion for today's meeting? None?

The date of the next meeting will be at the call of chair, whoever that might be at the time.

If there's nothing else for consideration, I will call for a motion to adjourn.

Mrs. Allard: So moved.

The Chair: Member Allard has moved that. All in favour? Online? Any opposed in the room? Online? That motion is carried. This meeting is adjourned. Thank you, all.

[The committee adjourned at 10:07 a.m.]

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