

Alberta Heritage Savings Trust Fund

BUSINESS PLAN 2012-15

ACCOUNTABILITY STATEMENT

This business plan was prepared under my direction taking into consideration the government's policy decisions as of January 19, 2012.

original signed by

Ron Liepert, Minister
January 27, 2012

ALBERTA HERITAGE SAVINGS TRUST FUND

The Alberta Heritage Savings Trust Fund was created in 1976 to save a portion of Alberta's non-renewable resource revenue. From inception until 1987, the government set aside part of the province's oil and gas revenue in the Fund. Since 1982, income from the Fund has been transferred to the General Revenue Fund. To date, over \$33 billion has been made available to fund Albertans' priorities such as health care, education and infrastructure.

The Fund is managed as an endowment fund with the goal of maximizing long-term returns at a prudent level of risk. Past public consultations have confirmed the importance of the Heritage Fund as an endowment, underscoring the need to preserve its real value over the long-term. The *Alberta Heritage Savings Trust Fund Act* includes an inflation-proofing provision requiring a portion of Heritage Fund income to be retained to protect its real value. Regular inflation-proofing of the Heritage Fund started in 2005-06 once the province's accumulated debt was eliminated.

The Fund consists of investments in bonds, public and private equities, hedge funds, real estate and other real asset investments such as infrastructure and timberlands. The assets of the Heritage Fund are globally diversified with investments in Canada and abroad.

Assets and income of the Heritage Fund are fully consolidated with the assets and revenue of the province. All income earned during a fiscal year, except for amounts retained for inflation-proofing, is transferred to the province's General Revenue Fund and used to help pay for government programs and services.

The Minister of Finance is responsible for the management and investment of the Fund and is required to report on the performance of the Fund within 60 days of the end of each quarter and make public the annual report within 90 days of the end of the fiscal year. The Minister of Finance prepares the business plan and presents it for approval to Treasury Board and the Standing Committee on the Alberta Heritage Savings Trust Fund.

When investing the assets of the Fund, the *Alberta Heritage Savings Trust Fund Act* requires the minister to adhere to investment policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk of loss and obtain a reasonable return.

GOALS, STRATEGIES AND PERFORMANCE MEASURES

Goal One: Maximize long-term returns at a prudent level of risk

Investment income from the Heritage Fund is an important component of the government's fiscal plan. All Fund income, except for amounts retained for inflation proofing, is transferred to the General Revenue Fund and used to fund Albertans' priorities. Income for this purpose is determined using accounting conventions and is generally defined as interest income, dividend income and recognized capital gains or losses. In order to provide the most benefit to Albertans, the fund must focus on maximizing returns over the long-term. However, the higher the return target, the higher the level of risk that will be needed in the portfolio to obtain the target. Therefore, the Fund must adopt a prudent investment strategy that balances the level of risk with the goal of high portfolio returns.

Priority initiatives:

- 1.1 Through an on-going review process, ensure the asset mix is best positioned to achieve the goal of maximizing long-term returns at a prudent level of risk. The Minister of Finance approved the policy asset mix which is shown in the Statement of Investment Policy and Guidelines. This policy asset mix calls for globally diversified investments in both public and private equity, fixed income and real assets.
- 1.2 Develop a framework for measurement and reporting of the risks associated with the investments of the Heritage Fund to ensure risk is being kept within prudent levels.

Performance Measures ¹	Last Actual 2010-11	Target 2010-11	Target 2011-12	Target 2012-13	Target 2013-14	Target 2014-15
1.a Five year annualized long-term objective ²	3.85%	6.29% ³	CPI + 4.5%	CPI + 4.5%	CPI + 4.5%	CPI + 4.5%
1.b Five year annualized active management value added ⁴	-0.32%	0.77%	0.87%	0.95%	1.00%	1.00%
1.c One year active management value added	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%

Notes:

- 1 All returns are net of fees unless otherwise noted.
- 2 Prior to any value add from active management.
- 3 The five year annualized Consumer Price Index measure is 1.79 per cent.
- 4 The one year active management value-added target will increase towards the new 1.00 per cent active management goal. Current year lower active management will be replaced over time by the new higher goals.

Risks to Achieving the Goal and Performance Measures

If the Fund's income is less than expected, the government fiscal plan may be affected. The return on risk-free assets such as Government of Canada bonds alone will not provide expected long-term returns. Assets that have some measure of volatility in their returns must be included in the portfolio in order for the Fund to meet its objectives. Therefore, investment returns and income may vary significantly from year to year and may underperform investment expectations for extended periods of time for a number of reasons, including:

- Diversification among various asset classes lowers but does not eliminate the risk of loss.
- Equities have historically provided investors with higher total returns than fixed income investments. However, equity returns have significantly higher volatility than fixed income so year-to-year variances in income can be significant. There have been extended periods where fixed income has outperformed equities in the past.
- The Fund is invested in some alternative asset classes, such as real estate, infrastructure, private equity and timberlands. Risks associated with these types of investments are illiquidity, long periods of time without cash flows and lack of market valuations. Despite these risks, the Fund can take advantage of the risks and earn superior risk adjusted returns because it has the capability to be invested for long periods of time.

Goal Two: Ensure the Heritage Fund aligns with the fiscal goals of the province

The Heritage Fund is one of the largest financial assets on the province's balance sheet providing a source of revenue. In order to ensure the fund aligns with the goals of the province, it is important to consider how the risks and return profile of the Fund interacts within the overall fiscal landscape of the province.

Priority Initiatives:

- 2.1 Continue to review the effects of currency fluctuations on the Heritage Fund and how these fluctuations interact within, and impact, the broad fiscal landscape of the province. Determine whether a currency strategy should be applied to the Heritage Fund.
- 2.2 Develop a risk measurement system that monitors the risk characteristics of the fund and looks at those risks in the context of the broad fiscal landscape of the province. Determine whether an investment policy can be implemented through the Heritage Fund that minimizes the risks the provinces faces as a whole.
- 2.3 Monitor and measure the risks that the Heritage Fund and province face and determine the factors that are common among the risks in order to minimize the effects of such risks in a prudent manner.