



BANK OF CANADA
BANQUE DU CANADA

CELEBRATING 75 YEARS
CÉLÉBRONS 75 ANS

ANNUAL REPORT 2009



The sky is some child's dream perhaps
always about to discover a new Canada!
Le ciel peut dans un rêve d'enfant peut-être
toujours sur le point de découvrir un Canada nouveau!

THE BANK'S COMPASS

As a public institution
and a workplace, we
take our bearings from
our commitment to
Canadians, to excellence,
and to one another.

Our commitment to Canadians

To promote the economic and financial welfare of Canada, we

- ▶ conduct monetary policy in a way that fosters confidence in the value of money
- ▶ promote the safety and efficiency of Canada's financial system
- ▶ supply quality bank notes that are readily accepted and secure against counterfeiting
- ▶ provide efficient and effective funds-management services
- ▶ communicate our objectives openly and effectively and stand accountable for our actions

Our commitment to excellence

Building on our strengths, we aim to meet our commitment to Canadians through performance that is second to none among the central banks of the world.

We strive for excellence through leading-edge research and analysis, through partnerships within the Bank and with outside organizations, and through

- ▶ innovation in all aspects of our work
- ▶ leadership that spurs us on to new success
- ▶ integrity in our business and in our actions
- ▶ diversity of people and ideas

Our commitment to one another

We aim to achieve our best in a workplace where we

- ▶ communicate clearly and openly
- ▶ share knowledge and experience
- ▶ develop our talents and careers
- ▶ recognize those who live up to our commitments
- ▶ respect one another and our lives outside work

Bank of Canada
234 Wellington Street
Ottawa, Ontario K1A 0G9

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Front Cover

Top photo: View of the Bank of Canada building from the Sparks Street Mall in Ottawa

Middle row (left to right): Prime Minister Mackenzie King and Bank of Canada Governor Graham Towers watch as the cornerstone is laid, August 1937; view of the atrium from the Noël Terrace, situated on the roof of the original Bank building; Canada's coat of arms over the Wellington Street entrance; spiral staircase linking fourth and fifth floors, original building; early photo of the Bank of Canada, Wellington Street façade





BANK OF CANADA
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CELEBRATING 75 YEARS
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Mark Carney
Governor - Gouverneur

26 February 2010

The Honourable James M. Flaherty, PC, MP
Minister of Finance
140 O'Connor Street
21st Floor
Ottawa, Ontario
K1A 0G5

Dear Minister,

In accordance with the provisions of the Bank of Canada Act, I am submitting the Bank of Canada's *Annual Report* for the year 2009 and the Bank's audited financial statements as at 31 December 2009.

Yours sincerely,

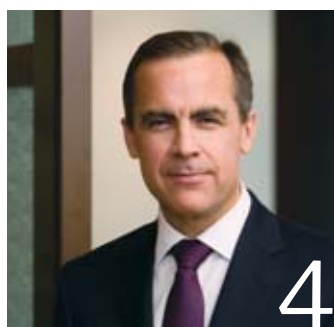
A handwritten signature in black ink, appearing to read 'M. Carney', with a long, sweeping underline.

The Year at a Glance

Global developments had a significant negative impact on the Canadian economy in 2009. The financial crisis intensified in late 2008 and early 2009, putting severe strains on financial markets, including those in Canada, and the world economy experienced a sharp decline in output. Against this backdrop, the Bank of Canada actively worked with domestic and international partners to contribute to the redesign of the international financial system, continued to provide significant liquidity to the country's financial system and, through aggressive monetary policy action, supported a return to economic expansion. By the end of the year, economic recovery had begun.

- *In April, the Bank reduced its policy interest rate to a historic low of 0.25 per cent and, conditional on the outlook for inflation, committed to holding it at that level until the end of the second quarter of 2010.*
- *To mitigate the effects of the financial crisis, the Bank continued to make liquidity available through new and expanded facilities; the demand for extraordinary liquidity diminished in 2009.*
- *Starting in the second quarter of 2009, financial markets improved considerably, and in the third quarter, the Canadian economy returned to positive growth.*
- *The Bank worked effectively with domestic and international partners in various international forums to implement G-20 agreements.*
- *Total CPI inflation was volatile in 2009, reflecting significant changes in energy prices, and ended the year at 1.3 per cent, within the 1 to 3 per cent target range.*
- *Work continued on a multi-year research program to examine possible improvements to the current inflation-targeting regime.*
- *Research was carried out on a variety of issues to strengthen the Bank's work in monetary policy, the financial system, currency, and funds management.*
- *Counterfeiting continued to decline, and important milestones were reached in preparing for the next generation of bank notes.*
- *Despite a challenging environment, the Bank's funds-management work was carried out effectively and efficiently.*
- *The Bank significantly enhanced its end-user computing environment.*
- *A new medium-term plan set out work priorities for 2010-12.*

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Message from the Governor

A year of financial market strains and economic disruption in 2009 gave way to initial signs of progress in 2010, the year the Bank of Canada celebrates its 75th anniversary. The lessons of the past year vividly illustrate what the Bank has demonstrated repeatedly through seven and a half decades: the value of well-researched policy frameworks and decisive action.

The financial crisis that began in 2007 in the United States and Europe gave way to a deep, synchronous global recession late in 2008. In the first few months of 2009, the Bank continued to sharply lower its policy rate so that by April, it had reached 0.25 per cent, effectively the lowest rate possible. Operating at the effective lower bound took the Bank of Canada, along with other central banks, into uncharted territory.

An initial, and unprecedented, initiative was the Bank of Canada's April announcement that it could be expected to hold the policy rate at 0.25 per cent for more than a year, subject to the outlook for inflation. As long as inflationary pressures did not build, Canadians could expect exceptionally low interest rates through the second quarter of 2010. This conditional commitment, backed by a corresponding lengthening of the terms of purchase and resale agreements, instilled confidence and eased financial conditions.

Further, the Bank drew on the depth of its research and policy expertise to develop and publish a complete framework for conducting monetary policy at low interest rates. In addition to the conditional commitment, the framework described a principles-based approach to quantitative easing and credit easing. While these policy options did not prove necessary in 2009, the framework underscored the Bank's determination to have the flexibility to respond to any eventuality and reinforced our accountability to Canadians.



Mark Carney, Governor

Throughout 2009, the Bank intensified its response to the financial crisis. Through concerted international efforts, including at the G-20 and the Financial Stability Board, the Bank contributed to creating a more resilient global financial system. Domestically, the Bank worked with key partners to keep financial markets continuously open, and promoted important initiatives to improve market infrastructure and practices. This work will continue, and Canadians can expect to benefit from the close co-operation among the relevant domestic authorities.

The guiding corporate framework is the Bank's medium-term plan (MTP). The 2007–09 plan provided a benchmark against which to assess the achievements of the past three years as 2009 drew to a close.



A priority for that plan was the renewal of the internal corporate structure and infrastructure. The Bank has achieved that goal, with the alignment of departments to add cohesiveness and efficiency; extensive enhancements to the IT that supports the Bank's research; investment in new data-management systems to underpin research and analysis; and investments in the mechanisms for the distribution of currency and in research related to state-of-the-art bank note security and design.

During the past three years, we have also done much to realize our MTP goal of creating a superior work environment by conducting staff surveys, investing in the development of leadership skills, achieving better work-life balance for staff, and providing staff with a safe working environment, including the rapid development of plans to deal with a potential influenza pandemic.

As part of the priorities set out in the medium-term plan, the Bank focused on accountability and good governance, with ever-greater transparency and increased efforts to explain policy to Canadians, and, of course, by setting clear goals, benchmarks, and reports of progress through its medium-term plan.

Under the banner of "Achieving Excellence Together," the 2010–12 MTP sets clear priorities for the years ahead. The Bank will further hone its pre-eminent research and analysis and concentrate on critical topics,

such as the renewal of the inflation target agreement with the Government of Canada in 2011. The Bank will focus on improving its ability to operate in times of disruption, through business-continuity planning and alternative working facilities. Work will begin on the renovation of the Bank's headquarters. Priority will also be placed on attracting new staff and keeping the excellent colleagues who are already part of our organization. That priority will be supported, in part, by the work done in 2009 to significantly adapt the Bank's approach to compensation, with an even greater emphasis on merit and the degree of contribution to the Bank's achievements.

In short, the Bank's ability to address the challenges of 2009 was based on two critical components: first, the expertise, creativity, and sheer dedication of the Bank's staff; second, clear mandates and principles-based policy formulation. Through the turmoil of 2009, it was critical to link our actions squarely with the Bank's 2 per cent inflation target. Contingency planning for operating at the zero lower bound required a clear approach to maximize its effectiveness. Similarly, as the global financial system is restored, the Bank's approach to policy formulation should be well-researched and framework-based.

The institutional focus that served us so well during the turbulence in 2009 will be part of what we celebrate this year, the 75th in the Bank's illustrious history.

Monetary Policy

Desired outcome: *Effective contribution to Canada's solid economic performance and to rising living standards for Canadians*

Strategy: *Keep inflation low, stable, and predictable, guided by a clearly defined inflation target*

Outcome goals: *Achieve a 2 per cent target for inflation and recommend a monetary policy framework that will best support economic performance in the future*

Experience has shown that the best way for monetary policy to contribute to economic performance is by keeping inflation low, stable, and predictable. Since 1991, the Bank's monetary policy actions towards this objective have been guided by a clearly defined inflation target.

Ongoing Work towards Goals and Desired Outcome

Achieving the 2 Per Cent Inflation Target

In mid-2009, the world economy began to emerge from the most severe economic crisis since the Great Depression. In response to extraordinary policy actions taken by authorities in the major economies, the global and Canadian economies began to recover in the second half of the year. However, the recovery in Canada and elsewhere was expected to be more modest than the average recovery from post-World War II recessions.

Aggressive and pre-emptive monetary policy actions taken by the Bank succeeded in keeping trend inflation well within the Bank's inflation-control range and helped to ensure that inflation expectations in Canada remained firmly anchored. The Bank devoted considerable analytic effort to developing a framework for conducting monetary policy at low interest rates. This framework, which was presented in the April *Monetary Policy Report*, describes the actions that the Bank could take to provide additional stimulus, if needed, and the principles that would guide their use (see page 8).

The recession and the policy response

The outlook for the global economy deteriorated significantly in early 2009. The financial crisis in the United States and Europe spread rapidly around the world through trade, financial, and confidence channels, triggering a synchronous and deep global recession. Canada's economy had fallen into recession in the autumn of 2008.

The G-20 countries responded to the deepening crisis with aggressive policy actions. Monetary authorities lowered policy rates to historic lows, and several central banks adopted unconventional monetary policy measures. Fiscal authorities introduced substantial stimulus packages and implemented initiatives to stabilize financial institutions and restore the normal flow of credit.

The Bank of Canada lowered its target for the overnight rate by 50 basis points on both 20 January and 3 March, and by a further 25 basis points on 21 April. These actions brought the overnight rate down to one-quarter of one per cent, which the Bank judges to be the effective lower bound for this rate—that is, the lowest possible rate that still provides sufficient incentive for market participants to trade with one another. At the same time, the Bank made a commitment, conditional on the outlook for inflation, to keep the policy rate at that level until the end of the second quarter of 2010. To reinforce this conditional commitment, the Bank rolled over a portion of its stock of 1- and 3-month term purchase

and resale agreements into 6- and 12-month terms at minimum and maximum rates that corresponded to the target rate and the Bank Rate, respectively.

The recession, which lasted from the fourth quarter of 2008 to the second quarter of 2009, was broadly felt. Canada's exports fell dramatically in response to a steep drop in U.S. demand, especially for automobiles and construction-related products. Canada's terms of trade also plunged, resulting in sharply lower real gross domestic income. With rising unused capacity and weaker terms of trade, firms cut back on employment and fixed investment. In response to weaker labour market conditions, declines in net worth, and increased uncertainty, household spending also fell. Government spending was the only component of aggregate demand to grow throughout this period.

The sizable drop in investment, as well as the significant restructuring taking place in several sectors of the economy, especially in the automotive and forestry sectors, led the Bank to sharply reduce its estimate of the growth rate of potential output. Notwithstanding

this lower estimate for potential output, the degree of excess supply in the Canadian economy increased substantially over the period, reaching an estimated 3 1/2 per cent by mid-year.

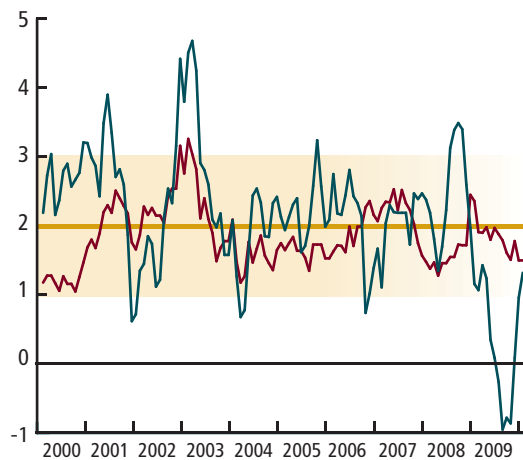
A nascent recovery

By mid-year, global financial conditions had started to improve in response to policy actions, and tentative signs of recovery in Canada and in the global economy were apparent. Financial conditions in Canada had also improved in line with global developments and continued to be more favourable than those of other advanced economies, as had been the case throughout the financial crisis.

The resumption of growth in Canada was supported by monetary and fiscal stimulus, improving financial conditions, increased household wealth, stronger business and consumer confidence, the beginning of the recovery in the global economy, and a strengthening in the terms of trade due to firmer commodity prices. However, heightened volatility and the persistent

Consumer Price Index

Year-over-year percentage change

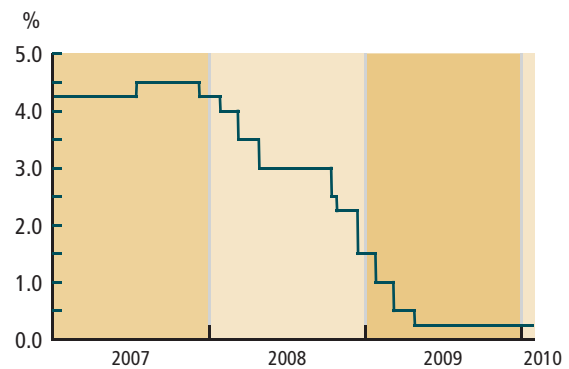


— Total CPI — Control range
— Core CPI* — Target

* CPI excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components
Source: Statistics Canada

Target Overnight Rate

Daily



Source: Bank of Canada

Framework for Conducting Monetary Policy at Low Interest Rates

Normally, the Bank conducts monetary policy by setting a target for the overnight interest rate. When the overnight rate is close to zero, the Bank needs to consider alternative instruments to provide additional stimulus to the economy, if required, to achieve the inflation objective.

Three alternative instruments were identified:

- (i) **Conditional statements about the future path of policy rates.** The Bank can influence longer-term interest rates by committing, conditional on the outlook for inflation, to keep its policy interest rate at the effective lower bound for a given period of time. To the extent that this commitment is seen as credible, it would put downward pressure on market interest rates further out the yield curve and support the prices of financial assets, thereby encouraging aggregate demand.
- (ii) **Quantitative easing.** This involves buying financial assets (public sector and/or private sector debt) through the creation of excess settlement balances (i.e., central bank reserves). These purchases would push up the price of, and reduce the yield on, the purchased assets. The expansion of settlement balances would also encourage financial institutions to acquire assets or increase the supply of credit to households and businesses, which in turn would help to support aggregate demand.
- (iii) **Credit easing.** This involves buying private sector assets in certain credit markets that are important to the functioning of the financial system, but that are temporarily impaired. The objective is to reduce risk premiums and improve liquidity and trading activity in these markets, which would, in turn, stimulate the flow of credit and help to support aggregate demand. Credit easing does not need to be financed through an expansion of settlement balances.

Four principles were articulated to guide the Bank's thinking in terms of which actions to undertake:

- (i) focus on the inflation target
- (ii) impact: asset purchases would be concentrated where they would be expected to have the greatest impact on the economy
- (iii) neutrality across sectors and across similar assets
- (iv) prudence: the Bank would take into account investment quality and would minimize operational risks

Further details, including the principles that would guide potential Bank actions, can be found at: <http://www.bankofcanada.ca/en/mpr/pdf/2009/mpr230409.pdf>.

strength of the Canadian dollar were working to slow growth and subdue inflation pressures. The Canadian dollar reached a high of over 97 cents U.S. in October, and ended the year at just over 95 cents U.S., an appreciation of almost 16 per cent from its level of just over 82 cents U.S. at the start of the year.

At each of the fixed announcement dates since April, the Bank maintained its target for the overnight rate at 1/4 per cent, and reaffirmed its conditional commitment to maintain the target rate at that level until the end of June 2010 in order to achieve the inflation target. The Bank did not see a need to engage in quantitative easing or credit easing, but kept these options available.

Total CPI inflation was volatile, falling to a low of -0.9 per cent in the third quarter, before rebounding to 1.3 per cent in December. This volatility was the result of large movements in energy prices. In contrast, core inflation remained fairly steady at close to 2 per cent in the first half of the year. It subsequently fell to 1.5 per cent at the end of the year, owing to the substantial excess supply in the economy, as well as a noticeable deceleration in the growth of core food prices.

Priorities for 2009

- Strengthen current economic analysis and monitoring
- Continue research on the monetary policy framework, especially the challenges posed by policy rates approaching zero
- Continue research on the linkages between the real economy and the financial system, and incorporate it into forecasting models and monitoring
- Implement the recommendations of the External Research Evaluation Committee



Rhys Mendes, Assistant Chief, Canadian Economic Analysis, speaking to participants at the Bank's annual economic conference, which focused on new frontiers in monetary policy design.

Progress on Priorities

Strengthen current economic analysis and monitoring

Effective policy requires the close monitoring and sound analysis of economic developments. In 2009, the Bank developed an integrated global projection model that includes China and that better captures international spillover effects from policy actions and other types of shocks. New techniques were used to project commodity prices and Canadian exports. In addition, several new tools and models, emphasizing the links between financial developments and the real economy, were developed. Finally, the Bank hosted its third workshop on current analysis techniques. The workshop attracted participants from several central banks and contributed to a better understanding of recent advances in the methods used for short-term forecasting.

Fellowship Program

The Bank of Canada's Fellowship Program helps to foster excellence in research and analysis and to develop partnerships with experts outside the Bank in areas important to the Bank's mandate.

Through this program, two research awards are available for academics working at Canadian universities.

The Fellowship Award is designed to recognize leading-edge researchers in areas critical to the Bank's mandate, and is granted for a five-year term. In 2009, the recipient of this award was David Andolfatto of Simon Fraser University. Professor Andolfatto's current research focuses on banking sector stability and policies designed to avert major financial crises.

The Governor's Award recognizes outstanding academics at a relatively early stage in their careers, and is granted for a two-year period. The 2009 recipient of the Governor's Award was Hafezh Bouakez of HEC Montréal. Professor Bouakez's current research focuses on the sources of economic fluctuations and the effects of macroeconomic policies on economic activity and welfare.

Additional details about the Fellowship Program, as well as a list of previous recipients of Fellowship and Governor's Awards, can be found on the Bank's website at <<http://www.bankofcanada.ca/en/fellowship/>>.

(Left to right): Senior Deputy Governor Paul Jenkins; 2009 Governor's Award recipient, Hafezh Bouakez; Governor Mark Carney; 2009 Fellowship Award recipient, David Andolfatto; and Jock Finlayson, Member of the Board of Directors and Chair of the Fellowship Nominating Committee



Continue research on the monetary policy framework, especially the challenges posed by policy rates approaching zero

A good deal of work went into researching and analyzing alternative instruments that could be used at the effective lower bound, which provided the basis for the framework for conducting monetary policy at low interest rates (see box on page 8). Through this work and close monitoring of the experiences of other central banks with the use of unconventional monetary policy instruments, the Bank has gained a better understanding of the challenges posed by conducting monetary policy at the effective lower bound, and of the potential effectiveness of unconventional monetary policy instruments.

In turn, this understanding contributed to the Bank's multi-year research program designed to determine the potential costs and benefits of (i) targeting a lower rate of inflation and (ii) pursuing a price-level target instead of an inflation target. The Bank has created a special website to share its research on inflation and price-level targeting. It can be accessed at <<http://www.inflationtargeting.ca/>>.

The Bank's 2009 annual economic conference, "New Frontiers in Monetary Policy Design," which attracted outstanding academic and central bank participants, examined many aspects of this research program, including issues related to the zero bound on nominal interest rates, nominal wage rigidities, welfare effects of changes in the inflation target, and the stabilization

properties of price-level targeting. The Bank also helped to organize other conferences and conference sessions related to optimal inflation and price-level targeting, and Bank staff continued to collaborate with external experts on research into these issues.

Continue research on the linkages between the real economy and the financial system, and incorporate it into forecasting models and monitoring

The global financial crisis underscored the importance of financial markets for the transmission of monetary policy and the functioning of the real economy, as well as the complementary nature of the monetary policy and financial stability functions. In 2009, substantial progress was made on developing macroeconomic models with real-financial linkages. Staff developed a global simulation model that incorporates a banking sector and an interbank market. Another model featuring a fundamental role for bank capital was developed, which will help in assessing the effects of financial regulation on monetary policy, as well as the role of bank capital in the transmission mechanism.

As the global financial crisis unfolded, the Bank continued to expend considerable effort monitoring the financial system and credit conditions. To better assess the overall level of financial conditions, Bank staff constructed an index of financial conditions for Canada, and estimated measures of effective borrowing costs for businesses and households. These indicators were made available on the new Credit Conditions web page, which can be accessed at <<http://credit.bank-banque-canada.ca/about>>.

Implement the recommendations of the External Research Evaluation Committee

As part of an ongoing effort to enhance its research capabilities, the Bank initiated an external review of its research in 2007. The evaluation committee

was asked to gauge the quality of the Bank's research and to make recommendations for improving the Bank's research environment, which it did in 2008.

In 2009, the Bank made further progress on the implementation of the committee's recommendations. In particular, the Bank's expectations with regard to the publication of research in external journals and the contribution of research to the Bank's policy formulation were clarified. In addition, the "research zone" portion of the Bank's new analytic-computing platform was launched. This provides Bank researchers with better access to specialized software and allows them to more easily communicate and share data with researchers outside the Bank.

Priorities for 2010

- *Strengthen our analysis and communication of current and future international and domestic economic conditions*
- *Complete and consolidate research efforts on the monetary policy framework in order to come to an informed view in advance of the 2011 renewal date for the inflation-control target*
- *Continue to conduct high-quality research and modelling on relevant topics, notably, macrofinancial linkages and global imbalances*
- *Complete the implementation of the Analytic Environment Program*

Financial System

Desired outcome: *Contribute to maintaining a stable and efficient financial system in Canada and globally*

Strategy: *Provide liquidity facilities and inform the public and private sectors so as to improve the safety and efficiency of the financial system*

Outcome goals: *Contain systemic risk; produce influential research, analysis, and policy advice; and provide effective liquidity facilities*

The financial system consists of financial institutions, financial markets, and clearing and settlement systems. The Bank of Canada promotes the safety and efficiency of the financial system by providing liquidity facilities; overseeing key domestic clearing and settlement systems; conducting and publishing research on policy issues affecting the financial system; and providing analysis and input to various domestic and international regulatory bodies. With regard to the latter, in Canada, a system-wide approach is the shared responsibility of the Department of Finance and all of the federal financial regulatory authorities, including the Bank of Canada, the Office of the Superintendent of Financial Institutions, and the Canada Deposit Insurance Corporation. Ultimately, it is the Minister of Finance who is responsible for the sound stewardship of the financial system.

Ongoing Work towards Goals and Desired Outcome

Promoting a Stable Financial System

The financial turmoil that began in August 2007 developed into a full-blown global financial crisis in September 2008. In the last four months of 2008, the crisis included the disruption and, in many cases, the freezing, of key financial markets around the world, as well as an acute and broad-based loss of confidence. Yield spreads on corporate bonds widened to historic

highs, equity markets declined sharply, and liquidity evaporated in key markets. In response, governments and central banks took a series of unprecedented actions aimed at stabilizing the global financial system.

Against a backdrop of concerns about liquidity constraints and systemic risk at financial institutions, turbulence in global financial markets increased in the first quarter of 2009 and credit markets deteriorated further. Pressures on bank balance sheets arising from the writedown of loans, the diversion of capital to rescue off-balance-sheet vehicles, and the reintermediation of loans into the banking system contributed to rapid deleveraging across financial market participants. Spreads on a broad range of credit assets peaked in early 2009.

The extraordinary G-20 policy response began to take effect in the second quarter. Credit spreads, including those for the major global banks, started to narrow, volatility in foreign exchange and equity markets declined, and demand for corporate bonds returned.

Financial market conditions around the world improved considerably during the second half of the year. Amid signs of global economic recovery, investor confidence began to return. While dislocations in financial markets persisted, they were more isolated. Short- and long-term funding costs for Canadian and international banks continued to decline, and access to market-based financing continued to recover, as did the market value of many risky assets.

As the profitability of global banks improved, concerns about counterparty risk abated, and risk appetite increased, reflecting growing confidence in the stability of the global financial system.

As in 2008, the provision of liquidity by the Bank of Canada played an important role in 2009 in supporting

the well-functioning of the Canadian financial system, and thus in mitigating the effects of the financial crisis and recession. (The Bank's liquidity facilities and its provision of liquidity are described in Box 1 below; the impact of the liquidity facilities on the Bank's balance sheet is discussed in Box 2 on page 15). As conditions improved over the course of the year,

Box 1: Bank of Canada Liquidity Facilities and Liquidity Provision in 2009

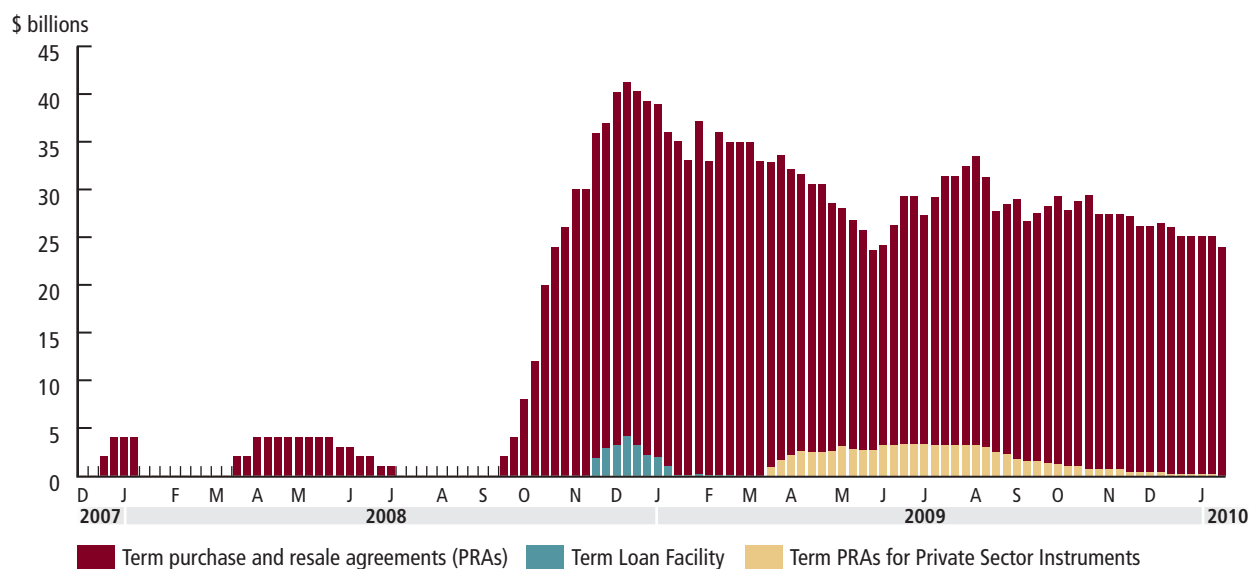
In 2009, the Bank of Canada continued to provide substantial liquidity support to the financial system. In February, in response to difficulties observed in Canadian corporate markets, the Bank announced the Term Purchase and Resale Agreement (PRA) Facility for Private Sector Instruments. This facility broadened the scope of the Term PRA Facility for Private Sector Money Market Instruments, introduced in 2008, by including non-money-market corporate securities.

As the year progressed, decreased demand for central bank liquidity support resulted in a reduction of the term liquidity provided to the financial system (see chart). At the end of October, the Bank discontinued its Term Loan Facility, which had been introduced in November 2008, as well as the Term PRA Facility for Private Sector Instruments. Auctions for regular term PRAs were reduced in frequency from weekly to biweekly.

In November, the Bank announced that it would continue to accept non-mortgage loans as collateral for Large Value Transfer System and Standing Liquidity Facility purposes, subject to a limit as a percentage of total collateral posted. This limit would be reduced in steps from 100 per cent to 20 per cent by 1 April 2010.

In December, the Bank announced that, starting in January 2010, auctions for regular term PRAs would be held monthly, and only Canadian-dollar securities eligible as collateral under the Bank's Standing Liquidity Facility would be eligible for term PRAs.

Weekly Par Value Outstanding at Bank of Canada Facilities



Source: Bank of Canada

demand for central bank liquidity decreased, and the Bank allowed two extraordinary facilities to expire and announced modifications to other facilities.

Throughout the year, financial conditions in Canada remained more favourable than in most other advanced countries. By mid-year, for example, short-term spreads in funding markets had returned to levels comparable to those before the rapid deterioration of credit markets in September 2008. The capital ratios of domestic banks improved further, their loans losses were lower than expected, and their leverage ratios remained low relative to those of many international peers. While credit remained readily available to Canadian households, lending to businesses declined, reflecting both tighter credit conditions and weaker demand. In sum, the Canadian financial system remained resilient despite severe shocks.

Importantly, in this year of crisis and recovery, Canada's regulatory framework provided a solid foundation for financial stability.

Assessing the Financial Sector

The *Financial System Review*, published by the Bank each June and December, identifies potential risks to the overall soundness of the financial system, and highlights the efforts of policy-makers, including the Bank of Canada, to mitigate those risks.

In 2009, the Bank continued to assess the following five key risks to the stability of the Canadian financial system: (i) funding and liquidity; (ii) capital adequacy; (iii) household balance sheets; (iv) the global economic outlook; and (v) global imbalances and currency volatility. Overall, the near-term risks related to the global financial crisis and recession were seen as diminishing over the course of the year. Over the medium term, the risk associated with rising household indebtedness relative to income, as well as the vulnerabilities associated with global financial and economic imbalances, were deemed likely to emerge as the most prominent risks to the Canadian financial system.

In 2009, the Bank's analysis of these and other risks was informed by participation in international committees, including the Financial Stability Board's Standing Committee on Assessment of Vulnerabilities.

Priorities for 2009

- Promote system-wide surveillance and regulation, and contribute to regulatory initiatives domestically and internationally
- Continue to develop a framework for the assessment of financial system stability, and strengthen the analysis and communication of risks to the Canadian financial system
- Reassess the principles and practices underlying the Bank's liquidity-provision facilities
- Analyze the microfoundations of financial markets, including the role played by complex instruments and infrastructure
- Identify and assess risks from clearing and settlement systems and other infrastructure

Progress on Priorities

Promote system-wide surveillance and regulation, and contribute to regulatory initiatives domestically and internationally

In 2009, the Bank played an important role, domestically and internationally, in promoting initiatives to improve system-wide surveillance and regulation (that is, surveillance and regulation that take the stability of the whole financial system, not just individual institutions, into account). The objective of this work is to strengthen the resilience of the financial system as a whole, both at home and abroad.

At G-20 meetings, and through its work with the Financial Stability Board, the Basel Committee on Banking Supervision, the Committee on the Global Financial System, the Committee on Payment and Settlement Systems, and their working groups, the Bank actively contributed to the analysis and development of system-wide policy proposals.

Box 2: Bank of Canada Select Assets and Liabilities, November 2007 to December 2009

In December 2007, the Bank joined an international initiative to address elevated pressures in short-term funding markets by providing additional term liquidity as market conditions warranted. Until late September 2008, the amount of liquidity provided was modest, and there was little persistent impact on the Bank's balance sheet. In October 2008, as part of another international initiative, the Bank significantly increased the amount of short-term liquidity provided to the financial sector, and introduced new facilities to enhance the functioning of the money markets and to provide liquidity against the non-mortgage loan portfolios of financial institutions. These measures resulted in a significant increase in the size of the Bank's balance sheet. Assets (Chart A) increased, reflecting the liquidity provided, primarily in the form of term purchase and resale agreements (PRAs), but were partially offset by a decline in the amount of treasury bills held. The offsetting liabilities (Chart B) were primarily in the form of an increase in Government of Canada deposits.

In April 2009, the Bank announced a reduction of the target overnight rate to its effective lower bound of 1/4 per cent, and to support this reduction, narrowed the operating band by 25 basis points and increased the level of daily LVTS settlement balances to \$3 billion to create incentives to trade at the bottom of the operating band, i.e., the target rate. This increase in settlement balances was matched by a reduction in government deposits, thus changing the composition of the liabilities. At the same time, to reinforce the Bank's conditional commitment to maintain the overnight rate at its effective lower bound through to the end of the second quarter of 2010, the terms of PRAs were extended to 6 and 12 months. As conditions in funding markets improved over the second half of 2009, the Bank reduced the amounts and the frequency of liquidity issuance. However, given the amount of longer-term PRAs outstanding, total liquidity outstanding was reduced by only a small amount in 2009; consequently, the overall size of the Bank's balance sheet decreased modestly.

Chart A: Bank of Canada Select Assets November 2007 to December 2009

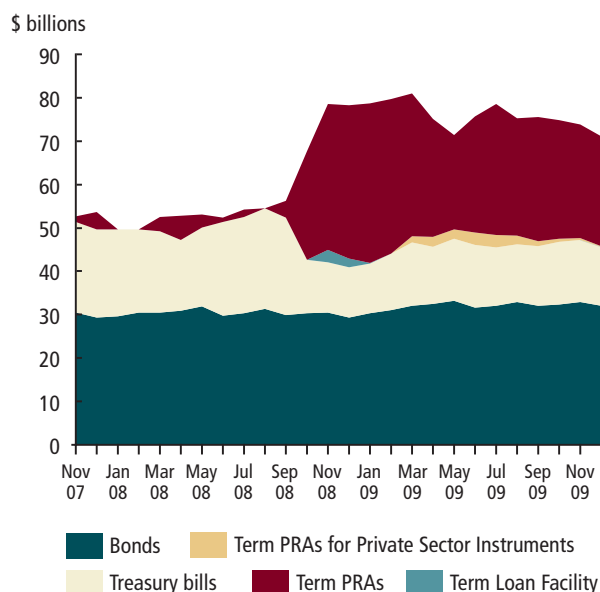
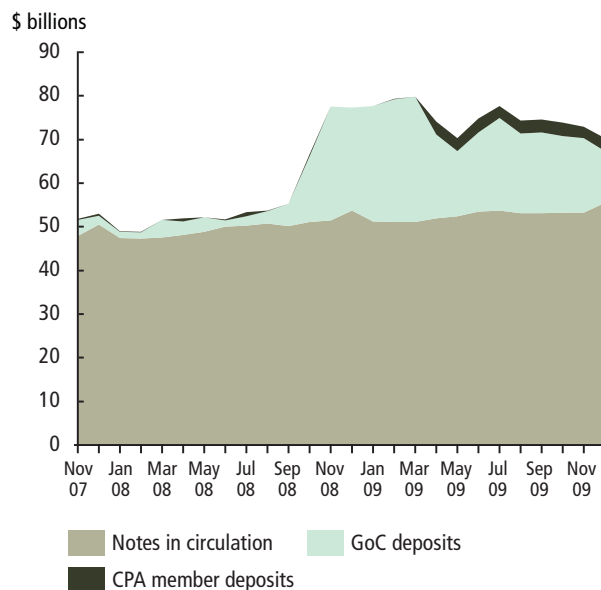
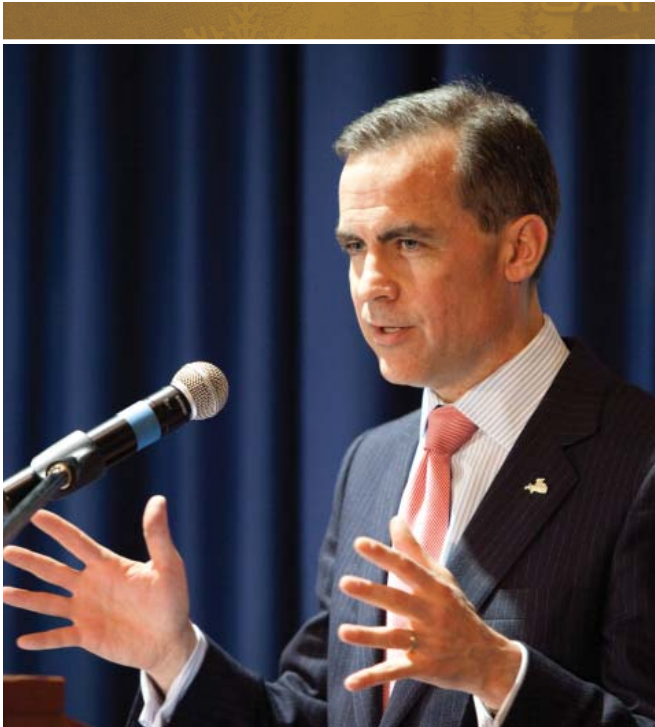


Chart B: Bank of Canada Select Liabilities November 2007 to December 2009





"Rebuilding Confidence in the Global Economy." Governor Carney addresses the Northwest Territories Chamber of Commerce and Yellowknife Chamber of Commerce, April 2009.

In Canada, the Bank worked with public and private sector agencies to increase the resilience of capital markets. The Bank developed a framework to identify and support core financial markets, including its role in providing liquidity support in times of market stress. The Bank also worked closely with industry partners on an initiative to develop a central counterparty for repo transactions, with the aim of supporting market resilience. Finally, in the *Financial System Review*, articles were published summarizing research on potential measures to reduce procyclicality in the financial system (that is, the degree to which the financial system amplifies the business cycle), and on other proposals for strengthening system-wide regulation and surveillance.

Continue to develop a framework for the assessment of financial system stability, and strengthen the analysis and communication of risks to the Canadian financial system

Building on work in previous years, the Bank further strengthened its analytical framework for monitoring financial system risks. It conducted research on how to enhance stress testing of the financial system by taking

account of interlinkages and contagion channels among financial institutions and markets. Other areas in which assessment of financial system stability was made more rigorous included the analysis of household sector vulnerabilities, liquidity risk in the Canadian financial sector, asset-price relationships in times of financial turmoil, and identification of important contributors to systemic risk in Canada.

Finally, members of the Bank's Governing Council made several public speeches to communicate the key priorities for system-wide policy development and changes in liquidity facilities.

Reassess the principles and practices underlying the Bank's liquidity-provision facilities

Central banks are the ultimate sources of liquidity to the financial system. In 2009, the Bank began a re-assessment of the principles and practices underlying its provision of liquidity, including the framework for calculating and applying "haircuts." Other activities included amending and publishing the Bank's investment policy to reflect actions related to the extraordinary provision of liquidity, and making further changes to the Bank's securities lending facilities so that they would be more effective in a low interest rate environment. An assessment of the Bank's liquidity actions in response to the financial market turmoil was published in the *Bank of Canada Review*.

Analyze the microfoundations of financial markets, including the role played by complex instruments and infrastructure

Bank staff researched three important microfoundations of financial markets in 2009: (i) liquidity, especially its role in determining asset prices; (ii) the decomposition of corporate yields into credit-risk and liquidity-risk components; and (iii) the impact of restrictions on the short-selling of equities.

The Bank hosted two important workshops related to the microfoundations of financial markets. One workshop focused on issues pertaining to financial institution liquidity. With Simon Fraser University, the Bank also organized a workshop to explore the factors that influence asset prices, funding-market inefficiencies, and the effects of bailouts.

Identify and assess risks from clearing and settlement systems and other infrastructure

Sound clearing and settlement systems are essential to a well-functioning economy. Under the Payment Clearing and Settlement Act (PCSA), the Bank is responsible for the oversight of clearing and settlement systems designated as systemically important. Although the financial stresses that continued into 2009 posed challenges for oversight, the systems continued to function well throughout this period.

Over the course of the year, the Bank assessed a number of significant changes for each of the designated systems. The Bank continued to work closely with the Canadian Depository for Securities Limited (CDS), whose subsidiary company, CDS Clearing and Depository Services Inc., operates CDSX, the system that handles securities transactions; the Canadian Payments Association (CPA), which operates the Large Value Transfer System, the system that handles large-value and time-sensitive Canadian-dollar payments; and CLS Bank, an international bank that provides simultaneous settlement of foreign exchange transactions. The Bank also worked with the CPA and CDS to ensure that business-continuity plans were current and effective. Each year, the Bank publishes on its website an account of its oversight activities under the PCSA.

In 2009, the Bank joined the international Over-the-Counter Derivatives Regulators Forum to influence the future oversight of systemically important infrastructure in this segment of the financial system. In addition, together with the Office of the Superintendent of Financial Institutions, the Bank assessed the foreign exchange settlement practices of major Canadian banks.

Priorities for 2010

- *Contribute to various regulatory initiatives, including the strengthening of the system-wide orientation of the regulatory framework*
- *Strengthen our understanding, analysis, and communication of financial system risks and vulnerabilities*
- *Identify systemic risks arising from clearing and settlement systems and other infrastructure, and determine appropriate policy actions*
- *Develop and evolve facilities and policy principles for liquidity provision to systemically important institutions and core markets in times of stress*
- *Renew the data and domestic market operations systems*

Currency

Desired outcome: *Canadians use bank notes with confidence*

Strategy: *Reduce counterfeiting below a clearly defined threshold*

Outcome goals: *Reduce counterfeiting to below 100 counterfeits detected annually for each million genuine notes in circulation by 2009, and prepare to start issuing a new series of bank notes in 2011*

The Bank of Canada is responsible for supplying Canadians with bank notes that they can use with confidence. At year-end 2009, there were 1.8 billion bank notes in circulation, an increase of 43 million over 2008. The total value of these bank notes was \$55.5 billion, an increase of \$1.7 billion over 2008.

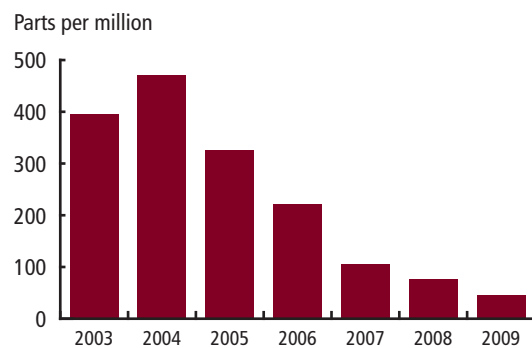
Ongoing Work towards Goals and Desired Outcome

The Bank's strategy to maintain confidence in Canadian bank notes consists of four elements: (i) developing bank notes that are difficult to counterfeit; (ii) increasing the routine verification of bank notes by retailers; (iii) promoting the deterrence of counterfeiting by law-enforcement agencies and prosecutors; and (iv) ensuring the quality of notes in circulation.

Concerted work in all four elements of the strategy reduced counterfeiting to the lowest level since 1996 and strengthened confidence in bank notes. The number of counterfeits detected for each million notes in circulation declined from 76 in 2008 to 45 in 2009, well below the target of fewer than 100 counterfeits per million, which was to be achieved by 2009. The face value of counterfeits detected decreased to \$3.4 million in 2009, just over half the value in 2008, when a large number of counterfeit \$100 notes were passed.

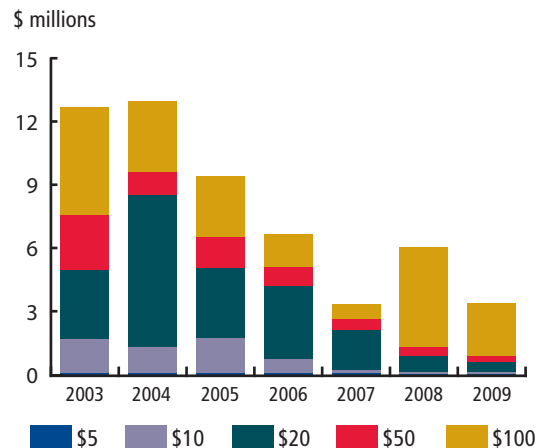
The \$20 and \$100 denominations were the most counterfeited in 2009. The majority of the counterfeits detected were of the current *Canadian Journey* bank note series.

Number of Counterfeit Bank Notes Detected per Million Notes in Circulation*



* Medium-term plan target for 2009: fewer than 100 ppm

Value of Counterfeit Bank Notes Detected in Circulation



Confidence in bank notes, as measured by surveys of retailers and analysis of media coverage, remained strong in 2009. The bank note confidence index, calculated from responses to an annual survey of the Canadian public, improved for a fourth consecutive year. Results of the Bank's surveys of public confidence in bank notes, and of the acceptance of bank notes by retailers, can be viewed at: <<http://www.bankofcanada.ca/en/banknotes/survey/index.html>>.

Despite the popularity of other means of retail payment, the demand for bank notes continued to grow in 2009. The demand for the higher denominations increased modestly during the financial turbulence in late 2008, but, in 2009, the growth rate of these denominations returned to its longer-term trend.

Priorities for 2009

- Continue the multi-year program to develop a significantly more secure next generation of bank notes
- Extend the program to increase bank note verification at point of sale
- Maintain the reach and effectiveness of the work with law-enforcement agencies, and increase the awareness among prosecutors of the consequences of counterfeiting
- Complete the refurbishment of note-processing equipment, and continue to strengthen the Bank Note Distribution System
- Summarize research on the use of, and demand for, bank notes and alternative payment methods, and identify opportunities for further study

Progress on Priorities

Continue the multi-year program to develop a significantly more secure next generation of bank notes

Extensive design work and testing of new technologies for the next series of bank notes were largely completed in 2009, and the program is on schedule for the planned issue of the first notes of the new series in late 2011.

In 2009, staff developed a communications strategy to support the launch of the new bank note series starting in 2011.

Collaboration and the sharing of information among central banks are essential to ensuring that Canadian bank notes are secure and that the circulation of bank notes in Canada is managed in line with international best practices. Bank staff continued their involvement in international organizations, including the Central Bank Counterfeit Deterrence Group (a group of 31 central banks), the Four Nations Group (Australia, Canada, England, and Mexico), and the Reproduction Research Centre (an anti-counterfeiting laboratory operated by central banks). In June 2009, the Bank hosted an international conference of central banks on the role of communications in supporting confidence in bank notes.

Extend the program to increase bank note verification at point of sale

Bank note security depends on retailers and the public routinely using the security features incorporated in bank notes to verify that a note is genuine. To promote bank note verification, the Bank produces a wide variety of print, video, and digital educational material. Material is available for five distinct audiences: the general public, retailers, law-enforcement agencies, financial institutions, and schools. Detailed information can be found at: <<http://www.bankofcanada.ca/en/banknotes/counterfeit/index.html>>.

Staff in the Bank's regional offices deliver customized training sessions to retailers and other cash handlers. In 2009, further progress was made on integrating bank note education into existing staff training programs in cash-intensive sectors of the economy, including convenience stores, gasoline retailers, and fast-food restaurants. In addition, a special project was undertaken to deliver training to retailers and the hospitality sector in the areas of British Columbia hosting visitors to the February 2010 Olympics.

Students are an important audience for bank note education, and in recent years, steady progress has been made on introducing a counterfeit-detection module into high school curricula across the country. First piloted in Ontario, this module was authorized for use in 2009 in schools across Alberta—the first time it has been adopted by a province's entire school system.

Canada's Currency Heritage

The National Currency Collection: Fifty Years in the Making

The Bank of Canada's Currency Museum is home to the National Currency Collection—the largest collection of Canadian coins, tokens, and paper money in the world. Established in 1959, the Collection reflects the development of money through the ages, with a particular focus on Canada.

The Collection includes more than 100,000 Canadian and foreign objects—from ancient Sumerian accounting tablets to African “bride price” money, and from 18th-century wampum beads to currently circulating coins that commemorate the Vancouver Olympics. The Collection is of great interest to history buffs, collectors, academics, and, on occasion, police officers who consult its holdings as part of investigations into counterfeiting.

Select pieces from the Collection are on display in the Currency Museum, which is housed in the atrium of the Bank of Canada's head office in Ottawa. Many pieces can also be seen on the Museum's website: <http://www.currencymuseum.ca/collection/>.

In 2009, the Currency Museum mounted an exhibition of artifacts from the National Currency Collection entitled “Broken Coins and Paper Promises,” which told the story of money in 17th-century Newfoundland and the problems that colonists faced in the absence of a central monetary authority.

The Collection continues to grow. Recent additions include a set of rare pre-World War I Labrador scrip that had been in the possession of Joey Smallwood, former premier of Newfoundland, and a unique item—unknown until it appeared at auction—a Magdalen Island bank note (c. 1815).

Access to the Collection and its supporting 8,000-volume library can be arranged by appointment (telephone: 613 782-7931; email: museum-musee@bankofcanada.ca).



Maintain the reach and effectiveness of the Bank's work with law enforcement, and increase the awareness among prosecutors of the consequences of counterfeiting

The apprehension and prosecution of counterfeiters are important factors in deterrence. The Bank works closely with the RCMP and other law-enforcement agencies, as well as with Crown prosecutors and schools that offer policing-related courses to raise awareness of the direct and indirect costs of counterfeiting, the importance of preventing it, and the need to prosecute offenders.

A key goal in 2009 was to broaden the collaboration with the Bank's law-enforcement partners by linking currency counterfeiting to other forms of retail fraud. The Bank's information tools and affidavits were used to good effect in prosecutions and sentencing. In recognition of the key role of the RCMP in reducing counterfeiting over the past five years, the Bank's 2009 Law Enforcement Award of Excellence for Counterfeit Deterrence was presented to the National Anti-Counterfeiting Bureau.

Complete the refurbishment of note-processing equipment, and continue to strengthen the Bank Note Distribution System

The Bank's two note-processing centres sort bank notes received from financial institutions, assessing them for quality and authenticity. A total of 608 million bank notes were processed in 2009. Of these, 330 million worn notes, or notes from less-secure older series were destroyed; good-quality notes returned to circulation; and counterfeits sent to the RCMP for analysis. Refurbishment of the note-processing equipment, which was installed in the 1990s, was completed in 2009 and will result in more efficient operations.

Through the Bank Note Distribution System, which is operated by the Bank and participating financial institutions, the Bank supplies new notes to financial institutions, which recirculate fit notes and return worn notes to the Bank. In 2009, the Bank and the financial institutions agreed to redesign the system. Piloting of

the new system, which incorporates common standards on bank note quality and new performance incentives for the participants, started in late 2009.

Summarize research on the use of, and demand for, bank notes and alternative payment methods, and identify opportunities for further study

The Bank conducts ongoing research on how bank notes are used, how counterfeiting affects confidence in bank notes, and trends in non-cash methods of retail payment. In 2009, staff researchers initiated a major survey project to generate data on the use of cash and other means of payment for econometric studies. Other research examined patterns in the adoption of means of payment, the factors affecting retail payments, and the policy implications of a move to non-cash means of retail payments. This research benefited from consulting and collaborating with researchers at other Canadian agencies and foreign central banks.

Priorities for 2010

- *Complete development and prepare for production of new bank notes that are significantly more secure, easy to authenticate, and that can be used with confidence, and complete communication plans for the issue of these notes beginning in 2011*
- *Closely monitor counterfeiting developments, and work with law-enforcement agencies and prosecutors to maintain counterfeit deterrence as a priority*
- *Upgrade information technology and physical infrastructure to support the new series of bank notes and to improve efficiency*
- *Conduct research on the evolution of the demand for bank notes relative to alternative payment methods*

Funds Management

Desired outcome: *Stable and effective management of the outstanding stock of federal debt, Government of Canada and Bank of Canada financial assets, and related operational and financial risks*

Strategy: *Maintain effective partnerships; leverage new analytical tools; review services, processes, and systems; enhance risk-management framework; and ensure clear and effective governance arrangements*

Outcome goal: *Provide cost-effective banking services within a strong risk-management framework, including sound policy advice and effective implementation*

The Bank of Canada is the federal government's fiscal agent. It advises on and operates the government's domestic and foreign debt programs, manages the flows of government funds, and invests the government's financial assets. The Bank also provides banking services to the federal government. Integral to this work is managing financial and operational risks through a sound risk-management framework. In addition, the Bank manages the risks in its own balance sheet, and manages and administers the assets held by its pension fund. It also undertakes banking activities on behalf of other central banks and international financial organizations, and provides banking services to financial institutions and designated clearing and settlement systems.

Ongoing Work towards Goal and Desired Outcome

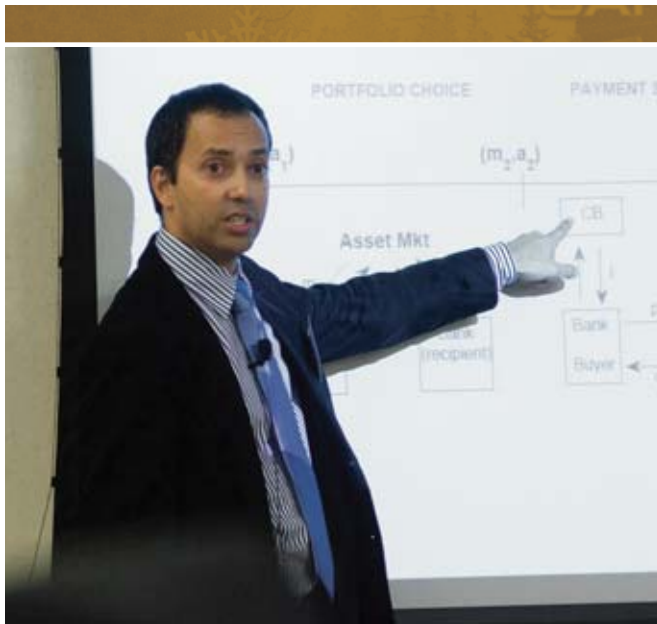
Funds-management operations increased significantly in 2009. Expanded government funding commitments that were put in place to support economic recovery in Canada required a large increase in the issuance of Government of Canada debt. In addition, to provide support to the International Monetary Fund (IMF), there was an increase in the funding requirements for Canada's official international reserves.

Fiscal Agent Responsibilities

As part of its fiscal agent responsibilities, the Bank provides banking services to the federal government. These include making and receiving payments, settling and paying entitlements on domestic debt, and providing information to facilitate cash-management and reconciliation activities. In 2009, higher government borrowing requirements resulted in an increase in the volume of these activities.

The Bank's treasury-management operations aim to ensure that funds are available to meet the government's daily operating requirements. Supporting the Bank's liquidity facilities and raising funds for government spending commitments resulted in a significant increase in the average Government of Canada cash balance, from the 2008 average of \$12.0 billion to \$30.1 billion in 2009.

Canada's official international reserves, held mainly in the Exchange Fund Account, provide foreign currency liquidity and, if required, funds to help promote orderly conditions for the Canadian dollar in foreign exchange markets. At year-end, official international reserves totalled over US\$54 billion, an increase of almost US\$10.5 billion over the previous



Presenter Miguel Molico at the workshop, "Payment Systems, Collateral, and Liquidity," held at the Bank in September 2009

year. Most of this increase reflected Canada's share of a new allocation of Special Drawing Rights at the International Monetary Fund.

As part of its global commitment to help stabilize financial markets and restore the flow of credit, the Government of Canada introduced two temporary facilities aimed at ensuring that Canadian financial institutions were not at a competitive disadvantage when raising funds in wholesale markets. The Canadian Lenders Assurance Facility, set up at the end of 2008, provided access to government insurance on specific debt instruments issued by banks and other qualifying deposit-taking institutions. The Canadian Life Insurers Assurance Facility, set up at the beginning of 2009, covered wholesale term borrowing by federally regulated life insurance companies. The Bank of Canada acted as administrative agent for the Government of Canada for these facilities and was responsible for their operation. In response to improved conditions in funding markets, the government began to reduce or phase out its

extraordinary liquidity facilities. The Canadian Lenders Assurance Facility and the Canadian Life Insurers Assurance Facility were not accessed by eligible participants, and these facilities expired on 31 December 2009. In contrast to the situation in many other countries, Canadian deposit-taking institutions and life insurance companies had access to debt financing without the need for a government guarantee.

Other Funds-Management Responsibilities

The Bank undertakes transactions with chartered banks and federally chartered trust and loan companies that arise from the requirement that these institutions transfer to the Bank all unclaimed balances in accounts domiciled in Canada that are in Canadian currency and that have been inactive for 10 years. The owners of these accounts can have their money returned if they can provide proof of ownership. In 2009, financial institutions transferred \$59.9 million in unclaimed balances to the Bank. There were approximately 24,000 general inquiries, and the Bank paid a total of \$11.9 million to satisfy about 7,000 claims.

The Bank provides services to foreign central banks and to international financial organizations, including the provision of Canadian-dollar-denominated operating accounts, the provision of a securities account for the settlement and custody of securities, and the safekeeping of gold. In 2009, the volume of services provided was in line with previous years.

In 2009, the Bank's pension fund remained fully funded on a going-concern basis. On a solvency basis, the Bank's pension fund fell below the 100 per cent level. As a result, the Bank paid \$47 million into the fund for 2009, and will continue to make contributions for the next four years to restore the solvency ratio to 100 per cent. As part of its ongoing management of the fund, the Bank completed an asset-liability management study to evaluate its approach to the investment of pension assets.

Priorities for 2009

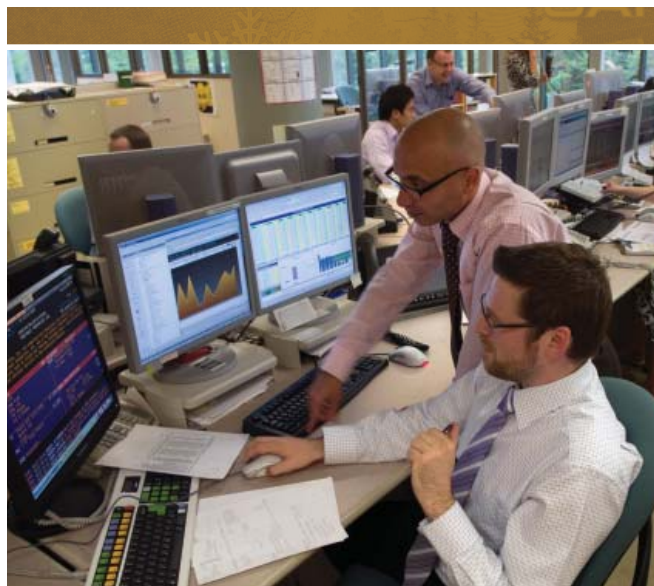
- Provide focused, timely policy advice on the domestic debt program and foreign reserves management in view of evolving borrowing requirements and market conditions
- Implement the medium-term framework for managing operational risk arising from expanded collateral on the Bank's balance sheet
- Achieve key milestones and objectives for enhancing the operational cost-effectiveness of the retail debt program
- Build business resilience and support initiatives that address the financial crisis
- Advance a research program to better understand trade-offs between risk and efficiency for payment and settlement systems

Progress on Priorities

Provide focused, timely policy advice on the domestic debt program and foreign reserves management in view of evolving borrowing requirements and market conditions

In 2009, to meet the increased funding requirements arising from weaker economic conditions, fiscal stimulus, and the government's "Extraordinary Financing Framework," the Bank helped the government to expand its domestic borrowing program. New maturities were introduced, and the Bank updated the framework used to monitor and manage the borrowing program. A model to improve the pricing analysis of Canada Savings Bonds and Canada Premium Bonds was developed and put in place.

To increase the liquid portion of official foreign reserves, and to provide support to the International Monetary Fund, the Bank assisted the government in issuing a US\$3 billion global bond, the first such issue in over a decade. The issue was met with high demand from the international investment community. The Bank also developed a framework to manage financial risks associated with Government of Canada transactions with the IMF.



The Bank's Trading Room

Implement the medium-term framework for managing operational risk arising from expanded collateral on the Bank's balance sheet

The Bank carefully monitors the operational risk related to the management of its balance sheet, which supports both monetary and financial system policy. In 2009, the Bank actively managed the risks associated with the operations undertaken to supply liquidity to the Canadian financial system.

Achieve key milestones and objectives for enhancing the operational cost-effectiveness of the retail debt program

The federal government's retail debt instruments are Canada Savings Bonds, which can be redeemed at any time, and Canada Premium Bonds, which typically carry a higher rate of interest but can be redeemed only once a year. The Bank is responsible for the marketing and sales of these instruments. Retail debt operations were conducted effectively in 2009, and sales and redemptions were in line with those of recent years.

An ongoing objective is to achieve significant reductions in program costs over time. In 2009, approximately \$5 million in new savings was realized as a result of the new business framework within which the Bank works with its external retail-debt service provider and from streamlining contracts for printing, storing, and distributing marketing materials.

Build business resilience and support initiatives that address the financial crisis

An important goal in the Bank's continuity planning is to operate payment and settlement systems continuously from two separate locations. Progress towards this goal in 2009 included defining and testing the staffing and work arrangements required for such operations.

Advance a research program to better understand trade-offs between risk and efficiency for payment and settlement systems

The Bank of Canada is responsible for the oversight of the clearing and settlement systems that are designated as being systemically important. While the primary concern of the Bank is to minimize risk, the efficiency of the systems is also important. In 2009, as part of its ongoing research into these dual objectives, the Bank conducted analysis into the structure of transactions in the Large Value Transfer System (LVTS), the behaviour of LVTS participants, and the links among different payment systems. Much of this research was conducted in collaboration with external partners.

Priorities for 2010

- *Provide sound advice on debt and investment management to the Government of Canada, and manage relationships, agreements, and contracts for efficient and effective program delivery*
- *Perform high-quality research that advances the understanding of risk and efficiency trade-offs in payment, clearing, and settlement systems*
- *Enhance business effectiveness and resilience by implementing split operations at a second site*

Corporate Administration

Desired outcome: *Efficient and effective corporate administration services in support of achieving Bank objectives*

Strategy: *Further develop the Bank's policy and accountability framework to enhance effectiveness and efficiency in the areas of human resources and financial management, infrastructure, and internal communications*

Outcome goal: *Provide cost-effective services and sound policy advice on the management of Bank resources*

To achieve the objectives of its core functions, the Bank of Canada relies on a variety of internal services in areas such as human resources, information technology, finance, legal services, communications, knowledge and information management, facilities, and security.

H1N1 outbreak and with a disruption in the supply of heat at head office. Despite these challenges, steady progress was made on priority initiatives in the area of corporate administration, and the delivery of core services was maintained.

Ongoing Work towards Goal and Desired Outcome

The Bank's response to the economic recession and financial crisis had a significant impact on the demand for corporate services. Changes in the structure and size of the Bank's balance sheet required comprehensive analysis and monitoring. Legal frameworks were further developed to support changes in how the Bank provides liquidity to the financial system and to inform discussions of proposed changes in the regulation of the financial system. Internal demand for economic and financial information was particularly acute in 2009, a challenge that was successfully met by staff who retrieve, research, and deliver such information. In the autumn, the Bank launched a new medium-term plan to communicate work priorities over the next three years. Finally, the Bank's framework for Continuity of Operations was successfully applied to deal with the

Priorities for 2009

- Review the Bank's strategies for total compensation and for recruitment and retention
- Simplify and standardize IT infrastructure
- Develop and implement innovative solutions to support priority business needs
- Complete strategies for long-term renewal of facilities and for enhanced business continuity
- Address evolving requirements for financial reporting
- Enhance communications to support Bank functions

Progress on Priorities

Review the Bank's strategies for total compensation and for recruitment and retention

To meet its goals, the Bank needs to recruit and retain talented employees. In 2009, the Bank completed a comprehensive review of its total compensation (pay and benefits). The review took into account evolving business needs, the competitive environment for certain skills, and the implications of a changing workforce. Changes in total compensation will support the Bank's ability to recruit and retain the talent it needs to be successful, while making effective use of public funds.

The changes, which anchor total compensation to the median of relevant markets of comparison, include the introduction of wider salary ranges to allow for the recognition of special skills and competencies and a faster response to changing market conditions; a separate salary line for economists and financial sector specialists to reflect more directly the labour market conditions and hiring challenges for these groups; and changes in the design of pensions for future hires that will increase the age of normal retirement to recognize increasing longevity. These changes will be implemented over the next few years, in line with the Bank's financial plan outlined in the medium-term plan.

In addition, progress was made on developing a communications strategy to aid in recruitment. As part of its efforts to retain talented staff, the Bank supported enhanced learning and development activities and expanded its Management Leadership Development program.

Simplify and standardize IT infrastructure

The Bank made significant progress in 2009 in its ongoing efforts to make its information technology (IT) infrastructure more robust and efficient. All end-user hardware and software were replaced, servers were consolidated, and storage capacity was optimized—three key achievements towards simplifying and standardizing the Bank's IT infrastructure.

Develop and implement innovative solutions to support priority business needs

In 2009, the Analytic Environment Program was substantially completed, resulting in significant improvements in the computing environment and business processes that support the Bank's economic and financial analysis. This achievement enabled the Bank to respond to changes in economic and financial conditions through more timely projection simulations and current analysis. In addition, the Bank developed a plan to enhance access to, and retrieval and disposition of, its electronic records.

Complete strategies for long-term renewal of facilities and for enhanced business continuity

The Bank is engaged in long-term efforts to modernize the head office complex, which is more than 30 years old, and to support business continuity should a disruptive event occur. Work began on detailed planning for the long-term renewal of facilities. With respect to enhancing business continuity, the Bank finalized a plan to split its critical payment and settlement operations between two sites and to establish a backup data centre.



All-staff Town Hall meeting, September 2009

Address evolving requirements for financial reporting

Internal controls over financial reporting (ICFR) are important in maintaining accurate and reliable financial information. During 2009, the Bank implemented a comprehensive risk-based program to review the Bank's ICFR. The first phase of the program, evaluating the design and implementation of internal controls, is expected to be carried out in 2010. The Bank has also established a process to ensure that it can adopt International Financial Reporting Standards by 2011 (see Summary of 2009 Financial Results, page 35).

Enhance communications to support Bank functions

Effective communications support the Bank's policy and operational work. In 2009, the Bank created and adapted communications to an increasingly broad range of audiences. A notable achievement was the launch of a website that presents a variety of credit-market indicators in statistical and graphical formats. The site, which uses technology developed in collaboration with two other central banks, quickly gained a large audience. It can be found at <<http://credit.bank-banque-canada.ca/about>>. In response to the increased complexity of, and interest in, economic and monetary policy developments, the Bank began publishing four full *Monetary Policy Reports* per year. Finally, with a view to sharing best practices in communication during a crisis, the Bank hosted a meeting of 20 central bank communication directors.

Priorities for 2010

- *Begin implementation of a plan to modify the Bank's total compensation program*
- *Strengthen business-continuity arrangements*
- *Develop a plan to renew the infrastructure of the head office complex*
- *Begin implementation of a plan to enhance and simplify corporate management processes*
- *Improve email, electronic document, and records management*
- *Further enhance communications to increase public understanding of the Bank and its roles*
- *Implement IT solutions aligned with functional priorities, such as applications for auctions and the monitoring of markets*

Our People and Work Environment

The Bank of Canada relies on talented staff to conduct research, analyze complex issues, provide services, and manage operations. The Bank's staff are actively involved in developing a superior work environment.

Most of the Bank's 1,200 employees work at the head office in Ottawa, while about 10 per cent are located at operations centres in Montréal and Toronto, and in small regional offices in Vancouver, Calgary, Toronto, Montréal, and Halifax. Staff in these regional offices help the Bank to monitor economic and financial developments across the country, and to deliver currency-education programs to retailers, law-enforcement agencies, and financial institutions.

The Bank's "compass" (which can be found on the inside front cover of this report) sets out three commitments that guide employees as they plan and carry out the Bank's work. In addition to our "commitment to Canadians," which covers the Bank's key responsibilities, we are committed to demonstrating excellence—performance that is "second to none among the central banks of the world"—and to achieving a superior workplace that promotes professional development, respect, and high achievement.

Staff come from a wide range of professional and operational backgrounds, and are recruited from across Canada and internationally. The Bank benefits from this diversity and encourages new ideas and creative approaches to the challenges of its work. The Bank supports the development of its staff through learning opportunities that include attendance at conferences, participation in working committees, involvement in international meetings and briefings, as well as on-the-job coaching by subject-matter experts. In addition, staff are supported in learning and using both official languages. With about 65 per cent of employees functionally bilingual, both English and French are used regularly in the workplace. Staff also benefit from flexibility in work arrangements, health and benefits options, and compensation that rewards performance. To guide its efforts to maintain a superior working environment, the Bank surveys staff on a regular basis.

Further information about the Bank and career possibilities can be found at <http://www.bankofcanada.ca/en/hr/index.html>.

By All Accounts—Outside Perspectives on the Bank of Canada

Five years ago, the Bank of Canada launched a series of commemorative books on various aspects of the central bank's work and history. The publication of the fifth and final volume, By All Accounts, on 11 March 2010, marks the Bank's 75th anniversary.

By All Accounts is an "outside-in" portrait of how the Bank of Canada has been viewed over the decades by journalists, cartoonists, politicians, and academics. The commentary, sometimes pointed, often colourful, is presented in the context of the Bank's evolution as an institution.

The five volumes are available individually for \$25 each, or as a boxed set for \$125.

More information on the commemorative series is available at http://www.bankofcanada.ca/en/publication/pub_res.html.



Governance

Board of Directors



Mark Carney ^{6*}
Governor
Appointed in 2008



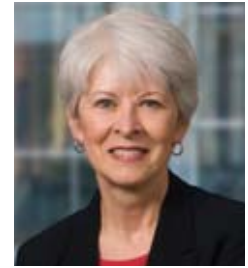
Paul Jenkins ^{6, 7*}
Senior Deputy Governor
Appointed in 2003



William Black ^{1, 6, 8*}
Corporate Director
Halifax, Nova Scotia
Appointed in October 2006



Philip Deck ^{3, 5, 8}
Executive Chairman, MKS Inc.
Toronto, Ontario
Appointed in October 2006



Bonnie DuPont ^{3*, 4, 6, 8}
Corporate Director
Calgary, Alberta
Appointed in October 2006



Douglas Emsley ^{2, 5*, 8}
Chairman and President,
Agriculture Development
Corporation
Regina, Saskatchewan
Appointed in June 2007



Jock Finlayson ^{3, 4, 8}
Executive Vice-President, Policy,
Business Council of
British Columbia
Vancouver, British Columbia
Appointed in June 2007



Carol Hansell ^{3, 4*, 6, 8}
Senior Partner, Davies Ward
Phillips & Vineberg LLP
Toronto, Ontario
Appointed in October 2006



Brian Henley ^{5, 7, 8}
President and CEO
Alec G. Henley & Associates Ltd.
St. John's, Newfoundland
and Labrador
Appointed in March 2008



Daniel Johnson ^{2, 3, 8}
Counsel, McCarthy Tétrault LLP
Montréal, Quebec
Appointed in April 2008



David Laidley ^{2, 4, 8}
Chairman Emeritus, Deloitte &
Touche LLP (Canada)
Montréal, Quebec
Appointed in June 2007



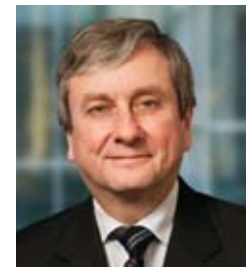
Leo Ledohowski ^{2, 5, 8}
President and Chairman,
Canad Inns
Winnipeg, Manitoba
Appointed in March 2008



Richard McGaw ^{4, 7, 8}
Professor
Department of Economics,
University of New Brunswick
Fredericton, New Brunswick
Appointed in March 2008



Michael O'Brien ^{2*, 6, 7, 8}
Business Advisor,
McInnes Cooper Law Firm
Charlottetown,
Prince Edward Island
Appointed in October 2006



Michael Horgan ⁶
Deputy Minister of Finance
Member ex officio

- 1. Lead Director
- 2. Member of Audit and Finance Committee
- 3. Member of Human Resources and Compensation Committee
- 4. Member of Corporate Governance Committee
- 5. Member of Capital Projects Committee

- 6. Member of Executive Committee
- 7. Member of Pension Committee
- 8. Member of Special Committee
- * Indicates committee chair

The Bank's Legislative Framework and Mandate

The Bank's legislative framework is described in the Bank of Canada Act (R.S., 1985, c. B-2), which sets out the mandate and governance of the Bank. In accordance with its mandate to promote the economic and financial welfare of Canada, the Bank pursues a monetary policy that is directed at keeping inflation low, stable, and predictable. It also promotes a stable and efficient financial system; oversees Canada's key clearing and settlement systems; and supplies secure, high-quality bank notes. As the Government of Canada's fiscal agent, the Bank manages the government's foreign exchange reserves, the public debt, and treasury activities. Additional information can be found at <<http://www.bankofcanada.ca/en/about/legislation.html>>.

Bank Governance

Under the Bank of Canada Act, the Governor is both Chief Executive Officer of the Bank and Chair of its Board of Directors. The Governor has specific authority and responsibility for the business of the Bank as set out in its mandate, notably, with respect to the formulation and implementation of monetary policy.

The Board of Directors oversees the management and administration of the Bank, especially with respect to matters relating to strategic planning and risk management, financial and accounting matters, human resources, other internal policies, and the operations of the Board itself. The Board and the Governor work in close co-operation, since the effective oversight of financial and administrative matters by the Board is crucial to the effective conduct of the Bank's business by the Governor.

The Board and the Bank regularly review and consider the relevant best practices of other public institutions, central banks, and private sector organizations, with a view to continuously improving and achieving excellence in corporate governance.

Role of the Board

Composition

The Board is composed of the Governor, the Senior Deputy Governor, and 12 independent directors appointed to three-year renewable terms by the Governor in Council (the Cabinet). The deputy minister of finance is an ex officio non-voting member of the Board.

Board operations

The Board and each of its committees have adopted written terms of reference setting out their various responsibilities, as well as those of the committee chairs. The Board and each committee agree on written work plans prior to the commencement of each calendar year. The Board currently has the following standing committees to enable it to carry out its responsibilities more effectively. Each of the committees makes recommendations to the Board regarding matters within its purview.

- The **Audit and Finance Committee** provides Board oversight of the financial affairs of the Bank, including its medium-term plan, annual budget, and expenses (\$366 million in 2009). The committee oversees the internal auditors and manages the relationship with the Bank's external auditors, who are appointed by the Governor in Council (the Cabinet).
- The **Human Resources and Compensation Committee** provides Board oversight for the Bank's human resources policies and practices, compensation policies, succession planning, senior executive performance, and compensation of the Governor and the Senior Deputy Governor. The latter are based on ranges established by the Treasury Board's Advisory Committee on Senior Level Retention and Compensation, and are subject to approval of the Governor in Council (the Cabinet).
- The **Corporate Governance Committee** provides Board oversight of the Bank's corporate governance practices, including annually assessing the Board's effectiveness, reviewing committee memberships and chairmanships, and reviewing the terms of reference of the Board and its committees.

- The **Capital Projects Committee** (established in 2009) provides Board oversight for significant capital projects being undertaken by the Bank.
- The **Pension Committee** oversees the Bank's responsibilities as Administrator of the Bank of Canada Pension Plan, including the administration of pension benefits and management of the Pension Trust Fund, which had assets of approximately \$934.8 million at the end of 2009. The committee is composed of three independent Directors and three members of management, and is chaired by the Senior Deputy Governor. A quorum of the committee must include at least two independent Directors.

In 2009, the Board met six times, the Audit and Finance Committee six times, the Corporate Governance Committee four times, the Capital Projects Committee six times, the Human Resources and Compensation Committee seven times, and the Pension Committee five times.

In addition, the Bank of Canada Act provides for an Executive Committee to act in the place of the Board. The Executive Committee met twice in 2009. All Directors are invited to the Executive Committee's July meeting for an economic briefing between the June and September meetings. The Executive Committee reports to the Board on its activities after every meeting.

Board independence

Since the Governor is, by statute, both Chairman of the Board and Chief Executive Officer of the Bank, the independent Directors have elected a Lead Director to enhance Board effectiveness and to act as a liaison between the Board and the Bank's management. The Board has adopted written terms of reference outlining the Lead Director's responsibilities. At both Board and committee meetings, the independent Directors regularly hold sessions without management or non-independent Directors present. Each committee of the Board, except for the Pension Committee, is composed solely of independent Directors. The Audit and Finance Committee meets privately on a regular basis with both internal and external auditors. The Board and

its committees have the right to retain independent advisers at the Bank's expense, as the Human Resources and Compensation Committee did in 2009 as part of its oversight of the Bank's Total Compensation Review.

Board effectiveness

The Board conducts an annual self-assessment through one-on-one interviews between each Director and the Lead Director, supported by a survey that solicits Directors' views on various elements of Board operations, governance, and effectiveness. The surveys are completed electronically, and aggregated results are distributed to Directors for discussion in open session. The Board has developed and maintains a skills map of current Board competencies and takes note of any gaps or deficiencies. New Directors are provided with comprehensive orientation briefings when they join the Board. The Board regularly considers its education requirements with respect to the operations of the Bank and other areas of interest. In 2009, the Board adopted an education curriculum that provides for sessions conducted by Bank executives at each Board meeting on subjects related to the business of the Bank.

Annually, the Board convenes a meeting outside of Ottawa and uses the opportunity to gain an understanding of local concerns and to explain the Bank's policies. In 2009, the meeting was held in Regina. To assist in its understanding of the monetary policy process, the Board receives annual confidential briefings from the independent Special Advisers seconded to the Bank from academic and private sector organizations.

In 2009, the Board implemented a web-based Board portal that permits secure access for Board members to all Board materials, current and historical, and eliminates the inconvenience and expense of physically delivering Board materials to all members.

Additional Board information

More information relating to the Bank's Board of Directors and its activities during 2009, including Board and Committee mandates, Board and Committee composition, Director attendance and compensation, can be found on the Bank's website at: <http://www.bankofcanada.ca/en/about/board.html>.



Governing Council (left to right): Pierre Duguay, Deputy Governor; Timothy Lane, Deputy Governor; Paul Jenkins, Senior Deputy Governor; Mark Carney, Governor; John Murray, Deputy Governor; David Longworth, Deputy Governor

The Nominating Committee for the Bank's Fellowship Program is chaired by a member of the Board. The role of the Nominating Committee is described in more detail on the Bank's website at http://www.bankofcanada.ca/en/fellowship/selection_process.html. Highlights of this year's Fellowship Program are provided in the Monetary Policy section of this report.

Board oversight

To fulfill its mandate, the Board of Directors focuses on aspects of governance critical to the effective functioning of the Bank. In addition to its regular activities, the Board exercised its oversight role in the following areas of note during 2009:

- The Board was fully engaged in the process of reviewing the Bank's medium-term plan for 2010–12, discussing individual elements of the

three-year plan at each Board meeting, commencing in the last quarter of 2008, and approving the final version of the plan in June 2009.

- The Board's Human Resources and Compensation Committee oversaw the formulation of the Bank's Total Compensation Review during 2009, receiving updates and providing input at both regularly scheduled and specially convened meetings of the committee, ultimately approving its recommendations.
- In October 2009, immediately following the announcement of the departure of the Senior Deputy Governor, the Board, in keeping with its statutory responsibilities under the Bank of Canada Act, formed a Special Committee to conduct a search process leading up to the appointment of a successor by the Board in February 2010, subject to approval by the Governor in Council (the Cabinet).

Role of the Governing Council

The Governor shares responsibility for decisions related to monetary policy, financial stability, and the strategic direction of the Bank with fellow members of the Bank's Governing Council: the Senior Deputy Governor and four Deputy Governors. Governing Council works by consensus to formulate, implement, and communicate its monetary policy and financial stability decisions, with the support of the Bank's economics and communications departments.

The Bank's strategic direction is set out in the Bank's medium-term plan, which describes the desired outcomes, goals, priorities, and financial strategies that will drive the Bank's activities for the period 2010 to 2012.

Key elements of the plan, which can be viewed at http://www.bankofcanada.ca/en/pdf/mtp_corporate_plan_2009e.pdf, are discussed later in this report.

Role of the Corporate Management Committee

The Corporate Management Committee is chaired by the Senior Deputy Governor and is responsible for overseeing corporate operations and corporate policy. Composed of the department chiefs and advisers associated with corporate administration, it provides leadership and guidance on corporate policies and on management and communication issues, and recommends proposals for consideration and approval by the Board of Directors.



Corporate Management Committee (left to right): Brigid Janssen, Chief, Communications; Carole Briard, Chief, Information Technology Services; W. John Jussup, General Counsel and Corporate Secretary; Colleen Leighton, Chief, Corporate Services; Janet Cosier, Adviser on Strategic Planning and Risk Management; Paul Jenkins, Senior Deputy Governor; Sheila Vokey, Chief, Financial Services; Sheila Niven, Adviser

Management Commentary

Summary of 2009 Financial Results

The financial results presented in the Bank's financial statements are shaped by the activities the Bank undertakes to support its mandate, which is to promote Canada's economic well-being. Revenues are not driven by profit-maximization objectives. This section of the *Annual Report* presents management's commentary on the financial results for the year.

The Bank's Balance Sheet

In 2009, the assets and liabilities of the Bank's balance sheet declined by \$7,229 million from 2008. The main reason for this decrease is the reduced demand for term liquidity in the Canadian financial system.

In mid-October 2008, as part of the Bank's response to the intensification of the global financial crisis, several measures to provide exceptional liquidity to the financial system were announced. As a result, as at 31 December 2008, the balance sheet had increased relative to the previous year. During 2009, the Bank continued to offer term liquidity through purchase and resale agreements and the Canadian-dollar Term Loan Facility. In September, owing to improved conditions in funding markets, the Bank announced that both its Term Purchase and Resale Facility for Private Sector Instruments and its Canadian-dollar Term Loan Facility would expire in late October 2009. In addition, weekly regular term purchase and resale operations were moved to a biweekly schedule and, effective 19 January 2010, to a monthly schedule.

On the Bank's balance sheet, *Securities purchased under resale agreements* decreased by \$9,952 million from 2008, a decrease that reflects both the conclusion of the private sector purchase and resale facility, as well as the smaller size of purchase and resale operations in the latter part of 2009. *Advances to members of the Canadian Payments Association* decreased to zero in 2009, owing to the expiration of the Term Loan Facility

in October 2009. Partially offsetting these decreases, the Bank's investment in treasury bills increased by \$1,967 million in 2009.

Within the Bank's liabilities, deposits from *Members of the Canadian Payments Association* have increased by \$2,974 million. This increase relates to a decision taken by the Bank in April 2009 to increase the targeted daily settlement balances to \$3,000 million when it reduced the target for the overnight interest rate (the rate the Bank pays on deposits from financial institutions) to 25 basis points. By providing significantly more aggregate balances than required by participants in the Large Value Transfer System, an incentive is created for overnight funds to trade at the rate the Bank pays on deposits. *Bank notes in circulation*, the liability created through the issuance of Canadian bank notes, rose to \$55,468 million at 31 December 2009, an increase of 3 per cent over 2008, despite the contraction in the economy. Offsetting these increases to liabilities was a reduction in the value of Government of Canada deposits, which declined from \$23,604 million in 2008 to \$11,848 million in 2009. This decrease is directly related to the reduction in Government of Canada deposit balances required to support the term liquidity operations.

Statement of Net Income

Revenue

The Bank's main source of revenue is interest earned on holdings of federal government securities. In 2009, the Bank's revenue decreased by \$518 million, or 23 per cent from 2008.

Revenue from Government of Canada treasury bills and bonds in 2009 was \$1,620 million, a decrease of 23 per cent or \$487 million from 2008. This was primarily the result of lower yields on short-term investments and a smaller average treasury bill portfolio. Lower yields have also reduced interest revenue on purchase and resale agreements, despite higher average balances throughout

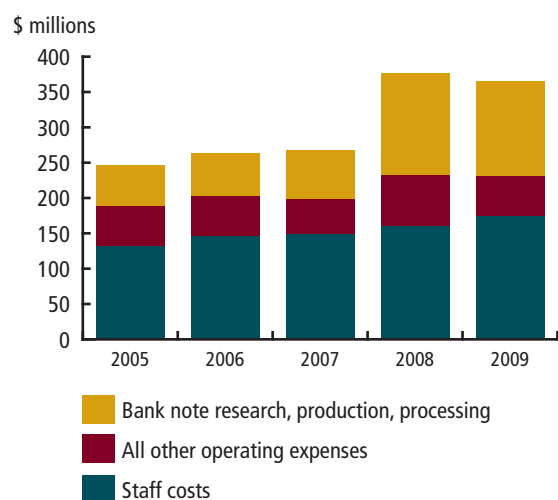
the year. Similarly, interest paid on deposits decreased as a result of the decline in interest rates, even though the average level of deposits for both the Government of Canada and members of the Canadian Payments Association in 2009 was higher than in 2008.

Operating expenses

Operating expenses support the Bank's activities in its four functions: monetary policy, financial system, currency, and funds management. Operating expenses for the Bank in 2009 were \$366 million, a decrease of \$10 million over 2008 (see note 14 in the Financial Statements).

Expenses for *Bank note research, production, and processing*, part of the Currency function, decreased by \$15 million because of a lower volume of notes printed in 2009. The number of notes printed in 2008 was unusually high, owing to production delays in 2007. *Staff costs*, which comprise salaries, benefits, and other staff-related expenses, increased by \$14 million. About 50 per cent of this increase was attributable to higher costs for employee benefits, including higher future benefit costs, which are affected by lower values for pension assets, along with lower interest rates used to value pension obligations. The remainder of this increase was largely due to changes in compensation to keep pace with trends in the labour market, increased staffing as a result of the financial crisis, and other initiatives. The remaining \$9 million decrease pertains mainly to other operating expenses

Operating Expenses



Note: Prior to 2008, operating costs are presented net of retail debt services, which were 100 per cent recovered from the Government of Canada.

associated with the funds-management function, which includes the retail debt program. Costs declined in 2009, owing to lower transaction volumes for Canada Savings Bonds, more efficient warehousing and distribution, and lower costs for outsourced system services.

For 2009, the amount transferred to the Receiver General for Canada was \$1,344 million, approximately \$508 million less than the amount transferred in 2008.

Future Accounting Changes

As a government business entity, the Bank will be required to report under International Financial Reporting Standards (IFRS), beginning with the year ended 31 December 2011. In that year, the Bank will be required to present its 2010 comparative figures compliant with IFRS and to provide a reconciliation to the figures previously reported under Canadian generally accepted accounting principles.

To meet the IFRS transitional requirements, in 2008 the Bank established a project team and a formal approach for conversion to IFRS involving both oversight by a Steering Committee and regular reporting to the Audit and Finance Committee. The transition plan has three phases: the diagnostic assessment and planning phase; the detailed evaluation and analysis phase; and, lastly, the conversion and embedding phase. Following the completion of the first phase in 2008, the second phase of the project was substantially completed in 2009.

As part of the evaluation and analysis phase, a comprehensive analysis of IFRS standards was completed, and any differences with existing accounting policies were highlighted. Internal training and awareness sessions on IFRS have been completed. Proposed recommendations on accounting policy have been presented to the Bank's Audit and Finance Committee, with approval expected in the first half of 2010.

At this time, management cannot quantify the impact that the future adoption of IFRS will have on the Bank's financial statements, but has determined that the impact may be material. No significant changes to information technology and data systems are anticipated as a result of the IFRS conversion. Management anticipates that employee future benefits and financial instruments will be the areas of the financial statements most significantly affected, owing to measurement differences under IFRS.

Financial Highlights of the 2007-09 Medium-Term Plan

The year 2009 was the last year of the Bank's current medium-term plan (MTP): Moving Forward—Building the Future Together. The plan focused on three strategic priorities: renewing the Bank's infrastructure, creating a superior work environment, and staying at the forefront of good governance.

The MTP financial plan differs from the audited financial statements, since it excludes expenses associated with both non-current deferred employee benefits and the procurement of bank notes, because of their volatility. Deferred employee benefits are susceptible to changes in the year-end discount rates used to value future financial obligations. Bank note costs are subject to year-to-year swings in the volume of notes required. Retail debt costs were reflected on a net recovery basis, since these costs were being recovered from the Department of Finance when the plan was developed.

Beginning 1 January 2008, retail debt expenses were no longer recovered from the Department of Finance, rendering the Bank's actual expenses for 2008 and beyond significantly higher than in previous years. The chart highlights the impact of this change on MTP estimates and presents an adjusted financial profile for the three-year period. The following paragraphs provide an overview of the areas of the MTP that have a significant financial impact.

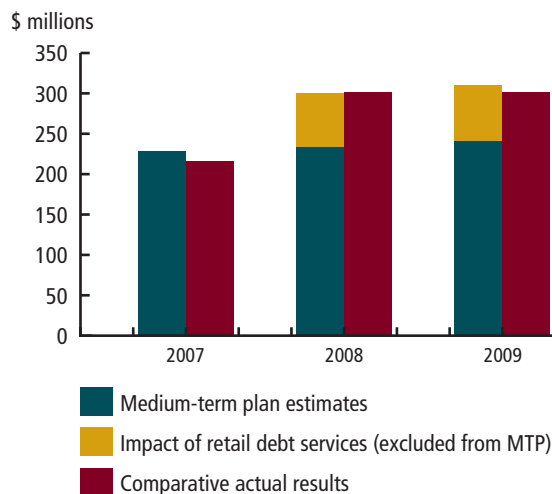
In 2007, the focus was to establish a robust high-availability environment for critical banking systems. In 2008, this initiative was successfully concluded, ensuring that the Bank's banking systems would continue to operate in a highly reliable manner.

In 2009, the Analytic Environment Program was substantially completed, delivering important enhanced analytic capabilities and facilitating the Bank's response to the global financial crisis. This program involved renewal of the infrastructure and business processes for data management, research, and analysis.

The development of the next generation of bank notes is on schedule, with the planned launch of the first new notes beginning in 2011.

Overall, as reflected in the MTP financial profile, including the adjustment for retail debt, results for the three years are within the expectations outlined in the MTP financial plan.

Medium-Term Plan Financial Profile



Note: Comparative actual results are as per note 14 to the Financial Statements, less non-current deferred employee benefits and the procurement costs of bank notes.

The International Accounting Standards Board (IASB) has several projects under way, some of which will affect IFRS standards relevant to the Bank. The Bank will closely monitor the progress of IASB projects on financial instruments and employee benefits, which may result in revised standards being issued before 2011. Any revisions made to these standards could potentially have a significant impact on the Bank's financial statements and may cause management to revisit its assessment of transitional impacts.

The Bank's Medium-Term Plan 2010-12

In June 2009, the Board approved the next medium-term plan for the period 2010 to 2012: *Achieving Excellence Together*. This plan is available on the Bank's external website at <http://www.bankofcanada.ca/en/pdf/mtp_corporate_plan_2009e.pdf>.

For the Bank to meet the challenges ahead, the accomplishments of the past three years will be built upon with three priorities: conducting leading research and policy analysis; strengthening our business resilience and infrastructure; and attracting, retaining, and engaging high-quality staff. Included in the financial plan of the medium-term plan is an average annual growth of 4 per cent¹ for operating expenses for the three years to support the Bank's responsibilities for monetary policy, financial system, currency, and funds management.

Risk Management

Overview

The Bank has a well-established, integrated risk-management framework for identifying, managing, and monitoring key areas of risk, including business, reputational, financial, operational, and project risks. Through an annual self-assessment process, senior managers identify and assess the key risks that could impede the fulfillment of the Bank's responsibilities and the achievement of its objectives. Risk-management strategies are reviewed and modified as required.

Risk-Governance Structure

The Bank's risk-management framework is supported by a strong risk-governance structure. The responsibilities of the key stakeholders of risk management are described below.

Board of Directors

The Board of Directors oversees the risk-management process. This involves an annual review of the Bank's risk "scorecard" and functional briefings on risk throughout the year. The Audit and Finance Committee also assists the Board in fulfilling its responsibilities with respect to the management of financial reporting risk associated with the Bank's balance sheet and the adequacy of internal controls.

Senior Management

Annually, areas of corporate risk and the approaches to managing these risks are reviewed and discussed with the Governing Council and the Corporate Management Committee. The Deputy Governors and Department Chiefs are responsible to the Governor and Senior Deputy Governor for the management of corporate risk in their respective areas of responsibility. As part of the Bank's ongoing monitoring of performance, the Governing Council reviews any significant changes in the levels of risk and any new areas of risk identified during the year and reports these changes to the Board on a timely basis.

Financial Risk Office

The Bank has a Financial Risk Office, independent of operations, that is responsible for monitoring and reporting on the financial risks relating to the Bank of Canada's balance sheet. In addition, the Office reports to the Department of Finance and the Bank on risks and investment performance arising from the management of the government's debt and foreign reserves.

Financial Services and Internal Audit

Financial Services is responsible for financial planning, accounting, and financial reporting. Appropriate systems of internal control are used to safeguard assets and

¹ As with the previous plan, the procurement of bank notes and non-current deferred employee benefits are excluded. In addition, the plan excludes two large projects: enhanced business continuity and the renewal of the head office complex.

produce accurate financial reports. Internal Audit, which reports functionally to the Audit and Finance Committee, independently conducts periodic reviews of Bank operations, including the Bank's risk-management process, to assess the appropriateness and effectiveness of the systems of internal control implemented by management to manage risk. This process provides reasonable assurance that objectives will be achieved.

Risk-Management Working Group

The Risk-Management Working Group, made up of senior representatives from across the Bank, is responsible for facilitating the Bank's annual risk self-assessment process. Members also meet on a quarterly basis to review the corporate risk profile and share risk-management initiatives within their respective departments.

Financial Risk

Financial risk is the risk associated with the Bank's management of its financial assets and liabilities. During the year, the operations undertaken to increase liquidity resulted in only slight changes to the levels of both credit and interest rate risk.

Credit risk—Credit risk is the risk that a counterparty to a financial contract will fail to discharge its obligations in accordance with agreed-upon terms.

The Bank's exposure to credit risk is very limited because of the high-quality investments that it holds and by virtue of the fact that section 18 of the Bank of Canada Act prohibits the Bank from lending funds on an uncollateralized basis. Strict eligibility criteria are set for all collateral, and the Bank requires excess collateral relative to the size of the loan provided.

For term purchase and resale agreements, the fair value of the collateral is monitored on a daily basis, and margin calls are made when the fair value of the collateral falls below established minimum levels. Counterparties are assigned maximum individual and aggregate auction allocation limits based on credit ratings.

Interest rate risk—Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

During 2009, interest rate risk increased slightly as the Bank moved to purchase additional treasury bills as some of the term liquidity operations unwound. Treasury bills are the only financial asset that the Bank carries at fair value.

More information on financial risk is available in note 6 to the financial statements.

Operational Risk

Operational risk is defined as the risk of a negative impact on the Bank's assets, resources, or operational requirements resulting from people, processes, systems, and external sources (including those from external partners/suppliers). Operational risk is one of the broad categories of risk assessed and monitored by the Bank's management. Monitoring risk events during the year enables the Bank to identify potential exposures and trends over time, which is important for the purposes of planning and resource allocation.

In addition to monitoring risk incidents and events, the Bank has contingency plans in place that ensure the continuity of operations in the event of a disruption to regular business. These plans focus on supporting critical banking operations, providing for the safety of staff, and protecting assets.





FINANCIAL STATEMENTS

As at 31 December 2009

FINANCIAL REPORTING RESPONSIBILITY

The accompanying financial statements of the Bank of Canada have been prepared by management in accordance with Canadian generally accepted accounting principles and contain certain items that reflect best estimates and judgment of management. The integrity and reliability of the data in these financial statements are management's responsibility. Management is responsible for ensuring that all information in the *Annual Report* is consistent with the financial statements.


In support of its responsibility for the integrity and reliability of these financial statements and for the accounting system from which they are derived, management has developed and maintains a system of internal controls to provide reasonable assurance that transactions are properly authorized and recorded, that financial information is reliable, that the assets are safeguarded and liabilities recognized, and that the operations are carried out effectively. The Bank has an internal Audit Department whose functions include reviewing internal controls, including accounting and financial controls and their application.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls and exercises this responsibility through the Audit and Finance Committee of the Board. The Audit and Finance Committee is composed of members who are neither officers nor employees of the Bank and who are financially literate. The Audit and Finance Committee is therefore qualified to review the Bank's annual financial statements and to recommend their approval by the Board of Directors. The Audit and Finance Committee meets with management, the Chief Internal Auditor, and the Bank's external auditors who are appointed by Order-in-Council. The Audit and Finance Committee has established processes to evaluate the independence of the Bank's external auditors and reviews all services provided by them. The Audit and Finance Committee has a duty to review the adoption of, and changes in, accounting principles and procedures that have a material effect on the financial statements, and to review and assess key management judgments and estimates material to the reported financial information.

These financial statements for the year ended 31 December 2009 have been audited by the Bank's external auditors, KPMG LLP and PricewaterhouseCoopers LLP, and their report is presented herein. The external auditors have full and unrestricted access to the Audit and Finance Committee to discuss their audit and related findings.



M. Carney, Governor



S. Vokey, CA, Chief Accountant

Ottawa, Canada
22 January 2010

AUDITORS' REPORT

To the Minister of Finance, registered shareholder of the Bank of Canada (the "Bank")

We have audited the balance sheet of the Bank as at 31 December 2009 and the statements of net income, comprehensive income, changes in capital and cash flows for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at 31 December 2008 and for the year then ended were audited by Ernst & Young LLP and PricewaterhouseCoopers LLP who expressed an opinion without reservation in their report dated 23 January 2009.



KPMG LLP
Chartered Accountants
Licensed Public Accountants



PRICEWATERHOUSECOOPERS LLP
Chartered Accountants
Licensed Public Accountants

Ottawa, Canada
22 January 2010

BALANCE SHEET

As at 31 December
(Millions of dollars)

ASSETS

Cash and foreign deposits (note 3)

Loans and receivables

Securities purchased under resale agreements (note 4a)

Advances to members of the Canadian Payments Association (note 4b)

Other receivables

Investments (note 5)

Treasury bills of Canada

Government of Canada bonds

Other investments

Property and equipment (note 7)

Other assets (note 8)

LIABILITIES AND CAPITAL

Bank notes in circulation (note 9)

Deposits (note 10)

Government of Canada

Members of the Canadian Payments Association

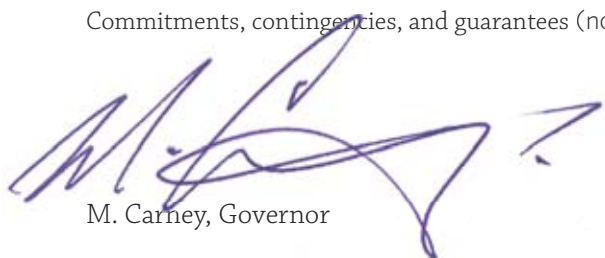
Other deposits

Other liabilities (note 11)


Capital (note 13)

Commitments, contingencies, and guarantees (note 15)

	2009	2008
Cash and foreign deposits (note 3)	20.4	119.5
Loans and receivables		
Securities purchased under resale agreements (note 4a)	25,374.8	35,326.9
Advances to members of the Canadian Payments Association (note 4b)	-	1,902.3
Other receivables	2.2	4.5
	25,377.0	37,233.7
Investments (note 5)		
Treasury bills of Canada	13,684.0	11,717.1
Government of Canada bonds	31,986.2	29,267.7
Other investments	38.0	38.0
	45,708.2	41,022.8
Property and equipment (note 7)	150.5	140.5
Other assets (note 8)	98.6	67.0
	71,354.7	78,583.5
LIABILITIES AND CAPITAL		
Bank notes in circulation (note 9)	55,467.9	53,731.3
Deposits (note 10)		
Government of Canada	11,847.6	23,604.0
Members of the Canadian Payments Association	2,999.6	25.9
Other deposits	703.0	783.3
	15,550.2	24,413.2
Other liabilities (note 11)	199.8	226.1
	71,217.9	78,370.6
Capital (note 13)	136.8	212.9
	71,354.7	78,583.5



M. Carney, Governor



M. L. O'Brien, FCA,
Chair, Audit and Finance Committee

On behalf of the Board



S. Vokey, CA, Chief Accountant



W. A. Black,
Lead Director

See accompanying notes to the financial statements.

STATEMENT OF NET INCOME

Year ended 31 December
(Millions of dollars)

	2009	2008
REVENUE		
Interest earned on investments	1,619.8	2,107.1
Dividend revenue	4.5	4.2
Realized gains on sales of treasury bills of Canada	16.1	31.5
Interest earned on securities purchased under resale agreements	178.2	212.9
Other revenue	0.1	8.5
Interest expense on deposits	(109.0)	(136.1)
	1,709.7	2,228.1
EXPENSE by function (notes 1 and 14)		
Monetary policy	74.2	67.8
Financial system	51.2	54.5
Currency	137.1	142.2
Funds management	103.5	111.4
	366.0	375.9
NET INCOME	1,343.7	1,852.2

STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December
(Millions of dollars)

	2009	2008
NET INCOME	1,343.7	1,852.2
OTHER COMPREHENSIVE INCOME		
Change in net unrealized gains on available-for-sale assets	(60.0)	89.7
Reclassification of gains on available-for-sale assets realized during year	(16.1)	(31.5)
	(76.1)	58.2
COMPREHENSIVE INCOME	1,267.6	1,910.4

See accompanying notes to the financial statements.

STATEMENT OF CHANGES IN CAPITAL

Year ended 31 December
(Millions of dollars)

	2009	2008
SHARE CAPITAL	5.0	5.0
STATUTORY RESERVE	25.0	25.0
SPECIAL RESERVE		
Balance, beginning of year	100.0	100.0
Allocation from net income	-	-
Balance, end of year	100.0	100.0
RETAINED EARNINGS		
Balance, beginning of year	-	-
Net income	1,343.7	1,852.2
Transfer to Receiver General for Canada (note 13)	(1,343.7)	(1,852.2)
Balance, end of year	-	-
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Balance, beginning of year	82.9	24.7
Other comprehensive income	(76.1)	58.2
Balance, end of year	6.8	82.9
CAPITAL (note 13)	136.8	212.9

See accompanying notes to the financial statements.

STATEMENT OF CASH FLOWS

Year ended 31 December
(Millions of dollars)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest received	2,000.3	2,379.5
Dividends received	4.5	4.2
Recoveries and other revenue received	13.0	43.9
Interest paid	(109.0)	(136.8)
Payments to suppliers and employees	(390.4)	(349.8)
Net decrease (increase) in advances to members of the Canadian Payments Association	1,900.6	(1,899.2)
Net (decrease) increase in deposits	(8,862.9)	21,432.6
Proceeds from maturity of securities purchased under resale agreements	236,367.8	192,416.4
Acquisition of securities purchased under resale agreements	(226,463.2)	(223,704.4)
Repayments of securities sold under repurchase agreements	(724.8)	(5,989.3)
Proceeds from securities sold under repurchase agreements	724.8	5,989.3
Net cash provided by (used in) operating activities	4,460.7	(9,813.6)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (increase) decrease in treasury bills of Canada	(2,177.3)	8,517.1
Purchases of Government of Canada bonds	(6,537.8)	(3,888.4)
Proceeds from maturity of Government of Canada bonds	3,817.4	3,988.7
Purchase of property and equipment	(25.9)	(18.5)
Net cash (used in) provided by investing activities	(4,923.6)	8,598.9
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in bank notes in circulation	1,736.6	3,166.1
Amount paid to Receiver General for Canada	(1,372.3)	(1,836.0)
Net cash provided by financing activities	364.3	1,330.1
EFFECT OF EXCHANGE RATE CHANGES ON FOREIGN CURRENCY	(0.5)	0.8
(DECREASE) INCREASE IN CASH AND FOREIGN DEPOSITS	(99.1)	116.2
CASH AND FOREIGN DEPOSITS, BEGINNING OF YEAR	119.5	3.3
CASH AND FOREIGN DEPOSITS, END OF YEAR	20.4	119.5

See accompanying notes to the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2009

(Amounts in the notes to the financial statements are in millions of Canadian dollars, unless otherwise stated.)

1. The business of the Bank of Canada

The responsibilities of the Bank of Canada (the Bank) focus on the goals of low and stable inflation, financial system stability, a safe and secure currency, and the efficient management of government funds and public debt. These responsibilities are carried out as part of the broad functions described below.

Monetary policy

Contributes to solid economic performance and rising living standards for Canadians by keeping inflation low, stable, and predictable.

Financial system

Promotes a safe, sound, and efficient financial system, both within Canada and internationally.

Currency

Designs, produces, and distributes Canada's bank notes, focusing on counterfeit deterrence through research on security features, public education, and partnership with law enforcement; replaces and destroys worn notes.

Funds management

Provides high-quality, effective, and efficient funds-management services: for the Government of Canada, as its fiscal agent; for the Bank; and for other clients.

2. Significant accounting policies

The financial statements of the Bank are in accordance with Canadian generally accepted accounting principles (GAAP) and conform to the disclosure and accounting requirements of the Bank of Canada Act and the Bank's bylaws. The significant accounting policies of the Bank are summarized below. These standards have been consistently applied to both years, unless otherwise stated.

a) Change in accounting policies

During the year, in accordance with new standards issued by the Canadian Institute of Chartered Accountants (CICA), the Bank adopted the following accounting standards:

Intangible assets

On 1 January 2009, the Bank adopted CICA Handbook Section 3064, Goodwill and Intangible Assets replacing Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. This new standard provides guidance for the identification, recognition, and measurement of externally acquired or internally developed intangible assets and requires separate disclosure thereon (note 7). The implementation of this standard has not resulted in any changes to the recognition or measurement of intangible assets. Intangible assets are presented with *Property and equipment* on the *Balance Sheet*.

Financial instruments—disclosure and presentation

In June 2009, the CICA issued amendments to CICA Handbook Section 3862, Financial Instruments—Disclosures. The amendments, effective for the years ending on or after 30 September 2009, enhance required disclosures about fair-value measurements, including the relative reliability of the inputs used in

those measurements. The amendments also change the definition of liquidity risk and enhance required disclosures of the liquidity risk of financial instruments. Enhanced disclosures under this standard have been incorporated in note 6.

b) Use of estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions based on information available at the financial statement date. Actual results could differ from these estimates. These estimates are primarily in the area of pension and other employee future benefits and fair values of certain financial instruments and collateral taken.

c) Revenue recognition

Investments

Interest revenue earned on treasury bills and bonds is recorded using the effective interest method.

Dividend revenue on the Bank for International Settlements (BIS) shares is recorded as dividends are declared.

Realized gains on the sale of treasury bills of Canada are recorded at the time of sale as a reclassification from *Other Comprehensive Income* and are calculated as the excess of proceeds over the amortized cost.

Other

Interest earned on securities purchased under resale agreements is recorded using the effective interest method.

Other revenue is comprised mostly of interest earned on advances to members of the Canadian Payments Association and is recorded using the effective interest method.

d) Employee benefit plans

The Bank sponsors a number of defined-benefit plans that provide pension and other post-retirement and post-employment benefits to its eligible employees. The Bank accrues its obligations under these benefit plans and the related costs, net of plan assets. The costs and the obligations of the plans are actuarially determined using the projected benefit method and using management's best estimate of the expected investment performance of the plans, salary escalation, retirement ages of employees, and expected health-care costs.

The benefit plan expense (income) for the year consists of the current service cost, the interest cost, the expected return on plan assets, and the amortization of unrecognized past service costs, actuarial losses (gains), as well as the transitional obligation (asset). Calculation of the expected return on assets for the year is based on the market value of plan assets using a market-related value approach. The market-related value of plan assets is determined using a methodology where the difference between the actual and expected return on the market value of plan assets is amortized over five years.

The excess of the net accumulated actuarial loss (gain) over 10 per cent of the greater of the benefit obligation and the market-related value of plan assets is amortized over the expected average remaining service lifetime (EARSL) of plan members. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the EARSL at the date of amendments.

On 1 January 2000, the Bank adopted the new accounting standard on employee future benefits using the prospective application method. The initial transitional balances are amortized on a straight-line basis over the EARSL, as at the date of adoption.

e) Translation of foreign currencies

Investment income denominated in foreign currencies is translated at the rate in effect at the date of the transaction.

Assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the rates of exchange prevailing at the balance sheet dates. The resulting gains and losses are included in *Other revenue*.

f) Financial instruments

Financial instruments are measured at fair value on initial recognition. Subsequent to initial recognition, they are accounted for based on their classification. Transaction costs are expensed as incurred for all classes of financial instruments. The Bank accounts for all financial instruments using settlement date accounting.

Subsequent to initial recognition, financial assets classified as available-for-sale (AFS) are measured at fair value using quoted market prices or at cost if the instruments are not traded in an active market. Unrealized changes in values of AFS financial assets held at fair value are recognized in *Other Comprehensive Income*.

The Bank's financial assets designated as AFS consist of the Treasury bills of Canada and Other investments portfolios.

Subsequent to initial recognition, financial assets classified as held-to-maturity (HTM) are measured at amortized cost less any impairment losses using the effective interest method. The Government of Canada bonds portfolio is classified as HTM.

The Bank has not classified any of its financial assets as held-for-trading (HFT).

All other financial assets are classified as loans and receivables. Subsequent to initial recognition, these are measured at amortized cost less any impairment losses using the effective interest method.

Subsequent to initial recognition, financial liabilities are measured at amortized cost using the effective interest method, with the exception of bank notes in circulation, which are measured at face value. The Bank has not classified any of its financial liabilities as HFT.

g) Securities-Lending Program

The Bank operates a Securities-Lending Program to support the liquidity of Government of Canada securities by providing a secondary and temporary source of these securities to the market. These securities-lending transactions are fully collateralized by securities and are generally one business day in duration. The securities loaned continue to be accounted for as investment assets. Lending fees charged by the Bank on these transactions are included in *Other revenue* at the maturity date of the transaction.

h) Property and equipment

Property and equipment consists of land, buildings, computer hardware, other equipment, intangible assets, and projects in progress. Property and equipment are recorded at cost less accumulated amortization except for land, which is recorded at cost and projects in progress, which are recorded at cost but not amortized until the asset is put into service.

Intangible assets are non-monetary assets without physical substance. The Bank's intangible assets consist of computer software and computer software components of the ongoing costs of projects in progress. Costs that are directly associated with the acquisition or internal development of identifiable software which will, in management's best estimate, provide a future economic benefit to the Bank are recognized as intangible assets (note 7).

Amortization is calculated using the straight-line method and is applied over the estimated useful lives of the assets, as shown below.

Buildings	25 to 40 years
Computer hardware	3 to 7 years
Other equipment	5 to 15 years
Intangible assets	3 to 7 years

When completed, projects in progress are classified according to the above categories.

i) Securities purchased under resale agreements

Securities purchased under resale agreements are reverse repo-type transactions in which the Bank purchases securities from designated counterparties with an agreement to sell them back at a predetermined price on an agreed transaction date. For accounting purposes, these agreements are treated as collateralized lending transactions and are recorded on the balance sheet at the amounts at which the securities were originally acquired plus accrued interest.

j) Securities sold under repurchase agreements

Securities sold under repurchase agreements are repo-type transactions in which the Bank sells Government of Canada securities to designated counterparties with an agreement to buy them back at a predetermined price on an agreed transaction date. For accounting purposes, these agreements are treated as collateralized borrowing transactions and are recorded on the balance sheet at the amounts at which the securities were originally sold plus accrued interest.

k) Future accounting changes

International Financial Reporting Standards (IFRS)

On 28 October 2009, the Public Sector Accounting Board approved an amendment to the scope of public sector accounting standards requiring government business entities to report under IFRS for the years beginning on or after 1 January 2011. As a government business entity, the Bank will be required to report under IFRS beginning with the year ended 31 December 2011, and to present its 2010 comparative figures in compliance with IFRS which will then be reconciled to the Canadian GAAP figures previously reported.

The Bank continues to evaluate the impact of these new standards on the recognition, measurement, presentation, and disclosure of financial statement items.

As a result of work completed to the reporting date, management anticipates that employee future benefits and financial instruments will be the areas of the financial statements most significantly affected owing to measurement differences under IFRS.

The International Accounting Standards Board (IASB) has several projects under way, some of which will have an impact on standards that are relevant to the Bank. In particular, the Bank is closely monitoring the progress of projects on financial instruments, employee benefits and leases that may result in revised standards being issued before 2011. Any revisions made to these standards may cause management to revisit its assessment of transitional impacts.

3. Cash and foreign deposits

Cash and foreign deposits is composed of highly liquid demand deposits with other central banks or international institutions and Canadian-dollar demand deposits used for operational purposes. Included in this balance is Can\$3.3 million (Can\$108.3 million in 2008) of U.S. dollars.

4. Loans and receivables

Loans and receivables are comprised primarily of securities purchased under resale agreements and, if any, advances to members of the Canadian Payments Association. In 2009, the Bank continued to provide access to exceptional term liquidity to the Canadian financial system through both of these instruments. These transactions are fully collateralized in accordance with publicly disclosed collateral eligibility and margin requirements. Financial risks related to these instruments are discussed in note 6.

a) Securities purchased under resale agreements

Securities purchased under resale agreements for terms of one business day are acquired through buyback transactions with primary dealers in Government of Canada securities to reinforce the target overnight interest rate.

Securities purchased under resale agreements for terms of longer than one business day are acquired through an auction process for the purposes of providing liquidity in support of the efficient functioning of financial markets and also for reinforcing the Bank's conditional statement regarding the expected future path of the target overnight interest rate. Details of these auctions are announced by the Bank in advance. Bids are submitted on a yield basis, and funds are allocated in descending order of bid yields.

Balances outstanding at 31 December consist of agreements with original terms to maturity ranging from 84 to 363 days. (Balances outstanding at 31 December 2008 consist of agreements with original terms to maturity ranging from 28 to 91 days.)

b) Advances to members of the Canadian Payments Association

Advances to members of the Canadian Payments Association is typically comprised of liquidity loans made under the Bank's Standing Liquidity Facility. These advances mature the next business day. Interest on overnight advances is calculated at the Bank Rate.

In 2008, these advances included term advances made through the Bank's Term Loan Facility consistent with the Bank's commitment to provide term liquidity to the Canadian financial system. This facility ended in October 2009.

5. Investments

In *Other investments*, the Bank holds 9,441 BIS shares in order to participate in the BIS and in international initiatives generally. Ownership of the BIS shares is limited to central banks, and new shares can only be acquired following an invitation to subscribe extended by the BIS Board of Directors. The shares are non-transferable unless prior written consent is obtained from the BIS. BIS shares are classified as AFS but are measured at cost, since they do not have a quoted market value in an active market.

Financial risks relating to *Investments* are discussed in note 6.

6. Financial instruments and risk

The Bank's financial instruments consist of cash and foreign deposits, securities purchased under resale agreements, advances to members of the Canadian Payments Association, other receivables, investments, bank notes in circulation, deposits, and other liabilities (net of post-employment and post-retirement obligations).

Fair value of financial instruments

a) Carrying amount and fair value of financial instruments

The fair values of financial assets and liabilities are presented in the following table.

	2009		2008	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets				
Cash and foreign deposits	20.4	20.4	119.5	119.5
Securities purchased under resale agreements	25,374.8	25,377.5	35,326.9	35,334.9
Advances to members of the Canadian Payments Association	-	-	1,902.3	1,902.3
Other receivables	2.2	2.2	4.5	4.5
Treasury bills of Canada	13,684.0	13,684.0	11,717.1	11,717.1
Government of Canada bonds	31,986.2	34,128.0	29,267.7	33,197.2
Other investments	38.0	307.1	38.0	295.8
	<u>71,105.6</u>	<u>73,519.2</u>	<u>78,376.0</u>	<u>82,571.3</u>
Financial liabilities				
Bank notes in circulation	55,467.9	55,467.9	53,731.3	53,731.3
Deposits	15,550.2	15,550.2	24,413.2	24,413.2
Other financial liabilities	61.7	61.7	100.8	100.8
	<u>71,079.8</u>	<u>71,079.8</u>	<u>78,245.3</u>	<u>78,245.3</u>

b) Financial instruments measured at fair value

Treasury bills of Canada are measured at fair value using unadjusted quoted market prices in an active market.

c) Financial instruments not measured at fair value

Fair values of securities purchased under resale agreements are determined using market yields to maturity for similar instruments available at the balance sheet date.

Fair values of Government of Canada bonds are determined based on unadjusted quoted market prices in an active market.

The fair value for BIS shares (*Other investments*) is determined as being 70 per cent of the Bank's interest in the BIS shareholders' equity as of 30 November 2009. The approach used to calculate fair value is based on a decision by the International Court at The Hague for the acquisition of shares from former private shareholders of the BIS.

The amortized cost of advances to members of the Canadian Payments Association, other receivables, deposits, and other financial liabilities (which is composed of other liabilities, excluding the portion representing accrued post-retirement and post-employment benefits liabilities as described in note 12) approximates fair value, given their short-term nature. The face value of bank notes in circulation is equal to their fair value.

Financial risk

The Bank is exposed to credit risk, market risk, and liquidity risk as a result of holding financial instruments. The following is a description of those risks and how the Bank manages its exposure to them.

a) Credit risk

Credit risk is the risk that a counterparty to a financial contract will fail to discharge its obligations in accordance with agreed-upon terms.

The Bank is exposed to credit risk through its investment portfolio, advances to members of the Canadian Payments Association, and through market transactions conducted in the form of securities purchased under resale agreements and loans of securities. The maximum exposure to credit risk is estimated to be the carrying value of the items listed above. There are no past due or impaired amounts.

Advances to members of the Canadian Payments Association and securities purchased under resale agreements are fully collateralized loans. Collateral is taken in accordance with the Bank's publicly disclosed eligibility criteria and margin requirements accessible on its website. Strict eligibility criteria are set for all collateral, and the Bank requires excess collateral relative to the size of the loan provided.

In the unlikely event of a counterparty default, collateral can be liquidated to offset credit exposure. The credit quality of collateral is managed through a set of restrictions based on asset type, term to maturity, and the credit ratings of the securities pledged.

During the year, the Bank increased the duration of certain of its *Securities purchased under resale agreements* (note 4). These longer-term agreements are subject to the same collateral and margin requirements as all other securities purchased under resale agreements.

Concentration of credit risk

The Bank's investment portfolio, representing 64 per cent of the carrying value of its total assets (52 per cent in 2008), is essentially free of credit risk because the securities held are primarily direct obligations of the Government of Canada. The Bank's advances to members of the Canadian Payments Association and securities purchased under resale agreements, representing 36 per cent of the carrying value of its total assets (45 per cent in 2008), are collateralized obligations of various Canadian-based financial institutions.

The fair value of collateral pledged against securities purchased under resale agreements at the balance sheet date is \$26,655.8 million (\$37,753.5 million in 2008), representing 105 per cent (107 per cent in 2008) of the amortized cost of \$25,374.8 million (\$35,326.9 million in 2008).

Collateral is concentrated in the following major categories:

	2009		2008	
	\$	%	\$	%
Securities issued or guaranteed by the Government of Canada	15,517.3	58.3	20,727.6	54.9
Securities issued or guaranteed by a provincial government	8,621.4	32.3	8,031.8	21.3
Securities issued by a municipality	239.6	0.9	153.6	0.4
Corporate securities	1,918.5	7.2	5,604.5	14.8
Asset-backed commercial paper	359.0	1.3	3,236.0	8.6
Total fair value of collateral pledged	26,655.8	100.0	37,753.5	100.0

b) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk, and other price risk.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Bank's investment in treasury bills and bonds acts as a counterpart to the non-interest-bearing bank notes in circulation liability, and supports the Bank's operational independence to conduct monetary policy. These assets are acquired in proportions that broadly resemble the structure of the Government of Canada's domestic debt outstanding to reduce interest rate risk from the perspective of the Government of Canada.

The Bank's exposure to fair-value interest rate risk arises principally through its investment in treasury bills. The aforementioned instruments are short term in duration. The fair value of the treasury bills of Canada portfolio held by the Bank is exposed to fluctuations owing to changes in market interest rates since these securities are classified as AFS and are measured at fair value. Unrealized gains and losses on the treasury bills of Canada portfolio are recognized in *Accumulated Other Comprehensive Income* in the *Capital* section of the balance sheet until they mature or are sold. All other financial assets or liabilities are carried at amortized cost or at face value.

The figures below show the effect at 31 December 2009 of an (increase)/decrease of 25 basis points in interest rates on the fair value of the treasury bill portfolio and other comprehensive income.

	2009	2008
Treasury bills of Canada	\$ (11.4)/10.3	\$ (16.9)/16.2

The Bank's exposure to interest rate risk in the form of fluctuations in future cash flows of existing financial instruments is limited to Government of Canada deposits and cash and foreign deposits, since these instruments are subject to variable interest rates. The remainder of the Bank's financial assets and liabilities have either fixed interest rates or are non-interest-bearing.

The figures below show the effect in 2009 of an increase/(decrease) of 25 basis points in interest rates on the interest expenses paid on Government of Canada deposits.

	2009	2008
Interest expense on Government of Canada deposits	\$ 50.8/(50.8)	\$ 15.7/(15.7)

For all financial instruments, except bank notes in circulation, the future cash flows of the Bank are dependent on the prevailing market rate of interest at the time of renewal.

The following table illustrates interest rate risk relative to future cash flows by considering the expected maturity or repricing dates of existing financial assets and liabilities.

As at 31 December 2009

	Weighted-average interest rate %	Total	Non-interest-sensitive	1 business day to 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years
FINANCIAL ASSETS								
Cash and foreign deposits	0.09	20.4	-	20.4	-	-	-	-
Loans and receivables								
Securities purchased under resale agreements	0.27	3,141.8	-	3,141.8	-	-	-	-
	0.27	4,003.2	-	-	4,003.2	-	-	-
	0.38	18,229.8	-	-	-	18,229.8	-	-
		25,374.8						
Other receivables		2.2	2.2	-	-	-	-	-
Investments								
Treasury bills of Canada	0.51	1,999.9	-	1,999.9	-	-	-	-
	0.41	4,548.8	-	-	4,548.8	-	-	-
	0.48	7,135.3	-	-	-	7,135.3	-	-
	0.46	13,684.0						
Government of Canada bonds ¹	9.77	26.1	-	-	26.1	-	-	-
	4.57	4,319.9	-	-	-	4,319.9	-	-
	4.02	14,746.1	-	-	-	-	14,746.1	-
	4.85	12,894.1	-	-	-	-	-	12,894.1
	4.43	31,986.2						
Shares in the BIS		38.0	38.0	-	-	-	-	-
		71,105.6	40.2	5,162.1	8,578.1	29,685.0	14,746.1	12,894.1
FINANCIAL LIABILITIES								
Bank notes in circulation		55,467.9	55,467.9	-	-	-	-	-
Deposits								
Government of Canada	0.34	11,847.6	-	11,847.6	-	-	-	-
Members of the CPA	0.25	2,999.6	-	2,999.6	-	-	-	-
Other deposits								
Unclaimed balances		395.5	395.5	-	-	-	-	-
Other	0.05	307.5	-	307.5	-	-	-	-
Other financial liabilities								
		61.7	61.7	-	-	-	-	-
		71,079.8	55,925.1	15,154.7	-	-	-	-
Interest rate sensitivity gap		25.8	(55,884.9)	(9,992.6)	8,578.1	29,685.0	14,746.1	12,894.1

1. Carrying amounts of Government of Canada bonds include accrued interest.

As at 31 December 2008

	Weighted- average interest rate %	Total	Non- interest- sensitive	1 business day to 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years
FINANCIAL ASSETS								
Cash and foreign deposits	0.00	119.5	-	119.5	-	-	-	-
Loans and receivables								
Advances to members of the CPA	1.75	1,902.3	-	1,902.3	-	-	-	-
Securities purchased under resale agreements	1.97	28,863.2	-	28,863.2	-	-	-	-
	2.30	6,463.7	-	-	6,463.7	-	-	-
		35,326.9						
Other receivables		4.5	4.5	-	-	-	-	-
Investments								
Treasury bills of Canada	2.94	50.0	-	50.0	-	-	-	-
	2.64	99.9	-	-	99.9	-	-	-
	2.23	11,567.2	-	-	-	11,567.2	-	-
	2.24	11,717.1						
Government of Canada bonds ¹	11.56	17.2	-	-	17.2	-	-	-
	4.76	3,811.2	-	-	-	3,811.2	-	-
	4.90	12,834.7	-	-	-	-	12,834.7	-
	5.08	12,604.6	-	-	-	-	-	12,604.6
	4.96	29,267.7						
Shares in the BIS		38.0	38.0	-	-	-	-	-
		78,376.0	42.5	30,935.0	6,580.8	15,378.4	12,834.7	12,604.6
FINANCIAL LIABILITIES								
Bank notes in circulation		53,731.3	53,731.3	-	-	-	-	-
Deposits								
Government of Canada	0.95	23,604.0	-	23,604.0	-	-	-	-
Members of the CPA	1.25	25.9	-	25.9	-	-	-	-
Other deposits								
Unclaimed balances		351.4	351.4	-	-	-	-	-
Other	1.30	431.9	-	431.9	-	-	-	-
Other financial liabilities								
		100.8	100.8	-	-	-	-	-
		78,245.3	54,183.5	24,061.8	-	-	-	-
Interest rate sensitivity gap		130.7	(54,141.0)	6,873.2	6,580.8	15,378.4	12,834.7	12,604.6

1. Carrying amounts of Government of Canada bonds include accrued interest.

The Bank's revenue will vary over time in response to future movements in interest rates. These variations would not affect the ability of the Bank to fulfill its obligations since its revenues greatly exceed its expenses.

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

At 31 December 2009, the Bank did not hold a significant amount of U.S. dollars (Can\$108.3 million in 2008). Given the small size of the net foreign currency exposure relative to the total assets of the Bank, currency risk is not considered material.

Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from changes in interest and exchange rates), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. The Bank is not exposed to significant other price risk.

c) Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. As shown in the following table, the Bank's largest liability is *Bank notes in circulation*. As a counterpart to this non-interest-bearing liability with no fixed maturity, the Bank holds a portfolio of highly liquid, interest-bearing securities. In the event of an unexpected redemption of bank notes, the Bank has the ability to settle the obligation by selling its assets.

As the nation's central bank, the Bank is the ultimate source of liquid funds to the Canadian financial system, and has the power and operational ability to create Canadian-dollar liquidity in unlimited amounts at any time. This power is exercised within the Bank's commitment to keep inflation low, stable, and predictable.

The following table presents a maturity analysis of the Bank's financial assets and liabilities. The balances in this table do not correspond to the balances in the *Balance Sheet*, since the table presents all cash flows on an undiscounted basis.

As at 31 December 2009

	Total	No fixed maturity	1 business day	1 business day to 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years
FINANCIAL ASSETS								
Cash and foreign deposits	20.4	20.4	-	-	-	-	-	-
Loans and receivables								
Securities purchased under resale agreements	25,406.4	-	-	3,142.1	4,005.0	18,259.3	-	-
Other receivables	2.2	-	-	2.2	-	-	-	-
Investments								
Treasury bills of Canada	13,700.0	-	-	2,000.0	4,550.0	7,150.0	-	-
Government of Canada bonds ¹	43,761.9	-	-	-	100.1	5,583.2	18,250.2	19,828.4
Shares in the BIS	38.0	38.0	-	-	-	-	-	-
	82,928.9	58.4	-	5,144.3	8,655.1	30,992.5	18,250.2	19,828.4
FINANCIAL LIABILITIES								
Bank notes in circulation	55,467.9	55,467.9	-	-	-	-	-	-
Deposits								
Government of Canada	11,847.6	11,847.6	-	-	-	-	-	-
Members of the CPA	2,999.6	-	2,999.6	-	-	-	-	-
Other deposits								
Unclaimed balances	395.5	395.5	-	-	-	-	-	-
Other	307.5	307.5	-	-	-	-	-	-
Other liabilities								
	61.7	-	-	61.7	-	-	-	-
	71,079.8	68,018.5	2,999.6	61.7	-	-	-	-
Net maturity difference	11,849.1	(67,960.1)	(2,999.6)	5,082.6	8,655.1	30,992.5	18,250.2	19,828.4

1. Interest payments on Government of Canada bonds are classified according to their coupon date.

In cases where counterparties to securities purchased under resale agreements substitute collateral after the outset of an agreement, portions of the carrying values presented may mature earlier than as presented where the amount maturing early is dependent on the value of collateral being substituted. Where collateral has been substituted, new agreements are typically re-established under the same terms and conditions. The information presented in the above table is prepared according to agreements currently in place.

As at 31 December 2008

	Total	No fixed maturity	1 business day	1 business day to 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years
FINANCIAL ASSETS								
Cash and foreign deposits	119.5	119.5	-	-	-	-	-	-
Loans and receivables								
Advances to members of the CPA	1,902.3	-	0.7	1,901.6	-	-	-	-
Securities purchased under resale agreements	35,367.3	-	-	28,884.9	6,482.4	-	-	-
Other receivables	4.5	-	-	4.5	-	-	-	-
Investments								
Treasury bills of Canada	11,775.0	-	-	50.0	100.0	11,625.0	-	-
Government of Canada bonds ¹	41,556.0	-	-	-	182.2	5,014.1	16,493.4	19,866.3
Shares in the BIS	38.0	38.0	-	-	-	-	-	-
	90,762.6	157.5	0.7	30,841.0	6,764.6	16,639.1	16,493.4	19,866.3
FINANCIAL LIABILITIES								
Bank notes in circulation	53,731.3	53,731.3	-	-	-	-	-	-
Deposits								
Government of Canada	23,604.0	23,604.0	-	-	-	-	-	-
Members of the CPA	25.9	-	25.9	-	-	-	-	-
Other deposits								
Unclaimed balances	351.3	351.3	-	-	-	-	-	-
Other	431.9	431.9	-	-	-	-	-	-
Other liabilities								
	100.8	-	-	100.8	-	-	-	-
	78,245.2	78,118.5	25.9	100.8	-	-	-	-
Net maturity difference	12,517.4	(77,961.0)	(25.2)	30,740.2	6,764.6	16,639.1	16,493.4	19,866.3

1. Interest payments on Government of Canada bonds are classified according to their coupon date.

In the tables above, liabilities with no fixed maturity include *Bank notes in circulation* and *Government of Canada Deposits*. Historical experience has shown that bank notes in circulation provide a stable source of long-term funding for the Bank. *Government of Canada Deposits* are deposits held in the Bank's capacity as the Government of Canada's fiscal agent. Included in these deposits are funds deposited with the Bank to support the provision of exceptional liquidity to the Canadian financial system.

7. Property and equipment

	31 December 2009			31 December 2008		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Tangible						
Land and buildings	195.1	112.4	82.7	193.9	106.8	87.1
Computer hardware	26.1	16.1	10.0	21.4	12.7	8.7
Other equipment	126.1	99.5	26.6	118.1	95.0	23.1
Intangible						
Computer software	49.9	37.4	12.5	48.5	35.1	13.4
	397.2	265.4	131.8	381.9	249.6	132.3
Projects in progress						
Tangible	7.5	-	7.5	3.5	-	3.5
Intangible	11.2	-	11.2	4.7	-	4.7
	18.7	-	18.7	8.2	-	8.2
	415.9	265.4	150.5	390.1	249.6	140.5

Projects in progress consist primarily of the Analytic Environment Program (\$14.3 million at 31 December 2009; \$5.3 million at 31 December 2008). The project to upgrade bank-note processing equipment, in progress at 31 December 2008 (\$1.9 million at 31 December 2008), was completed during the year.

In 2009, \$1.4 million in computer software was acquired externally. \$4.7 million in intangible assets in progress were developed internally during the year and \$1.7 million in intangible assets were acquired externally.

During 2009, a total of \$15.7 million in amortization expense was recorded of which \$13.4 million relates to tangible assets and \$2.3 million relates to intangible assets.

During the year, the National Currency Collection and Leasehold improvements, formerly reported under *Other assets*, were reclassified to *Other equipment*, resulting in an increase in net book value of \$3.5 million for 2008.

The net carrying amount of both tangible and intangible assets is reviewed when events or changes in circumstances indicate that future benefits may no longer be reasonably assured, and is adjusted if required. No such adjustments were recorded during the year ended 31 December 2009. During 2008, the Bank's work in preparation for the Canadian Payments Association's Truncation and Electronic Cheque Presentation initiative was terminated prior to completion and accumulated project costs to the date of termination, totalling \$2.4 million, were written off.

8. Other assets

Other assets include the pension accrued benefit asset of \$83.2 million (\$53.3 million in 2008) and other items related to the administrative functions of the Bank.

9. Bank notes in circulation

In accordance with the Bank of Canada Act, the Bank has the sole authority to issue bank notes for circulation in Canada. A breakdown by denomination is presented below.

	2009	2008
\$5	1,054.8	1,017.9
\$10	1,125.7	1,091.8
\$20	16,463.0	16,126.3
\$50	7,773.0	7,563.2
\$100	27,535.6	26,354.1
Other bank notes	1,515.8	1,578.0
	<u>55,467.9</u>	<u>53,731.3</u>

Other bank notes include denominations that are no longer issued but remain as legal tender. *Bank notes in circulation* are non-interest-bearing liabilities and are due on demand.

10. Deposits

The liabilities within this category consist primarily of \$15,550.2 million in Canadian-dollar demand deposits (Can\$24,315.9 million in Canadian-dollar demand deposits and Can\$97.3 million in U.S.-dollar demand deposits in 2008). The Bank pays interest on the deposits for the Government of Canada, banks, and other financial institutions at market-related rates.

11. Other liabilities

This category primarily includes accrued post-retirement and post-employment benefits liabilities of \$138.1 million (\$125.2 million in 2008), an accrued transfer payment to the Receiver General for Canada of \$23.6 million (\$52.2 million in 2008) which is included in the total transfer to the Receiver General for the year presented in the *Statement of Changes in Capital*, accounts payable and accrued liabilities of \$37.9 million (\$48.4 million in 2008), and payroll liabilities of \$0.2 million (\$0.3 million in 2008).

12. Employee benefit plans

The Bank sponsors a number of defined-benefit plans that provide pension and other post-retirement and post-employment benefits to its eligible employees.

The pension plans provide benefits under a Registered Pension Plan and a Supplementary Pension Arrangement. The pension calculation is based mainly on years of service and average pensionable income and is generally applicable from the first day of employment. The pension is indexed to reflect changes in the consumer price index on the date payments begin and each 1 January thereafter.

The Bank sponsors post-retirement health, dental, and life insurance benefits, as well as post-employment self-insured long-term disability and continuation of benefits to disabled employees. The Bank also sponsors a long-service benefit program for employees hired before 1 January 2003.

The Bank measures its accrued benefits obligations and fair value of plan assets for accounting purposes as at 31 December of each year. The most recent actuarial valuation for funding purposes of the Registered Pension Plan was done as of 1 January 2009 and the next required valuation will be as of 1 January 2010.

Information about the employee benefit plans is presented in the tables below.

Plan assets, benefit obligation, and plan status

	Pension benefit plans¹		Other benefit plans	
	2009	2008	2009	2008
Plan assets				
Fair value of plan assets at beginning of year	792.4	997.5	-	-
Bank contributions	51.3	7.2	-	-
Employee contributions	8.0	7.7	-	-
Benefit payments and transfers	(35.3)	(34.6)	-	-
Actual return (loss) on plan assets	118.4	(185.4)	-	-
<i>Fair value of plan assets at year-end²</i>	<i>934.8</i>	<i>792.4</i>	<i>-</i>	<i>-</i>
Benefit obligation				
Benefit obligation at beginning of year	1,132.9	965.5	182.3	167.6
Current service cost	35.0	29.9	8.1	7.3
Employee contributions	8.0	7.7	-	-
Interest cost	45.5	44.8	6.5	7.5
Benefit payments and transfers	(35.3)	(34.6)	(6.7)	(6.6)
Actuarial (gain) loss	(112.3)	119.6	(12.8)	6.5
<i>Benefit obligation at year-end</i>	<i>1,073.8</i>	<i>1,132.9</i>	<i>177.4</i>	<i>182.3</i>
Plan status				
Deficiency of fair value of plan assets over benefit obligation at year-end	(139.0)	(340.5)	(177.4)	(182.3)
Unamortized net transitional obligation (asset)	(25.9)	(38.8)	11.4	13.8
Unamortized cost of amendments	10.3	12.7	-	-
Unamortized net actuarial loss	237.8	419.9	27.9	43.3
<i>Accrued benefit asset (liability)</i>	<i>83.2</i>	<i>53.3</i>	<i>(138.1)</i>	<i>(125.2)</i>

1. For the Supplementary Pension Arrangement, in which the accrued benefit obligation exceeds plan assets, the accrued benefit obligation and fair value of plan assets totalled \$67.3 million (\$71.0 million in 2008) and \$50.9 million (\$40.3 million in 2008), respectively.

2. The assets of the pension benefit plans were composed as follows: 56 per cent equities; 26 per cent bonds; 8 per cent real return Government of Canada bonds; 1 per cent other real return investments; 4 per cent real estate assets; and 5 per cent short-term securities and cash (52 per cent, 28 per cent, 6 per cent, 4 per cent, 6 per cent, and 4 per cent, respectively, in 2008).

The accrued benefit asset for the defined-benefit pension plans is included in the balance sheet category, *Other assets*. The accrued benefit liability for the other benefits plans is included in the balance sheet category, *Other liabilities*.

Benefit plan expense

	Pension benefit plans		Other benefit plans	
	2009	2008	2009	2008
Current service cost, net of employee contributions	35.0	29.9	8.1	7.3
Interest cost	45.5	44.8	6.5	7.5
Actual (return) loss on plan assets	(118.4)	185.4	-	-
Actuarial loss	(112.3)	119.6	(12.8)	6.5
<i>Benefit plan expense (income), before adjustments to recognize the long-term nature of employee future benefit costs</i>	(150.2)	379.7	1.8	21.3
Adjustments				
Difference between expected return and actual return on plan assets for the year	56.9	(244.9)	-	-
Difference between amortization of past service costs for the year and actual cost of plan amendments for the year	2.3	2.3	-	1.0
Difference between amortization of actuarial loss for the year and actuarial loss on accrued benefit obligation for the year	125.2	(111.2)	15.3	(3.5)
Amortization of transitional obligation (asset)	(12.9)	(12.9)	2.5	2.5
<i>Benefit plan expense recognized in the year</i>	21.3	13.0	19.6	21.3

Significant assumptions

The significant assumptions used are as follows (on a weighted-average basis).

	Pension benefit plans		Other benefit plans	
	2009	2008	2009	2008
Accrued benefit obligation as at 31 December				
Discount rate	4.50 %	4.00 %	4.10 %	3.50 %
Rate of compensation increase	3.50 %	3.50 %	3.50 %	3.50 %
	+ merit	+ merit	+ merit	+ merit
Benefit plan expense for year ended 31 December				
Discount rate	4.00 %	4.25 %	3.50 %	4.20 %
Expected rate of return on assets	6.50 %	6.50 %	-	-
Rate of compensation increase	3.50 %	3.50 %	3.50 %	3.50 %
	+ merit	+ merit	+ merit	+ merit
Assumed health-care cost trend				
Initial health-care cost trend rate			7.00 %	7.60 %
Health-care cost trend rate declines to			4.50 %	4.70 %
Year that the rate reaches the ultimate trend rate			2029	2018

2009 sensitivity of key assumptions

(Millions of dollars)

	Change in obligation	Change in expense
Impact of 0.25 per cent increase/decrease in assumptions		
Pension benefit plans		
Change in discount rate	(43.5) / 46.5	(6.3) / 6.7
Change in long-term return on plan assets	n.a. / n.a.	(2.4) / 2.4
Other benefit plans		
Change in discount rate	(6.5) / 7.0	(0.2) / 0.2
Impact of 1.00 per cent increase/decrease in assumptions		
Other benefit plans		
Change in the assumed health-care cost trend rates	29.8 / (20.7)	2.1 / (1.5)

The total cash payment from the Bank for employee future benefits for 2009 was \$58.0 million (\$13.8 million in 2008), consisting of \$51.3 million (\$7.2 million in 2008) in cash contributed by the Bank to its pension plans and \$6.7 million (\$6.6 million in 2008) in cash payments directly to beneficiaries for its unfunded other benefits plans.

Regulations governing federally regulated pension plans establish certain solvency requirements that assume that the plans are wound up at the valuation date. The actuarial valuation of the Registered Pension Plan completed at 1 January 2009 reported a solvency deficit of \$129 million. The Bank is contributing an amount sufficient to fund this solvency deficit over a period of five years. During the year, approximately \$25.9 million of the employer contributions to the plan reflect solvency deficit payments. It is anticipated that \$28.2 million in employer contributions will be required in 2010. The amount of contributions in future years is dependent on the investment experience of plan assets, as well as the discount rate used to value liabilities for solvency purposes.

13. Capital

The Bank's objective in managing its capital is compliance with the externally imposed requirements of the Bank of Canada Act, which are outlined below. Capital is composed of share capital, a statutory reserve, a special reserve, retained earnings, and accumulated other comprehensive income. The Bank is not in violation of any externally imposed capital requirements at the balance sheet date. The Bank's objectives in managing its capital have not changed from the prior year.

Share capital

The authorized capital of the Bank is \$5.0 million divided into 100,000 shares with a par value of \$50 each. The shares are fully paid and have been issued to the Minister of Finance, who is holding them on behalf of the Government of Canada.

Statutory reserve

The statutory reserve was accumulated out of net income until it reached the stipulated maximum amount of \$25.0 million in 1955.

Special reserve

The special reserve was created in 2007 further to an amendment to the Bank of Canada Act to offset potential unrealized valuation losses due to changes in the fair value of the Bank's available-for-sale portfolio. The amount held in the special reserve is reviewed regularly for appropriateness using Value-at-Risk analysis and scenario-based stress tests and may be amended, pursuant to a resolution passed by the Board of Directors. The Value-at-Risk analysis uses historical data to estimate the maximum possible extent of unrealized valuation losses on the Bank's treasury bill portfolio. The scenario-based stress tests assess the impact of a rapid increase in interest rates on the value of the Bank's treasury bill portfolio. This reserve is subject to a ceiling of \$400 million; an initial amount of \$100 million was established in September 2007.

Retained earnings

The Bank does not hold retained earnings. The net income of the Bank, less any allocation to reserves, is considered ascertained surplus and is transferred to the Receiver General for Canada, consistent with the requirements of section 27 of the Bank of Canada Act.

Accumulated other comprehensive income

Accumulated other comprehensive income records and tracks unrealized valuation gains and losses on the Bank's available-for-sale portfolio, excluding BIS shares, which are recorded at cost.

14. Expense by class of expenditure

	2009	2008
Staff costs	175.2	161.0
Bank note research, production, and processing	56.6	71.8
Premises maintenance	26.2	29.3
Amortization	15.7	15.5
Other operating expenses	103.6	109.3
	377.3	386.9
Recoveries	(11.3)	(11.0)
	366.0	375.9

15. Commitments, contingencies, and guarantees

a) Operations

The Bank has a long-term contract with an outside service provider for retail debt services, which expires in 2021. At 31 December 2009, fixed payments totalling \$135.9 million remained, plus a variable component based on the volume of transactions.

The Bank occupies leased premises in Halifax, Montréal, Toronto, Calgary, and Vancouver. At 31 December 2009, the future minimum payments are \$7.1 million for rent, real estate taxes, and building operations. The expiry dates vary for each lease, from October 2010 to September 2018.

Minimum annual payments for long-term commitments

	Outsourced services	Leased space	Total
2010	12.1	1.6	13.7
2011	12.1	1.1	13.2
2012	12.1	1.1	13.2
2013	12.1	0.8	12.9
2014	12.1	0.7	12.8
Thereafter	75.4	1.8	77.2
	135.9	7.1	143.0

b) Foreign currency contracts

The Bank is a counterparty to several foreign currency swap facilities as follows:

	<u>Maximum available</u>
Contracts denominated in U.S. dollars	
Federal Reserve Bank of New York	30,000.0
Federal Reserve Bank of New York	2,000.0
	<u>32,000.0</u>
Contracts denominated in Canadian dollars	
Banco de México	<u>1,000.0</u>

The US\$30 billion facility with the Federal Reserve Bank of New York expires on 1 February 2010. The other facilities have indefinite terms and are subject to annual renewal.

The Bank is also party to a standing foreign currency swap facility with the Exchange Fund Account of Canada. There is no stated maximum amount under this agreement.

These swap facilities were not used in 2009 or 2008 and, therefore, there were no related commitments at 31 December 2009.

c) Contingency

The 9,441 shares in the BIS have a nominal value of 5,000 special drawing rights (SDRs) per share, of which 25 per cent, i.e., SDR1,250, is paid up. The balance of SDR3,750 is callable at three months' notice by decision of the BIS Board of Directors. The Canadian equivalent of this contingent liability was \$58.1 million at 31 December 2009, based on prevailing exchange rates.

d) Guarantees

In the normal course of operations, the Bank enters into certain guarantees, which are described below.

Large Value Transfer System (LVTS) Guarantee

The LVTS is a large-value payment system, owned and operated by the CPA. Any deposit-taking financial institution that is a member of the CPA can participate in the LVTS, provided that it maintains a settlement account at the Bank, has the facilities to pledge collateral for LVTS purposes, and meets certain technical requirements. The system's risk-control features, which include caps on net debit positions and collateral to secure the use of overdraft credit, are sufficient to permit the system to obtain the necessary liquidity to settle in the event of the failure of the single LVTS participant having the largest possible net amount owing. The Bank guarantees to provide this liquidity, and in the event of the single participant failure, the liquidity loan will be fully collateralized. In the extremely unlikely event that there were defaults by more than one participant during the LVTS operating day, in an aggregate amount in excess of the largest possible net amount owing by a single participant, there would not likely be enough collateral to secure the amount of liquidity that the Bank would need to provide to settle the system. This might result in the Bank having unsecured claims on the defaulting participants in excess of the amount of collateral pledged to the Bank to cover the liquidity loans. The Bank would have the right, as an unsecured creditor, to recover any amount of its liquidity loan that was unpaid. The amount potentially at risk under this guarantee is not determinable, since the guarantee would be called upon only if a series of extremely low-probability events were to occur. No amount has ever been provided for in the liabilities of the Bank, and no amount has ever been paid under this guarantee.

Other indemnification agreements

In the normal course of operations, the Bank provides indemnification agreements with various counterparties in transactions such as service agreements, software licences, leases, and purchases of goods. Under these agreements, the Bank agrees to indemnify the counterparty against loss or liability arising from acts or omissions of the Bank in relation to the agreement. The nature of the indemnification agreements prevents the Bank from making a reasonable estimate of the maximum potential amount that the Bank would be required to pay such counterparties.

e) Insurance

The Bank does not insure against direct risks of loss to the Bank, except for potential liabilities to third parties and where there are legal or contractual obligations to carry insurance. Any costs arising from risks not insured are recorded in the accounts at the time they can be reasonably estimated.

16. Related-party transactions

The Bank is related in terms of common ownership to all Government of Canada departments, agencies, and Crown corporations. To achieve its monetary policy objectives, the Bank maintains a position of structural and functional independence from the Government of Canada through its ability to fund its own operations without external assistance and through its management and governance structures.

All related-party transactions are recorded at their exchange amounts, which is the amount of consideration established and agreed upon by the related parties. Related-party transactions with the Government of Canada are disclosed as part of the financial statements or the relevant notes.

17. Comparative figures

Comparative figures have been reclassified where necessary to conform to the presentation adopted for the current year.

Senior Officers

Governing Council

Mark Carney, *Governor*, W. Paul Jenkins, *Senior Deputy Governor**

Deputy Governors

Pierre Duguay, Timothy Lane, David J. Longworth, John D. Murray

W. John Jussup, *General Counsel and Corporate Secretary**

Advisers

Janet Cosier,^{*1} Agathe Côté, Allan Crawford, David Wolf, Jean Boivin,² Sheila Niven,^{*} Jack Selody

Canadian Economic Analysis

Paul Fenton, *Chief*
Don Coletti, *Deputy Chief*
Robert Amano, *Research Director*
Césaire Meh, *Research Director*
Stephen Murchison, *Research Director*

International Economic Analysis

Lawrence L. Schembri, *Chief*
Sharon Kozicki, *Deputy Chief*
Robert Lafrance, *Research Director*
Eric Santor, *Research Director*

Financial Markets

Donna Howard, *Chief*
Carolyn Wilkins, *Deputy Chief*
Mark Caplan, *Senior Representative, Director*
Miville Tremblay, *Senior Representative, Director*
Scott Hendry, *Research Director*
Grahame Johnson, *Director*

Financial Stability

Mark Zelmer, *Chief*
Toni Gravelle, *Deputy Chief*
Carol Ann Northcott, *Director*
Graydon Paulin, *Director*

Data and Statistics Office

Dinah Maclean, *Director*

Funds Management and Banking

George Pickering, *Chief*
Ron Morrow, *Deputy Chief*³
Louise Hyland, *Director*

Currency

Gerry T. Gaetz, *Chief*
Lorna Thomas, *Deputy Chief*
Nicole Poirier, *Director*
Charles Spencer, *Director*
Richard Wall, *Director*

Audit

Carmen Prévost Vierula, *Chief Internal Auditor*

Communications

Brigid Janssen, *Chief**
Jill Vardy, *Deputy Chief*

Corporate Services

Colleen Leighton, *Chief**
Janice Gabie, *Deputy Chief*
Frances Boire-Carrière, *Director*
John Reinburg, *Director*
Susan Chibuk, *Project Director*
Dale M. Fleck, *Program Director*

Executive and Legal Services

W. John Jussup, *General Counsel and Corporate Secretary**
Marie Bordeleau, *Deputy Corporate Secretary*
Robert Turnbull, *Assistant General Counsel*

Financial Services

Sheila Vokey, *Chief and Chief Accountant**
Rudy Wytenburg, *Deputy Chief*

Information Technology Services

Carole Briard, *Chief**
Daniel Lamoureux, *Director*
Pierre Gagnon, *Director*
Jan Pilbauer, *Director*
Janne Shaw, *Director*

* *Member of Corporate Management Committee*

1. *Also Chair of the Board of Directors of the Canadian Payments Association*
2. *Visiting Special Adviser*
3. *Also Deputy Chair of the Board of Directors of the Canadian Payments Association*

Note: Positions as of 26 February 2010

Bank of Canada Regional Offices

Atlantic Provinces

1583 Hollis Street, 5th Floor
Halifax, Nova Scotia B3J 1V4
David Amirault, *Senior Regional Representative (Economics)*
Monique LeBlanc, *Senior Regional Representative (Currency)*

Quebec

1501 McGill College Avenue, Suite 2030
Montréal, Quebec H3A 3M8
Vacant, *Senior Regional Representative (Economics)*
Phuong Anh Ho Huu, *Senior Regional Representative (Currency)*

Ontario

150 King Street West, Suite 2000
Toronto, Ontario M5H 1J9
Brigid Brady, *Assistant Chief, Regional Analysis Division, Canadian Economic Analysis Department*
Jane Voll, *Senior Regional Representative (Economics)*
Manuel Parreira, *Senior Regional Representative (Currency)*

Prairie Provinces, Nunavut, and Northwest Territories

404 – 6th Avenue SW, Suite 200
Calgary, Alberta T2P 0R9
Alexander Fritsche, *Senior Regional Representative (Economics)*
Ted Mieszkalski, *Senior Regional Representative (Currency)*

British Columbia and Yukon

200 Granville Street, Suite 2710
Vancouver, British Columbia V6C 1S4
Farid Novin, *Senior Regional Representative (Economics)*
Lori Rennison, *Senior Regional Representative (Economics)*
Trevor Frers, *Senior Regional Representative (Currency)*

New York Office

Canadian Consulate General
1251 Avenue of the Americas
New York, NY 10020-1175 U.S.A.
Scott Kinnear, *Consul and Senior Representative for the Bank of Canada*

Note: Positions as of 26 February 2010

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