BANK OF CANADA ANNUAL REPORT

2001

Bank of Canada
234 Wellington Street
Ottawa, Ontario K1A 0G9
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BANK OF CANADA
David A. Dodge
Governor - Gouverneur

BANQUE DU CANADA
Ottawa K1A 0G9

28 February 2002

The Honourable Paul Martin, PC, MP
Minister of Finance
Ottawa

Dear Mr. Martin,

In accordance with the provisions of the Bank of Canada Act, I am submitting the Bank of Canada's *Annual Report* for the year 2001 and the Bank's audited financial statements as at 31 December 2001.

Yours sincerely,

OUR COMMITMENT
TO CANADIANS

- To contribute to the economic well-being of Canadians by
  - conducting monetary policy in a way that fosters confidence in the value of money
  - promoting the safety and soundness of Canada's financial system
  - supplying bank notes that are readily accepted without concerns about counterfeiting
- To provide efficient and effective central banking and debt-management services
- To communicate our objectives openly and effectively and to be accountable for our actions

Head Office, Ottawa

MESSAGE FROM **THE GOVERNOR**

The year that just passed posed many challenges for all Canadians. The slowdown in the global economy became more pronounced as the year went on, and this affected households, businesses, and governments alike. The tragedy of 11 September compounded the economic difficulties and issues facing us all. Through this period of rapidly changing circumstances, the Bank met its responsibilities by responding quickly and vigorously to events in order to underpin confidence and support the economy.

For the staff of the Bank, changes in our operations and procedures also posed challenges. In this, my first Annual Report *as Governor, I would like to touch on some of the key events and challenges faced by Canadians and by the Bank of Canada during the year.*

Fixed Announcement Dates

Effective communication is critical if the Bank is to do its job properly. We try to explain to Canadians what we are doing, and why we are doing it. Equally importantly, we need to listen to Canadians and their concerns. Our new system of announcing interest rate decisions on eight pre-established dates fits with our goal of good communication. We experienced the first full year for our new system in 2001. The announcement dates were carefully chosen to tie into the flow of economic information used to assess the direction of monetary policy. This new system has allowed the Bank to focus greater public attention on Canada's monetary and economic situation. I'm pleased to say that, as a result, debate and discussion surrounding monetary policy issues in Canada appear to have benefited significantly.

In each of the first six fixed announcement dates in 2001, the Bank steadily lowered the target for the overnight rate of interest in response to signs that weakness in the U.S. economy was affecting Canada. But by the end of the summer, evidence had accumulated that the economic slowdown, not just in North America but globally, would be deeper and more protracted than previously thought. So, over the final two fixed dates, we quickened the pace of interest rate reduction to underpin domestic demand and to support a resumption of Canadian economic growth in the months ahead.

As well, we responded quickly to the devastating terrorist attacks of 11 September. Apart from the tragic loss of life, the attacks weakened Canada's economic prospects and made the outlook much more uncertain. Business and consumer confidence were shaken. In response, the Bank lowered interest rates on 17 September—outside our fixed announcement schedule—to help underpin confidence.

Inflation-Control Targets Renewed

In 2001, we renewed a crucial agreement with the federal government—our agreement to keep inflation within a range of 1 to 3 per cent.

Since the Bank and the government first agreed to a system of inflation-control targets in 1991, Canada has enjoyed a decade of low, stable, and predictable inflation. With this agreement in place, Canadians have been able to make economic decisions with confidence, and with firm expectations about the influence that inflation would have on their future purchasing power. In response to our inflation-control record, inflation expectations in Canada have remained anchored near the 2 per cent midpoint of the target range.

Reflecting the success of Canada's inflation-control system, the Bank and the Government of Canada jointly announced, on 17 May, that the agreement would be extended for a full five years, until the end of 2006. It was also decided that the Bank would focus on keeping the trend of inflation at the 2 per cent midpoint of the target range over the life of the agreement. This renewed agreement, along with our flexible exchange rate system, should give Canadians added confidence that Canada will maintain a low rate of inflation for years to come.

More details about our targets, including refinements to our measure of core inflation, can be found on page 26 in this *Report*.

Restructuring for the Future

The Bank has been reviewing its strategic direction and key priorities for the next several years. The goal is to have a central bank that concentrates on its most important functions—conducting monetary policy, contributing to a stable financial system, designing and providing Canadians with secure bank notes, and managing the federal government's funds and public debt.

A major outcome of this strategic review was the decision to outsource the operations and systems that support the government's retail debt program. This will result in significant savings for Canadians. In September, about 430 of the Bank's staff, including consultants and contract employees, joined the successful contractor, EDS Canada. I am confident that our former colleagues are in a position to take advantage of new opportunities with a dynamic company that specializes in this type of business. Holders of Canada Savings Bonds can be assured that the Bank of Canada remains responsible for customer service, bondholder records, and accounting.

Further restructuring within the Bank will occur in the coming year, as we complete our review of corporate services to realign them with the future needs of a smaller Bank.

Bank Notes

Another challenge for the Bank in 2001 was a rise in counterfeiting activity, particularly of the $100 note. Police in southern Ontario broke up a counterfeiting operation responsible for a wave of bogus $100 notes, and the counterfeiters were convicted in October. Despite these actions by law-enforcement agencies, a number of retailers have refused to accept $100 notes. Although counterfeiting has now returned to low levels, we are stepping up our currency-education program, so that retailers and the general public can confidently accept genuine bills and readily spot counterfeits.

That counterfeiting episode points to the importance of the Bank's new bank note series, which contains new anti-counterfeiting features. The new $10 note was released in 2001, and the new series will continue to be rolled out, with the $5 note slated for 2002. Higher-denomination notes—the $20, $50, and $100 notes—will incorporate additional security features and will be introduced over the next few years.

More details on bank notes can be found in the currency section of this *Report*, starting on page 30.

Supporting the Financial System

The events on 11 September presented another challenge to the Bank, beyond the impact on the economy. Following the attacks, the Bank moved quickly to make sure that Canada's financial system continued to operate smoothly. Bank staff reacted within minutes of the attacks to assess the impact on our clearing and settlement systems, and the Bank stepped in with liquidity to ensure that these vital systems continued to function. We also worked closely with other agencies and institutions, both in Canada and abroad. Our swap facility with the U.S. Federal Reserve was temporarily increased to ensure that Canadian banks would be able to settle their U.S.-dollar transactions in the aftermath of the attacks. In light of these disruptions, the Bank—in conjunction with the Department of Finance—postponed an auction of federal government treasury bills for two days and an auction of Real Return Bonds for one week, without threatening the government's cash position.

Before concluding, I would like to mention the death in July of Deputy Governor Tim Noël. All of us at the Bank were saddened by Tim's passing, which came at the end of a two-year battle with amyotrophic lateral sclerosis. Tim left his mark on the Bank in many ways during a career that spanned 35 years. His substantial contributions in the area of financial markets will remain a valuable legacy, while his expertise and counsel will be sorely missed.

In all, 2001 presented the Bank's staff with some extraordinary challenges. But these challenges were met with the high levels of skill and professionalism for which the Bank's employees are known. As well, I am grateful for the support received from the Bank's Board of Directors throughout the year. To them, and to all the employees of the Bank, I extend my thanks for your help during a challenging year, and I look forward to working with you as we continue to meet our commitments to Canadians during 2002.

David A. Dodge

ABOUT
THE BANK

THE BUSINESS OF THE BANK

The Bank of Canada's responsibilities focus on the goals of low and stable inflation, a safe and secure currency, financial stability, 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

The goal of monetary policy is to contribute to solid economic performance and rising living standards for Canadians by keeping inflation low, stable, and predictable.

Currency

The Bank issues Canada's bank notes and is responsible for note design (including anti-counterfeiting features), distribution of new notes, and replacement of worn notes.

Central Banking Services

This function involves two major activities: the promotion of financial stability and the provision of efficient funds-management services to the federal government.

Retail Debt Services

The Bank is responsible for ensuring that all holders of Canada Savings Bonds and Canada Premium Bonds have their information registered and their accounts serviced through efficient operations and systems support.

Corporate Services

To manage and carry out the Bank's business effectively, the expertise of staff in a range of service areas such as human resources, technology, finance, communications, and administration is essential.

LOOKING **AHEAD**

Over the past year, the Bank has been taking stock of its priorities, its work environment, and the scope of its business activities. A key result of this effort will be the adoption, in the spring of 2002, of a new strategic plan covering the next several years.

One major decision that has already been implemented was the outsourcing of the operations and systems supporting retail debt services. The transition was completed in 2001. The new arrangements should improve the cost-effectiveness of service delivery, while allowing the Bank to focus on its primary functions. Related restructuring of the Bank's corporate services areas will be completed over the next year.

The Bank's focus for the future was reviewed by an internal working group of senior staff. It concentrated on finding the most effective ways to carry out the Bank's mandate and on identifying elements of the work environment that would best support that mandate in the coming years.

Overall, the Bank plans to expand its work in the following areas: research and analysis on structural and macroeconomic policy issues, currency education and the security of bank notes, promotion of the safety and soundness of domestic and international financial systems, management of the government's financial assets and liabilities, and the promotion of a well-functioning Canadian-dollar debt market.

The quality of the work environment is essential to achieving a high standard of performance. At the Bank, this includes a fundamental commitment to a bilingual and diverse workplace. The Bank strives to create an atmosphere where knowledge is shared and learning thrives, where collaboration and partnerships with external organizations are effective, and where delegation and good communication support the work of our staff.

As the Bank moves ahead, it will continue to focus on attracting and retaining the best employees to meet these objectives and to fulfill its critical responsibilities as Canada's central bank.

Security guards Pascal Coutu and Sylvain St-Jacques in the lobby of the West Tower, Head Office, Ottawa

Board meeting at Head Office

CORPORATE STRUCTURE **AND LEADERSHIP**

Board of Directors

Under the Bank of Canada Act, the Board is responsible for general oversight of the Bank and has specific duties related to finance, human resources, and overall administration, while the Governor is responsible for monetary policy and the other business of the Bank.

The Bank's Board is composed of 12 Directors from outside the Bank, plus the Governor and the Senior Deputy Governor. The Deputy Minister of Finance sits on the Board as a non-voting member. The external Directors come from across Canada and provide an important link to the various regions of the country. Directors are appointed by the Minister of Finance for three-year terms and may be reappointed at the end of their terms.

Board Stewardship in 2001

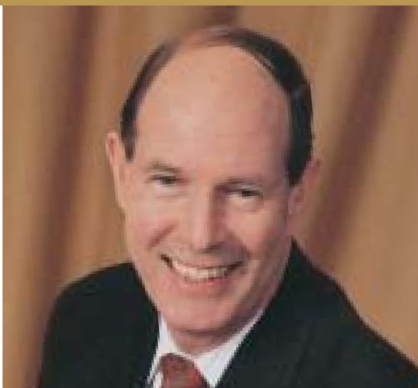
During 2001, the Board oversaw a management-led review of the Bank's strategic direction, laying the groundwork for the development of the next medium-term plan. A key challenge this year, and one where a special committee of the Board provided guidance, was the outsourcing of the operations and systems supporting retail debt services. Following the outsourcing initiative, the Board continues to closely monitor the restructuring of the Bank's corporate services departments.

The Board also supports the development of a work environment that will continue to attract and retain high-quality staff. Other key areas of interest for the Board have been improvements in the total compensation regime, the development of a leadership program for senior officers, and the effective management of the succession-planning process. The Board also took an active interest in the work of the Bank's regional offices, recognizing their important contribution to the Bank's economic analysis.

In 2001, the Board supported a significant change in the structure of the Bank's senior management team with the creation of the Executive Management Committee. The Committee was established to enhance the Bank's strategic management capabilities at the executive level.

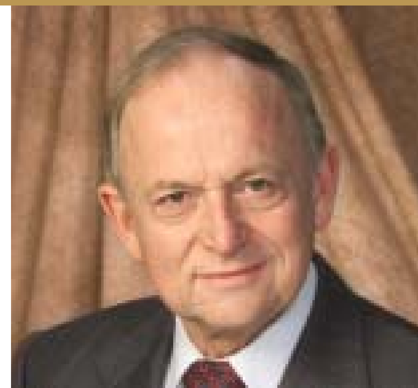
Although the Board is not responsible for the conduct of monetary policy, its broad oversight responsibility includes monitoring the effectiveness of the monetary policy formulation process, including the standards applied in gathering information, together with the quality

THE BOARD OF **DIRECTORS**



David Dodge

Malcolm Knight



Harold H. MacKay

David Dodge
Governor

Malcolm Knight
Senior Deputy Governor

Harold H. MacKay
Regina, Saskatchewan
Appointed in January 1999
Lead Director

Raymond Garneau
Westmount, Quebec
Appointed in March 1996

James S. Hinds
Sudbury, Ontario
Appointed in March 1996

J. Spencer Lanthier
Toronto, Ontario
Appointed in March 2000

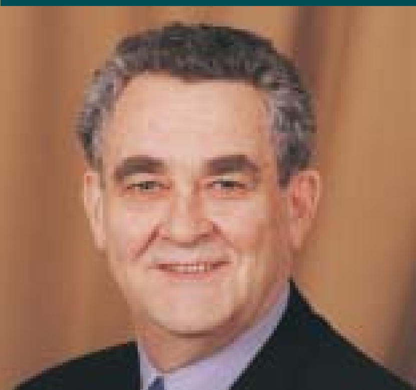
Paul J. Massicotte
Montréal, Quebec
Appointed in June 1995

Raymond Garneau

James S. Hinds

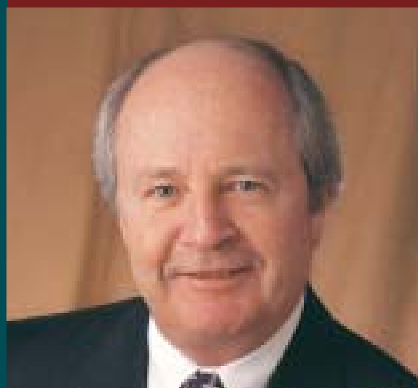
J. Spencer Lanthier

Paul J. Massicotte


Winston Baker


Kit Chan


Walter Dubowec


Daniel F. Gallivan


Barbara Hislop


Aldéa Landry


Barbara Stevenson


Kevin Lynch

Winston Baker
St. John's, Newfoundland
Appointed in March 1996

Kit Chan
Calgary, Alberta
Appointed in April 1999

Walter Dubowec
Winnipeg, Manitoba
Appointed in March 1996

Daniel F. Gallivan
Halifax, Nova Scotia
Appointed in July 2000

Barbara Hislop
Vancouver, British Columbia
Appointed in March 1998

Aldéa Landry
Moncton, New Brunswick
Appointed in March 1996

Barbara Stevenson
Charlottetown, Prince Edward Island
Appointed in October 1994

Kevin Lynch
Deputy Minister of Finance
Member *Ex officio*

THE BOARD OF **DIRECTORS**

David Dodge

Governor

Malcolm Knight

Senior Deputy Governor

Harold H. MacKay

Lead Director, Chair of Corporate Governance Committee, and member of Executive Committee

Lawyer

- Chairman, MacPherson Leslie & Tyerman
- Director, IMC Global Inc.
- Director, Canada Life Financial Corporation
- Chair, Saskatchewan Institute of Public Policy

Raymond Garneau

Member, Audit Committee

- Chairman of the Board of Industrial Alliance, Insurance and Financial Services and its subsidiaries, National Life of Canada and Industrial Alliance Pacific Insurance and Financial Services
- Member of the boards of directors of several corporations, including MAAX Inc.

James S. Hinds

Member, Audit Committee, Human Resources and Compensation Committee, Trustee, Pension Fund

Lawyer

- Partner, Hinds and Sinclair

J. Spencer Lanthier

Chair, Audit Committee

Chartered Accountant

- Former Chairman and CEO of KPMG Canada
- Vice-Chairman and member of the Board, Toronto Stock Exchange
- Member of the Board, Co-Steel Inc.
- Member of the Board, Ellis-Don Inc.
- Member of the Board, Visible Genetics Inc.
- Member of the Board, Bruce Power Inc.
- Member of the Board, Intertape Polymer Group Inc.

Paul J. Massicotte

Member, Executive Committee, Corporate Governance Committee and Premises Committee

Chartered Accountant

- President, Alexis Nihon Group
- Member, Board of Directors of the Canadian Institute of Public Real Estate Companies
- Member, Board of Directors of the Council for Canadian Unity
- Member, Board of Directors of St. Anne's Hospital Foundation

Winston Baker

Member, Executive Committee and Corporate Governance Committee

- Former educator and politician
- President, WB Holdings Ltd.

Kit Chan

Member, Human Resources and Compensation Committee and Premises Committee

- Principal of KBC Enterprises Ltd.
- Member, Board of Governors of Mount Royal College
- Member, Board of Directors of United Way of Calgary and Area
- Director and Corporate Secretary of ACT Cinemage Group Ltd.
- Partner, Canada Education Inc.
- Partner, Good Earth Art

Walter Dubowec

Member, Executive Committee, Corporate Governance Committee, Human Resources and Compensation Committee

Chartered Accountant

- Former Office Managing Partner, Deloitte & Touche LLP
- Chairman and President, The Joe Brain Foundation Inc. and its subsidiary, J.M.B. Canadian Explorations Ltd.
- Treasurer, Foundation for Health Inc.
- Director, Manitoba Medical College Foundation
- Director and Treasurer, The Antonia Kotowich Foundation Inc.
- Member, The Associates, Asper School of Business
- Member and Advisor, St. John's Haven Inc.
- Member of the Canadian Club of Winnipeg

Daniel F. Gallivan

Member, Audit Committee and Premises Committee

Lawyer

- Partner, Cox Hanson O'Reilly Matheson
- Director, Canadian Banking Ombudsman Inc.
- Director, ASCO Canada Ltd.
- Secretary, NovaScotian Crystal Limited
- Chair, Nova Scotia Sports Hall of Fame
- Chair, Oil and Gas Committee of the Halifax Metropolitan Chamber of Commerce

Barbara Hislop

Chair, Premises Committee and Member, Human Resources and Compensation Committee

- Group Vice-President, Wood Products, Canfor Corporation
- Director, Forintek Canada Corp.
- Director, Hudson's Bay Company
- Director, Vancouver Board of Trade
- Director, Genus Resource Management Technologies Inc.

Aldéa Landry

Chair, Planning and Budget Committee and Member, Premises Committee

Lawyer

- President, Landal Inc. and J.F.L. Arbitration Services Inc.
- Director, The Shaw Group of Halifax
- Chair, TVA National Advisory Group (National Television Network)
- Director, Community Foundation of Greater Moncton
- Director, Beauséjour Medical Research Institute
- Member, Atlantic Provinces Economic Council

Barbara Stevenson

Chair, Human Resources and Compensation Committee, Member, Audit Committee

Lawyer

- Partner, Carr Stevenson & MacKay
- First Vice-President of the Heart and Stroke Foundation of Prince Edward Island
- Member, Ethics Committee and Rules Committee, Law Society of Prince Edward Island

Kevin Lynch

Deputy Minister of Finance

(Ex officio)

- Executive Committee

of both the staff and the analysis they provide. To gain another perspective on the Bank's work, the Board met in private session with Special Adviser Angela Redish, an academic who worked with the Bank's management team for a one-year period, ending in August 2001.

Board Governance Practices

The Board follows best governance practices appropriate to the Bank and works to ensure that all Board members are informed of current corporate governance issues. New Board members are given an orientation session to familiarize them with the Bank and with their responsibilities.

The Board has six committees to deal with the issues brought before it for consultation or decision.

- The Executive Committee provides a forum where Bank management can seek informal comment on broad policy and planning matters relating to the administration of the Bank. It also reviews and approves human resources decisions involving senior officers.
- The Corporate Governance Committee, chaired by the Lead Director, assesses all aspects of governance and recommends changes to the Board. The Committee met five times in 2001 and developed a profile of the requirements for Board membership that will assist in the search for new Board members.
- The Human Resources and Compensation Committee oversees this function and approves the compensation strategy and levels of pay for Bank staff.
- The Audit Committee oversees the Bank's financial accountability framework and risk-management framework, as well as the external and internal audit.
- The Planning and Budget Committee participates in the Bank's strategic planning and budget process.
- The Premises Committee is responsible for overseeing the Bank's long-term facilities plan.

As a general practice, the Lead Director and the Chair of the Human Resources and Compensation Committee meet annually with the Governor and Senior Deputy Governor to review their performance and to discuss objectives for the coming year. The Corporate Governance Committee and the Board also contribute to the annual performance evaluations of the Deputy Governors.

To ensure that the Board can operate independently of management, the Lead Director chairs private sessions of outside Directors at the conclusion of each Board meeting. In 2001, the Board continued the annual practice of evaluating its stewardship to ensure that best practices of corporate governance are achieved.

Directors are paid according to a fee structure recommended by the government and approved by Order-in-Council. For 2001, the remuneration paid to all external Directors totalled $284,000.

Governing Council

The Governor, the Senior Deputy Governor, and four Deputy Governors sit on the Governing Council, which takes responsibility for monetary policy.

GOVERNING COUNCIL (From left to right) ›

PIERRE DUGUAY
Deputy Governor
Domestic economic issues /
Bank notes

CHARLES FREEDMAN
Deputy Governor
Financial institutions /
Clearing and settlement systems

PAUL JENKINS
Deputy Governor
International economic and financial issues /
Public communications

DAVID DODGE
Governor, Chairman of the Board of Directors

MALCOLM KNIGHT
Senior Deputy Governor
Chief Operating Officer

SHERYL KENNEDY
Deputy Governor
Financial markets

Tim Noël in his office, 1998

Tim Noël

In July 2001, Deputy Governor Tim Noël died at the age of 58, after a courageous battle with amyotrophic lateral sclerosis, also known as Lou Gehrig's disease.

Tim joined the Bank's Securities Department in 1966 and subsequently served as Secretary of the Bank and Adviser to the Governor, before becoming Deputy Governor responsible for financial markets in 1994.

His broad knowledge of the securities industry earned him the high regard of its participants. He was dedicated to his profession and continued his work through the two years that he battled the disease. In doing so, he taught all who came into contact with him the meaning of courage and dignity.

He is greatly missed.

The Governing Council also oversees various committees of Bank staff to facilitate discussions that generate a wide range of views. The Monetary Policy Review Committee plays an important role in the assessment of economic conditions during the process leading up to the decision taken on each fixed announcement date. The Financial Stability Review Committee deals with domestic and international issues affecting the stability of the Canadian financial system.

In addition to their responsibility for formulating monetary policy, members of Governing Council are responsible for specific departments and head up various Bank-wide initiatives.

Executive Management Committee

The Executive Management Committee was established in 2001 to ensure that matters related to strategic direction and management receive close attention at the executive level. This Committee also provides a broader representation of management that supports a delegated and coordinated approach to the decision-making process. The Executive Management Committee includes the members of Governing Council, the Bank's General Counsel/Corporate Secretary, the Adviser on Strategic Planning and Risk Management, the Chief Administrative Officer, and the Chief of Corporate Services.

The Bank's operations are organized into ten departments. Department Chiefs are responsible for the operations in their own areas and for ensuring that the policies and values of the Bank are implemented. Each Department Chief establishes an annual agreement with a member of the Executive Management Committee that outlines overall objectives and financial authority.

Executive Management Committee (left to right): Dan MacDonald, Gerry Gaetz, Janet Cosier, Paul Jenkins, Malcolm Knight, David Dodge, Sheryl Kennedy, Pierre Duguay, Mark Jewett, Charles Freedman

The Management Forum

Consisting of the Executive Management Committee, Advisers, and Department Chiefs, the Management Forum meets regularly to exchange information on general management issues and to review policy proposals. This group plays a key role in medium-term planning by helping to identify strategic issues and priorities. The members also have important individual management responsibilities. In 2001, one of the members assumed responsibility for a major review of the Bank's pension plan, while another took responsibility for the Debt Administration Office, which manages the outsourced operations for retail debt. A Special Adviser, who joins the Bank on a one-year contract—usually from a Canadian university—works with staff on special studies that further the Bank's research agenda. The Special Adviser is also a member of the Monetary Policy Review Committee and the Financial Stability Review Committee.

Regional Representatives

The Bank has representatives in five regional offices across the country to strengthen and expand its ties with industry, government, educational institutions, and other organizations and associations. These offices make an important contribution to the Bank's analysis of regional economic and financial developments and to the effectiveness of the bank note distribution system. They are located in Halifax, Montréal, Toronto, Calgary, and Vancouver.

www.bankofcanada.ca

The Bank's Web site continued to fill its vital role of conveying economic data, research, and policy information to domestic and international audiences. The site—which by year-end was providing data and documents to over 100,000 users per week—featured a variety of new content and services in 2001. These included an expanded recruitment site, an investment calculator, enhanced data search and display capabilities, and the introduction of live "Webcasts" of major speeches and press conferences. The Bank has also taken a leadership role in promoting effective use of the Web among other central banks.

A noteworthy addition to the site in 2001 was an extensive section on payment, clearing, and settlement systems. It provides detailed information on various clearing and settlement systems (both those overseen by the Bank and others) and supplies links to other sites carrying related material. This section enhances the transparency of the Bank's oversight activities, while increasing public awareness of the importance of these systems to an efficiently operating economy.

AN ACCOUNT OF
OUR STEWARDSHIP

MONETARY
POLICY

"Monetary policy has successfully maintained low inflation, and the Bank of Canada's policy management over the past year has further enhanced the credibility of the monetary policy framework."

2002 Article IV Consultation Statement of the IMF Mission (December 2001)

The monetary policy formulated by the Bank of Canada contributes to solid economic performance and rising living standards for Canadians by keeping inflation low, stable, and predictable.

In May 2001, the Bank and the government reaffirmed their commitment to inflation-control targets for the consumer price index (CPI) centred on a 2 per cent target midpoint. The Bank strengthened the implementation of the targeting arrangements through its commitment to report and explain any persistent deviations from the target midpoint, extended the length of the agreement with the government to five years from three years, and adopted a new measure of core (or underlying) inflation. All these changes should help to bolster the confidence of Canadians that future inflation will average close to 2 per cent.

The inflation target provides an anchor for inflation expectations and forms the central part of the Bank's monetary policy framework, which includes a flexible exchange rate. Canada's flexible exchange rate acts as a shock absorber and permits us to pursue an independent monetary policy suited to the needs of our own economy.

THE NEW MEASURE OF **CORE INFLATION**

The inflation-control target is expressed in terms of the total CPI. As an operating guide for the Bank's forward-looking monetary policy, it is useful to have a measure of the underlying trend in inflation. Measures of core inflation provide this by removing transitory influences on the CPI that stem from its most volatile components. The Bank's new measure of core CPI excludes the eight most volatile components of the CPI: three energy components (gasoline, fuel oil, and natural gas), two food components (fruit and vegetables), and three other components (mortgage interest, tobacco, and intercity transportation). It also excludes the effect of changes in indirect taxes on the remaining components. Overall, the new measure includes 84 per cent of the consumer basket, compared with the 74 per cent included in the previous measure of core inflation, which excluded food, energy, and the effect of changes in indirect taxes.

The Bank implements monetary policy by changing its target for the overnight interest rate. This target rate influences other interest rates and other rates of return, as well as the exchange rate for the Canadian dollar. Over time, these rates all have an impact on spending which, in turn, eventually affects inflation. Thus, the Bank's influence on inflation comes only indirectly and is typically felt over a period of 18 months to 2 years.

Meeting the Inflation Target

The Bank's core measure of inflation began the year just below the 2 per cent target and then rose to around 2.3 per cent, where it hovered through the spring and summer before moving down to 1.6 per cent in December. Because of volatile energy prices, total CPI inflation was higher and much more variable for most of the year, fluctuating between 2.5 per cent and 3.9 per cent in the first nine months. By the end of the year, however, it had fallen below 1 per cent. Thus, the period in which CPI inflation was above the 1 to 3 per cent target range was short-lived.

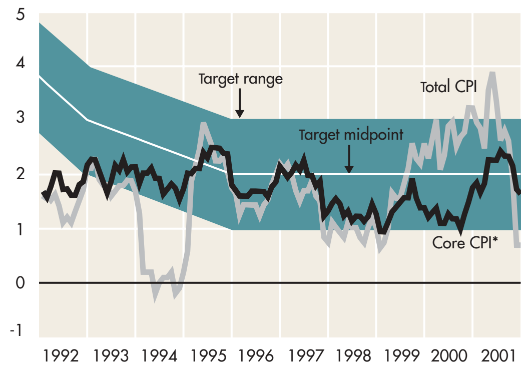
In December, average private sector forecasts for the total CPI, at around 1.5 per cent for 2002 and 1.9 per cent for 2003, showed that expectations of future inflation were well anchored to the 2 per cent target midpoint.

Expectations of inflation for longer time horizons, also based on average private sector forecasts, remained near 2 per cent as well. Another indicator of longer-term expectations, the spread between the yields on conventional and inflation-indexed bonds, ended the year slightly under 2 per cent.

Largely because of the rapidly slowing U.S. economy, economic growth in Canada decelerated through 2001, and was close to zero in the second half of the year. To stay on top of a rapidly changing economic environment, the Bank kept a close watch on incoming economic and financial data, as well as gathering information through its regional offices and other contacts with firms, associations, and provincial governments. The regional offices' regular quarterly survey of firms and associations was particularly important in this regard.

Over the five fixed announcement dates between January and mid-July, the Bank lowered its target for the overnight rate by 150 basis points on the expectation that the economy would begin to recover in the second half of the year. Then, with the global and domestic economies showing more sluggishness than expected—especially following the 11 September terrorist attacks—it became apparent that the recovery would not begin until some time in 2002. As a result, the pace of interest rate reductions picked up, with the next 200 basis points of cuts occurring in the three-month period from late August to late November. This took short-term interest rates down to 40-year lows.

Consumer Price Index
Year-over-year percentage change



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

THE TARGET FOR THE OVERNIGHT RATE

The target for the overnight rate is the average interest rate that the Bank wants to see in the marketplace for overnight, or one-day, loans between financial institutions. The target is the middle of the Bank's operating band for these overnight loans, which is one-half of a percentage point wide. The Bank Rate is at the top of the operating band and is thus one-quarter of a percentage point above the target rate.

The target for the overnight rate is the appropriate rate to use when comparing levels of short-term policy interest rates with those of other countries. For example, it corresponds directly to the U.S. Federal Reserve's target for the federal funds rate.

Assessing International Developments

In 2001, most of the shocks affecting the Canadian economy emanated from abroad, particularly from the United States. In such circumstances, understanding and interpreting foreign developments is particularly important, and the exchange of information in the international groups in which Bank officials participate is invaluable. These include the meetings of the G-10 central bank governors, other regular meetings held at the Bank for International Settlements, working parties and committees of the Organisation for Economic Co-operation and Development, and meetings of the G-7, G-10, G-20, and the International Monetary and Financial Committee of the International Monetary Fund. The last two bodies met in Ottawa in November.

In addition to discussions at these formal meetings, Bank officials are in regular contact with their counterparts at other major central banks to discuss the economic environment and the background of monetary policy decisions. Such contacts were particularly important in the days and weeks following the 11 September terrorist attacks. Because of the increased importance of international issues, the Bank has modestly increased the number of staff involved in this area in the last couple of years.

Through technical assistance provided at the Bank and abroad, as well as through international meetings in which emerging-market countries participate, Bank staff provide insights and advice on the use of inflation targeting in a flexible exchange rate regime. In addition, the Bank hosted a G-20 workshop in June designed to promote discussion of the various practical issues that confront countries operating under various exchange rate regimes.

Promoting an Understanding of Monetary Policy

On 5 December 2000, the Bank began announcing its official interest rate decisions on eight pre-established dates per year. Over 2001, it was apparent that the fixed dates led to greater public attention on Canada's economic and monetary situation relative to that in the United States. Press releases issued on the fixed dates provided opportunities to underscore the medium-term perspective that underlies monetary policy. Overall, the debate and discussion in Canada surrounding monetary policy issues appear to have benefited significantly.

To complement the communications surrounding the fixed announcement dates, media relations were strengthened during the year to provide additional perspectives and information on the issues.

Communication between Bank officials, industry, and governments on economic and monetary policy issues is a priority at the Bank. Regional staff carry out a regular outreach program, as well as assisting the Governing Council and Directors with their communications activities across the country.

Carrying Out Research and Analysis

Research and analysis underpin the formulation and implementation of monetary policy. Bank researchers actively participated in over 80 academic and central bank seminars and conferences in 2001. During the year, the Bank increased its partnerships with academics, research institutes, and foreign central banks.

Of particular importance has been the research carried out over the past few years to support the decision regarding the inflation target. Two technical background documents summarized this research, much of which has been published by the Bank in various forms (working papers, technical reports, and a seminar volume).

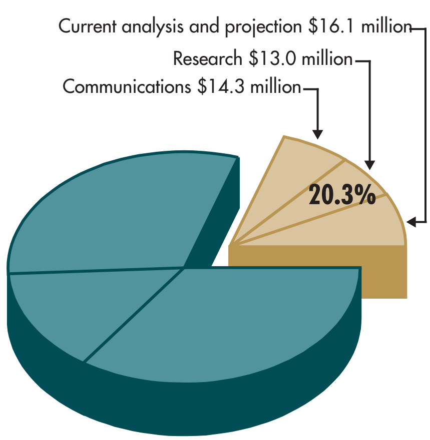
The implication of uncertainty for the conduct of monetary policy continues to be a major focus of research. In October, the Bank hosted a workshop in which the effectiveness of various rules for setting central bank interest rates across 12 models of the Canadian

economy was discussed. The models included five private sector models, two from international organizations, two from the Department of Finance, and three from the Bank of Canada. The conclusion was that no single rule produces low variability of inflation and output in all models.

The Bank also had arrangements for partnerships or consulting contracts with about 15 academics during the year, in addition to those who participated in the Bank's conferences and workshop.

Operating Expenses

Monetary Policy Activities as a Proportion of Total Bank Expenses



Engraver Jorge Peral works on the image of Sir John A. Macdonald for the new $10 note.

CURRENCY

Although Canadians are making increasing use of credit and debit cards, they rely on bank notes for many of their daily transactions. They depend on the Bank of Canada to supply bank notes that are secure against counterfeiting and to make these notes available reliably and economically.

The Bank is committed to strengthening the security of Canadian bank notes through research and development on bank note technology and through public education about the security features found on genuine bank notes.

THEMES FOR THE ***CANADIAN JOURNEY*** NOTE SERIES

$5	Children at Play
$10	Remembrance and Peacekeeping
$20	Arts and Culture
$50	Nation Building
$100	Exploring and Innovating

Launching the New Note Series

In January 2001, the Bank launched a new series of bank notes, entitled *Canadian Journey.*

A launch event in Ottawa introduced the public to the themes of the new series and to the first note to be put into circulation—the $10 denomination. In addition to new security features, the notes have a new tactile feature for use by the blind and vision-impaired as an aid to recognizing different denominations.

Immediately after the launch, the Bank gave technical briefings and presentations across Canada. These events allowed interested members of the public, cash handlers, and retailers to deepen their knowledge of the new security and tactile features of the note.

The remaining denominations in the new series ($5, $20, $50, and $100) will be introduced over the next three years.

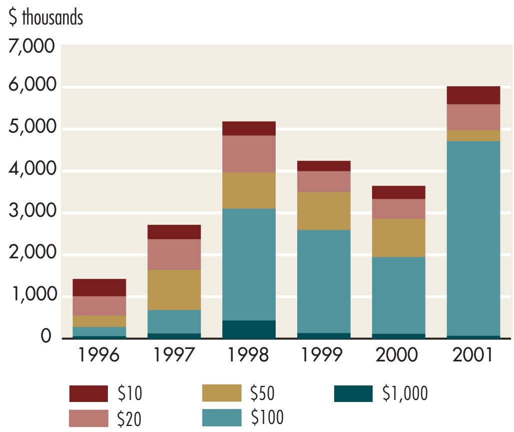
To accompany the launches of the various denominations in the new series, the Bank's Currency Museum has developed a travelling exhibit, *The Colour of Your Money.* The exhibit features the themes of the new series and explores other aspects of bank note history such as design, production, security features, and aids for the blind and vision-impaired. The exhibit was on display at the Currency Museum until early October 2001 and will be travelling to other locations across Canada.

Counterfeit Prevention and Detection

The Incidence of Counterfeiting

The value of counterfeit notes found in circulation rose to some $6.0 million in 2001 from $3.7 million in 2000. This increase can be attributed mainly to a sharp jump in the counterfeiting of $100 notes.

Value of Counterfeit Bank Notes Found in Circulation



The majority of counterfeit $100 notes found in circulation during 2001 originated from a single counterfeiting operation. Those

FOR COLLECTORS

To mark the launch of the new $10 note, the Bank is offering limited-edition bank note sets entitled *Lasting Impressions.* Each set features two uncirculated bank notes: one $10 note from the 1986 *Birds of Canada* series paired with a $10 note from the new *Canadian Journey* series. Both notes have identical serial numbers and are packaged in a presentation folder that contains an informative booklet recounting the history of the $10 note and highlighting the features that make the notes both secure and unique.

The sets are available at the Currency Museum, at all major Canada Post outlets, and at participating coin dealers.

Inspecting sheets of the new $10 note

responsible were arrested in mid-July and convicted in October. The number of counterfeit $100 notes found in circulation peaked in July and declined sharply thereafter.

This episode led a number of retailers to refuse to accept $100 bank notes. As a result, the Bank stepped up its efforts with retailers and retailer associations to ensure timely sharing of information about counterfeit detection and prevention, to enlist their co-operation in spotting counterfeits, and to provide training to cash handlers. Specifically, the Bank emphasized that counterfeit notes are readily distinguishable from genuine notes by the absence of a clear gold-to-green colour shift in the Optical Security Device—the shiny rectangle in the upper left-hand corner of genuine $20, $50, $100, and $1,000 notes.

Counterfeit Prevention

Since the introduction of the current note series 16 years ago, major technological developments in bank note production have made it possible to incorporate improved security features into paper currency. These advances help to enhance security at a time when affordable high-resolution colour copiers, ink-jet printers, and computer scanners have increased the potential for counterfeiting. During 2001, the Bank pursued its program of research and development in bank note technology to strengthen the security of the new note series. The security features of this series will be subject to periodic evaluation and possible upgrades as new counterfeiting threats and new solutions emerge.

One security feature of the $10 denomination in the new *Canadian Journey* series is the group of three iridescent maple leaves on the face of the note. When a genuine note is tilted, these leaves, initially pale and matte in appearance, change to a reflective gold colour. Another security feature is fluorescence. A genuine note does not glow under ultraviolet light, except for the following features, which are not visible in normal light:

- the coat of arms and the words "Dix • Ten" and "BANK OF CANADA BANQUE DU CANADA" glow blue over the portrait;
- white security fibres that glow red.

For more information about the security features found on genuine bank notes, telephone 1-888-513-8212 or visit the Bank's Web site at ‹www.bankofcanada.ca/banknotes/counterfeit/education›.

The Bank works closely with the Royal Canadian Mounted Police (who are responsible for the enforcement of Canada's anti-counterfeiting laws) to monitor and analyze counterfeiting in Canada. This monitoring and analysis was instrumental in closing down the operation responsible for the rise in counterfeit $100 notes. This activity also provides valuable input to the Bank's program of public education.

Public Education

The most effective defence against counterfeiting is an informed public that recognizes the security features found on genuine bank notes.

The Bank runs a public education program aimed at increasing awareness of the key security features of genuine bank notes. As part of that program, Bank staff made some 300 presentations to cash handlers in the retail and financial services sectors, to business and civic groups, to educational institutions, and to law-enforcement agencies during 2001, compared with approximately 230 during 2000.

The presentations were complemented by media interviews; by the information provided directly through the 1-888 telephone line and the Bank's Web site; by the distribution of posters, leaflets, training videos, and information kits; and by programs and activities offered through the Currency Museum.

International Initiatives

Counterfeiting is an international threat, and demands a coordinated international response. Accordingly, the Bank of Canada is actively involved in a number of initiatives with other central banks, note-issuing authorities, and equipment manufacturers and suppliers. These activities range from providing a forum for the exchange of views on all aspects of the design, production, and distribution of bank notes to the co-operative development, assessment, and implementation of bank note technology and security.

One example of such involvement is the Central Bank Counterfeit Deterrence Group (CBCDG), established in 1993 by the governors of the G-10 central banks and chaired by a senior officer of the Bank of Canada. The group's main task has been the development of a system to deter computer-based

Debra Rohac welcomes a visitor to the Currency Museum, while Colleen Bauman checks out a display.

counterfeiting. The CBCDG is now working with manufacturers and software developers to facilitate adoption of this system.

Another example of international involvement is the Currency Developments Advisory Group (CDAG), established in 1997 by the central banks of Canada, the United States, Mexico, and Colombia. This group's primary focus is the assessment of alternative materials that have the potential for enhancing the security of bank notes and extending their life. CDAG members share their unique skills and expertise as well as the results of their individual work.

Supplying Bank Notes

Under the Bank Note Distribution System (BNDS), introduced in 1998, participating deposit-taking institutions manage the flow of notes between themselves in co-operation with the Bank. The Bank is responsible for distributing notes when they are first issued, maintaining records of its own note inventories in the system, withdrawing notes when they are no longer fit for circulation, and overseeing note quality and authenticity.

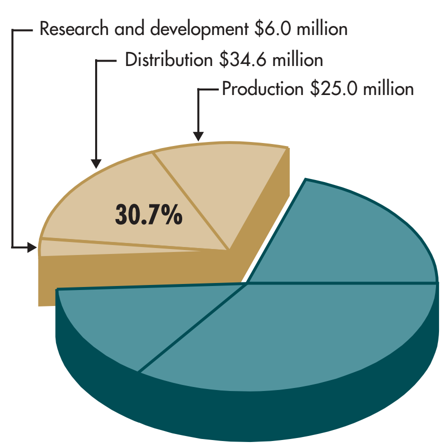
The Bank's currency detectives
Staff in the Mutilated Note Service carefully sift through charred bank notes. Each year, the Bank is asked to identify, for the purpose of reimbursement, the value of notes that have been burned, decomposed, torn, shredded, or contaminated.

The BNDS successfully met the challenges presented by the disruptions to air traffic following the events of 11 September. Contingency plans were robust and effectively mitigated the risks involved. Users of bank notes experienced no shortages.

In May 2000, the Bank stopped issuing $1,000 bank notes and began to withdraw them from circulation as part of the federal government's fight against money laundering and organized crime. During 2001, some 520,000 $1,000 notes were returned to the Bank and destroyed, leaving about 2.3 million $1,000 notes in circulation at year-end. Those notes represented less than 0.2 per cent of the total number of all notes in circulation and about 6 per cent of the value.

Operating Expenses

Currency Activities as a Proportion of Total Bank Expenses



November 2001 Conference on Financial Markets
Speakers (left to right): Richard Lyons, University of California, Berkeley; Asani Sarkar, Federal Reserve Bank of New York; Eli Remolona, Bank for International Settlements

This function involves two major activities: the promotion of financial stability and the provision of funds-management services to the federal government. We are also concerned with the efficient and effective functioning of financial markets.

Promoting Financial Stability

Widespread confidence in financial institutions, markets, and clearing and settlement systems is essential to support economic activity in Canada and abroad. Promoting the safe and efficient operation of these key parts of the financial system is an important activity of central banks and other public sector bodies.

Clearing and Settlement Systems

Oversight of Major Systems

The Bank oversees Canada's major clearing and settlement systems (under the authority of the Payment Clearing and Settlement Act). Financial institutions use these systems to transfer funds or financial assets (such as debt, equity, or derivatives) and to discharge related payment obligations, either on their own behalf or on behalf of their customers.

While the Bank oversees these systems primarily for their safety, it also takes into account efficiency concerns.

In November 2001, the Committee on Payment and Settlement Systems of the Bank for International Settlements and the Technical Committee of the International Organization of Securities Commissions released their joint report, *Recommendations for Securities Settlement Systems*. The report identifies minimum standards that securities settlement systems should meet. The recommendations on the design, operation, and oversight of such systems are intended to promote the worldwide implementation of measures to reduce risks, increase efficiency, and provide adequate safeguards for investors. These recommendations will be incorporated into the Bank's minimum standards for the securities settlement system that it oversees.

The Bank continues to monitor the work done by the Canadian Depository for Securities Ltd. to enhance the functionality of the Debt Clearing Service (DCS). In the autumn of 2001, corporate debt was added to the list of securities transactions eligible to settle through the DCS, and the ability to net repo transactions was introduced in January 2002. In both cases, the Bank assessed the risk implications of these new activities and the robustness of the proposed risk-control measures, and concluded that any possible systemic risks were well controlled.

The Bank remains closely involved in the international banking industry initiative to reduce and control the risks associated with the settlement of foreign exchange transactions. The start-up of this arrangement, which is being developed by CLS ("Continuous Linked Settlement") Services and its subsidiary, the CLS Bank, has been delayed, and is expected to become operational in the second half of 2002. The Bank is part of a group of central banks examining the risk-control measures proposed by CLS Services, and the Bank has the primary responsibility to satisfy itself that all risks associated with the settlement of transactions involving the Canadian dollar have been appropriately addressed. During 2001, the Bank worked with the CLS Bank to test the services that the Bank of Canada will provide and to develop contingency arrangements in the event of system failures.

WHAT SYSTEMS DOES **THE BANK OVERSEE?**

The Bank of Canada oversees two major clearing and settlement systems: the Large Value Transfer System (LVTS), which processes approximately $100 billion in payments every day, and the Debt Clearing Service (DCS), which daily handles about $100 to $150 billion of securities transactions (primarily involving Government of Canada bonds and treasury bills as well as money market securities).

Parliament passed the Canadian Payments Act in the autumn of 2001, which gives the federal government the capacity to oversee payments systems, including those currently overseen by the Bank of Canada. To minimize any duplication or overlap of oversight activities and to coordinate work related to payments systems, the Bank and the Department of Finance have established a payment advisory committee.

Given the critical nature of major clearing and settlement systems, the Bank's oversight activities have increasingly focused on operational risks in these systems. Operational risks relate to potential disruptions because of internal systems failures or human error. The year-2000 concerns and the 11 September terrorist attacks in the United States have highlighted the need for sound operational arrangements and well-developed contingency plans. The Bank annually audits the implementation of risk-control arrangements in these systems, the nature and testing of backup arrangements, and system-capacity planning.

Operational Support for Clearing and Settlement Systems

The provision of accounts at the Bank of Canada to settle obligations among participants in major clearing and settlement systems, the provision of liquidity to system participants, and other central bank services are also critical elements of the Bank's contribution to the safe and reliable operation of these systems.

On 1 November, the Bank expanded the range of securities that it is prepared to accept as collateral when providing liquidity in normal circumstances through its Standing Liquidity Facility. This initiative will reduce costs for direct participants in payments systems and lessen concerns regarding the adequacy of the future supply of government securities for collateral purposes (see ‹www.bankofcanada.ca/en/notices_fmd/not221001.htm›).

In June, the Bank outsourced the platform on which the computer applications used to support clearing and settlement systems are run. This has resulted in improved recovery times in the event of system problems and has enhanced the Bank's contingency plans in this area.

International Financial Stability Activities

In collaboration with the Bank of England, the Bank published a paper in November that lays out a clear framework for resolving international financial crises. The paper, *The Resolution of International Financial Crises: Private Finance and Public Funds,* is available on the Bank's Web site.

FINANCIAL STABILITY **AND THE BANK**

The Bank's contribution to financial stability reflects its system-wide perspective and draws on its expertise as a monetary authority, its ability to create liquidity in the form of risk-free claims on the Bank, and its knowledge of clearing and settlement systems and financial markets. The Bank works closely with other federal and provincial agencies that contribute to financial stability.

Action in the Bank's Trading Room
Left to right: Alan Andree, Ivan Semerdjiev, and Sébastien Guilbault

The Bank participates in the Financial Stability Forum, which in 2001 focused on the implications of the global slowdown for domestic and international financial systems and reviewed such issues as the supervisory and information-exchange practices of off-shore centres, as well as the implementation of international standards. In this last area, the Bank provided experienced personnel to participate in joint missions of the International Monetary Fund and the World Bank. These missions assess the progress of countries in adopting international standards and codes of conduct.

The Bank also continued to support and participate in the work of the many committees and working groups of the Bank for International Settlements, which address a wide range of financial stability issues.

The issues discussed in the G-20 by finance ministers and central bank governors are of significant importance from the Bank's perspective. These include exchange rate regimes, prudent debt management, and the use of standards and codes.

At the November G-20 meetings held in Ottawa and chaired by Finance Minister Paul Martin, the Bank participated in discussions on detecting and preventing the misuse of the global financial system by terrorists and ways of making the world less vulnerable to financial crises.

THE BANK AND FINANCIAL STABILITY RESEARCH

The Bank is intensifying its research into financial stability issues, including the examination of various arrangements in the financial system and their policy implications. Examples include assessing models of financial contracting, studying the impact on market liquidity of the consolidation of financial intermediaries, and analyzing the evolution of financial market structure. Some of this work is being conducted jointly with other research organizations.

Financial Markets

Financial markets have been experiencing important and rapid changes, owing to such factors as consolidation among market participants, the adoption of new technologies, and evolving regulations governing market structure and practices. The Bank has increased its research in this area and has expanded its contacts with other public sector agencies interested in the operation and evolution of markets.

The Bank took part in discussions with market participants and securities commissions regarding issues associated with the development of alternative electronic trading systems in the domestic fixed-income market. The Bank drew on its research and practical experience in financial markets as well as on the specialized experience of a Bank of England employee seconded to the Bank to assist in this work.

In November 2001, the Bank held a conference entitled "Financial Market Structure and Dynamics," to help improve the understanding of financial market structures and their implications for market liquidity and price dynamics.

Funds Management

In the past year, the Bank's regular strategic review process reaffirmed the importance of providing funds-management services to the government. With the rapid pace of change in financial markets, it was concluded that further investment will be needed in financial markets expertise and technological infrastructure.

Advising the Government on Its Borrowing Program

As fiscal agent for the government, the Bank advises the government on the management of the federal public debt and provides treasury-management services. The objective of debt management continues to be to provide stable, low-cost funding to the government.[1]

Debt-management initiatives are developed in conjunction with the Department of Finance after consultations with market participants.

1. Link to Debt Management Objectives ‹http://www.fin.gc.ca/dms/dms01_1e.html#DebtManagementObjectives›

The Bank's Response to 11 September

Following the terrorist attacks on the United States, central banks around the world moved quickly to support the financial system. The Bank of Canada rapidly assured financial market participants and the general public of its willingness to take actions to promote a stable financial system. Specifically, the Bank:

- provided LVTS participants with ready access to additional liquidity;
- agreed to extraordinary arrangements under which direct participants in the Automated Clearing Settlement System could trade and reduce imbalances in their payments positions;
- arranged for a temporary increase (to US$10 billion) to an existing swap facility with the U.S. Federal Reserve to enhance the Bank's capacity to provide short-term U.S.-dollar liquidity to Canadian banks. In the event, it was not necessary to draw on this facility.
- communicated its activities quickly and openly to the market and the general public.

The events of 11 September were a significant test for Canadian financial markets and market participants, and for clearing and settlement arrangements. The financial system performed very well, reflecting previous efforts to develop robust, timely, and effective contingency plans, as well as a high degree of dedication and professionalism on the part of all participants.

UNCLAIMED **BALANCES**

Chartered banks and federally chartered trust and loan companies are required to transfer to the Bank of Canada all unclaimed balances maintained in Canada in Canadian currency that have been inactive for a period of ten years.

To increase public access to information on unclaimed balances, the Bank provides a toll-free telephone service **(1-888-891-6398)** and an e-mail address at **ucbalances@bankofcanada.ca.**

There is also a search facility on the Bank's Web site at **www.bankofcanada.ca** where members of the public can find out if there is an unclaimed balance to which they may be entitled. They will also be told how to claim a balance. The public can also access information on unclaimed balances at any of the Bank's five regional offices. (See page 68 for addresses.)

During 2001, financial institutions transferred $26 million in unclaimed balances to the Bank. In addition, the Bank handled more than 19,000 general inquiries, completed nearly 45,300 searches, and paid a total of $8.1 million to satisfy 7,600 claims.

These have continued to focus on enhancing the market for Government of Canada securities and improving the government's treasury operations in an environment of budget surpluses and declining debt.

In 2001, two initiatives were taken to promote additional liquidity in the secondary market for Government of Canada securities. First, the target size for issues of benchmark bonds was increased by about 30 per cent for 10- and 30-year bonds. Second, the bond-buyback program, under which the government repurchases existing, less-liquid debt issues in exchange for a cash payment to the seller of the debt, was used more extensively. This allowed the government to maintain the level of issuance of benchmark bonds in spite of its declining financial requirements. A new feature of the program, to be implemented in 2002, will give investors the opportunity to exchange outstanding debt for new issues of current benchmark securities. Another debt-management initiative launched in 2001 was a pilot cash-management buyback program. This program aims at smoothing the government's cash needs over the year and reducing fluctuations in the size of the treasury bill program by repurchasing selected bonds with a remaining term to maturity of less than one year.

Significant improvements continued to be made in the auction services provided to the government. New technology and improved business processes reduced the time between the deadline for the submission of bids and the release of the auction results from 30 to 15 minutes.

Investing Government Funds

The Bank manages the investment of the government's Canadian-dollar cash balances and its foreign exchange reserves. Domestic cash balances range between $1 billion and $23 billion, typically rising to the upper end of this range prior to quarterly principal and interest payments. Foreign exchange reserves stood at US$34.2 billion, up from

US$32.4 billion in 2000 (year-end data). Foreign exchange reserves increased principally as a result of cross-currency swaps of domestic obligations. Foreign exchange reserves are held to provide general liquidity for the government and to fund exchange market intervention. Overall, the net difference between the liabilities of the Exchange Fund Account and its assets fell to US$4.9 billion (on a par value basis) from US$6.5 billion last year as a result of U.S.-dollar purchases.[2]

Several key initiatives, involving both Bank and Department of Finance staff, are underway to improve the investment of the government's funds. New draft terms and conditions for Receiver General Auctions of Canadian-dollar-denominated funds were published for comment in August 2001 and included revisions based on the comments on an earlier discussion paper. These rules will broaden participation in auctions and lower credit risk for the government, because a significant proportion of the investments will be collateralized. The new framework is expected to be ready in 2002. Research also began on refining the measurement of the cost of foreign exchange reserves in order to better assess the financial performance of the Exchange Fund Account. The results of this work will be implemented in 2002 when the Bank installs a new trading, portfolio-management, risk-management, and accounting system for the Account. Finally, 2001 saw the start of a program to improve the management of the operational risk related to funds management.

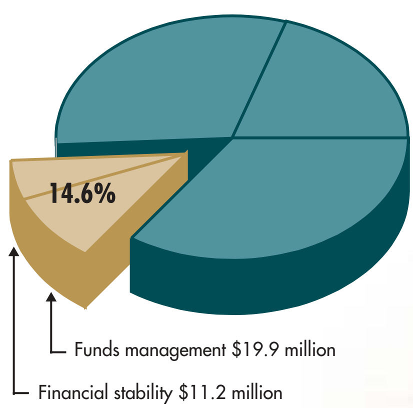
Banking Agent for the Government

Government of Canada receipts and payments transferred through Canadian financial institutions are forwarded to the Bank of Canada for settlement. While large in value, the number of items processed by the Bank is very low, because financial institutions consolidate the individual payment items and forward them to the Bank for bulk settlement. These settlement payments are channelled through the Canadian Payments Association's (CPA) LVTS, which is also used by the federal government to make most of its large payments.

Working with the federal government and the CPA, the Bank is involved in several initiatives to further improve the efficiency of processing government payments and deposits. For example, a more secure Web-based system for submitting payments from financial institutions to the Bank was introduced in 2001 as a pilot project. It will be made available to all financial institutions in 2002.

Operating Expenses

Central Banking Services Activities as a Proportion of Total Bank Expenses



2. Link to Exchange Fund Report ‹http://www.fin.gc.ca/efa/efa2000_1e.html#Gap›

RETAIL DEBT **SERVICES**

As the government's fiscal agent, the Bank is responsible for providing advice and operations- and systems-support services for the retail debt program. The program is directed by the Department of Finance through its agency, Canada Investment and Savings, which determines the products to be offered, the interest rates to be paid, and strategies for sales and marketing.

Under the retail debt program, the government issues traditional Canada Savings Bonds (CSBs), which are redeemable at any time, and Canada Premium Bonds (CPBs), which offer a higher interest rate at the time of issue than CSBs but are redeemable only annually. Bonds are available through a network of sales agents, as well as organizations sponsoring the Payroll Savings Program, and through direct sales by telephone or via the Internet.

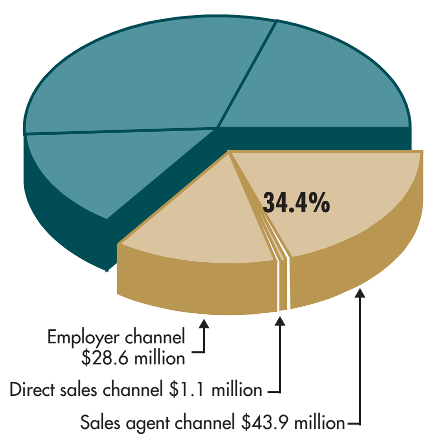
In 2001, a milestone in retail debt services was achieved as the Bank outsourced the operations and systems support to a private sector firm, EDS Canada Inc. An integral part of this outsourcing was the transfer of about 430 of the Bank's staff, including consultants and contract employees, to EDS effective 1 September 2001.

The contract with EDS was the result of a rigorous, year-long competitive process to select a private sector partner from among several leading outsourcing companies. This arrangement will ensure more flexible and cost-effective "back-office" services for the retail debt program. The contract stipulates detailed service levels that EDS must meet to ensure that bondholders continue to receive the same high level of service. In line with this initiative, the Bank has established a new department, the Debt Administration Office, to oversee the contract. The Bank remains fully accountable for bondholder records and debt accounting, as well as customer service.

This major change involves a one-time charge to the retail debt program of $23.2 million, for which the government will reimburse the Bank. This amount will be more than recaptured from the annual operational savings that will be achieved over the life of the contract.

Operating Expenses

Retail Debt Activities as a Proportion of Total Bank Expenses



FINANCIAL
SUMMARY

REVENUE AND EXPENSES

Revenue from Investments

Total revenue from investments was $2.1 billion in 2001, an increase of 1.8 per cent over 2000. The main source of revenue is interest earned on holdings of federal government securities, financed primarily by the bank notes issued by the Bank. Net revenue paid to the Government of Canada in 2001 was $2.0 billion.

Net revenue is not a good indicator of the Bank's management performance. The Bank deals in financial markets to achieve policy goals, not to maximize its revenues, and these revenues are highly dependent on interest rates. For these reasons, the level of operating expenses is a better indicator of the Bank's stewardship of public resources.

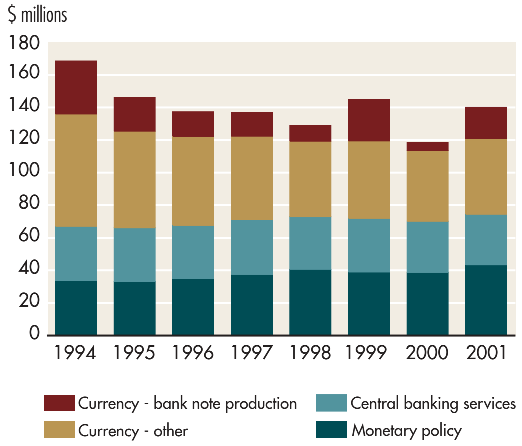
Operating Expenses

Monetary Policy, Currency, and Central Banking Services

Over the past several years, activities involving the Bank's main functions—monetary policy, currency, and central banking services—have been reviewed to focus more sharply on the Bank's role as a public policy organization, the needs of its clients, and the efficiency and effectiveness of its operations. From 1994 to 2000, operating expenses in each of these areas were successively reduced, with the exception of 1999, when additional expenditures were incurred in preparation for the year-2000 changeover. The overall downward trend for this period was reversed in 2001 in response to new demands.

Operating expenses in monetary policy rose by $4.6 million to $43.4 million in 2001 as more resources were assigned to support new initiatives in formulating, implementing, and communicating monetary policy.

Operating Expenses
Monetary policy, currency, and central banking services



Expenses in currency operations reached $65.6 million in 2001, an increase of $17.1 million over 2000. This increase mainly reflects a gradual return to a more normal level of bank note production following the year-2000 inventory buildup in 1999 and the resulting low level of bank note production in 2000.

Expenses in central banking services remained fairly constant in 2001 at $31.1 million. Cost reductions in the area of wholesale debt management have offset the increases in other programs.

In 2002, operating expenses for the Bank's three main functions are expected to increase. The continued return to normal levels of bank note production, higher production costs for the new, more secure, series of bank notes, additional staff to undertake new work on strategic priorities, the implementation of a comprehensive disaster-recovery plan for the Bank's mainframe, and various other automation initiatives will account for most of the increase.

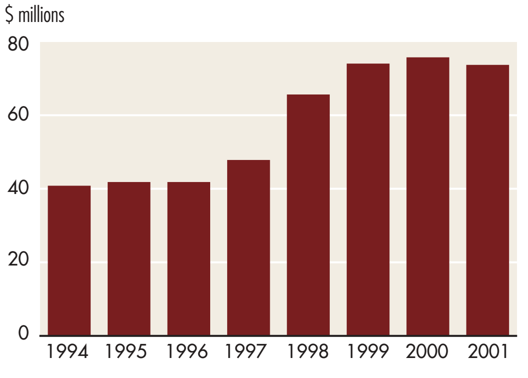
Retail Debt

The Bank has provided "back-office" services to Canada Investment and Savings—the agency of the Department of Finance responsible for the government's retail debt program—since the agency's inception in 1996. After reaching a level of $75.6 million in 2000, expenses decreased by $2.0 million in 2001 to $73.6 million. This reduction results from the streamlining of retail debt operations in preparation for the outsourcing in September 2001.

Intensive preparations for the transfer of retail debt operations to EDS Canada Inc. (EDS) took place from mid-2000 to the end of the third quarter of 2001 and resulted in a one-time cost of $23.2 million. This non-recurring expense will be more than offset by the savings that will be realized over future years.

All the expenditures required to support the retail debt program as well as those incurred for the outsourcing of operations to EDS are recovered from the federal government.

Operating Expenses
Retail debt services



Corporate Services Restructuring

The restructuring of corporate services, which is currently underway, is aimed at creating an integrated approach to corporate services in order to deliver these services cost-effectively and efficiently to a smaller Bank. Various restructuring options were analyzed in 2001, and the restructuring program is scheduled for completion in 2003. Total outlays are expected to amount to approximately $27 million.

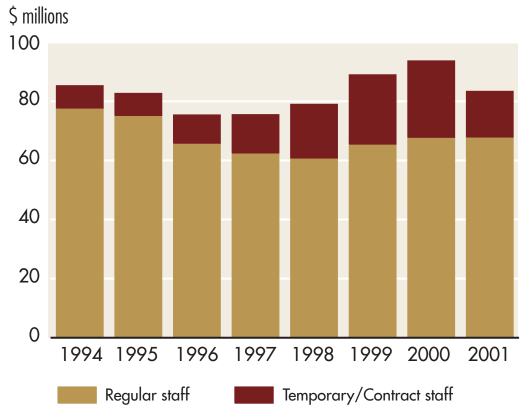
Salaries

The objective of the Bank's compensation strategy is to offer a market-competitive total compensation program. The program includes base pay, re-earnable performance pay, flexible benefits, and recognition awards.

The Bank's total salary expenses in 2001 decreased by over 11 per cent from 2000 levels. The outsourcing of retail debt operations in the last quarter of 2001 resulted in the transfer of about 430 employees to EDS. In addition, fewer contract resources were required in 2001 to support the Bank's business lines, since low-priority initiatives within corporate services were delayed or postponed during the outsourcing process.

Salary expenditures are expected to decrease further in 2002, as the full impact of the outsourcing of retail debt operations and the restructuring of corporate services are felt.

Salary Expenses
Monetary policy, currency, central banking services, and retail debt services



FINANCIAL **STATEMENTS**

(Year ended 31 December 2001)

BANK OF CANADA

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. The integrity and objectivity 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, management maintains financial and management control systems and practices to provide reasonable assurance that the financial information is reliable, that the assets are safeguarded, and that the operations are carried out effectively. The Bank has an internal Audit Department, whose functions include reviewing internal controls and their application on an ongoing basis.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control and exercises this responsibility through the Audit Committee of the Board. The Audit Committee reviews the Bank's annual financial statements and recommends their approval by the Board of Directors. The Audit Committee meets with management, the internal auditor, and the Bank's external auditors appointed by Order-in-Council.

These financial statements have been audited by the Bank's external auditors, Raymond Chabot Grant Thornton, General Partnership and Arthur Andersen LLP, and their report is presented herein.

D.A. Dodge, Governor

D.W. MacDonald, Chief Administrative Officer

Ottawa, Canada

AUDITORS OF THE BANK OF CANADA
VÉRIFICATEURS DE LA BANQUE DU CANADA

AUDITORS' REPORT

To the Minister of Finance, registered shareholder of the Bank of Canada

We have audited the balance sheet of the Bank of Canada as at 31 December 2001 and the statement of revenue and expense 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 2001 and the results of its operations for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at 31 December 2000 and for the year then ended were audited by Caron Bélanger Ernst & Young and Raymond Chabot Grant Thornton, General Partnership, who expressed an opinion without reservation in their report dated 16 January 2001.

Raymond Chabot Grant Thornton

RAYMOND CHABOT GRANT THORNTON
General Partnership
Chartered Accountants

Arthur Andersen LLP

ARTHUR ANDERSEN LLP
Chartered Accountants

Ottawa, Canada
18 January 2002

BANK OF CANADA

STATEMENT OF REVENUE AND EXPENSE

Year ended 31 December 2001

	2001	2000
	Millions of dollars	
REVENUE		
Revenue from investments, net of interest paid on deposits of $23.2 million ($42.8 million in 2000)	**2,149.2**	2,111.0
EXPENSE by function (notes 1 and 3)		
Monetary policy	**43.4**	38.8
Currency	**65.6**	48.5
Central banking services	**31.1**	31.3
	140.1	118.6
Retail debt services – expenses	**73.6**	75.6
Retail debt services – outsourcing costs (note 11)	**23.2**	-
Retail debt services – recoveries	**(96.8)**	(75.6)
	140.1	118.6
OTHER EXPENSE		
Restructuring costs (note 11)	**28.7**	-
	168.8	118.6
NET REVENUE PAID TO RECEIVER GENERAL FOR CANADA	**1,980.4**	1,992.4

(See accompanying notes to the financial statements.)

BANK OF CANADA

BALANCE SHEET

As at 31 December 2001

ASSETS	2001	2000
	Millions of dollars	
Deposits in foreign currencies		
U.S. dollars	**391.9**	742.0
Other currencies	**3.8**	4.9
	395.7	746.9
Advances to members of the Canadian Payments Association	**647.5**	952.3
Investments (note 4)		
Treasury bills of Canada	**12,605.6**	9,134.7
Other securities issued or guaranteed by Canada maturing within three years	**8,799.8**	8,342.5
Other securities issued or guaranteed by Canada not maturing within three years	**16,976.7**	15,293.8
Other bills	**428.8**	1,666.7
Other investments	**2.6**	1,500.3
	38,813.5	35,938.0
Bank premises (note 5)	**149.2**	162.8
Other assets		
Securities purchased under resale agreements	**1,410.7**	1,357.5
All other assets (note 6)	**387.9**	390.6
	1,798.6	1,748.1
	41,804.5	39,548.1

(See accompanying notes to the financial statements.)

LIABILITIES AND CAPITAL

	2001	2000
	Millions of dollars	
Capital paid up (note 7)	**5.0**	5.0
Rest fund (note 8)	**25.0**	25.0
Bank notes in circulation	**38,820.6**	36,775.3
Deposits		
Government of Canada	**1,005.2**	16.1
Banks	**1,307.1**	1,669.2
Other members of the Canadian Payments Association	**23.8**	101.8
Other deposits	**289.6**	267.0
	2,625.7	2,054.1
Liabilities in foreign currencies		
Government of Canada	**224.6**	584.4
Other liabilities		
Securities sold under repurchase agreements	–	–
All other liabilities	**103.6**	104.3
	103.6	104.3
	41,804.5	39,548.1

D.A. Dodge, Governor

S. Vokey, CA, Chief Accountant

On behalf of the Board

J.S. Lanthier, CM, FCA, Chair, Audit Committee

H.H. MacKay, QC, Lead Director

(See accompanying notes to the financial statements.)

BANK OF CANADA

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2001

1. Bank functions

The Bank of Canada's primary responsibilities are set out in the Bank of Canada Act and can be grouped into four broad functions, which are described below. Expenses in the *Statement of revenue and expense* are reported on the basis of these four corporate functions.

Monetary policy

The goal of monetary policy is to contribute to solid economic performance and rising living standards for Canadians by keeping inflation low, stable, and predictable.

Currency

The Bank issues Canada's bank notes and is responsible for note design (including anti-counterfeiting features), the distribution of new notes, and the replacement of worn notes.

Central banking services

This function involves two major activities: the promotion of financial stability and the provision of efficient funds-management services to the federal government.

Retail debt services

The Bank is responsible for ensuring that all holders of Canada Savings Bonds and Canada Premium Bonds have their information registered and their accounts serviced through efficient operations and systems support. The Bank recovers the cost of retail debt operations on a full-cost basis.

2. Significant accounting policies

The financial statements of the Bank are in accordance with Canadian generally accepted accounting principles and conform to the disclosure and accounting requirements of the Bank of Canada Act and the Bank's bylaws. A *Statement of cash flows* has not been prepared as the liquidity and cash position of the Bank are not of primary concern to users of these financial statements. Other information regarding the Bank's activities may be derived from the *Statement of revenue and expense* and the *Balance sheet*.

The significant accounting policies of the Bank are:

a) Accounting estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the financial statements and notes to financial statements. These estimates are based on management's best knowledge of current events and actions that the Bank may undertake in the future. Actual results may differ from those estimates.

b) Revenues and expenses

Revenues and expenses are accounted for on the accrual basis.

c) Employee benefit plans

The Bank sponsors a number of defined benefit plans that provide pension and other post-retirement and post-employment benefits to most of its employees. The Bank accrues its obligations under these benefit plans and the related costs, net of plan assets. The costs of the plans are actuarially determined using the projected benefit method to determine the current service costs. Past service costs resulting from plan amendments, and the transitional balances are amortized on a straight-line basis over the average remaining service period of active plan members (12 years). The excess of the net actuarial gain (loss) over 10 per cent of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active plan members (12 years). For the purpose of calculating the expected return on plan assets, assets are valued at fair value.

Changes resulting from adoption as at 1 January 2000 of the new accounting standards for employee benefits have been applied on a prospective basis.

d) Translation of foreign currencies

Assets and liabilities in foreign currencies are translated to Canadian dollars at the rates of exchange prevailing at year-end. Foreign currency assets held under short-term foreign currency swap arrangements with the Exchange Fund Account of the Government of Canada, as described in note 10(b), are converted to Canadian dollars at the contracted rates. Gains and losses from translation of, and transactions in, foreign currencies are included in revenue.

e) Advances

Advances to members of the Canadian Payments Association are liquidity loans that are fully collateralized and generally overnight in duration. The Bank charges interest on advances under the Large Value Transfer System LVTS at the Bank Rate. For advances under the Automated Clearing Settlement System ACSS, the Bank charges the Bank Rate plus a margin, which was 150 basis points at 31 December 2001 (150 basis points in 2000).

f) Investments

Investments, consisting mainly of Government of Canada treasury bills and bonds, are recorded at cost and are adjusted for amortization of purchase discounts and premiums using the constant yield method for treasury bills and bankers' acceptances and the straight-line method for bonds. The amortization, as well as gains and losses on disposition, are included in revenue.

g) Bank premises

Bank premises, consisting of land, buildings, computer hardware/software, and other equipment, are recorded at cost less accumulated depreciation. Computer software is capitalized only when its cost exceeds $2 million. Depreciation 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/software	3 to 7 years
Other equipment	5 to 15 years

h) Special purchase and resale agreements (SPRAs)

SPRAs are repo-type transactions in which the Bank offers to purchase Government of Canada securities from designated counterparties with an agreement to sell them back at a predetermined price on the agreed resale date, generally the next business day. The Bank is prepared to enter into SPRAs at the policy target rate, defined as the midpoint of the operating band for the overnight interest rate (i.e., 25 basis points below the Bank Rate), if overnight funds are generally trading above the indicated target level. SPRAs are transacted with primary dealers, a subgroup of government securities distributors that have reached a threshold level of activity in the Government of Canada debt markets.

The balance sheet category *Securities purchased under resale agreements* represents the value receivable by the Bank. As such, this amount includes the purchase of treasury bills and bonds, the purchase of accrued interest on bonds, and the interest earned by the Bank. The treasury bills and bonds purchased under resale agreements are not recorded as investment assets.

i) Deposits

The liabilities within this category are Canadian dollar demand deposits. For members of the Canadian Payments Association, the Bank pays interest on positive balances associated with the LVTS at the lower end of the operating band for the overnight interest rate (50 basis points below the Bank Rate), and on positive balances related to the ACSS at the lower end of the operating band for the overnight interest rate less a margin, which was 150 basis points at 31 December 2001 (150 basis points in 2000). On Special Deposit Accounts, which serve as collateral for LVTS participants, the Bank pays interest at the published overnight rate less a margin, which was 6.25 basis points at 31 December 2001 (6.25 basis points in 2000).

j) Sale and repurchase agreements (SRAs)

SRAs are reverse repo-type transactions in which the Bank offers to sell Government of Canada securities to designated counterparties with an agreement to buy them back at a predetermined price the next business day. The Bank is prepared to enter into SRAs at the policy target rate, defined as the midpoint of the operating band for the overnight interest rate (i.e., 25 basis points below the Bank Rate), if overnight funds are generally trading below the indicated target level. SRAs are transacted with primary dealers, a subgroup of government securities distributors that have reached a threshold level of activity in the Government of Canada debt markets.

The balance sheet category *Securities sold under repurchase agreements* represents the value payable by the Bank. As such, this amount includes the sale of treasury bills and bonds, the sale of accrued interest on bonds, and the interest owed by the Bank. The treasury bills and bonds sold under repurchase agreements continue to be recorded as investment assets.

k) 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 these risks are recorded in the accounts at the time they can be reasonably estimated.

3. Expense by classes of expenditure

	2001	2000
	Millions of dollars	
Salaries	**83.4**	93.6
Benefits and other staff expenses	**13.8**	15.7
Currency costs	**24.6**	10.0
Premises maintenance	**18.9**	18.5
Services and supplies	**54.3**	36.9
Depreciation	**26.3**	26.0
	221.3	200.7
Outsourcing costs	**23.2**	–
Recoveries		
Retail debt services	**(96.8)**	(75.6)
Other	**(7.6)**	(6.5)
	140.1	118.6
Restructuring costs	**28.7**	–
Total	**168.8**	118.6

Certain comparative figures have been reclassified to conform with the presentation adopted in the current year.

Recoveries represent the fees charged by the Bank for a variety of services. Retail debt services recoveries for 2001 include outsourcing costs.

4. Investments

This category includes Government of Canada treasury bills and bonds as well as other investments, which are held under short-term foreign currency swap arrangements with the Exchange Fund Account of the Government of Canada as described in note 10(b).

The Bank typically holds its investments in treasury bills and bonds until maturity. The amortized book values of these investments approximate their par values. At year-end, the average yield on the Bank's holdings of treasury bills, which average three months to maturity, was 3.3 per cent (5.8 per cent in 2000). The average yield for bonds maturing within three years was 6.0 per cent (6.4 per cent in 2000), and for those maturing in over three years it was 6.3 per cent (6.5 per cent in 2000). The average yield for other bills, which average less than one month to maturity, was 2.3 per cent (5.8 per cent in 2000). The total fair value of investments is $40,385.6 million ($37,198.9 million in 2000).

5. Bank premises

	2001			**2000**		
	Millions of dollars					
	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
Land and buildings	**167.5**	**74.9**	**92.6**	168.0	71.9	96.1
Computer hardware/ software	**57.0**	**37.4**	**19.6**	63.0	37.2	25.8
Other equipment	**139.4**	**102.4**	**37.0**	139.0	98.1	40.9
	363.9	**214.7**	**149.2**	370.0	207.2	162.8

6. All other assets

This category includes accrued interest on investments of $279.0 million ($305.1 million in 2000).

7. Capital paid up

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, in accordance with the Bank of Canada Act, have been issued to the Minister of Finance, who is holding them on behalf of the Government of Canada.

8. Rest fund

The rest fund was established in accordance with the Bank of Canada Act and represents the general reserve of the Bank. The rest fund was accumulated out of net revenue until it reached the stipulated maximum amount of $25.0 million in 1955.

9. Employee benefit plans

The Bank sponsors a number of defined benefit plans that provide pension and other post-retirement and post-employment benefits to most of its employees. The following table provides information about these plans.

	Pension benefit plan		Other benefit plans	
	2001	2000	2001	2000
	Millions of dollars		Millions of dollars	
For the year				
Bank contributions	**2.0**	1.4	**5.7**	2.6
Employees' contributions	**0.4**	0.3	**0.0**	0.0
Benefits paid	**20.8**	19.8	**5.7**	2.6
Benefit plan expense (revenue)	**(15.1)**	(12.3)	**14.7**	11.8
Curtailment loss	–	–	**8.9**	–

	Pension benefit plan		Other benefit plans	
	2001	2000	2001	2000
	Millions of dollars		Millions of dollars	
As at 31 December				
Accrued benefit obligation	**486.4**	444.2	**87.4**	88.6
Fair value of plan assets	**632.6**	657.8	**0.0**	0.0
Funded status-plan surplus (deficit)	**146.2**	213.6	**(87.4)**	(88.6)
Accrued benefit asset (liability)	**55.6**	39.0	**(41.0)**	(23.1)

The significant actuarial assumptions (weighted averages as of 31 December) used in calculating the accrued benefit obligations are as follows.

	Pension benefit plan		Other benefit plans	
	2001	2000	2001	2000
Discount rates	**5.75%**	6.11%	**5.99%**	6.05%
Expected rates of return on plan assets for the year	**5.70%**	6.06%	**N/A**	N/A
Rate of compensation increase	**3.00% + merit**	3.00% + merit	**3.00% + merit**	3.00% + merit

Interest rates for Government of Canada marketable bonds are used. These rates are different than those employed by the Bank for funding valuations of the *pension benefit plan*.

For measurement purposes, a 9.0 per cent annual rate of increase in the per capita cost of covered hospital and drug benefits was assumed. The rate was assumed to decrease gradually to 4.5 per cent over 10 years and remain at that level thereafter. The per capita cost of other health care benefits was assumed to increase at 3.0 per cent per annum.

10. Commitments

a) Operations

The Bank has entered into a long-term support agreement for retail debt services, expiring in 2011, that calls for fixed payments totalling $136.7 million and a variable component based on the volume of transactions. The Bank recovers the cost of retail debt services from the Canada Investment and Savings Agency.

Commitments related to other support services are $9.7 million over the next three years.

b) Foreign currency contracts

In the ordinary course of business, the Bank enters into commitments involving the purchase and sale of foreign currencies. In particular, the Bank enters into short-term foreign currency swap arrangements with the Exchange Fund Account (EFA) of the Government of Canada as part of its cash-management operations within the Canadian banking system. These transactions, which are made with the concurrence of the Minister of Finance under a standing authority, involve the temporary acquisition by the Bank of foreign currency investments from the EFA. These investments are paid for in Canadian dollars at the prevailing exchange rate with a commitment to reverse the transaction at the same rate of exchange at a future date. The fair values of these investments are not materially different from their book values. At year-end, there were no investments held by the Bank under this arrangement. At the end of 2000, the average yield for these investments was 6.1 per cent.

As well, the Bank is a participant in two foreign currency swap facilities with foreign central banks. The first, amounting to US$2 billion, is with the U.S. Federal Reserve. The second, amounting to Can$1 billion, is with the Banco de México. There were no drawings under either facility in 2001 or 2000.

All commitments outstanding at 31 December are settled in the subsequent year.

A summary of these outstanding commitments follows.

		2001	**2000**
		Millions of dollars	
Foreign currency contracts	– purchases	**165.4**	133.0
	– sales	**165.4**	1,654.5

At 31 December 2001, there were no outstanding foreign currency contracts included in sale commitments ($1,521.5 million in 2000) under swap arrangements with the EFA.

c) Investment contracts

In the ordinary course of business, the Bank enters into commitments involving the purchase and sale of securities. All commitments outstanding at 31 December are settled in the subsequent year. A summary of these outstanding commitments follows.

		2001	**2000**
		Millions of dollars	
Investment contracts	– purchases	–	–
	– sales	**1,411.1**	1,358.3

Outstanding sale investment contracts of $1,411.1 million, at an interest rate of 2.25 per cent under special purchase and resale agreements, were settled by 8 January 2002 ($1,358.3 at the end of 2000 at an interest rate of 5.75 per cent).

11. Retail debt outsourcing and corporate services restructuring

In 2000, the Bank launched a major initiative to investigate options for the appropriate arrangements to provide operations and systems support for the federal government's retail debt program. As a result of its studies, the Bank began a process to outsource support for the program to a private sector supplier, while maintaining its role as fiscal agent for retail debt. In 2001, the Bank signed a contract with EDS Canada for the provision of operations and systems support. The contract is for a term of 9.5 years and commenced 1 September 2001. Under the contract, Bank staff joined EDS in its Ottawa offices. The total one-time cost of outsourcing associated with this initiative was $23.2 million, all of which is recoverable from the Canada Investment and Savings Agency of the federal government.

With the outsourcing initiative completed, the Bank has undertaken to restructure its corporate services to align them with the needs of a smaller organization. This restructuring program is scheduled for completion in 2003. The cost of restructuring in 2001 is $28.7 million, which includes an accrual of $5.8 million for staff redundancies expected in 2002, as well as a curtailment loss from post-retirement benefits (note 9).

GOVERNING COUNCIL

David A. Dodge, Governor*
Malcolm D. Knight, Senior Deputy Governor*

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Charles Freedman* **Sheryl Kennedy***

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* Member of Executive Management Committee
1. Visiting economist
2. Also Chair of the Board of Directors of the Canadian Payments Association
3. Also Deputy Chairman of the Board of Directors of the Canadian Payments Association

Note: Positions as of 25 January 2002

FOR FURTHER INFORMATION ABOUT THE BANK OF CANADA

PUBLICATIONS

Monetary Policy Report* and *Update

A detailed summary of the Bank's policies and strategies, as well as a look at the current economic climate and its implications for inflation. *Report* published in April and October; *Update* published in January and July. Without charge.

Bank of Canada Review

A quarterly publication that contains economic commentary and feature articles. By subscription.

Bank of Canada Banking and Financial Statistics

A comprehensive package of Canadian data. Published monthly. By subscription.

Weekly Financial Statistics

A 20-page package of banking and money market statistics. By subscription.

INTERNET

http://www.bankofcanada.ca
Provides timely access to press releases, speeches by the Governor, most of our major publications, and current financial data.

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Note: Positions as of 25 January 2002