

Central Banking Services

Central banking services encompass a wide range of activities. The primary function is the implementation of monetary policy. Central banking services also include the Bank's dealings with the financial industry to promote a safe and sound financial system. A particular challenge for the past several years has been the preparation for the Large-Value Transfer System (LVTS) being developed by the Canadian Payments Association (CPA) to handle large-value payments. The LVTS is currently scheduled to begin operating in mid-1998. Finally, central banking services include services provided to various clients, including the federal government, financial institutions, and the general public. The Bank's goal here is to provide these services as efficiently and effectively as possible.

Year in review

Market operations to implement monetary policy

In implementing monetary policy, the Bank focusses on the overnight (one-day) interest rate. The Bank announces a band of 1/2 of a percentage point for movements of this rate and sets the Bank Rate—the Bank's official lending rate—at the upper limit of the band. This band was raised by 1/4 of a percentage point on three occasions during 1997 and once by 1/2 of a percentage point. On each occasion, a press release explained the reason for the change. The Bank also operates in the money market to keep the overnight rate within the band that has been announced. During 1997, there were 8 transactions aimed at keeping the rate from falling below the band and 31 to keep it from rising above.

Since 1996, with the Bank Rate no longer tied to the interest rate set at auctions for 3-month treasury bills, there has been less reason for the Bank to intervene in the treasury bill market and less need to hold a large portfolio of these bills. During the year, the Bank continued to work towards bringing the proportion of treasury bills and bonds in its portfolio into closer alignment with that of the government's outstanding debt.

Promoting the safety and soundness of the Canadian financial system

The Payment Clearing and Settlement Act (PCSA), enacted in 1996, gave the Bank of Canada formal responsibility for the regulatory oversight of major clearing and settlement systems in Canada (see page 55).

Towards the end of 1997, the Bank issued a guideline on how it will carry out these oversight activities. The guideline notes

Under the Payment Clearing and Settlement Act, the Bank of Canada has formal responsibility for the regulatory oversight of major clearing and settlement systems in Canada.

some of the factors that will be considered when deciding if a system should be designated as subject to the act, as well as the minimum standards that the Bank intends to apply to such systems. It also explains how the act will apply to systems located outside Canada that include Canadian participants.

During the year, the Bank continued to work closely with the operators of all the major clearing and settlement systems to identify potential risks in their systems and the appropriate mechanisms to control these risks. In particular, the Bank promoted discussions among participants in the LVTS and other large-value clearing and settlement systems so that the links among them can be identified and strengthened.

To date, private sector institutions have acted as settlement agents for these systems. There is a remote risk, however, that such an institution could fail after it had received payments from participants in the system and before it had made payments to other participants, thus preventing the system from settling. One way to eliminate this risk is for the Bank to act as settlement agent or banker for these systems, a power provided to the Bank in the PCSA. The Bank is actively discussing this possibility with the operators of a number of systems.

A deputy governor of the Bank of Canada served as co-chair of the Payments System Advisory Committee along with a senior official of the Department of Finance. The committee was established by the Minister of Finance in June 1996 to advise him on various issues related to the payments system, including public policy objectives for the system, access to various parts of the payments system, and governance arrangements. Four background papers were prepared for the committee. These papers, along with a summary of the discussions of the committee, are available on the Bank of Canada's web site. The committee completed its work in October 1997, and subsequent steps are currently being considered by the Department of Finance.

Client services

... to the federal government

As the federal government's banker, the Bank manages the government's cash balances. To enhance return, the Bank regularly conducts auctions to place the government's excess cash on deposit in the banking system. Such auctions were conducted almost daily in 1997.

The Bank also measures and monitors the government's exposure to financial risk. Following the release in 1997 of broad guidelines from the Minister of Finance, some detailed operat-

ing policies and procedures were put in place. The Bank also introduced new risk-management software.

As agent for the Minister of Finance, the Bank manages the government's foreign exchange reserves. During the year, the Bank increased efforts to minimize the net cost of holding government foreign exchange reserves by more closely matching the maturities of assets and liabilities in the Exchange Fund portfolio. While intervention in foreign exchange markets was stepped up with the weakness of the Canadian dollar towards year-end, the frequency of intervention remained well below the levels experienced before the introduction of new criteria for intervention in 1995. International reserves were U.S.\$18 billion at the end of 1997, compared with U.S.\$20.6 billion a year earlier.

Legislation passed in 1997 gave the government the authority to act as principal in international bridge-lending operations for countries seeking financial assistance from the International Monetary Fund or from the World Bank. This legislation also allows the Bank of Canada to act as the government's agent in such transactions. Although no bridge-loan operations were conducted during 1997, the monetary authorities of the G-10 countries (including Canada) and of other Asian and European countries agreed that they stood ready to support the Bank of Thailand by providing short-term liquidity through the Bank for International Settlements. Subsequently, as the Asian crisis widened, the Bank of Canada and the federal government participated in discussions in Manila to devise a framework of financial and technical support for affected countries in the region.

... to financial institutions

In 1997, to prepare for the startup of the LVTS, the Bank implemented an electronic system for receiving pledges of collateral. The pledges are made to secure advances from the Bank that CPA members might need to meet their settlement obligations or to support the use of intra-day credit by private sector participants in the LVTS. The Bank is also developing systems for the processing and management of its own payments and account activity, which will facilitate automatic access to the LVTS.

Under the Bank Act, the Bank must provide a security registry service in all of the provinces. Lenders register with the Bank of Canada their intention to take security in the form of certain assets from borrowers. This register can be searched for prior registrations. During 1997, alternative ways to deliver this service were investigated in light of both the Bank's need to update its computer systems and service requirements and the

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closure of most of its regional agencies. These service requests, most of which are received by mail, facsimile, and courier, are currently being processed centrally by the Bank of Canada. A new computer system and client service arrangements now in development are expected to be implemented during 1998.

New arrangements to consolidate and centralize other banking services were established in 1997. Financial institutions from across Canada are now able to ship redeemed government payment items directly to the government's cheque-processing centre at Matane, Quebec, and to settle these transactions through the Bank of Canada in Ottawa. In late 1997, in connection with the closing of its agencies in six Canadian centres, the Bank made new arrangements with members of the CPA to exchange cheques through the clearings in each of these locations.

The Bank of Canada's U.S.\$2 billion reciprocal swap facility with the Federal Reserve Bank of New York and a similar Can.\$1 billion facility with the Bank of Mexico were renewed in December 1997. Neither facility was activated during the year.

... to the general public

Chartered banks are required to transfer to the Bank of Canada all unclaimed bank balances maintained in Canada in Canadian currency that have been inactive for a period of 10 years. As part of the 1997 amendments to the Bank of Canada Act, the government has increased from \$100 to \$500 the amount below which unclaimed balances will be transferred to the federal government after being unclaimed for 20 years.

To provide the general public with easier access to information about unclaimed bank balances, the Bank introduced a 1-800 telephone service and an Internet e-mail address. In 1997 the Bank responded to 7,200 general inquiries, completed 28,000 searches, and paid a total of \$3.45 million to more than 6,100 claimants. The Bank is continuing to look at ways to improve the public's access to information on these unclaimed balances.

Operating expenses

Expenses for central banking services were approximately \$25 million in 1997, or about 14 per cent of the Bank's total operating expenses. This represents an increase in expenses of



PHOTO: MICHELLE KAMINSKI, CALGARY REGIONAL OFFICE

L-R: John Todd, Finance Minister, NWT, meeting with Senior Regional Representative Hung-Hay Lau

Canadians can telephone
without charge for
information on unclaimed
bank balances:
1-888-891-6398
or e-mail
ucbalances@bank-banque-
canada.ca

about 12 per cent over the previous year. Once completely in place, the streamlining of banking services operations will provide savings of about \$1.6 million annually. In 1997, the initial savings were more than offset by investment in a number of computer systems. These investments included the replacement and updating of account-administration systems and the development of the LVTS, as well as support for the Bank's risk-management unit and its regulatory oversight responsibility for major clearing and settlement systems.

Operating expenses related to central banking services

