

Currency*

Each day Canadians make hundreds of millions of transactions using bank notes. They depend on the Bank of Canada to provide bank notes that can be used with confidence and to make bank notes available in the most economical way possible. The Bank took a number of important steps in 1997 to meet these two objectives, including completing the implementation of a new distribution system, the first phase of a public education program, and increased investment in research and development.

Year in review

Implementing the new bank note distribution system

In October 1996, the Bank and participating financial institutions began the implementation of a new bank note distribution system that is serving the needs of the institutions and the Bank more efficiently and at less cost than the previous system based on regional Bank of Canada agencies. The new system was first piloted in Calgary (October 1996) and Quebec City (January 1997) and was then implemented at seven other regional distribution points throughout 1997: Ottawa, Regina, Winnipeg, Vancouver, Halifax, Montreal, and St. John's. Toronto—the final location—followed in January 1998. The financial institutions that participated in the system's development, including all Canada's major chartered banks, will manage the flow of notes among themselves in co-operation with the Bank. The Bank will be responsible for handling the notes when they are first issued, maintaining records of note inventories in the system, and for withdrawing notes when they are no longer fit for circulation, as well as for the oversight of quality assurance and authenticity.

In the first full year after implementation, the new arrangement for bank note distribution will result in annual savings to the Bank of Canada of approximately \$8 million. Most of these savings come from the closing of the Bank's cash operations at the agencies in seven cities. Oversight of bank note distribution will be an important function of the staff in the five regional offices in Halifax, Montreal, Toronto, Calgary, and Vancouver.

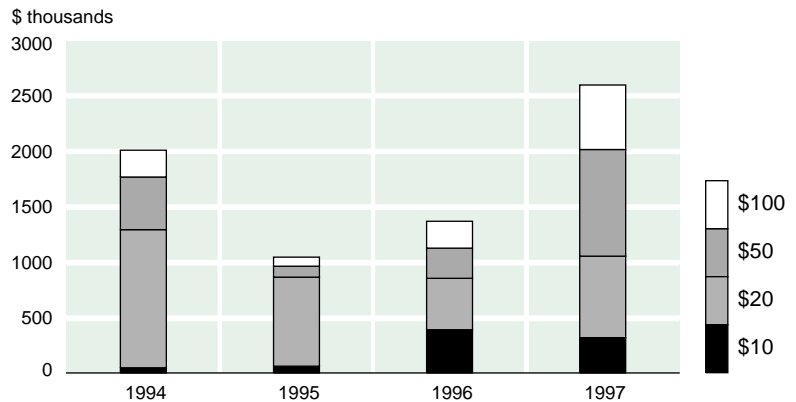
An article on the new bank note distribution system was published in the Summer 1997 issue of the Bank of Canada Review.

* This function, previously called "Bank Notes," includes the monitoring and analysis of all forms of retail payments, including electronic cash, in addition to the production and distribution of bank notes. The Bank also maintains a close consultative relationship with the Royal Canadian Mint, which is responsible for issuing coin.

Protecting bank notes from counterfeiting

Counterfeiting remains at relatively low levels in Canada but has increased in recent years. The value of counterfeits found in circulation in 1997—a small fraction of one per cent of the total value of notes in circulation—is up substantially from 1996, owing to the increased counterfeiting of the \$20 note and of higher denominations. At the same time, counterfeiting of the \$10 note has fallen from 1996 levels. While counterfeiting was lower in the second half of 1997, the overall upward trend will be watched closely, particularly because the most-affected denominations are those bearing the Optical Security Device. Statistics on the counterfeiting of Canadian currency are published in the *Bank of Canada Review*.

Value of counterfeit bank notes found in circulation



A well-informed public is the best guarantee of bank note security. Canada's bank notes include a number of security features that allow users to confirm that the notes they are using are genuine. Nearly every bank note transaction involves a member of the public and a retailer or financial institution. The Bank has therefore launched a new program to increase awareness of the security features of Canadian bank notes. The first phase of the currency education program was designed to help cash handlers at retailers and financial institutions recognize the features of genuine bank notes. Posters and leaflets were produced in consultation with financial institutions and the retail sector, which also participated in their distribution. Close to half a million posters and leaflets have been distributed to users to date, and the industry response has been very positive.

The new education material explains the characteristics of the Optical Security Device, the shiny rectangle in the upper left-hand corner of the \$20, \$50, \$100, and \$1,000 notes, as well as the distinctive look and feel of the other visible security features.

The Bank also informs the public about the features of genuine bank notes through its regional representatives and its Currency Museum.

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Research and development

The Bank constantly monitors the level of counterfeiting and the threats posed by new reproduction technologies such as colour copiers. It also follows the development of effective countermeasures, so that bank notes with enhanced security features can be issued as soon as they are required. In 1997, the Bank significantly increased its investment in research on new anti-counterfeiting devices and on new production techniques that increase the durability and economy of bank notes, with a view to producing new note designs over the next several years. The Bank is also consulting note-issuing authorities in other countries and private sector specialists in these fields and continues to work closely with the RCMP and other police forces on training, research, and enforcement.

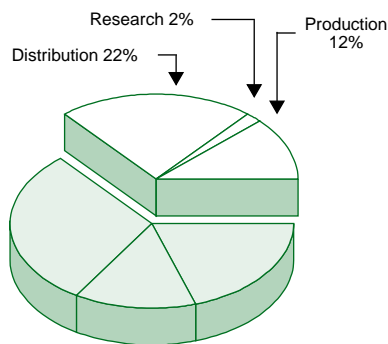
Electronic money

The Bank continues to monitor the pilot projects for stored-value cards that are currently under way in Canada. Electronic money has the potential, over time, to reduce the use of bank notes in small transactions. The Mondex and Exact (Proton) card systems are being tested in Guelph and Kingston by several financial institutions, hundreds of merchants, and thousands of cardholders. Other financial institutions are sponsoring tests of the VISA Cash card system in Vancouver, Montreal, Toronto, and Barrie.

Operating expenses

Expenses for currency activities were just under \$66 million in 1997, about 36 per cent of the Bank's total operating expenses. This represents a decrease in expenses of more than 5 per cent compared with 1996. The cost of the function is declining primarily as a result of changes to distribution, as well as lower production requirements for new notes. The cost savings from the new distribution system will not have full effect until these new arrangements have been fully implemented early in 1998. The savings are partially offset by increased investment in anti-counterfeiting measures such as the currency education program and research and development related to the design and production of the next generation of secure and durable bank notes.

Operating expenses related to currency



Due Diligence: The Bank of Canada's Wartime Gold Project

The subject of gold and other assets looted by the Nazi regime from governments and individuals in occupied Europe during World War II has generated worldwide interest over the last several years. There had been no indication of Canadian involvement, however, until a declassified U.S. document surfaced in July 1997, alleging that the Bank of Canada might have facilitated two wartime swaps of “tainted” gold between Portugal and Switzerland.

When the U.S. document was brought to the Bank's attention, an immediate search of its gold records was launched. The initial search showed that Bank of England gold was sent to Canada before and during the war for safekeeping. Ownership of a small portion of that gold was transferred from the Bank of England's account to that of the Swiss central bank and later to the accounts of the Portuguese and Swedish central banks. These were paper transactions on the Bank of Canada's books, and no gold was returned to Europe.

Recognizing the need for more extensive research into its records, the Bank asked Professor Duncan McDowall, an historian at Carleton University, to prepare an independent assessment. He had full access to the Bank's records, and Bank staff reconstructed the accounting ledgers from 1935 to 1956.

In his 100-page report, published at the end of November, Professor McDowall concluded that the Bank of Canada had exercised due diligence in handling these transfer requests from Europe during the war. He found no dormant gold accounts and saw no possibility that tainted gold ever found its way into the Bank's gold holdings. The Bank has made all the documents available to the public, except for information exempt under the Access to Information and Privacy Acts, and has prepared a Finding Aid for researchers.

Professor McDowall's report, entitled *Due Diligence*, and a Finding Aid that describes the records for researchers are available on the Bank's web site or through its Publications Distribution service (see page 58).