



BANK OF CANADA
BANQUE DU CANADA

ANNUAL **2006** REPORT

THE BANK'S COMPASS

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

Our commitment to Canadians

To promote the economic and financial welfare of Canada, we

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

Our commitment to excellence

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

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

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

Our commitment to one another

We aim to achieve our best in a workplace where we

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





BANK OF CANADA
BANQUE DU CANADA

David A. Dodge
Governor - Gouverneur

27 February 2007

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

Dear Minister,

In accordance with the provisions of the Bank of Canada Act, I am submitting the Bank of Canada's Annual Report for the year 2006 and the Bank's audited financial statements as at 31 December 2006.

Yours sincerely,

A handwritten signature in black ink, appearing to read "D.A. Dodge".



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MESSAGE FROM THE GOVERNOR

The year 2006 marked a turning point for the Bank of Canada. We successfully completed our medium-term plan, The Way Forward, and began writing a fresh chapter in the Bank's history based on a new three-year plan. In this annual report, we do more than give an accounting of past achievements.

We also provide forward-looking information on the plans and priorities in our new medium-term plan. And as we advance, we are always mindful of the Bank's original mandate, set out more than 70 years ago, to "promote the economic and financial welfare of Canada."



David Dodge, Governor

Policy Developments: 2006

Maintaining low, stable, and predictable inflation remains central to how the Bank meets its core responsibility of promoting the economic and financial welfare of Canadians. Our commitment to this goal was reaffirmed through the renewal of the inflation-targeting agreement, which was announced jointly with the federal government in November.

Over the past year, global economic forces continued to necessitate considerable adjustment across regions and sectors of the Canadian economy. At the same time, variability in energy prices meant some sizable swings in the consumer price index. Inflation moved from a high of 2.8 per cent in January to a low of only 0.7 per cent in September. The core rate of inflation opened 2006 somewhat below 2 per cent, but by the autumn, had moved just above 2 per cent. This rise in core inflation was consistent with an overall economy that was operating slightly above the limits of its capacity. Against a background of increasing pressures on capacity through the first half of the year, the Bank raised its policy interest rate (the target for the overnight interest rate) on four occasions. That brought the target rate to 4.25 per cent by July, where it

remained through the balance of the year. In the second half of the year, we judged that the principal upside risks to our outlook for inflation were related to the momentum in household spending and housing prices, while the main downside risk was a sharper slowdown in the U.S. economy than was previously expected. These risks were seen to be roughly balanced.

In 2006, we also completed the rollout of the new *Canadian Journey* series of bank notes, which carry such up-to-date security features as a metallic holographic stripe, a watermark portrait, a windowed colour-shifting thread woven into the paper, and a see-through number. With this new series of notes and the benefits of the partnerships described below, we saw real progress in the fight against counterfeiting, as the value and number of counterfeit notes dropped for the second year in a row.

Given the importance of well-functioning Canadian and international financial systems in today's global economy, the Bank put a great deal of effort this past year into researching and promoting financial system efficiency and in advocating for a stronger and more effective International Monetary Fund.

“The Way Forward” 2003–06

As 2006 came to a close, so, too, did work under the medium-term plan launched in 2002: *The Way Forward*. Over the past four years, we have achieved the significant objectives set out under this program. These objectives were designed to help us better fulfill our commitments to Canadians, while striving to be at the forefront of the world’s central banks. Our objectives were organized into three broad themes – research, partnerships, and communications – that cut across all the Bank’s functions.

Our commitment to *research* was apparent in our efforts to bolster the Bank’s analytical capacity. With our emphasis on attracting and retaining the best personnel, we have been able to deliver high-quality research and current analysis of the rapidly changing global and Canadian economies. This has been invaluable in supporting our conduct of monetary policy. Our enhanced research efforts have also included financial sector policies and how best to promote the stability and efficiency of our financial system.

This long-standing commitment to research also applies to longer-term projects. Research and analysis were crucial in the renewal of the inflation-control agreement. In the renewal, the Bank clarified several aspects of the inflation-targeting system and set out a research program to determine whether and how it might be possible to further improve

our inflation-control framework for the decades ahead.

Our emphasis on research can be seen through the breadth of other research themes discussed later in this report. Here I would like to particularly note the development and implementation of a new model for economic projections and policy analysis, known as the Terms-of-Trade Economic Model (ToTEM). This model builds on the strength of the Bank’s earlier model for the Canadian economy. But ToTEM, by taking advantage of the leaps in technological progress in economics and computing power made over the past decade, provides a richer description of the Canadian economy.

The theme of *partnerships* was illustrated by our achievements in the currency function.

We developed a comprehensive education and awareness program to help retailers and the public to distinguish genuine notes from counterfeits. The Bank has also collaborated closely with law-enforcement agencies and other central banks to combat computer-based counterfeiting. An information network has been created to enhance federal, provincial, and territorial prosecutors’ awareness of counterfeiting and to promote the tools available for successful prosecution of counterfeiting crimes.

The Bank’s emphasis on partnerships also supported our funds-management function. As fiscal agent to the federal government, we worked with both the government and

financial market participants to improve the functioning of markets for government debt. We also improved the efficiency of the auction process for government bonds and treasury bills.

Partnerships with the academic world were also bolstered by the establishment of the Bank of Canada Fellowship Program, a program that aims to recognize and encourage research in areas of particular importance to the functions of the Bank.

We have worked hard to make our work more transparent, recognizing that policies are most effective when they are well communicated and widely understood. The medium-term plan's theme of fostering *clear communication* emphasized that commitment. Our *Monetary Policy Report* and press releases issued at the time of our interest rate announcements have provided more details about our assumptions, analyses, and economic projections. Members of our Governing Council have continued to speak on monetary policy issues generally, to better explain such topics as changes in the global economy, the impact of emerging markets in Asia, and exchange rate movements, to cite just a few examples.

Our commitment to communication has also underpinned our achievements in the financial system function, where we have provided more in-depth analysis of financial stability and efficiency issues through our *Financial System Review*. Over the past four years, we have

expanded our knowledge of financial system issues, and have communicated this to Canadians. We have also enhanced transparency by improving our website to make a wide variety of information more readily available to all Canadians.

Our medium-term plan, *The Way Forward*, was extended to four years from the original three to deal with a number of issues that arose. For example, we identified a need to strengthen our planning for continuity of operations and to renew several aspects of our infrastructure. We continue to work on these issues, and they form part of the foundation of our new medium-term plan.

“Moving Forward”: The New Medium-Term Plan 2007–09

Over the next three years, we will continue to conduct monetary policy with the goal of keeping inflation at 2 per cent. At the same time, we will embark on a research program to see whether our very successful inflation-control framework can be made even better. We will be asking researchers to focus on two main questions. First, what would be the costs and benefits of an inflation target lower than 2 per cent? Second, what would be the costs and benefits of replacing the current inflation target with a longer-term, price-level target? We hope others will join us in this effort with the goal of completing this research well before the current agreement expires in 2011. We will

try to improve our understanding of the impact of globalization on the Canadian economy, examine the effects of demographic changes on productivity and the economy, and look for ways to improve the effectiveness of the Bank's monetary policy.

We will work to bolster public confidence in Canada's bank notes through further reductions in counterfeiting. The Bank has set as a goal reducing the number of counterfeits by over 50 per cent by 2009. Research will be conducted on new security features, themes, and designs for the next generation of bank notes. We will continue to strengthen our relationships with merchants, police, and prosecutors. And because counterfeiting is a worldwide problem, work on these goals will continue with other central banks and security specialists.

Over the span of the next medium-term plan, the Bank intends to continue improving its capacity to oversee major clearing and settlement systems and improve the collection and use of financial data. We will develop better ways to assess the stability of the financial system and the efficiency of the Canadian financial sector. Efforts to help reform the International Monetary Fund will continue, to make it more relevant and important in today's global economy.

To continue to effectively manage the Government of Canada's debt, cash, and foreign exchange reserves, as well as the Bank of Canada's own financial assets, we will aim

in the coming three years to renew our funds-management systems and to enhance our analytic capabilities.

In carrying out this new plan, there are three bank-wide priorities involving investments over the three years of the plan. The priorities are: renewing our infrastructure; creating a superior work environment; and staying at the forefront of good governance to preserve the trust of Canadians in our ongoing stewardship of the Bank. To attract and retain qualified and talented staff, the Bank's human resource strategy encompasses offering distinctive challenges and development opportunities, competitive total compensation, and a distinctive work environment.

You can find the medium-term plan on our website at *About the Bank* under *Management and Administration*.

Concluding Comments

As I said earlier, this annual report goes beyond a recounting of past achievements in our four functions: monetary policy; currency; financial system; and funds management. It also sets out our goals and priorities for the medium term. Further details and strategies for achieving these goals can be found within this annual report.

The Bank of Canada's strong reputation and its ability to continue to succeed rely on the skills and professionalism of its entire staff. I want

to personally thank the employees of the Bank for their hard work in 2006 and throughout *The Way Forward*. I am grateful for their efforts and for their commitment to excellence. I also wish to thank the members of the Board of Directors for their continuing support. I especially wish to express my appreciation to the Directors whose terms expired in 2006 for their dedicated service to the Bank and to Canadians. They are Ronald Keefe, Daniel Gallivan, J. Spencer Lanthier, Kit Chan, and Jim Hinds. Sadly, Jim Hinds of Sudbury,

Ontario, passed away shortly after leaving our Board. We all benefited greatly over the years from Jim's wise counsel.

I welcome our new Board members and look forward to working with them. Canada's central bank will continue to be accountable to all Canadians and to fulfill its mandate to promote the economic and financial welfare of Canada and its citizens.

A handwritten signature in black ink, appearing to read "C. A. Dodge". The signature is fluid and cursive, with a long horizontal stroke at the end.

GOVERNANCE

The Mandate of the Bank

As Canada's central bank, the Bank is mandated to contribute to the economic well-being of Canadians. It does this by aiming to keep inflation low, stable, and predictable; supplying safe and secure bank notes; promoting a stable and efficient financial system; and by overseeing key clearing and settlement systems. As the Government of Canada's fiscal agent, the Bank manages foreign exchange reserves, the public debt, and treasury activities.

Corporate Governance Framework

The Bank's corporate governance framework is founded on well-defined roles and responsibilities to fulfill its mandate and relies on key elements such as strategic planning, risk management, transparency, and clear accountability for the priorities set by the Bank and for the results achieved.

Central to the Bank's approach to corporate governance is the development of a three-year medium-term plan. The Board of Directors has overall responsibility for approving the strategic direction and the plan itself, and monitors progress of the plan's implementation.

The plan sets out the Bank's strategic priorities and financial plans, includes an integrated analysis of related risks, and provides performance measures aligned with the objectives of the plan. The Board conducts an annual review of the Bank's stewardship to take stock of progress and of the overall achievement of the plan's objectives.

Risk management is a fundamental element of governance. The Bank identifies key areas of risk, based on its responsibilities and strategic priorities. In an annual assessment, senior managers examine business, reputational, financial, operational, security, and disaster-recovery risks. They identify and assess risks that could impede the fulfillment of the Bank's

objectives. Cost-effective mitigation strategies are put into place, monitored by management, and reviewed periodically as part of the internal Audit Department's work plan. The Bank's Audit Department reports to the Audit Committee of the Board and meets with the Committee privately to discuss the effectiveness of the internal controls put in place to mitigate risks. The Board of Directors oversees the entire risk-management process.

The Bank has a Financial Risk Office independent of operations. It monitors and reports on risks and investment performance arising from the management of the government's debt and foreign reserves. The Department of Finance and the Bank have oversight responsibilities for the results of this monitoring.

The Bank also has a detailed business-continuity plan in place. This plan has two main objectives: to provide the public with continuity of critical banking operations and to provide for the safety of Bank staff and the protection of other assets.

Transparency through effective and regular communication is another critical part of the Bank's governance framework. Regular appearances by the Governor and Senior Deputy Governor before committees of the House of Commons and the Senate, together with speeches by senior officials, publications, research material, and reports on the website, serve to demonstrate the Bank's accountability in achieving its public policy objectives. The Bank's website <www.bankofcanada.ca> regularly provides information of interest to the public about Bank activities.

Highlights in 2006

A major accomplishment in 2006 was the approval of the new medium-term plan. Through the process leading up to approval of the plan by the Board, management presented possible strategic priorities for the Board's consideration. After several stages of refinement that took account of the Board's guidance on risks and on the financial framework for the plan, a final version was approved for a three-year term. Key elements of the new plan are discussed later in this report.

In light of developing labour market trends, consideration of issues related to the Bank's compensation strategy were the subject of discussions at the Board and with the Executive Management Committee. The context for these discussions is the Bank's human resource framework, which aims to provide staff with competitive levels of pay related to comparable markets, along with distinctive challenges and opportunities and a superior work environment. These issues will continue to require Board attention in 2007. In response to concerns about workload management, Board requirements and other corporate processes were reviewed to identify opportunities for streamlining with the objective of reducing the overall work effort, while maintaining all the information needed for effective decision making.

As part of its oversight responsibility to monitor the effectiveness of the process for formulating monetary policy, the Board met in private session with Special Adviser Bruce Little, one of Canada's most respected financial

Bank Staff

The Bank's 1,200 staff are critical to its success as a knowledge-based organization. While most of the staff are located at the head office in Ottawa, about 100 work at operations centres in Toronto and Montréal. A small number of staff with expertise in economic, financial market, and currency issues are located at regional offices in Vancouver, Calgary, Toronto, Montréal, and Halifax.

In striving to create a work environment where ideas thrive and knowledge is shared, the Bank works hard to provide opportunities for career development and challenging work. Fundamental to this environment is the Bank's support for bilingualism, employment equity, and a balance between work challenges and personal needs. As with many organizations, Bank staff represent a broad demographic of experience; human resource policies are being reviewed to ensure that the Bank can continue to respond to changing workforce needs and interests. For more information, see *About the Bank* at <www.bankofcanada.ca>.

journalists. Mr. Little's communications experience with macroeconomic issues contributed to discussions of transparency and related issues with the Bank's management during a one-year period ending in August 2006. In 2006, the Board also met with representatives of the International Monetary Fund, who provided additional external views on the Bank's capacity to accomplish its monetary policy objectives.

In keeping with the Bank's objective of maintaining best practices in corporate governance, monitoring of external trends, particularly as they relate to Crown corporation governance, has continued, and the structure of this year's annual report reflects enhancements modelled after the best practices of other institutions. Finally, modifications to accounting practices in response to new standards issued by the Canadian Institute of Chartered Accountants were approved.

Board of Directors

The Board of Directors contributes to the governance of the Bank by overseeing all administrative functions, as well as the process by which the Bank ensures the effective formulation of monetary policy.

In addition to the Governor, who by statute chairs the Board, and the Senior Deputy Governor, the Board is composed of 12 independent Directors and the Deputy Minister of Finance (who has no vote but is an important link to the Department of Finance).

The 12 independent Directors are appointed by the Minister of Finance (with the approval of the Governor-in-Council) for renewable three-year terms. In 2006, five new Directors joined the Board, and orientation meetings with Bank staff were held to familiarize Directors with the functions, operations, and plans of the Bank.

As noted earlier, the Board is responsible for reviewing and approving the Bank's corporate objectives, plans, and budget. The independent Directors are also responsible for appointing the Governor and the Senior Deputy Governor to seven-year terms (with the approval of the Governor-in-Council) and for evaluating their performance. An inherent part of the Board's oversight of management effectiveness is its annual review of the Bank's succession plans to ensure continuity of knowledge for the effective ongoing management of the Bank.

In 2006, the independent Directors elected a new Lead Director, Dr. David Barnard. As Chairperson of the Board's Corporate Governance and Nominating Committee, he oversees the corporate governance practices of the Board and the Bank. The Lead Director chairs private meetings of the independent Directors at each Board meeting and leads the annual Board self-assessment process, a tool that facilitates a full discussion of the Board's practices. Dr. Barnard replaced Spencer Lanthier, who completed two terms as a Director, making notable contributions to the Bank's governance since becoming Lead Director in 2003.

To fulfill its responsibilities of governance and oversight, the Board has several permanent committees. In addition to the Executive Committee, provided for in the Bank of Canada Act, there are committees on corporate governance, human resources and compensation,

audit, planning and budget, and pension. As required, Advisory Groups of several Directors provide a forum for discussing issues of particular interest. Three Advisory Groups currently exist to discuss currency, information technology, and pension matters. The Board forms a Special Committee to direct the recruitment process when a new Governor or Senior Deputy Governor must be chosen.

- Executive Committee: Chair, David Dodge (Governor)
- Corporate Governance and Nominating Committee: Chair, Dr. David Barnard (Lead Director)
- Human Resources and Compensation Committee: Chair, Jocelyne Pelchat
- Audit Committee: Chair, Michael O'Brien
- Planning and Budget Committee: Chair, Jean-Guy Desjardins
- Pension Committee: Chair, Paul Jenkins (Senior Deputy Governor)

Directors are paid according to a fee structure recommended by the government, approved by Governor-in-Council and published in the *Canada Gazette*. For 2006, the aggregate remuneration paid to all independent Directors was \$274,400. This remuneration includes payment of annual retainers and per diems (six Board meetings and those of Advisory Groups and Committees noted above) and participation in other Bank-related activities.

BOARD OF DIRECTORS



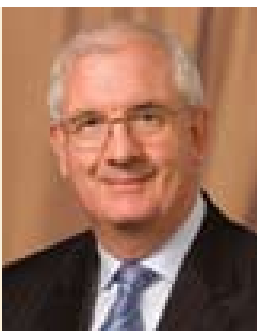
David Dodge
Governor
Appointed in 2001



Paul Jenkins
Senior Deputy Governor
Appointed in 2003



Dr. David T. Barnard
Lead Director
President and CEO, iQmedX
Regina, Saskatchewan
Appointed in February 2005



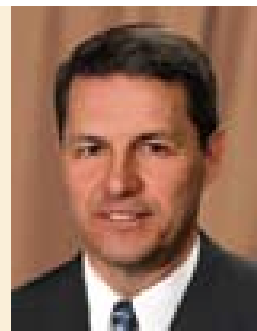
William Black
Corporate Director
Halifax, Nova Scotia
Appointed in October 2006



Philip Deck
Chairman and CEO, MKS Inc.
Toronto, Ontario
Appointed in October 2006



Jean-Guy Desjardins
Chairman and CEO, Centria Inc.
Montréal, Quebec
Appointed in March 2003



Paul D. Dicks
Partner, Benson Myles
St. John's, Newfoundland and Labrador
Appointed in December 2002



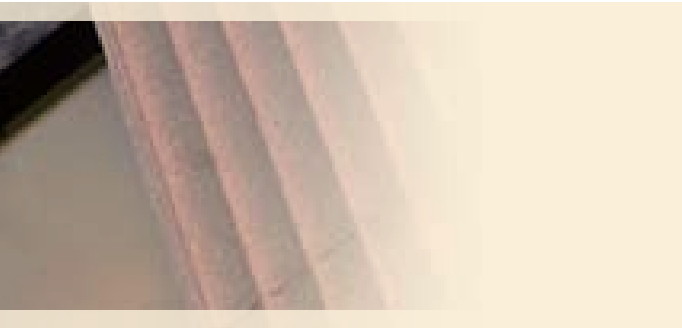
Bonnie DuPont
*Group Vice-President,
 Corporate Resources, Enbridge Inc.
 Calgary, Alberta
 Appointed in October 2006*



Carol Hansell
*Senior Partner
 Davies Ward Phillips & Vineberg LLP
 Toronto, Ontario
 Appointed in October 2006*



Barbara Hislop
*Executive Director
 Variety—The Children's Charity of British Columbia
 Vancouver, British Columbia
 Appointed in March 1998*



Gilles Lepage
*Corporate Director
 Caraquet, New Brunswick
 Appointed in May 2005*



Michael O'Brien
*Corporate Director
 Charlottetown, Prince Edward Island
 Appointed in October 2006*



Jocelyne Pelchat
*President and CEO, Entreprises Pelchat Moïse Inc.
 Sutton, Quebec
 Appointed in February 2005*



Thomas J. Rice
*Chairman, Jovian Capital Corp.
 Winnipeg, Manitoba
 Appointed in June 2005*



Robert Wright
*Deputy Minister of Finance
 Member ex officio*

Governing Council

Under the Bank of Canada Act, the Governor alone is responsible for implementing monetary policy. In practice, however, the Governor shares this responsibility with fellow members of the Bank's Governing Council. The Council works by consensus to formulate, implement, and communicate monetary policy with the support of the Bank's economics and communications departments. A central element of the accountability framework for monetary policy is the agreement between the Bank and the federal government on the inflation-control target. This agreement was renewed on 23 November 2006 for a five-year period

ending 31 December 2011. The inflation target remains the 2 per cent midpoint of a 1 to 3 per cent inflation-control range. Monetary policy decisions on the appropriate setting of the policy interest rate, consistent with delivering the inflation target over the medium term, are normally taken on eight pre-announced fixed dates. The decisions are communicated in press releases and in the *Monetary Policy Report and Update*, which discuss current economic and financial trends in the context of Canada's inflation-control strategy.

The Governing Council is composed of the Governor, Senior Deputy Governor, and the four Deputy Governors.



Governing Council (left to right): David Longworth, Deputy Governor; Tiff Macklem, Deputy Governor; David Dodge, Governor; Sheryl Kennedy, Deputy Governor; Paul Jenkins, Senior Deputy Governor; Pierre Duguay, Deputy Governor



Executive Management Committee (left to right): Sheila Vokey, Chief of the Financial Services Department; David Longworth, Deputy Governor; Tiff Macklem, Deputy Governor; Janet Cosier, Adviser on Strategic Planning and Risk Management; David Dodge, Governor; Mark Jewett, General Counsel/Corporate Secretary; Sheryl Kennedy, Deputy Governor; Paul Jenkins, Senior Deputy Governor; Pierre Duguay, Deputy Governor; Sheila Niven, Chief of the Corporate Services Department

Executive Management Committee

The Bank's Executive Management Committee provides the direction and guidance required to carry out the Bank's responsibilities, oversees all the operations of the Bank, and decides on broad organizational, financial, and strategic issues to be recommended to the Board of Directors for approval.

Financial System Committee

The Financial System Committee reviews issues relating to the domestic and international financial systems, and formulates policy in areas specific to the Bank's responsibilities on matters of general principle, oversight policy, and risk/efficiency trade-offs.

The Committee is composed of all members of the Governing Council, along with the General Counsel/Corporate Secretary; the Adviser, Regulatory Policy; and the Chief of Communications.

MONETARY POLICY

It has been 15 years since Canada adopted an inflation-targeting framework to guide its monetary policy. During this time, consumer price index (CPI) inflation has been reduced to a low, stable, and predictable level of close to 2 per cent, real output has expanded at an average rate of 3 per cent per year, and the unemployment rate has fallen to 30-year lows.

*Joint Statement of the Government of Canada and the Bank of Canada
on the Renewal of the Inflation-Control Target
23 November 2006*

Experience in Canada and elsewhere has shown that the best contribution monetary policy can make to the economic well-being of households and businesses is to follow a strategy aimed at delivering low, stable, and predictable inflation. This objective is pursued not as an end in itself, but as a means of promoting sustainable economic growth and stability. The inflation-targeting framework introduced in 1991 is designed to facilitate the achievement of this objective, and to improve the Bank of Canada's accountability, by specifying an explicit target for the annual rate of increase in the consumer price index (CPI). In November 2006, the Government of Canada and the Bank of Canada renewed Canada's inflation-control framework for a further five-year period, maintaining the inflation target at the 2 per cent midpoint of a 1 to 3 per cent control range.

Monetary policy in Canada was quite successful in 2006, but was not without significant challenges. Although CPI inflation remained within the inflation-control range for most of the year, and averaged 2 per cent, the macroeconomic environment required some adjustment of the Bank's primary monetary policy instrument: the overnight interest rate.

In 2006, as throughout the 2003–06 medium-term plan, the Bank analyzed economic and financial developments, undertook high-quality research, and communicated clearly and openly. Priorities over the duration of the plan and for 2006 included deepening the analysis of sectoral developments, enhancing the Bank's projection models, improving its understanding of external developments and their implications for the Canadian economy, and assessing Canada's experience with targeting inflation.

Meeting the Inflation Target

The major challenge for monetary policy during 2006 was to keep the macroeconomy in balance and CPI inflation close to the 2 per cent target, while facilitating the adjustment that was under way across many economic regions and sectors of the country. As the year began, the Canadian economy was judged to be operating close to its production capacity, and unemployment was hovering near 30-year lows. During the first five months of 2006, the overnight interest rate was raised on four successive occasions, withdrawing some of the monetary stimulus that had been introduced earlier to help the economy respond to external shocks.

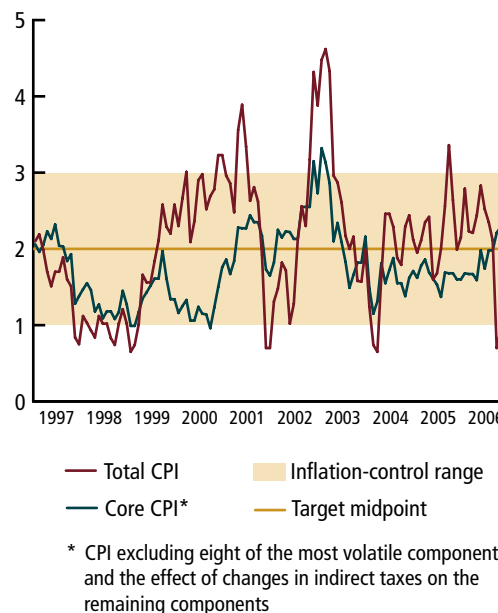
Although the economy was judged to be operating with slight excess demand by mid-year, the Bank decided to leave the target overnight interest rate unchanged at 4.25 per cent at its July fixed announcement date and through the rest of the year. The Bank's baseline projections, incorporating a balanced view of the risks, suggested that this level of the overnight interest rate was consistent with achieving the 2 per cent inflation target over the medium term. In its annual examination of the Canadian economy, the IMF commented that "The Bank of Canada has adroitly balanced ... competing risks, and has appropriately left rates on hold since May."¹

Inflation, as measured by the 12-month growth rate of the CPI, was quite volatile over 2006, moving from a high of 2.8 per cent in January to a low of only 0.7 per cent in September, and then rebounding to an average rate of 1.5 per cent through the final months of the

year (see chart). Most of the variability through this period was related to dramatic movements in oil and natural gas prices. But the sharp decline in inflation recorded in the second half of the year reflected the combined influence of a one-percentage-point reduction in the Goods and Services Tax that became effective in July and the spike in energy prices a year earlier in the wake of Hurricane Katrina.

Consumer Price Index

Year-over-year percentage change



Core inflation, which excludes eight of the most volatile components of the CPI, as well as the effects of changes in indirect taxes, followed a very different track. It remained within a narrow range of 1.6 to 2.0 per cent during the first half of 2006, and then rose to a high of 2.2 per cent in the final quarter, in response to a strong economy and rising housing prices.

1. *Preliminary Conclusions of the IMF Mission, 2007 Article IV Consultation with Canada, 7 December 2006*

Achieving the Bank's objectives for the target overnight interest rate posed challenges in the spring, when there was strong downward pressure on the rate on overnight loans secured by government collateral. To reinforce its objectives for the overnight interest rate, the Bank undertook numerous sale and repurchase agreements (SRAs) and announced that it would typically leave the level of balances at zero and would not commit to neutralizing the effect of the SRAs. As the downward pressure on collateralized loan rates continued, the Bank occasionally left the level of settlement balances in the system in deficit after undertaking SRAs. These cost incentives encouraged market participants to trade overnight funds at levels closer to the target rate.

Renewing the Inflation-Control Target

On 23 November, the Bank of Canada and the Government of Canada renewed Canada's inflation-targeting framework for another five years. While the main elements of the inflation-targeting framework remain unchanged, research was undertaken on several related issues in anticipation of the renewal, with a view to strengthening and clarifying the manner in which the framework is applied. Three issues received special attention: the role of core inflation measures; the time horizon over which policy-makers should aim to return inflation to target following a shock; and the recognition that should be given to asset prices in the context of inflation targeting.

The background document published by the Bank of Canada at the time of the renewal also indicated the need for further research

on the type of policy framework that would best contribute to the economic well-being of Canadians in the decades ahead. Two issues were highlighted. The first was, what are the costs and benefits of an inflation target lower than 2 per cent? The second was, what are the costs and benefits of replacing the current inflation target with a longer-term, price-level target? Over the next three years, the Bank plans to lead a concerted research effort focused on these broad questions. Other researchers are invited to join in this effort. The goal is to complete this research before 2011 to ensure enough time for discussion of the results and their implications.

Assessing International and Domestic Developments

The formulation and implementation of monetary policy requires comprehensive and detailed monitoring of international and domestic developments, as well as longer-term research. Information is drawn from Statistics Canada and from many international sources, as well as from outreach programs and frequent meetings with representatives of Canadian industry and labour. This is combined with the Bank's own work, including surveys conducted by the five regional offices, to get a clearer view of current economic conditions in Canada and the world and of their likely future paths.

Staff projections and the Bank's short-term monitoring of the Canadian economy also rely on econometric models. The most important of these is ToTEM (Terms-of-Trade Economic Model), the Bank's new dynamic stochastic general-equilibrium model, which came into



Regional outreach: Peter Kinley (left), President of Lunenburg Industrial Foundry & Engineering, shows Deputy Governor Tiff Macklem (centre) and Senior Regional Representative David Amirault around the company's shipyard in Lunenburg, Nova Scotia, June 2006.

full use at the start of 2006.² ToTEM is used for forecasting, risk assessments, and policy simulations of the Canadian economy. Two other large models, MUSE and GEM, provide information on the evolution of the U.S. and global economies.³

Issues that received particular attention in 2006 include the macroeconomic risks

associated with changing distributions of household debt; the determinants of potential output and productivity growth; the linkages between the financial and real sectors of the economy; the responsiveness of exports and imports to exchange rate movements and income growth; and the determinants and consequences of sectoral and regional adjustment in Canada.

2. See the article "ToTEM: The Bank of Canada's New Projection and Policy-Analysis Model," in the autumn 2006 issue of the *Bank of Canada Review*, for more information.

3. MUSE stands for Model of the U.S. Economy, and GEM stands for Global Economy Model.

Carrying Out Longer-Term Research

Not all of the Bank's analytic resources are devoted to monitoring and forecasting activities. Longer-term research is equally important. It improves our understanding of how economies operate and how they are likely to respond to various policy initiatives.

Over the period of the 2003–06 medium-term plan, these research activities have focused on such important topics as determinants of price and wage behaviour in Canada; the effects of productivity growth and shifting demographic trends on potential output; and sectoral adjustments to external shocks. Much of the research effort through 2005 and 2006, however, was directed towards identifying possible

Bank of Canada Fellowship Program

Launched in 2002, the Bank's Fellowship Program is designed to recognize and encourage leading-edge research in areas critical to the Bank's mandate: macroeconomics, monetary economics, international finance, and the economics of financial markets and institutions (including issues related to financial stability). Successful candidates receive an annual stipend for a renewable five-year period, together with

additional funds for research assistance and related expenses.

The 2006 Fellowship was awarded to Professor Gregor Smith, who is recognized internationally for his work in empirical macroeconomics, open-economy macroeconomics, and economic history. With this appointment, there are now five Fellows participating in the program.



Fellowship award for 2006 (left to right): Senior Deputy Governor Paul Jenkins, Governor David Dodge, Professor Gregor Smith of Queen's University (Fellowship recipient), and Dr. David Barnard, Director and Chair of the Nominating Committee



improvements to the Bank's inflation-targeting framework and related issues, in anticipation of the target renewal. These and other areas of interest are described in greater detail on the Bank's website at <www.bankofcanada.ca/en/fellowship/highlights_res_06.html>.

The Bank's research efforts benefit from outside commentary and insights, and from partnerships with external authors. This infusion of ideas and the active debate that it sometimes

generates, have been aided by an ambitious program of external publications and the active participation of Bank staff in numerous conferences, seminars, and workshops. Some of these have been organized by the Bank, others were hosted by universities, research institutes, and other outside bodies. During 2006, Bank staff published 21 papers in refereed journals and books, 49 working papers, made 167 external presentations, and hosted 11 conferences and workshops at the Bank of Canada.

CURRENCY

The Bank of Canada is responsible for supplying Canadians with bank notes they can use with confidence. The past year was the last of the Bank's 2003–06 medium-term plan, which focused on increasing the intrinsic security of bank notes, building awareness of new security features, and promoting counterfeiting deterrence by law-enforcement agencies and the justice system.

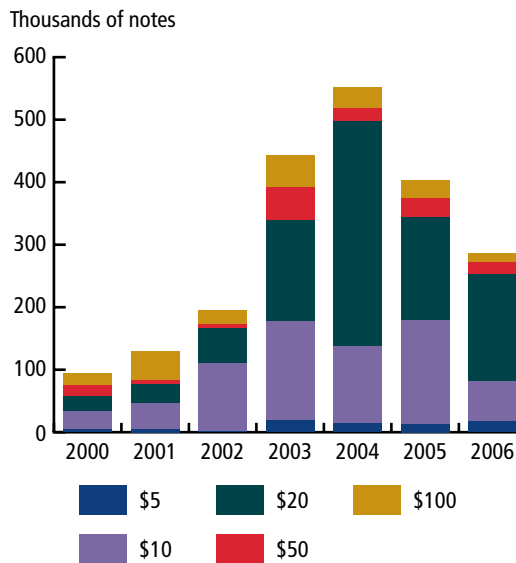
The Bank has made significant progress on these three fronts: it launched the new *Canadian Journey* series notes with state-of-the-art security features, built partnerships with the retail industry, and raised awareness in the law-enforcement and judicial communities of the seriousness of counterfeiting as a crime. As a result of these efforts, counterfeiting has fallen significantly in the past two years. As part of its new 2007–09 medium-term plan, the Bank is targeting a further reduction in counterfeiting. It will develop a new series of bank notes that will be even more difficult to replicate. It will also work to increase note verification by retailers, further counterfeit deterrence, and improve the efficiency and effectiveness of the note-distribution system.

Getting Results: Incidence of Counterfeiting

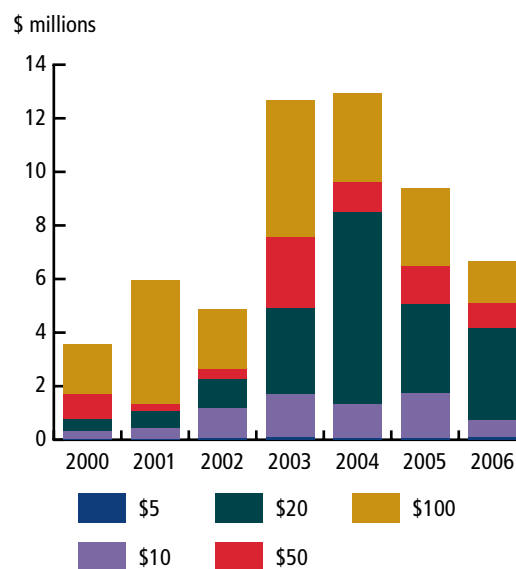
For the second year in a row, the *value* and *number* of counterfeit notes detected in circulation fell significantly, to \$6.7 million (287,088 notes) in 2006, from \$9.4 million (402,568 notes) in 2005 and \$12.9 million (552,700 notes) in 2004. The decline in counterfeiting primarily reflects the issuance of the more secure *Canadian Journey* series notes and the success of law-enforcement agencies in dismantling a number of counterfeiting operations. As well, the courts have become less lenient on counterfeiting as a crime, and substantial progress has been made in improving retailers' verification practices. In its new

medium-term plan, the Bank aims to reduce counterfeiting to fewer than 100 detected counterfeit notes per million notes in circulation by 2009, from 221 in 2006 and 326 in 2005.

Number of Counterfeit Bank Notes Found in Circulation



Value of Counterfeit Bank Notes Found in Circulation



Enhancing Bank Note Security

As part of its strategy to supply Canadians with secure bank notes, the Bank issued an upgraded *Canadian Journey* series \$5 note on 15 November 2006. With this new \$5 note, all *Canadian Journey* series notes now carry the security features introduced in 2004, including a metallic holographic stripe, a watermark portrait, a windowed colour-shifting thread woven into the paper, and a see-through number. The Bank continues to recommend checking more than one security feature.

In 2006, the Bank applied its research and development efforts to the next generation of bank notes and mapped out an ambitious plan to begin issuing a new note series with significantly improved security features by 2011 at the latest. Work has begun on developing and testing generic bank note designs and on simulating the performance of bank notes in circulation.

Counterfeiting is a threat to currencies around the world, and it demands a coordinated international response. The Bank is actively involved in a number of initiatives with other central banks, the security industry, and equipment manufacturers. The Bank is also a member of the Central Bank Counterfeiting Deterrence Group. This group of 27 central banks is deploying counterfeit-deterrence systems and identifying future international threats and possible responses.

The Art and Design of Canadian Bank Notes

Bank notes are the most tangible connection between the central bank and the public it serves. A bank note is a medium of exchange, a cultural artifact, a national symbol, and a communication vehicle, and it must be secure against counterfeiting. When all these elements are considered, the design and production of a bank note is a formidable challenge.

The Art and Design of Canadian Bank Notes is the second in a series of books about the Bank of Canada. This journey behind the scenes explores the demanding world of bank note design, highlighting the beauty of Canada's bank notes and celebrating the engraver's art.

This book can be purchased through the Bank's website at www.bankofcanada.ca or at the Currency Museum in the Bank of Canada's head office building in Ottawa.



Building Awareness of Security Features

Security features are effective only when people use them to authenticate notes. Through its regional offices, the Bank delivers training and information sessions to retailers across the country and works with the media to increase awareness of the security features used on bank notes. The Bank works closely with the RCMP and other Canadian law-enforcement agencies in developing and delivering education and awareness programs to help deter and prevent

counterfeiting. Online materials and a training module are available at www.bankofcanada.ca/en/banknotes/education.

The Bank conducts surveys of bank note usage, including retailers' verification practices. Results from these surveys are posted on the Bank's website at www.bankofcanada.ca/en/banknotes/survey and are used to help formulate strategies for training and communication. The Bank has also started to conduct research on the ease with which security features can be used to authenticate bank notes.

During the year, the Bank's Currency Museum in Ottawa continued to play an important role in educating the public about bank notes and counterfeit detection, in addition to maintaining the National Currency Collection and promoting an understanding of the Bank's role in Canada's economy. Approximately 37,000 people visited the Museum's exhibitions or took part in school programs in Ottawa, and an impressive 182,500 people participated in outreach programs outside Ottawa.

For its new medium-term plan, the Bank developed a new bank note communication strategy, which will be directed towards both parties involved in a cash transaction: the retailer and the customer. It will encourage retailers to check bank notes as an integral

part of their daily routine and will promote public awareness of that behaviour as a prudent practice that benefits everyone.

Promoting Compliance

The Bank assists in the deterrence and apprehension of counterfeiters through its compliance program. This program focuses on

- increasing recognition of counterfeiting as a serious crime by raising awareness of its social and economic consequences
- providing police officers and Crown prosecutors with information and material to facilitate the investigation and prosecution of counterfeiting offences



RCMP officer demonstrates security features at Vancouver's Agribition.



Deputy Governor Pierre Duguay presented the Law Enforcement Award of Excellence for Counterfeit Deterrence to Sergeant Mary Kostashuk from RCMP "E" Division Commercial Crime Section in British Columbia and Constable Kurtis Bosnell from the Upper Fraser Valley Regional Detachment of the RCMP. Their efforts resulted in the shutdown of a major operation and the conviction of its leader. From left to right: Deputy Governor Pierre Duguay, Sergeant Mary Kostashuk, RCMP Commissioner Giuliano Zaccardelli, and Constable Kurtis Bosnell.

In 2006, the Bank increased the reach and effectiveness of its compliance program.

An important element of this program involves working with the federal Department of Justice and the provincial Attorneys General to support prosecution efforts by providing background material on trials and sentencing precedents. Increasingly, an affidavit on the prevalence and impact of counterfeiting is being used successfully in the sentencing of persons convicted of counterfeiting. These resources are posted on the Bank's website at www.bankofcanada.ca/en/banknotes/legal_resources.html.

Maintaining the Quality of Bank Notes in Circulation

The bank note distribution system, developed in partnership with financial institutions, provides for the joint management of the flow of notes among these institutions. It enables the Bank to remove worn and counterfeit notes from circulation and to provide an adequate supply of quality bank notes. Branches of financial institutions ship their unfit and surplus notes to their regional distribution centres, which hold fit notes on behalf of the Bank and send unfit notes to the Bank's

operations centres for processing. Liaison with staff of the financial institutions at regional distribution points is maintained by the Bank's regional representatives. During 2006, the Bank examined ways of enhancing the distribution system to improve the condition of notes in circulation.

With help from Canadian financial institutions, the Bank conducted an aggressive program to replace bank notes from earlier series with the new *Canadian Journey* series. It is estimated that at the end of 2006, 87 per cent of all notes in active circulation (excluding the newly upgraded \$5 denomination) were from the new series.

In conjunction with the RCMP and the financial institutions participating in the bank note

distribution system, the Bank implemented a new process to speed the collection and processing of counterfeit bank notes removed from circulation. This process provides the Bank with more timely information on the incidence of counterfeiting and lets law-enforcement agencies focus on investigative work rather than the administrative matters involved in handling counterfeit notes. This has proven very valuable to all participants.

The Bank has begun a program to upgrade its note-processing infrastructure. This will provide additional capability and flexibility in processing notes, while ensuring efficiency and reducing risks. Important work was also carried out to strengthen contractual relationships with suppliers.

FINANCIAL SYSTEM

The Bank of Canada promotes the safety and efficiency of the financial system by providing unique banking services, including a lender-of-last-resort facility, by overseeing key domestic clearing and settlement systems, by conducting and publishing research, and by providing advice to various domestic and international policy-making bodies.

The activities of the financial system function over the past four years have been guided by the Bank's medium-term plan that ended in 2006. The Bank has improved its capacity to carry out the oversight of major clearing and settlement systems. It has conducted research on the operations of clearing and settlement systems, the risks associated with increased cross-border linkages in securities markets and securities-settlement systems, macrofinancial stress testing, the monitoring of systemic risk, forecasting financial stress, and the workings of a broad range of financial markets. This work has supported the Bank's policy advice on legislation, regulations, and practices affecting financial institutions, financial markets, and financial infrastructure arrangements. The Bank has led improvements in the continuity

of operations in critical parts of the domestic financial system and has reduced its operational risk in the provision of payment services and other related banking activities. It has also played a leadership role in bringing forward and promoting proposals to improve the safety and efficiency of the international financial system.

In 2006, the Bank's analysis and research focused on the risk and efficiency issues facing the domestic financial system. The Bank also participated in multi-country groups to address issues related to the safety and efficiency of the international financial system, including the reform of the International Monetary Fund to reflect global economic realities.

Promoting Safety and Efficiency in the Financial System

The Bank supports financial system efficiency by conducting and publishing research and by providing advice to domestic and international policy-making bodies. It works with other regulatory and public sector agencies, financial sector participants and their associations, and academics. During 2006, research was concentrated on the transparency of fixed-income, derivative, equity, and foreign exchange markets; on conducting research on macro-financial stress testing and the assessment of potential risks posed by cross-border linkages among clearing and settlement systems; and on examining the productivity and efficiency of the Canadian banking system.

In 2006, the Bank continued to actively support work that promotes international financial stability. It played a leadership role in the international debate on the reform of international financial institutions, particularly the International Monetary Fund. The Bank's work reflects a desire for the IMF to remain a key player in international financial matters and a need to realign IMF operations with changing global economic realities. The Bank has carried out research and analysis on the governance of the IMF, as well as its surveillance and lending activities. This has involved joint studies with the Department of Finance and other central banks. This work has been underpinned by collaborative research with the Bank of England and has been communicated in international forums and in articles aimed at the policy-making community. In addition, the Governor

of the Bank of Canada addressed the Executive Directors of the IMF on its potential reform.

The Bank also participates in international groups, such as the G-7 and G-20, the Financial Stability Forum, and several committees and working groups of the Bank for International Settlements. These groups address a wide range of topics, including assessments of potential risks to the financial system; the oversight and development of payments systems; arrangements for continuity of operations for key parts of financial systems in a cross-border context; issues associated with changes in asset allocation by pension funds and insurance companies; housing finance; and the consequences of China's emergence as a major economic power and its integration into world trade and other cross-border arrangements. The Bank also continues to provide technical assistance to other countries by participating in various IMF activities.

In response to international developments, changing perceptions of best practices, and domestic imperatives, the Bank continues to work with the operators and participants of systemically important Canadian clearing and settlement systems in their efforts to enhance arrangements for continuity of operations. These systems are at the centre of Canada's financial system, and serious economy-wide repercussions could arise if their operations were not extremely reliable. In 2006, the operators of these systems took further steps to make their continuity of operations more robust by locating business staff at separate sites and by improving their ability to recover from

Canada's Systemically Important Clearing and Settlement Systems

All systemically important clearing and settlement systems processed record daily volumes and/or values during 2006.

Large Value Transfer System (LVTS):

Operated by the Canadian Payments Association. Handles large-value or time-sensitive Canadian-dollar payments. Average daily number of transactions: 19,000. Average daily value of transactions: \$166 billion. Records for daily volume and value were registered in 2006: 31,000 transactions and \$253 billion in value.

CDSX: Operated by the CDS Clearing and Depository Services Inc. Settles virtually all debt and equity trades in Canada. Average daily number of trades settled: 391,000. Average daily gross value of trades settled: \$232 billion. A record daily volume was registered in 2006: 684,000 transactions.

CLS Bank: Operated by CLS Bank. Settles foreign exchange transactions in 15 currencies. Average daily number of instructions settled: 252,000. Average daily value settled: US\$2.7 trillion. Records for daily volume and value were registered in 2006: 502,000 instructions and US\$5.5 trillion in settled instructions.

severe operational disruptions more quickly than the current target of two hours.

The Bank is the sole provider of unique services to these systems and continued to move on two fronts to strengthen its ability to supply these services on an extremely reliable basis. The first involves the multi-year redevelopment project

to modernize both the business application and the supporting infrastructure for providing banking services to financial institutions.

While completion of this project was expected in 2006, the need for additional testing of the business application and the challenges experienced in setting up the required infrastructure have postponed the planned implementation. The Bank also continued to examine its own arrangements for continuity of operations. In 2005, the Bank completed its three-year effort to improve the ability of its backup site to respond effectively to serious operational disruptions. Testing during 2006 revealed some shortcomings that are being addressed as a high priority.

In addition, the Bank has continued to communicate its views on the crucial role of systemically important clearing and settlement systems to provincial organizations responsible for determining the priority of these systems to access essential inputs such as hydro, diesel fuel, or municipal services during a seriously disruptive event. It also worked with these organizations on this issue by, for example, participating in exercises to simulate the management of shortages of critical inputs.

Under the Payment, Clearing and Settlement Act (PCSA), the Bank is responsible for the oversight of systemically important clearing and settlement systems. These systems enable the daily transfers of funds and other financial assets worth hundreds of billions of dollars, such as foreign exchange or securities, among their participants or among the customers of system participants. The Bank's objective is to be satisfied that the risk-control mechanisms in these systems virtually eliminate the possibility

that a disruption in their operation, caused by a participant failure or otherwise, could have severe repercussions across the financial system and the economy as a whole.⁴

The focus of the Bank's oversight activities during 2006 was on: (i) implementation of a memorandum of understanding with the Canadian Payments Association that describes how the two organizations intend to work together towards the common goal of a safe

and efficient large-value payment system; (ii) analysis of the impact of the corporate restructuring of The Canadian Depository for Securities Limited on the risks and risk-containment mechanisms in CDSX; and (iii) continuing joint work with the supervisor of Canadian banks to bring about greater use of the CLS Bank by these banks for the settlement of foreign exchange transactions, which is now considered best practice for mitigating foreign exchange settlement risk.



Deputy Governor Pierre Duguay (left) and Guy Legault, President and CEO of the Canadian Payments Association, sign memorandum of understanding, November 2006.

4. See "The Bank of Canada's Role in Clearing and Settlement Systems," *Financial System Review* (June 2006)



Meeting of the Financial System Review Steering Committee

Conducting and Communicating Research

Promoting an active debate and a public policy focus on issues affecting the financial system is a key component of the Bank's work. It publishes its semi-annual *Financial System Review* and hosts conferences and workshops to raise awareness and promote discussion of financial system issues. The *Financial System Review* has evolved since it was first published in December 2002. A survey of readers conducted in 2006 suggests that, overall, they are satisfied with the publication. Nevertheless, the Bank intends to sharpen the *Review's* focus over the

next few years. Beginning in June 2006, the Bank decided to use the *Financial System Review* as the primary vehicle for reporting on its oversight activities related to the design and operation of systemically important clearing and settlement systems.

In 2006, the Bank held workshops on topics related to the functioning of financial markets, including a joint workshop with the Norges Bank on the microstructure of foreign exchange and equity markets. A conference on fixed-income markets was held in May 2006. A joint workshop with the Department of Finance examined IMF-related issues, and



the Bank actively pursued these topics with other central banks and at a variety of conferences. The Governor also continued to host quarterly meetings of heads of regulatory authorities in securities markets. The Bank made submissions to the Investment Dealers Association's Task Force to Modernize Securities Regulation in Canada and to the Canadian Securities Administrators on issues related to securities markets.

The Bank's research addressed such topics as

- modelling LVTS payment activity to assess trade-offs between liquidity and collateral

costs and to assess the impact of a participant default in this system

- the development of tools to assess risks in the financial system and further work on approaches to macrofinancial stress testing
- continued analysis of how Canadian banks manage foreign exchange settlement risk
- the market microstructure in fixed-income and foreign exchange markets
- the efficiency of the Canadian banking system

Much of this work was published as working papers or in economic journals.

FUNDS MANAGEMENT

The Bank's funds-management activities are related to its role as fiscal agent for the federal government and to the banking activities that it undertakes on its own account and on behalf of other central banks and international financial organizations.

Over the 2003–06 medium-term plan, the Bank improved the cost-effectiveness and efficiency of its operations. Several initiatives have been implemented to maintain the liquidity and efficiency of the market for Government of Canada bonds in the face of declining government debt. Overall, the debt-management program has been strengthened to ensure that it keeps pace with innovation and the evolving roles of intermediaries and investors. The governance and oversight structure for all funds-management activities were significantly enhanced. Systems for monitoring and measuring risk and performance have been steadily upgraded in the management of official international reserves. Partnerships with reserve and risk managers at other central banks, sovereign debt agencies, and private sector institutions have been expanded. Operational costs for retail debt continued to be driven down over much of the period, and a significant restructuring of the business functions that support the retail debt program was begun. With regard to the Bank's own account, the investment activities of its pension fund were reviewed in the context of a comprehensive asset-liability framework,

and several improvements were made to its investment policy.

Acting as Fiscal Agent

The Bank's role as fiscal agent to the federal government covers a range of activities: wholesale government debt management, government liquidity management, investment of financial assets, providing related banking services, monitoring risks arising from its fiscal-agent activities, and providing various services to the government's retail debt program.

The objective of the federal government's wholesale domestic debt and cash-management is to raise stable and low-cost funding to meet operational needs. This is facilitated by maintaining a well-functioning market in Government of Canada securities. In 2006, bond buybacks were higher than forecast, with buybacks and switch operations totalling \$10.9 billion supporting gross bond issuance. Increased recognition of the degree of substitutability between the newly issued 2-year benchmark bonds and existing bond issues carrying the same maturity date allowed the issuance of more bonds with

longer-dated maturities. For bonds with 5-year maturities, changes were introduced to the issuance cycle that will further increase the substitutability between existing bonds and newly issued benchmarks. On a number of occasions in 2006, the Bank lent securities off of its balance sheet on a fully collateralized basis under the securities-lending program. Under this program, which was established in 2002, the Bank supports the liquidity of the market for Government of Canada securities by providing a secondary and temporary source of securities for a specific maturity when there is a strong demand for these securities.

The plan to meet the government's objective of reducing the share of fixed-rate debt to 60 per cent in 2007–08 is on track, and the stock of bonds declined in 2006 by \$2.3 billion to \$252.4 billion. The stock of treasury bills decreased by \$2.4 billion to \$124.7 billion. Further efficiency gains in auctions were also realized as turnaround times were reduced from an average of 1.99 minutes in 2005 to 1.89 minutes in 2006 for regular auctions, and from 3.95 minutes to 3.07 minutes over the same period for buybacks and switches.

The Bank's treasury-management operations are directed to ensuring that funds are available to meet the daily operating requirements of the federal government and to minimize the cost of holding unused cash balances. Improvements in cash-management techniques resulted in the average balances of the Receiver General declining from \$7.6 billion in 2005 to \$6.6 billion in 2006.

Canada's official international reserves, held mainly in the Exchange Fund Account (EFA), are maintained to provide foreign currency liquidity and to provide funds, if required,

to help promote orderly conditions for the Canadian dollar in foreign exchange markets. At year-end, official international reserves totalled US\$35.1 billion, an increase of US\$2.0 billion over the previous year-end. The assets of the EFA are funded principally through an ongoing program of cross-currency swaps of domestic obligations. Securities denominated in foreign currencies are also issued to fund reserves. In 2006, the nominal value of the gross issuance of cross-currency swaps was US\$4.8 billion. This was partially offset by maturing debt and maturing cross-currency swaps of US\$2.9 billion. The return for the EFA net of its associated liabilities during the calendar year, taking into account all valuation gains or losses whether realized or not, was 52 basis points, reflecting movements in interest rate spreads for both assets and liabilities.

The Bank's risk-management activities involve monitoring and reporting risks that arise from the operations it undertakes as fiscal agent to the government. The Bank uses market-based, risk-measurement tools that are consistent with best practices in the central banking community and the financial sector. In 2006, the Bank enhanced its risk-management tools by implementing a new system to track the frequency and severity of operational risk events and by introducing some new liquidity-risk stress tests. The governance structure, which delineates accountability and decision-making structure, was also strengthened further.

Through 2006, the Bank continued its medium-term objective of increasing research and analysis in support of its fiscal-agent responsibilities. Research included a debt-modelling project. Policy advice was primarily directed at supporting the Crown Corporation Funding

Consolidation study and addressing issues of bond market liquidity.

The Bank was also involved in two Treasury Evaluation Program reviews, which pertained to the EFA and the management of Receiver General cash balances. Both programs were found to be effective in meeting their stated objectives.

Provision of services to the government's retail debt program was directed towards promoting cost reduction. In this respect, the major development in 2006 was the decision by the government to wind down Canada Investment and Savings Agency (CI&S) by 31 March 2007 and to consolidate additional retail debt functions relating to sales, distribution, and marketing within the Bank's fiscal-agent responsibilities. This change is expected to reduce total government expenditures for the retail debt program. In addition, the Bank continued to work with the Canadian Payments Association and its members on the inclusion of retail debt certificates in the cheque-imaging initiative launched by the Canadian Payments Association.

Other Funds-Management Activities

The governance structure for managing the Bank's balance sheet was strengthened through the formalization of an investment policy covering the assets of the Bank (see www.bankofcanada.ca/en/about/corp.html).

The assets of the Bank are invested primarily in a range of Government of Canada treasury bills and bonds with a range of maturities that closely matches the maturity profile of the government's debt.

The investment framework of the Bank's Pension Trust Fund continued to be adjusted to reflect a better match of pension assets to pension liabilities, a process that has been under way for the past three years. More use has been made of external managers who direct their trading activities to exceeding the total return of an index on a risk-adjusted basis. This has been associated with a more rigorous review and selection process for external managers.

Banking services to other central banks and to international organizations increased by 3 per cent in 2006. The Bank also undertakes transactions with chartered banks and federally chartered trust and loan companies arising from the requirement that these institutions must transfer to the Bank all unclaimed balances maintained in Canada in Canadian currency that have been inactive for a period of 10 years. The owners of these accounts can have their money returned once they provide the Bank with proof of ownership. In 2006, financial institutions transferred \$38 million in unclaimed balances to the Bank. There were approximately 33,000 general enquiries, and the Bank paid out or returned a total of \$10.7 million to satisfy 7,000 claims.

The Retail Debt Program

The federal government's two retail debt instruments are Canada Savings Bonds (CSBs), which are redeemable at any time, and Canada Premium Bonds (CPBs), which are typically issued at a higher interest rate but are redeemable only annually. There are several ways to buy these bonds: through a network of sales agents; through organizations sponsoring the Payroll Savings Program; and through direct sales by telephone or via the Internet.

The 60th anniversary of the Canada Savings Bond program was celebrated in October 2006 at the Museum of Civilization in Gatineau. New designs for the bond certificates were launched to commemorate the anniversary.



Left to right: Finance Minister James Flaherty; Mrs. Jean Spear, Canadian war bride; and Governor Dodge



LOOKING AHEAD

Medium-Term Plan 2007–09

The Bank's vision for fulfilling its responsibilities is to be second to none among the world's central banks. The year 2007 is the first year of the Bank's new medium-term plan. The plan builds on the accomplishments of the previous plan, which focused on innovative research and the integration of that research into analysis to support the Bank's policy decisions; strengthening our partnerships; and enhancing the effectiveness of our communication.

The Bank's new plan has three Bank-wide priorities involving investments over the three years of the plan:

- renewing our infrastructure
- creating a superior work environment
- staying at the forefront of good governance to preserve the trust of Canadians in our ongoing stewardship of the Bank

To attract and retain qualified and talented staff, the Bank's human resource strategy offers distinctive challenges and development opportunities, competitive total compensation, and a distinctive work environment.

This section outlines the Bank's desired outcomes and the strategies to achieve them over the medium term, as well as the priorities for 2007. The complete medium-term plan,

approved by the Bank's Board of Directors, is available on the Bank's external website at www.bankofcanada.ca/en/pdf/mtp_2007-09e.pdf.

Monetary Policy

Desired Outcome: Contribute to Canada's solid economic performance and to rising living standards for Canadians

Strategy to Achieve Desired Outcome: Keep inflation low, stable, and predictable by the use of a clearly defined inflation target

Outcome Goals: Achieve a 2 per cent target for total consumer price inflation and recommend a monetary policy framework that will deliver the greatest contribution to economic performance in the future

Priority will be given to the following topics in 2007 and over most of the medium-term plan:

- research the costs and benefits of a lower inflation target and the costs and benefits of a price-level target
- improve our understanding of the process and implications of globalization
- carry out a more extensive investigation of real and financial linkages in the monetary policy transmission mechanism
- analyze sectoral and regional adjustments to large relative price shocks and other major disturbances
- reassess potential output growth in the context of changing demographics and shifting productivity trends
- explore the bounds of transparency and enhance the Bank's communications

Currency

Desired Outcome: Canadians use bank notes with confidence

Strategy to Achieve Desired Outcome: Reduce counterfeiting below a clearly defined threshold

Outcome Goal: Reduce counterfeiting to below 100 detected counterfeits annually for each million genuine notes in circulation by 2009

To achieve the desired outcome, four priority areas will be pursued over the next three years:

- develop a significantly more secure next generation of bank notes, and begin issuing new series in 2011

- increase verification by retailers
- fully engage prosecutors, law-enforcement officers, and other participants in the judicial system to improve counterfeit deterrence
- replace notes from older series, and improve the efficiency and effectiveness of note operations

In 2007, the Bank will:

- conduct research on security features, theme, and design of next generation of bank notes, while continuing to evaluate various substrates
- further its understanding of bank note usage, counterfeiting behaviour, and alternative payment methods and technologies
- redirect education efforts to engage retailers in authenticating bank notes
- continue to support and promote counterfeit deterrence
- replace notes from older series, and enhance the bank note distribution system
- refurbish aging note-processing equipment

Financial System

Desired Outcome: Contribute to maintaining a stable and efficient financial system in Canada

Strategy to Achieve Desired Outcome: Provide essential banking services and influence public sector agencies and private sector behaviour to improve the safety and efficiency of the financial system

Outcome Goals: Contain systemic risk; produce influential research, analysis, and policy advice; and provide reliable banking services

The priorities over the medium term are:

- implement a strategy to improve the collection and use of financial data
- enhance emergency preparedness at a second site
- develop a framework to assess financial system stability
- examine the efficiency of the Canadian financial sector

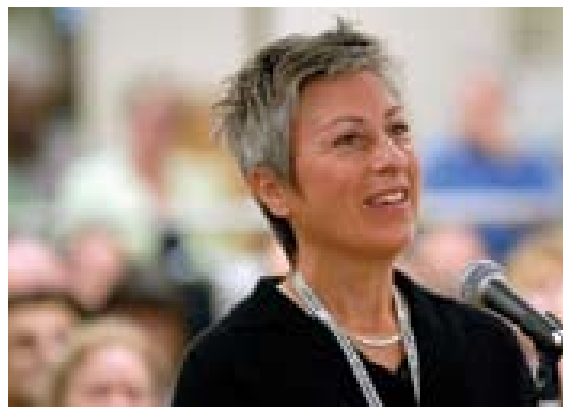
In 2007, the Bank intends to:

- work towards completion of the new business application for banking services and strengthen the resiliency of the systems that support banking operations
- carry out further research on the cross-border linkages among clearing and settlement systems for payments and securities
- analyze the operations of large, complex financial institutions with a view to their implications for the financial system
- pursue its efforts to reform the IMF by enhancing the IMF's role in surveillance

Funds Management

Desired Outcome: Stable and effective management of Government of Canada and Bank of Canada financial assets, investment performance, and risks

Strategy to Achieve Desired Outcome: Maintain effective partnerships; leverage new



Questions on the new medium-term plan

analytical tools; review services, processes, and systems; enhance risk-management framework; and ensure clear and effective governance arrangements



Governor Dodge addresses staff at "town hall" meeting on new medium-term plan.

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

The priorities over the medium term are to:

- enhance analytic capabilities
- renew systems and improve processes
- enhance risk management
- strengthen business-continuity planning

In 2007, the Bank intends to take the following key initiatives:

- continue to support liquidity in the market for Government of Canada securities
- improve the measurement and reporting of performance and risks of the Exchange Fund Account

- complete the transition of sales and marketing for retail debt from Canada Investment and Savings into the Bank

Corporate Administration

Desired Outcome: Efficient and effective support of corporate administration functions for achieving Bank objectives

Strategies to Achieve Desired Outcome: Further develop the Bank's policy and accountability framework to enhance effectiveness and efficiency in the areas of human resource management, infrastructure, and internal communications

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

Over the medium term, the Bank will be facing many of the same challenges as other organizations. In the area of human resource management, the labour markets the Bank draws on are tightening, specialized knowledge is in short supply, and increasing retirements will require more proactive knowledge-retention strategies, succession planning, and possibly retention incentives. To help meet these challenges, investments will be made in a number of areas to strengthen the work environment. In 2007 and over the medium term, the Bank will focus on the following key initiatives:

- develop recruitment and compensation strategies that address changing business needs, demographics, and labour market conditions

- expand the leadership-development program for management
- improve its capacity to access and retain knowledge

Renewing our infrastructure is another corporate priority, with the Bank investing in its information technology to deliver advanced technologies that support key business objectives, as well as in its facilities and security. Clear and open internal communication will continue to be a priority at the Bank, and managerial effort at all levels will be devoted to explaining to staff the Bank's desired outcomes and priorities, and linking the staff's own work to the priority areas. Finally, accountability for the Bank's use of public funds in carrying out its responsibilities is central to this plan.

FINANCIAL REVIEW



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FINANCIAL DISCUSSION

This section of the annual report presents management's discussion of the financial aspects of our operations, including financial operating highlights, financial risk management, and future accounting changes.

The Bank's Balance Sheet

To understand the finances of a central bank, it is helpful to know how it operates in support of its public policy mandate. The Bank's balance sheet is fairly straightforward, compared with those of major Canadian financial institutions, with its assets and liabilities supporting one or more of its functions.

The most significant single item on the Bank's balance sheet is the liability that is created through the issuance of Canadian bank notes under the Bank's currency function. The face value of the bank notes issued is an asset in the hands of the Canadian public but represents a financial liability to the Bank of Canada. This liability tends to increase over time with the growth in demand for bank notes, which is directly related to the growth in the Canadian economy. The bank note liability is supported by the Bank's financial assets in the form of Government of Canada bonds and treasury bills. Seasonal fluctuations in the demand for bank notes are managed by acquiring treasury bills and other short-term assets, such as term

repurchase agreements, that mature when the seasonal demand for bank notes is expected to abate.

The Bank of Canada's financial assets support its operational independence to conduct monetary policy by providing an independent revenue stream outside of the government's budget process. A portion of this revenue is used to fund the Bank's operations; the remaining net revenue is remitted to the federal government periodically throughout the year.

Canada's approach to implementing monetary policy requires that a small portion of the Bank's assets be available as collateral for sale and repurchase operations. Implementing monetary policy based on an inflation target and flexible exchange rate focuses on influencing short-term interest rates through the setting of the overnight rate. On each fixed announcement date, the Bank of Canada announces the target overnight rate, which is the interest rate that financial institutions charge each other for overnight loans. The operating range for this

rate is set by policy, allowing direct-clearing members of the Canadian Payments Association (CPA) to hold deposits with the Bank at the target rate minus 25 basis points, or to take collateralized advances at the target rate plus 25 basis points. When required, the Bank will also offer purchase and resale agreements and sale and repurchase agreements to maintain the overnight rate near the target.

The Bank's financial assets also support the financial system function. Every day, relatively small advances are routinely made under the Bank's standing liquidity facility. Financial intermediaries are usually able to allocate liquidity among themselves without having to make significant use of the Bank's collateralized advance and deposit facilities. However, in exceptional circumstances, advances could become significant if the Bank is required to provide emergency lending assistance to a liquidity-challenged financial institution. The last such event was in 1986. Advances from the Bank can be funded by the outright sales of treasury bills, government securities repurchase agreements (repos), or the issuance of interest-bearing securities.

The Bank's investments, managed through the funds-management function, consist primarily of government securities in a proportion that broadly mirrors the structure of the federal government's domestic marketable debt. This makes the Bank's balance sheet a neutral factor in the government's debt-management and fiscal-planning activities. The Bank also operates a securities-lending program to support the efficiency of the market for Government of Canada securities by providing a temporary secondary source of securities. When specific

Government of Canada treasury bills or bonds are in short supply in the secondary market and are trading below a predetermined threshold interest rate in the repo market, the Bank will lend up to 50 per cent of its holdings in these securities on an overnight basis in exchange for other securities.

Unlike most central banks, the Bank does not hold foreign exchange reserves on its balance sheet. Instead, Canada's official international reserves are largely held in a separate entity, called the Exchange Fund Account, which the Bank manages on behalf of the federal government.

Financial Operating Highlights

For a central bank, profit maximization is not an objective. The finances of the Bank of Canada are shaped by the activities it undertakes in support of its public policy responsibilities, as outlined in previous sections of this report.

Balance sheet highlights

At 31 December 2006, the majority of the Bank's \$51.6 billion in assets were held in investments totalling \$48.3 billion. The Bank's main liability is the bank notes in circulation, valued at \$48.8 billion, which rose 6 per cent during the year, reflecting the increased demand for notes by the Canadian public.

Revenue from investments

Total revenue from investments in 2006 was \$2.2 billion, an increase of 9 per cent over 2005, primarily because of a larger investment portfolio and higher interest rates. The main source of revenues is interest earned on holdings of federal government securities. After expenses,

the net revenue paid to the Government of Canada in 2006 was \$1.9 billion, approximately \$160 million more than the amount paid in 2005.

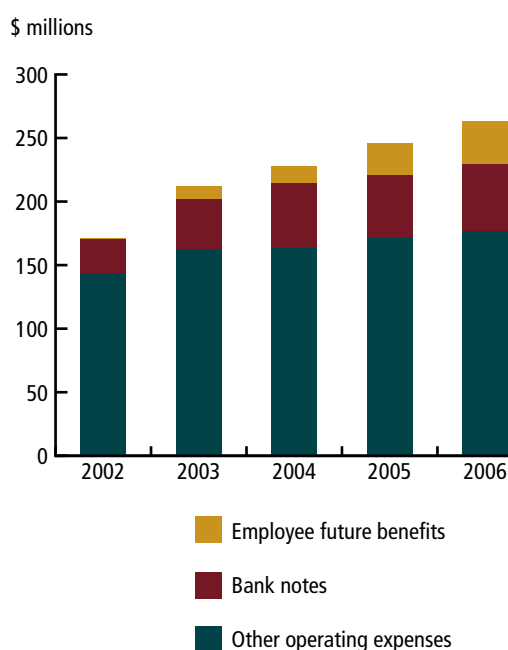
Net revenue is not a good indicator of the Bank's management performance. As noted above, the Bank deals in financial markets to achieve policy goals, not to maximize its revenues. For this reason, the level of operating expenses is a better indicator of the Bank's stewardship of public resources.

Operating expenses

Operating expenses support the Bank's activities in its four main functions: monetary policy, currency, financial system, and funds management. The expenses for these functions in 2006 were \$264 million, an increase of \$18 million

Operating Expenses

Net of retail debt recovery



from 2005. Compensation and currency-related costs represent two of the largest expenses by class of expenditure (see note 3, page 62) and also accounted for a significant portion of the year-over-year increase in 2006. Expenses for retail debt operations, which are now reported as part of funds management, are fully recovered from the Government of Canada.

Compensation

For 2006, the Bank's total compensation expense, made up of salaries, benefits, and other staff expenses, increased by \$13 million. The most significant cost driver continues to be employee future benefit costs, which increased by \$9 million in 2006, representing more than one-half of the increase in total operating expenses. Most of this change was due to the lower discount rate used to calculate the present value of future obligations. Salaries increased by approximately \$3 million, which was mainly attributable to general market adjustments.

Currency costs

Bank notes, which are included in currency costs, increased by slightly more than \$3 million in 2006, reflecting the increased volume of notes produced during the year and the higher unit cost of the upgraded \$5 note introduced in November. The launch of the \$5 note completed the issuance of the *Canadian Journey* series.

Financial Plan for 2007

The year 2007 is the first of the Bank's new medium-term plan, which covers the period 2007–09. The new plan focuses on three strategic priorities: the Bank's operational infrastructure, work environment, and

Financial Profile Over the Period of the 2003–06 Medium-Term Plan

The medium-term plan that ended in 2006 established a number of strategic priorities involving investments in the Bank's research and analytic capabilities, bank note security, and clear communication within the Bank and with Canadians. As we look at the expense profile over the period, the costs were predominately driven by two factors that accounted for two-thirds of the increase: employee future benefit costs and the costs of printing bank notes.

Employee future benefits rose significantly over the four years, increasing by \$34 million, which represents 36 per cent of the expense growth during the period. This increase follows updates to demographic, economic, and actuarial assumptions, as well as a period of low discount rates used to calculate the present value of future obligations.

The second significant component of expense growth is attributable to the cost of printing bank notes, which accounts for 29 per cent,

or \$26 million, of the increase over the period. Bank note costs are the single largest component of operating expenses in the currency function. The medium-term plan focused on launching a new series of bank notes to protect the integrity of Canada's currency. In 2004, the Bank issued the high-denomination notes (\$20, \$50, \$100) in its new series with enhanced security features. The upgraded \$10 and \$5 notes were issued in 2005 and 2006, respectively.

The average annual increase in the remaining operating expenses was 5 per cent over the period of the plan. The focus here has been on strengthening the Bank's analytic capability and, as a result, a significant investment has been made in attracting and retaining qualified staff. Another major focus during this period, in terms of both financial and human resources, has been the redevelopment of technology systems, in particular the Bank's analytic tools and its systems for essential banking services.

governance. Operational expenses for 2007 (excluding bank note costs and non-current deferred employee benefits) are expected to increase by no more than 5 per cent relative to the 2006 budgeted spending levels. Over the three years, the plan includes an average annual growth in expenses of 4 per cent.

With the recent government decision to consolidate the administration of the retail debt program and wind up the Canada Investment and Savings Agency, the costs to the Bank, along with the associated recoveries for this program, are expected to grow in 2007,

as these responsibilities are transferred to the Bank. These operations will continue to be part of the funds-management function.

Financial Risk Management

Financial risk is the risk associated with the Bank's management of its assets and liabilities, including those that appear on and off the balance sheet. The Bank is exposed to two underlying financial risks – interest rate risk and credit risk – both of which are inherently low risks and are described here.

Credit risk

The Bank's portfolio is essentially free of credit risk since the securities held are direct obligations of the Government of Canada. Advances to members of the Canadian Payments Association and securities purchased under resale agreements do not pose material credit risk for the Bank because they are fully collateralized transactions backed by high-quality Canadian-dollar-denominated securities.

Interest rate risk

The Bank is exposed to interest rate risk from fluctuations in interest rates on treasury bills and bonds issued by the Government of Canada. Since the Bank's interest revenues greatly exceed its expenses, changes in underlying interest rates would not affect the ability of the Bank to fulfill its financial obligations.

Future Accounting Changes

The Canadian Institute of Chartered Accountants' new accounting standards will affect the Bank of Canada: *Section 3855: Financial Instruments—Recognition and Measurement* and *Section 1530: Comprehensive Income* establish standards for the recognition, measurement, and presentation of financial instruments.

The new standards, described in note 2 (m) on page 62, will apply to the Bank starting in 2007. Under section 3855, the Bank will designate its treasury bill portfolio as available for sale and

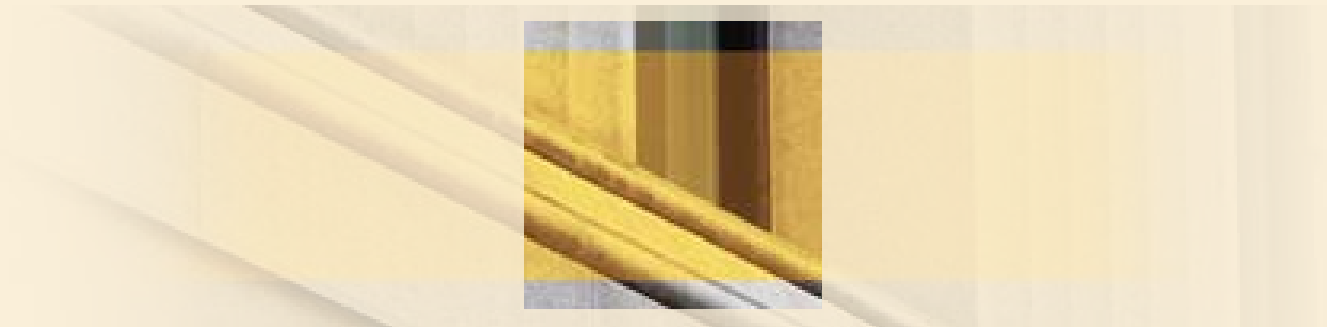
will therefore measure these assets at fair value, with any unrealized gains or losses being recorded in *other comprehensive income*. The bond portfolio will be designated as held to maturity and will continue to be valued at amortized cost. This designation will still allow bonds to be lent or repoed.

Section 1530 introduces a new component of the balance sheet entitled "Comprehensive Income." This new component is part of shareholder's equity and includes the Bank's net revenue and other comprehensive income. Other comprehensive income includes any gains and losses resulting from the change in the market value of assets that are classified as available for sale. Upon settlement of these assets, any associated gains or losses are removed from other comprehensive income and brought into the current period's income.

The current wording of the Bank of Canada Act requires that the Bank remit all of its net revenues to the Government of Canada. The government has introduced legislation to amend the capital clauses of the Act, which upon royal assent would enable the Bank to retain a maximum of \$400 million of its net revenue through the establishment of a special reserve fund. This reserve fund will ensure that the Bank has the ability to maintain a capital base sufficient to manage unrealized investment gains and losses resulting from the fair value valuation of the treasury bill portfolio.

FINANCIAL STATEMENTS

(Year Ended 31 December 2006)



BANK OF CANADA

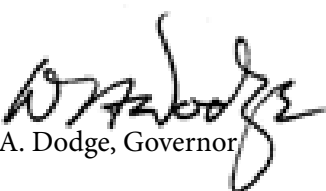
FINANCIAL REPORTING RESPONSIBILITY

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

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

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

These financial statements have been audited by the Bank's external auditors, Ernst & Young LLP and PricewaterhouseCoopers LLP, and their report is presented herein. The external auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings.



D.A. Dodge, Governor

Ottawa, Canada



S. Vokey, CA, Chief Accountant

BANK OF 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 2006 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 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at 31 December 2005 and for the year then ended were audited by Ernst & Young LLP and Deloitte & Touche LLP who expressed an opinion without reservation in their report dated 20 January 2006.



ERNST & YOUNG LLP
Chartered Accountants



PRICEWATERHOUSECOOPERS LLP
Chartered Accountants

Ottawa, Canada
22 January 2007

BANK OF CANADA

STATEMENT OF REVENUE AND EXPENSE

Year ended 31 December 2006

(Millions of dollars)

	<u>2006</u>	<u>2005</u>
REVENUE		
Revenue from investments, net of interest paid on deposits of \$71.5 million (\$43.9 million in 2005)	<u>2,159.6</u>	<u>1,978.3</u>
EXPENSE by function (notes 1 and 3)		
Monetary policy	65.6	60.6
Currency	122.9	113.7
Financial system	35.5	34.1
Funds management	92.6	92.7
Retail debt services recovery	<u>(53.1)</u>	<u>(55.2)</u>
Funds management net of retail debt recovery	<u>39.5</u>	<u>37.5</u>
	<u>263.5</u>	<u>245.9</u>
NET REVENUE FOR ACCOUNT OF THE RECEIVER GENERAL FOR CANADA	<u><u>1,896.1</u></u>	<u><u>1,732.4</u></u>

(See accompanying notes to the financial statements.)

BANK OF CANADA

BALANCE SHEET

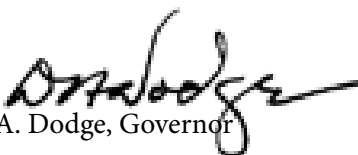
As at 31 December 2006


(Millions of dollars)

	<u>2006</u>	<u>2005</u>
ASSETS		
Deposits in foreign currencies		
U.S. dollars	1.4	84.6
Other currencies	1.7	3.5
	<u>3.1</u>	<u>88.1</u>
Advances to members of the Canadian Payments Association	12.0	-
Investments (note 4)		
Treasury bills of Canada	18,120.7	16,384.6
Other securities issued or guaranteed by Canada maturing within three years	10,971.8	10,337.1
Other securities issued or guaranteed by Canada maturing after three years	19,175.1	19,689.3
Other investments	38.0	38.0
	<u>48,305.6</u>	<u>46,449.0</u>
Bank premises (note 5)	133.8	136.6
Other assets		
Securities purchased under resale agreements	2,853.8	1,297.1
All other assets (note 6)	317.2	349.5
	<u>3,171.0</u>	<u>1,646.6</u>
	<u>51,625.5</u>	<u>48,320.3</u>


(See accompanying notes to the financial statements.)


	<u>2006</u>	<u>2005</u>
LIABILITIES AND CAPITAL		
Bank notes in circulation (note 7)	48,762.2	46,077.9
Deposits		
Government of Canada	2,228.1	911.1
Banks	9.2	32.8
Other members of the Canadian Payments Association	2.6	17.1
Other deposits	<u>443.9</u>	<u>422.4</u>
	2,683.8	1,383.4
Other liabilities		
Securities sold under repurchase agreements	-	684.3
All other liabilities	<u>149.5</u>	<u>144.7</u>
	149.5	829.0
	<u>51,595.5</u>	<u>48,290.3</u>
Capital		
Share capital (note 8)	5.0	5.0
Statutory reserve (note 9)	<u>25.0</u>	<u>25.0</u>
	30.0	30.0
	<u>51,625.5</u>	<u>48,320.3</u>


D.A. Dodge, Governor


S. Vokey, CA, Chief Accountant

On behalf of the Board


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


J.-G. Desjardins, LScCom, CFA,
Chair, Planning and Budget Committee

(See accompanying notes to the financial statements.)

BANK OF CANADA

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2006

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

1. 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. Expenses in the *Statement of revenue and expense* are reported on the basis of these four corporate functions as derived through the Bank's allocation model.

Monetary policy

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

Currency

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

Financial system

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

Funds management

Provides high-quality, effective, and efficient funds-management services: for the government, as its fiscal agent including the delivery of retail debt services; for the Bank; and for other clients. The Bank recovers the cost of retail debt services from the Canada Investment and Savings Agency.

In accordance with the Bank of Canada Act, the net revenue of the Bank is remitted to the Receiver General for Canada.

2. Significant accounting policies

The financial statements of the Bank are in accordance with Canadian generally accepted accounting principles (GAAP) and conform to the disclosure and accounting requirements of the Bank of Canada Act and the Bank's bylaws. A cash-flow statement has not been prepared, since the liquidity and cash position of the Bank and other cash-flow 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 reported in the financial statements and the notes to the financial statements. These estimates, mostly in the area of pension and other employee future benefits, are based on management's best knowledge of current events. Actual results may differ from those estimates.

b) Revenues and expenses

Revenues and expenses are accounted for on an 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 its eligible employees. The Bank accrues its obligations under these benefit plans and the related costs, net of plan assets. The costs and the obligations of the plans are actuarially determined using the projected benefit method and using management's best estimate of the expected investment performance of the plans, salary escalation, retirement ages of employees, and expected health care costs.

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

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

On 1 January 2000, the Bank adopted the new accounting standard on employee future benefits using the prospective application method. The initial transitional balances are amortized on a straight-line basis over the EARSL, as at the date of adoption. The EARSL has been determined to be 11 years (12 years for the period 2002–04) for the pension plans and for the long-service benefit program, 14 years for the post-retirement health care plan, and 7 years for post-employment benefits plans.

d) Translation of foreign currencies

Assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the rates of exchange prevailing at the balance sheet dates.

Investment income is translated at the rate in effect at the date of the transaction. The resulting gains and losses are included in the *Statement of revenue and expense*.

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.

f) Investments

Securities, consisting mainly of Government of Canada treasury bills and bonds, are held for investment purposes. These investments 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, is included in the *Statement of revenue and expense* as revenue.

g) Securities Lending Program

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

h) Bank premises

Bank premises, consisting of land, buildings, computer hardware/software, and other equipment, are recorded at cost less accumulated amortization. Amortization is calculated using the straight-line method and is applied over the estimated useful lives of the assets, as shown below.

Buildings	25 to 40 years
Computer hardware/software	3 to 7 years
Other equipment	5 to 15 years

Projects in progress are not amortized until the asset is put into use.

i) Securities purchased under resale agreements

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

j) Deposits

The liabilities within this category are Canadian-dollar demand deposits. The Bank pays interest on the deposits for the Government of Canada, banks, and other financial institutions at market-related rates. Interest paid on deposits is included in the *Statement of revenue and expense*.

k) Securities sold under repurchase agreements

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

l) 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.

m) Future accounting changes

The Canadian Institute of Chartered Accountants (CICA) issued two new accounting standards for the recognition and measurement of financial instruments that will impact the Bank: Section 1530, Comprehensive Income; and Section 3855, Financial Instruments—Recognition and Measurement. The Bank will apply the CICA's new accounting requirements effective 1 January 2007.

Section 1530 introduces a new component to equity entitled *Comprehensive income* to record unrealized gains and losses resulting from the change in fair value of assets that are classified as available-for-sale. Realized gains and losses would be recognized in the *Statement of revenue and expense*.

Upon initial adoption of the new Section 3855, the Bank will be required to classify its financial assets as held-for-trading (HFT), available-for-sale (AFS), held-to-maturity (HTM), or loans and receivables (L&R). It is expected that, commencing in 2007, the *Treasury bills* and the *Other investments* portfolios will be classified as AFS while the *Other securities issued or guaranteed by Canada* portfolio will be classified as HTM.

3. Expense by class of expenditure

	<u>2006</u>	<u>2005</u>
Salaries	92.9	89.5
Benefits and other staff expenses	53.2	43.2
Currency costs	57.6	55.4
Premises maintenance	23.3	21.1
Services and supplies	82.8	84.0
Amortization	16.3	17.2
	<u>326.1</u>	<u>310.4</u>
Recoveries		
Retail debt services	(53.1)	(55.2)
Other	(9.5)	(9.3)
	<u>263.5</u>	<u>245.9</u>

Retail debt services are recovered from the Canada Investment and Savings Agency. Other recoveries represent the fees charged by the Bank for a variety of services.

4. Investments

The Bank invests in treasury bills and bonds issued by the Government of Canada. These holdings are distributed to broadly resemble the structure of the Government of Canada domestic debt outstanding and are typically held to maturity. The amortized book values of these investments approximate their par values.

There were no securities loaned under the Securities Lending Program as at 31 December 2006.

The Bank also holds 9,441 shares in the Bank for International Settlements (BIS) in order to participate in the BIS and in international initiatives generally.

Credit risk

The portfolio is essentially free of credit risk because the securities held are direct obligations of the Government of Canada, the Bank's shareholder. Advances to Members of the Canadian Payments Association and securities purchased under resale agreements do not pose material credit risk for the Bank because they are collateralized transactions fully backed by high-quality Canadian-dollar-denominated securities. The credit quality of collateral is managed through a set of exposure limits tied to credit ratings of the collateral and term to maturity.

Interest rate risk

The Bank is exposed to interest rate risk arising from fluctuations in interest rates on treasury bills and bonds issued by the Government of Canada. Since the Bank's revenues greatly exceed expenses, changes in interest rates would not affect the ability of the Bank to fulfill its obligations. Fluctuations in fair value of the instrument resulting from changes in interest rates are not reflected in the Bank's revenue since the investments are typically held to maturity. The Bank does not use derivative instruments to reduce its exposure to interest rate risk.

Fair values

The fair values of the securities presented below are based on quoted market prices. The amortized cost of all other financial instruments held by the Bank (assets or liabilities including accounts payable, securities purchased under resale agreements, and securities sold under repurchase agreements) approximates the fair value, given their short-term nature.

The BIS shares are not traded; however, based on recent share issues, their fair value is estimated as being 70 per cent of the Bank's interest in the BIS shareholder's equity, which is denominated in special drawing rights (SDRs).

Securities	2006			2005		
	Amortized cost	Fair value	Average yield per cent	Amortized cost	Fair value	Average yield per cent
Treasury bills of Canada	18,120.7	18,122.7	4.2	16,384.6	16,365.2	3.2
Other securities issued or guaranteed by Canada maturing within 3 years	10,971.8	11,108.4	5.0	10,337.1	10,534.9	5.1
Other securities issued or guaranteed by Canada maturing after 3 years but not over 5 years	6,639.0	6,982.0	5.4	5,768.0	6,024.4	5.1
Other securities issued or guaranteed by Canada maturing after 5 years but not over 10 years	6,438.9	6,774.7	5.0	8,127.9	8,802.2	5.4
Other securities issued or guaranteed by Canada maturing after 10 years	6,097.2	7,563.8	5.8	5,793.4	7,379.3	5.9
	<u>48,267.6</u>	<u>50,551.6</u>		<u>46,411.0</u>	<u>49,106.0</u>	
Shares in the Bank for International Settlements	38.0	254.4		38.0	226.0	
	<u>48,305.6</u>	<u>50,806.0</u>		<u>46,449.0</u>	<u>49,332.0</u>	

5. Bank premises

	2006			2005		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Land and buildings	183.5	94.0	89.5	181.6	89.5	92.1
Computer hardware/ software	61.7	47.6	14.1	63.8	45.9	17.9
Other equipment	139.0	114.5	24.5	137.6	111.6	26.0
	384.2	256.1	128.1	383.0	247.0	136.0
Projects in progress	5.7	-	5.7	0.6	-	0.6
	389.9	256.1	133.8	383.6	247.0	136.6

Projects in progress in 2006 consist of upgrades to the Bank's computer infrastructure.

6. All other assets

This category includes accrued interest on Canadian investments of \$211.9 million (\$227.5 million in 2005). It also includes the pension accrued benefit asset of \$70.6 million (\$81.0 million in 2005).

7. Bank notes in circulation

In accordance with the Bank of Canada Act, the Bank has the sole authority to issue bank notes for circulation in Canada.

A breakdown by denomination is presented below.

	<u>2006</u>	<u>2005</u>
\$5	994.3	920.8
\$10	1,060.8	1,039.0
\$20	15,027.7	14,312.4
\$50	6,924.1	6,524.2
\$100	23,005.2	21,421.3
Other bank notes	<u>1,750.1</u>	<u>1,860.2</u>
	<u>48,762.2</u>	<u>46,077.9</u>

Other bank notes include denominations that are no longer issued but remain as legal tender.

8. Share capital

The authorized capital of the Bank is \$5.0 million divided into 100,000 shares with a par value of \$50 each. The shares are fully paid and, 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.

9. Statutory reserve

The statutory reserve was established in accordance with the Bank of Canada Act. It was accumulated out of net revenue until it reached the stipulated maximum amount of \$25.0 million in 1955.

10. Employee benefit plans

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

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

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

The Bank measures its accrued benefits obligations and fair value of plan assets for accounting purposes as at 31 December of each year. The most recent actuarial valuation for funding purposes of the Registered Pension Plan was done as of 1 January 2005, and the next required valuation will be as of 1 January 2008.

The total cash payment for employee future benefits for 2006 was \$10.4 million (\$8.8 million in 2005), consisting of \$4.7 million (\$4.2 million in 2005) in cash contributed by the Bank to its funded pension plans and \$5.7 million (\$4.6 million in 2005) in cash payments directly to beneficiaries for its unfunded other benefits plans.

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

Plan assets, benefit obligation, and plan status

	Pension benefit plans ¹		Other benefit plans	
	2006	2005	2006	2005
Plan assets				
Fair value of plan assets at beginning of year	893.5	799.4	-	-
Bank's contributions	4.7	4.2	-	-
Employees' contributions	6.3	6.1	-	-
Benefit payments and transfers	(30.3)	(28.8)	-	-
Actual return on plan assets	110.7	112.6	-	-
<i>Fair value of plan assets at year-end²</i>	<u>984.9</u>	<u>893.5</u>	<u>-</u>	<u>-</u>
Benefit obligation				
Benefit obligation at beginning of year	887.2	715.2	151.1	126.2
Current service cost	28.7	22.1	6.1	4.7
Interest cost	38.1	37.7	6.4	6.5
Benefit payments and transfers	(30.3)	(28.8)	(5.7)	(4.6)
Actuarial loss	0.1	141.0	2.2	18.3
<i>Benefit obligation at year-end</i>	<u>923.8</u>	<u>887.2</u>	<u>160.1</u>	<u>151.1</u>
Plan status				
Excess (deficiency) of fair value of plan assets over benefit obligation at year-end	61.1	6.3	(160.1)	(151.1)
Unamortized net transitional obligation (asset)	(64.6)	(75.5)	18.8	22.2
Unamortized cost of amendments	17.2	19.5	2.0	3.0
Unamortized net actuarial loss	56.9	130.7	41.3	41.6
<i>Accrued benefit asset (liability)</i>	<u>70.6</u>	<u>81.0</u>	<u>(98.0)</u>	<u>(84.3)</u>

1. For the Supplementary Pension Arrangement, in which the accrued benefit obligation exceeds plan assets, the accrued benefit obligation and fair value of plan assets totalled \$51.0 million (\$48.0 million in 2005) and \$32.5 million (\$26.7 million in 2005), respectively.
2. The assets of the pension benefit plans were composed as follows: 59 per cent equities, 26 per cent bonds; 9 per cent real return investments; 3 per cent real estate assets; and 3 per cent short-term securities and cash (58 per cent, 27 per cent, 10 per cent, 3 per cent, and 2 per cent, respectively, in 2005).

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

Benefit plan expense

	Pension benefit plans		Other benefit plans	
	2006	2005	2006	2005
Current service cost, net of employees' contributions	22.4	16.1	6.1	4.7
Interest cost	38.1	37.7	6.4	6.5
Actual return on plan assets	(110.7)	(112.6)	-	-
Actuarial loss	0.1	141.0	2.2	18.3
<i>Benefit plan expense (income), before adjustments to recognize the long-term nature of employee future benefit costs</i>	(50.1)	82.2	14.7	29.5
Adjustments				
Difference between expected return and actual return on plan assets for the year	67.7	71.8	-	-
Difference between amortization of past service costs for the year and actual plan amendments for the year	2.3	2.3	1.0	1.0
Difference between amortization of actuarial loss for the year and actual loss on accrued benefit obligation for the year	8.3	(135.8)	(0.1)	(16.8)
Amortization of transitional obligation (asset)	(12.9)	(12.6)	3.5	3.5
<i>Benefit plan expense recognized in the year</i>	15.3	7.9	19.1	17.2

Significant assumptions

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

	Pension benefit plans		Other benefit plans	
	2006	2005	2006	2005
Accrued benefit obligation as at 31 December				
Discount rate	4.25%	4.25%	4.25%	4.15%
Rate of compensation increase	3.50%	3.50%	3.50%	3.50%
	+merit	+merit	+merit	+merit
Benefit plan expense for year ended 31 December				
Discount rate	4.25%	5.00%	4.20%	4.80%
Expected rate of return on assets	5.50%	5.50%	–	–
Rate of compensation increase	3.50%	3.50%	3.50%	3.50%
	+merit	+merit	+merit	+merit
Assumed health care cost trend				
Initial health care cost trend rate			8.20%	8.25%
Health care cost trend rate declines to			4.75%	4.80%
Year that the rate reaches the ultimate trend rate			2016	2015

2006 sensitivity of key assumptions

	Change in obligation	Change in expense
Impact of 0.25 per cent increase/decrease in assumptions		
Pension benefit plans		
Change in discount rate	(39.9) / 42.6	(4.6) / 4.9
Change in the long-term rate of return on plan assets	0/0	(2.0) / 2.0
Other benefit plans		
Change in discount rate	(6.5) / 7.0	(0.2) / 0.2
Impact of 1.00 per cent increase/decrease in assumptions		
Other benefit plans		
Change in the assumed health care cost trend rates	22.3 / (16.8)	1.8 / (1.3)

11. Commitments, contingencies, and guarantees

a) Operations

The Bank has a long-term contract with an outside service provider for retail debt services, expiring in 2011. As at 31 December 2006, fixed payments totalling \$70.7 million remained, plus 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.

The Bank occupies leased premises in Halifax, Montréal, Toronto, Calgary, and Vancouver. As at 31 December 2006, the future minimum payments are \$3.4 million for rent, real estate taxes and building operations. The expiry dates vary for each lease, from October 2007 to August 2014.

Minimum annual payments for long-term commitments

	<u>Outsourced services</u>	<u>Leased space</u>	<u>Total</u>
2007	18.2	1.2	19.4
2008	17.1	0.6	17.7
2009	16.2	0.3	16.5
2010	15.4	0.3	15.7
2011	3.8	0.3	4.1
Thereafter	-	0.7	0.7
	<u>70.7</u>	<u>3.4</u>	<u>74.1</u>

b) Foreign currency contracts

The Bank is a participant in foreign currency swap facilities with the U.S. Federal Reserve for US\$2 billion, the Banco de México for Can\$1 billion, and with the Exchange Fund Account of the Government of Canada. There were no drawings under any of those facilities in 2006 or 2005 and, therefore, there were no commitments outstanding as at 31 December 2006.

c) Investment contracts

Sale investment contracts outstanding as at 31 December 2006, of \$2,853.8 million, at an interest rate of 4.23 per cent under special purchase and resale agreements, were settled by 8 January 2007 (\$1,297.1 at the end of 2005 at an interest rate of 3.21 per cent).

No purchase investment contracts were outstanding as at 31 December 2006 (\$684.3 million at the end of 2005, at an interest rate of 3.25 per cent).

d) Contingency

The 9,441 shares in the BIS have a nominal value of 5,000 special drawing rights (SDRs) of which 25 per cent, i.e., SDR1,250, is paid up. The balance of SDR3,750 is callable at three months' notice by decision of the BIS Board of Directors. The Canadian equivalent of this contingent liability was \$62.1 million at 31 December 2006, based on prevailing exchange rates.

e) Legal proceedings

In 2004, legal proceedings were initiated against the Bank relating to the Bank of Canada Registered Pension Plan. Since the Bank's legal counsel is of the view that the plaintiff's claims for compensation do not have a sound legal basis, management does not expect the outcome of the proceedings to have a material effect on the financial position or operations of the Bank.

f) Guarantees

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

Large Value Transfer System (LVTS) Guarantee

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

Other Indemnification Agreements

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

12. Comparative figures

Certain of the 2005 comparative figures have been reclassified to conform to the current year's presentation.

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Advisers

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John D. Murray, Ronald M. Parker,³
George Pickering, Bonnie J. Schwab, John G. Selody



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Rudy Wytenburg, *Deputy Chief*

Audit

David Sullivan, *Chief Internal Auditor*

* Member of Executive Management Committee

1. Also Chair of the Board of Directors of the Canadian Payments Association

2. Visiting Special Adviser

3. On Executive Interchange to Government of Canada

4. Also Deputy Chair of the Board of Directors of the Canadian Payments Association

Note: Positions as of 31 January 2007

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