

Statement of Policy
Governing the Acquisition and Management of
Financial Assets for the
Bank of Canada's Balance Sheet

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1. Purpose of Policy

This document sets out the policy governing the acquisition and management of domestic financial assets for the Bank of Canada's (the Bank's) balance sheet. This policy does not apply to the assets of the Bank's pension trust fund and supplementary trust fund.

2. Objectives of Holding Assets on the Bank's Balance Sheet

The issuance of bank notes creates a liability for the Bank. To offset this liability, the Bank needs to acquire financial assets. The bank note liabilities are denominated in Canadian dollars, and as such, the assets offsetting them should also be denominated in Canadian dollars. Apart from providing a counterpart to the Bank's currency liabilities, the financial assets should support the operational independence of the Bank to conduct monetary policy. This is accomplished in two ways:

- The financial assets should provide a source of revenue that ensures the Bank is not dependent on government appropriations; and
- The Bank avoids investments that infringe upon the process by which the federal government allocates funds or credit to the private sector or other levels of government.

3. Governance

The Bank of Canada's Executive Management Committee (EMC) has the responsibility to establish and approve this Statement of Policy. Operationally, the Chief of the Financial Markets Department (FMD), reporting to the Deputy Governor responsible for financial markets, is accountable for the execution of the policy. The policy will be posted on the Bank's website.

The Bank reports its balance-sheet positions through the *Weekly Financial Statistics*, balance sheets that are submitted to the Minister of Finance and regularly published in the *Canada Gazette*, and the Bank of Canada's *Annual Report*. Balance sheets are approved by the Governor and the Chief Accountant.

The *Statement of Policy Governing the Acquisition and Management of Financial Assets* will be reviewed at least annually by the Chief of the Financial Markets Department. Any suggested changes would require the approval of the EMC.

4. Operational Guidelines

Decisions regarding the acquisition and disposition of financial assets and the management of the balance sheet are based on the following guidelines:

Market neutrality: The composition of the balance sheet should be structured such that purchases of specific securities should not have a significant impact on the market prices of those assets.

Transparency: Any routine purchase or sale of securities by the Bank should be transparent to the public.¹ This will help to avoid any perceived conflict with monetary policy objectives.

5. Acquisition and Allocation of Assets

While the Bank of Canada Act (the Act) allows the acquisition of a broad range of eligible assets, the objectives and principles outlined above effectively restrict the permanent portion of the Bank's financial assets to Government of Canada domestic securities. Current practice is to acquire Government of Canada bonds and treasury bills via non-competitive bids at government securities auctions and to hold the securities until maturity. The Bank retains the right, however, to acquire assets in the secondary market, if required, to fulfill its mandates. The Bank also retains the right to sell treasury bills in the secondary market, if required, to fulfill its mandates. Holdings of Government of Canada bonds are not eligible to be sold in the secondary market and will be held to maturity.

Apart from Government of Canada securities, other short-term assets may be acquired from time to time as a result of the Bank carrying out its various mandates.

5.1. Government of Canada Securities

The Bank's holdings of Government of Canada nominal bonds and treasury bills are structured to broadly reflect the composition of the federal government's stock of nominal domestic marketable debt. The Bank does not purchase or hold Government of Canada Real Return Bonds, given the low level of issuance of such bonds and to avoid any perceived conflict with monetary policy.²

A fixed percentage of Government of Canada bonds are acquired on a non-competitive basis at each bond auction. Each year, the Chief of FMD will inform the EMC of the percentage participation required at bond auctions to achieve the target structure for asset allocations. The Bank's minimum purchase amount is disclosed in the bond auction Call for Tenders, and the actual amount purchased is disclosed in the bond-auction results.

Government of Canada treasury bills and cash-management bills are also acquired on a non-competitive basis but for a variable amount, depending on the Bank's specific needs at the time of each auction. These amounts are determined by the Bank's treasury managers, subject to the approval of the Chief of FMD, based on staff projections of expected future demand for bank notes and the amount of treasury bills and bonds that will mature in the following weeks. The minimum amount of treasury bills that the Bank intends to purchase is announced in the Final Call for Tenders, and the actual amount purchased is disclosed in the results of the treasury bill auctions. The general rule is to split the total amount purchased by the Bank proportionately across the three maturity

¹ This requirement for transparency may be waived under exceptional circumstances (outlined in Section 6.1).

² The perceived conflict with monetary policy may arise given that the nominal value of Real Return Bonds is indexed by inflation.

tranches, so that approximately the same percentage of each maturity tranche is purchased by the Bank.

5.2. *Transactions Related to Monetary Policy*

When, in the opinion of the Chief of FMD, the conditions in the Canadian General Collateral (GC) overnight interest rate market so warrant, the Bank of Canada may intervene in the market for overnight funds to either inject intraday liquidity through Special Purchase and Resale Agreements (SPRAs) or to withdraw liquidity through Sale and Repurchase Agreements (SRAs). SPRA and SRA operations are treated as collateralized lending (SPRA) or borrowing (SRA) transactions that are secured by Government of Canada securities. Under normal circumstances, these operations have a one-business-day term. Both individual counterparty limits and the aggregate limit for total transactions are recalculated every year and approved by the Chief of FMD.

5.3. *Securities-Lending Program*

This program is designed for situations when a specific Government of Canada security is in short supply in the secondary market and is costly to borrow relative to the overnight target rate. In such situations, the Bank may support the liquidity of this security by providing a secondary and temporary source of securities to the market. To this end, the Bank may make up to 50 per cent of its holdings of the specific security available to the repo market on a given day. Details of the program, including the threshold beyond which the Bank would make securities available to the repo market, are specified in the terms and conditions of the securities-lending program, which is available at http://www.bankofcanada.ca/en/notices_fmd/2003/terms_en0403.pdf. Any operation must be approved by the Chief of FMD after consultation with the Deputy Governor responsible for financial markets.

5.4. *Transactions Related to Bank Notes*

On the recommendation of the Bank's treasury managers and subject to the approval of the Chief of FMD, short-term assets collateralized by Government of Canada securities may be acquired in the secondary market from time to time to accommodate seasonal fluctuations in the demand for bank notes. These assets are acquired through a term repo agreement. Operations are conducted with primary dealers.

6. Exceptions to the Policy

6.1. *Exceptional Circumstances*

The Bank has the legislative authority under the Act to go beyond the Policy outlined above under the circumstances listed below. Any such decision would need to be approved by the Financial System Committee (FSC).

The following practices would, if necessary, be conducted in support of the Bank's financial system function.

- i) The Bank can provide Emergency Lending Assistance (ELA) to any member of the Canadian Payments Association for a maximum term-to-maturity of six months. These loans can be renewed as often as the Bank deems appropriate. The Bank is required to secure all lending with collateral, although the range of acceptable collateral is broader than it is for typical operations. Details of the Bank's ELA policy are available in *The Bank of Canada Lender-of-Last-Resort Policies*.³

ELA assistance to a member of the payments system will be financed by one or more of following approaches:

- Secondary market sales of treasury bills;
 - Sale and repurchase agreements secured by either treasury bills or government bonds. The term of these sale and repurchase agreements is not to exceed six months;
 - The issuance of Bank of Canada securities.
- ii) In the event that, in the opinion of the Governor, there is a severe or unusual stress on a financial market or the financial system, the Bank may buy or sell any other securities to the extent determined necessary by the Governor for the purpose of promoting the stability of the Canadian financial system. While the Act permits the sale of any securities held by the Bank, the Bank's policy is that the holdings of Government of Canada bonds will not be sold in the secondary market, but rather made available through either securities-lending operations or sale and repurchase agreements.

The authority granted under Sections 18(i) and 18(j) of the Act would only be used to make a one-business-day advance to the Government of Canada. This would only be done, as appropriate, to prevent the level of government deposits held at the Bank from falling below zero. Any such advances would be publicly disclosed.

6.2. *BIS Shares*

As part of its commitment to support international financial organizations, the Bank of Canada holds shares in the Bank for International Settlements (BIS). Furthermore, from time to time, the Bank may be invited to acquire additional BIS shares. The decision to purchase any newly allotted BIS shares, as well as any subsequent disposition of existing shareholdings, lies with the Bank of Canada's EMC.

6.3. *Foreign Assets*

The bank note liabilities of the Bank of Canada are denominated in Canadian dollars, and as such, the assets held as a counterpart to those liabilities should also be denominated in

³ These policies are available at <http://www.bankofcanada.ca/en.financial/llr.html>.

Canadian dollars. The Bank does, however, hold some foreign currency assets. These foreign assets are primarily composed of some relatively small working balances in foreign currencies held as deposits.

7. Administration Authorizations

Any purchase or sale of securities pursuant to the Bank's balance-sheet management must be approved by an officer authorized to sign on behalf of the Bank of Canada and whose signature is in Class IA,⁴ according to the Bank's document on signing authorizations.

8. Performance Assessment

The Bank operates to meet public policy objectives, not for the purpose of maximizing profit. As such, the Bank's financial statements and the financial indicators contained within them are not the appropriate measure upon which to gauge the Bank's performance. This is more properly reflected in the Bank's success in meeting its public policy goals, as outlined in various Bank publications, including the *Monetary Policy Report*, the *Financial System Review*, and the *Annual Report*.

Given that the structure of the Bank's domestic currency assets broadly mirrors the structure of the federal government's domestic marketable debt, the Bank is provided with a stream of interest income that is intended to be broadly correlated with the government's overall debt-service costs. A small portion of this income is used to fund the Bank's operations, and, subject to the provisions of the Act, a portion may be retained to ensure that the Bank maintains a sufficient capital base. The balance is remitted to the federal government. Thus, a comprehensive performance-management system is unnecessary. The performance-assessment system should, however, monitor how consistent the Bank's portfolio remains with the overall stock of marketable debt, and highlight the need for any adjustments should they become necessary. Such a review will be conducted within the Financial Markets Department on an annual basis.

9. Registration of Investment

Financial securities must be registered as follows:

- i) for securities represented by bearer certificates, the Bank takes physical delivery and possession of such certificates;
- ii) for security certificates delivered in physical form for which registration is possible, the registration must be in the name of the "Bank of Canada" on the books of the issuer of the security;

⁴ As maintained by the Department of Banking Operations

- iii) for securities held in book-based form with the Canadian Depository for Securities (CDS) or similar clearing institution, the ownership of such securities must be in the name of the “Bank of Canada.”

Appendix

According to Section 18 of the Bank of Canada Act, the Bank may:

(a) buy and sell gold, silver, nickel and bronze coin or any other coin and gold and silver bullion;

(b) buy and sell foreign currencies and maintain deposit accounts with banks or foreign banks, either in or outside Canada, to facilitate such operations;

(c) buy and sell securities issued or guaranteed by Canada or any province;

(d) buy and sell securities issued or guaranteed by the Government of the United States of America or Japan or the government of a country in the European Union;

(e) [Repealed, 2001, c. 9, s.194]

(f) buy and sell special drawing rights issued by the International Monetary Fund;

(g) buy and sell bills of exchange and promissory notes endorsed, accepted or issued by a bank or authorized foreign bank that is not subject to the restrictions and requirements referred to in subsection 524(2) of the *Bank Act* and having a maturity not exceeding one hundred and eighty days, excluding days of grace, from the date of acquisition by the Bank;

(g.1) if the Governor is of the opinion that there is a severe and unusual stress on a financial market or financial system, buy and sell any other securities, treasury bills, obligations, bills of exchange or promissory notes, to the extent determined necessary by the Governor for the purpose of promoting the stability of the Canadian financial system;

(h) make loans or advances for periods not exceeding six months to members of the Canadian Payments Association on taking security in any property that the institution to which the loan or advance is made is authorized to hold;

(i) make loans or advances for periods not exceeding six months to the Government of Canada or the government of a province on taking security in readily marketable securities issued or guaranteed by Canada or any province;

(j) make loans to the Government of Canada or the government of any province, but such loans outstanding at any one time shall not, in the case of the Government of Canada, exceed one-third of the estimated revenue of the Government of Canada for its fiscal year, and shall not, in the case of a provincial government, exceed one-fourth of that government's estimated revenue for its fiscal year, and such loans shall be repaid before the end of the first quarter after the end of the fiscal year of the government that has contracted the loan;

(k) for the purpose of its open-market operations, buy and sell in the open market from or to any person, either in or outside Canada, securities, bills of exchange and promissory notes of the kinds and maturities and subject to the limitations, if any, referred to in paragraphs (c) to (e) and (g) with or without the endorsement of a bank;

(l) accept deposits from the Government of Canada and pay interest on those deposits;

(l.1) accept deposits from any bank, authorized foreign bank that is not subject to the restrictions and requirements referred to in subsection 524(2) of the *Bank Act* or other member of the Canadian Payments Association;

(l.2) pay interest on the deposits referred to in paragraph (l.1) if the money deposited is to be used for the purpose of making loans or advances referred to in paragraph (h);

(l.3) accept deposits from the government of any province or from any corporation or agency of the Government of Canada;

(m) open accounts in a central bank in any other country or in the Bank for International Settlements, accept deposits from central banks in other countries, the Bank for International Settlements, the International Monetary Fund, the International Bank for Reconstruction and Development and any other official international financial organization, act as agent or mandatary, or depository or correspondent for any of those banks or organizations, and pay interest on any of those deposits;

(n) acquire, hold, lease or dispose of real property or immovables;

(o) accept deposits of money that are authorized or required by an Act of Parliament to be transferred to the Bank, and, in accordance with that Act, pay interest on money so deposited and pay out money to any person entitled to it under that Act; and

(p) carry on any business activity that is incidental to or consequential on something the Bank is allowed or required to do by this Act.