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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

The Statement of Policy Governing the Acquisition and Management of Financial Assets (Statement of Policy) establishes the policy governing the acquisition and management of domestic financial assets for the Bank of Canada's (the Bank's) balance sheet. It does not apply to the assets of the Bank's pension trust fund or supplementary trust fund.

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

Generally, the Bank of Canada's holdings of financial assets are driven by its role in issuing bank notes. The issuance of bank notes creates a liability for the Bank, the largest on its balance sheet. Government of Canada deposits, including those supporting the government's prudential liquidity plan, typically represent the second largest liability for the Bank. To offset these liabilities, the Bank needs to hold financial assets. The bank note and deposit liabilities are denominated in Canadian dollars, and as such, the assets offsetting them should also be denominated in Canadian dollars.

The Bank also undertakes a range of financial market transactions with eligible counterparties in support of its monetary policy and financial stability objectives. These transactions are typically short-term buyback/repurchase agreements where the Bank injects liquidity and acquires financial assets or provides financial assets and withdraws liquidity.

The financial assets help promote the Bank of Canada's operational independence and support the execution of its responsibilities. This is accomplished in two ways:

- The financial assets provide a means for the Bank to carry out its responsibilities without being dependent on government appropriations; and
- The Bank avoids investments that might impair the process by which the federal government allocates funds or credit to the private sector or other levels of government.

3. Governance

The acquisition and management of financial assets for the Bank of Canada's balance sheet is broadly governed by Section 18 of the *Bank of Canada Act* (the *Act*). The range of securities and financial instruments that the Bank may buy and sell for certain types of transactions, for the purposes of subparagraph 18(g)(i) of the *Act*, are further detailed in the *Bank of Canada Policy for Buying and Selling Securities under Subsection 18.1(1) of the Bank of Canada Act*.[1] Under the Bank of Canada's internal governance structure, the Bank's Governing Council (GC) has the responsibility to establish and

[1] Subsection 18.1(1) requires the Governor to establish a policy for buying and selling securities and financial instruments for the purposes of conducting monetary policy or promoting the stability of the Canadian financial system. This policy and amendments to it must be published in the *Canada Gazette*.

approve this Statement of Policy. Operationally, the Managing Director of the Financial Markets Department (FMD), reporting to the Deputy Governors responsible for the financial system, is accountable for the execution of the policy. The Statement of Policy is available on the Bank's website.

The Bank reports unaudited balance-sheet positions through the *Weekly Financial Statistics*. Monthly unaudited balance sheets are submitted to the Minister of Finance and regularly published in the *Canada Gazette*. The Bank publishes unaudited interim balance sheets on a quarterly basis on its website. The audited year-end balance sheet appears in the Bank of Canada's *Annual Report*. Published balance sheets are signed by the Governor or Deputy Governor and the Chief Accountant or Acting Chief Accountant in accordance with the *Bank of Canada Act*.

The Statement of Policy will be reviewed at least annually by the Managing Director of FMD. Any suggested changes would require the approval of GC.

4. Operational Guidelines

Decisions about the acquisition and disposition of financial assets and the management of the Bank's balance sheet are based on the following guidelines:

Neutrality: The Bank limits potential market distortions from its investment activities by acting in as broad and neutral a fashion as possible. The composition of the Bank's balance sheet should be structured such that the impact on the market prices of those assets from routine purchases of specific securities should be minimal.

Prudence: The Bank mitigates financial risks to its balance sheet that could arise from valuation losses or credit losses through a risk management framework. The framework includes collateralization, with appropriate haircuts, of any lending or advances and minimum credit quality requirements for securities eligible for collateral, repurchase transactions, or outright purchases.

Transparency: Any purchase or sale of assets by the Bank should be transparent to the public.[2]

5. Acquisition and Use of Securities Issued or Guaranteed by the Government of Canada, or Canadian Provincial Governments in the Normal Course

While the *Bank of Canada Act* allows for the acquisition of a broad range of eligible assets, the objectives and guidelines outlined above effectively limit the types of financial assets that the Bank should acquire in the normal course for its portfolio of financial assets. The Bank primarily acquires Government of Canada nominal bonds and treasury bills for its balance sheet outright through non-competitive bids at government securities auctions, and may also acquire these securities in the

[2] This requirement for transparency may be waived under exceptional circumstances (see Section 7).

secondary market. While the Bank's investments in Government of Canada nominal bonds are held to maturity, the Bank may sell treasury bills in the secondary market to fulfill its responsibilities.

The Bank may also acquire in the primary market securities issued by federal Crown corporations (or by entities established by federal Crown corporations primarily for the purpose of issuing securities) and guaranteed by the Government of Canada.

The Bank also regularly acquires assets through repurchase agreements (term repos) that are secured by securities issued or guaranteed by the Government of Canada or by Canadian provincial governments.

5.1. Routine purchases of Government of Canada securities at auction

The Bank's outright 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.[3]

Typically, a fixed percentage of Government of Canada bonds is acquired on a non-competitive basis at each bond auction to achieve the target structure for asset allocations. FMD will review the target percentage auction participation, and the Managing Director of FMD will inform GC of any changes.[4] The public will also be notified of any changes. 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 Managing Director of FMD, based on staff projections of expected future demand for bank notes and other liabilities and the amount of treasury bills and bonds that will mature in the following weeks. The actual amount purchased is disclosed in the results of the treasury bill auctions. The typical practice is to split the total amount purchased by the Bank, so that the Bank's purchases approximate the same proportions of issuance by the government across the three maturity tranches.

5.2. Secondary market purchases of Government of Canada securities

The Bank may acquire additional Government of Canada bonds in the secondary market with the aim of achieving the above-noted target portfolio structure for its outright holdings of these securities. The Bank will carefully consider its balance sheet requirements and the potential market impacts of its

[3] The perceived conflict with monetary policy may arise given that the nominal value of Real Return Bonds is indexed to inflation.

[4] This review may occur more frequently, subject to financial market conditions or changes in the Bank's balance sheet.

secondary market purchases before undertaking such transactions. At such time that the Bank considers secondary market purchases of Government of Canada securities appropriate, the Bank will publish terms and conditions for these transactions.

5.3. Primary market purchases of securities issued by federal Crown corporations and guaranteed by the Government of Canada

The Bank may acquire securities issued by federal Crown corporations (or by entities established by federal Crown corporations primarily for the purpose of issuing securities) and guaranteed by the Government of Canada. These purchases will be conducted in the primary market, and will initially only include Canada Mortgage Bonds. These securities will be acquired at such time as the Bank determines it appropriate to meet its balance sheet asset requirements.

5.4. Buyback transactions related to balance sheet management and to support financial stability

Term repurchase agreements (term repos) transacted by the Bank typically have approximately 1- and 3-month terms. However, the Bank may also conduct term repos for shorter or longer terms, for example to offset seasonal fluctuations in the demand for bank notes or to help support financial stability. Term repo operations are conducted on the recommendation of the Bank's treasury managers, subject to the approval of the Managing Director of FMD.

Assets held by the Bank from conducting term repo operations appear on the balance sheet as securities purchased under resale agreements. Although these transactions are legally characterized as purchases, accounting standards require that, for financial reporting purposes, they be treated as collateralized lending transactions. Details related to these operations can be found in the *Terms and Conditions for Term Repos.*

5.5. Buyback transactions related to monetary policy

When the conditions in the Canadian general collateral overnight interest rate market so warrant, the Bank of Canada may intervene in the market for overnight funds either to inject intraday liquidity through repurchase agreements (repos), called Overnight Repurchase (OR) operations and formerly known as Special Purchase and Resale Agreements (SPRAs), or to withdraw intraday liquidity through reverse repurchase agreements (reverse repos) called Overnight Reverse Repurchase (ORR) operations, formerly known as Sale and Repurchase Agreements (SRAs). Execution of these transactions is approved by the Managing Director (or delegate) of FMD.

ORs and ORRs appear on the balance sheet as securities purchased/sold under resale/repurchase agreements. Although these transactions are legally characterized as purchases/sales, accounting standards require that, for financial reporting purposes, they be treated as collateralized lending (OR) or borrowing (ORR) transactions. Under normal circumstances, these operations have a 1-business day term. Both individual counterparty limits and the aggregate limit for total transactions are recalculated every year and approved by the Managing Director (or delegate) of FMD. Details related to these operations can be found in the *Terms and Conditions for ORs and ORRs.*

5.6. 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 market liquidity by providing a secondary and temporary source of the security to the market. To this end, the Bank will 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 *Standard Terms for Auctions to Primary Dealers Under the Bank of Canada Securities-Lending Program*.

6. Acquisition and Use of Other Financial Assets

In accordance with Section 18 of the *Bank of Canada Act*, other assets may be acquired (or sold) from time to time in carrying out the Bank's responsibilities.

6.1. Foreign deposits

The bank note and deposit liabilities of the Bank of Canada are denominated in Canadian dollars, and the corresponding assets are largely denominated in 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 at other central banks or international financial institutions.

6.2. Advances to members of the Canadian Payments Association

The final daily positions of payment system participants settle on the books of the Bank of Canada. In this context, the Bank provides collateralized overnight loans to participants of the Large Value Transfer System (LVTS) who are experiencing temporary end-of-day shortfalls in settlement balances that arise in the daily settlement of payments. These routine liquidity loans are made under the Bank's Standing Liquidity Facility (SLF). The collateral eligible to secure credit from the SLF is reviewed on a regular basis and approved by GC. (See *Assets Eligible as Collateral under the Bank of Canada's Standing Liquidity Facility*.)

6.3. Other investments: 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 by the BIS Board of Directors 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 GC.

7. Exceptional Circumstances

The Bank has the legislative authority under the *Bank of Canada Act* to undertake other actions to fulfill its monetary policy and financial system responsibilities. The decision to undertake such actions must be approved by GC.

Any actions that entail the provision of liquidity (7.1 - 7.4) would be financed by one or more of the following approaches:

- secondary market sales of treasury bills
- Overnight Reverse Repurchase operations (ORR)
- an increase in liabilities

7.1. Operations to provide extraordinary liquidity

The Bank can undertake various extraordinary liquidity operations to support financial system stability and monetary policy, including the following:

i. Conducting exceptional buyback transactions, to a maximum term of 380 days, using an expanded range of securities and instruments provided that certain criteria are met.

ii. Engaging in outright purchases of an expanded range of securities and instruments provided that certain criteria are met and subject to amending the *Bank of Canada Policy for Buying and Selling Securities under Subsection 18.1(1) of the Bank of Canada Act*.

   The terms and conditions for these operations, including eligible counterparties and duration, would be recommended by the Managing Director of FMD and approved by GC. Terms and conditions would be published in advance of any operations.

iii. Lending to a broader range of financial institutions than participants of the LVTS and for terms longer than overnight. Collateralized loans may be provided to members of the Canadian Payments Association, subject to a maximum term of six months.

iv. Activating a Contingent Term Repo Facility (CTRF) that would offer eligible counterparties liquidity on a bilateral basis. Terms and conditions for the CTRF would be published upon activation. The range of eligible counterparties for this facility could be extended beyond Primary Dealers and their affiliates, at the Bank's discretion. These other counterparties would need to demonstrate significant activity in the Canadian money and/or bond markets, be subject to federal or provincial regulation and meet any other conditions the Bank requires.

7.2. Other sales or purchases

Under subparagraph 18(g)(ii) of the *Bank of Canada Act*, if the Governor is of the opinion that there is a severe or unusual stress on a financial market or the financial system, the Bank may buy or sell any other securities, including equity securities, to the extent determined necessary by the Governor for the purpose of conducting monetary policy or 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 holdings of Government of Canada bonds will not be sold in the secondary market.

7.3. Emergency Lending Assistance

The Bank can provide Emergency Lending Assistance (ELA) to eligible deposit-taking institutions and financial market infrastructures that require more substantial and prolonged credit. Lending may be against a range of collateral that is broader than it is for typical operations, and is subject to a maximum term-to-maturity of six months. These loans can be renewed as often as the Bank deems appropriate.

7.4. Forced LVTS loans

In the event that a participant defaults in the LVTS, the Bank can be obliged (under the LVTS bylaw) to lend to an insolvent institution against previously pledged collateral to settle that member's obligations to other participants in the LVTS, and so protect against systemic risk. In the extremely unlikely event of the failure of more than one LVTS participant on the same day during LVTS operating hours, the Bank can lend to a defaulting institution on a partially unsecured basis to ensure settlement, and so protect against systemic risk.

7.5. Loans or advances to the Government

The authority granted under Subsections 18(i) and 18(j) of the *Bank of Canada Act* to make loans or advances to the Government would only be used to make a 1-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.

8. 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,[5] according to the Bank's signing authorizations.

[5] As maintained by the Funds Management and Banking Department.

9. 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 measures 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 portion of the Bank's income is used to fund the Bank's operations. The remainder, after making provisions that the Bank's Board of Directors judges appropriate, is remitted to the federal government.

The performance assessment should monitor how consistent the Bank's portfolio remains with the overall stock of the federal government's domestic marketable debt, and highlight the need for any adjustments should they become necessary. Such a review will be conducted within FMD at a minimum on an annual basis.

10. Transfer of Securities

Securities that are sold to the Bank or granted as collateral must be transferred to the Bank as follows:

i. for securities represented by bearer certificates that are not held in a securities clearing system, 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;

iii. for securities held in book-based form with CDS Clearing and Depository Services Inc. or with another clearing system or institution, securities must be effected by making appropriate book entries to credit the securities to the Bank of Canada's account with the clearing system or institution.