

# 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 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's holdings of financial assets are driven by its unique role in issuing Canadian bank notes. The Bank passively supplies financial institutions with the notes needed to satisfy the demand for currency by businesses and the public. This issuance creates a liability for the Bank, typically one of the largest on its balance sheet. Government of Canada deposits, including those supporting the government's prudential liquidity plan, represent another large liability for the Bank. To offset these liabilities, the Bank needs to hold financial assets, which are primarily Government of Canada securities. Given that the Bank has no control over the level of either the bank note or Government deposit liabilities, the asset acquisition required to offset them is done passively, entirely in response to external changes in these liabilities. The bank note and deposit liabilities are denominated in Canadian dollars, and as such, barring any extraordinary circumstances the Bank aims to offset these liabilities with Canadian dollar assets to minimize currency risk. Assets acquired to offset currency and government deposit liabilities are referred to as being **acquired** under normal course.

The Bank can also undertake a range of financial market transactions with eligible counterparties in support of its monetary policy and financial stability objectives. While these transactions are typically short-term buyback/repurchase transactions, where the Bank injects liquidity and acquires financial assets or provides financial assets and withdraws liquidity, they may also include purchases of longer-term assets or the extension of longer-term loans. In these circumstances, all or part of the operations can be funded through the **creation of settlement balances**, which are the aggregate net deposits from members of the payment system held at the Bank. Assets acquired in support of the Bank's policy objectives are referred to as being acquired under exceptional circumstances for policy purposes.

Assets acquired under normal course help promote the Bank'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 aims to avoid investments that might impair the process by which the federal government allocates funds or credit to the private sector or other levels of government.

Balance sheet operations conducted under exceptional circumstances for policy purposes are intended to promote the effective implementation of the Bank's monetary policy and financial system objectives by helping to achieve financial conditions consistent with the Bank's desired policy stance.

### 3. Governance

The acquisition and management of financial assets for the Bank's balance sheet is broadly prescribed 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*.<sup>1</sup> Under the Bank of Canada's internal governance structure, the Bank's Governing Council (GC) has the responsibility to establish and 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 [\*\*\*Banking and Financial Statistics\*\*\*](#) statements. Monthly unaudited balance sheets are also 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 financial statements 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:* In the normal course, the Bank aims to limit 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 is structured such that the impact on the market prices of those assets from routine purchases of specific securities should be minimal. The Bank may deviate from the principle of neutrality in its purchases for policy purposes if necessary, to support its monetary policy and financial system objectives.

*Prudence:* The Bank manages financial risks within the parameters of the Risk Appetite Statement. The Bank mitigates financial risks to its balance sheet that could arise from valuation losses or credit losses through collateralization, with appropriate haircuts, of any lending or advances, and ensuring securities eligible for collateral, repurchase transactions, and / or outright purchases are aligned with the Bank's Risk Appetite. The Bank may acquire assets associated with a relatively higher degree of risk as necessary in support of its monetary policy and financial stability mandates. In such cases, further mitigation measures may be undertaken as appropriate to help manage the additional risk.

A Financial Risk Management Framework outlines the authority and delegation structure with respect to decision making and oversight, including monitoring and reporting, of financial risk management at the Bank of Canada. Consistent with the treatment of risk more broadly, the Governor, supported by the Executive Council,

has ultimate accountability for the financial risks of the Bank. The Board of Directors provides general oversight of the management and administration of the Bank, including the performance of risk management. As the functional authority over Enterprise Risk Management (ERM) within the Bank, the Chief Risk Officer is responsible for administering the Framework.

*Transparency:* Any purchase or sale of assets by the Bank should generally be transparent to the public.<sup>2</sup>

## **5. Acquisition and Use of Securities Issued or Guaranteed by the Government of Canada or Canadian Provincial Governments under 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 secondary market.<sup>3</sup> The Bank's intention is to hold investments in Government of Canada nominal bonds and Government of Canada treasury bills to maturity.

The Bank also acquires Canada Mortgage Bonds on a non-competitive basis in the primary market with the intention to hold these investments until maturity, and it may also acquire in the primary market securities issued by other 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 term 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 purchased under normal course are structured to broadly reflect the composition of the federal government's stock of nominal domestic marketable

debt. The Bank generally does not purchase Government of Canada Real Return Bonds, given the low level of issuance of such bonds and to avoid any perceived conflict with monetary policy.<sup>4</sup>

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 Bank's target percentage auction participation, and the Managing Director of FMD will inform GC of any changes.<sup>5</sup> 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, other liabilities and the amount of financial assets that will mature in the following weeks. The actual amount purchased is disclosed in the results of the treasury bill auctions. Generally, 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**

Under normal course purchases, 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 secondary market purchases before undertaking such transactions.

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

The Bank acquires Canada Mortgage Bonds and 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 for additional flexibility to offset the continued growth in bank notes. These purchases will be conducted in the primary market and 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 repos transacted by the Bank under normal course typically have approximately 1- and 3-month terms to maturity. 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 Overnight buyback transactions related to monetary policy**

When the conditions in the Canadian general collateral overnight interest rate market 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, or to withdraw intraday liquidity through reverse repurchase agreements (reverse repos) called Overnight Reverse Repurchase (ORR) operations. 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 (currently suspended) / Securities Repo Operations

Both the Securities-Lending Program and the Securities Repo Operations are 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. The Securities-Lending Program lends out specific Government of Canada securities against a range of eligible collateral (as defined in the program terms and conditions), while the Securities Repo Operation lends securities out against cash collateral. Given the significant overlap of the two programs, only one of the two is typically active at any given time. The choice of which program to activate is dependent on market conditions.

Details of the now suspended Securities-Lending 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\*](#). Program details of the Securities Repo Operations, are available on the [Securities Repo Operations webpage](#) and operational details are specified in the [\*Securities Repo Operations: Terms and Conditions\*](#).

## 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 currencies

The Bank holds some small foreign currency assets for general corporate purposes. 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. The Bank is also party to a swap facility with the Bank for International Settlements (BIS).

### 6.2 Advances to members of Payments Canada

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 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 Acquisition and Use of Financial Assets for Policy Objectives**

The Bank has the legislative authority under the *Bank of Canada Act* to undertake other actions if required to fulfill its monetary policy and financial system responsibilities.<sup>6</sup> The decision to undertake such actions must be approved by GC.

Any actions that entail the acquisition of assets or the provision of liquidity in support of the Bank's policy objectives (7.1 - 7.7) 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 settlement balances.

### **7.1 Operations to provide liquidity in support of policy objectives**

The Bank can undertake the following operations to support its financial system stability and monetary policy objectives:

- i. Conducting exceptional buyback transactions (expanded size, frequency, counterparties), to a maximum term of up to 24 months, and 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 are subject to the *Bank of*



*Canada Policy for Buying and Selling Securities* under Subsection 18.1(1) of the *Bank of Canada Act*. The Bank may hold these securities until maturity or, at its discretion, sell them in the secondary market to fulfill its policy objectives.

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 for terms longer than overnight and against a broader range of collateral. Collateralized loans may be provided to members of Payments Canada, subject to a maximum term of six months.
- iv. Activating the Contingent Term Repo Facility (CTRF) offers eligible counterparties liquidity on a bilateral basis (See [CTRF Terms and Conditions](#)). 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 dollar money and/or fixed income markets, be subject to federal or provincial financial sector/market regulation and meet any other conditions the Bank requires.
- v. Under its bilateral liquidity swap facilities with various central banks, the Bank can enter into reciprocal arrangements to exchange currencies should both the Bank and the corresponding central bank determine that market conditions warrant it. The foreign currency could then be made available to Canadian counterparties through a market-wide repurchase facility.

## **7.2 Standing Term Liquidity Facility**

To help support the efficient functioning of Canadian financial markets and address temporary liquidity stress at eligible financial institutions, the Bank's Standing Term Liquidity Facility (STLF) provides advances to federally or provincially prudentially regulated members of Payments Canada for which the Bank of Canada has no concern about their financial soundness. This liquidity stress can stem from various sources, including system-wide liquidity conditions as well as operational incidents such as cyber attacks, system failures and natural disasters. The STLF provides access to a broader set of eligible counterparties against a broader set of collateral at a higher price relative to routine term repo operations and the SLF. (See [STLF Terms and Conditions](#))

## **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 (See [ELA policy](#)).

#### **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 collateralized loans or advances to the Government would only be used to make a 1-business-day loan to the Government of Canada. The Bank would attempt to structure any liquidity operation to the Government as a repurchase or FX swap transaction instead of a loan or advance. Any such transaction(s) would only be done as appropriate in the event of a short-term technical market disruption to prevent the level of Government of Canada deposits held at the Bank from falling below zero and would be publicly disclosed.

#### **7.6 Other exceptional buyback transactions**

The Bank in its capacity as custodian of the financial assets of the Canada Deposit Insurance Corporation and Canada Mortgage Housing Corporation and as fiscal agent to the Government of Canada can conduct exceptional sale and buyback transactions with these two entities in certain cases.

#### **7.7 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.

## 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,<sup>7</sup> according to the Bank's signing authorizations.

## 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, in normal course, 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, the transfer of 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.

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## Footnotes

1. 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*.[\[↩\]](#)
2. 2. This requirement for transparency may be waived under exceptional circumstances (see Section 7) if the Bank deems that transparency would have implications on the Bank’s financial and monetary policy objectives.[\[↩\]](#)
3. 3. In a non-competitive bid, the bidder does not submit a price, but rather agrees to accept the average price at auction as determined by the competitive bids.[\[↩\]](#)
4. 4. The perceived conflict with monetary policy may arise given that the nominal value of Real Return Bonds is indexed to inflation.[\[↩\]](#)
5. 5. This review may occur more frequently, subject to financial market conditions or changes in the Bank’s balance sheet.[\[↩\]](#)
6. 6. Details about the Bank’s extended monetary policy toolkit can be found in the Annex to the April 2009 Monetary Policy Report available at [Monetary Policy Report \(bankofcanada.ca\)](#). Further information about the Bank’s financial system responsibilities, in particular the lender of last resort function, are available at [Lender of Last Resort - Bank of Canada](#)[\[↩\]](#)
7. 7. As maintained by the Banking and Payments Department.[\[↩\]](#)