BANK OF CANADA
BANQUE DU CANADA

ANNUAL REPORT 2012

bankofcanada.ca

The *Annual Report* is available on the Bank of Canada's website at **bankofcanada.ca**.

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BANK OF CANADA
BANQUE DU CANADA

Mark Carney
Governor – Gouverneur

28 February 2013

The Honourable James M. 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 2012 and the Bank’s audited financial statements as at 31 December 2012.

Yours sincerely,

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
- promote the safety and efficiency of Canada's financial system
- supply quality bank notes that are readily accepted and secure against counterfeiting
- 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

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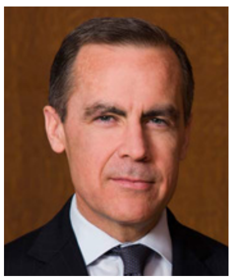
Message from the Governor



2012 was a year of tentative recovery for the world economy, but considerable accomplishment for the Bank of Canada as it worked to promote the economic and financial well-being of Canadians. Consistent with its flexible inflation-targeting framework, the Bank kept its policy interest rate very low to support a Canadian economy facing strong headwinds from a weak global economy. The Bank made substantial progress in its efforts to promote domestic and global financial stability, working closely with its federal partners and the Government of Canada to promote a sustainable evolution of household debt and the housing market. The Bank issued two new bank notes and further improved its debt-management services to the Government of Canada. Finally, this past year, the Bank launched an ambitious three-year plan to guide its policy and operations and to ensure that it remains well positioned to fulfill its important mandate in the years ahead.

All of this work took place in an environment of ongoing international challenges. Global economic growth was well below its long-term average, and the recovery was dampened by uncertainty and concerns about sovereign debt. Europe remained in recession, economic activity slowed in some major emerging-market countries, and the recovery in the United States was held back by private and public deleveraging.

The Canadian economy grew at a moderate pace throughout most of 2012. A soft export market forced reliance on domestic demand to maintain economic momentum. Although household debt continued to rise to record levels, there are encouraging signs that macroprudential measures put in place by federal authorities and prudent decisions taken by individuals and their lenders have helped to put household indebtedness on a more sustainable path.

The Bank provided considerable monetary policy stimulus in 2012, maintaining its policy interest rate at 1 per cent throughout the year. Both total CPI and core inflation were below the 2 per cent target, but within the Bank's 1 to 3 per cent inflation-control range, for most of the year. Expectations of future inflation remained well anchored at 2 per cent.

The Bank remains resolutely focused on preserving the price stability that it has achieved through more than two decades of flexible inflation targeting. It is also committed to increasing the resilience of our financial system, not only to ensure that markets function efficiently in good times and in bad, but also to ensure that the system can support a stable and growing economy. During

2012, significant progress was made in advancing the Bank's work to better integrate financial stability considerations into monetary policy decision making. Canada's flexible inflation-targeting framework is a time-proven advantage in this regard, anchoring inflation expectations while leaving room for monetary policy to take into account financial stability objectives, if necessary.

During 2012, the Bank made important contributions to international and domestic efforts to strengthen the global financial system. In the international arena, the Bank helped to advance international regulatory reform, especially with regard to the Basel III capital and liquidity requirements for banks. Areas of particular focus have been global liquidity, shadow financing, and a framework for identifying domestic and global systemically important banks. Bank staff played an important role in the global move to the central clearing of over-the-counter (OTC) derivatives, including the establishment of four safeguards for the stability of local financial markets under the global approach to clearing—fair and open access, oversight and regulation, recovery and resolution, and access to emergency liquidity.

Domestically, Bank staff helped to design the Canadian strategy for the central clearing of OTC derivatives. On the strength of the progress made in establishing the four safeguards globally, Canadian authorities announced that Canadian market participants could clear OTC derivatives using any recognized central counterparty (CCP), including global CCPs. As well, the Bank worked with market participants to design central counterparty services for the Canadian repo and fixed-income markets that will be consistent with relevant international standards, and it established effective oversight of these services. The Bank improved the processes and systems that support government debt auctions and other domestic market operations. In collaboration with the Department of Finance, the Bank also assessed the impact of lower interest rates on the national debt program and adjusted the federal debt-management strategy for 2012–13.

The Bank's most tangible interaction with Canadians is through their daily use of bank notes. In 2012, the Bank launched two denominations in its *Polymer* series—the $50 note in March and the $20 note in November. The $10 and $5 notes will be issued by the end of 2013. The security features in the new notes are a significant advance in the Bank's ongoing efforts to keep the number of counterfeit bank notes detected in circulation well below a target of 50 counterfeits per million genuine notes. The polymer notes are more economical, lasting at least 2.5 times longer than conventional cotton-based paper notes, and they also have a reduced environmental footprint.

In 2012, the Bank launched its medium-term plan for 2013–15, the corporate road map by which we will achieve our policy and operational goals for the next three years. As we continue to deliver on our mandate to promote the economic and financial well-being of Canadians, we will focus on three priorities in this medium-term plan:

- To perform superior policy analytics to ensure that our policy frameworks are at the forefront of central bank practice. This means ensuring that we have the skilled people, the necessary tools, and adequate capacity to expand our research and analysis in support of our policy objectives.
- To help build a resilient global and domestic financial system. To this end, we will continue to participate in Canadian and international efforts to develop and implement regulatory reforms.
- To deliver excellent services to meet the evolving needs of Canadians, financial markets and the Government of Canada. We will continue to live up to high expectations as we change our own business models and adopt new practices to meet these changing needs.

Achieving these priorities takes an engaged and motivated workforce, equipped with the skills, tools and work environment it needs. This will require strategic investments that are judiciously managed, consistent with our responsibility to be a careful steward of public funds.

Highly specialized duties essential to the functioning of the Canadian economy are performed at the Bank's head office, including the daily processing of $15 billion in payments by the Bank within the large-value payment system and the management of more than $600 billion in federal government debt and about US$69 billion in foreign reserves. These functions, as well as the extensive research carried out by Bank staff, require a safe and resilient work facility. The Bank has therefore undertaken a project to renew completely its aging head office complex in Ottawa.

Following approval of the project by the Board of Directors in September, the Bank started preparations to move its staff to temporary quarters for the duration of the project, starting in the third quarter of 2013. When completed in 2016, the renewed head office facility will provide a more resilient, secure, modern and efficient work environment. The Bank is committed to carrying out this major project with effective governance and sound financial management, and in a way that preserves the architectural heritage and integrity of the original buildings.

In June of this year, I will leave the Bank of Canada to assume a new role as Governor of the Bank of England. My five years as Governor of the Bank of Canada have coincided with one of the most turbulent periods in recent history for the world economy. It has been an honour to lead this important institution during a time when its first-rate analysis and decisive policy actions were imperative to safeguarding Canada's economic prosperity. I believe that the work of the Bank, in coordination with the Government of Canada and other government agencies and financial authorities, helped Canada avoid the worst of the financial crisis and the ensuing global recession. I am confident that the expertise, dedication and professionalism that brought us through the crisis will continue to serve the country well in facing the challenges ahead.

I want to thank all my colleagues at the Bank for their commitment and their enormous contributions. It has been a privilege to work alongside the Bank's highly talented staff. I would also like to thank the members of the Board of Directors for their strong support. In particular, I want to express my appreciation to the three Directors whose terms expired in 2012—Bonnie DuPont, Carol Hansell and Michael O'Brien—for their exemplary service to the Bank and to Canadians, and to the two Lead Directors—Bill Black and David Laidley—who have served the Bank and Canada so ably during my tenure.

This *Annual Report* is an account of the Bank's policies and performance in 2012 and a testament to its ongoing commitment to Canadians.

Mark Carney

Governor

The Year at a Glance

- The Canadian economy continued to grow in 2012, and inflation expectations remained well anchored, despite the challenging and uncertain global economic environment.
- Both total and core inflation remained within the 1 to 3 per cent inflation-control range for most of the year, notwithstanding special factors that contributed to relatively weak inflation in the latter part of the year.
- The Bank made a significant contribution to efforts to strengthen the resilience of the global financial system by providing strategic direction at the Financial Stability Board and by participating in key international forums, working groups and committees.
- The Bank collaborated with other authorities and stakeholders on a number of initiatives to enhance the resilience of the Canadian financial system, including the launch of a new domestic central counterparty for repurchase agreements.
- The Bank successfully launched two denominations in the new *Polymer* series of bank notes in 2012: the $50 note in March and the $20 note in November.
- The number of counterfeit bank notes detected in circulation declined further and remained well below the Bank's target of 50 parts per million.
- The Bank of Canada implemented the mid-year change to the debt-issuance strategy for 2012–13, announced by the Minister of Finance on 27 September 2012, which provided for a temporary reallocation of short-term bond issuance toward long-term bonds to lock in additional long-term funding at historically low interest rate levels.
- The Bank developed and began to implement a framework for independent internal credit-risk assessment to reduce reliance on external credit-rating agencies in its funds-management activities.
- The Bank's balance sheet increased by 21 per cent in 2012 compared with 2011. This expansion was mainly due to the federal government's decision, announced in 2011, to build a prudential liquidity-management deposit of up to $20 billion at the Bank of Canada. This deposit grew by $10 billion in 2012, driving the increase in the Bank's balance sheet over the year.
- The Board of Directors approved a decision to modernize the Bank's head office complex, and plans were advanced for the project, as well as for the move of Bank staff to temporary quarters in 2013.

The Bank in 2012

The Bank of Canada's Mandate

The Bank of Canada Act is the Bank's legislative framework. The Act sets out the governance structure of the Bank as well as its mandate to "promote the economic and financial welfare of Canada."

The Bank strives to meet this mandate through its work in four core areas of responsibility:

Monetary policy. The Bank contributes to solid economic performance and rising living standards for Canadians by keeping inflation low, stable and predictable. Since 1991, the Bank's monetary policy actions toward this goal have been guided by a clearly defined inflation-control target.

Financial system. The Bank promotes the stability and efficiency of Canada's financial system by providing liquidity; overseeing systemically important payment, clearing and settlement systems; participating in the development of financial system policies in Canada and globally; and assessing and communicating risks to the overall stability of the financial system.

Currency. The Bank designs, produces and distributes Canada's bank notes and replaces worn notes. It deters counterfeiting through leading-edge bank note design, public education and collaboration with law-enforcement agencies.

Funds management. The Bank provides effective and efficient funds-management services for the Government of Canada, and administers and advises on the public debt and foreign exchange reserves. In addition, the Bank provides banking services to foreign central banks, as well as to critical payment, clearing and settlement systems.

The Medium-Term Plan

To meet its mandate in a changing environment, the Bank develops a medium-term plan (MTP) every three years. This year saw the completion of the 2010–12 plan, *Achieving Excellence Together.*

This plan set out key priorities for each of the Bank's four main functions: monetary policy, the financial system, currency and funds management. At the corporate level, the plan also identified three main priorities:

(i) **Conducting leading research and policy analysis.** The Bank conducts research and analysis to enhance its policy frameworks and strengthen its contributions to domestic and international discussions of economic and financial policy issues. System-wide financial stability and the linkages between the financial system and the macroeconomy were important areas of focus in 2012.

(ii) **Strengthening business resilience and infrastructure.** The Bank must be able to carry out its critical business functions, even during major disruptions such as power outages and pandemic alerts. In 2012, the Bank increased the resilience and robustness of its business-continuity arrangements, notably by upgrading its primary data centre, and refined its information technology strategy.

(iii) **Attracting, retaining and engaging quality staff.** In response to demographic trends and changing labour markets, as well as a growing need for specialized skills, the Bank gave increased attention to the attraction, retention and engagement of staff. As part of this initiative, the Bank completed the renewal of its total compensation strategy and is strengthening its talent-acquisition and career-development programs, promoting leadership effectiveness, improving the management of information, and refining its succession-planning strategy.

A Corporate Effectiveness Program was also added to the medium-term plan in 2011 to ensure that the Bank's business priorities could be met while respecting the federal government guidelines on holding expenses at 2010 levels. The Bank met the guidelines by rationalizing and standardizing some administration and support services. By the end of the MTP, this initiative achieved ongoing savings of $15 million per year, establishing a more efficient cost base that will benefit the Bank in the future.

All of the objectives of the medium-term plan, outlined above, were met or exceeded.

In late 2012, the Bank launched a new medium-term plan, *Building on Excellence: Strength, Stability and Confidence*, which covers priorities for 2013 to 2015. The strategic priorities for the new plan include providing superior policy analytics, building a resilient financial system and delivering excellent services. The new plan will help to ensure that the Bank can continue to fulfill its mandate in a cost-effective manner.

Key Achievements

Monetary Policy

Experience has shown that the most important contribution that monetary policy can make to the economic welfare of Canadians is to keep inflation low, stable and predictable. Since 1991, the Bank's monetary policy actions toward this objective have been guided by a clearly defined inflation-control target. In 2011, this target—2 per cent for total inflation—was renewed by the Bank and the Government of Canada and was extended to 2016.

Monetary policy decisions are made within a flexible inflation-targeting framework and must be forward looking. They rely importantly on the current analysis, forecasting and research activities of the Bank's economists, as well as on information drawn from external sources. Given the structure of Canada's economy, analysis of the external environment plays an important role in formulating monetary policy. In 2012, key priorities included advancing our understanding of the evolving impact of foreign developments on the Canadian economy, the linkages between financial market developments and the macroeconomy, and the structural challenges facing the Canadian economy.

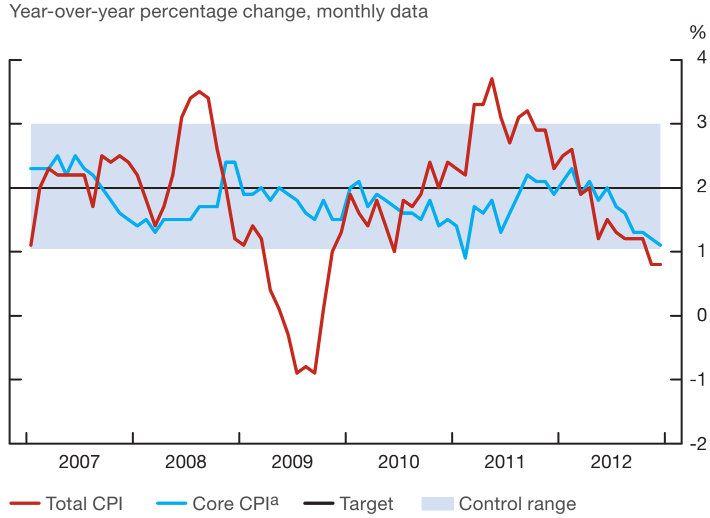
Economic uncertainty, the sovereign debt crisis and recession in Europe, as well as the modest pace of the recovery in the United States and slowing growth in a number of emerging-market economies, posed serious challenges for the Canadian economy in 2012. Domestically, ongoing competitiveness pressures and growing imbalances in the household and housing sectors remained important sources of concern. Against this backdrop, the Bank maintained its policy rate at 1 per cent throughout the year, keeping considerable monetary policy stimulus in place. Detailed economic analysis and explanation of the Bank's monetary policy are provided quarterly in the *Monetary Policy Report*.

Key Achievements in 2012

- In the face of a challenging and uncertain global environment, the Canadian economy continued to grow in 2012, and inflation expectations remained well anchored.
- Total CPI inflation and core inflation both remained within the 1 to 3 per cent inflation-control range for much of the year, but with a marked slowing toward the end of 2012 (**Chart 1**). An increase in excess production capacity, together with a number of special temporary factors, contributed to this decline.

Chart 1: Total CPI and core inflation remained within the 1 to 3 per cent inflation-control range for much of the year, but with a marked slowing toward the end of 2012

Year-over-year percentage change, monthly data



a. Consumer price index excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components

Source: Statistics Canada

Last observation: December 2012

- The analytic tools used to support monetary policy decision making were enhanced. New features were added to the Bank's main projection tools to facilitate the analysis of financial developments and their macroeconomic implications, and new state-of-the-art tools were developed for nowcasting and near-term forecasting.
- Analysis of the structural challenges facing the Canadian economy was expanded, notably in the areas of competitiveness and Canada's export markets, the implications of rising commodity prices for the economy, and interprovincial trade and labour mobility.

- The Bank made important contributions to international policy discussions at the G-20, the Bank for International Settlements, the International Monetary Fund and other forums. Topics included global policy coordination (in support of the G-20 Framework for Strong, Sustainable and Balanced Growth), the changing nature of international capital flows in the post-crisis environment and the evolution of the international financial architecture.
- Notable progress was made toward integrating domestic financial stability considerations into the analysis supporting monetary policy decision making, resulting in enhanced communication of the risks associated with monetary policy.

Canada's Monetary Policy: An External Assessment

In its biennial *Economic Survey of Canada*, released in June 2012, the Organisation for Economic Co-operation and Development (OECD) noted that Canada's "monetary framework enjoys a high degree of credibility, and inflation has remained close to the target of 2% since 1995." Commenting on the Bank's monetary policy stance, the OECD stated: "To support the economic recovery, the Bank of Canada has appropriately maintained a highly accommodative stance by keeping its policy rate at 1.0% since September 2010."

The Bank of Canada's Fellowship Program

The Bank of Canada's Fellowship Program helps to foster excellence in research and analysis and to develop partnerships with experts outside the Bank in areas important to its mandate. Through this program, two types of research awards are available for academics working at Canadian universities.

The **Fellowship Award**, which is granted for a five-year term, is designed to recognize excellence among well-established researchers in Canada. In 2012, the recipient was Professor Jean-Marie Dufour, the William Dow Professor of Economics at McGill University and one of the country's leading econometricians. He had previously received the Bank of Canada Research Fellowship for 2007. Through his expertise in applying statistical and mathematical techniques to economic and financial issues, Professor Dufour has made important contributions to the fields of dynamic macroeconomic modelling, structural macroeconomics and finance, inflation, the pricing of financial assets, taxation and investment, and export financing. His current research covers a wide range of issues in macroeconometrics, financial econometrics, statistics, macroeconomics and growth.

The **Governor's Award**, which is granted for a two-year period, recognizes outstanding academics at a relatively early stage in their careers. The 2012 recipient of the Governor's Award was Professor Francesco Trebbi, an Associate Professor of Economics at the University of British Columbia. His research interests are in political economics and macroeconomics, and he has published extensively in the areas of housing and banking regulation, election and campaign finance, political institutions and their design, as well as the political economy of the 2008–09 crisis.

Additional details about the Fellowship Program, as well as a list of current and previous recipients of Fellowship and Governor's awards, can be found on the Bank's website.

Financial System

The Bank promotes the stability and efficiency of Canada's financial system by providing liquidity; overseeing systemically important payment, clearing and settlement systems; participating in the development of financial system policies in Canada and globally; and assessing and communicating risks to the overall stability of the financial system. The Bank shares responsibility for the stability of the financial system with other federal financial regulatory authorities. Ultimately, the Minister of Finance is responsible for the sound stewardship of the financial system.

In 2012, the key challenges were: (i) internationally, advancing the comprehensive G-20 program of reform to strengthen the global financial system; (ii) implementing these reforms domestically; (iii) assessing the evolution of risks to the stability of the financial system in light of changing economic and financial conditions; and (iv) standing ready to implement appropriate policy responses in the event that risks materialized.

Key Achievements in 2012

- The Bank applied an enhanced analytic framework to the assessment and communication of risks to the Canadian financial system. The Bank judged that the overall level of risk remained high in 2012, owing largely to the euro-area sovereign debt and banking crisis. The main domestic sources of risk were judged to be the high levels of household debt and elevated valuations in some segments of the housing market—conditions that make households especially vulnerable to economic shocks. The Bank worked with its partners to assess these risks and ways to mitigate them. Risk assessments were communicated in the *Financial System Review* and in speeches by members of the Bank's Governing Council. Actions taken by the federal government and the Office of the Superintendent of Financial Institutions, in combination with increased awareness by households of the risks inherent in rising debt loads, are contributing to the beginnings of a more constructive evolution of household imbalances.
- The Bank continued its significant contribution to international efforts to strengthen the resilience of the global financial system. It helped advance reforms in a number of areas, including: over-the-counter (OTC) derivatives; resolution regimes for failing financial institutions; shadow banking; and bank liquidity standards. This work was done in key international forums, including the Financial Stability Board, the Committee on the Global Financial System, the Basel Committee on Banking Supervision, and the Committee on Payment and Settlement Systems.
- In collaboration with its domestic partners, the Bank made substantial progress in the analysis, development and oversight of Canada's key financial infrastructure. The Bank collaborated with the Canadian Derivatives Clearing Corporation and market participants to launch a new domestic central counterparty (CCP) for repurchase agreements, with robust risk controls. To meet a key G-20 commitment to centrally clear standardized OTC derivatives, the Bank and other relevant Canadian authorities announced in October that market participants can clear these derivatives using any central counterparty recognized by Canadian authorities, including global central counterparties. In addition, the Bank contributed to devising new international and domestic risk-control standards for systemically important financial market infrastructure, and adopted these standards for its own oversight of this infrastructure.[1]

1 See http://www.bankofcanada.ca/wp-content/uploads/2012/06/fsr-0612-chatterjee.pdf; http://www.bankofcanada.ca/wp-content/uploads/2012/12/fsr-1212-chande.pdf; and http://www.bankofcanada.ca/wp-content/uploads/2012/12/fsr-1212-mcvanel.pdf.

- More generally, the Bank, together with the other responsible authorities, contributed to policies to enhance the resilience of Canada's financial system with regard to the recovery and resolution of failing financial institutions.
- The Bank made significant progress in developing the systems that support government debt auctions and other domestic market operations, thereby reducing operational risk in these areas.

The Canadian Financial System: External Assessments

In 2012, the Canadian financial system was assessed by two external authorities, the Organisation for Economic Co-operation and Development (OECD) and the Financial Stability Board (FSB).

In its 2012 *Economic Survey of Canada*, the OECD noted that "Canadian authorities have taken welcome steps to address vulnerabilities in the financial system, while actively participating in international efforts to strengthen macro-prudential regulation." One initiative cited by the OECD was the implementation of regular system-wide joint stress testing by the Office of the Superintendent of Financial Institutions and the Bank of Canada.

The FSB's 2012 *Peer Review of Canada* also described the progress Canada had made in recent years in strengthening its financial system, and stated that "the good performance of the financial system both during and after the crisis provides further evidence of its soundness and resilience."

Currency

The Bank of Canada is responsible for supplying Canadians with bank notes that they can use with confidence. The Bank has a four-part strategy to maintain that confidence: (i) developing bank notes that are difficult to counterfeit and easy to authenticate; (ii) increasing the routine verification of bank notes by retailers; (iii) promoting the deterrence of counterfeiting by law-enforcement agencies and prosecutors; and (iv) ensuring a focus on quality throughout the life cycle of a bank note—from production to efficient distribution to the withdrawal of worn and obsolete notes for destruction and replacement.

In 2012, a key priority for the currency function was to issue two additional denominations of its new *Polymer* series—the $50 and $20 notes—and to continue to increase awareness of the new notes.

The demand for bank notes increased in 2012, roughly in line with the growth of the economy. At year-end, there were about 2 billion bank notes in circulation, up by about 2.7 per cent from 2011. The total value of bank notes outstanding increased by $2.7 billion to $63.7 billion.

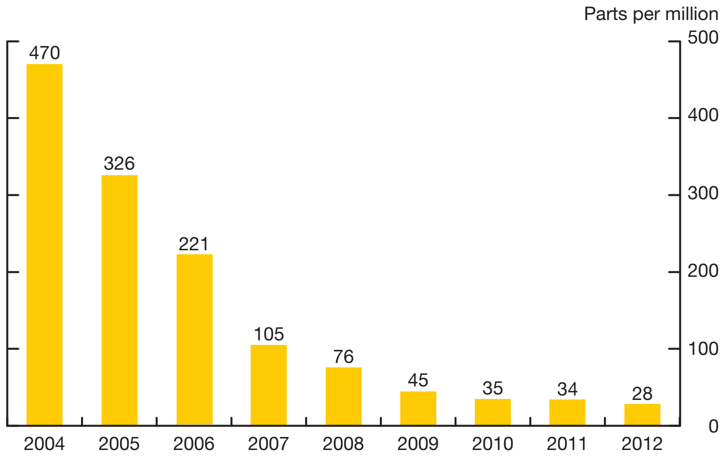
In its 2010–12 medium-term plan, the Bank set a target of 50 counterfeits detected annually for each million genuine bank notes in circulation.

Key Achievements in 2012

- The Bank successfully launched two denominations in the new *Polymer* series: the $50 note in March and the $20 note in November (**Box 1**). Public awareness of the series was high (at 77 per cent), based on a survey of 2,000 Canadians conducted after the release of the new $20 note.

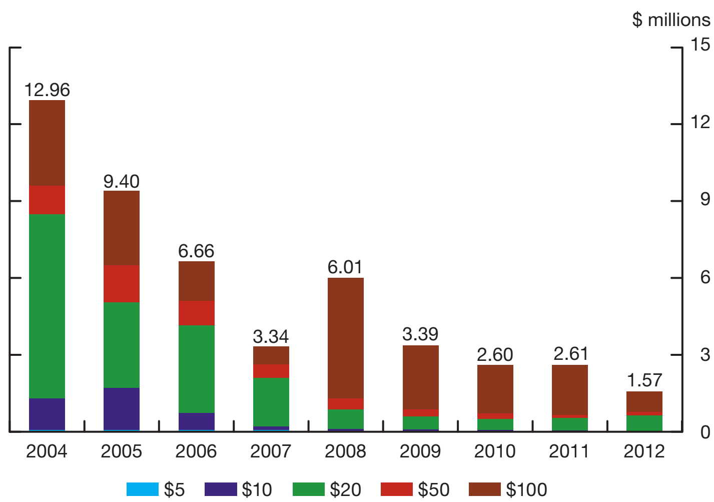
- Development of the new $5 and $10 notes was completed, and preparation began for the issue of these denominations in 2013.
- Since the $20 note is the most circulated denomination, the Bank increased its already extensive support and coordination with key stakeholders in advance of the issue of this note.
- Counterfeiting fell to 28 parts per million (ppm) last year from 34 ppm in 2011. This was well below the target of 50 ppm (**Chart 2**), and the face value of counterfeit notes detected in circulation fell by 40 per cent from the previous year to $1.6 million in 2012 (**Chart 3**).

Chart 2: Number of counterfeit bank notes detected per million notes in circulation[a]



a. Medium-term plan target for 2010–12: 50 ppm

Chart 3: Face value of counterfeit bank notes found in circulation



- The Bank continued its work with international groups such as the Central Bank Counterfeit Deterrence Group (a group of 32 central banks); the Four Nations Group (Australia, Canada, England and Mexico); and the Reproduction Research Centre (an anti-counterfeiting laboratory operated by central banks). A joint research program was established with the Four Nations Group to further support counterfeit deterrence.

Box 1

The New Polymer $20 Note: The Canadian National Vimy Memorial

In November, the Bank of Canada issued the new $20 note as part of its *Polymer* series. The imagery on the back of the note features the Canadian National Vimy Memorial. This iconic monument, located in Vimy, France, commemorates the Allies' 1917 victory at Vimy Ridge. It also honours those Canadians who fought and gave their lives in the First World War in France and have no known grave.

The introduction of the $20 note is an important milestone for the new *Polymer* series. Making up half of all bank notes in circulation, the $20 note is the denomination that Canadians use the most in their daily transactions.

While the imagery on the new $20 note reminds us of the past, in all other respects, the *Polymer* series represents the future.

Safer, cheaper and greener, these notes are the result of innovative technology and Canadian ingenuity. The combination of transparency, holography and other sophisticated security elements makes them unique among the world's currencies.

State-of-the-art security features will deter counterfeiters and ensure that Canadians can use bank notes with complete confidence. Since these notes will last at least 2.5 times longer than those made with cotton-based paper, they are more economical and their environmental footprint is smaller.

When a new series of bank notes is issued, the equipment that accepts, processes or dispenses them must be adapted by financial institutions, cash processors, retailers and other entities that accept bank notes. In advance of this issue, the Bank worked closely with financial institutions and the manufacturers of bank note equipment to support a smooth transition to the new polymer notes.

The remaining bank notes in the series—the $5 and $10 notes—will be issued by the end of 2013. The designs and images featured on these denominations will be released when the notes are officially unveiled.

Funds Management

As the federal government's fiscal agent and banker, the Bank of Canada administers and advises on the government's debt and reserves. The Bank also works with the Department of Finance to develop principles, policies and programs for managing the federal government's borrowing and investment activities. The Bank's goal is to provide fiscal-agent and related banking services effectively and efficiently within a strong risk-management framework.

The Bank manages Government of Canada cash balances held at the Bank of Canada and other financial institutions, which averaged about $17 billion in 2012. It also managed, on behalf of the government, official international reserves amounting to about US$69 billion in 2012.

The Bank manages the risks associated with its own balance sheet, and manages and administers the assets held by its employee pension fund. In addition, the Bank undertakes banking activities on behalf of other central banks and international organizations, and provides banking services to financial institutions and designated payment, clearing and settlement systems.

Key challenges for the funds-management function in 2012 were to reduce the reliance on external credit-rating agencies in the government's funds-management activities; to implement changes to the Canada Savings Bond Program; and to coordinate research related to the increased use of digital alternatives to cash.

Key Achievements in 2012

- The Bank developed and began to implement a framework for independent, internal credit-risk assessment for its funds-management activities. Once fully implemented, this framework will significantly reduce reliance on external credit-rating agencies, consistent with the Financial Stability Board's Principles and the G-20 commitments.
- The Bank of Canada implemented the mid-year change to the debt-issuance strategy for 2012–13, announced by the Minister of Finance on 27 September 2012, which provided for a temporary reallocation of short-term bond issuance toward long-term bonds to lock in additional long-term funding at historically low interest rate levels. These adjustments helped the government to meet its goal of raising stable and low-cost funding while reducing refinancing risk.
- The Bank proceeded with the implementation of the Government of Canada's prudential liquidity-management plan announced in the 2011 federal budget.
- In collaboration with the Department of Finance, the Bank managed a successful U.S.-dollar global bond issue and contributed to strengthening the asset-allocation process in the investment framework for the Exchange Fund Account. This bond was subsequently named the 2012 "SSAR Bond of the Year" by the *International Financing Review*.
- The Bank of Canada implemented a number of changes to the retail debt program to improve the efficiency of the program and better align product offerings to the needs of Canadian investors.
- Banking operations ran smoothly, with no serious events or outages. The fee structure for banking services was reviewed and revised to ensure that the Bank's cost-recovery objectives are achieved.

Unclaimed Balances

When a Canadian bank account has been inactive for 10 years and the relevant financial institution has been unable to contact the owner, the assets of the account are transferred to the Bank of Canada.

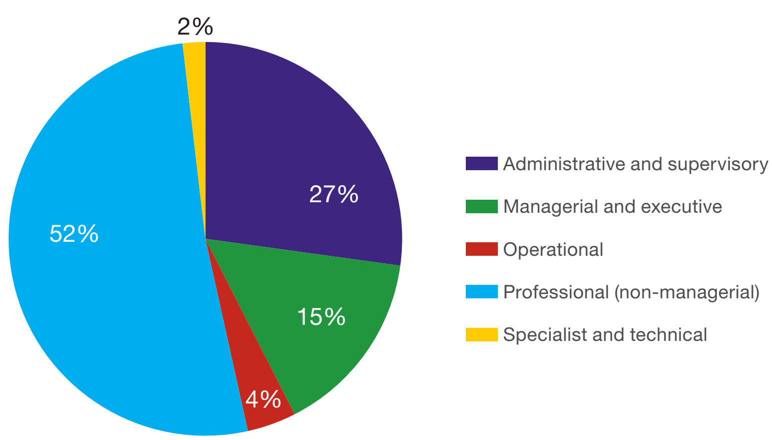
If you think that you (or someone you know, living or deceased) may have money in a forgotten account, you can go to the Bank of Canada's website, type "unclaimed balances" in the search box, and use the tool provided to see whether such an account exists. At the end of 2012, the Bank was the custodian of 1.3 million of these accounts, which had a total value of $496 million.

Owners of these accounts can claim their money if they are able to provide proof of ownership. In 2012, the Bank released more than $17.4 million of this money to the rightful owners.

Our People and Work Environment

To fulfill its responsibilities, the Bank relies on talented staff with a wide range of specialized skills. Most of the Bank's employees work at the head office in Ottawa; about 10 per cent are located at operations centres in Montréal and Toronto, and in regional offices in Vancouver, Calgary, Toronto, Montréal, Halifax and New York. Bank staff have diverse professional and operational backgrounds and are recruited from across Canada and internationally by means of job postings on our website and other sites geared to specific professions (**Chart 4**). The Bank also actively recruits university graduates of economics and finance programs. In 2012, 49 employees were hired through this recruitment initiative.

Chart 4: Composition of Bank staff, by role
Regular employees



An important part of what makes the Bank an attractive workplace is the way it engages and challenges staff while providing a range of development opportunities. This is reflected in the number of internal job changes that occur every year as employees win promotions through competitions, move laterally or take on temporary assignments that further their career objectives (**Table 1**). Additional development opportunities occur through such activities as attending workshops and presenting papers at conferences. Information about working at the Bank, as well as a list of current job postings, is available on the Bank's website at Careers.

Following Board approval for the renewal of the Bank's head office complex, the Bank engaged in detailed planning and preparations for a move to temporary quarters in 2013. When completed in 2016, the head office facility will provide a more resilient, secure, modern and effective work environment for Bank staff (**Box 2**).

Table 1: Workforce Indicators
(Regular employees)

	2010	2011	2012
Number of regular employees	1,305	1,228	1,239
Average years of service for regular employees	12.8	12.6	12.3
Number of regular employees hired	69	47	56
Number of internal job changes for regular employees	277	214	261

The Bank's Staff in 2012

As a knowledge-based institution, the Bank dedicates many of its resources to research and analysis to support the formulation and implementation of policy in each of its four core functions. In 2012, the Bank strengthened its recruitment of external talent in the areas of economics and finance and increased the focus of its recruitment program on mid-career professionals.

The Bank's turnover rate, which is lower than the average rates in the public and private sectors, is a positive indicator of job satisfaction (**Table 2**).

Table 2: Voluntary Turnover Rate[a]
(Regular employees)

	2010	2011	2012
Bank of Canada	4.0	3.5	2.9
Public sector	4.3	3.9	4.6
Private sector	6.8	7.8	8.2

a. The methodology for calculating turnover was modified from previous years to ensure consistency with external benchmarks.
Source: Conference Board of Canada survey

Top 100 Employers in Canada

The Bank was named one of Canada's Top 100 Employers for 2013, as it was for 2011 and 2012, based on an assessment of its work practices, policies and communications.

See http://www.eluta.ca/top-employer-bank-of-canada. The Bank was also recognized as one of the National Capital Region's Top Employers.

Box 2

Head Office Renewal

In 2012, the Board of Directors approved a plan to renew the Bank's head office complex in Ottawa. Located at 234 Wellington Street, across from Parliament Hill, this site has been the Bank's home since 1938. Highly specialized duties essential to the functioning of the Canadian economy are performed at the Bank's head office, including $15 billion in payments processed daily by the Bank within the large-value payment system, and the management of more than $600 billion in federal government debt and about US$69 billion in foreign reserves. Staff based at the head office also perform leading-edge economic and financial analysis to guide the conduct of monetary policy and promote financial stability. A resilient work facility is therefore critical for the Bank to continue to fulfill its mandate to promote the economic and financial welfare of Canada.

Consistent with the 2010–12 medium-term plan priority to strengthen its infrastructure and business resilience, the Bank conducted a detailed assessment of the condition of its head office facility, as well as the organization's current and long-term business needs.

Comprehensive analysis by both bank staff and external experts determined that the head office facility is in need of extensive renovation. The main systems—ventilation, heating, plumbing and electrical—have reached the end of their lifespans. The facility also needs to be upgraded to align with modern requirements for health and safety standards and seismic stability, and to better meet the Bank's evolving security and business requirements. Renewing the head office is also an opportunity to make it more energy efficient, cost effective and environmentally sustainable.

In undertaking this project, the Bank is committed to exercising sound stewardship of public funds. Ensuring the best possible value has formed the basis of the analysis that the Bank has conducted in planning this project. Ultimately, the Bank concluded that a complete renewal of the head office facility provided the best value for money. The project will involve a complete overhaul of all systems, as well as renovation of the building, over a three-year construction period. The estimated cost of the construction is $460 million.

Construction will begin in 2014 and is expected to be finished in 2016. By the end of 2013, head office staff will be relocated to 234 Laurier Avenue West. Vacating the current building will allow the Bank to complete the renovations more rapidly, shorten the period of disruption, lessen the risk of a system failure and lower program costs. Relocation costs of $150 million during the project period will be partially offset by lower facility-related operating costs associated with the Wellington Street head office facility during the period of construction.

This is the Bank's largest infrastructure project since the two glass office towers were built in the 1970s. It follows an ambitious timeline, and the Bank is committed to meeting it with effective governance, sound financial management, and in a way that preserves the architectural heritage and integrity of the original buildings.

Key Corporate Priorities for 2013

The Bank's main priorities for 2013 are:

- enhance the analysis of linkages between the macroeconomy and financial system developments and policies, including their international dimensions, and enable the integration of these elements into assessments of Canada's economic outlook
- deepen the Bank's knowledge of emerging-market economies and their influence on the global and Canadian economies
- influence the global financial reform agenda, particularly with regard to capital and liquidity standards, financial infrastructure, shadow banking and the framework for systemically important financial institutions, and help implement these reforms domestically
- further develop the analytic framework for assessing risks to the financial system and support the development of appropriate policies
- in collaboration with the Department of Finance, strengthen Canada's framework for foreign reserve management by updating governance and refining the investment strategy
- reduce the Bank's reliance on credit-rating agencies for the government's funds-management activities and the Bank's internal operations
- maintain operational excellence in funds-management and market operations
- complete the issuance of the remaining denominations of the *Polymer* series
- begin implementation of the Currency Department's new business model, which will provide efficiencies in an evolving bank note environment
- begin the comprehensive program to overhaul and modernize the Bank's head office facility so that it meets future needs, and move to our temporary location without interruption
- enhance recruitment strategies and further develop recognition and career-development programs

Financial Highlights

Table 3 presents highlights of the Bank's 2012 financial statements and provides comparative figures. Further explanation and commentary are found in the Management's Discussion and Analysis section of this *Report*. Additional information about the Bank's balance sheet is available on the Bank's website.

Table 3: Financial Statement Highlights
(Millions of dollars)

	Value at 31 December				
	2012	2011	2010[a]	2009[b]	2008[b]
Total assets **and** ***Total liabilities and equity***	77,807.3	64,247.2	61,216.1	71,354.7	78,583.5
Significant Financial Statement items					
ASSETS					
Loans and receivables	1,905.6	1,530.8	2,087.0	25,377.0	37,233.7
Investments	75,607.3	62,424.2	58,767.4	45,988.9	41,022.8
LIABILITIES					
Bank notes in circulation	63,700.0	61,028.8	57,874.2	55,467.9	53,731.3
Deposits	13,291.3	2,481.0	2,556.8	15,550.2	24,413.2
Comprehensive income					
Revenue	1,575.4	1,606.8	1,543.3	1,709.7	2,228.1
Expenses	475.6	353.1	380.8	366.0	375.9
Other comprehensive (loss) income	(63.7)	(178.9)	(122.1)	(76.1)	58.2
Comprehensive income	1,036.1	1,074.8	1,040.4	1,267.6	1,910.4

a. Comparative figures have been restated in accordance with International Financial Reporting Standards (IFRS).
b. Comparative figures are reported in accordance with Canadian Generally Accepted Accounting Principles (GAAP).

The Bank's balance sheet increased by 21 per cent in 2012 compared with 2011. This expansion was mainly due to the federal government's decision, announced in 2011, to build a prudential liquidity-management deposit of up to $20 billion at the Bank of Canada. This deposit grew by $10 billion in 2012, driving the increase in the Bank's balance sheet over the year.

While the total size of the balance sheet at end-2012 was comparable with that in 2008, its composition and the underlying reasons for the expansion were quite different. The expansion of the Bank's balance sheet during 2008–09 mainly reflected the extraordinary liquidity the Bank provided to the financial system in response to the global financial crisis, principally by means of term purchase and resale agreements (PRAs). In contrast, the expansion of the balance sheet in 2012 to accommodate the government's liquidity-management plan mainly involved outright purchases of government securities: only two term PRAs, issued for general balance-sheet-management purposes, were outstanding at 31 December 2012.

Bank notes are the principal liability on the Bank's balance sheet. The value of bank notes in circulation increased by 4.4 per cent in 2012, roughly in line with the growth of nominal GDP.

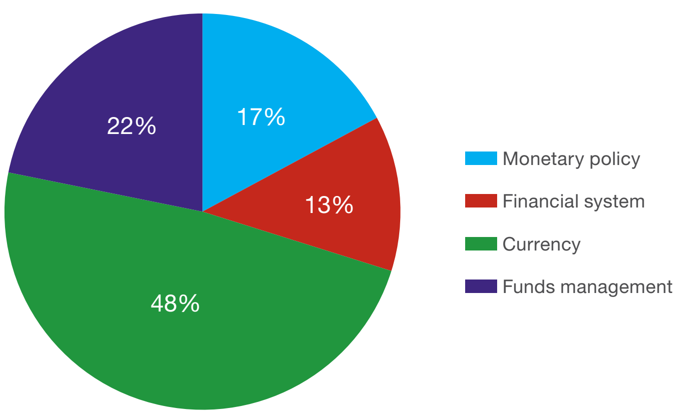
Revenue decreased by 2.0 per cent compared with the previous year, owing to lower yields on investments. The increase in expenses in 2012 of about 35 per cent is attributable to a rise in bank note production costs associated with the launch of the new *Polymer* series, as well as costs related to strategic initiatives in the Bank's medium-term plan.

The *Other comprehensive loss* recorded in 2012 mainly comprises actuarial losses related to the Bank's deferred employee benefit plans, reflecting a 60-basis-point reduction in the discount rate used to value the defined-benefit obligation.

Expenses by function

The composition of the Bank's 2012 expenses by function (excluding costs associated with the Enhanced Business-Continuity Program and the Head Office Renewal Program) are shown in the chart below.

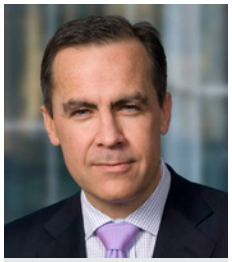
Chart 5: Operating expenses, by function[a]

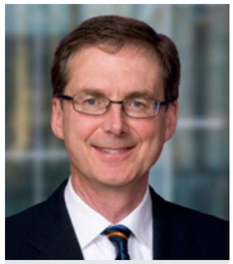


a. Expenses exclude the non-recurring program costs associated with the Enhanced Business-Continuity Program and the Head Office Renewal Program.

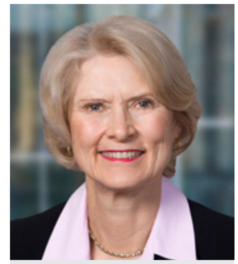
Costs associated with the Currency function, mainly bank note production, represented almost half of the Bank's total expenses. With the launch of the new *Polymer* series, these costs increased in 2012, both absolutely and as a share of total costs. Although the initial cost of producing the polymer notes is higher than that of the previous cotton-based paper notes, they are expected to last at least 2.5 times longer.

Board of Directors and Management of the Bank


Mark Carney[6*]
Governor,
Chairman of the Board

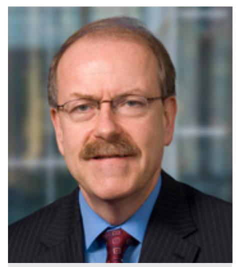

Tiff Macklem[6, 7*]
Senior Deputy Governor


William Black[3,* 6, 7]


Phyllis Clark


Philip Deck[3, 5]

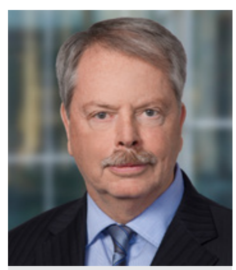

Douglas Emsley[2, 5,* 6]


Jock Finlayson[3, 4, 8]


Brian Henley[5, 7]


Daniel Johnson[2, 4*]

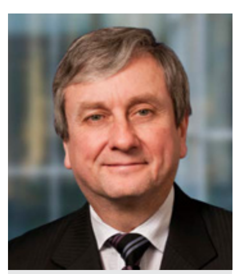

Claire Kennedy


Derek Key


David Laidley[1, 2,* 4, 5, 6]


Leo Ledohowski[3, 5]


Richard McGaw[4, 7]


Michael Horgan[6]
Deputy Minister
of Finance,
Member ex officio

1. Lead Director
2. Member of Audit and Finance Committee
3. Member of Human Resources and Compensation Committee
4. Member of Corporate Governance Committee
5. Member of Capital Projects Committee
6. Member of Executive Committee
7. Member of Pension Committee
8. Chair of the Fellowship Nominating Committee

* Indicates committee chair

Role of the Board

Under the statutory governance framework established in the Bank of Canada Act, the Governor is the Chief Executive Officer of the Bank and Chair of its Board of Directors. The Governor has specific authority and responsibility for the business of the Bank, notably with respect to the formulation and implementation of monetary policy, the provision of fiscal-agent services to the federal government, the issuance of bank notes, the provision of liquidity to the financial system, and oversight of Canada's major clearing and settlement systems as set out in the Payment Clearing and Settlement Act.

The Board of Directors provides general oversight of the management and administration of the Bank with respect to strategic planning, financial and accounting matters, risk management, human resources, and other internal policies. The Board and the Governor work in close co-operation, since the oversight of financial and administrative matters by the Board is important to the conduct of the business of the Bank by the Governor.

The Board and the Bank regularly review and consider the relevant best practices of other public institutions, central banks and private sector organizations with a view to continuously improving and achieving excellence in the Bank's corporate governance.

Board Composition and Activities

The Board is composed of the Governor, the Senior Deputy Governor and 12 independent directors appointed for three-year renewable terms by the Governor in Council (the Cabinet). The Deputy Minister of Finance is an ex officio, non-voting member of the Board. In November 2012, Phyllis Clark and Derek Key were appointed as directors to succeed Bonnie DuPont and Michael O'Brien, respectively, and in December, Claire Kennedy was appointed to succeed Carol Hansell.

The Board and each of its committees meet regularly throughout the year. The Board has adopted written terms of reference setting out committee responsibilities, as well as the responsibilities of the committee chairs. The committees in turn adopt written work plans for each calendar year.

Board Committees and Activities

The Board has established the following standing committees to enable it to carry out its responsibilities effectively:

- The **Audit and Finance Committee**, chaired by David Laidley, oversees the financial affairs of the Bank, including its medium-term plan, annual budget and expenditures, as well as the activities of the Bank's internal and external auditors.
- The **Human Resources and Compensation Committee**, prior to November 2012 chaired by Bonnie DuPont,[2] provides Board oversight with respect to the Bank's human resources policies and practices, compensation policies, succession planning and senior executive performance, as well as, subject to approval by the Governor in Council, the compensation of the Governor and the Senior Deputy Governor.
- The **Corporate Governance Committee**, chaired by Daniel Johnson, is responsible for the oversight of the Bank's corporate governance practices, including the annual assessment of the Board's effectiveness, and a review of both the composition of committees and the terms of reference of the Board and its committees.

2 William Black replaced Ms. DuPont as Chair.

- The **Capital Projects Committee**, chaired by Douglas Emsley, provides Board oversight for significant capital projects undertaken by the Bank. During 2012, the committee's primary focus was the review of the Bank's plans for the renewal of its head office complex in Ottawa.
- The **Pension Committee**, chaired by the Senior Deputy Governor, Tiff Macklem, is responsible for advising the Board regarding the Bank's responsibilities as sponsor and administrator of the Bank of Canada pension plan, including plan investment policies, plan administration, communication and stakeholder relations.[3]

In addition, the Bank of Canada Act provides for an Executive Committee to act in the place of the Board. In 2012, the Executive Committee met in February to receive its regular annual report from the Human Resources and Compensation Committee regarding senior staffing matters, and in July to receive an in-depth economic briefing from senior management (all Board members are invited to this meeting).

An independent director, Jock Finlayson, acts as Chair of the Nominating Committee of the Bank's Fellowship Program. Highlights of this year's Fellowship Program are provided on page 8 in the Monetary Policy section of this *Report*.

In November and December, the Board, in keeping with its statutory responsibilities under the Bank of Canada Act, formed Special Committees to conduct search processes for the recruitment of a Deputy Governor, following the resignation of Jean Boivin, and for candidates for Governor, following the announcement of the resignation of Mark Carney, effective June 2013. Both appointments will be made by the Board in 2013.[4] The appointment of the new Governor is subject to approval by the Governor in Council (the Cabinet).

Meetings and Attendance

In 2012, the Board met nine times; the Executive Committee, twice; the Audit and Finance Committee, seven times; the Capital Projects Committee, seven times; the Human Resources and Compensation Committee, four times; and the Pension Committee, four times. Attendance data are available on the Bank's website: About The Bank>Management and Corporate Governance>Board of Directors.

Board Independence

Since the Governor is both Chairman of the Board of Directors and Chief Executive Officer, the independent (non-management) directors elect a Lead Director for a two-year renewable term to represent their interests and act as a link between them and the Governor. In September 2012, David Laidley replaced William Black at the end of Mr. Black's term as Lead Director.

As well, both the Board and its committees regularly hold sessions without management or non-independent directors present. Each committee of the Board, except the Pension Committee, consists solely of independent directors. The Audit and Finance Committee meets privately on a regular basis with the co-auditors, the Chief Internal Auditor, and the Chief Accountant and Chief Financial Officer. The Board and its committees have the right to retain independent advisers at the Bank's expense.

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3 The Pension Committee is composed of three independent directors, three members of management and the Senior Deputy Governor.

4 On 21 February 2013, Lawrence Schembri was appointed Deputy Governor, effective 25 February 2013.

Board Effectiveness

The Board conducts a regular self-assessment of its effectiveness by means of an annual process that solicits directors' views on various aspects of the Board's operations, governance and effectiveness. The Board regularly examines its continuing education requirements and receives training on matters pertinent to its duties. New directors are provided with comprehensive orientation briefings when they join the Board.

Each year, the Board holds a meeting outside of Ottawa and uses the opportunity to gain an understanding of regional concerns and to explain the Bank's policies. In 2012, the meeting was held in Halifax.

Director Compensation

Independent directors are paid within the ranges established under the *Remuneration Guidelines for Part-Time Governor in Council Appointees in Crown Corporations* administered by the Privy Council Office. During 2012, directors were paid an annual retainer of $8,000 and an additional $625 per diem for attendance (including attendance by telephone) at Board or committee meetings. An additional annual retainer of $3,000 was paid to each director serving on the Executive Committee. Each director who chairs a committee of the Board was paid an additional retainer of $1,000, except for the Chair of the Corporate Governance Committee, who was paid an additional $2,000. In his role as Chair of the Nominating Committee of the Fellowship Program, Mr. Finlayson was paid on a per diem basis.

In addition, all independent directors are reimbursed for travel, accommodation and meal expenses incurred while attending meetings of the Board, its committees or other Board-related events. The Governor, the Senior Deputy Governor and the Deputy Minister of Finance receive no compensation with respect to their duties as members of the Board.

Management of the Bank

The Governing Council is the Bank's policy-making body. It consists of the Governor, the Senior Deputy Governor and four Deputy Governors, and is responsible for monetary policy, decisions aimed at promoting a sound and stable financial system, and the strategic direction of the Bank.

Governing Council (*left to right*): John Murray, Deputy Governor; Tiff Macklem, Senior Deputy Governor; Timothy Lane, Deputy Governor; Mark Carney, Governor; Lawrence Schembri, Deputy Governor (appointed 21 February 2013); Agathe Côté, Deputy Governor

The Management Council provides leadership and guidance on strategic management issues and corporate policies, as well as oversight of all Bank operations. Chaired by the Senior Deputy Governor, the Council consists of two Deputy Governors, two Advisers, the General Counsel and Corporate Secretary, and the Chief Accountant and Chief Financial Officer.

The Chiefs' Committee was created in 2011 to streamline the Bank's decision-making processes by strengthening the partnership between departments that share responsibilities for developing and executing common responses to operational issues. The Committee is composed of the Chiefs of all Bank departments, the Adviser responsible for head office renewal and the Director of Human Resources. An Adviser who is also a member of the Management Council liaises with the Chiefs' Committee.

The Bank is organized into 12 departments: Audit, Canadian Economic Analysis, Communications, Corporate Services, Currency, Executive and Legal Services, Financial Markets, Financial Services, Financial Stability, Funds Management and Banking, Information Technology Services, and International Economic Analysis.

From time to time, the Bank reviews its policies to ensure that they are in keeping with international best practices. In 2012, the Bank approved a Code of Business Conduct and Ethics, covering areas such as ethics and financial reporting. It will come into effect in April 2013.

Risk Management—Highlights

Managing risk is an important element of management's responsibilities. It encompasses the management of not only financial, but also business and enterprise risks, which may directly or indirectly affect the Bank's ability to deliver on its core functions. The Bank has a well-established framework for identifying, managing and monitoring these risks. A complete description of the Bank's risk-management framework and risk profile can be found in Management's Discussion and Analysis on pages 34 and 35, respectively.

Risk Monitoring and Reporting

Each year, through a self-assessment process, senior managers identify and assess the key risks that could compromise the fulfillment of the Bank's responsibilities and the achievement of its strategic objectives. Approaches for managing these risks are identified, and quarterly assessments are made of the likelihood of the risks occurring and of their potential consequences. The preliminary results of the assessments are discussed with the Management Council to incorporate its views and perspectives. Semi-annual risk reports are presented to and discussed with the Board of Directors.

The Chief Risk Officer works closely with management to analyze changes in the environment that could affect the level of risk associated with each of the key risk areas, as well as to identify emerging risks. Deputy Governors and Department Chiefs are responsible to the Governor and Senior Deputy Governor for the management of risk in their respective areas of responsibility. As part of the ongoing monitoring, serious operational events or significant changes in risk are discussed on a timely basis with the Management Council and the Board of Directors.

The Audit Department conducts periodic reviews of Bank operations, including the Bank's risk-management process, to assess the effectiveness of the systems of internal control put in place by management to mitigate risk.

The Bank's Risk Profile

The Bank's risk profile largely reflects the challenges and uncertainties in the external and internal environments that are judged to persist over the short to medium term. Ineffective management of risk could affect the Bank's reputation, leading to a loss of confidence in its ability to fulfill its responsibilities. The key areas of risk facing the Bank are as follows:

Financial risk, which includes credit, liquidity and market risk, is associated with the management of the Bank's assets and liabilities and with the assets and liabilities it manages as the fiscal agent of the Government of Canada.

Business risk in the areas of monetary policy, the financial system and funds management arises from a number of sources, including uncertainties in the global economy and the international financial system. To mitigate these risks, the Bank has well-defined policy frameworks and an extensive body of research to guide its analysis and policy decisions. The Bank also participates in key international forums and collaborates with other major central banks and financial sector regulatory partners. To mitigate the implementation risks related to the new polymer bank note series, the Bank has detailed execution plans in place and works closely with external stakeholders.

Enterprise risks relate to people, project execution, continuity of operations and the Head Office Renewal Program. To mitigate these key areas of risk, the Bank is strengthening its human resource programs, its project-management and reporting framework, and its continuity-of-operations capacity. In addition, there is a comprehensive governance and oversight framework in place for the head office renewal initiative, which is being managed by a multidisciplinary team of Bank staff and external experts.

Management's Discussion and Analysis

This Management's Discussion and Analysis (MD&A) is to be read in conjunction with the audited financial statements of the Bank of Canada (the Bank) for the year ended 31 December 2012.

The Bank develops and implements policy within its mandate, specifically in relation to its four core functions: monetary policy, the financial system, currency and funds management. The activities and operations of the Bank are not undertaken with the intention to generate revenue or profits and cannot be fully captured in a discussion of the financial statements. While the Bank strives to provide sufficient disclosure of its activities in its financial statements, those statements alone do not permit a full understanding of the Bank's activities. Additional details and perspectives concerning the full range of the Bank's policy activities are provided in other sections of this *Annual Report*.

The Bank's Operations

The Business and Mandate of the Bank

The Bank of Canada began operations in 1935 as the nation's central bank. It is now a Crown corporation, wholly owned by the Government of Canada through the Minister of Finance, and governed by the Bank of Canada Act (the Act). The Act describes the Bank's legislative and governance framework, as well as its broad mandate to "promote the economic and financial welfare of Canada." The Bank of Canada is not a commercial bank and does not offer banking services to the public.

Understanding the Bank's Financial Results

Although the Bank's activities are not driven by profit-maximization objectives, its assets and liabilities, as well as its revenues and expenditures, support one or more of its core functions.

The Bank has the exclusive right to issue Canadian bank notes. The face value of these bank notes is recorded as a liability on the Bank's Statement of Financial Position (balance sheet). The Bank issues bank notes to financial institutions, which then credit the Bank with the face value of the bank notes. The proceeds are used immediately to purchase Government of Canada securities (treasury bills and bonds) that appear as assets on the Bank's balance sheet. The Bank acquires these securities on a non-competitive basis at auctions and structures its holdings to broadly reflect the composition of the federal government's stock of nominal domestic marketable debt.

Interest income derived from these Government of Canada securities is the Bank's primary source of revenue. The income generated from the assets backing the bank notes in circulation (net of bank note production and distribution costs) is referred to as "seigniorage" and provides a stable and constant source of funding for the Bank's operations, enabling it to function independently of government appropriations. Other sources of revenue include interest earned on lending facilities and deposits, as well as dividends received from the Bank for International Settlements (BIS). In addition to generating income, Government of Canada securities are used to support the Bank's monetary policy and financial system functions.

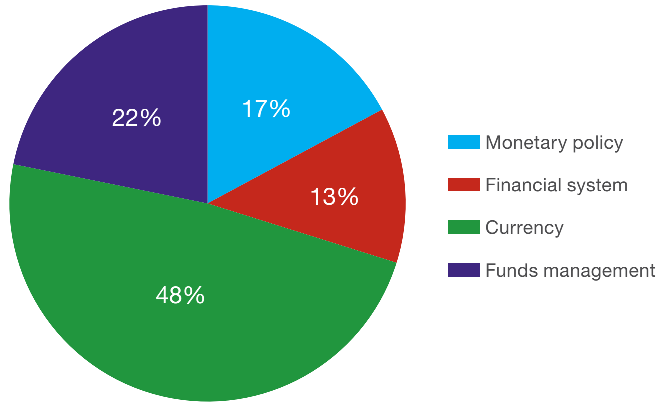
A portion of the Bank's income is used to fund its operations. The balance of this income, subject to agreed reserves and deductions, is remitted to the Receiver General for Canada on a biweekly basis. This amount was $1,022.2 million in 2012.

The Bank's 2012 expenses support its four core functions, as shown in the accompanying chart.

The costs associated with the currency function represent the largest portion of the Bank's expenses (48 per cent), because this item includes the costs incurred in the production of bank notes. These costs increased in 2012 in connection with the launch of the new *Polymer* series. A complete analysis of the Bank's operating expenses is included in the Financial Discussion Overview section of this *Report*.

The following sections describe how the operations of the Bank's four core functions relate to its financial results.

Operating expenses, by function[a]



a. Expenses exclude the non-recurring program costs associated with the Enhanced Business-Continuity Program and the Head Office Renewal Program.

Monetary Policy

The Bank's monetary policy actions are guided by a clearly defined inflation-control target, which is set out in a written agreement with the Government of Canada. This agreement, which was renewed in 2011 for a five-year term, establishes the inflation target as the 2 per cent midpoint of a 1 to 3 per cent inflation-control range.

The following table describes the relationship between the Bank's conduct of monetary policy and its financial results.

Tools used by the Bank	Impact on the Bank's financial results
The target for the overnight rate is the main instrument used by the Bank to conduct monetary policy. Direct-clearing members of the Canadian Payments Association (CPA) can hold deposits with the Bank (referred to as settlement balances) and take advances. Deposits earn interest at the target rate minus 25 basis points, and collateralized advances are charged interest at the target rate plus 25 basis points.	The Bank normally targets $25 million in net settlement balances but will adjust this amount as warranted to provide required liquidity to the financial system. The Bank of Canada can supply virtually unlimited amounts of these deposits to participants. See the Financial System section below for details on the impact of settlement balances on the Bank's financial statements.
When required to maintain the overnight rate close to the target, the Bank offers term purchase and resale agreements and sale and repurchase agreements to designated counterparties.	These agreements are recorded as collateralized lending transactions in *Loans and receivables* or as collateralized borrowing transactions in *Other liabilities* on the Statement of Financial Position at the amounts at which the securities were acquired or sold, plus accrued interest.
Receiver General cash balances are invested through an auction process with participating financial institutions that is administered by the Bank.	Receiver General cash balances held at the Bank appear on the Statement of Financial Position as *Deposits–Government of Canada*.

Financial System

The Bank promotes the stability and efficiency of the Canadian financial system by: (i) providing liquidity; (ii) overseeing systemically important payment, clearing and settlement systems; (iii) participating in the development of financial system policies in Canada and globally; and (iv) assessing and communicating risks to the overall stability of the financial system.

The Payment Clearing and Settlement Act (PCSA) gives the Bank responsibility for the oversight of payment and other clearing and settlement systems in Canada. The systems that have been designated as being subject to oversight under the PCSA are the Large Value Transfer System (LVTS), the Canadian Depository for Securities Exchange, the Continuous Linked Settlement Bank and, effective 30 April 2012, the Canadian Derivatives Clearing Service (CDCS).

The CDCS, which is operated by the Canadian Derivatives Clearing Corporation, commenced operations in February 2012. The CDCS provides central counterparty services for the fixed-income market, and also acts as the central clearing counterparty for exchange-traded and over-the-counter derivatives in Canada. The designation of the CDCS in April 2012 affected the responsibilities and processes of the Bank but did not have a direct impact on the Bank's financial operations.

The Bank's financial assets are used to support the financial system function, as described below.

Services provided by the Bank	Impact on the Bank's financial results
Settlement balances Typically, participants in the LVTS settle net payment positions among themselves on a daily basis. Where required, participants can hold deposits or take advances from the Bank through the Standing Liquidity Facility.	Settlement balances appear as *Deposits—Members of the Canadian Payments Association* and as *Advances to members of the Canadian Payments Association* on the Statement of Financial Position.
Standing Liquidity Facility Advances to financial institutions at a rate of 25 basis points above the target rate are routine under this facility. The framework for the target overnight interest rate provides an incentive for financial intermediaries to allocate liquidity among themselves without having to make significant use of the Bank's deposit facilities and collateralized advances.	These advances appear on the Statement of Financial Position as *Advances to members of the Canadian Payments Association*. Interest on these advances is included in the Bank's Statement of Comprehensive Income.
Securities-lending program The Bank 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, the Bank will lend up to 50 per cent of its holdings in these securities on an overnight basis in exchange for other securities.	Securities-lending transactions are fully collateralized by securities. The securities loaned by the Bank continue to be accounted for as assets. Lending fees are recorded in *Other revenue* in the Statement of Comprehensive Income.
Securities purchased or sold under repurchase agreements In the normal course of managing its balance sheet, the Bank needs to undertake repurchase operations from time to time. These assets are typically acquired to offset seasonal flows of bank notes, but can be used for other temporary purposes.	These agreements are recorded as collateralized lending transactions in *Loans and receivables* or as collateralized borrowing transactions in *Other liabilities* on the Statement of Financial Position at the amounts at which the securities were acquired or sold, plus accrued interest. Interest received is recorded in the Bank's Statement of Comprehensive Income.
Emergency Lending Assistance (ELA) The Bank has the ability to provide ELA to a participant that is judged to be solvent but requires short-term liquidity. Under the Bank of Canada Act, the Bank can provide collateralized ELA to a member of the Canadian Payments Association. Under the Payment Clearing and Settlement Act, the Bank may also provide liquidity loans to a clearing house or a central counterparty. The provision of ELA is extremely rare, and the last such event occurred in 1986.	ELA would appear as a collateralized loan on the Statement of Financial Position; the interest received would be recorded in the Bank's Statement of Comprehensive Income.

Currency

The Bank is the exclusive issuer of bank notes in Canada. It is responsible for supplying Canadians with bank notes that they can use with confidence and without concerns about counterfeiting. The Bank has been issuing bank notes since 1935 and periodically introduces new series that incorporate the most up-to-date security features. In 2012, the $50 and $20 denominations in the new *Polymer* series were issued. These denominations, like the $100 notes issued in 2011, include a number of unique features designed to make them difficult to counterfeit and easy to verify. The $5 and $10 denominations are scheduled to be issued in 2013.

Currency items	Impact on the Bank's financial results
Bank notes in circulation liability	*Bank notes in circulation* is the largest item on the Bank's Statement of Financial Position. This liability tends to increase over time with the growth in demand for bank notes and is subject to important seasonal variations (typically reaching its lowest level at the end of the first quarter and peaking in the second and fourth quarters around holiday periods).
Bank note production	The costs of producing bank notes are expensed as the bank notes are produced and received in finished form by the Bank. The raw materials purchased by the Bank for the production of notes are recorded as *Inventory* on the Bank's balance sheet until they are used in note production.

Funds Management

The Bank manages the investments and liabilities that are reported on its own balance sheet, as well as the investments held by its pension plan (which are held and maintained in a pension trust separate from the Bank).

In addition, the Bank provides funds-management services for the Government of Canada and for other central banks and international organizations, including securities settlement and custodial services, as well as custodial services for gold. Assets held under custody agreements do not appear as assets on the Bank's Statement of Financial Position; however, fees earned for these services are included in the Bank's income. Settlement accounts held on behalf of other central banks and international organizations appear on the Statement of Financial Position as *Deposits—Other deposits*.

The Bank's fiscal-agent responsibilities relating to the management of public funds are presented below.

Fiscal-agent responsibilities of the Bank	Impact on the Bank's financial results
Government banker and treasury manager The Bank manages the accounts of the Receiver General, through which almost all monies collected and spent by the government flow, and ensures that there are sufficient funds in these accounts to meet the government's daily requirements and invests any surplus in term deposits.	Amounts are recorded as *Deposits—Government of Canada* on the Statement of Financial Position.
Foreign exchange reserves Canada's official international reserves are held in the Exchange Fund Account, which the Bank manages on behalf of the Government of Canada. Unlike many central banks, the Bank does not hold foreign exchange reserves on its balance sheet, and holds only minimal foreign cash balances.	None. The foreign reserves are reported by the government in the Public Accounts of Canada and do not appear in the Bank's financial statements. The costs associated with the provision of these fiscal-agent services are part of the Bank's expenses. No fees are earned for these services.
Debt management The Bank advises the Department of Finance on the efficient management of the public debt (treasury bills and bonds) and sells the securities at auction to financial market distributors. The Bank advises the Department of Finance on the government's retail debt program (consisting of Canada Savings Bonds and Canada Premium Bonds). The Bank also administers the program (including operations and system support services, accounting, and sales and marketing initiatives).	None. The debt liabilities are reported by the government in the Public Accounts of Canada and do not appear within the Bank's financial statements. The costs associated with the provision of these fiscal-agent services are part of the Bank's expenses. The Bank does not earn fees for these services.

Capability to Deliver Results

Management Structure and Leadership

The Bank has identified the following key management personnel as being responsible for planning, directing and controlling the Bank: the Board of Directors, the Governing Council and the Management Council. The table below outlines the composition and responsibilities of the Bank's key management.

Board of Directors	Governing Council	Management Council
The Governor, Senior Deputy Governor and 12 independent directors[a] (the Deputy Minister of Finance is an ex officio, non-voting member)	The Governor,[b,c] Senior Deputy Governor,[b,d] and four Deputy Governors[e]	The Senior Deputy Governor, two Deputy Governors, the Chief Accountant and Chief Financial Officer, the General Counsel and Corporate Secretary, and two Advisers[f]
The Board oversees the management and administration of the Bank, including strategic planning and risk management, finance and accounting, human resources, and other internal policies.	Members of Governing Council are collectively responsible for monetary policy, the financial system and the strategic direction of the Bank.	The Management Council provides leadership and guidance on strategic management issues and corporate policies, as well as oversight of all Bank operations.

a. Directors are appointed by the Governor in Council for three-year renewable terms.
b. Appointed by the Board of Directors with the approval of the Governor in Council for a term of seven years
c. The term of the Governor, Mark Carney, expires on 31 January 2015. It was announced on 26 November 2012 that Her Majesty the Queen approved the appointment of Mark Carney as Governor of the Bank of England, effective 1 July 2013. Governor Carney's last day with the Bank of Canada will be 1 June 2013.
d. The term of the Senior Deputy Governor, Tiff Macklem, expires on 1 July 2017.
e. Following the appointment of Jean Boivin as Associate Deputy Minister of Finance, effective 25 October 2012, a selection process for a new Deputy Governor was initiated. On 21 February 2013, Lawrence Schembri was appointed Deputy Governor, effective 25 February 2013.
f. As a result of the retirement of an Adviser in January 2013, there is currently one Adviser on Management Council.

Under the statutory governance framework established in the Bank of Canada Act, the Governor is both Chief Executive Officer of the Bank and Chair of its Board of Directors. The Governor has specific authority and responsibility for the business of the Bank. The Senior Deputy Governor is the alternate to the Governor and *de facto* Chief Operating Officer.

The salaries of the Governor and the Senior Deputy Governor are set by the Board of Directors on advice from its Human Resources and Compensation Committee, within the guidelines established by the Privy Council Office, and are subject to the approval of the Governor in Council. As stipulated in Section 6(3) of the Bank of Canada Act, these salaries do not include any performance-based element. The Governor and Senior Deputy Governor also receive benefits available to all Bank employees, including participation in the Bank of Canada's Registered Pension Plan, as well as health and dental benefits.

People

The Bank's key resource is its people. As a knowledge-based institution, with many of its resources dedicated to research and analysis to support the formulation and implementation of policy in each of its four core functions, the Bank requires a significant number of highly skilled professionals to achieve its objectives.

Details concerning the Bank's staff are presented in the following table.

Human resources statistics (as at 31 December 2012)

Number of employees	1,239 regular
Languages	810 (65 per cent) of the regular employees are bilingual (English/French)
Locations	1,100 (89 per cent) of the regular employees are located at head office in downtown Ottawa and the operations centre in suburban Ottawa. 97 (8 per cent) of the regular employees are located at operations centres in Toronto and Montréal. 42 (3 per cent) of the regular employees are located at regional offices in Vancouver, Calgary, Toronto, Montréal, Halifax and New York.

Tangible and Intangible Assets

The Bank's head office complex located in downtown Ottawa is its principal tangible capital asset. This facility consists of two major elements: the original building that was completed in 1938 and two adjoining towers connected by an atrium, which were designed by Arthur Erickson and completed in 1979. The majority of the Bank's staff work at the head office facility, and it is home to a number of specialized activities. These include $15 billion of payments processed daily by the Bank through the large-value payment system; a trading floor that manages more than $600 billion in federal government debt and about US$69 billion in foreign reserves; specialized currency laboratories; and leading-edge economic and financial analysis.

In 2012, the Bank's Board of Directors approved a proposal to renovate and modernize the aging head office complex (the Head Office Renewal Program). A resilient work facility is critical for the Bank to continue to fulfill its mandate. The glass towers are now 35 years old, and core systems in the buildings have reached the end of their lifespans: wiring, plumbing, heating and ventilation must all be updated. The facility also needs to be brought up to current building, seismic and fire-safety standards to provide a safe and healthy work environment for staff. As well, the security needed for the facility has evolved since the 1970s, when the glass towers were constructed, and must now be upgraded. The renewed facility will support a more collaborative and flexible work environment, will be more economical to operate and will be more environmentally efficient. Construction costs for the renovation and refurbishment are expected to be $460 million over the next four to five years.

Intangible assets are identified as non-monetary assets without physical substance. The Bank's intangible assets consist primarily of computer software assets that are developed internally or acquired externally. The Bank owns no other significant non-monetary assets.

Liquidity and Capital

Liquidity

Given the Bank's ability to create virtually unlimited quantities of settlement balances (see the table in the Monetary Policy section on page 27), its operations are not constrained by its cash flow or by its holdings of liquid assets, since its seigniorage income is predictable and greatly exceeds its expenses.

Capital

The Bank's primary capital includes $5 million of authorized capital and a $25 million statutory reserve.

The Bank's *Other comprehensive income* includes fluctuations in the fair value of the available-for-sale assets and actuarial gains and losses on the Bank's post-employment benefit plans. If, at any time, the cumulative net unrealized losses exceed the amount of the Bank's capital base of $30 million, the Bank would report a capital deficiency. To eliminate this risk, the Bank has the following agreement and reserves in place.

Description of agreement and reserves	Value at 31 December 2012
Memorandum of Understanding with the Department of Finance The Memorandum of Understanding with the Department of Finance allows the Bank to deduct from its remittances to the Receiver General and hold within retained earnings an amount equal to unrealized losses on available-for-sale assets, unrealized actuarial losses on post-employment benefit plans and other unrealized or non-cash losses. The amount withheld at 31 December 2012 represents unrealized actuarial losses incurred in 2011 and 2012.	$266 million
Special reserve The Bank of Canada Act authorizes the Bank to create a special reserve in order to offset any unrealized valuation losses arising from changes in the fair value of the Bank's available-for-sale assets. This reserve is currently $100 million but may be increased by the Board of Directors to a maximum of $400 million. Management and the Board of Directors review the adequacy of this reserve annually.	$100 million
Actuarial gains reserve The actuarial gains reserve was established to accumulate net actuarial gains and to cover net actuarial losses related to the Bank's post-employment defined-benefit plans.	$Nil
Available-for-sale reserve Available-for-sale assets comprise Government of Canada treasury bills and the Bank's investment in the Bank for International Settlements (BIS). Fair-value changes are reported in *Other comprehensive income* and are accumulated within the reserve for available-for-sale assets. The reserve consists primarily of the fair-value change in the Bank's investment in the BIS.	$308.5 million

Deferred employee benefit plans

The Bank sponsors a funded defined-benefit pension plan (supplemented by a funded defined-benefit supplementary pension arrangement) and other unfunded benefit plans. As reported in note 14 to the financial statements, the Bank had a net pension liability of $19.3 million and an unfunded non-pension benefit plan obligation of $182.7 million at 31 December 2012 ($15.4 million pension asset and $164.7 million non-pension obligation at 31 December 2011).

The value of the registered pension plan's assets increased from $1.1 billion at the end of 2011 to $1.2 billion at the end of 2012. The registered pension plan earned a rate of return in excess of 10 per cent in 2012.

For funding purposes, the Bank has been conducting annual actuarial valuations of the funded defined-benefit plan since 2008, and the latest completed valuation was as at 31 December 2011. On a going-concern basis (which assesses the plan over the long term on the assumption that it will operate indefinitely), the funding status of the plan at 31 December 2011 was an actuarial surplus of $116 million and a funding ratio of 112 per cent. On a solvency basis (which assesses the plan on the assumption that it would be terminated on the date of the valuation), the funding status of the plan was an actuarial deficit of $96 million and a solvency ratio of 92 per cent.

The funding requirements of the deferred employee benefit plans are determined by actuarial funding valuations on a going-concern basis and depend on a number of factors, including actual returns on plan assets, long-term interest rates, plan demographics, and applicable regulations and actuarial standards. As well, since 2009 the Bank has made $179.9 million in additional contributions toward eliminating the solvency deficit within five years. The Bank's estimated funding requirement for 2013 is $44.7 million, which consists of $25.9 million in regular contributions to cover current service costs and $18.8 million toward the elimination of the solvency deficit within five years.

Capital Expenditures

The Bank uses the majority of its capital budget in any given year to maintain its assets, address obsolescence and undertake strategic projects as described on the following page. In all instances, the capital spending plan supports the attainment of the Bank's priorities and strategies.

The Bank relies on a number of information technology systems that support its functions. A primary objective of the 2010–12 medium-term plan was to strengthen business resilience and infrastructure. To attain this objective, the Bank has undertaken a number of significant projects in addition to its ongoing capital expenditures.

Nature of expenditure	Expected completion	Multi-year estimate[a]	Cost capitalized		Benefits to be achieved
			2012	2011	
Expenditures included in MTP financial plan					
Ongoing capital expenditures	Ongoing	—	$5.6 million	$8.3 million	Ongoing expenditures on facilities, fixtures and technology equipment
Strategic priorities					
Currency operations: Replace aging legacy systems and implement three critical applications for managing bank note inventories	2013	$13 million	$0.7 million	$7.2 million	Provide for consolidated reporting of bank note inventories, inventory-management systems and management-control processes in advance of the full release of the new *Polymer* series
Financial market operations: Replace legacy systems that support liquidity provision, auction, treasury-management and collateral-management activities	2013	$37 million	$10.5 million	$10.9 million	Provide functionality to address operational risks and business requirements not available with the current legacy systems
Economic and financial analysis: Develop new software architecture and functionality	2012	$10 million	$3.7 million	$4.0 million	Enhance the Bank's capabilities to analyze data and provide data warehousing, and implement data-management solutions for economic and financial analysis
Information technology: Improve IT infrastructure	2012	$11 million	$1.9 million	$2.8 million	Upgrade obsolete network components, improve performance and reduce the risk of system failures
Tri-Agency Database System: Renew the system that collects, validates, manages and stores financial data from financial institutions and private pension plans[b]	2014	$7 million	$1.6 million	—	A solution that includes improved data-management capabilities and the flexibility to capture, properly manage, and report on new and different types of data from financial institutions
Strategic priority expenditures outside MTP financial plan					
Head Office Renewal Program[c]	2016	$460 million	$3.3 million	$3.3 million	Renovate the head office facility to meet evolving health, safety and security needs
Enhanced Business-Continuity Program	2013	$64 million	$21.4 million	$23.2 million	Enhance the Bank's resilience with respect to the operations of critical payment, clearing and settlement systems, and the resilience of its data centres
Total costs capitalized			**$48.7 million**	**$59.7 million**	

a. Includes estimates for both capital and operating expenditures on significant programs and projects
b. This project is being undertaken jointly with the Office of the Superintendent of Financial Institutions and the Canada Deposit Insurance Corporation. The costs presented include only the Bank's portion of the Tri-Agency Database System.
c. This amount excludes relocation costs, which will be expensed as incurred.

Risk

Risk-Management Framework and Strategy

The Bank manages risk by identifying, assessing and mitigating risks that could compromise the fulfillment of its responsibilities and the achievement of the strategic objectives and the desired outcomes that are set out in the medium-term plan. An integrated risk-management framework identifies the objectives of risk management, the roles and responsibilities of key parties in the process, the tools and processes used in the identification of risk, and the management and reporting of the identified risks. The Bank recognizes that it cannot completely eliminate the risks involved in its activities.

Since it was first developed in the late 1990s, the Bank's risk-management framework has evolved by incorporating best practices relevant to its operations and activities. The Bank keeps abreast of best practices through its contacts at major central banks, public sector organizations and financial institutions, as well as by examining the evolution of well-established risk-management frameworks.

Risk Self-Assessment Process

Senior managers in each functional area of the Bank are responsible for controlling and mitigating risks on a day-to-day basis. Through a self-assessment process, they identify and assess the key risks for each function—monetary policy, the financial system, currency, funds management and corporate administration. The broad categories of risk assessed are financial, business and enterprise risks. Ineffective management of these areas of risk could not only have a financial impact or hinder the Bank's ability to achieve its corporate objectives, but could also affect the Bank's reputation, leading to a loss of confidence in its ability to fulfill its responsibilities.

Each function identifies the approaches in place for managing the risk for each key risk area. Taking into account the risk-mitigation strategies, quarterly assessments are then made of the likelihood of the risks occurring and the severity of potential consequences. The preliminary results of the assessments are shared with the Management Council to incorporate its views and perspectives. The Board of Directors receives semi-annual risk reports and in-depth briefings on each function during the year.

Risk Monitoring and Reporting

The Chief Risk Officer works closely with management to assess changes in the environment that could affect the level of the risk associated with each of the key risk areas and to identify emerging risks. Deputy Governors and Department Chiefs are responsible to the Governor and Senior Deputy Governor for the management of risk in their respective areas of responsibility. As part of its ongoing monitoring, Management Council reviews any significant changes in the levels of risk or any new risks that arise and reports these changes to the Board of Directors.

In order to provide reasonable assurance that objectives will be achieved, the Audit Department conducts periodic reviews of Bank operations, including the Bank's risk-management process, to assess the appropriateness and effectiveness of the risk-mitigation systems in place.

The Bank's Risk Profile

The Bank's risk profile largely reflects short- to medium-term challenges and uncertainties in the external and internal environments. The following summary identifies and defines the key areas of risk facing the Bank and discusses the mitigating strategies that are in place.

Residual risk ratings	
Acceptable: Appropriate risk management is already in place.	●
Cautionary: Active monitoring and/or enhanced risk-mitigation measures are required, as well as active monitoring by senior management.	▲
Serious concern: Immediate and significant strengthening of risk-mitigation measures is required, as well as active monitoring and reporting to senior management and the Board of Directors.	■

Financial Risks

The Bank's asset portfolio consists of securities that are primarily direct obligations of the Government of Canada. Owing to the nature of these securities, financial risk is assessed as low. However, these securities do expose the balance sheet to credit, market and liquidity risks. For further information about the Bank's financial risks, see note 7 to the financial statements.

Financial risks	Ratings for		Measures to reduce financial risks
	2013	2012	
Credit: The Bank's investment portfolio is subject to credit risk, or the risk that a counterparty will fail to discharge its obligations in accordance with agreed-upon terms. The maximum exposure to credit risk is the carrying amount of the portfolio, which consists mainly of Government of Canada securities. Advances and securities purchased under resale agreements are offset by collateral taken in accordance with the Bank's publicly disclosed policies. Additional risk arises when the Bank undertakes extraordinary liquidity operations in support of financial system stability and monetary policy. Operations may include exceptional buyback transactions, purchases of an expanded range of securities and Emergency Lending Assistance[a] to solvent members of the Canadian Payments Association. The terms and conditions for these operations are approved by the Governing Council.	●	●	The Financial Risk Office is independent of operations and is responsible for monitoring and reporting on financial risks relating to the Bank's balance sheet. Collateral policies are reviewed and updated regularly in connection with the Bank's liquidity operations. With respect to the Bank's overall operations, management has established and actively monitors a system of internal controls, and periodic reviews are conducted to assess the appropriateness and effectiveness of these controls.
Market: The Bank is exposed to market risk primarily through its available-for-sale investments, including Government of Canada treasury bills and the Bank's investment in the Bank for International Settlements (BIS), which are held at fair value. The investment in the BIS is subject to currency risks and other price risk, since the fair value of the shares is estimated on the basis of the net asset value of the BIS translated into Canadian dollars on the reporting date. These variations would not affect the Bank's ability to fulfill its obligations, since its income greatly exceeds its expenses.	●	●	
Liquidity: The Bank's largest liability is *Bank notes in circulation*, which are non-interest-bearing and have no fixed maturity. In the event of an unexpected redemption of bank notes, the Bank has the ability to settle the obligation by selling its portfolio of highly liquid interest-bearing securities.	●	●	

a. The last such event occurred in 1986.

Business Risks

Business risks arise from policy risks, governance issues or external factors that directly affect the Bank's ability to carry out its four core functions: monetary policy, the financial system, currency and funds management.

Business risks	Ratings for		Measures to reduce business risks
	2013	2012	
Monetary policy: Implementation risks arise from a number of sources, including significant uncertainty around the global economic outlook and the global financial system, as well as challenges in attracting a sufficient number of skilled and experienced staff.	▲	▲	To manage business risks, the Bank has well-established policy frameworks, an extensive research program and analytical models that are enhanced on a regular basis. The Bank also participates in a number of key international forums, and collaborates with other major central banks and with Canadian and international financial sector regulatory partners. In addition, a comprehensive communications strategy informs Canadians about the goals and objectives of the Bank's policy decisions, as well as financial system issues and potential vulnerabilities.
Financial system: Policy and oversight risks arise from the expanding nature of the Bank's role in domestic and international financial system reforms, oversight of new central counterparties and challenges in attracting qualified staff.	▲	▲	
Funds management: Risks are associated with the operations of safekeeping services; the payment, clearing and settlement system; and the management of foreign exchange reserves.	▲	●	
Currency: Implementation risks relate to the possibility that the new *Polymer* series of bank notes does not meet program objectives.	▲	▲	Risk-mitigation measures include detailed execution plans, careful monitoring and reporting of key milestones for the issuance of the new polymer notes; extensive pre-production testing; ongoing interaction with financial institutions and bank note printing companies; and a comprehensive communications and education program.

Enterprise Risks

All of the Bank's activities are exposed to enterprise risks, which may affect the delivery of the Bank's business functions.

Enterprise risks	Ratings for		Measures to reduce enterprise risks
	2013	2012	
People and capacity: Risks relate to the increasing complexity of the Bank's work, changes in the mix of skills required, the limited labour market pool of economists and financial system specialists, and demographics.	▲	▲	The Bank continues to strengthen its recruitment strategy and ensures that its human resources policies and programs remain relevant and effective. Positions have been added where core responsibilities have been expanded, and capacity planning and change-management capabilities have been enhanced.
Project execution and impacts: Risks relate to the number of large, complex initiatives under way and the interdependence of projects.	▲	▲	The Bank mitigates risks with a sound IT governance structure, project monitoring and reporting, portfolio-management practices, and the use of external expertise, where appropriate.
Continuity of critical business processes: Business-continuity risks pertain to the possibility that the Bank would be unable to carry out its critical business processes owing to the unavailability of staff, information technology systems or the backup facility.	▲	▲	The Bank's continuity-of-operations program (COOP) is tested regularly and then strengthened based on the test results. Ongoing training in operational processes and systems is carried out to ensure the availability of adequately cross-trained staff. Operational events are monitored, and action plans are implemented to mitigate potential risks.
Head Office Renewal Program: In 2013, risks relate to the relocation of staff to 234 Laurier Avenue West, and the readiness of the Bank's head office complex for renovation.	▲	N/A	The Bank has a comprehensive governance and oversight framework for managing this initiative, and has engaged external experts to provide independent overall advice on the project and to carry out the design and construction work.

Performance Against Plan

The Medium-Term Plan (2010–12)

The three-year medium-term plan (MTP) is the main planning tool that the Bank uses to establish its strategic priorities. The 2010–12 MTP priorities were to: conduct leading-edge research and policy analysis; strengthen business resilience and infrastructure; attract, retain and engage staff; and unveil and issue a new series of bank notes. The final year of this strategic plan was 2012.

Key Corporate Priorities

The Bank sets annual work priorities with reference to both its medium-term plan and the changing environment. The following table summarizes the Bank's key priorities for 2012 and lists the key achievements against these priorities. The activities carried out by the Bank over the past year in each of these strategic areas are described in the section entitled "The Bank in 2012," which begins on page 5 of this *Report.*

Key corporate priorities for 2012	Key achievements in 2012
Conduct leading-edge research and policy analysis	The Bank made important contributions to international macroeconomic and financial reform initiatives in 2012, in such areas as over-the-counter derivatives reform, including the four safeguards for global clearing; shadow banking; liquidity standards; and financial institution resolution. Substantial progress was made on the development, analysis and oversight of key financial market infrastructure, reducing the potential for counterparty credit risk to transmit and amplify financial stress. Financial stability considerations and communications were successfully integrated into the monetary policy decision-making process. The Bank strengthened its current analysis and projection tools, which facilitate the analysis of financial developments and macroeconomic implications.
Strengthen business resilience and infrastructure	Approval for the Head Office Renewal Program was obtained in September 2012. Enhancements at the Ottawa Support Centre to strengthen the Bank's business-continuity arrangements were completed. The completion of the Analytic Environment Program and four phases of the Auctions and Markets Applications Program strengthened the bank's infrastructure and lowered operational risk. The Bank successfully launched and issued the $50 and $20 denominations in the new *Polymer* series.
Attract, retain and engage staff	The Bank introduced an approach to identify a wider talent pool, focusing on mid-career professionals and on increasing its ability to attract high-quality applicants in the areas of economics and finance.

Corporate Measures of Performance

In order to assess the Bank's performance in the execution of its strategy and the monitoring of its financial results, the Bank reviews key performance drivers and monitors key performance indicators. The following table summarizes the Bank's 2012 performance against these key indicators.

Key performance indicator	2012 performance
Inflation	Both total CPI and core inflation remained within the 1 to 3 per cent inflation-control range for most of the year.
Counterfeiting levels	The number of counterfeit bank notes detected in circulation remained well below the Bank's maximum target of 50 parts per million.
Turnaround times for market operations	Turnaround times for market operations were below the five-minute ceiling for responding to auction participants' bid submissions for treasury bill and bond auctions, and for responding to offering submissions for buybacks and switches.
Systems availability	The systems-availability target of 99.5 per cent for the Bank's critical banking system was met.

Financial Performance Compared with the Medium-Term Plan

The Bank monitors its expenses in two ways—total operating expenses as reported in the Bank's financial results in accordance with International Financial Reporting Standards (IFRS) and MTP operating expenses,[5] which are a subset of the total operating expenses reported in the financial statements.

Certain costs have a record of volatility or are non-recurring and are excluded from the three-year MTP financial plan because of the complexities involved in predicting these costs. The following expenses are excluded:

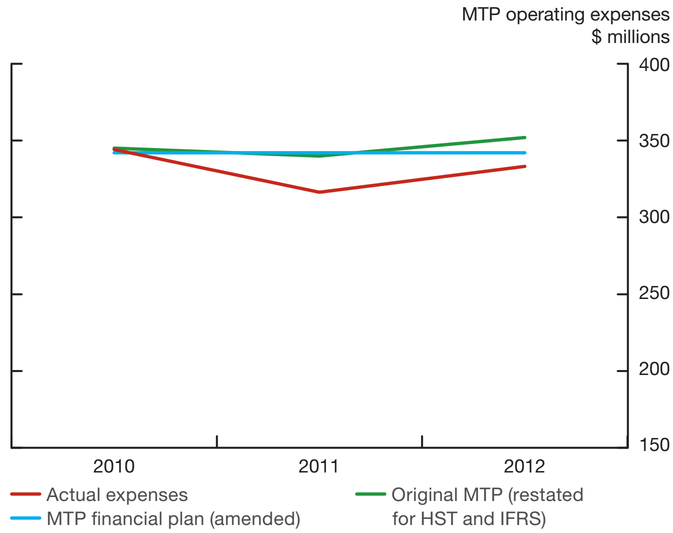
- expenses for non-current deferred employee benefits, which are subject to volatility primarily because of changes in discount rates;
- costs related to the production of bank notes, which vary with note volumes; and
- significant one-time costs associated with two major capital projects: the Enhanced Business-Continuity Program and the Head Office Renewal Program.

The Bank's original financial plan was approved in 2009, and was subsequently adjusted for the impact of the introduction of the harmonized sales tax (HST) and the adoption of IFRS. In 2010, the Bank reduced its medium-term spending targets for 2011 and 2012 in order to remain consistent with federal government guidelines to hold spending at 2010 levels. The Bank achieved this revised spending profile, while meeting the objectives of the medium-term plan, through the Corporate Effectiveness Program, which identified ongoing savings of $15 million per year and established a more efficient cost base for the Bank's operations.

A summary of the Bank's financial results over the course of the 2010–12 medium-term plan shows that MTP operating expenses were 3.1 per cent below plan for the duration of the plan. This profile mainly reflects the timing of initiatives over the period, which resulted in lower spending in 2011.

Expenses for 2012 were expected to be higher than actual expenses in 2011 because of the timing of costs associated with the Bank's multi-year projects. Actual costs for 2012 were within the $342 million plan estimate. MTP operating expenses in the final year of the plan were $333.1 million, or 2.6 per cent below plan. These expenses are explained in the Financial Discussion Overview section of this *Report*.

2010–12 MTP financial plan



5 MTP operating expenses are considered a non-IFRS measure that does not have a standardized meaning.

Financial Discussion Overview

Changes in Financial Position and Comprehensive Income

Highlights of the Statement of Financial Position at 31 December
(Millions of dollars)

	2012	2011
Assets		
Cash and foreign deposits	**6.8**	11.7
Loans and receivables	**1,905.6**	1,530.8
Investments	**75,607.3**	62,424.2
Capital assets (includes *Property and equipment* and *Intangible assets*)	**246.0**	221.2
Other assets	**41.6**	59.3
	77,807.3	64,247.2
Liabilities and Equity		
Bank notes in circulation	**63,700.0**	61,028.8
Deposits	**13,291.3**	2,481.0
Other liabilities	**377.5**	312.8
Equity	**438.5**	424.6
	77,807.3	64,247.2

At the close of 2012, the Bank had assets of $77,807.3 million. Compared with year-end 2011, assets increased by $13,560.1 million, or 21 per cent. In 2011, the federal government announced its prudential liquidity-management plan and its intention to deposit up to $20 billion at the Bank of Canada. This deposit grew by $10 billion in 2012, driving an increase in the Bank's balance sheet over the year. The Bank purchased a higher level of *Investments* during the year to match the growth in the deposits liability.

Loans and receivables increased by $374.8 million since 31 December 2011, in connection with term purchase and resale agreement (PRA) operations outstanding at year-end. These operations are undertaken to offset the seasonal demand for bank notes, and are no longer required once the demand for bank notes returns to pre-holiday levels. The Bank issued two term PRAs in December 2012 for general balance-sheet-management purposes, related to the seasonal increase in the demand for bank notes. (The 31 December 2011 figure presented for comparison also includes term PRAs issued for the same purpose.)

Investments increased by $13,183.1 million, owing primarily to purchases of Government of Canada bonds to match a higher level of deposits held for the government's prudential liquidity-management plan. Government of Canada bonds increased by $12,724.0 million, and Government of Canada treasury bills increased by $441.7 million, with the balance of the increase in *Investments* resulting from fair-value changes in the Bank's investment in the BIS.

The increases in *Property and equipment* and *Intangible assets* resulted from capital spending of $48.7 million, which was offset by depreciation and amortization of $23.8 million. Of this amount, spending related to the Enhanced Business-Continuity Program and the Head Office Renewal Program totalled $24.7 million. In addition, $24.0 million was spent on initiatives to upgrade aging systems, as outlined in the MTP and for ongoing capital expenditures. The largest component of these investments is the Auctions and Markets Applications Program, which aims to support end-to-end post-trade processing and to strengthen business-continuity capacity.

Other assets decreased by $17.7 million since 31 December 2011, owing mainly to a lower accrued pension benefit asset as a result of actuarial losses recorded in 2012, which was offset by higher inventories of raw materials for bank note production.

The *Bank notes in circulation* liability rose by $2,671.2 million (4.4 per cent), reflecting typical growth in the demand for bank notes.

The main components of the *Deposits* liability are $1,701.5 million held for the Government of Canada for operational balances and $10,000 million held for the government's prudential liquidity-management plan. The operating portion of the deposit is dependent on the cash needs of the Government of Canada, and fluctuations that occur result from cash-flow-management decisions. Deposits at 31 December 2012 increased by $10,810.3 million compared with the 2011 year-end, mainly as a result of the growth in the interest-bearing deposit for the prudential liquidity-management plan.

Other liabilities increased by $64.7 million compared with year-end 2011. Increased liabilities resulted from a rise of $22.1 million in the Bank's defined-benefit plan obligations as a result of a decrease in the discount rate, as well as higher amounts owed to suppliers in connection with strategic initiatives and capital investments.

Income

Income highlights per the Statement of Comprehensive Income for the year ended 31 December
(Millions of dollars)

	2012	2011
Interest revenue	**1,653.1**	1,621.1
Interest expense	**(87.8)**	(23.4)
Other revenue	**10.1**	9.1
Total income	**1,575.4**	1,606.8

Total income for 2012 was $1,575.4 million, a decrease of $31.4 million, or 2 per cent, compared with the previous year. The decrease in income resulted from lower yields on government securities in 2012 compared with 2011.

The Bank's primary source of revenue is *Interest revenue* derived from investments in Government of Canada securities. In 2012, the Bank recorded $1,653.1 million in interest revenue from treasury bills and bonds, an increase of $32 million compared with the previous year. The growth in *Interest revenue* can be attributed to a higher level of investments, which is offset by lower yields on newly acquired treasury bills and bonds compared with yields on maturing investments. The remaining components are interest earned on PRAs and dividend revenue from the Bank's investment in the BIS, which are consistent with 2011 levels.

Income is reported net of interest paid on Government of Canada deposits. The higher level of Government of Canada deposits increased the *Interest expense* on deposits by $64.4 million compared with 2011. Interest rates paid on deposits are based on market-related rates and have not changed significantly over the comparable period in 2011.

The Bank's revenues from its remaining sources increased slightly from 2011 levels, owing mainly to higher revenues from securities held for safekeeping.

Expenses

As noted in the Financial Performance Compared with the Medium-Term Plan section, the Bank monitors its expenses in two ways—total operating expenses as reported in the Bank's financial statements in accordance with International Financial Reporting Standards and MTP operating expenses, which are a subset of total operating expenses. The following two tables summarize the Bank's expenses under each type of analysis.

Expense highlights for the year ended 31 December (Strategic Plan view)
(Millions of dollars)

	2012	2011
MTP operating expenses[a] (see Financial Performance Compared with Plan)	**333.1**	316.4
Bank note production	**115.6**	46.3
Non-current deferred employee benefits[a]	**(2.9)**	(13.3)
Head Office Renewal and Enhanced Business-Continuity programs	**29.8**	3.7
Total expenses	**475.6**	353.1

a. MTP operating expenses and non-current deferred employee benefits are considered non-IFRS measures that do not have a standardized meaning.

Operating expenses are in line with expectations for 2012, reflecting the progress made in the year on many of the MTP initiatives including the new polymer bank note series. As mentioned in the Financial Performance Compared with the Medium-Term Plan section, 2012 MTP expenses were expected to be higher than in 2011, owing to the timing of certain projects.

Expense highlights as per the Statement of Comprehensive Income for the year ended 31 December
(Millions of dollars)

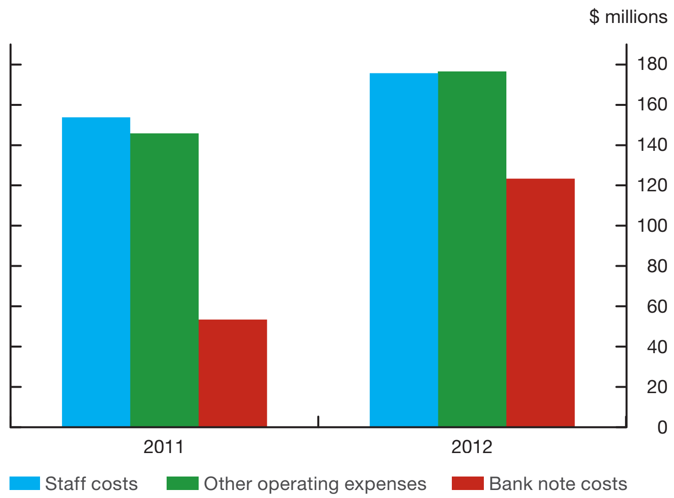
	2012	2011
Bank note research, production and processing	**123.4**	53.5
Staff costs (includes salaries and employee benefits)	**175.7**	153.8
Other expenses	**176.5**	145.8
Total expenses	**475.6**	353.1

Expenses were $122.5 million higher in 2012 than in 2011, owing mainly to higher costs for bank note production associated with the launch of the $50 and $20 polymer notes.

Costs associated with bank note production increased by $69.9 million from 2011 levels. The increase is attributable to a rise in the volume of notes received in 2012 and the higher unit cost[6] of producing polymer notes ($0.20 per polymer note in 2012 versus $0.11 per cotton-based paper note in 2011). In 2012, the Bank received 580 million polymer notes from the printers, compared with 205 million cotton-based paper notes and 107 million polymer notes received in 2011.

Staff costs for 2012 increased by $21.9 million, owing mainly to higher benefit costs associated with the Bank's deferred employee benefit plans. Deferred employee benefit costs increased by $12.8 million largely as a result of a 115-basis-point reduction in the discount rate used to calculate the benefit expenses for 2012. The remainder of the increase reflects a 1.5 per cent salary adjustment to maintain market-competitive compensation, as well as temporary resourcing in support of MTP projects.

Total operating expenses



The remainder of the cost increase is attributable to the Enhanced Business-Continuity and Head Office Renewal programs, which account for a $26 million increase over the previous year. This increase affects *Staff costs*, as well as *Depreciation* and *Premises costs.*

Net income

Highlights of the Statement of Comprehensive Income for the year ended 31 December
(Millions of dollars)

	2012	2011
Net Income	***1,099.8***	1,253.7
Other Comprehensive Income (Loss)	***(63.7)***	(178.9)
Comprehensive Income	***1,036.1***	1,074.8

Net income for 2012 was $1,099.8 million. Net income earned on the Bank's assets, after deductions for operating expenses and allocations to reserves, is paid each year to the Receiver General for Canada. In 2012, the Bank transferred $1,022.2 million to the Receiver General for Canada.

6 The new polymer bank notes are expected to last at least 2.5 times longer than the cotton-based paper notes.

Other comprehensive income (loss)

Other comprehensive loss of $63.7 million consists of an increase of $13.9 million in the fair values of available-for-sale assets, offset by an actuarial loss of $77.6 million related to the Bank's deferred employee benefit plans.

Available-for-sale assets comprise Government of Canada treasury bills and the Bank's investment in the BIS. Fair-value changes are accumulated in the reserve for available-for-sale assets within the Bank's *Equity*. As at 31 December 2012, this reserve totalled $308.5 million and consisted primarily of the fair-value change in the Bank's investment in the BIS.

Actuarial losses are affected by the actual return, compared with the expected return, on plan assets, and the discount rate used to determine defined-benefit obligations. The loss recorded in 2012 is the result of a reduction of 60 basis points during the year in the discount rate used to value the defined-benefit obligation, offset by higher returns on plan assets. The 60-basis-point reduction in the discount rate reflects the change in AA-rated corporate bond yields over the past 12 months.

Financial Controls and Procedures

Management is responsible for establishing and maintaining adequate internal controls over financial reporting, as well as for establishing appropriate disclosure controls and procedures. The Bank maintains a certification regime to evaluate the design and effectiveness of internal controls over financial reporting, as well as disclosure controls and procedures. As of 31 December 2012, the Bank's certifying officers assessed the design and effectiveness of its internal controls over financial reporting, and its disclosure controls and procedures, and found them to be appropriate.

Significant Accounting Policies and Estimates

The Bank's accounting policies are presented in note 3 to the financial statements. The Bank elected to adopt the amendments to IAS 1 (entitled *Presentation of Items of Other Comprehensive Income*) in advance of the effective date (annual periods beginning on or after 1 July 2012). Other than changes to presentation, the new standard did not have a significant impact on the Bank's financial statements.

The preparation of financial statements requires that management use judgment to make estimates and assumptions. The Bank's significant accounting estimates are primarily in the areas of the fair value of financial instruments and of pension and other future benefits costs, and are described, respectively, in notes 7 and 14 to the financial statements and are summarized in the following table.

Investment in the Bank for International Settlements	
The Bank records its investment in BIS shares at fair value.	The fair value of the BIS shares is estimated as being 70 per cent of the Bank's interest in the net asset value of the BIS at the reporting date. This formula is equivalent to the methodology applied by the BIS to determine the pricing of any new shares issued.
	The Bank's financial statements incorporate the most recently available data from the BIS.
	The Bank expects the value of the BIS shares to fluctuate over time in conjunction with the strength of the BIS balance sheet and the exchange rate.
Employee benefits	
The costs of providing deferred employee benefits are charged to the Statement of Comprehensive Income over the period during which benefit is derived from the employee's services.	The assumptions on which these costs are calculated are disclosed in note 14 to the financial statements. The key assumptions include the expected long-term rate of return on plan assets, the rate of compensation increase and the discount rate. The expected long-term rate of return on investments is determined based on the portfolio mix of government and provincial bonds, as well as projections on other assets such as equities. The assumption with the greatest potential impact on the benefit obligation is the discount rate. The discount rate is determined with reference to yields on AA-rated corporate bonds.
	Sensitivity analysis is provided in note 14, "Employee benefit plans." A rise of 50 basis points in the discount rate would result in a decrease in the net pension obligation of the pension plans of $101 million and a decrease in the benefit expense of $2.8 million.

Significant Contracts and Agreements

During 2012, the Bank entered into agreements and contracts related to the renewal of its head office facility. Bank employees will be relocated to a temporary location during the construction period. In 2012, a five-year lease was signed and will commence 1 July 2013. The Bank also entered into agreements for construction-management and architectural services for the renewal project. Commitments related to the Head Office Renewal Program are provided in notes 8 and 16 to the financial statements.

In December 2012, the bilateral liquidity swap facilities with the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve Bank of New York and the Swiss National Bank were extended and will now expire on 1 February 2014. The NAFA swaps with the Federal Reserve Bank of New York and the Banco de México were also extended and will expire on 14 December 2013.

Related-Party Transactions

The Bank is related in terms of common ownership to all Government of Canada departments, agencies and Crown corporations. To achieve its monetary policy objectives, the Bank maintains a position of structural and functional independence from the Government of Canada through its ability to fund its own operations without external assistance and through its management and governance.

In the normal course of its operations, the Bank enters into transactions with those related parties, and material transactions and balances are reported as described in note 18 to the financial statements. The Bank provides funds-management, fiscal-agent and banking services to the federal government, and the costs of these services are recorded within the Bank's expenses. The assets and liabilities that are managed on behalf of the government are not included in the Bank's financial statements since they do not represent assets or liabilities of the Bank.

Financial Statement Outlook

The Bank's forecasts for its operations do not include projections of net income and financial position. Such projections would require assumptions of interest rates, which the Bank avoids, since they could be interpreted as a signal of future monetary policy.

2013 (in the context of the new MTP for the period 2013–15)

The three-year medium-term plan (MTP) is the main planning tool the Bank uses to establish its strategic priorities. In September 2012, the 2013–15 MTP was approved by the Board of Directors. Operating expenses in the first year of the Plan are higher than in 2012, partly as a result of new non-discretionary operating costs to enhance the Bank's business resilience, such as the new primary and secondary data centres. As well, in the short term, the Bank will make investments to refocus and reconfigure some of its business models and operations to achieve future savings. In 2014, as the Bank begins to realize the benefits of these investments, operating expenses are anticipated to decline from their 2013 level.

The Bank prepares its plan with a distinction between MTP operating expenses (a subset of the total expenses) and those expenses that have a history of volatility (bank note production and deferred employee benefits), as well as the non-routine costs associated with the Head Office Renewal and Enhanced Business-Continuity programs.

The Bank's 2013 plan (Strategic Plan view) (Millions of dollars)	**2013 plan**
MTP operating expenses[a]	359.0
Bank note production	166.0
Non-current deferred employee benefits[a]	20.1
MTP programs including Head Office Renewal	60.7
Total expenses	605.7

a. MTP operating expenses and non-current deferred employee benefits are considered non-IFRS measures that do not have a standardized meaning.

Statement of Financial Position

Capital expenditures of $92 million are expected in 2013, consisting of $64 million associated with the Head Office Renewal Program, with the remainder targeted for other strategic priorities and ongoing capital expenditures.

In connection with the Government of Canada's prudential liquidity-management plan, government deposits held at the Bank are expected to increase by $10 billion in 2013.

Developments in Accounting Standards

The Bank's financial statements are prepared in accordance with International Financial Reporting Standards as required by the Canadian Accounting Standards Board. New standards and amendments issued by the International Accounting Standards Board that may affect the Bank in the future are described in note 3 to the financial statements. The Bank is currently assessing the impact of the standards and amendments that are not yet effective on its financial statements. Based on its preliminary assessments, the Bank has determined that amendments to IAS 19 *Employee Benefits* are expected to have an impact on the financial statements in 2013. While the final quantitative impact of adopting the amendments cannot be confirmed, the estimated net impact of the restatement for the year ended 31 December 2012 will be an increase in benefit plan expenses and a reduction in actuarial losses on defined-benefit plans of $16 million.

Financial Reports

FINANCIAL REPORTING RESPONSIBILITY

The accompanying financial statements of the Bank of Canada have been prepared by management in accordance with International Financial Reporting Standards and contain certain items that reflect the best estimates and judgments 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.

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 and Finance Committee of the Board. The Audit and Finance Committee is composed of members who are neither officers nor employees of the Bank and who are financially literate. The Audit and Finance Committee is therefore qualified to review the Bank's annual financial statements and to recommend their approval by the Board of Directors. The Audit and Finance Committee meets with management, the Chief Internal Auditor, and the Bank's independent auditors who are appointed by Order-in-Council. The Audit and Finance Committee has established processes to evaluate the independence of the Bank's independent auditors and oversees all services provided by them. The Audit and Finance 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 independent auditors, KPMG LLP and Deloitte LLP, and their report is presented herein. The independent auditors have full and unrestricted access to the Audit and Finance Committee to discuss their audit and related findings.

M. Carney, Governor

S. Vokey, CPA, CA,
Chief Accountant and
Chief Financial Officer

Ottawa, Canada
15 February 2013

INDEPENDENT AUDITORS' REPORT

To the Minister of Finance, registered shareholder of the Bank of Canada (the "Bank")

We have audited the accompanying financial statements of the Bank, which comprise the statement of financial position as at 31 December 2012 and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2012 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte LLP	KPMG LLP
Chartered Accountants	Chartered Accountants
Licensed Public Accountants	Licensed Public Accountants

Ottawa, Canada
15 February 2013

STATEMENT OF FINANCIAL POSITION

(Millions of dollars)

	31 December 2012	As at 31 December 2011
ASSETS		
Cash and foreign deposits (note 4)	**6.8**	11.7
Loans and receivables		
Securities purchased under resale agreements (note 5a)	**1,838.3**	1,447.7
Advances to members of the Canadian Payments Association (note 5b)	**61.8**	81.5
Other receivables	**5.5**	1.6
	1,905.6	1,530.8
Investments (note 6, 7)		
Government of Canada treasury bills	**18,987.3**	18,545.6
Government of Canada bonds	**56,277.3**	43,553.3
Other investments	**342.7**	325.3
	75,607.3	62,424.2
Property and equipment (note 8)	**190.4**	176.6
Intangible assets (note 9)	**55.6**	44.6
Other assets (note 10)	**41.6**	59.3
Total assets	**77,807.3**	64,247.2
LIABILITIES AND EQUITY		
Bank notes in circulation (note 11)	**63,700.0**	61,028.8
Deposits (note 12)		
Government of Canada	**11,701.5**	1,512.5
Members of the Canadian Payments Association	**186.4**	106.7
Other deposits	**1,403.4**	861.8
	13,291.3	2,481.0
Other liabilities (note 13)	**377.5**	312.8
	77,368.8	63,822.6
Equity (note 15)	**438.5**	424.6
Total liabilities and equity	**77,807.3**	64,247.2

Commitments, contingencies and guarantees (note 17)

M. Carney, Governor

S. Vokey, CPA, CA,
Chief Accountant and
Chief Financial Officer

David H. Laidley, FCPA, FCA,
Lead Director and
Chair, Audit and Finance Committee

Daniel Johnson,
Member,
Audit and Finance Committee

(See accompanying notes to the Financial Statements.)

STATEMENT OF COMPREHENSIVE INCOME

(Millions of dollars)

	For the year ended 31 December	
	2012	2011
INCOME		
Net interest income		
Interest revenue		
Interest earned on investments	**1,646.1**	1,614.7
Dividend revenue	**4.4**	4.3
Interest earned on securities purchased under resale agreements	**2.3**	1.9
Other interest revenue	**0.3**	0.2
	1,653.1	1,621.1
Interest expense		
Interest expense on deposits	**(87.8)**	(23.4)
	1,565.3	1,597.7
Other revenue	**10.1**	9.1
Total income	**1,575.4**	1,606.8
EXPENSES		
Staff costs	**175.7**	153.8
Bank note research, production and processing	**123.4**	53.5
Premises maintenance	**40.8**	24.4
Technology and telecommunications	**33.4**	27.0
Depreciation and amortization	**23.8**	17.4
Other operating expenses	**78.5**	77.0
Total expenses	**475.6**	353.1
NET INCOME	**1,099.8**	1,253.7
OTHER COMPREHENSIVE INCOME (LOSS)		
Items that will not be reclassified to net income		
Actuarial losses on defined-benefit plans	**(77.6)**	(202.5)
Items that may subsequently be reclassified to net income		
Change in fair value of available-for-sale financial assets	**13.9**	23.6
Other comprehensive income (loss)	**(63.7)**	(178.9)
COMPREHENSIVE INCOME	**1,036.1**	1,074.8

(See accompanying notes to the Financial Statements.)

STATEMENT OF CHANGES IN EQUITY

(Millions of dollars)

For the year ended 31 December	Share capital	Statutory reserve	Special reserve	Available-for-sale reserve	Actuarial gains reserve	Retained earnings	Total
Balance, 1 January 2012	**5.0**	**25.0**	**100.0**	**294.6**	**-**	**-**	**424.6**
Comprehensive income for the year							
Net income	**-**	**-**	**-**	**-**	**-**	**1,099.8**	**1,099.8**
Change in fair value of available-for-sale financial assets	**-**	**-**	**-**	**13.9**	**-**	**-**	**13.9**
Actuarial losses on defined-benefit plans	**-**	**-**	**-**	**-**	**-**	**(77.6)**	**(77.6)**
	-	**-**	**-**	**13.9**	**-**	**1,022.2**	**1,036.1**
Transfer to Receiver General for Canada	**-**	**-**	**-**	**-**	**-**	**(1,022.2)**	**(1,022.2)**
Balance, 31 December 2012	**5.0**	**25.0**	**100.0**	**308.5**	**-**	**-**	**438.5**
Balance, 1 January 2011	5.0	25.0	100.0	271.0	14.1	1.7	416.8
Comprehensive income for the year							
Net income	-	-	-	-	-	1,253.7	1,253.7
Change in fair value of available-for-sale financial assets	-	-	-	23.6	-	-	23.6
Actuarial losses on defined-benefit plans	-	-	-	-	(14.1)	(188.4)	(202.5)
	-	-	-	23.6	(14.1)	1,065.3	1,074.8
Transfer to Receiver General for Canada	-	-	-	-	-	(1,067.0)	(1,067.0)
Balance, 31 December 2011	5.0	25.0	100.0	294.6	-	-	424.6

(See accompanying notes to the Financial Statements.)

STATEMENT OF CASH FLOWS

(Millions of dollars)

	For the year ended 31 December	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest received	**1,696.5**	1,641.6
Dividends received	**4.4**	4.3
Other revenue received	**6.1**	9.9
Interest paid	**(87.8)**	(23.4)
Payments to or on behalf of employees and to suppliers	**(450.9)**	(385.8)
Net increase (decrease) in advances to members of the Canadian Payments Association	**19.7**	(59.0)
Net increase (decrease) in deposits	**10,810.3**	(76.4)
Proceeds from maturity of securities purchased under resale agreements	**40,109.3**	17,052.7
Acquisition of securities purchased under resale agreements	**(40,500.2)**	(16,438.6)
Repayments of securities sold under repurchase agreements	**-**	(764.8)
Proceeds from securities sold under repurchase agreements	**-**	764.8
Net cash provided by operating activities	**11,607.4**	1,725.3
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (increase) decrease in Government of Canada treasury bills	**(449.8)**	6,362.5
Purchases of Government of Canada bonds	**(17,766.7)**	(15,422.9)
Proceeds from maturity of Government of Canada bonds	**5,000.0**	5,403.1
Additions of property and equipment	**(31.2)**	(36.2)
Additions of intangible assets	**(17.5)**	(23.5)
Net cash used in investing activities	**(13,265.2)**	(3,717.0)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in bank notes in circulation	**2,671.2**	3,154.6
Remittance of ascertained surplus to the Receiver General for Canada	**(1,018.4)**	(1,156.1)
Net cash provided by financing activities	**1,652.8**	1,998.5
EFFECT OF EXCHANGE RATE CHANGES ON FOREIGN CURRENCY	**0.1**	0.2
INCREASE (DECREASE) IN CASH AND FOREIGN DEPOSITS	**(4.9)**	7.0
CASH AND FOREIGN DEPOSITS, BEGINNING OF YEAR	**11.7**	4.7
CASH AND FOREIGN DEPOSITS, END OF YEAR	**6.8**	11.7

(See accompanying notes to the Financial Statements.)

NOTES TO THE FINANCIAL STATEMENTS OF THE BANK OF CANADA

For the year ended 31 December 2012

(Amounts in the notes to the Financial Statements of the Bank of Canada are in millions of Canadian dollars, unless otherwise stated.)

1. The business of the Bank of Canada

The Bank of Canada (the Bank) is the central bank of Canada. The Bank is a corporation under the Bank of Canada Act and is wholly owned by the Government of Canada and is exempt from income taxes. The Bank is a Government Business Enterprise, as defined by the Public Sector Accounting Board Handbook and, as such, adheres to the standards applicable to publicly accountable enterprises as outlined by the Canadian Institute of Chartered Accountants (CICA).

The responsibilities of the Bank focus on the goals of low and stable inflation, financial system stability, a safe and secure currency, and the efficient management of government funds and public debt. These responsibilities are carried out as part of the broad functions described below.

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

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

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

Funds management
Provides high-quality, effective and efficient funds-management services: for the Government of Canada, as its fiscal agent; for the Bank; and for other clients.

2. Basis of preparation

Compliance with International Financial Reporting Standards (IFRS)

These financial statements have been prepared in accordance with IFRS and conform to the disclosure and accounting requirements of the Bank of Canada Act and the Bank's bylaws.

The Board of Directors approved the financial statements on 15 February 2013.

Measurement base

The financial statements have been prepared on the historical cost basis, except for the available-for-sale financial assets (AFS), which are measured at fair value, and the defined-benefit assets and obligations, which are recognized as the net of the plan assets, and the present value of the defined-benefit obligation.

Significant accounting estimates and judgments in applying accounting policies

The preparation of the financial statements requires management to make judgments, estimates and assumptions based on information available at the statement date that affect the application of accounting policies and the reported amounts of assets, liabilities, income, expenses and related information. Actual results could differ from these estimates, in which case, the impact will be recognized in the financial statements of a future fiscal period.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. These estimates are primarily in the area of employee benefit plans (note 14) and the fair values of certain financial instruments and collateral taken (note 7).

Functional and presentation currency

The Bank's functional and presentation currency is the Canadian dollar.

Fiscal-agent and custodial activities

Responsibility for the operational management of the Government of Canada's financial assets and liabilities is jointly borne by both the Bank (as fiscal agent for the Government) and the Department of Finance. In this fiscal-agent role, the Bank provides transactional and administrative support to the Government of Canada in certain areas. Assets, liabilities, expenditures and revenues to which this support relates are those of the Government of Canada and are not included in the financial statements of the Bank.

Securities safekeeping and gold custodial activities are provided to foreign central banks and international organizations. The assets, and income arising thereon, are excluded from these financial statements, since they are not assets or income of the Bank.

3. Significant accounting policies

The significant accounting policies of the Bank are summarized below. These policies have been consistently applied to all years presented, unless otherwise stated.

a) Translation of foreign currencies

Investment income and expenses denominated in foreign currencies are translated at the exchange rate in effect at the date of the transaction. Fair-value items denominated in foreign currencies are translated at the exchange rate in effect at the date of the fair-value measurement. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the rates of exchange prevailing at the end of the reporting period. The resulting gains and losses are included in *Other revenue*. Gains or losses on equity investments classified as AFS, along with any exchange-related gains or losses, are recognized in the available-for-sale reserve within *Other Comprehensive Income*.

b) Financial instruments

The Bank accounts for all financial instruments using settlement-date accounting. Financial instruments are measured at fair value on initial recognition, plus transaction costs, if any, for all financial assets not carried at fair value through net income. Subsequent to initial recognition, they are accounted for based on their classification.

Subsequent to initial recognition, financial assets classified as AFS are measured at fair value using quoted market prices, with the exception of the Bank for International Settlements (BIS) shares, which are measured using significant non-observable inputs. Unrealized changes in the values of AFS financial assets measured at fair value are recognized in *Other Comprehensive Income* and accumulated in the available-for-sale reserve in equity until the financial asset is derecognized or becomes impaired. At that time, the cumulative unrealized gain or loss previously recognized in *Other Comprehensive Income* is reclassified from equity to net income. The Bank's financial assets designated as AFS consist of Government of Canada treasury bills and other investments, which comprise BIS shares.

Financial assets that the Bank has the intent and ability to hold to maturity are classified as held-to-maturity (HTM). Subsequent to initial recognition, financial assets classified as HTM are measured at amortized cost using the effective interest method less any impairment losses. The effective interest method uses the rate inherent in a financial instrument that discounts the estimated future cash flows over the expected life of the financial instrument so as to recognize interest on a constant-yield basis. Government of Canada bonds are classified as HTM.

The Bank has not classified any of its financial assets as fair value through net income, other than cash and foreign deposits.

All other financial assets are classified as loans and receivables. Subsequent to initial recognition, these are measured at amortized cost less any impairment losses using the effective interest method of amortization.

The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire. On derecognition of a financial asset measured at amortized cost, the difference between the asset's carrying amount and the sum of the consideration received and receivable is recognized in net income.

The Bank has classified its financial liabilities as other liabilities. These liabilities are initially recognized at fair value. Subsequent to initial recognition, financial liabilities are measured at amortized cost using the effective interest method, with the exception of bank notes in circulation, which are measured at face value. The Bank has not classified any of its financial liabilities as fair value through net income.

The Bank derecognizes financial liabilities when the Bank’s obligations are discharged, cancelled or expire. The difference between the carrying amount of the financial liability derecognized and the sum of the consideration paid and payable, including any non-cash assets transferred or liabilities assumed, is recognized in net income.

c) Securities purchased under resale agreements

Securities purchased under resale agreements are reverse repo-type transactions in which the Bank purchases securities from designated counterparties with an agreement to sell them back at a predetermined price on an agreed transaction date. For accounting purposes, these agreements are treated as collateralized lending transactions and are recorded on the Statement of Financial Position at the amounts at which the securities were originally acquired, plus accrued interest.

d) 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. For accounting purposes, these agreements are treated as collateralized borrowing transactions and are recorded on the Statement of Financial Position at the amounts at which the securities were originally sold, plus accrued interest.

e) 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 by securities and are generally one business day 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 *Other revenue* at the maturity date of the transaction.

f) Property and equipment

Property and equipment consists of land, buildings, computer equipment, other equipment and related projects in progress. *Property and equipment* is recorded at cost less accumulated depreciation, except for land, which is not depreciated, and is net of any related impairment losses. Projects in progress are recorded at cost but are not depreciated until the asset is available for use. Cost includes expenditures that are directly attributable to the acquisition or construction of the asset.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. Upon replacing a significant part of an item of property and equipment, the carrying amount of the replaced part is derecognized.

Depreciation is calculated using the straight-line method and is applied over the estimated useful lives of the assets, as shown below. The estimated useful life and depreciation method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Buildings	25 to 65 years
Computer equipment	3 to 7 years
Other equipment	5 to 15 years

g) Intangible assets

Intangible assets are identified non-monetary assets without physical substance. The Bank's intangible assets consist of computer software internally developed or externally acquired.

Costs that are directly associated with the internal development of identifiable software are recognized as intangible assets if, in management's best estimate, the asset can technically be completed and will provide a future economic benefit to the Bank. Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates.

Computer software assets that are acquired by the Bank and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses.

Amortization is calculated using the straight-line method and is applied over the estimated useful lives of the assets, which may vary from 3 to 15 years. The estimated useful life and amortization method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

h) Bank note inventory

Bank note inventory consists of production materials, including polymer substrate and ink, and is recorded at the lower of cost and the net realizable value. The cost to produce finished bank notes is expensed as incurred.

i) Leases

Where the Bank is a lessee

Leases of equipment where the Bank has assumed substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's inception at the lower of the fair value of the leased asset or the present value of the minimum lease payments. The corresponding lease obligations, net of finance charges, are included in *Other liabilities*. Each lease payment is allocated between the liability and finance charges to achieve a constant rate of return on the finance lease obligation outstanding. Equipment acquired under finance leases is depreciated over the shorter of the asset's useful life or the lease term.

Other leases are classified as operating leases. Payments made under operating leases are charged to the Statement of Comprehensive Income on a straight-line basis over the period of the lease.

Where the Bank is a lessor

Leases granted on the Bank's property were assessed and classified as operating leases because the risks and rewards of ownership are not transferred to the lessees. Operating lease income is recognized on a straight-line basis over the period of the lease.

j) Impairment

Impairment of financial assets

For financial assets that are not classified as fair value through net income, the Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of assets is impaired. Once impaired, financial assets carried at amortized cost are remeasured at the net recoverable amount, with the amount of impairment recognized in net income. Unrealized losses on impaired AFS financial assets are recognized in net income at the time of impairment.

Impairment of non-financial assets

Non-financial assets, including property and equipment, and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount exceeds its recoverable amount.

Intangible assets under development are assessed for impairment on an annual basis.

k) Employee benefits

Short-term employee benefits

Short-term employee benefits include cash salary, bonus, annual leave, health benefits, dental care and statutory benefits and are measured on an undiscounted basis.

Long-term employee benefits

The Bank sponsors a long-term disability program.

The liability recognized in respect of this plan amounts to the present value of the defined-benefit obligation. The present value of the defined-benefit obligation is calculated by discounting estimated future cash flows using interest rates of high-quality corporate bonds with terms to maturity approximating the estimated duration of the obligation. The expense recognized for the fiscal year consists of current service costs, interest costs, actuarial gains and losses, and past service costs.

The current service costs and the benefit obligations of the plan are actuarially determined on an event-driven accounting basis. Actuarial gains and losses are recognized immediately in net income in the period in which they occur. Past service costs arising from plan amendments are recognized immediately in *Staff costs* in the period in which they occur.

Post-employment defined-benefit plans

The Bank sponsors a funded defined-benefit pension plan (the Bank of Canada Registered Pension Plan) and a funded defined-benefit supplementary pension arrangement (the Bank of Canada Supplementary Pension Arrangement), which are designed to provide retirement income benefits to eligible employees. Benefits provided under these plans are calculated based on years of service and average full-time salary for the best five consecutive years and are indexed to reflect changes in the consumer price index on the date payments begin and each 1 January thereafter.

Effective 1 January 2012, the plan bylaws were amended to reflect a new defined-benefit plan design for eligible employees hired after that date and for current plan members who selected the new design for service from that date forward. The amendment increased the age at which members are entitled to receive pension benefits, removed the bridge benefit and adjusted employee contributions.

The Bank also sponsors other unfunded post-employment defined-benefit plans, which include life insurance and eligible health and dental benefits, as well as a long-service benefit program for employees hired before 1 January 2003.

The net asset or liability of these plans is recorded on the Statement of Financial Position. The asset or liability recognized at fiscal year-end in respect of these plans is composed of the present value of the defined-benefit obligation less the fair value of plan assets, where applicable. The present value of the defined-benefit obligation is calculated by discounting estimated future cash flows using interest rates of high-quality corporate bonds with terms to maturity approximating the estimated duration of the obligation. The expense recognized for the fiscal year consists of current service costs, interest costs, expected return on plan assets and past service costs.

The current service costs and the benefit obligations of the plans are actuarially determined using the projected unit credit method. Actuarial gains or losses arise from the difference between the actual rate of return and the expected rate of return on plan assets for that period and from changes in the actuarial assumptions used to determine the accrued benefit obligation. Actuarial gains or losses are recognized immediately in the period in which they occur in *Other Comprehensive Income*. Past service costs arising from plan amendments that have vested are immediately recognized as an expense. Non-vested past service costs are amortized over the period until the related benefits become vested. Plan assets of funded benefit plans are determined according to their estimated fair value at the end of the fiscal year.

l) Provisions

A provision is recognized if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably as at the statement of financial position date, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are included under *Other liabilities* (note 13).

m) Revenue recognition

Interest revenue earned on Government of Canada treasury bills and bonds is recorded using the effective interest method. Dividend revenue on the BIS shares is recorded as dividends are declared.

Realized gains (losses) on the sale of Government of Canada treasury bills are recorded at the time of sale as a reclassification from O*ther Comprehensive Income* and are calculated as the excess of proceeds over the amortized cost at the transaction date.

Interest earned on securities purchased under resale agreements is recorded using the effective interest method.

Other revenue is composed mostly of interest earned on advances to members of the Canadian Payments Association (CPA) and is recorded using the effective interest method.

n) Changes in accounting policies

IFRS 7

The Bank adopted the amendments to IFRS 7 *Financial Instruments: Disclosures* (IFRS 7), effective 1 January 2012. IFRS 7 was amended in October 2010 to provide additional disclosure on the transfer of financial assets, including the possible effects of any residual risks that the transferring entity retains. These amendments require disclosure relating to the Bank's securities sold under repurchase agreements and securities-lending transactions. There was no material impact on the financial statements as a result of these amendments.

IAS 1

IAS 1 *Presentation of Financial Statements* (IAS 1) was amended in June 2011 to provide additional disclosure in the *Other Comprehensive Income* section of the financial statements by grouping items of *Other Comprehensive Income* into two categories: (i) items that will not be reclassified to net income; and (ii) items that may subsequently be reclassified to net income when specific conditions are met. The amendments are effective for annual periods beginning on or after 1 July 2012 and are to be applied retrospectively. The Bank early adopted these amendments effective 1 January 2012 and applied them retrospectively. The adoption of these amendments resulted only in presentation changes on the Statement of Comprehensive Income.

o) Future changes in accounting policies

The following new standards and amendments issued by the International Accounting Standards Board (IASB) have been assessed as having a possible effect on the Bank in the future. The Bank is currently determining the impact of these standards and amendments on its financial statements.

(i) Standards effective for annual and interim financial statements for periods beginning on or after 1 January 2013

IAS 19

In June 2011, the IASB published an amended version of IAS 19 *Employee Benefits* (IAS 19). Adoption of the amendment is required for annual periods beginning on or after 1 January 2013, with early adoption permitted. The amendment is generally applied retrospectively with certain exceptions.

The amendments require the following:

- immediate recognition of actuarial gains and losses in *Other Comprehensive Income*;
- immediate full recognition of past service costs in profit or loss;
- recognition of expected return on plan assets in profit or loss to be calculated based on the rate used to discount the defined-benefit obligation; and
- additional disclosures that explain the characteristics of the entity's defined-benefit plans and risks associated with the plans, as well as disclosures that describe how defined-benefit plans may affect the amount, timing and uncertainty of future cash flows, and details of any asset-liability match strategies used to manage risks.

The amendments also affect termination benefits, which would now be recognized at the earlier of: when the entity recognizes costs for a restructuring within the scope of IAS 37 *Provisions* or when the entity can no longer withdraw the offer of the termination benefits.

The Bank will not be affected by the elimination of the corridor approach, since the policy to immediately recognize all actuarial gains and losses was adopted at the time of the Bank's transition to IFRS.

While the final quantitative impact of adopting the amendments cannot be confirmed, the estimated net impact of the restatement for the year ended 31 December 2012 will be an increase in benefit plan expenses and a reduction of actuarial losses on defined-benefit plans of $16 million.

Other standards

IFRS 11

On 12 May 2011, the IASB issued IFRS 11 *Joint Arrangements* (IFRS 11). IFRS 11 provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method to account for interests in jointly controlled entities.

The Bank is currently evaluating the impact and has made a preliminary determination that IFRS 11 will result in additional disclosures but will not have an impact on the Bank's financial statements. IFRS 11 is to be applied retrospectively.

IFRS 12

On 12 May 2011, the IASB issued IFRS 12 *Disclosure of Interests in Other Entities* (IFRS 12). IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities.

The Bank is currently evaluating the impact and has made a preliminary determination that IFRS 12 will result in additional disclosures but will not have an impact on the Bank's financial statements. IFRS 12 is to be applied retrospectively.

IFRS 13

On 12 May 2011, the IASB issued IFRS 13 *Fair Value Measurement* (IFRS 13). IFRS 13, which is effective from 1 January 2013, defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair-value measurements. IFRS 13 does not determine when an asset, a liability or an entity's own equity instrument is measured at fair value. Rather, the measurement and disclosure requirements of IFRS 13 apply when another IFRS requires or permits the item to be measured at fair value (with limited exceptions).

The Bank is currently evaluating the impact and has made a preliminary determination that IFRS 13 will result in additional disclosures but will not have an impact on the Bank's financial statements. IFRS 13 is to be applied prospectively.

IFRS 7 and IAS 32

IFRS 7 *Financial Instruments: Disclosures* (IFRS 7) and IAS 32 *Financial Instruments: Presentation* (IAS 32) were amended in December 2011 to provide additional accounting requirements and disclosures related to the offsetting of financial assets and financial liabilities. The new disclosures under IFRS 7 are effective for annual and interim financial statements for periods beginning on or after 1 January 2013. The clarifying amendments to IAS 32 are effective for annual periods beginning on or after 1 January 2014. The Bank is currently evaluating the impact of these amendments to IFRS 7 and IAS 32 on its financial statements and has made a preliminary determination that they do not have an impact on the Bank's financial statements.

(ii) Standards effective for annual periods beginning on or after 1 January 2015

IFRS 9

IFRS 9 *Financial Instruments* (IFRS 9) as issued in November 2009 and revised in October 2010, and the related consequential amendments, will replace International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (IAS 39). IFRS 9 relates to the recognition and derecognition and measurement of financial assets and financial liabilities.

IFRS 9 eliminates the existing financial asset categories and requires all financial assets to be classified on initial recognition, either at amortized cost or at fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.

Gains and losses on financial assets measured at fair value will be recognized through net income, with the exception of equity investments not held for trading, which the Bank elects on initial recognition to have gains or losses recognized directly in equity.

The new standard also requires the use of a single impairment method for financial assets based on expected losses and incurred losses, replacing the multiple impairment methods in IAS 39.

IFRS 9 requires all financial liabilities not designated at fair value through net income to be subsequently measured at amortized cost using the effective interest method.

IFRS 9 is effective for annual periods beginning on or after 1 January 2015, although early adoption is permitted. The Bank is currently evaluating the impact of IFRS 9 on its financial statements, and will continue to do so as the remaining stages of this project, relating to hedge accounting and financial asset impairment, are finalized.

4. Cash and foreign deposits

Cash and foreign deposits is composed of cash on hand as well as highly liquid demand deposits in foreign currencies with other central banks or international financial institutions. Included in this balance is Can$6.7 million (Can$6.2 million at 31 December 2011) of foreign deposits.

5. Loans and receivables

Loans and receivables are composed primarily of securities purchased under resale agreements and, if any, advances to members of the Canadian Payments Association (CPA). These transactions are fully collateralized in accordance with publicly disclosed collateral eligibility and margin requirements. Financial risks related to these instruments are discussed in note 7.

a) Securities purchased under resale agreements

Securities purchased under resale agreements for terms of one business day are acquired to reinforce the target overnight interest rate. Securities are acquired through buyback transactions with primary dealers where the counterparties may accept an amount up to their pre-specified limit.

Securities purchased under resale agreements for terms of longer than one business day are acquired through an auction process. Details of these auctions are announced by the Bank in advance. Bids are submitted on a yield basis, and funds are allocated in descending order of bid yields.

Balances outstanding at 31 December 2012 consist of agreements with original terms to maturity ranging from 23 to 24 days. (Balances outstanding at 31 December 2011 consist of an agreement with original terms to maturity of 14 days.)

b) Advances to members of the CPA

Advances to members of the CPA are typically composed of liquidity loans made under the Bank's Standing Liquidity Facility. These advances mature the next business day. Interest on overnight advances is calculated at the Bank Rate. The Bank Rate is the rate of interest that the Bank charges on one-day loans to major financial institutions.

6. Investments

There were no securities loaned under the Securities Lending Program at 31 December 2012 ($Nil at 31 December 2011).

In *Other investments*, the Bank holds 9,441 BIS shares (9,441 BIS shares at 31 December 2011) in order to participate in the BIS. Ownership of the BIS shares is limited to central banks, and new shares can only be acquired following an invitation to subscribe extended by the BIS Board of Directors. The shares are non-transferable unless prior written consent is obtained from the BIS.

7. Financial instruments and risk management

The Bank's financial instruments consist of cash and foreign deposits, securities purchased under resale agreements, advances to members of the CPA, other receivables, investments (consisting of Government of Canada treasury bills, Government of Canada bonds and shares in the BIS), bank notes in circulation, deposits and other liabilities (excluding post-employment and long-term employee benefit obligations).

Cash and foreign deposits, Government of Canada treasury bills and BIS shares are measured at fair value. All other financial instruments are measured at amortized cost using the effective interest method, with the exception of bank notes in circulation, which are measured at face value.

a) Fair value of financial instruments

(i) Carrying amount and fair value of financial instruments

The carrying amount and fair values of financial assets and liabilities are presented in the following table:

	31 December 2012		31 December 2011	
	Carrying amount	**Fair value**	**Carrying amount**	**Fair value**
Financial assets				
Cash and foreign deposits	**6.8**	**6.8**	11.7	11.7
Securities purchased under resale agreements	**1,838.3**	**1,838.3**	1,447.7	1,447.7
Advances to members of the Canadian Payments Association	**61.8**	**61.8**	81.5	81.5
Other receivables	**5.5**	**5.5**	1.6	1.6
Government of Canada treasury bills	**18,987.3**	**18,987.3**	18,545.6	18,545.6
Government of Canada bonds	**56,277.3**	**60,881.8**	43,553.3	48,511.0
Other investments	**342.7**	**342.7**	325.3	325.3
Total financial assets	**77,519.7**	**82,124.2**	63,966.7	68,924.4
Financial liabilities				
Bank notes in circulation	**63,700.0**	**63,700.0**	61,028.8	61,028.8
Deposits	**13,291.3**	**13,291.3**	2,481.0	2,481.0
Other financial liabilities	**174.6**	**174.6**	132.1	132.1
Total financial liabilities	**77,165.9**	**77,165.9**	63,641.9	63,641.9

(ii) Financial instruments measured at fair value

Financial instruments measured at fair value are classified using a fair-value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 – inputs for the assets or liabilities that are not based on observable market data (unobservable inputs).

The fair-value hierarchy requires the use of observable market inputs wherever such inputs exist. A financial instrument is classified at the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

	Level 1	Level 2	Level 3	Total
Financial assets at fair value as at 31 December 2012				
Cash and foreign deposits	**6.8**	**-**	**-**	**6.8**
Government of Canada treasury bills	**18,987.3**	**-**	**-**	**18,987.3**
BIS shares	**-**	**-**	**342.7**	**342.7**
	18,994.1	**-**	**342.7**	**19,336.8**
Financial assets at fair value as at 31 December 2011				
Cash and foreign deposits	11.7	-	-	11.7
Government of Canada treasury bills	18,545.6	-	-	18,545.6
BIS shares	-	-	325.3	325.3
	18,557.3	-	325.3	18,882.6

There were no transfers of amounts between levels in 2012.

The fair value of the BIS shares is estimated as being 70 per cent of the Bank's interest in the net asset value (NAV) of the BIS at the reporting date. This formula is equivalent to the methodology applied by the BIS to determine the pricing of any new shares issued. While the Bank considers that the 30 per cent discount against the BIS's net asset value continues to be the appropriate basis for valuation, the valuation inputs are not considered to be observable, and a 5 per cent change in discount to the NAV would not materially impact the fair value of the BIS shares. There were no changes to the valuation technique during the year.

The following table reconciles the estimated fair value of the BIS shares determined using Level 3 fair-value measurements for the period from 1 January to 31 December:

	31 December 2012	31 December 2011
Opening balance at beginning of year	**325.3**	310.7
Change in fair value recorded through *Other Comprehensive Income*	**17.4**	14.6
Closing balance at end of year	**342.7**	325.3

(iii) Financial instruments not measured at fair value

Fair values of securities purchased under resale agreements are determined using market yields to maturity for similar instruments available at the Statement of Financial Position date.

Fair values of Government of Canada bonds are determined based on unadjusted quoted market prices in an active market.

The carrying amount of cash and foreign deposits, advances to members of the CPA, other receivables, deposits, and other financial liabilities (which is composed of other liabilities, excluding the portion representing accrued benefits liabilities as described in note 14) approximates fair value, given their short-term nature. The face value of bank notes in circulation is equal to their fair value.

b) Financial risk

The Bank has a well-established framework for identifying, managing and monitoring pertinent areas of risk. This framework is supported by the Board of Directors, which ensures that the Bank has a robust risk-management process in place. The Bank is exposed to financial risk (credit risk, market risk and liquidity risk) associated with the management of the Bank's financial assets and liabilities. The Financial Risk Office, which is independent of operations, monitors and reports on the financial risks relating to the Bank's balance sheet. The following is a description of those risks and how the Bank manages its exposure to them.

(i) Credit risk

Credit risk is the risk that a counterparty to a financial contract will fail to discharge its obligations in accordance with agreed-upon terms.

The Bank is exposed to credit risk through its cash and foreign deposits, investment portfolio, and advances to members of the CPA, and through market transactions conducted in the form of securities purchased under resale agreements and loans of securities. The maximum exposure to credit risk is estimated to be the carrying value of the items listed above. There are no past due or impaired amounts.

Advances to members of the CPA and securities purchased under resale agreements are fully collateralized loans. Collateral is taken in accordance with the Bank's publicly disclosed eligibility criteria and margin requirements accessible on its website. Strict eligibility criteria are set for all collateral, and the Bank requires excess collateral relative to the size of the loan provided.

In the unlikely event of a counterparty default, collateral can be liquidated to offset credit exposure. The credit quality of collateral is managed through a set of restrictions based on asset type, term to maturity, and the credit ratings of the securities pledged.

Concentration of credit risk

The credit risk associated with the Bank's investment portfolio, representing 97 per cent of the carrying value of its total assets (97 per cent in 2011), is low because the securities held are primarily direct obligations of the Government of Canada, which holds a credit rating of AAA. The Bank's advances to members of the CPA and securities purchased under resale agreements, representing 2 per cent of the carrying value of its total assets (2 per cent in 2011), are collateralized obligations of various Canadian-based financial institutions.

Collateral held against securities purchased under resale agreements at the end of the reporting period was in the form of securities issued or guaranteed by the Government of Canada. The fair value of collateral held totalled $1,864.0 million, representing 101 per cent of the amortized cost of $1,838.3 million ($1,481.0 million, representing 102 per cent of the amortized cost at 31 December 2011).

Large Value Transfer System (LVTS) guarantee

The Bank is exposed to credit risk through its guarantee of the LVTS. The maximum exposure under this guarantee is described in note 17, *Commitments, contingencies and guarantees*.

(ii) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Bank's investment in Government of Canada treasury bills and bonds counteracts the non-interest-bearing bank notes in circulation liability, and supports the Bank's operational independence to conduct monetary policy. These assets are acquired in proportions that broadly resemble the structure of the Government of Canada's domestic debt outstanding in order to reduce interest rate risk from the perspective of the Government of Canada.

The Bank's exposure to fair-value interest rate risk arises principally through its investment in Government of Canada treasury bills, which are short term in duration, and Government of Canada bonds. The fair value of the Government of Canada treasury bills portfolio held by the

Bank is exposed to fluctuations owing to changes in market interest rates. Unrealized gains and losses on the Government of Canada treasury bill portfolio are recognized in the *Available-for-sale reserve* in the *Equity* section of the Statement of Financial Position until they mature or are sold. Government of Canada bonds are carried at amortized cost and are acquired with the intention of holding them to maturity. All other financial assets or liabilities with an interest rate component are carried at amortized cost or at face value.

The Bank's revenue will vary over time in response to future movements in interest rates. These variations would not affect the ability of the Bank to fulfill its obligations, since its revenues greatly exceed its expenses.

The figures below show the effect at 31 December of an (increase)/decrease of 25 basis points in interest rates on the fair value of the Government of Canada treasury bill portfolio and other comprehensive income.

	31 December 2012	**31 December 2011**
Government of Canada treasury bills	**$ (16.2) / 15.4**	$ (15.9) / 15.4

The Bank's exposure to interest rate risk in the form of fluctuations in future cash flows of existing financial instruments is limited to Government of Canada deposits and cash and foreign deposits, since these instruments are subject to variable interest rates. The remainder of the Bank's financial assets and liabilities have either fixed interest rates or are non-interest-bearing.

The figures below show the effect at 31 December of an increase/(decrease) of 25 basis points in interest rates on the interest expenses paid on Government of Canada deposits.

	31 December 2012	**31 December 2011**
Interest expense on Government of Canada deposits	**$20.5 / (20.5)**	$5.0 / (5.0)

For all financial instruments, except bank notes in circulation, the future cash flows of the Bank are dependent on the prevailing market rate of interest at the time of renewal.

The following table illustrates interest rate risk relative to future cash flows by considering the expected maturity or repricing dates of existing financial assets and liabilities.

As at 31 December 2012

	Weighted-average interest rate %	Total	Non-interest-sensitive	1 business day to 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years
FINANCIAL ASSETS								
Cash and foreign deposits	**0.14**	**6.8**	**-**	**6.8**	**-**	**-**	**-**	**-**
Loans and receivables								
Advances to members of the CPA	**1.25**	**61.8**	**-**	**61.8**	**-**	**-**	**-**	**-**
Securities purchased under resale agreements	**1.03**	**1,838.3**	**-**	**1,838.3**	**-**	**-**	**-**	**-**
Other receivables		**5.5**	**5.5**	**-**	**-**	**-**	**-**	**-**
Investments								
Government of Canada treasury bills	**0.99**	**3,049.2**	**-**	**3,049.2**	**-**	**-**	**-**	**-**
	1.02	**7,039.2**	**-**	**-**	**7,039.2**	**-**	**-**	**-**
	1.09	**8,898.9**	**-**	**-**	**-**	**8,898.9**	**-**	**-**
	1.05	**18,987.3**						
Government of Canada bonds[1]	**1.87**	**1,840.3**	**-**	**-**	**1,840.3**	**-**	**-**	**-**
	2.75	**5,987.2**	**-**	**-**	**-**	**5,987.2**	**-**	**-**
	2.02	**30,439.4**	**-**	**-**	**-**	**-**	**30,439.4**	**-**
	4.59	**18,010.4**	**-**	**-**	**-**	**-**	**-**	**18,010.4**
	2.90	**56,277.3**						
Shares in the BIS		**342.7**	**342.7**	**-**	**-**	**-**	**-**	**-**
		77,519.7	**348.2**	**4,956.1**	**8,879.5**	**14,886.1**	**30,439.4**	**18,010.4**
FINANCIAL LIABILITIES								
Bank notes in circulation		**63,700.0**	**63,700.0**	**-**	**-**	**-**	**-**	**-**
Deposits								
Government of Canada	**1.03**	**11,701.5**	**-**	**11,701.5**	**-**	**-**	**-**	**-**
Members of the CPA	**0.75**	**186.4**	**-**	**186.4**	**-**	**-**	**-**	**-**
Other deposits								
Unclaimed balances		**496.1**	**496.1**	**-**	**-**	**-**	**-**	**-**
Other	**0.98**	**907.3**	**-**	**907.3**	**-**	**-**	**-**	**-**
Other financial liabilities		**174.6**	**174.6**	**-**	**-**	**-**	**-**	**-**
		77,165.9	**64,370.7**	**12,795.2**	**-**	**-**	**-**	**-**
Interest rate sensitivity gap		**353.8**	**(64,022.5)**	**(7,839.1)**	**8,879.5**	**14,886.1**	**30,439.4**	**18,010.4**

1. Carrying amounts of Government of Canada bonds include accrued interest.

								As at 31 December 2011
	Weighted-average interest rate %	Total	Non-interest-sensitive	1 business day to 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years
FINANCIAL ASSETS								
Cash and foreign deposits	0.03	11.7	-	11.7	-	-	-	-
Loans and receivables								
Advances to members of the CPA	1.25	81.5	-	81.5	-	-	-	-
Securities purchased under resale agreements	1.06	1,447.7	-	1,447.7	-	-	-	-
Other receivables		1.6	1.6	-	-	-	-	-
Investments								
Government of Canada treasury bills	1.01	2,999.3	-	2,999.3	-	-	-	-
	0.97	6,666.1	-	-	6,666.1	-	-	-
	1.07	8,880.2	-	-	-	8,880.2	-	-
	1.03	18,545.6						
Government of Canada bonds[1]	1.47	452.2	-	-	452.2	-	-	-
	3.47	4,573.2	-	-	-	4,573.2	-	-
	2.56	23,129.2	-	-	-	-	23,129.2	-
	4.24	15,398.7	-	-	-	-	-	15,398.7
	3.23	43,553.3						
Shares in the BIS		325.3	325.3	-	-	-	-	-
		63,966.7	326.9	4,540.2	7,118.3	13,453.4	23,129.2	15,398.7
FINANCIAL LIABILITIES								
Bank notes in circulation		61,028.8	61,028.8	-	-	-	-	-
Deposits								
Government of Canada	0.86	1,512.5	-	1,512.5	-	-	-	-
Members of the CPA	0.75	106.7	-	106.7	-	-	-	-
Other deposits								
Unclaimed balances		466.6	466.6	-	-	-	-	-
Other	0.85	395.2	-	395.2	-	-	-	-
Other financial liabilities		132.1	132.1	-	-	-	-	-
		63,641.9	61,627.5	2,014.4	-	-	-	-
Interest rate sensitivity gap		324.8	(61,300.6)	2,525.8	7,118.3	13,453.4	23,129.2	15,398.7

1. Carrying amounts of Government of Canada bonds include accrued interest.

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Bank is exposed to currency risk primarily by holding shares in the BIS. These shares are denominated in Special Drawing Rights (SDRs). The SDR serves as the unit of account for the International Monetary Fund (IMF) and its value is based on a “basket” of four major currencies: the euro, the U.S. dollar, the pound sterling and the Japanese yen. SDRs are translated into Canadian-dollar equivalents at the rates prevailing on the date when the fair value is determined.

Consistent with 2011, at 31 December 2012, the Bank did not hold a significant amount of foreign currencies.

Given the small size of the Bank’s net foreign currency exposure relative to its total assets, currency risk is not considered significant.

Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from changes in interest and exchange rates), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or by factors affecting all similar financial instruments traded in the market.

The Bank is exposed to other price risk through its investment in the BIS. For accounting purposes, the Bank treats BIS shares as AFS and the fair value of these shares is estimated on the basis of the net asset value of the BIS, less a discount of 30 per cent. Accordingly, these shares are revalued to reflect movements in the net asset value of the BIS and in the Canadian dollar. The price risk faced on BIS shares is incidental to the general reasons for holding them and is immaterial compared with other market risks faced by the Bank.

(iii) Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. As shown in the following table, the Bank’s largest liability is *Bank notes in circulation*. As a counterpart to this non-interest-bearing liability with no fixed maturity, the Bank holds a portfolio of highly liquid, interest-bearing securities. In the event of an unexpected redemption of bank notes or a significant withdrawal from the Government of Canada’s deposit for the prudential liquidity-management plan, the Bank has the ability to settle the obligation by selling its assets.

As the nation’s central bank, the Bank is the ultimate source of liquid funds to the Canadian financial system and has the power and operational ability to create Canadian-dollar liquidity in unlimited amounts at any time. This power is exercised within the Bank’s commitment to keep inflation low, stable and predictable.

LVTS guarantee

The Bank is exposed to liquidity risk through its guarantee of the LVTS. The maximum exposure under this guarantee is described in note 17, *Commitments, contingencies and guarantees*.

The following table presents a maturity analysis of the Bank's financial assets and liabilities. The balances in this table do not correspond to the balances in the *Statement of Financial Position*, since the table presents all cash flows on an undiscounted basis.

								As at 31 December 2012
	Total	No fixed maturity	1 business day	1 business day to 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years
FINANCIAL ASSETS								
Cash and foreign deposits	**6.8**	**6.8**	**-**	**-**	**-**	**-**	**-**	**-**
Loans and receivables								
Advances to members of the CPA	**61.8**		**61.8**					
Securities purchased under resale agreements	**1,838.3**	**-**	**-**	**1,838.3**	**-**	**-**	**-**	**-**
Other receivables	**5.5**	**-**	**-**	**5.5**	**-**	**-**	**-**	**-**
Investments								
Government of Canada treasury bills	**19,050.0**	**-**	**-**	**3,050.0**	**7,050.0**	**8,950.0**	**-**	**-**
Government of Canada bonds[1]	**55,344.6**	**-**	**-**	**-**	**1,830.0**	**5,950.0**	**30,295.8**	**17,268.8**
Shares in the BIS	**342.7**	**342.7**	**-**	**-**	**-**	**-**	**-**	**-**
	76,649.7	**349.5**	**61.8**	**4,893.8**	**8,880.0**	**14,900.0**	**30,295.8**	**17,268.8**
FINANCIAL LIABILITIES								
Bank notes in circulation	**63,700.0**	**63,700.0**	**-**	**-**	**-**	**-**	**-**	**-**
Deposits								
Government of Canada	**11,701.5**	**11,701.5**	**-**	**-**	**-**	**-**	**-**	**-**
Members of the CPA	**186.4**	**-**	**186.4**	**-**	**-**	**-**	**-**	**-**
Other deposits								
Unclaimed balances	**496.1**	**496.1**	**-**	**-**	**-**	**-**	**-**	**-**
Other	**907.3**	**907.3**	**-**	**-**	**-**	**-**	**-**	**-**
Other liabilities	**174.6**	**-**	**-**	**174.6**	**-**	**-**	**-**	**-**
	77,165.9	**76,804.9**	**186.4**	**174.6**	**-**	**-**	**-**	**-**
Net maturity difference	**(516.2)**	**(76,455.4)**	**(124.6)**	**4,719.2**	**8,880.0**	**14,900.0**	**30,295.8**	**17,268.8**

1. Interest payments on Government of Canada bonds are classified according to their coupon date.

In cases where counterparties to securities purchased under resale agreements substitute collateral after the outset of an agreement, portions of the carrying values presented may mature earlier than as presented, where the amount maturing early is dependent on the value of the collateral being substituted. Where collateral has been substituted, agreements are typically re-established under the same terms and conditions. The information presented in the above table is prepared according to agreements in place as at 31 December 2012.

Liabilities with no fixed maturity include *Bank notes in circulation* and *Government of Canada Deposits*. Historical experience has shown that bank notes in circulation provide a stable source of long-term funding for the Bank. *Government of Canada Deposits* are deposits held in the Bank's capacity as the Government of Canada's fiscal agent.

								As at 31 December 2011
	Total	No fixed maturity	1 business day	1 business day to 1 month	1 to 3 months	3 to 12 months	1 to 5 years	Over 5 years
FINANCIAL ASSETS								
Cash and foreign deposits	11.7	11.7	-	-	-	-	-	-
Loans and receivables								
Advances to members of the CPA	81.5	-	81.5	-	-	-	-	-
Securities purchased under resale agreements	1,447.7	-	-	1,447.7	-	-	-	-
Other receivables	1.6	-	-	1.6	-	-	-	-
Investments								
Government of Canada treasury bills	18,600.0	-	-	3,000.0	6,675.0	8,925.0	-	-
Government of Canada bonds[1]	42,994.6	-	-	-	450.0	4,560.0	22,990.8	14,993.8
Shares in the BIS	325.3	325.3	-	-	-	-	-	-
	63,462.4	337.0	81.5	4,449.3	7,125.0	13,485.0	22,990.8	14,993.8
FINANCIAL LIABILITIES								
Bank notes in circulation	61,028.8	61,028.8	-	-	-	-	-	-
Deposits								
Government of Canada	1,512.5	1,512.5	-	-	-	-	-	-
Members of the CPA	106.7	-	106.7	-	-	-	-	-
Other deposits								
Unclaimed balances	466.6	466.6	-	-	-	-	-	-
Other	395.2	395.2	-	-	-	-	-	-
Other liabilities	132.1	-	-	132.1	-	-	-	-
	63,641.9	63,403.1	106.7	132.1	-	-	-	-
Net maturity difference	(179.5)	(63,066.1)	(25.2)	4,317.2	7,125.0	13,485.0	22,990.8	14,993.8

1. Interest payments on Government of Canada bonds are classified according to their coupon date.

8. Property and equipment

	Land and Buildings	Computer Equipment	Other Equipment	Total
2012				
Cost				
Balances, 31 December 2011	**218.2**	**30.8**	**99.5**	**348.5**
Additions	**23.6**	**5.6**	**2.0**	**31.2**
Disposals	**(4.2)**	**(9.2)**	**(2.7)**	**(16.1)**
Transfers to other asset categories	**3.1**	**-**	**(3.1)**	**-**
Balances, 31 December 2012	**240.7**	**27.2**	**95.7**	**363.6**
Depreciation				
Balances, 31 December 2011	**(85.1)**	**(12.1)**	**(74.7)**	**(171.9)**
Depreciation expense	**(8.5)**	**(4.0)**	**(4.7)**	**(17.2)**
Disposals	**4.2**	**9.0**	**2.7**	**15.9**
Transfers to other asset categories	**-**	**-**	**-**	**-**
Balances, 31 December 2012	**(89.4)**	**(7.1)**	**(76.7)**	**(173.2)**
Carrying amounts				
At 31 December 2011	**133.1**	**18.7**	**24.8**	**176.6**
At 31 December 2012	**151.3**	**20.1**	**19.0**	**190.4**
Projects in progress 2012				
Included in Carrying amounts at 31 December 2012	**48.2**	**6.9**	**2.1**	**57.2**
Additions during 2012	**23.6**	**4.2**	**1.7**	**29.5**
Commitments at 31 December 2012	**22.2**	**3.4**	**3.0**	**28.6**

Projects in progress consist primarily of $42.3 million related to the Enhanced Business-Continuity initiative (31 December 2011—$26.2 million), $8.2 million related to the Head Office Renewal Program (31 December 2011—$4.9 million) and $2.3 million related to the Currency equipment adaptation (31 December 2011—$1.0 million). The Currency Systems Evolution Program (31 December 2011—$1.2 million) was put in service in 2012 and removed from Projects in progress.

As a result of the program to overhaul and modernize the head office building, the estimated useful lives of the components related to the existing facility were adjusted to reflect the planned start of the construction on 31 December 2013. The impact of this change was an increase to depreciation expenses of $2.5 million for the year ended 31 December 2012 and an estimated increase of $17.9 million for the year ending 31 December 2013.

Commitments consist primarily of $17.7 million related to the program to overhaul and modernize the head office building (31 December 2011—$Nil million).

	Land and Buildings	Computer Equipment	Other Equipment	Total
2011				
Cost				
Balances, 31 December 2010	197.3	25.8	122.2	345.3
Additions	21.1	10.2	4.9	36.2
Disposals	(0.2)	(5.2)	(27.6)	(33.0)
Transfers to other asset categories	-	-	-	-
Balances, 31 December 2011	218.2	30.8	99.5	348.5
Depreciation				
Balances, 31 December 2010	(80.1)	(13.9)	(98.3)	(192.3)
Depreciation expense	(5.0)	(3.5)	(4.0)	(12.5)
Disposals	-	5.2	27.6	32.8
Transfers to other asset categories	-	-	-	-
Balances, 31 December 2011	(85.1)	(12.2)	(74.7)	(171.9)
Carrying amounts				
At 31 December 2010	117.2	11.9	23.9	153.0
At 31 December 2011	133.1	18.6	24.8	176.6

Projects in progress 2011				
Included in Carrying amounts at 31 December 2011	25.1	12.3	4.6	42.0
Additions during 2011	20.5	10.2	4.4	35.1
Commitments at 31 December 2011	0.6	0.3	-	0.9

9. Intangible assets

	Internally generated software	Other software	Total
2012			
Cost			
Balances, 31 December 2011	**42.8**	**40.2**	**83.0**
Additions	**-**	**17.5**	**17.5**
Disposals	**-**	**(1.9)**	**(1.9)**
Transfers to other asset categories	**-**	**-**	**-**
Balances, 31 December 2012	**42.8**	**55.8**	**98.6**
Amortization			
Balances, 31 December 2011	**(25.8)**	**(12.6)**	**(38.4)**
Amortization expense	**(3.9)**	**(1.9)**	**(5.8)**
Disposals	**-**	**1.2**	**1.2**
Transfers to other asset categories	**-**	**-**	**-**
Balances, 31 December 2012	**(29.7)**	**(13.3)**	**(43.0)**
Carrying amounts			
At 31 December 2011	**17.0**	**27.6**	**44.6**
At 31 December 2012	**13.1**	**42.5**	**55.6**
Projects in progress 2012			
Included in Carrying amounts at 31 December 2012	**-**	**32.8**	**32.8**
Additions during 2012	**-**	**16.1**	**16.1**
Commitments at 31 December 2012	**-**	**0.1**	**0.1**

Projects in progress consist primarily of $21.7 million related to the Auctions and Markets Applications Program (31 December 2011—$11.2 million), $1.7 million related to the Currency equipment adaptation (31 December 2011—$1.5 million), $7.7 million related to the data-management stream of the Analytic Environment Program (31 December 2011—$4.0 million) and $1.4 million related to the Tri-Agency Database System Renewal (31 December 2011—$Nil million). The Currency Systems Evolution Program (31 December 2011—$7.8 million) was put in service in 2012 and removed from Projects in progress.

	Internally generated software	Other software	Total
2011			
Cost			
Balances, 31 December 2010	42.8	16.8	59.6
Additions	-	23.5	23.5
Disposals	-	-	-
Transfers to other asset categories	-	(0.1)	(0.1)
Balances, 31 December 2011	42.8	40.2	83.0
Amortization			
Balances, 31 December 2010	(21.9)	(11.8)	(33.7)
Amortization expense	(3.9)	(0.8)	(4.7)
Disposals	-	-	-
Transfers to other asset categories	-	-	-
Balances, 31 December 2011	(25.8)	(12.6)	(38.4)
Carrying amounts			
At 31 December 2010	20.9	5.0	25.9
At 31 December 2011	17.0	27.6	44.6
Projects in progress 2011			
Included in Carrying amounts at 31 December 2011	-	25.6	25.6
Additions during 2011	-	23.5	23.5
Commitments at 31 December 2011	0.9	-	0.9

10. Other assets

	31 December 2012	31 December 2011
Bank note inventory	**32.1**	21.7
Accrued pension benefit asset (note 14)	**0.8**	31.4
All other assets	**8.7**	6.2
Total other assets	**41.6**	59.3

11. 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.

	31 December 2012	31 December 2011
$5	**1,130.5**	1,138.0
$10	**1,204.1**	1,197.3
$20	**17,202.1**	16,894.1
$50	**10,144.8**	9,447.7
$100	**32,742.5**	31,027.1
Other bank notes	**1,276.0**	1,324.6
Bank notes in circulation	**63,700.0**	61,028.8

Other bank notes include denominations that are no longer issued but continue to be legal tender. Bank notes in circulation are non-interest-bearing liabilities and are due on demand.

12. Deposits

The liabilities within *Deposits* consist of $13,291.3 million in Canadian-dollar demand deposits ($2,481.0 million at 31 December 2011). The Bank pays interest on the deposits for the Government of Canada, banks and other financial institutions at short-term market rates, and interest expense on deposits is included in the Statement of Comprehensive Income. Further information on the rates of interest is presented in the interest rate risk table in note 7.

Deposits from the Government of Canada consist of $1,701.5 million for operational balances and $10,000.0 million held for the prudential liquidity-management plan ($1,512.5 million and $Nil, respectively, at 31 December 2011).

13. Other liabilities

	31 December 2012	31 December 2011
Accrued transfer payment to the Receiver General for Canada	**82.2**	78.4
Post-employment defined-benefit obligations (note 14)		
Pension benefit plans	**20.1**	16.0
Other benefit plans	**182.7**	164.7
All other liabilities and provisions	**92.5**	53.7
Total other liabilities	**377.5**	312.8

The accrued transfer payment to the Receiver General for Canada of $82.2 million (31 December 2011—$78.4 million) is included in the $1,022.2 million transfer to the Receiver General for the year presented in the Statement of Changes in Equity (31 December 2011—$1,067 million), and is included under *Other liabilities*.

For the year ended 31 December 2012, an amount of $78.4 million related to 2011 net income and $940.0 million related to 2012 net income was remitted to the Receiver General for Canada ($126.1 million related to 2010 net income and $1,030 million related to 2011 net income was remitted in 2011).

14. Employee benefit plans

Effective 1 January 2012, the plan bylaws were amended to reflect a new defined-benefit plan design for eligible employees hired after that date and for current plan members who selected the new design for service from that date forward.

The Bank also sponsors other benefit plans, which include life insurance and eligible health and dental benefits and a long-term disability program, as well as a long-service benefit program for employees hired before 1 January 2003.

The Bank is the administrator of the pension plans. The Bank's Board of Directors has established a Pension Committee and has delegated to it the responsibility for carrying out the Bank's duties as administrator of the plans, including adherence to the guidelines established in the Statement of Investment Policy and Procedures (SIPP) that is approved annually by the Board. A separate trust fund has been established for each plan to receive and invest contributions and pay benefits due under the plans.

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 2012, and the next required valuation will be as of 1 January 2013.

The total cash payment for employee future benefits for 2012 was $48.5 million ($52.2 million in 2011), consisting of $38.6 million ($43.1 million in 2011) in cash contributed by the Bank to its pension plans and $9.9 million ($9.1 million in 2011) in cash payments directly to beneficiaries for its other post-employment benefit plans. The total cash payments expected for 2013 are $44.7 million, consisting of $36.5 million in cash contributed to its pension plans and $8.2 million in cash payments to its other post-employment benefit plans.

Regulations governing federally regulated pension plans establish certain solvency requirements that assume that the plans are wound up at the valuation date. The actuarial valuation of the Registered Pension Plan completed at 1 January 2012 reported a solvency deficit of $95.9 million, and the Bank is making additional contributions to fund this solvency deficit over a period of five years. In 2012, $19.4 million of the employer contributions to the plan represented solvency deficit payments. Contributions in 2013 will be based on the actuarial valuation as at 1 January 2013, and are estimated to be $36.5 million, which consists of $20.2 million in regular contributions to cover current service costs and $16.3 toward the elimination of the solvency deficit.

Benefit obligations and plan assets of post-employment defined-benefit and long-term benefit plans were composed of the following components during the year:

	Pension benefit plans[1]		Other benefit plans	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
Fair value of plan assets				
Fair value at beginning of year	**1,143.1**	1,081.8	-	-
Expected return on plan assets	**67.1**	68.8	-	-
Actuarial gains (losses)	**48.1**	(18.1)	-	-
Bank contributions	**42.0**	43.1	-	-
Employee contributions	**11.9**	11.0	-	-
Benefit payments and transfers	**(45.7)**	(43.5)	-	-
Fair value of plan assets at end of year	**1,266.5**	1,143.1	-	-
Defined-benefit obligation				
Benefit obligation at beginning of year	**1,127.7**	916.7	**164.7**	149.9
Current service cost	**25.9**	17.3	**7.4**	6.0
Interest cost	**52.1**	52.3	**7.4**	8.3
Employee contributions	**11.9**	11.0	**-**	-
Actuarial losses	**113.9**	172.5	**12.5**	9.6
Past service costs	**-**	1.4	**0.6**	-
Benefit payments and transfers	**(45.7)**	(43.5)	**(9.9)**	(9.1)
Defined-benefit obligation at end of year	**1,285.8**	1,127.7	**182.7**	164.7
Defined-benefit asset/(liability)	**(19.3)**	15.4	**(182.7)**	(164.7)
Accrued pension benefit asset	**0.8**	31.4	**-**	-
Post-employment defined-benefit obligations	**(20.1)**	(16.0)	**(182.7)**	(164.7)
Defined-benefit asset/(liability)	**(19.3)**	15.4	**(182.7)**	(164.7)

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 $83.2 million ($74.4 million at 31 December 2011) and $63.1 million ($58.4 million at 31 December 2011), respectively.

The Plan's investments are subject to credit, liquidity and market risks. Of these risks, the most significant is asset volatility, since plan liabilities are calculated using a discount rate set with reference to Canadian AA-corporate bond yield. If plan assets underperform this yield, a deficit will be created. Requirements for asset diversification and investment eligibility serve as basic risk-management tools for the investment portfolio as a whole.

The Plan's SIPP requires that its investments be held in a diversified mix of asset types and also sets out requirements for investment eligibility. The diversification of assets serves to decrease the variations in the expected return performance of the portfolio. The current practice is to conduct an Asset-Liability Modelling (ALM) study every three years. The ALM assists the Pension Committee in establishing an asset allocation that is consistent with the pension plan's objectives and the Bank's risk tolerance.

Plan assets consist of the following:

	31 December 2012				31 December 2011			
	Quoted	Unquoted	Total	in %	Quoted	Unquoted	Total	in %
Money market instruments	**12.2**	**-**	**12.2**	**1.0**	25.6	-	25.6	2.2
Equity instruments								
Canadian equity funds	**279.9**	**-**	**279.9**	**22.0**	240.2	-	240.2	21.1
Foreign equity funds	**425.7**	**-**	**425.7**	**33.6**	362.3	-	362.3	31.7
Debt instruments[1]								
Securities issued or guaranteed by the Government of Canada	**171.4**	**-**	**171.4**	**13.5**	165.9	-	165.9	14.5
Other securities	**284.4**	**-**	**284.4**	**22.5**	262.6	-	262.6	23.0
Real estate funds	**-**	**63.1**	**63.1**	**5.0**	-	59.7	59.7	5.2
Statutory deposit and other	**-**	**29.8**	**29.8**	**2.4**	-	26.8	26.8	2.3
	1,173.6	**92.9**	**1,266.5**	**100.0**	1,056.6	86.5	1,143.1	100.0

1. Debt instruments consist of fixed-income securities and inflation-linked assets.

Benefit plan expenses recognized in the Statement of Comprehensive Income are composed of the following components:

	Pension benefit plans		Other benefit plans	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
Current service cost	**25.9**	17.3	**7.4**	6.0
Interest cost	**52.1**	52.3	**7.4**	8.3
Expected return on plan assets	**(67.1)**	(68.8)	**-**	-
Actuarial (gain)/loss	**-**	-	**0.7**	(2.3)
Past service costs	**-**	1.4	**0.6**	-
Benefit plan expense recognized	**10.9**	2.2	**16.1**	12.0

Actuarial gains and losses pertaining to post-employment benefit plans are recognized in *Other Comprehensive Income* and are accumulated in *Equity* in the Actuarial gains reserve.

	Pension benefit plans		Other benefit plans	
	31 December 2012	**31 December 2011**	**31 December 2012**	**31 December 2011**
Cumulative actuarial losses recognized in *Other Comprehensive Income*				
Cumulative actuarial losses recognized, beginning of year	**(280.4)**	(89.9)	**(27.8)**	(15.9)
Actuarial losses recognized in current year	**(65.9)**	(190.5)	**(11.7)**	(11.9)
Cumulative actuarial losses recognized, end of year	**(346.3)**	(280.4)	**(39.5)**	(27.8)

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

	Pension benefit plans		Other benefit plans	
	31 December 2012	**31 December 2011**	**31 December 2012**	**31 December 2011**
Accrued benefit obligation				
Discount rate	**4.00%**	4.60%	**3.86%**	4.44%
Rate of compensation increase	**3.30% + merit**	3.30% + merit	**3.30% + merit**	3.30% + merit
Benefit plan expense				
Discount rate	**4.60%**	5.75%	**4.44%**	5.50%
Expected rate of return on assets	**6.00%**	6.50%	0%	0%
Rate of compensation increase	**3.30% + merit**	3.30% + merit	**3.30% + merit**	3.50% + merit
Assumed medical cost trend				
Initial medical cost trend rate			**6.43%**	6.75%
Medical cost trend rate declines to			**4.50%**	4.50%
Year that the rate reaches the ultimate trend rate			**2029**	2029

The discount rate is determined by reference to Canadian AA-corporate bonds with terms to maturity approximating the duration of the obligation.

The expected rate of return on assets that is determined by management relates to the entire Plan asset portfolio on a weighted-average basis, and is based on market expectations, at the beginning of the period, for returns over the entire life of the obligation. As such, the expected rate of return may not be indicative of the short-term performance of Plan assets or of market conditions generally.

The assumption for life expectancy for the scheme valuations assumes that a male member reaching 60 in 2012 will live for 25 years (2011: 25 years) and a female member 27 years (2011: 27 years). The mortality assumptions used in the scheme valuations are based on standard tables published by the Society of Actuaries, which were adjusted in line with both current industry and the actual experience of the relevant scheme.

Sensitivity analysis	**Pension benefit plans**		**Other benefit plans**	
	Change in obligation	**Change in expense**	**Change in obligation**	**Change in expense**
Discount rate	**4.00%**	**4.60%**	**3.86%**	**4.44%**
Impact of 0.50 percentage point increase	**(101.0)**	**(2.8)**	**(14.2)**	**(0.5)**
Impact of 0.50 percentage point decrease	**115.0**	**3.2**	**16.2**	**0.5**
Expected rate of return on plan assets	**n.a**	**6.00%**	**n.a**	**n.a**
Impact of 0.50 percentage point increase	**n.a**	**(5.6)**	**n.a**	**n.a**
Impact of 0.50 percentage point decrease	**n.a**	**5.6**	**n.a**	**n.a**
Medical cost trend rates	**n.a**	**n.a**	**6.43%**	**4.50%**
Impact of 1.00 percentage point increase	**n.a**	**n.a**	**31.2**	**2.5**
Impact of 1.00 percentage point decrease	**n.a**	**n.a**	**(24.0)**	**(1.9)**

The above sensitivity analyses are based on a change in assumptions while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The method and types of assumptions used in preparing the sensitivity analysis did not change compared with the previous year.

Summary of historical adjustments	**31 December 2012**	**31 December 2011**	**31 December 2010**	**1 January 2010**
Fair value of plan assets	**1,266.5**	1,143.1	1,081.8	934.8
Defined-benefit obligation	**(1,468.5)**	(1,292.4)	(1,066.6)	(866.6)
Surplus (deficit)	**(202.0)**	(149.3)	15.2	68.2
Experience adjustments on plan assets	**48.1**	(18.1)	53.0	-
Experience adjustments on plan benefits	**8.8**	(19.2)	9.4	-
Change in actuarial assumptions	**(135.2)**	(162.9)	(169.2)	-

15. Equity

The Bank's objectives in managing its capital are in compliance with the Bank of Canada Act and have not changed from the previous year. There are no other externally imposed capital requirements at the end of the reporting year.

The elements of equity are shown in the table below:

	31 December 2012	**31 December 2011**
Share capital	**5.0**	5.0
Statutory reserve	**25.0**	25.0
Special reserve	**100.0**	100.0
Available-for-sale reserve	**308.5**	294.6
Actuarial gains reserve	-	-
Retained earnings	-	-
	438.5	424.6

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 have been issued to the Minister of Finance, who is holding them on behalf of the Government of Canada.

Statutory reserve

The statutory reserve was accumulated out of net income until it reached the stipulated maximum amount of $25.0 million in 1955.

Special reserve

The special reserve was created in 2007 further to an amendment to the Bank of Canada Act to offset potential unrealized valuation losses due to changes in the fair value of the Bank's available-for-sale portfolio. The amount held in the special reserve is reviewed regularly for appropriateness using value-at-risk analysis and scenario-based stress tests and may be amended, pursuant to a resolution passed by the Board of Directors. The value-at-risk analysis uses historical data to estimate the maximum possible extent of unrealized valuation losses of the Bank's treasury bill portfolio. The scenario-based stress tests assess the impact of a rapid increase in interest rates on the value of the Bank's treasury bill portfolio. This reserve is subject to a ceiling of $400 million; an initial amount of $100 million was established in September 2007.

Available-for-sale reserve

The available-for-sale reserve represents cumulative movements in the fair value of the Bank's available-for-sale portfolios, as shown below.

	31 December 2012	**31 December 2011**
Government of Canada treasury bills	**3.9**	7.4
BIS shares	**304.6**	287.2
Available-for-sale reserve	**308.5**	294.6

Actuarial gains reserve

The actuarial gains reserve was established on 1 January 2010 upon the Bank's transition to IFRS at an initial amount of $119.7 million to cover future net actuarial losses and to accumulate the net actuarial gains related to the Bank's post-employment defined-benefit plans.

	31 December 2012	**31 December 2011**
Actuarial gains reserve established on 1 January 2010	**119.7**	119.7
Accumulated net actuarial losses applied to the reserve	**(119.7)**	(119.7)
Actuarial gains reserve	**-**	-

Retained earnings

The net income of the Bank, less any allocation to reserves, is considered to be ascertained surplus and is transferred to the Receiver General for Canada, consistent with the requirement of Section 27 of the Bank of Canada Act.

Based on an agreement signed with the Minister of Finance, the Bank will deduct from its remittances to the Receiver General and set against *Retained earnings* an amount equal to unrealized losses on AFS financial assets, unrealized actuarial losses on post-employment benefit plans and other unrealized or non-cash losses that would expose the Bank to the risk of negative capital arising as a result of changes in accounting standards or legislation. During 2012, the Bank withheld $77.6 million ($188.4 million during 2011) and, as at 31 December 2012, $266.0 million ($188.4 million as at 31 December 2011) in withheld remittances was outstanding.

16. Leases

a) Operating leases commitments

The Bank occupies leased premises in Ottawa, Halifax, Montréal, Toronto, Calgary and Vancouver. The minimum payments are determined at the beginning of the lease and may vary during the term of the lease. Contingent rent on premises leases is based on building operating costs; for office equipment leases, contingent rent is based on usage.

As a result of the program to overhaul and modernize the head office building, during 2012, the Bank signed a five-year lease agreement for temporary office space. In 2012, provisions totalling $15.1 million for the final year of the lease and for site restoration costs were recorded and are included under *Other liabilities*.

At 31 December 2012, the future minimum payments are $82.9 million for rent, real estate taxes and building operations. The expiry dates vary for each lease, from October 2013 to October 2025.

Premises leases

	31 December 2012	31 December 2011
Commitments		
Due within one year	**8.8**	1.6
Due within one to five years	**63.2**	4.5
Due later than five years	**10.9**	4.6
Total premises lease commitments	**82.9**	10.7

b) Lease payments receivable

The Bank owns buildings in Ottawa, Montréal and Toronto and leases space to Government of Canada departments and agencies under operating leases. Under the current non-cancellable lease agreements, the total minimum lease payments receivable and contingent rent included in income are as follows:

Lease payments receivable

	31 December 2012	31 December 2011
Receivable within one year	**2.7**	4.1
Receivable within one to three years	-	2.7
Total lease payments receivable	**2.7**	6.8

17. Commitments, contingencies and guarantees

a) Long-term contracts other than leases

The Bank has a long-term contract with an outside service provider for retail debt services that expires in 2021. At 31 December 2012, fixed payments totalling $172.9 million remained, plus a variable component based on the volume of transactions.

In 2010, the Bank entered into a long-term agreement with an outside service provider for data centre services that commences in 2013 and expires in 2022. Fixed payments over the term of the agreement totalling $17.5 million will begin on 1 January 2013.

Commitments related to the program to overhaul and modernize the head office building are included in commitments for Property and equipment in note 8.

Minimum annual payments for long-term contracts other than leases

	Outsourced services
Due within one year	**22.1**
Due within one to three years	**44.2**
Due within three to five years	**44.2**
Thereafter	**79.9**
Total minimum annual payments	**190.4**

b) Foreign currency contracts

The Bank is a counterparty to several foreign currency swap facilities as follows:

	Maximum available
Bilateral liquidity swap facilities with central banks	
Bank of Japan (denominated in Japanese yen)	**Unlimited**
Swiss National Bank (denominated in Swiss francs)	**Unlimited**
Bank of England (denominated in British pounds)	**Unlimited**
European Central Bank (denominated in euros)	**Unlimited**
Federal Reserve Bank of New York (denominated in U.S. dollars)	**30,000.0**
Other swap facilities	
Exchange Fund Account of Canada (denominated in Canadian dollars)	**Unlimited**
Federal Reserve Bank of New York (denominated in U.S. dollars)	**2,000.0**
Banco de México (denominated in Canadian dollars)	**1,000.0**

Bilateral liquidity swap facilities with central banks

The bilateral liquidity swap facilities were established to provide liquidity in each jurisdiction in any of their currencies, should market conditions warrant.

The US$30 billion facility with the Federal Reserve Bank of New York expires on 1 February 2014. The swap facilities with the Bank of Japan, the Swiss National Bank, the Bank of England and the European Central Bank expire on 1 February 2014.

These facilities can be structured as either a Canadian-dollar liquidity or a foreign currency liquidity swap arrangement and can be initiated by either party. The exchange rate applicable to the swap facilities is based on the prevailing market spot exchange rate as mutually agreed upon by the parties.

Other swap facilities

The other swap facilities established with the Federal Reserve Bank of New York and with the Banco de México have indefinite terms and are subject to annual renewal, expiring on 14 December 2013.

The Bank is also party to a standing foreign currency swap facility with the Exchange Fund Account of Canada. There is no stated maximum amount under this agreement.

None of the liquidity or other swaps were accessed, by either party, in 2012 or 2011. No related commitments exist at 31 December 2012 ($Nil at 31 December 2011).

c) Contingency

The 9,441 shares in the BIS have a nominal value of 5,000 special drawing rights (SDRs) per share, of which, 25 per cent (i.e., SDR1,250) is paid up. The balance of SDR3,750 is callable at three months' notice by a decision of the BIS Board of Directors. The Canadian equivalent of this contingent liability was $54.2 million at 31 December 2012 ($55.3 million at 31 December 2011), based on prevailing exchange rates.

d) Guarantees

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

LVTS guarantee

The LVTS is a large-value payment system, owned and operated by the CPA. Any deposit-taking financial institution that is a member of the CPA can participate in the LVTS, provided that it maintains a settlement account at the Bank, has the facilities to pledge collateral for LVTS purposes, and meets certain technical requirements. 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 a 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 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. No amount has ever been paid under such indemnifications.

e) 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 risks not insured are recorded in the accounts if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably as at the statement of financial position date, and it is probable that an outflow of economic benefits will be required to settle the obligation.

18. Related parties

The Bank is related in terms of common ownership to all Government of Canada departments, agencies and Crown corporations. To achieve its monetary policy objectives, the Bank maintains a position of structural and functional independence from the Government of Canada through its ability to fund its own operations without external assistance and through its management and governance.

In the normal course of its operations, the Bank enters into transactions with related parties, and material transactions and balances are presented in these financial statements. Not all transactions between the Bank and government-related entities have been disclosed as permitted by the partial exemption available to wholly owned government entities in International Accounting Standard 24 *Related Parties* (IAS 24).

The Bank provides funds-management, fiscal-agent and banking services to the Government of Canada, as mandated by the Bank of Canada Act, and does not recover the costs of these services.

Bank of Canada pension plans

The Bank provides management, investment and administrative support to the Bank of Canada Registered Pension Plan. Services in the amount of $0.6 million ($0.6 million in 2011) were fully recovered from the Plan in 2012.

Key management personnel and compensation

The key management personnel, responsible for planning, directing and controlling the activities of the Bank, are: the members of the Governing Council, the Management Council and the Board of Directors. The number of key management personnel as at 31 December 2012 was 22 (23 in 2011).

The compensation of key management personnel is presented in the following table:

	31 December 2012	**31 December 2011**
Short-term employee benefits	**3.2**	3.1
Post-employment benefits	**0.8**	0.7
Directors' fees	**0.3**	0.3
Total compensation	**4.3**	4.1

Short-term employee benefits and post-employment benefits apply to Bank of Canada employees only.

There were no other long-term employee benefit costs or termination benefits related to key management personnel in 2012.

Senior Officers

Governing Council

Mark Carney, *Governor*
Tiff Macklem, *Senior Deputy Governor**

Deputy Governors
John D. Murray,** Timothy Lane, Agathe Côté,**
Lawrence Schembri

General Counsel and Corporate Secretary
Jeremy S.T. Farr**

Advisers
Janet Cosier,[1] Allan Crawford, Dale Fleck, Donna Howard,
Sheila Niven,** David Wolf

Special Advisers
David T. Beers, Evan Siddall

Audit
Julie Champagne, *Chief Internal Auditor*

Canadian Economic Analysis
Sharon Kozicki, *Chief*
Stephen Murchison, *Deputy Chief*
Robert Amano, *Research Director*
Greg Bauer, *Research Director*
Pierre St-Amant, *Research Director*

Communications
Jill Vardy, *Chief*
Glen Nichols, *Deputy Chief*

Corporate Services
Colleen Leighton, *Chief*
Dinah Maclean, *Deputy Chief*
Susan Chibuk, *Project Director*
Alexis Corbett, *Director*
Robert Murray, *Director*

Currency
Gerry T. Gaetz, *Chief*
Yvonne de Lint, *Deputy Chief*
John Robert Fortin, *Director*
Nicole Poirier, *Director*
Richard Wall, *Director*

Executive and Legal Services
Jeremy S.T. Farr, *General Counsel and Corporate Secretary***
Marie Bordeleau, *Deputy Corporate Secretary*
Pierre Roach, *Assistant General Counsel*
Bob Fay, *Special Assistant to the Governor*
Rob Turnbull, *Special Counsel, Financial System*

Financial Markets
Paul Chilcott, *Chief*
Grahame Johnson, *Deputy Chief*
Scott Hendry, *Research Director*
Stéphane Lavoie, *Director*
Miville Tremblay, *Senior Representative*, *Director*
Eric Tuer, *Director*
Harri Vikstedt, *Director*

Financial Services
Sheila Vokey, *Chief Accountant and Chief Financial Officer***
Rudy Wytenburg, *Deputy Chief*
Annie Guilbault, *Director*

Financial Stability
Carolyn Wilkins, *Chief*
Toni Gravelle, *Deputy Chief*
Arthur Berger, *Director*
Césaire Meh, *Director*
Carol Ann Northcott, *Director*
Graydon Paulin, *Director*

Funds Management and Banking
Ron Morrow, *Chief*
Eric Wolfe,[2] *Deputy Chief*
Louise Hyland, *Director*
Miguel Molico, *Research Director*

Information Technology Services
Sylvain Chalut, *Chief*
Maureen Carroll, *Deputy Chief*
Janne Shaw, *Director*

International Economic Analysis
Donald Coletti, *Chief*
Eric Santor, *Deputy Chief*
Rhys Mendes, *Director*

Note: Positions as of 25 February 2013

* Chair of Management Council
** Member of Management Council
1. Also Chair of the Board of Directors of the Canadian Payments Association
2. Also Deputy Chair of the Board of Directors of the Canadian Payments Association

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Martin Coiteux, *Senior Regional Representative (Economics)*
Phuong Anh Ho Huu, *Senior Regional Representative (Currency)*

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For information about the Bank of Canada:

Internet
bankofcanada.ca
Provides timely access to press releases, speeches by the Governor, the Bank's major publications and current financial data.

Public Information
For general information on the role and functions of the Bank of Canada, contact our Public Information Office.
Telephone: **1 800 303-1282**
Fax: **613 782-7713**
Email: **info@bankofcanada.ca**

For information on unclaimed balances:
Telephone: **1 800 303-1282**
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