Department of Finance Canada | Ministère des Finances Canada

Report on the **Management of Canada's** Official International Reserves

April 1, 2014 – March 31, 2015

Canada

Cette publication est également disponible en français.

Cat. No.: F1-31E-PDF
ISSN: 1912-1075

Table of Contents

Purpose of the Report 5

Executive Summary 6

Report on Operations in 2014–15 8

Market Developments 8

Initiatives in 2014–15 10

Performance Versus Strategic Objectives 11

EFA Financing 16

Annex 1: Statement of Investment Policy for the Government of Canada (June 2011) 18

Annex 2: Overview of the Exchange Fund Account Management Framework 25

Annex 3: Changes in the Level of the Official International Reserves 29

Annex 4: Detailed Portfolio Performance 34

Annex 5: List of Agents and Mandataries as Defined by the Currency *Act* 42

Exchange Fund Account Unaudited Statement of Financial Position and Statement of Operations 43

Purpose of the Report

This edition of the *Report on the Management of Canada's Official International Reserves* provides details on official international reserves operations from April 1, 2014 to March 31, 2015 (the 2014–15 fiscal year).

As required under the *Currency Act*, the report provides a comprehensive account of the framework within which the Exchange Fund Account (EFA) is managed, the composition and changes in the Account during the year, a statement of whether the strategic objectives established for the EFA have been met, and information on agents appointed to perform services concerning the EFA.

Unless otherwise noted, in this report, the official international reserves are reported in US dollars on a market-value basis. The unaudited financial statements that appear at the end of this report are in Canadian dollars, as reported in the *Public Accounts of Canada*.

Exchange Fund Account

The EFA, which is held in the name of the Minister of Finance, represents the largest component of Canada's official international reserves. It is a portfolio that is primarily made up of liquid foreign currency securities, special drawing rights (SDRs), and a small holding of gold. SDRs are international reserve assets created by the International Monetary Fund (IMF) whose value is based on a basket of international currencies. In addition to the EFA, Canada's official international reserves include Canada's reserve position at the IMF. This position, which represents Canada's investment in the activities of the IMF, fluctuates according to drawdowns by and repayments from the IMF.

The legislative objective of the EFA, as specified in the *Currency Act*, is to aid in the control and protection of the external value of the Canadian dollar. Assets held in the EFA are managed to provide foreign currency liquidity to the Government and to promote orderly conditions for the Canadian dollar in the foreign exchange markets, if required. Under the *Currency Act*, the Minister of Finance has the authority to acquire, borrow, sell or lend assets held in the EFA in accordance with the Statement of Investment *Policy* (see Annex 1).

The Department of Finance and the Bank of Canada jointly develop and implement the investment policy and funding program of the EFA. As fiscal agent of the Government, the Bank of Canada executes investment and funding transactions and manages EFA cash flows.

A detailed description of the EFA's management framework is provided in Annex 2. The framework includes the objectives, principles and governance structure of the EFA. Annex 2 also describes the policies that pertain to investments, risk management, performance measurement and foreign currency funding activities.

Executive Summary

The *Currency Act* stipulates that this report provide a statement of whether the strategic objectives established for the EFA have been met during the review period. These objectives—to maintain a high standard of liquidity, preserve capital value and, upon meeting these primary objectives, optimize return—were achieved during 2014–15.

Level of the official international reserves: The market value of Canada's official international reserves increased to $77.7 billion as at March 31, 2015 from $76.5 billion as at March 31, 2014. The change comprised a $3,085 million increase in EFA assets and a $1,854 million decrease in the reserve position in the IMF. EFA assets, which totalled $74.9 billion as at March 31, 2015, were held at a level that is consistent with the Government's commitment to maintain holdings of liquid foreign exchange reserves at or above 3 per cent of gross domestic product. EFA assets are composed primarily of the debt securities of highly rated sovereigns, agencies and supranational organizations that borrow on public markets.

Table 1
The EFA and Official International Reserves
market value in millions of US dollars, settled basis

	March 31, 2015	March 31, 2014	Change
Securities	66,510	62,394	4,116
Deposits	549	612	-63
Total securities and deposits (liquid reserves)	67,059	63,006	4,053
Gold	114	124	-10
SDRs	7,751	8,709	-958
Total EFA	74,924	71,839	3,085
IMF reserve position	2,757	4,611	-1,854
Total official international reserves	77,681	76,450	1,231

Note: Numbers may not add due to rounding.

EFA composition: As at March 31, 2015, the US-dollar share of EFA liquid investments was US$49.2 billion or 73.4 per cent, the euro share was equivalent to US$15.2 billion or 22.7 per cent, the pound sterling share was equivalent to US$2.0 billion or 2.9 per cent, and the yen portion was equivalent to US$643 million or 1 per cent.

Investments in fixed-income securities of sovereigns and agencies made up 85.3 per cent of EFA liquid investments while 13.9 per cent was invested in securities issued by supranational organizations. Less than 1 per cent was held in cash.

Based on the second highest rating among those provided by Moody's Investors Service, Standard & Poor's, Fitch Ratings and Dominion Bond Rating Service, as of March 31, 2015, 91 per cent of liquid reserve investments were rated AAA and 97 per cent were rated AA+ or better. In addition, all EFA assets have been assigned an internal credit rating.

EFA funding sources: The foreign currency reserve assets held in the EFA are funded in a cost effective manner through a funding framework that mitigates the potentially negative impacts of movements in interest rates and foreign exchange rates on the Government's fiscal position by matching the funding with the currency, term and duration of the reserve assets.

During 2014–15, EFA operations were financed through cross-currency swaps of domestic obligations and direct issuance. Cross-currency swaps totalling $7.1 billion were transacted in a number of currencies and at various terms at an average cost equivalent to 3-month US$ LIBOR (London Interbank Offered Rate) less 40 basis points. This compared to an average rate of 3-month US$ LIBOR less 39 basis points for 2013–14. In March 2015, a 3-year $3.5-billion global bond was issued at 9 basis points over the comparable US Treasury security, outperforming its peers (sovereigns and supranational institutions) issuing at the 3-year point of the curve. This was the largest ever US-dollar global note issued by Canada. In addition, $697 million of medium-term notes were issued in US dollars and euros at various terms during 2014–15 at an average funding cost equivalent to 3-month US$ LIBOR less 5 basis points. The level of outstanding short-term US-dollar commercial paper issued under the Canada bills program was increased to $3.05 billion over the period, at an average cost of US$ LIBOR less 19 basis points, which was lower than the previous year's funding level (US$ LIBOR less 16 basis points).

Portfolio return: In 2014–15, the EFA earned an average positive spread (or net "coupon return") of 20 basis points, down slightly from 22 basis points the previous year. This spread represents the difference between the yield to maturity on foreign currency fixed-income assets held in the EFA and the average cost of foreign currency liabilities used to fund the assets. The spread measures the underlying net return of the portfolio on the assumption that all the assets and liabilities are held to maturity and the coupons are reinvested at their respective yield to maturity.

On a cash flow basis, that is, taking into account realized gains and losses on portfolio rebalancing and coupon flows, the EFA portfolio earned 9.0 basis points (or a gain of $22.9 million) in 2014–15, down from 25.5 basis points (or a gain of $95 million) the previous fiscal year.

Taking into account cash flows and unrealized changes in the market value of assets and liabilities due to changes in interest rates and credit spreads, the EFA reported a total return of -21 basis points in 2014–15. This is equivalent to a mark-to-market loss of $156 million. In the previous year, the EFA reported a total return of 71 basis points (a gain of $406 million).

Report on Operations in 2014–15

The following sections describe the impact of market developments on the EFA, portfolio performance and risk measures, and policy and program initiatives undertaken in 2014–15.

Market Developments

Interest Rates

During the 2014–15 reporting year, interest rates in the US and Europe fell as central banks maintained accommodative monetary policies. Changes in interest rates in 2014–15 resulted in an increase of $811 million in the market value of the liquid foreign reserves.

US-dollar-denominated holdings in the EFA are composed mainly of fixed-income securities issued by the US government and supranational institutions. The Federal Open Market Committee announced the first reduction in its bond purchase program in December 2013 and continued reducing its monthly purchases during 2014. The latest round of quantitative easing ended when the central bank announced that it would terminate its bond purchase program during its October 2014 policy rate setting meeting. While yields rose in the weeks following the announcement, their downward trend re-emerged. The benchmark 10-year Treasury note touched an historic low yield of 1.64 per cent in January 2015, before settling at 1.92 per cent by the end of the fiscal fourth quarter. Over the fiscal year ending March 31, 2015, the yield on US 3-month Treasury bills was little changed while the yield on 10-year Treasury bonds fell by 84 basis points.

Euro-denominated holdings in the EFA are composed of fixed-income securities issued by European countries, their agencies, and supranational institutions. In addition to maintaining its key policy rates at record lows, in January 2015, the European Central Bank announced that it would expand its asset purchase program to include purchases of European sovereign bonds. In Germany, yields on government bonds with 8 years or less to maturity ended the fiscal year in negative territory, while yields on benchmark 10-year bonds ended the year with a record low yield of 18 basis points, down 140 basis points from the previous year.

Credit Spreads

Credit spreads on fixed-income securities issued in US dollars widened as a result of factors including geopolitical risks in Russia and the Middle East, global economic concerns in Europe, China and Japan, and lower oil prices. Credit spreads of European sovereign periphery bonds narrowed relative to German government bonds. Overall, there was an approximately US$188.3 million decrease in the market value of reserves due to changes in credit spreads.

Exchange Rates

In 2014–15, exchange rate movements versus the US dollar resulted in a reduction of $5.8 billion in the market value of the liquid foreign reserve assets. However, the foreign reserves are managed under an asset-liability matching framework, and as such, exchange rate movements had a relatively minor impact on the Government's financial position, as reported in the *Public Accounts of Canada*, since the decrease in the market value of assets was offset by a similar decrease in the value of associated liabilities.

During 2014–15, the euro fell by approximately 22 per cent against the US dollar. As 22.7 per cent of the liquid reserves were held in euro-denominated securities (as at March 31, 2015), changes in the value of the euro against the US dollar had a negative impact on the market value of the reserves.

During 2014–15, the British pound sterling (GBP) fell 11 per cent against the US dollar. While there were signs of general improvement in the UK economy last year, the pace of improvement trailed that of the US. Changes in the GBP/US-dollar exchange rate, while significant, had little impact on the total market value of liquid reserves since only 2.9 per cent of the reserves were held in GBP-denominated assets as at March 31, 2015.

During 2014–15, the yen fell 16 per cent against the US dollar. Changes in the yen/US-dollar exchange rate, while significant, had little impact on the total market value of liquid reserves since only 1 per cent of the reserves were held in yen-denominated assets as at March 31, 2015.

For financial reporting purposes, the results are presented in Canadain-dollar terms. In comparison to the previous year, the Canadian dollar fell almost 15 per cent against the US dollar. The financial statements are based on the prevailing exchange rate on March 31, 2015, which was 1.2666 CAD/USD.

Initiatives in 2014–15

During 2014–15, the Department of Finance and the Bank of Canada continued to work on initiatives to improve the management of the EFA. These initiatives include developing options and considerations in the review of the *Statement of Investment Policy* and working to update the investment process for managing foreign reserves to incorporate a new, customized investment benchmark. This work is being undertaken to improve asset allocation decisions and to clarify the roles and responsibilities of officials who are tasked with managing the EFA.

Other initiatives included: concluding consultations with counterparties on the Government's collateral and margining policies for swaps; and beginning negotiations to establish new derivative agreements with counterparties.

The Department of Finance and the Bank of Canada concluded consultations with counterparties on the Government's collateral and margining policies for swaps and began establishing symmetric, daily margining, zero-threshold collateral agreements with its counterparties. These agreements are being updated to reflect guidance on margin requirements for non-centrally cleared derivatives as agreed by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions.

As a result of moving to two-way margining for swaps, the Government implemented processes for funding, tracking and posting collateral to support its swap program. The Government appointed Thomas Murray IDS to carry out a competitive process to select a collateral management firm to manage collateral transactions in connection with foreign exchange swaps and cross-currency swaps. As a result of this process, State Street Trust Company Canada was appointed by the Government to act as an agent for collateral management and custodian services in the summer of 2015.

Performance versus Strategic Objectives

The *Currency Act* stipulates that this report provide a statement of whether the strategic objectives established for the EFA have been met during the review period. These objectives—to maintain a high standard of liquidity, preserve capital value and optimize return—were achieved. The planned level of liquidity was maintained for the reserves portfolio throughout the reporting period, and the portfolio's exposure to market and credit risks was managed within approved limits. In addition, the net underlying return was positive (see Annex 4).

Term Structure of the Official International Reserves

Table 2 shows the distribution of investments in the official international reserves by currency and term to maturity as at March 31, 2015. US-dollar holdings, which made up slightly more than 75 per cent of the reserves, were roughly equally distributed across the under 6 months, 1 to under 5 year, and 5 year and over maturity buckets. The euro holdings were more heavily weighted towards the 1 to under 5 year and 5 year and over maturity buckets. Yen holdings remained minimal and relatively unchanged from the previous year. GBP holdings were minimal and were focused in the 5 year and over maturity bucket.

Gold, SDR holdings[1] and the IMF reserve position, which have no terms to maturity, are translated into US dollars. The IMF reserve position is classified as an investment of indefinite term.

[1] SDRs are international reserve assets created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas.

Table 2

Term Structure of the Official International Reserves as at March 31, 2015

market value in millions of US dollars, settled basis

Term	Cash and term deposits	Government securities in domestic currency	Other securities	Gold	SDR holdings	Total EFA assets	IMF reserve position	Total official international reserves
US-dollar holdings								
Under 6 months	348	8,949	8,381	–	–	17,678	–	17,678
6 months to under 1 year	–	1,472	502	–	–	1,975	–	1,975
1 year to under 5 years	–	11,163	10,467	–	–	21,630	–	21,630
5 years and over	–	6,871	1,061	–	–	7,932	–	7,932
Indefinite term	–	–	–	114	7,751	7,865	2,757	10,622
Total US-dollar holdings	348	28,455	20,411	114	7,751	57,080	2,757	59,837
Euro holdings								
Under 6 months	149	541	528	–	–	1,218	–	1,218
6 months to under 1 year	–	210	227	–	–	437	–	437
1 year to under 5 years	–	6,351	1,478	–	–	7,828	–	7,828
5 years and over	–	5,413	322	–	–	5,736	–	5,736
Total euro holdings	149	12,515	2,555	0	0	15,219	0	15,219
Yen holdings								
Under 6 months	14	–	–	–	–	14	–	14
6 months to under 1 year	–	111	–	–	–	111	–	111
1 year to under 5 years	–	518	–	–	–	518	–	518
5 years and over	–	–	–	–	–	–	–	–
Total yen holdings	14	629	0	0	0	643	0	643
GBP holdings								
Under 6 months	38	–	–	–	–	38	–	38
6 months to under 1 year	–	–	–	–	–	–	–	–
1 year to under 5 years	–	1,943	–	–	–	1,943	–	1,943
5 years and over	–		–	–	–	–	–	–
Total GBP holdings	38	1,943	0	0	0	1,981	0	1,981
Total	549	43,542	22,966	114	7,751	74,923	2,757	77,681

Notes: The exchange rates prevailing on March 31, 2015 are used for the euro, GBP and yen assets. Numbers may not add due to rounding.

Liquidity and Preservation of Capital

In practice, the EFA's liquid reserves (which exclude gold and SDR holdings) are mainly invested in the debt of sovereigns and their agencies (85.3 per cent as at March 31, 2015), as these securities both enhance the liquidity and preserve the capital value of the EFA (Table 3). A more detailed description of the changes in the level of the official international reserves is provided in Annex 3.

Table 3

Composition of EFA Liquid Reserves

market value in millions of US dollars, settled basis

	March 31, 2015	March 31, 2014	Change
Sovereigns and agencies	57,208	55,207	2,001
Supranationals	9,302	7,388	1,914
Private sector investments	0	0	0
Cash	549	411	138

Notes: Liquid reserves exclude gold and SDR holdings. Numbers may not add due to rounding.

The largest portion of EFA liquid reserves is in US dollars because foreign currency needs are mostly in US dollars and, historically, foreign exchange market intervention has mainly consisted of transactions involving the US dollar. As at March 31, 2015, the US-dollar share of EFA liquid investments was US$49.2 billion or 73.4 per cent, the euro share was equivalent to US$15.2 billion or 22.7 per cent, the GBP share was equivalent to US$2.0 billion or 2.9 per cent, and the yen portion was equivalent to US$643 million or 1.0 per cent (Table 4). By comparison, as at March 31, 2014, the US-dollar share was 69.0 per cent, the euro share was 30.3 per cent, the yen share was 0.5 per cent and the GBP share was 0.3 per cent.

Table 4

Currency Composition of EFA Liquid Reserves

market value in millions of US dollars, settled basis

	March 31, 2015	March 31, 2014	Change
US dollars	49,215	43,452	5,763
Euros	15,220	19,076	-3,856
GBP	1,981	181	1,800
Yen	643	297	346

Notes: Liquid reserves exclude gold and SDR holdings. Numbers may not add due to rounding.

As specified in the *Statement of Investment Policy,* to help achieve the objective of preserving capital value, an issuing entity must have a credit rating of at least A- to be eligible for investment in the EFA. Compliance with counterparty limits is monitored on a real-time basis. For illustration purposes, the majority of EFA investments are in the AAA category, as indicated in Table 5.

Table 5
Credit Composition of EFA Liquid Reserves
market value in millions of US dollars, settled basis

	March 31, 2015	March 31, 2014	Change
AAA	61,131	56,585	4,546
AA+	3,901	5,784	-1,883
AA	1,384	241	1,143
AA-	0	297	-297
A+	643	0	643
A	0	0	0
A-	0	0	0
Below A-	0	99	-99

Notes: Liquid reserves exclude gold and SDR holdings. Numbers may not add due to rounding.

Portfolio Returns

The EFA is a financial asset portfolio within the *Public Accounts of Canada.* For risk management purposes and to provide transparency on the net economic return or cost to the Government of maintaining the EFA, several performance indicators are measured and tracked on a regular basis and reported to senior management at the Department of Finance and the Bank of Canada. Of these performance indicators, coupon return and carry are reported at book value, while total return is reported at market value. A brief overview of the portfolio's performance is provided below (a more detailed description is provided in Annex 4).

Overview

Given the low interest rate environment and foreign exchange movements, the assets held in the EFA generated lower net revenues in 2014–15 than in 2013–14 (C$0.8 billion versus C$1.51 billion). The cost of advances to the EFA, which represents the estimated economic cost to the Government of financing the EFA, modestly decreased compared to the previous fiscal year (C$1.45 billion versus C$1.53 billion). In 2014–15, the cost of EFA advances was higher than the net revenue earned on EFA assets, mainly due to the reinvestment of securities at lower yields and with higher credit quality.

Table 6

Summary of Main Performance Indicators for the Official International Reserves

	April 1, 2014 to March 31, 2015	April 1, 2013 to March 31, 2014
1) Net revenue of the Exchange Fund Account (C$ millions)	840	1,505
2) Measures of the net return on assets and liabilities		
Coupon return (basis points)	20	22
Carry (basis points)	-23	-24
Carry including net realized gains or losses (basis points)	9	25
Total return (basis points)	-21	71
3) Cost of advances to the EFA (C$ millions)	1,452	1,527
	As at March 31, 2015	**As at March 31, 2014**
4) Risk measures		
Total market risk (99% 10-day VaR, US$ millions)	561	n/a
Foreign exchange-interest rate risk under asset-liability matching (99% 10-day VaR, US$ millions)	14	15
Asset-only market risk (99% 10-day VaR, US$ millions)	1,157[1]	1,104
Credit risk (99.9% 1-year VaR, US$ millions)	1,451	1,756

[1] Starting in 2015, the VaR calculation includes credit spreads. Using the same methodology as in 2014, the asset-only VaR would have been C$1,065 million.

In 2014–15, the coupon return for the EFA, the difference between the yield to maturity of reserve assets and liabilities issued to fund the assets, was 20 basis points.

Two carry performance measures are used for the EFA: carry including only interest receipts and payments; and carry including interest receipts and payments as well as net realized gains and losses from the sale or purchase of assets. When net realized gains and losses are included in the carry measure, the carry improved from -23 basis points to 9 basis points.

Taking into account unrealized changes in the market value of assets and liabilities, the total return of the EFA decreased to -21 basis points. This compares to an increase of 71 basis points in the market value of the EFA in 2013–14. The loss was due primarily to an increase in the market value of outstanding liabilities caused by changes in funding spreads.

Total Market Value at Risk (which measures the loss arising from interest rate, foreign exchange rate, and credit and funding spread changes that will not be exceeded 99 per cent of the time if the EFA is held over a 10-business-day period) was introduced over the fiscal year and stood at $561 million. The Foreign Exchange–Interest Rate Value at Risk (FX-IR VaR) measure of potential losses due to interest rate and foreign exchange rate movements under the asset-liability matching framework was relatively unchanged from the prior fiscal year ($14 million versus $15 million). The asset-only VaR measure, or Asset VaR, looks at potential losses but for assets only. On March 31, 2015, the Asset VaR stood at $1,157 million. The VaR measure of potential losses due to credit exposure to issuers (Credit VaR) decreased as a result of tighter credit spreads associated with somewhat improved funding costs for European sovereign issuers. The Credit VaR stood at $1,451 million on March 31, 2015.

EFA Financing

EFA assets are funded by borrowings from a variety of sources (Table 7). Funding requirements are partially met through an ongoing program of cross-currency swaps[2] of domestic obligations. Total cross-currency swap funding and maturities during the reporting period were US$ 7.1 billion and US$ 3.2 billion respectively.

During 2014–15, foreign currency was raised through cross-currency swaps at an average cost of 3-month LIBOR less 40 basis points. This funding cost was better than rates obtained during the previous fiscal year, which averaged 3-month LIBOR less 39 basis points.

As at March 31, 2015, Government of Canada cross-currency swaps outstanding stood at US$47.0 billion (par value). Swaps of US dollars, euros, yen and GBP made up 71.2 per cent, 23.3 per cent, 1.3 per cent and 4.1 per cent of the swap portfolio respectively.

The EFA can also be funded through direct foreign currency issuance using three programs: a short-term US-dollar paper program (Canada bills[3]); a medium-term note issuance (Canada notes[4] and euro medium-term notes[5]); and a global bond program.[6] The choice of direct issuance method depends on funding needs and market conditions.

The changes shown in Table 7 reflect issuance and maturities denominated in US dollars (as the foreign currency issues are reported in US dollars).

Table 7
Outstanding Foreign Currency Issues
par value in millions of US dollars

	March 31, 2015	March 31, 2014	Change
Swapped domestic issues	47,036	44,767	2,269
Global bonds	11,650	11,755	-105
Canada bills	2,991	2,021	970
Euro medium-term notes	961	125	836
Canada notes	400	550	-150
Total	63,038	59,218	3,820

Note: Liabilities are stated at the exchange rates prevailing on March 31, 2015.

2 Agreements that exchange one type of obligation for another involving different currencies and the exchange of the principal amounts and interest payments.

3 Promissory notes denominated in US dollars and issued only in book-entry form. Canada bills mature not more than 270 days from their date of issue, and are discount obligations with a minimum order size of US$1,000,000 and a minimum denomination of US$1,000. Delivery and payment occur in same-day funds through Citibank, N.A. in New York City. Primary distribution occurs through four dealers: CIBC World Markets, Credit Suisse First Boston LLC, Goldman, Sachs & Co. and RBC Dominion Securities Inc. Rates on Canada bills are posted daily for terms of one to six months.

4 Promissory notes usually denominated in US dollars and available in book-entry form. Canada notes are issued in denominations of US$1,000 and integral multiples thereof. Notes can be issued for terms of nine months or longer, and can be issued at a fixed or a floating rate. The interest rate or interest rate formula, issue price, stated maturity, redemption or repayment provisions, and any other terms are established by the Government of Canada at the time of issuance of the notes and are indicated in the Pricing Supplement. Delivery and payment occur through Citibank, N.A. The Government may also sell notes to other dealers or directly to investors. Canada notes are issued for foreign exchange reserve funding purposes only.

5 Medium-term notes issued outside the United States and Canada. Government of Canada euro medium-term notes (EMTNs) are sold through TD Securities or by other dealers who are acting as the Government's agent for the particular transaction. The arranger for the EMTN program is TD Securities. The maturities of EMTNs are not fixed, and can range from short- to long-term. Notes issued under this program can be denominated in a range of currencies and structured to meet investor demand. EMTNs are issued for foreign exchange reserve funding purposes only.

6 Global bonds are syndicated, marketable debt instruments issued in a foreign currency with a fixed interest rate. The majority of global bonds issued by Canada are denominated in US dollars. Global bonds are issued for foreign exchange reserve funding purposes only.

Further information on the management of foreign currency liabilities and the associated credit risks can be found in the *Debt Management Report* at http://www.fin.gc.ca/dtman/2013-2014/dmr-rgd14-eng.asp.

IMF Programs

The Government of Canada participates in two lending arrangements with the IMF outside of the quota system: the multilateral New Arrangements to Borrow (NAB) and General Arrangements to Borrow (GAB). Canada also participates in the Voluntary Standing Arrangement (VSA), which was put in place by the IMF to facilitate the purchase or sale of SDRs held by member countries. The objective of the VSA is to allow less developed countries to exchange SDRs for liquid currencies such as the US dollar. Under the VSA, Canada could be required to buy up to about $4.5 billion of SDRs from other IMF member countries. Amounts advanced under these arrangements are considered part of the official international reserves of Canada and directly impact the Government of Canada's consolidated financial statements.

Canada's participation in the expanded NAB became effective on March 11, 2011. The maximum lending by Canada to the IMF under the NAB is limited to SDR 7,624 million. As at March 31, 2015, the amount outstanding under the NAB was SDR 774.62 million. Canada continues to participate in the GAB, which was most recently renewed in December 2013. The maximum lending by Canada to the IMF under the GAB is limited to SDR 893 million. As at March 31, 2015, no lending had been provided by Canada to the IMF under the GAB.

Funding of IMF activities during 2014–15 included $7,082 million of issued cross-currency swaps and $3,219 million of swap maturities.

Annex 1: Statement of Investment Policy for the Government of Canada (June 2011)

1. Purpose of Policy

The *Statement of Investment Policy for the Government of Canada* sets out the policy, approved by the Minister of Finance under the *Currency Act*, governing the acquisition, management and divestiture of assets for the Exchange Fund Account (EFA).

2. Purpose of EFA

The purpose of the Exchange Fund Account (EFA) is to aid in the control and protection of the external value of the Canadian dollar. Assets held in the EFA are managed to provide foreign-currency liquidity to the Government and to promote orderly conditions for the Canadian dollar in the foreign exchange markets, if required.

3. Governance

Part II of the *Currency Act* governs the management of the EFA. As amended in 2005, the Act requires the Minister of Finance to establish an investment policy for EFA assets. Responsibility for the implementation of approved policy and strategy is delegated to officials of the Department of Finance and the Bank of Canada.

The *Bank of Canada Act* provides statutory authority for the Bank of Canada to act as the Government's fiscal agent in the management of the Government of Canada's Exchange Fund Account.

The Funds Management Committee (FMC), which comprises senior management from the Department of Finance and the Bank of Canada, is responsible for the oversight of EFA investments. For policy development, the FMC is supported by a Risk Committee (RC) and an Asset-Liability Management Committee (ALMC)[7]. The RC is an advisory body to the FMC that reviews and provide opinions on the risk implications while the ALMC is responsible for strategic planning and performance evaluation. The Financial Risk Office (FRO) at the Bank of Canada provides support to the RC and the ALMC on risk issues. Officials from the Department of Finance and the Bank of Canada are responsible for the implementation of the strategic plan and day-to-day management of investment. Further information regarding oversight and governance is available within the *Funds Management Governance Framework* document (available at www.fin.gc.ca/treas/Goveev/TMGF_-eng.asp).

4. No Inconsistent Business or Activity

This policy prohibits any business or activity that is inconsistent with the investment objectives set forth below or in a manner that is contrary to the *Currency Act*.

[7] The Asset-Liability Management Committee (ALMC) was renamed to the Foreign Reserves Committee (FRC) in 2011.

5. Investment Objective

There are three investment objectives:

- *Maintain a high standard of liquidity:* Hold reserves in assets that mature or can be sold on very short notice with minimal market impact and therefore loss of value.
- *Preserve capital value:* Minimize risk of loss of market value by holding a diversified portfolio of high quality assets (in terms of credit rating and type of issuer), managing liquid assets and liabilities on a matched basis[8] (in terms of currency and duration), and using appropriate practices to mitigate risks.
- *Optimize return:* Achieve the highest possible level of return, while respecting the liquidity and capital preservation objectives.

6. Investment Policy

6.1 Eligible Asset Classes

The EFA may hold the following classes of assets: 1) fixed-income securities (including bonds, notes, bills and short-term discount notes/commercial paper) issued by sovereigns (including, central banks, and explicit agencies[9]) or fully guaranteed by sovereigns, government-supported entities, sub-sovereign entities[10] and supranational institutions; 2) deposits with commercial banks, central banks and the Bank for International Settlements; 3) repurchase agreements; 4) commercial paper and certificates of deposit issued by private sector entities; 5) gold; and 6) International Monetary Fund (IMF) special drawing rights. Subject to section 6.9, bonds with embedded options (such as callable bonds) and holdings of securities issued by and deposits with Canadian-domiciled entities (or entities that derive a majority of their revenues from their Canadian operations) are not permitted. All other classes of assets not listed in this policy are prohibited.

6.2 Eligible Investment Ratings

Eligibility for investment in the EFA is based on external credit ratings. To be eligible for investment, an entity[11] must have a senior unsecured debt credit rating in the top seven categories from at least two of the four main rating agencies[12]: Moody's Investors Service, Standard & Poor's (S&P), Fitch Ratings and Dominion Bond Rating Service (DBRS). When credit ratings for an entity differ, the rating of the second highest rating agency will be used to assess eligibility[13], consistent with the Basel II approach.

The only allowable unrated investments are the following: a) securities issued by and deposits with central banks and the Bank for International Settlements and b) investments in special drawing rights created by the IMF.

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8 Liabilities, which fund EFA assets, are managed outside the EFA.

9 An agency is deemed to be explicit, if and only if, the government support is guaranteed by law.

10 Sub-sovereigns are defined as levels of government within a sovereign territory, and hierarchically below the sovereign. For example, this could include, but not limited to, states, provinces or municipalities within a sovereign.

11 Under exceptional circumstances, the credit rating of an entity's issuance may be used, at the discretion of the ALMC.

12 EFA ratings of sovereigns are based on the lower of domestic and foreign currency ratings.

13 Stand-alone credit ratings for commercial banks by Moody's (Bank Financial Strength Rating (BFSR)),DBRS (Intrinsic Assessments), S&P and Fitch, which provide the relative credit quality of entities. The use of stand-alone ratings is to remove the assumption of implicit government support embedded in the official ratings of Moody's and DBRS. However, in cases where two or more ratings are the same, for example, Moody's is AA, S&P is AA, DBRS is AA- and Fitch Ratings is AA-, the EFA rating would be AA (not AA-).

Eligible Ratings

Ratings agency	Minimum rating
Moody's Investors Service	A3 or better
Standard & Poor's	A- or better
Fitch Ratings	A- or better
Dominion Bond Rating Service	A (low) or better

Note: Rating references in this document use the ratings scale of S&P for illustrative purpose.

6.3 Credit Exposure Limits

Exposure limits are based on credit quality for classes of assets, aggregate and individual counterparties.

6.3.1 Fixed-Income Securities

Exposure to fixed-income securities issued by sovereigns (including central banks and explicit agencies), government-supported entities, sub-sovereigns, and supranationals are shown in the tables below.

Limits on sovereigns in domestic and foreign currency (including central banks, and explicit agencies)—Aggregate limits

Issuer type	Aggregate limits (% of reserves target level)
"AAA"	Unlimited
"AA-" to "AA+"	25
"A-" to "A+"	2 (to be included in the above 25% limit)

Limits on sovereigns in domestic and foreign currency (including central banks, and explicit agencies)—Individual counterparty limits

Issuer type	Individual counterparty limits (% of reserves target level)
"AAA"	20 (Excluded from above would be direct domestic currency obligations of US, France, Germany and Netherlands)
"AA-" to "AA+"	10
"A+"	1.67
"A"	0.83
"A-"	0.33

Limits on Government Supported Entities (senior unsecured obligations) and sub-sovereigns—Aggregate limits

Issuer type	Aggregate limits (% of reserves target level)
"AA-" to "AAA"	25 (10% sub-sovereign limit)
"A-" to "A+"	2 (to be included in the above 25% limit)

Limits on Government Supported Entities (senior unsecured obligations) and sub-sovereigns—Individual counterparty limits

Issuer type	Individual counterparty limits (% of reserves target level)
"AAA"	3
"AA-" to "AA+"	1.5
"A+"	0.3
"A"	0.2
"A-"	0.1

Limits on supranationals—Aggregate limits

Issuer type	Aggregate limits (% of reserves target level)
"AA-" to "AAA"	25
"A-" to "A+"	2 (to be included in the above 25% limit)
Bank for International Settlements	10

Limits on supranationals—Individual counterparty limits

Issuer type	Individual counterparty limits (% of reserves target level)
"AAA"	10.0
"AA-" to "AA+"	5.0
"A+"	1.0
"A"	0.5
"A-"	0.2
Bank for International Settlements	–

6.3.2 Deposits and Other Short-Term Securities

Individual actual exposure limits to private sector entities in the form of forwards, deposits, commercial paper and certificates of deposit, together with swaps used for funding purposes, are determined by credit rating, as shown in the following table. These limits are cumulative across all lines of EFA business and represent the mark-to-market value for swaps and forwards and the par-value exposure for deposits, commercial paper and certificates of deposit. Total exposure to private sector entities may not exceed 25 per cent of the reserves target level, including a maximum of 2 per cent of the reserves target level for private sector entities rated A+ to A-.

Exposure limits by credit rating of private sector counterparties/issuers[14]—Total actual exposure

Issuer type	Total actual exposure (% of reserves target level)
"AA-" to "AAA"	25
"A-" to "A+"	2 (to be included in the 25% aggregate limit)

Exposure limits by credit rating of private sector counterparties/issuers[15]—Individual actual exposure

Issuer type	Individual actual exposure (% of reserves target level)
"AAA"	1.00
"AA+"	0.67
"AA"	0.50
"AA-"	0.33
"A+"	0.17
"A"	0.08
"A-"	0.03

6.4 Structure of EFA Holdings

Investments will be held in either a Liquidity Tier or an Investment Tier. Only highly liquid US-dollar-denominated securities are eligible for investment in the Liquidity Tier: 1) sovereign (including explicit agencies and central banks) and "AAA" rated supranational securities; 2) US government-supported entity securities; 3) "AAA" rated US and European government-supported entity discount notes and commercial paper; 4) callable Bank for International Settlement deposits and medium-term investments; 5) overnight commercial bank deposits; 6) commercial paper and certificates of deposit issued by private sector entities; and 7) overnight repurchase agreements. Investment in EFA eligible securities, excluding securities held under the Liquidity Tier, is classified as investment in the Investment Tier.

6.5 Eligible Currencies

The Exchange Fund Account may hold US dollars, euros, and Japanese yen and IMF special drawing rights[16]. The minimum floor for US-dollar-denominated assets is US$12 billion on a market-value basis.

6.6 Terms of Investments

The maximum term to maturity of EFA assets is based on type of instrument, credit rating and currency of issuance, as shown in the following table.

[14] Exposure limits on deposits, commercial paper, and/or certificate of deposit will be determined at discretion of ALMC.
[15] Exposure limits on deposits, commercial paper, and/or certificate of deposit will be determined at discretion of ALMC.
[16] The Minister of Finance approved the addition of British pound sterling to the EFA in March 2013.

Maximum Term to Maturity of EFA assets

Instrument	Maximum term to maturity
Marketable securities from issuers rated "AA-" or better	10.5 years
Investments from issuers rated from "A-" to "A+"	5 years
Commercial paper and certificates of deposit	1 year
Commercial bank deposits, repurchase agreements and all non-marketable instruments, such as deposits.	3 months

6.7 Permitted Activities

EFA officials may acquire or borrow assets to be held in the EFA and sell or lend those assets. Short sales are prohibited.

6.8 Use of Derivatives

EFA officials may use derivatives to mitigate risk and reduce costs. Derivatives shall not be used to establish speculative or leveraged positions.

6.9 Securities Lending and Repurchase Agreements

EFA officials may lend or borrow securities held in the EFA through a securities-lending program or repurchase agreements to enhance portfolio returns, provided it does not compromise liquidity or engender material exposure to loss. Officials are responsible for appointing and supervising agents, determining eligible collateral and setting collateral margins. Eligible collateral may include, but is not limited to, bonds with embedded options. Officials have the authority to either manage themselves or delegate to an agent the authority to select borrowers, negotiate terms to maturity and rates, and invest cash or securities collateral.

Individual exposure limits to private sector entities, in the form of repurchase ("repo") transactions, are determined by credit rating, as shown in the following table.

Exposure limits by credit rating of private sector entities for repurchase transactions

	EFA Credit Rating (% of the reserves target level)		
Individual Counterparty Limits	"AAA"	"AA-" to "AA+"	"A-" to "A+"
Versus US Treasury and US Agency collateral combined	2.50	1.67	1.00

6.10 Exceptions

In exceptional circumstances such as a ratings downgrade or an event of default, the EFA may hold assets (acquired either through direct investment or by taking possession of collateral following an event of default) that do not otherwise meet the criteria for eligible asset classes and/or breach the credit exposure limits for up to a three-month period, or such longer period as the Minister of Finance may approve.

7. Performance Assessment and Risk Management

Officials are responsible for measuring, monitoring and reporting on the performance and risk exposures of the EFA and tracking these positions against appropriate indices. Performance and risk exposures will be reported on a timely and regular basis to the ALMC, the RC, the FMC, the Minister of Finance and Parliament. Measures should be consistent with leading practices in the private sector and provide information on the returns on EFA assets, the cost of associated liabilities and financial risks. Detailed information on the Government's risk management policies is provided in the *Government of Canada Treasury Risk Management Framework*.

8. Review

The *Statement of Investment Policy* will be reviewed annually and updated as required. Investment programs and practices should be subject to periodic external review to ensure that they contribute effectively to the achievement of EFA objectives.

Annex 2: Overview of the Exchange Fund Account Management Framework

Objective

The legislative objective of the Exchange Fund Account (EFA), specified in Part II of the *Currency Act*, is to aid in the control and protection of the external value of the Canadian dollar. Liquid foreign-currency assets held in the EFA are managed to provide liquidity to the Government and to promote orderly conditions for the Canadian dollar in the foreign exchange market, if required. The assets held in the EFA also form a key component of the Government of Canada's prudential liquidity, which is available to meet financial requirements in situations where normal access to funding markets may be disrupted or delayed.

The EFA also facilitates foreign-currency transactions between the Government of Canada and the International Monetary Fund (IMF) under the Bretton Woods articles of agreement. These transactions include the provision of freely usable currencies to the IMF and the purchase and sale of Special Drawing Rights (SDRs).

Governance of the EFA

Under the provisions of the *Currency Act,* the Minister of Finance is allowed to acquire, borrow, sell or lend assets held in the EFA in accordance with the *Statement of Investment Policy (SIP).* This policy (1) sets out the investment objectives and provides details that govern the acquisition, holding and divestiture of assets for the EFA, including the specification of eligible asset classes, currencies and risk exposure limits; and (2) is designed to ensure prudent and effective management practices are followed in accordance with the Government of Canada's treasury management principles.

Investment Objectives of the EFA

- **Maintain a high standard of liquidity:** The EFA shall be managed so that foreign reserve assets can be sold on very short notice with limited market impact and therefore loss of value.
- **Preserve capital value:** The EFA shall be managed to maintain a low risk of loss in the market value of reserve assets, by holding a diversified portfolio of assets (in terms of currency, credit rating and type of issuer), mitigating exchange rate and interest rate market risks, and using appropriate practices to manage other risks.
- **Maximize return:** The EFA shall be managed to achieve the highest possible level of return, while respecting the liquidity and capital preservation objectives.

Treasury Management Principles

The SIP is based on principles that a person of ordinary prudence would apply in dealing with the property of others. The EFA shall be managed according to the fundamental principles of transparency, effectiveness, efficiency, accountability and risk management in order to protect the interests of Canadians.

- **Effectiveness and efficiency:** Policy development and operations shall take into account, to the extent possible, leading practices of other comparable sovereigns. Regular evaluations shall be conducted to ensure the efficiency and effectiveness of the governance framework and borrowing and investing programs.
- **Transparency and accountability:** Information on investment and funding plans, activities and outcomes shall be made publicly available in a timely manner. Borrowing costs, investment performance and material exposures to financial risk shall be measured, monitored, controlled and regularly reported, as applicable.
- **Risk management:** Risk monitoring and oversight shall be independent of financial asset and liability management operations.
- **Fiscal prudence:** The EFA is an account that forms part of the Government of Canada's balance sheet. Recognizing the importance of fiscal prudence and sustainability in public finances, the EFA shall be funded in a cost effective manner through a funding framework that mitigates the potentially negative impacts of movements in interest rates and foreign exchange rates on the Government's fiscal position by matching the funding with the currency, term and duration of the reserve assets. Credit risks associated with assets and liabilities are not offset under this framework and shall be addressed by other means.
- **Financial stability:** The EFA is an account that supports Canada's preparedness for financial contingencies. As a result, the management of the EFA shall take into account Canada's international commitments and global regulatory initiatives to support financial stability.

Governance Structure

Responsibility for the management of the EFA is shared between the Department of Finance and the Bank of Canada. The Bank of Canada, acting as fiscal agent for the Minister of Finance, executes transactions for the Account. The strategic planning and the operational management of the EFA are conducted jointly by the two organizations.

- Within the Minister of Finance's delegated authorities, the Funds Management Committee (FMC), composed of senior officials from the Department of Finance and the Bank of Canada, prepares recommendations for the Minister of Finance and oversees the management of the EFA. The Committee advises the Minister on policy and strategy, oversees the implementation of approved policy and plans, reviews performance outcome reports and makes decisions related to the management of the reserves.
- The FMC is supported by the Risk Committee (RC). The RC is an advisory body to the FMC that reviews and provides opinions on the risk implications of market and operational developments, and of the policy proposals and recommendations put forward to the FMC. The Financial Risk Office at the Bank of Canada provides analytical support to the RC and is responsible for monitoring and regularly reporting on the EFA's financial performance and its exposure to credit, liquidity, market and operational risks.
- The FMC is also supported by the Foreign Reserves Committee (FRC). The FRC provides strategic policy advice to the FMC and directs and oversees the operational management of foreign reserves.

EFA Management Policy

Management of the EFA follows a set of policies that apply to investments, funding, risk management and performance measurement.

Investment Policy

The policy governing the management of EFA assets, set out in the SIP, is designed to achieve the above-mentioned investment objectives of the EFA. To achieve these objectives, the EFA shall be governed by a framework that includes a formalized investment management style that provides clarity on roles, decision-making authority and accountability to facilitate the achievement of the EFA's objectives. The Minister of Finance or his/her delegate shall establish the risk tolerances of the portfolio through the approval of eligible assets and risk parameters. The FMC shall establish risk preferences for the portfolio that allocate assets to broad asset classes with varying degrees of credit and liquidity risks. The FRC shall establish detailed asset allocations to individual investments, consistent with the FMC's preferences and within the risk tolerances established by the Minister of Finance or his/her delegate.

Risk Management Policy

The risk management policy of the EFA requires identifying, monitoring, mitigating, to the extent required, and the regular and timely reporting of treasury risk exposures. Treasury risk includes currency, interest rate, credit, liquidity, legal and operational risks related to the financing and investment of the foreign exchange reserves. For information on recent risk policy initiatives, see the section entitled "Initiatives in 2014–15."

Asset-liability management policy: Foreign currency reserve assets held in the EFA and the foreign currency liabilities and the cross-currency swaps that finance those assets shall be matched as closely as possible in currency and duration on a portfolio basis so that the net exposure to currency and interest rate risks is limited.

Credit risk management policy: The Department of Finance and the Bank of Canada use a variety of tools to assess and manage credit risk. The Credit Rating Assessment Group (CRAG) within the Financial Risk Office at the Bank of Canada monitors credit conditions and measures the credit quality of investment counterparties. The CRAG supports a Credit Ratings Committee, which is composed of Department of Finance and Bank of Canada officials responsible for assessing the credit quality of trading and investment counterparties of the EFA. Foreign currency reserve assets held in the EFA shall be managed within credit limits based on these internal assessments and other relevant credit information.

Liquidity risk policy: Liquidity risk of EFA assets shall be kept low by investing in high credit quality investments that have demonstrated liquidity in various market environments. In addition, liquidity risk shall be managed by limiting the portion of the reserve asset portfolio and foreign liabilities that is rolled over at any particular point in time.

Legal and operational risks: Legal and operational risks shall be managed to support the achievement of the EFA's objectives. Legal risk associated with agreements and contracts with external parties, including fiscal agents, mandataries and private sector borrowers and lenders, is managed by the Department of Finance. Operational risk is managed by the Bank of Canada and reported on a regular basis.

Performance Assessment and Risk Management Reporting

EFA officials shall be responsible for measuring and monitoring the performance and risk exposures of the EFA, tracking these positions against investment preferences and/or other appropriate indices, and providing regular reports to senior officials and the Minister of Finance.

Performance and risk measures shall be consistent with leading practices and provide timely and accurate information on the returns on EFA assets, the cost of associated liabilities and the relevant financial risks.

Public reporting: *The Currency Act* requires annual reporting to Parliament on whether the performance of the investment portfolio has resulted in the achievement of the EFA's objectives. This is accomplished through the annual reporting of the EFA's performance in the *Report on the Management of Canada's Official International Reserves*. In addition to the legislative requirement to report on an annual basis, the Minister of Finance provides monthly updates on the performance of the EFA, in accordance with the IMF's Special Data Dissemination Standard guidelines.

The *Financial Administration Act* requires annual reporting to Parliament on the funding associated with EFA investments.

Commercial confidentiality: Notwithstanding the requirement to ensure timely and comprehensive information on the EFA to Canadians, the names of individual counterparties or securities held in the EFA shall not be disclosed for reasons of financial stability and commercial confidentiality.

Review

The SIP shall be reviewed regularly. Until the Minister of Finance otherwise amends and approves the SIP and the governance and risk management frameworks, they shall remain in effect.

Annex 3: Changes in the Level of the Official International Reserves

Unless otherwise noted, in this report the official international reserves are reported in US dollars on a market-value basis.

The level of the official international reserves changes over time due to a variety of factors. As shown in Table A3.1, over the 12-month reporting period the level of reserves increased by $1,231 million. The increase was due to reserves management operations ($6,323 million) and return on investments ($1,942 million), which was partially offset by currency revaluation effects (-$5,814 million), foreign currency debt charges (-$1,197 million) and net government operations (-$23 million).

Table A3.1
Sources of Change in Canada's Official International Reserves Between March 31, 2014 and March 31, 2015
market value in millions of US dollars

	Change
Official intervention	–
Net government operations	-23
Reserves management operations	6,323
Gains and losses on gold sales	–
Return on investments	1,942
Foreign currency debt charges	-1,197
Revaluation effects	-5,814
Other	–
Total change	1,231

Official Intervention

Official intervention involves buying or selling foreign currencies in exchange for Canadian dollars, and would therefore affect the level of the official international reserves. Intervention in the foreign exchange market for the Canadian dollar might be considered if there were signs of a serious near-term market breakdown (e.g., extreme price volatility with both buyers and sellers increasingly unwilling to transact), indicating a severe lack of liquidity in the Canadian-dollar market. It might also be considered if extreme currency movements seriously threatened the conditions that support sustainable long-term growth of the Canadian economy. The goal would be to help stabilize the currency and to signal a commitment to back up the intervention with further policy actions, as necessary.

Since September 1998, the Bank of Canada has not undertaken any foreign exchange market intervention in the form of either purchases or sales of US dollars versus the Canadian dollar.[17]

[17] Official intervention is separate from net purchases of foreign currency for government foreign exchange requirements and for additions to reserves.

Table A3.2
Official Intervention
millions of US dollars

	2007–08	2008–09	2009–10	2010–11[1]	2011–12	2012–13	2013–14	2014–15
Purchases	–	–	–	-124	–	–	–	–
Sales	–	–	–	–	–	–	–	–
Net	–	–	–	-124	–	–	–	–

[1] In March 2011, the Bank of Canada joined central banks in the United States, Europe and Japan in a concerted intervention to stabilize the Japanese currency by selling yen in an amount equivalent to US$124 million (C$120 million).

Net Government Operations

The net purchase of foreign currencies for government foreign exchange requirements and for additions to reserves totalled -$23 million. These transactions offset the repayment of two IMF loans to the EFA.

Reserves Management Operations

The purchase and sale of foreign currency assets along with the issuance and maturity of debt used to fund those assets totalled $6.3 billion. Over the reporting period, funds raised through the issuance of bonds, foreign exchange (FX) swaps, cross-currency swaps, medium-term notes and Canada bills, totalling $20.9 billion, exceeded debt maturities totalling $14.6 billion (including Canada bill maturities of $7.9 billion, bond maturities of $3 billion, FX swap maturities of $0.5 billion and cross-currency swap maturities of $3.2 billion).

Gains and Losses on Gold Sales

This factor reflects the gains or losses on sales of gold which are the difference between the proceeds of the sales and the market value of gold sold. There were no gold transactions during the period.

Return on Investments

Return on investments comprises interest earned on investments ($1.13 billion) and the increase in the market value of securities resulting from changes in interest rates ($811 million). The overall effect on the official international reserves was a net increase of $1.94 billion.

Foreign Currency Debt Charges

Foreign currency debt charges reduced the level of the official international reserves by $1.197 billion. These expenses are charged to the Consolidated Revenue Fund but paid using foreign assets of the EFA.

Revaluation Effects

Revaluation effects resulting from movements in exchange rates and gold market rates reflect changes in the market value of the official international reserves. Revaluation effects decreased the official international reserves by $5.81 billion, primarily due to the depreciation of the euro versus the US dollar during the reporting period.

International Monetary Fund Reserve Position

Each member country of the International Monetary Fund (IMF) is assigned a quota that represents the maximum amount of resources that it is obliged to provide to the IMF, upon request. As well, the IMF typically has on deposit with each government holdings in the form of non-interest-bearing notes and non-interest-bearing accounts. Canada’s reserve position at the IMF represents the difference between Canada’s quota and the IMF’s holdings of Canadian dollars, which is equivalent to the cumulative amount of all the money that Canada has advanced to the IMF over the years.

Canada’s reserve position at the IMF is an asset that is included as a component of the official international reserves but is not held in the EFA. As such, changes in Canada’s reserve position that may result from advances, repayments or revaluations directly impact the Government of Canada’s consolidated financial statements. During 2014–15, the reserve position decreased over the previous fiscal year.

More detailed information on monthly levels and changes in Canada's official international reserves is provided in Tables A3.3 and A3.4.

Table A3.3
Canada's Official International Reserves
Month-to-Month Changes
market value in millions of US dollars

Month-end	Securities	Deposits	Gold[1]	Special drawing rights[2]	Reserve position in the IMF[3]	Total	Total monthly change
2014							
March	62,394	612	124	8,709	4,611	76,450	-719
2014–15							
April	63,244	574	124	8,730	4,623	77,295	845
May	60,726	3,794	120	8,680	4,565	77,885	590
June	61,905	505	126	8,710	4,628	75,874	-2,011
July	61,648	502	123	8,628	4,565	75,466	-408
August	60,704	1,703	123	8,557	4,527	75,614	148
September	59,928	991	117	8,354	4,297	73,687	-1,927
October	60,487	758	112	8,330	4,225	73,912	225
November	61,096	466	113	8,251	4,185	74,111	199
December	62,053	703	116	8,164	3,664	74,700	589
January	62,732	596	121	7,944	3,444	74,837	137
February	62,888	662	116	7,927	3,175	74,768	-69
March	66,510	549	114	7,751	2,757	77,681	2,913
Total	n/a	n/a	n/a	n/a	n/a	n/a	1,231

Note: Numbers are from the *Official International Reserves* press release.

1 Gold valuation is based on the London p.m. fix on the last business day of the reporting month.

2 SDR-denominated assets are valued in US dollars at the SDR rate established by the IMF. A rise in the SDR in terms of the US dollar generates an increase in the US-dollar value of Canada's holdings of SDR-denominated assets.

3 The reserve position in the IMF represents the amount of foreign exchange that Canada is entitled to draw from the IMF on demand for balance of payments purposes. It equals the Canadian quota, less IMF holdings of Canadian dollars, plus loans to the IMF.

Table A3.4

Canada's Official International Reserves
Details of Month-to-Month Changes

market value in millions of US dollars

Month-end	Reserves management operations[1]	Gains and losses on gold sales	Return on investments[2]	Foreign currency debt charges	Revaluation effects	Net government operations[3]	Official intervention	Other transactions[4]	Total monthly change
2014									
March	-446	0	-100	-115	-58	0	0	0	-719
2014–15									
April	561	0	178	-68	174	0	0	0	845
May	682	0	407	-78	-421	0	0	0	590
June	-1,988	0	58	-217	136	0	0	0	-2,011
July	267	0	-25	-102	-548	0	0	0	-408
August	392	0	333	-118	-459	0	0	0	148
September	-698	0	-73	-111	-1,045	0	0	0	-1,927
October	238	0	267	-70	-210	0	0	0	225
November	382	0	196	-75	-304	0	0	0	199
December	1,221	0	47	-70	-608	0	0	-1	589
January	1,149	0	577	-122	-1,467	0	0	0	137
February	419	0	-254	-93	-138	-4	0	1	-69
March	3,698	0	231	-73	-924	-19	0	0	2,913
Total	6,323	0	1,942	-1,197	-5,814	-23	0	0	1,231

Note: Numbers are from the Official International Reserves press release.

1 Net change in securities and deposits resulting from foreign currency funding activities of the Government. (Issuance of foreign currency liabilities used to acquire assets increases reserves, while maturities decrease reserves).

2 Return on investments comprises interest earned on investments and changes in the market value of securities resulting from changes in interest rates.

3 Net government operations are the net purchases of foreign currency for government foreign exchange requirements and for additions to reserves.

4 Related to the securities assumed by the Government of Canada following the privatization of Petro-Canada in July 1991 and the subsequent dissolution of Petro-Canada Limited in 2001.

Annex 4: Detailed Portfolio Performance

Unless otherwise noted, in this report the official international reserves are reported in US dollars on a market-value basis.

This annex provides detailed technical information on indicators used to measure the portfolio's performance in four areas: 1) revenues; 2) net return on assets; 3) cost of advances to the EFA; and 4) market and credit risk measures.

1) Revenues

Revenues include income from investments and foreign exchange gains. Data are reported in Canadian dollars, as EFA revenues are reported in Canadian dollars in the attached financial statements. In 2014–15, income totalled C$0.84 billion compared to C$1.51 billion in 2013–14. The main categories of income are summarized in Table A4.1.

Table A4.1

Revenues of the Exchange Fund Account

millions of Canadian dollars

	April 1, 2014 to March 31, 2015	April 1, 2013 to March 31, 2014
Net revenue from investments		
Marketable securities	1,386	1,423
Cash and cash equivalents	-	1
Special drawing rights	6	8
Gains on sale of gold	-	12
Total net revenue from investments	1,392	1,444
Other income		
Net foreign exchange gain/loss	(552)	61
Net revenue	840	1,505

2) Net Return on Assets

The net return on assets of the EFA is reported using two separate measures. The first is called "carry" and represents the net revenue generated by funding and holding reserve assets from a cash only perspective (i.e., interest paid and received and realized gains or losses). The second measure is called "total return." It represents the net return generated by the EFA by including the cash flows used in the carry measure, as well as the changes in the market values of the assets and liabilities over the reporting period. By including the market or fair values of the EFA's assets and corresponding liabilities, the total return measure includes unrealized gains or losses, which is the difference between what an asset (or liability) is worth compared to what it cost.

Carry

Carry represents the interest received on the EFA's assets minus the interest paid on the liabilities that fund the assets. The carry measure is also reported including any realized gains or losses stemming from asset sales, which is the difference between the amount for which an asset is sold and the amount it originally cost.

Table A4.2 provides an estimate of the carry for the EFA and its constituent currency portfolios. The carry for the 2014–15 fiscal year is estimated at -23.2 basis points, a 0.8-basis-point difference from 2013–14. This result indicates that the coupon rates on newly purchased assets are approximately equal to the coupons of the replaced assets.

Taking into account gains or losses on the sale of assets during 2014–15, the EFA incurred net gains of $23 million, or 9 basis points. These sales resulted in a realized gain of $197 million and a net loss in interest income of $174 million. The EFA realized $102 million in gains on US asset sales and $95 million in gains on euro asset sales.

Table A4.2
Carry of the Official International Reserves[1,2]

	April 1, 2014 to March 31, 2015					April 1, 2013 to March 31, 2014	
	Interest earned on assets (millions of US dollars)	Interest paid on liabilities (millions of US dollars)	Net interest earned on assets (millions of US dollars)	Carry (basis points)	Carry (including net realized gains) (basis points)	Carry (basis points)	Carry (including net realized gains) (basis points)
Euro portfolio	307.9	435.5	-127.6	-18.9	-3.4	-12.7	16.1
GBP portfolio	17.5	15.2	2.3	0.4	0.4	0	0
Yen portfolio	1.3	-2.5	3.8	0.6	0.6	0.3	0.3
US$ portfolio	639.5	692.0	-52.5	-5.4	11.3	-11.6	9.1
Total carry[3]	966.1	1,140.2	-174.1	-23.2	9.0	-24.0	25.5

[1] The carry figures show the contribution of each currency portfolio to the overall carry.
[2] Numbers may not add due to rounding.
[3] Excludes gold holdings, and IMF reserve position and associated liabilities.

Total Return on a Market-Value Basis

The total return measure is used in several different ways. It is used to compare the performance of the EFA's assets to its liabilities in order to depict the net return of the portfolio on a market-value basis. It is also compared to an external benchmark index in order to provide an independent measure of the performance of the EFA and to enhance the understanding of performance in relation to broader market developments. Lastly, the EFA's total return is decomposed into the key sources of return. This is done by decomposing the total return measures for both the assets and liabilities through a technique called "performance attribution." Performance attribution allows management to discern what aspects of total return resulted from controllable influences as compared to those sources that are market-driven. As well, the attribution analysis provides an indication as to how well objectives of the asset-liability management framework of the EFA are being met.

Table A4.3 provides an estimate of the total return on a market-value basis for the EFA as a whole and its key portfolios compared to the corresponding liabilities. The total return was -21 basis points, or a loss of $156 million, in the fiscal year ending March 31, 2015, compared to 71 basis points, or a gain of $405 million, in the year ending March 31, 2014. This reflects net returns in US-dollar terms of 7 basis points for the US-dollar portfolio, -42 basis points for the euro portfolio, -75 basis points for the GBP portfolio and -53 basis points for the yen portfolio. The negative net total return was due primarily to an increase in the market value of outstanding liabilities caused by changes in funding spreads. These numbers include interest flows as well as all gains or losses earned over the period, regardless of whether they were realized or not.

Table A4.3

Total Return of the EFA Compared to Liability Benchmarks

	April 1, 2014 to March 31, 2015					April 1, 2013 to March 31, 2014
	US$ portfolio	Euro portfolio	GBP portfolio	Yen portfolio	Total EFA	Total EFA
EFA asset portfolio						
Return in original currency	2.44%	4.73%	5.73%	0.48%	n/a	n/a
Return in US$ (A)	2.44%	-18.28%	-5.91%	-13.53%	-3.72%	1.82%
Liability benchmarks						
Return in original currency	2.51%	5.27%	6.57%	1.10%	n/a	n/a
Return in US$ (B)	2.51%	-17.86%	-5.16%	-13.00%	-3.51%	1.11%
Return vs. liability benchmark in basis points (A – B) in US$	7	-42	-75	-53	-21	71

Table A4.4 compares the total return of the EFA to a set of Merrill Lynch government securities indices.[18] This provides some insight into how the total return of the EFA compares to a portfolio invested solely in US Treasury and German government securities. While the indices have been combined and weighted to reflect the currency composition and duration of the EFA, they only provide a general indication of its performance because the EFA is invested in a broader range of high quality assets. In the fiscal year ending March 31, 2015, the EFA's total return was higher than the return on the external indices by 25 basis points. This was due to the US Treasury and German government securities in the external indices underperforming the more diversified holdings in the EFA. The EFA's total return was higher than the external indices by 30 basis points in the fiscal year ending March 31, 2014.

[18] Merrill Lynch, used with permission. "MERRILL LYNCH IS LICENSING THE MERRILL LYNCH INDICES 'AS IS,' MAKES NO WARRANTIES REGARDING SAME, DOES NOT GUARANTEE THE QUALITY, ACCURACY AND/OR COMPLETENESS OF THE MERRILL LYNCH INDICES OR ANY DATA INCLUDED THEREIN OR DERIVED THEREFROM, AND ASSUMES NO LIABILITY IN CONNECTION WITH THEIR USE."

Table A4.4
Total Return of the EFA Compared to External Indices[1,2,3,4]
April 1, 2014 to March 31, 2015

	US$ portfolio	Euro portfolio	GBP portfolio	Yen portfolio	Total EFA
EFA asset portfolio					
Return in original currency (A)	2.44%	4.73%	5.73%	0.48%	n/a
Return in US$	2.44%	-18.28%	-5.91%	-13.53%	-3.72%
External indices					
Return in original currency (B)	2.29%	4.20%			n/a
Return in US$	2.29%	-18.69%	n/a	n/a	-3.97%
Return vs. external indices in basis points (A – B) in original currency[5]	15	53	n/a	n/a	25

1 Composite index for the US portfolio is constructed as weighted average of the following Merrill Lynch indices: US Treasury Bills (G0BA), US Treasuries 1-3yr (G1O2), US Treasuries 3-5yr (G2O2), US Treasuries 5-7yr (G3O2) and US Treasuries 7-10yr (G4O2). The weights for the composite index are updated on a monthly basis according to the holdings of the EFA US asset portfolio.

2 Composite index for the euro portfolio is constructed as weighted average of the following Merrill Lynch indices: German Govt Bills (G0DB), German Federal Govts 1-3yr (G1D0), German Federal Govts 3-5yr (G2D0), German Federal Govts 5-7yr (G3D0) and German Federal Govts 7-10yr (G4D0). The weights for the composite index are updated on a monthly basis according to the holdings of the EFA euro asset portfolio.

3 EFA liability returns for the yen portfolio were used in place of external indices for the purpose of determining the aggregate EFA comparison between assets and external indices.

4 EFA liability returns for the GBP portfolio were used in place of external indices for the purpose of determining the aggregate EFA comparison between assets and external indices.

5 Return versus external indices is expressed in original currency except for the total EFA, where both assets and index returns are converted to US dollars.

Performance Attribution of Total Return

Table A4.5 summarizes the attribution results for the EFA's US-dollar and euro portfolios for the fiscal year ending March 31, 2015. Total return is decomposed into four underlying return factors: coupon and amortization, changes in credit spreads, changes in interest rates and securities-lending activities.
For 2014–15, the attribution results indicate that the yield curve effect and credit spread effect contributed negatively to portfolio returns, resulting in an overall negative total return for the portfolio.

The coupon effect (the difference between the yield to maturity of reserve assets and liabilities issued to fund the assets) contributed positively to total return. The coupon effect generally represents the underlying return of the portfolio if matched assets and liabilities are held to maturity.

The credit spread effect (the difference between the change in the market value of EFA assets and the foreign liabilities due to changes in the credit quality of EFA issuers and Canada) was the main driver of the negative total return in the EFA's portfolio. Although changes in the credit spreads impacted both assets and liabilities, the effects were smaller for assets than for liabilities, notably in the euro portfolio, resulting in an overall negative impact on the EFA. The credit spread effect is transitory to the extent that assets are held to maturity.

The yield curve effect (the impact of changes in the general level of interest rates) demonstrates the extent to which the EFA's assets and liabilities are matched in terms of their sensitivity to changes in interest rates. Although total returns for both the US-dollar and euro asset portfolios were significantly affected by yield curve movements over the period, similar effects were observed in the corresponding liabilities. This demonstrates the benefit of the asset-liability management framework of the EFA over the reporting period.

As well, a component of the total return is generated through securities-lending activities. Any difference between the actual return and the sum of the above effects is the residual return, which reflects the fact that performance attribution approximately explains total return.

Table A4.5
Performance Attribution for the US-Dollar and Euro Portfolios Compared to Liability Benchmarks
April 1, 2014 to March 31, 2015[1]
per cent

	US$ portfolio			Euro portfolio		
	Assets	Liabilities	Difference	Assets	Liabilities	Difference
Coupon effect	0.89	0.72	0.17	0.29	-0.03	0.32
Yield curve effect	1.39	1.44	-0.05	3.80	4.11	-0.31
Credit spread effect	0.17	0.40	-0.23	0.63	1.11	-0.48
Securities-lending activities	0.00					
Residual return	-0.00	-0.05	0.05	0.01	0.08	-0.07
Return in original currency	2.44	2.51	-0.07	4.73	5.27	-0.54
Exchange rate effect				-23.01	-23.13	0.12
Total return in US$	2.44	2.51	-0.07	-18.28	-17.86	-0.42

1 Numbers may not add due to rounding.

3) Notional Cost of Advances to the EFA

From the Consolidated Revenue Fund

The cost of advances represents an estimate of the cost of maintaining the EFA by adding the cost of foreign debt payments (including the interest on cross-currency swaps) to the notional amount of foreign interest that would be paid on non-interest-bearing items or items funded in Canadian dollars. The EFA is a stand-alone account of assets while foreign liabilities are paid out of the Consolidated Revenue Fund (CRF). EFA advances represent funds (liabilities) from the CRF in support of maintaining the EFA. The level of foreign currency advances, measured in Canadian dollars, varies with the flow of foreign currencies between the EFA and the CRF.

Actual foreign interest charges: The proceeds from foreign currency borrowings are remitted to the CRF and concurrently advanced to the EFA. Foreign debt interest and principal repayments are charged to the CRF but are paid using the foreign assets of the EFA, reducing the amount advanced to the EFA. Actual foreign interest paid is converted into Canadian currency for the purpose of determining this portion of the notional cost of advances; for 2014–15, this value was C$1,285 million.

Notional interest charged in Canadian dollars: Because domestically funded EFA assets, SDR advances, and the portion of net revenues reinvested in the EFA (i.e., cumulative net revenues of the EFA less cumulative foreign debt interest payments) are not linked to foreign liabilities, an imputed interest cost is used to approximate the notional interest charge on the portion of advances from the CRF related to those assets. For 2014–15, a weighted cost of domestic and foreign funding (2.27 per cent) was used in calculating notional interest paid in Canadian dollars, resulting in a value of C$167.4 million.

4) Risk Measures

The risk management framework covers market, credit, liquidity, legal and operational risks related to the financing and investment of the foreign reserves. Risk measures are reported on a monthly basis to management at the Department of Finance and the Bank of Canada.

Market Risk

Market risk stems from changes in interest rates, credit spreads and exchange rates. Several industry-standard measures of market risk exposure are employed: scenario analysis, stress testing and Value at Risk (VaR) (Table A4.6). Stress testing and scenario analysis are used to evaluate the portfolio's performance under extraordinary circumstances in the market. VaR is a statistical measure for estimating potential losses to the EFA portfolio arising from extreme but plausible market movements such as changes in interest and exchange rates.

Stress tests are regularly carried out to gauge the sensitivity of the EFA portfolio to large changes in exchange rates and interest rates, including the portfolio impact of a 1-per-cent depreciation of the euro, GBP and yen vis-à-vis the US dollar and a 1-per-cent increase in interest rates across the yield curve. The results showed that, on a net basis during the reporting period, the EFA assets and the associated liabilities had very minimal exposure to currency depreciations and upward shifts in the yield curve.

In addition, some hypothetical scenario analyses that mimic market conditions during four previous extraordinary market events were regularly conducted: the tightening of monetary policy by the US Federal Reserve in 1994; the 1997 Asian financial crisis; the 1998 Russian debt default and Long-Term Capital Management (LTCM) collapse; and the 2001 terrorist attacks on the US. The scenario analyses showed that the EFA would generally perform well during such periods of market turbulence. The March 31, 2015 results were broadly in line with those reported for March 31, 2014. Scenario creation is a dynamic process. New scenarios continue to be considered and will be added when relevant and feasible.

Total Market VaR is a statistical measure that estimates the possible loss in portfolio value within a specific time period during normal market conditions as a result of interest rate, foreign exchange rate and credit spread changes. This is regularly reported for the entire EFA portfolio and on the net position of assets and liabilities. As of March 31, 2015, the EFA had a 99-per-cent 10-day Total Market VaR of $561 million, which implied that 99 per cent of the time, the value of the portfolio was not expected to decline by more than $561 million, on a net basis, over a 10-trading-day period. The Foreign Exchange-Interest Rate VaR (FX-IR VaR) under asset-liability matching measures only the loss arising from interest rate and foreign exchange rate changes that will not be exceeded 99 per cent of the time if the EFA is held over a 10-business-day period. As of March 31, 2015, the FX-IR VaR component was $14 million on a net basis over a 10-trading-day period. The asset-only VaR measure estimates the possible loss in the value of EFA assets within a 10-day period during normal market conditions as a result of interest rate, exchange rate and credit spread changes. As of March 31, 2015, the Asset VaR was $1,157 million.

Table A4.6
Market Risk Measures
millions of US dollars

	March 31, 2015		March 31, 2014	
	Assets only	Assets vs. liabilities (net)	Assets only	Assets vs. Liabilities (net)
Single factor stress tests				
1% depreciation of euro, GBP and yen	-178	-2	-196	-3
1% upward parallel shift in yield curve	-1,915	15	-2,032	2
Scenario analyses				
1994 Fed tightening	-4,632	72	-5,140	68
1997 Asian financial crisis	-652	181	-795	180
1998 Russian default/LTCM collapse	-453	322	-702	329
2001 terrorist attacks	1,638	159	1,813	188
99% 10-day Total Market VaR		561		n/a
99% 10-day Asset VaR[1]	1,157		1,104	
99% 10-day FX-IR VaR		14		15

[1] The March 31, 2014 figure only takes into account the effect of interest rates and exchange rates, while the March 31, 2015 figure also includes credit spreads.

Credit Risk

Credit risk includes the risk that a counterparty or issuer will be unable or unwilling to meet their obligations to pay as well as the risk that the value of an instrument will change as a result of actual or perceived changes in the credit quality of a counterparty or issuer.

Credit risk, which is the most important risk faced by the EFA, is controlled by setting limits on both actual and potential exposures to counterparties and issuers. A collateral management framework is used for managing the credit risk to financial institution counterparties arising from the cross-currency swaps used to fund the EFA. Under this framework, high quality collateral is placed with collateral managers for the EFA when the market value of the swap contracts exceeds specified thresholds. The Credit VaR model and some selected credit risk stress tests were used to measure the EFA's exposure to credit risk during the reporting period (Table A4.7). However, the Credit VaR estimate does not capture the market risk effect of cross-currency funding and therefore does not reflect the total risk of the EFA.

Table A4.7
Credit Risk Measures
millions of US dollars

	March 31, 2015	March 31, 2014
Credit VaR and expected shortfall		
99.9% 1-Year Credit VaR	1,451	1,756
Expected shortfall	4,802	4,637
Stress test		
Potential loss if counterparties with negative outlook or negative watch are downgraded one notch	29.7	112.3

The Credit VaR model provides an estimate of the maximum potential loss in portfolio value within a year as a result of a credit event, such as the downgrade or default of counterparties or issuers, under normal market conditions. As of March 31, 2015, the EFA had a 99.9-per-cent 1-year Credit VaR of $1.5 billion, which implied that 99.9 per cent of the time, the value of the portfolio was not expected to decline by more than $1.5 billion over a 1-year period due to credit events. The decrease in Credit VaR from the previous year reflects tighter credit spreads, which decrease the possible losses associated with downgrades and defaults. An associated measure, expected shortfall, computes the expected average loss in portfolio value during a 1-year period due to an extreme, unexpected credit event, whose possibility of happening (less than 0.1 per cent) was not captured by the Credit VaR statistic. The expected shortfall measure for the EFA was $4.8 billion as of March 31, 2015.

Credit risk stress tests were also carried out to evaluate potential losses to the EFA assets and the associated liabilities arising from extraordinary credit events in the market. These tests subjected the EFA to hypothetical scenarios, such as all counterparties or issuers with a negative outlook being downgraded by one notch. The difference between this year and last is mainly attributed to changes in the level of credit spreads. As a result, the potential loss to the EFA under this hypothetical scenario has decreased compared to the previous fiscal year.

Annex 5: List of Agents and Mandataries as Defined by the *Currency Act*

The *Currency Act* stipulates that this report include a list of the following agents and mandataries appointed by the Minister under subsection 17.2(3) of the Act to perform services concerning the EFA.

Bank of Canada

The Bank of Canada, as specified under the *Bank of Canada Act*, is the fiscal agent for the Government of Canada. As part of its fiscal agency responsibilities, the Bank manages the Government's foreign exchange reserves.

RBC Investor Services Trust and State Street Corporation

RBC Investor Services Trust (formerly RBC Dexia Investor Services) and State Street Corporation manage the securities-lending program for the EFA. As the Government's agents and mandataries, they carry out securities lending on behalf of the Government. The program involves loaning a security from the Government to a counterparty, who must eventually return the same security, in order to earn additional return on the portfolio.

Thomas Murray Custodian Monitoring (Canada) Inc. Trading as Thomas Murray IDS

Thomas Murray Custodian Monitoring (Canada) Inc. trading as Thomas Murray IDS acted as agent for the selection of a collateral manager for the EFA. The collateral manager will be responsible for managing the collateral pledged in connection with foreign exchange swaps and cross-currency swaps.

Exchange Fund Account
Unaudited Statement of Financial Position
and Statement of Operations

Year Ended 31 March 2015

Statement of Financial Position of the Exchange Fund Account *(unaudited)*
As at 31 March
(in millions of Canadian dollars)

	2015	2014
Financial Assets		
Cash and cash equivalents (notes 2, 3)	695	677
Investments (note 2, 3)		
Narketable securities (note 3)	81,442	67,054
Droits de tirage spéciaux (note 3)	9,818	9,628
Or (note 3)	6	6
Total investments	91,266	76,688
Total financial assets	91,961	77,365
Liabilities		
Due to the Consolidated Revenue Fund (note 4)	91,961	77,365

The accompanying notes are an integral part of these financial statements.

Paul Rochon
Deputy Minister
Department of Finance

Randy Larkin, CPA, CMA
Chief Financial Officer
Department of Finance

Statement of Operation *(unaudited)*
for the year ended 31 March
(in millions of Canadian dollars)

	2015	2014
Net revenue from investments		
Marketable securities		
Interest	1,152	1,130
Gains on sales of marketable securities	238	294
Transaction costs and other	(4)	(1)
Interest on cash and cash equivalents	-	1
Interest on special drawing rights	6	8
Gains on sales of gold	-	12
Total net revenue from investments	1,392	1,444
Other		
Net foreign exchange gain (loss)	(552)	61
Net revenue for the year (note 2)	840	1,505

The accompanying notes are an integral part of these financial statements.

Notes to the financial statements for the year ended 31 March 2015 *(unaudited)*

1. Authority and Objectives

The Exchange Fund Account (the Account) is governed by Part II of the *Currency Act*. The Account is in the name of the Minister of Finance and is administered by the Bank of Canada as fiscal agent. The *Financial Administration Act* does not apply to the Account.

The legislative mandate of the Account is to aid in the control and protection of the external value of the Canadian dollar. The Minister of Finance empowers the Account to acquire or sell assets deemed appropriate for this purpose, in accordance with the Account's *Statement of Investment Policy*.

Assets held in the Account are managed to provide foreign-currency liquidity to the government and to promote orderly conditions for the Canadian dollar in foreign exchange markets, if required. Canada's current policy is to intervene in foreign exchange markets on a discretionary, rather than a systematic, basis and only in the most exceptional of circumstances. Since September 1998, no transactions have been aimed at moderating movements in the value of Canadian dollar.

In accordance with the *Currency Act*, the net revenue for the year is paid to or charged to the Consolidated Revenue Fund (CRF) of the Government of Canada within three months after the end of the fiscal year, and the Minister of Finance reports to Parliament on the operations of the Account within the first 60 days on which Parliament is sitting after the end of the fiscal year. These statements have been prepared by the Department of Finance.

2. Significant Accounting Policies

As stipulated in the *Currency Act*, the financial statements of the Account are prepared in a manner consistent with the accounting policies used by the Government of Canada to prepare its financial statements.

Revenue recognition

Revenue from investments is recognized on an accrual basis and includes interest earned, the amortization of premiums and discounts using the straight-line method, gains or losses on sales of securities and on sales of gold, and revenues from securities lending activities. Interest is accrued on short-term deposits, deposits held under repurchase agreements, marketable securities, and Special Drawing Rights (SDRs).

Expense recognition

The Account's administrative, custodial, and fiscal agency services are provided and paid for by the Bank of Canada and the Department of Finance. These costs have not been recognized in the Statements.

In addition, the notional cost of the funding of the Account's assets and advances from the CRF are not recognized in the Statements.

Financial assets

Cash and cash equivalents

Cash and cash equivalents consists of cash and short-term deposits. Short-term deposits are measured at cost and are generally held to maturity. The resulting revenue is included in interest on cash and cash equivalents.

Deposits held under repurchase agreements

Deposits held under repurchase agreements are measured at cost. The resulting revenue is included in income from marketable securities. At the reporting date, and in the prior year, the Account did not hold deposits held under repurchase agreements.

Marketable securities

Purchases and sales of securities are recognized at the settlement dates. Marketable securities are measured at cost and are adjusted for amortization of purchase discounts and premiums on a straight-line basis over the term to maturity of the security. The carrying value of marketable securities includes accrued interest.

On de-recognition 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 revenue.

Short-term deposits, deposits held under repurchase agreements and marketable securities are written down to their recoverable amount in the event of an other-than-temporary impairment in value. Write-downs to reflect other-than-temporary impairment are recognized in *Total net revenue from investments* in the Statement of Operations.

Securities lending program

Under the securities lending program, the Account has agency agreements with two major financial institutions. Loans of securities are effected on behalf of the Account by these agents, who guarantee the loans and obtain collateral of equal or greater value from approved counterparties. These transactions can range from 1 to 31 days in duration. The securities loaned continue to be accounted for as investment assets. Income on securities lending transactions is included in *Total net revenue from investments* on the Statement of Operations.

Special Drawing Rights

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, US dollar, the British pound sterling and the Japanese yen.

SDRs are initially recognized at cost and are subsequently remeasured at each reporting date into Canadian-dollars at market exchange rates.

Gold

Gold is carried in the Account at a value of 35 SDRs per fine ounce.

Translation of foreign currencies and Special Drawing Rights

Assets denominated in foreign currencies and SDRs are translated into Canadian-dollar equivalents at the rates prevailing as of the date of the Statements, which were as follows:

	2015	2014
US dollar	1.2666	1.1055
Euro	1.3615	1.5230
Japanese yen	0.0106	0.0107
British pound sterling	1.8792	1.8430
SDRs	1.7473	1.7087

Gains or losses resulting from the translation of assets and advances from the CRF denominated in foreign currencies and SDRs, as well as from transactions throughout the fiscal year, are recorded as net foreign exchange gains or losses and are included in the Statement of Operations.

Investment revenue in foreign currencies and SDRs is translated into Canadian-dollars at the foreign exchange rates prevailing on the date the revenue is earned.

Use of estimates and measurement uncertainty

The preparation of the Statements requires management to make estimates and assumptions based on information available as of the date of the Statements. Significant estimates are primarily in the area of the fair values of financial instruments, including any impairment (note 3).

3. Financial Instruments

Fair value of financial assets
(in millions of Canadian dollars)

	31 March 2015		31 March 2014	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and cash equivalents				
US dollar	441	441	391	391
Euro	189	189	51	51
Japanese yen	17	17	10	10
British pound sterling	48	48	2	2
Short-term deposits	-	-	223	223
Total cash and cash equivalents	695	695	677	677
Investments				
Marketable securities				
US dollars	60,558	61,895	46,636	47,423
Euros	17,685	19,088	19,903	21,037
Japanese yen	794	797	316	318
British pound sterling	2,405	2,461	199	198
Total marketable securities	81,442	84,241	67,054	68,976
SDRs	9,818	9,818	9,628	9,628
Gold	6	144	6	137
Total investments	91,266	94,203	76,688	78,741
Total financial assets	91,961	94,898	77,365	79,418

The estimated fair value of cash and cash equivalents approximates their carrying value, given their short term to maturity.

The estimated fair values of marketable securities are based on quoted market prices and include accrued interest. If such prices are not available, the fair value is determined by discounting future cash flows using an appropriate yield curve. During the year, and in the prior year, no marketable securities were written down to reflect other-than-temporary impairment in value.

Since SDRs are translated into Canadian-dollar equivalents at the rates prevailing at the Statement date, the carrying value approximates fair value on the reporting date.

The estimated fair value of gold is based on the London gold fixing of $1,503.45 at 31 March 2015 ($1,428.03 at 31 March 2014) per fine ounce.

Credit risk

Credit risk is the risk that a counterparty to a financial contract will cause a loss to the Account by failing to discharge its obligations in accordance with agreed upon terms.

To ensure that the Account's asset portfolio is prudently diversified with respect to credit risk, the *Statement of Investment Policy* prescribed by the Minister of Finance specifies limits on holdings by class of issuer (sovereign, agency, supranational, corporation or commercial financial institution), by any one issuer or counterparty, and by type of instruments.

The *Statement of Investment Policy* also specifies the treatment of holdings that do not meet eligibility criteria or limits due to exceptional circumstances such as ratings downgrades.

With respect to the *Statement of Investment Policy*, the Account may hold fixed income securities of highly rated sovereigns, central banks, government-supported entities and supranational organizations. To be eligible for investment, an entity must have a credit rating in the top seven categories from two of four designated rating agencies (Standard & Poor's, Moody's, Fitch, and Dominion Bond Rating Service). The Account may also make deposits and execute other transactions, up to prescribed limits, with commercial financial institutions that meet the same rating criteria.

As stipulated in the *Currency Act*, the Minister of Finance may appoint agents to perform services concerning the Account. Through the securities lending program, agents can lend securities only up to a prescribed maximum amount and only to a list of approved counterparties. Each borrower must enter into a Securities Loan Agreement with at least one of the agents. Borrowers are also required to provide collateral for securities borrowed, according to a specific list approved by the Government. Collateral is limited to specific security types, terms to maturity, and credit ratings.

The agents also provide an indemnity in the event of default by the borrower. The Account enters into securities lending transactions in order to increase its return on investments.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk, and other price risk. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. 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. 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 interest rate risk or currency risk. The Account is not exposed to significant other price risk.

Interest rate and currency risks are managed, with due consideration of the risk to the Government of Canada, through the asset-liability management policy. This policy utilizes a strategy of matching the duration structure and the currency of the Account's assets with the foreign currency borrowings of the Government of Canada that notionally finance the Account's assets. Other price risks are mitigated by holding high quality liquid assets.

Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting its obligations associated with financial liabilities. Liquidity risk is minimized by limiting the portion of the Government of Canada's foreign liabilities that needs to be renewed within a one year period. In addition, liquidity risk is mitigated by holding short-term investments that are matched to the Government of Canada's maturing liabilities in foreign currencies.

Securities lending

As at 31 March 2015, the Account's investments included securities held by its agents in connection with the securities lending program. Investments with a fair market value of $387 million ($316 million at 31 March 2014) and an amortized cost of $380 million ($332 million at 31 March 2014) were being used in the securities lending program. A higher fair value compared to amortized cost is attributable to regular market fluctuations.

No securities were lent to eligible borrowers at the reporting date (nil at 31 March 2014).

4. Due to the Consolidated Revenue Fund (CRF)

The Account is funded by the Government of Canada through interest-free advances from the CRF. Advances to the Account from the CRF are authorized by the Minister of Finance under the terms and conditions prescribed by the Minister of Finance. Pursuant to Section 19 of the *Currency Act*, these advances are limited to US$150 billion by order of the Minister of Finance effective March 26 2015.

The CRF advances the proceeds of the Government of Canada's borrowings in foreign currencies and allocations of SDRs by IMF to the Account. Subsequent repayments of foreign currency debt are made using the assets of the Account and result in reductions of foreign currency advances from the CRF. Interest payable by the Government of Canada on borrowings in foreign currencies and charges on allocations of SDRs to Canada are charged directly to the CRF.

The Account requires Canadian-dollar advances to settle its purchases of foreign currencies. Canadian dollars received from sales of foreign currencies are remitted to the CRF. This, together with foreign currency payments made on behalf of the Government of Canada causes reductions in the level of outstanding Canadian-dollar advances and can result in overall net deposits of Canadian-dollars by the Account with the CRF.

At 31 March, advances from the CRF were comprised of the following currencies:

Currency composition of advances from the CRF
(in millions of Canadian dollars)

	2015	2014
US dollars	63,301	50,846
Euros	16,822	18,725
Japanese yen	2,440	317
British pound sterling	797	201
SDRs	8,035	7,858
Subtotal - foreign currencies	91,395	77,947
Canadian dollars	(274)	(2,087)
Net revenue	840	1,505
Total	91,961	77,365