

**Statement of Investment Policy
for the Government of Canada**

January 2008

Table of Contents

1. Purpose of Policy	1
2. Purpose of EFA.....	1
3. Governance	1
4. No Inconsistent Business or Activity	1
5. Investment Objective	2
6. Investment Policy.....	2
6.1 Eligible Asset Classes.....	2
6.2 Eligible Investment Ratings.....	2
6.3 Credit Exposure Limits	3
6.3.1 Fixed Income Securities.....	3
6.3.2 Deposits and Other Short-Term Securities	3
6.4 Structure of EFA Holdings.....	4
6.5 Eligible Currencies	4
6.6 Terms of Investments.....	5
6.7 Permitted Activities.....	5
6.8 Use of Derivatives	5
6.9 Securities Lending and Repurchase Agreements.....	5
6.10 Exceptions.....	6
7. Performance Assessment and Risk Management.....	6
8. Review	6

1. Purpose of Policy

The *Statement of Investment 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). 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 *Treasury Management Governance Framework* document (available at www.fin.gc.ca/treas/Goveev/TMGF_e.html).

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*.

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 basis¹ (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 directly guaranteed agencies), central banks, government-supported entities 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 entity² must have a senior unsecured debt credit rating in the top seven categories from at least two of the four main rating agencies³: 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 eligibility⁴, 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.

¹ Liabilities, which fund EFA assets, are managed outside the EFA.

² Under exceptional circumstances, the credit rating of an entity's issue may be used, at the discretion of the ALMC.

³ EFA ratings of sovereigns are based on the lower of domestic and foreign currency ratings.

⁴ Stand-alone credit ratings for commercial banks by Moody's (Bank Financial Strength Rating (BFSR)) and by DBRS (Intrinsic Assessments) will be used in conjunction with official credit ratings from S&P and Fitch to 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-).

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 directly guaranteed agencies), government-supported entities and supranationals are shown in the table below.

Issuer	Aggregate limits (% of reserves target level)	Individual counterparty limits (% of reserves target level)
"AAA" sovereigns in domestic and foreign currency (including central banks and directly guaranteed agencies)	Unlimited	20 (Excluded from above would be direct domestic currency obligations of US, France, Germany and Netherlands)
"AA-" to "AA+" sovereigns in domestic and foreign currency (including central banks and directly guaranteed agencies)	25	10
"A+" sovereigns (including central banks and directly guaranteed agencies)	2 (to be included in the above 25% limit)	1.67%
"A" sovereigns (including central banks and directly guaranteed agencies)		0.83%
"A-" sovereigns (including central banks and directly guaranteed agencies)		0.33%
Government-supported entities (senior unsecured obligations)	15	3
Supranationals (excluding Bank for International Settlements)	25	10
Bank for International Settlements	10	-

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
(% of the reserves target level)

Type of Exposure	EFA Credit Rating						
	"AAA"	"AA+"	"AA"	"AA-"	"A+"	"A"	"A-"
Individual actual exposure	1.00%	0.67%	0.50%	0.33%	0.17%	0.08%	0.03%
Total Actual exposure	N/A				2%		
Deposits	At discretion of ALMC						
Commercial Paper /Certificate of Deposit	At discretion of ALMC						

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 directly guaranteed agencies) and supranational securities; 2) US government-supported entity securities; 3) 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.

6.5 Eligible Currencies

The Exchange Fund Account may hold US dollars, euros, Japanese yen and IMF special drawing rights. 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.

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 (% of the reserves target level)

Individual Counterparty Limits	EFA Credit Rating		
	“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, provided that timely efforts are made to divest the EFA of those assets or otherwise bring any such exceptional holdings into compliance.

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.