CELEBRATING
70 YEARS
1935–2005

Registered Pension Plan

Annual Report 2004

Your Future in Focus

The photo on the cover depicts one of two large ornamental urns—or amphorae—that are mounted on each end of the terrace of the Bank's centre building on Wellington Street.

The urn symbolizes the storage of wealth. In ancient times, similar urns were used to store grain, oil, coins, and jewels.

The urns were designed by the firm Ricci and Zari of New York and became part of the Bank's front entrance between 1937 and 1938.

The Bank's Pension Plan is registered with the Office of the Superintendent of Financial Institutions (OSFI) for the purposes of the federal Pension Benefits Standards Act (1985), which regulates its funding, investment policy, and operations. It is also registered with the Canada Revenue Agency for purposes of the Income Tax Act, which regulates the maximum permissible benefits payable from a tax-sheltered pension arrangement.

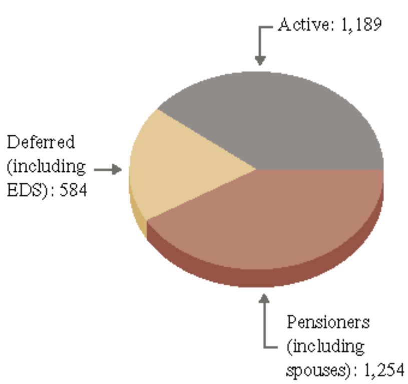
PLAN HIGHLIGHTS

Your Plan at a Glance

- The Pension Plan had a total of 3,027 members at the end of 2004 (Figure 1).
- Figure 2 shows payments from the Pension Trust Fund (the Fund) in 2004. The average annual pension payment from the Fund for members who retired from the Bank over the past three years with at least 30 years of service was $41,479.
- The total market value of the Fund's assets was $776.2 million at the end of 2004.
- The average return on the market value of assets, net of expenses, since the last valuation as at 1 January 2002 was 7.63 per cent per year.
- The Fund's rate of return was 12.3 per cent in 2004, 2.0 per cent better than the benchmark (Figure 3).*
- On a going-concern basis, the funding status of the Plan was an actuarial surplus of $87.0 million as at 1 January 2005 (Figure 4).
- On a solvency basis, the funding status of the Plan was an actuarial surplus of $91.0 million as at 1 January 2005 (Figure 4).

* The Fund's benchmark is a combination of equity and bond market indexes weighted in accordance with the Fund's investment policy.

Figure 1
Membership
(as at 31 December 2004)



More information on the actuarial valuation is provided on pages 16–18.

Figure 2
Payments from the Fund in 2004
($ millions)

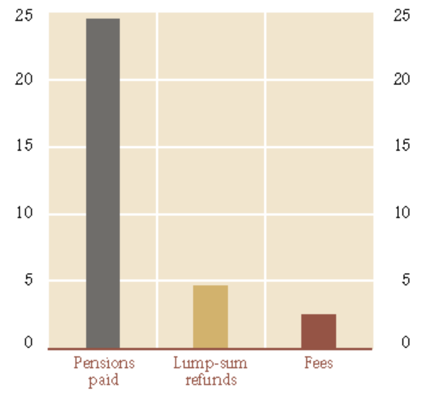


Figure 3
Total Fund Rate of Return
(per cent, as at 31 December 2004)

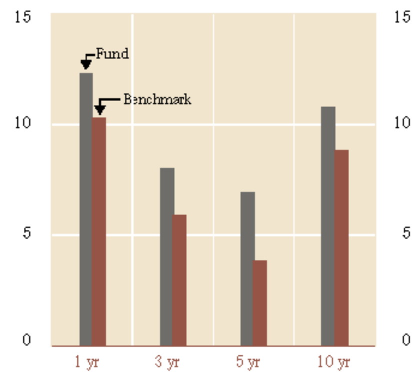
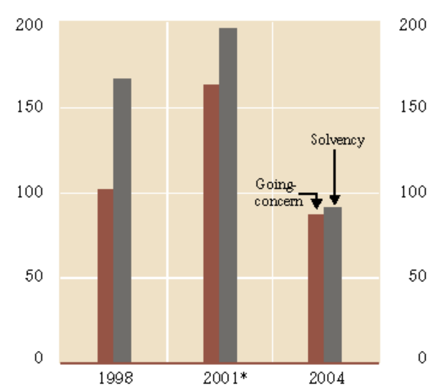


Figure 4
Actuarial Surplus Results over the Past Three Valuations
($ millions)



*2001 results updated to reflect 2002 pension improvement

"ONE OF OUR GOALS IS TO CONTINUE TO FAMILIARIZE MEMBERS WITH THE FEATURES OF THEIR PENSION PLAN."

Paul Jenkins
Senior Deputy Governor and
Chair, Pension Committee

MESSAGE FROM THE CHAIR

About this Report

On behalf of the Pension Committee, I am pleased to present the Bank of Canada *Registered Pension Plan Annual Report* for 2004.

This year's report is being released as the Bank celebrates its 70th anniversary. The report's theme, **Your Future in Focus**, reflects our goal of continuing to familiarize members with the features of their Pension Plan—one of the best defined-benefit plans in Canada.

This year, as last, we have tried to present the information in an easy-to-read format. We have included charts to illustrate Pension Plan activities and performance in 2004, and we have added a Member Services section. As well, a glossary is provided on page 32.

Learn about your Plan's design, benefits, and services on pages 4–9.

I thank everyone who took the time last year to respond to the questionnaire or offer suggestions. Your feedback helps us fulfill our commitment to achieving an effective two-way flow of communication. I encourage you to provide your comments again this year, both on the report and on any matter relating to your pension.

"I encourage you to provide your comments again this year, both on the report and on any matter relating to your pension."

I would also like to express my appreciation to the members of the Pension Committee, the Pension Fund Investment Committee, and the Pension Administration Committee for providing effective Plan governance, and to all those who contributed to this year's report.

A Plan with Staying Power

The first full year under our new governance structure was a busy one. Our structure provides for focused decision making and regular review of performance in a transparent and accountable manner. Further enhancing service standards and continuing to achieve benchmark returns remain key objectives.

"Further enhancing service standards and continuing to achieve benchmark returns remain key objectives."

To this end, the Pension Committee commissioned an asset/liability study in 2004 to assist us in our deliberations about the appropriate allocation of Fund assets. The Pension Fund Investment Committee analyzed initiatives that could further improve Fund performance. The Pension Administration Committee renegotiated the Bank's contract with Mercer Human Resource Consulting, which helped reduce administrative expenses and improve service standards.

Find out more about the Plan's governance on page 10.

The Fund's Position

The Bank has just completed its triennial actuarial valuation of the Pension Trust Fund, as at 1 January 2005. Results indicate that the Fund remains in a surplus position on all three valuation bases. In accordance with the provisions of the Income Tax Act, the Bank will continue to be prohibited from making regular contributions to the Plan.

I invite you to read about contributions on pages 5–6, or about the actuarial valuation, in detail, on page 16.

Litigation

The Bank of Canada Pensioners' Association has initiated legal proceedings against the Bank with respect to the Bank's Pension Plan. The Bank's responses will be made in the context of these proceedings.

Building on Our Commitments

"As always, the Bank is committed to meeting its pension payment obligations."

In 2004, we introduced new service standards, measured performance against those standards, and rolled out an enhanced Pension Benefit Calculator. In 2005, we are introducing an opt-out provision, which allows new regular employees to delay enrolment in the Plan for up to the first five years of employment with the Bank (find out more on page 5).

We are also committed to continuing to practise full and open communication with you, our members. As always, the Bank is committed to meeting its pension payment obligations.

For active members and pensioners alike, your defined-benefit Pension Plan is an important part of your lifetime stream of income. It is important, therefore, that you understand your Plan—its design, benefits, and services. I hope this year's report adds to your knowledge base.

W. P. Jenkins

Paul Jenkins
Senior Deputy Governor and
Chair, Pension Committee

ABOUT YOUR REGISTERED PENSION PLAN

Defined benefit: safeguarding your future

The Bank's defined-benefit Pension Plan means:

- ***Your benefits are stable***
  They are not subject to market fluctuations
- ***Your benefits have buying power***
  They rise with the cost of living
- ***Your benefits are predictable***
  You can estimate your future benefits using the Pension Benefit Calculator

Design

The Bank of Canada Registered Pension Plan (the Plan) provides a defined benefit—a guaranteed amount of money you can begin collecting upon retirement. You, the Bank, and investment income from the Pension Trust Fund all contribute to your retirement benefits.

You contribute a fixed percentage of your earnings, and the Bank contributes any additional amount necessary to pay the benefits owing to Plan members and their survivors. The Bank, as administrator of the Plan, assumes responsibility for investing all contributions and is obligated to do so in a prudent manner.

Benefits

Under the Bank's Plan, your benefits are based on a formula that considers your average salary (the best five consecutive years), number of years of service (up to 35 years), and the average year's maximum pensionable earnings (YMPE). These elements of the formula are always the same, whether benefits are being calculated when you retire, when your employment terminates, or in the event of your death.

Payment of Benefits

Pensioners

Retired members receive benefits based on the formula as described in the preceding paragraph, under "Benefits." The annual payment you receive will reflect your number of years of service. Benefits and contribution levels are designed to take into account the employee contributions to, and benefits from, the Canada and Quebec Pension Plans. Figure 5 shows the benefits paid from the Fund over the past three years.

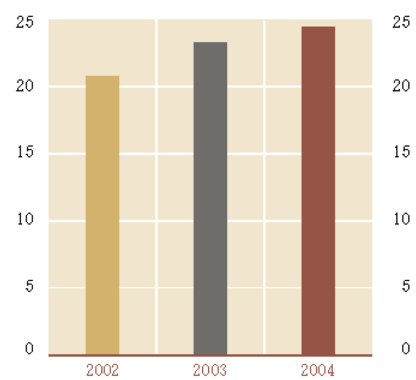
Pre-retirement

Members leaving the Bank before retirement age are entitled to transfer values or to deferred pensions. The Plan provides for a reduced pension benefit from age 50, or from age 45 if the member has 30 or more years of pensionable service at the time of retirement.

Beneficiaries

The Plan provides benefits to eligible survivors in the event of a member's death.

Figure 5
Pension Benefits Paid from the Fund over the Past Three Years
($ millions)



Contact HR Centre: 1-613-782-7766 / 1-866-404-7766 / hrcentre@bankofcanada.ca

Temporary Bridge Pension

In addition to your lifetime pension benefit, the Bank's Plan pays a temporary bridge pension until age 65, when government benefits—including the Canada Pension Plan (CPP) and Old Age Security—normally begin. If you retire early from the Bank, you will receive the bridge pension between the date of your retirement and age 64. The bridge pension is payable until the age of 65 or death, whichever occurs first.

Refer to the Glossary on page 32.

Indexing

To protect the buying power of your retirement income, your pension is indexed to reflect increases in the consumer price index (CPI)—a measure of inflation. This means that if the cost of living rises, so does your pension. While many other plans are capped, the Bank's Plan is fully indexed, allowing your benefit to increase by the full amount of the CPI increase.

Each year from the date your pension becomes payable, your pension is increased by a percentage that reflects the average increase in the CPI over the previous year. If the CPI were to decrease, your pension payment would remain the same. Indexing also applies to deferred pensions and to benefits that are paid to your survivors.

Plan Options

Increasing your service

Your service can be increased in certain circumstances through buyback arrangements for previous service at the Bank and through transfers from certain employers. Details are available on HR Online or from a Mercer customer service representative.

The opt-out provision for new regular employees

If you are a new regular full-time or part-time employee with an employment date of 15 April 2005 or later, you may choose to delay enrolment in the Plan for up to the first five years of service, after which point you are automatically enrolled. The Bank is offering this option in order to attract prospective talented employees by providing financial flexibility.

Contributions

Both you and the Bank contribute to the Pension Plan.

Contributing your share

Your contributions to the Plan are based on your annual salary. They are fully tax deductible, and are taken from your pay before income tax is calculated. You continue to contribute to the Plan until either the end of the year in which you reach age 69, if you are still working for the Bank, or you have been contributing for 35 years.

You contribute 5.7 per cent of your salary up to the YMPE under the Canada and Quebec Pension Plans, and 7.5 per cent of your salary above the YMPE. For 2004, the YMPE was set at $40,500.

Unless you are subject to the Income Tax Act maximum described under "Supplementary Pension Arrangement" on page 6, your contributions go into the Pension Trust Fund. The Bank also contributes to the Fund, as described in the following section.

All contributions to the Fund are held in trust, totally separate from the Bank's operating funds, and may be invested only in assets permitted by the Pension Benefits Standards Act (1985). The Bank has appointed CIBC Mellon as its corporate trustee.

Supplementary Pension Arrangement

At the end of 2004, 85 active members and 58 pensioners were participating in the Supplementary Pension Arrangement.

The Income Tax Act places a restriction on the annual benefit that can be paid under a defined-benefit registered pension plan. This restriction means that the maximum salary on which you can contribute to the Plan was $101,791 in 2004. If your salary is greater than the maximum salary, you contribute 7.5 per cent of the amount of your salary above this limit to the Bank's Supplementary Pension Arrangement.

Find out about the Supplementary Trust Fund on page 15.

The Bank's contributions

The Bank is responsible for contributing whatever amount is needed above your contributions and the investment income earned by the Pension Trust Fund in order to meet its pension payment obligations to members and their beneficiaries. This means that the Bank's contributions are not fixed; they vary according to various demographic and financial factors determined by an independent actuary at least every three years through an actuarial valuation.

Contribution holiday

When the Pension Trust Fund is in a surplus that exceeds 110 per cent of pension liabilities (the amount of money that has to be paid out in current and future benefits) on a going-concern basis, the Income Tax Act requires that the Bank temporarily stop making regular contributions to the Pension Plan. This is known as a contribution holiday.

A contribution holiday does not affect your current or future benefits in any way.

The Bank's most recent actuarial valuation, conducted as at 1 January 2005, indicates that the actuarial surplus exceeds the maximum funding excess established by the Income Tax Act. As a result, the Bank is required by law to continue its contribution holiday. The Bank has been prohibited from making contributions since 1999.

MEMBER SERVICES

Did you know?

- *The average age of the Bank's active members is 43.7*
- *The average age of retirement from the Bank over the last three years is 56.5*
- *The average age of the Bank's pensioners and their survivors is 68.8*

The Bank is committed to providing Pension Plan members with accurate, responsive, and professional customer service. Since 2002, services related to the Plan's administration have been performed by Mercer Human Resource Consulting on behalf of the Bank.

Mercer's pension administration centre in Toronto maintains all pension-related information, such as the date you joined the Pension Plan, beneficiary designations, and your accumulated pension contributions to date. This information is protected under the Privacy Act.

Mercer: Your First Point of Contact

Mercer's customer service representatives can answer your questions about the Bank's Registered Pension Plan or about relevant pension and tax legislation. You can call Mercer directly to speak with a representative, or, if you are an active member, you can access Pension Plan information or calculators through HR Online on Banque Centrale 24 hours a day, seven days a week.

Through Mercer's service options, members, pensioners, and beneficiaries can benefit from a full line of service offerings, including transfers of service earned with another employer; transfers of a pension entitlement to a new employer; buybacks of prior Bank service; and information on survivor benefits and bridge payments.

HR Online: The Active Members' Source of Pension Information

HR Online, launched on Banque Centrale in June 2004, is the Bank's intranet site for all human resources information. Key terms throughout the site link to definitions, and you can access the Pension Benefit Calculator to estimate your future pension.

The Pension Benefit Calculator

This calculator is an easy-to-use tool that allows you to personalize your retirement-planning estimates. Available through HR Online, the Pension Benefit Calculator resides on a fully secure site maintained by Mercer.

Seminars and Information Sessions

The Bank periodically holds retirement-planning seminars for staff and their spouses who are within 10 years of retirement. In 2004, the Bank also held seminars at all regional offices on how to use the enhanced Pension Benefit Calculator.

Quality Control: Your Assurance of Accountability

The Bank monitors the service provided by Mercer to ensure that you get the information you need about your pension. To do so, the Bank has established norms for the time required to perform certain key transactions and to measure the accuracy, quality, and timeliness of the transactions. If at any time you feel you are not receiving quality service, you are encouraged to contact the HR Centre to file a customer service complaint.

Administrative Expenses

Administrative and consultant services provided by outside suppliers are paid from the Pension Trust Fund. In addition, management and custodial fees are paid to outside managers to direct the investment of the Fund. The Bank takes considerable care to ensure that only costs directly attributable to services that benefit Plan members are charged to the Fund.

Table 1
Expenses Paid from the Fund

	2004	2003	2002
Investment management fees	$1,274,606	$1,030,950	$1,037,055
Pension administration fees	$588,418	$715,373	$333,678*
Other administrative fees	$597,602	$1,452,010	$794,942
Total	$2,460,626	$3,198,333	$2,165,676

*Pension administration was outsourced to Mercer in June 2002.

As reported in Table 1, expenses paid from the Fund in 2004 totalled approximately $2.5 million—about $700,000 lower than in 2003. The slight increase in investment and management fees is due in part to the hiring of CIBC Mellon as the custodian of the pension assets. The remainder is explained by the fact that investment management fees are a percentage of assets. When assets increase, so does the cost of managing them.

The decrease in “Pension administration fees” in 2004 reflects the Bank’s successful renegotiation of its contract with Mercer for more predictable and contained costs. Finally, the significant decrease in other administrative fees is a result of several factors, including a reduction in the use of external consultants for work such as the documentation of policies, procedures, and guidelines. The decrease can also be attributed to the deferral of some consulting work to 2005.

Audit and actuary fees, which are included in “Other administrative fees,” vary over the years, depending primarily upon the amount of actuarial work completed each year—in particular, the actuarial valuation that is done every three years. The expense for 2005 will reflect the current triennial actuarial valuation.

Who Is a Member of the Bank’s Registered Pension Plan?

Regular employees

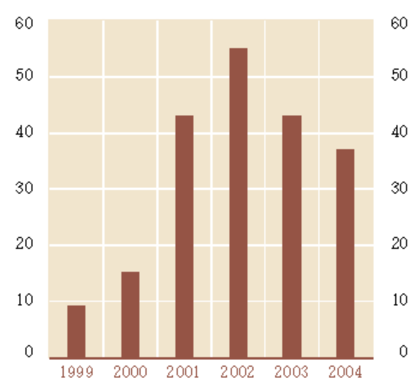
If you are a regular full-time or regular part-time employee, you are eligible to become a member of the Plan the day you start work.

Term employees

If you are a term employee, you can choose to join the Plan any time after the date you have completed 24 continuous months of full-time or part-time employment with the Bank, provided that your annual earnings equal at least 35 per cent of the YMPE in each of two consecutive calendar years.

In all cases, once you join the Plan, you remain a member for as long as you are employed by the Bank. Figure 6 shows the number of new pensioners over the past six years.

Figure 6
Number of New Pensioners by Year, over the Past Six Years



Staying in touch

In addition to the reports that it is required to produce, the Bank aims to provide you with timely and meaningful information about your Pension Plan, such as information bulletins.

Explanation of Plan provisions

The Bank must provide you and your spouse, as well as every employee who is eligible to join the Plan, with a written explanation of Plan provisions, which are, in the Bank's case, Bylaw 15 and Bylaw 18. When the Plan is amended, the Bank must inform you of the amendment within six months.

Personalized benefits statement

Each year, the Bank provides you with a personalized statement of the benefits you have earned under the Plan. This statement is also addressed to your spouse.

Information filed with the Office of the Superintendent of Financial Institutions

You, your spouse and children, your beneficiary, or legal counsel representing any of these parties may examine the documents or information filed with the Office of the Superintendent of Financial Institutions. These documents are held at the Bank's head office, and include the triennial actuarial valuation, financial interrogatories (such as the annual audited financial statements), the annual information return, and the filing of bylaw changes. You can request, in writing, a photocopy of any of these documents by contacting the Pension Plan Director.

CONTACT INFORMATION

Contact Mercer for pension or post-retirement questions and requests

- between 8 a.m. and 6 p.m. (Eastern Time), Monday to Friday
- by phone at 1-888-903-3308 or 1-416-868-7985 (Toronto region)
- by email at bank-banque-canada@mercer.com
- by mail at Mercer Human Resource Consulting, 900-70 University Avenue, Box 5, PO Box 19538 STN BRM B, Toronto, ON M7Y 3M1

Contact the HR Centre for payroll questions or customer service complaints

- between 10 a.m. and 4 p.m. (Eastern Time), Monday to Friday
- by phone at 7766 (internal), 1-613-782-7766 (in Ottawa), or 1-866-404-7766
- by email at hrcentre@bankofcanada.ca
- by mail at HR Centre, Bank of Canada, 12th Floor, West Tower, 234 Wellington Street, Ottawa, ON K1A 0G9

GOVERNANCE

The Bank's Role and Authority

Through its Board of Directors, the Bank of Canada acts as both the sponsor and the administrator of the Registered Pension Plan and the Supplementary Pension Arrangement (SPA).

Under this authority, the Board established, and currently oversees, the Pension Trust Fund and the Supplementary Trust Fund, and is responsible under law for all matters relating to the Plan's interpretation and application of the provisions.

The Board is responsible for ensuring the long-term financial viability of the Plan. In this capacity, the Board analyzes the actuarial position of the Plan, reviews current benefits and contribution rates, and periodically examines the Plan's design to ensure that it remains appropriate. Its goal in this regard is to provide competitive total compensation in order to attract and retain the talent the Bank needs now and in the future.

In December 2003, the Board created the Pension Committee and delegated to it the major responsibilities for the overall administration of the Plan.

Pension Committee

The Pension Committee—consisting of the Senior Deputy Governor as Chair, three Board members, three senior Bank officers, and the secretary—is responsible for the investment of the Pension Trust Fund and for administrative operations. Its specific duties include overseeing the management of the Plan's assets and liabilities, communication, funding, the administration of benefits, the performance of investment managers, and the selection of actuaries, accountants, and other advisers. The Pension Committee recommends changes to the Statement of Investment Policy and Procedures for Board approval each year. It also reports to the Board on its work on a semi-annual basis, and prepares an annual report for Plan members. It is supported by a Pension Plan Director and two subcommittees: the Pension Administration Committee and the Pension Fund Investment Committee.

Pension Committee (left to right): Mark Jewett, General Counsel and Corporate Secretary; Paul Dicks, Board of Directors; Paul Jenkins, Senior Deputy Governor and Chair; Sheila Vokey, Chief, Financial Services and Chief Accountant; Jean-Guy Desjardins, Board of Directors; Sheryl Kennedy, Deputy Governor, Financial Markets; James Hinds, Board of Directors; Robert Turnbull, Assistant General Counsel and Pension Committee Secretary

Pension Administration Committee (left to right): Terri Cugno, Pension Plan Director, ex officio member; Frances Boire-Carrière, Director, Human Resources; Doug Sinclair, Assistant Director, Financial Services; Jeanne Meredith-Pallascio, Senior HR Consultant; Sheila Niven, Chief, Corporate Services and Chair; Absent: Jacqueline Bourque, Internal Communications

Pension Fund Investment Committee (left to right): Ron Morrow, Director, Financial Markets; Jacobo De Leon, Principal, Financial Markets; Miville Tremblay, Director, Financial Markets (Montréal); George Pickering, Chief, Financial Markets and Chair; Terri Cugno, Pension Plan Director, ex officio member

Pension Administration Committee

Chaired by the Chief of the Corporate Services Department or another officer of the Bank, the Pension Administration Committee is responsible for retaining competent professional actuaries, monitoring changes in liabilities, overseeing benefits administration and compliance, managing communications and member relations, and monitoring relevant legislation to identify the need for Plan amendments. Various Bank staff working on the Plan's administration from the Communications, Financial Services, Executive and Legal Services, and Corporate Services departments, as well as external service providers, carry out their functions under the direction of this subcommittee.

Pension Fund Investment Committee

Chaired by the Chief of the Financial Markets Department or another officer of the Bank, the Pension Fund Investment Committee oversees the investment of assets held in the Pension Trust Fund and Supplementary Trust Fund in accordance with the Statement of Investment Policy and Procedures. In this capacity, the subcommittee makes recommendations concerning the policy to the Pension Committee, monitors the performance of its investments and investment managers, and reviews the monthly reports of the trustee of the Funds.

A pension plan with good governance aims to manage risks through clear roles and responsibilities, ongoing training and development, effective decision making, and regular monitoring of investments and service-provider costs. It also ensures that fiduciary and other obligations of the plan are fulfilled, such as compliance with legislation and plan policies.

Pension Plan Director

The Pension Plan Director works closely with the Chair of each committee and with other staff members to develop and implement the governance framework. This includes establishing strategic objectives, developing clear policies in all aspects of Plan administration, assessing and monitoring risks, establishing and monitoring performance objectives, monitoring compliance with regulations and policies, and conducting periodic assessments of Pension Committee performance.

Compliance

All members of the Pension Committee, Pension Administration Committee, and Pension Fund Investment Committee comply with policies adopted by the Bank, including the Bank's Conflict of Interest policy and other policies applicable to those persons who exercise fiduciary duties in connection with the administration of the Plan.

Fiduciary responsibility: working to protect your future

Committee members have fiduciary responsibilities in connection with the administration of the Plan. This means that they are obligated to act in the best interest of Plan members and beneficiaries by interpreting the Plan terms fairly and impartially and by preventing personal interests from conflicting with those of the Plan. In addition to this fiduciary responsibility, committee members are accountable to the Bank to manage assets and liabilities and to control administrative costs.

Ongoing Education

The Bank provides committee members with training to help them do their jobs effectively. Committee members attended a seminar on actuarial valuations in July 2004.

THE ASSETS OF THE FUND AND THE INVESTMENT APPROACH

Asset/liability management

An important undertaking for the Pension Fund Investment Committee during 2004 was a review of the current portfolio asset mix and its appropriateness in the context of the asset/liability management of the Fund.

For this study, the Fund's pension obligations, its liabilities, were defined in terms of a financial market-basis equivalent portfolio of bonds. The appropriateness of the current asset allocation was then assessed relative to this bond portfolio.

In general, the Fund's current allocation is broadly in line with the type of investment objectives being targeted; efforts are ongoing to find ways to improve the match between the risk characteristics of the Fund's assets and its liabilities.

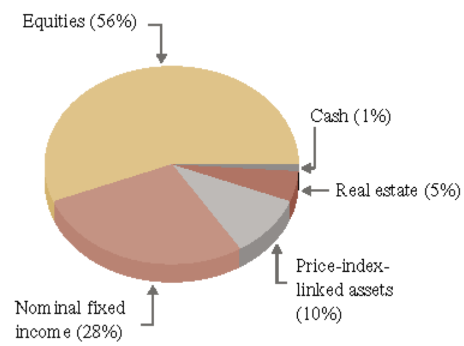
Asset Mix

The Pension Trust Fund's portfolio incorporates a diversified asset mix. The purpose of this approach is twofold: to achieve the long-term investment objective and to lower the risks to the Fund in pursuing this objective. Diversification helps enhance the portfolio's performance because different asset classes perform differently from year to year. On average, it lowers the variations in the portfolio's expected return, thus contributing to the stability of total Fund returns.

In addition to the existing statutory and regulatory requirements, such as a set investment objective and diversification, risk-control guidelines are in place to ensure the quality of individual investments.

In 2004, there were five main asset categories in the portfolio: equities, nominal fixed income, price-index-linked assets, real estate, and cash (Figure 7). The Statement of Investment Policy and Procedures sets out broad ranges for the percentage of assets to be invested in each category. The Pension Committee establishes narrower bands. At the end of 2004, the midpoints of the five bands were: 56 per cent for equities, 28 per cent for nominal fixed income, 10 per cent for price-index-linked assets, 5 per cent for real estate, and 1 per cent for cash.

Figure 7
The Five Main Asset Categories in the Fund's Portfolio, 2004*
(as at 31 December 2004)



*Benchmark midpoints

Investment Approach

In addition to its long-term objectives, the Fund's investment performance is assessed over the short term against the performance of a benchmark portfolio. The benchmark portfolio is composed of the same asset categories as the Fund's portfolio. Each benchmark category is given a weight equal to the midpoint of the Fund's five bands. The performance of each benchmark category is measured by the performance of a market index.

The equity portion of the Pension Trust Fund is invested by external professional investment managers subject to an investment policy approved by the Bank's Board of Directors and in accordance with current pension regulations. The policy is available on the Bank's external website.

Because the value of individual assets may vary over time, the actual percentage of the Fund's assets in each of the categories may vary from the benchmark weightings. Actual asset holdings are formally reviewed at least once a month and compared with the benchmark weightings. Appropriate investment action is taken to ensure that asset holdings are maintained within the permissible bands, but the managers of the Fund may deviate from the midpoints. This is one way in which Fund management may add value compared with the benchmark.

Equities

The equity investments of the Pension Trust Fund cover a wide range of the eligible equity universe, including large-, medium-, and small-capitalization Canadian stocks, as well as U.S. and other foreign stocks.

The investment strategy is for equity investments in large- and medium-capitalization stocks in Canadian and U.S. stock markets to be managed in a passive manner according to a market index. In 2004, approximately 70 per cent of the equity portfolio was managed this way. In keeping with the belief that managers in other areas can add value against the index, foreign equities outside the U.S. and small-capitalization Canadian stocks are managed actively.

At the end of 2004, equity holdings were divided more or less evenly between Canadian and foreign equities. Foreign equities are hedged against foreign currency risk.

All of the equity investments are managed externally by various portfolio managers, who are monitored on a regular basis and formally reviewed annually by the Pension Fund Investment Committee.

Nominal fixed income

The fixed-income portfolio is invested chiefly in three segments: provincial, municipal, and corporate issues. The investment strategy pays close attention to possible relative movements in credit spreads between sectors, issuers, and specific issues. The portfolio's performance is compared with the Scotia Capital Market Universe bond index.

In recent years, trading in the portfolio has become more active because of the more frequent need to undertake rebalancing transactions between bonds and equities. This has led to increased investment in larger, more liquid issues of provincial bonds.

Price-index-linked assets

About three-quarters of the holdings in this asset class are in the form of Government of Canada Real Return Bonds. Other holdings include index-linked mortgages guaranteed by the Canada Mortgage and Housing Corporation. Generally, these investments are regarded as permanent core holdings of the Fund aligned with the indexed pensions paid to Plan beneficiaries. For that reason, transactions would be rare for these types of assets, other than for rebalancing activities.

Real estate

The Fund's real estate holdings consist of investments in closed-end pooled funds. In this type of arrangement, external managers are given the discretion to create and manage a diversified portfolio of commercial, industrial, and office real estate across different regions of Canada. This allows the Fund to participate in the real estate asset class while minimizing the administrative burden of doing so.

In 2004, the Fund's holdings of real estate were below the band of the target range, although efforts were under way to increase these holdings. Real estate liquidity is much lower than that of other assets in the Fund, and there are times, as in this instance, when long lags exist in reaching the desired amount of real estate holdings. Moreover, real property tends to be unique, and obtaining the specific types of properties desired for the Fund has been difficult, because there has not been a sufficient supply in the marketplace at attractive prices.

Cash

The Fund also maintains a level of liquidity in the form of deposits, Government of Canada treasury bills, or other forms of money market instruments sufficient to meet anticipated payments and investment commitments. During 2004, the Fund maintained cash at its midpoint allocation.

Performance of the Fund

Reflecting positive conditions in capital markets, all asset categories held in the Fund yielded positive rates of return during 2004. The one-year return, ending on 31 December 2004, was 12.3 per cent, exceeding the return on the benchmark portfolio of 10.3 per cent. As noted earlier, the long-term investment objective is to achieve the target rate, which has been inflation plus 4 per cent net of expenses (approximately 25 basis points) for the past three years. For the next three years, the target rate has been revised back to 3.5 per cent. Since benefits paid out under the Plan are increased to keep pace with inflation each year, the target rate must be measured after the effects of inflation and net of expenses.

In each of the 10-year periods shown in Table 2, the Fund has met or exceeded the current long-term investment objective, and has outperformed the benchmark.

Table 2
Ten-Year Rates of Return
(per cent, as at 31 December)

	1994–2004	1992–2002	1990–2000	1988–1998	1986–1996
Fund	10.8	10.1	12.7	11.2	10.7
Benchmark return*: Inflation + 4%	6.0	5.8	6.0	6.5	7.1

*Performance numbers are calculated before expenses.

Supplementary Trust Fund

The Pension Fund Investment Committee directs the management of the Supplementary Trust Fund (STF) investment portfolio. The STF's assets are held in two separate accounts. One account is under the direct control of the Pension Committee and the Pension Fund Investment Committee and is referred to as the "investable portion" of the STF. The other is in the form of a non-interest-bearing deposit at the Canada Revenue Agency. It consists of a 50 per cent share of the Bank and employee contributions to the STF and 50 per cent of the income of STF investments. The Pension Committee and the Pension Fund Investment Committee do not control this account.

Although the STF's return and diversification objectives have been managed in a manner similar to that of the Pension Trust Fund, there are some important differences between the two. The STF's relatively small size and the past variability of cash flows into and out of it have required a relatively large cash position. As well, given the required contributions to the Canada Revenue Agency account, the allocation of STF assets is geared to minimize the receipt of current income and realization of capital gains in favour of unrealized capital gains. From that perspective, investments are oriented to equities and are managed according to a low-turnover strategy.

ACTUARIAL VALUATION: GAUGING THE PLAN'S FUNDING STATUS

An actuarial valuation establishes the total expected cost of the benefits payable to members and is meant to ensure that the Plan is adequately funded.

The valuation monitors the progress of contributions, returns, and withdrawals from the Pension Trust Fund against previous economic and demographic assumptions. It also keeps in check changes in liabilities due to Plan experience. If the Fund's cumulative experience is more favourable than the assumptions allowed for, the Fund will be in an actuarial surplus. If the cumulative experience is less favourable, the Fund will be in an actuarial deficit.

The Bank must make up any deficit over a predetermined number of years. Once the Fund reaches a funding status of 110 per cent—in other words, once the Plan's assets are 110 per cent or more of the current value of the Plan's expected future liabilities on a going-concern basis—the Income Tax Act prohibits the Bank from making any further contributions to the Plan. This temporary ban on sponsor contributions is called a contribution holiday. More information is provided on page 6.

How an Actuarial Valuation Is Performed

Actuarial valuations are based on Plan membership data, Plan provisions, and actuarial assumptions. The demographic and economic assumptions that the actuary uses are estimates of future events, such as mortality, employee turnover, salary levels, inflation, and rates of return on Plan assets.

Demographic Assumptions

Some of the demographic assumptions, such as retirement rates and employee turnover, are based on the Bank's previous years of experience. For other assumptions, such as mortality rates, the Bank's experience is not significant enough to derive credible assumptions. For example, the assumed mortality rates are those published by the Society of Actuaries and are based on the experience of large civil service pension plans and large insurance companies. The mortality rates also take into account future mortality improvements.

Economic Assumptions

Economic assumptions reflect expectations based on prevailing economic and financial conditions at the time of the valuation. The actuary takes into account various economic factors, such as interest rates and the YMPE, as well as changes in the consumer price index and Income Tax Act maximums.

Plan liability

All of these assumptions are used to determine the value of benefits owed to current pensioners, as well as the future benefit that has been accumulated by current employees and members entitled to deferred pensions. This total is called the Plan liability.

Common Bases for Performing an Actuarial Valuation

Current legislation requires the use of three common bases when performing actuarial valuations. Each basis provides a different insight into the Plan.

Going-concern basis

The going-concern basis (Table 3) assumes that the Plan will continue indefinitely. Therefore, the actuary must predict the Fund liabilities and determine whether there are sufficient assets to meet those liabilities. The Bank's actuary uses a five-year actuarially smoothed value of the assets.

The discount rate, which is used to determine the current value of future liabilities, was based on the expected long-term return on the Fund for the target asset mix specified in the Statement of Investment Policy and Procedures, less an allowance for investment and administrative expenses, and less a margin for adverse deviations. If, on a going-concern basis, the Fund is in a deficit position, which means that the discounted liabilities are greater than the smoothed value of assets, the Bank must make up the difference over 15 years.

Employee contribution rates and benefit levels are fixed. Any deficiency in the Fund will be made up by the Bank.

Solvency basis

The solvency basis (Table 4) assumes that the Plan will be wound up on the valuation date. Fewer assumptions are needed to calculate the solvency liability number. Since this basis assumes that the Plan is winding up immediately, there is no need to assume future salary increases, and when employees will terminate their membership in the Plan. Also, a market value of assets is used in this case. If, on a solvency basis, the Fund is in a deficit position, which means that the liabilities are greater than the market value of assets, the Bank must make up the difference over five years.

Accounting or expensing basis

The accounting or expensing basis (Table 5) is used to determine the asset, liability, and pension expense values that will appear in the Bank's financial statements. The main objective of this approach is to enable comparisons between different organizations using standard measures.

Table 3
Going-Concern Basis
($ millions as at 31 December)

	1992	1995	1998	2001	2001*	2004
Actuarially smoothed value of assets	290.7	397.5	539.4	676.6	676.6	739.6
Liabilities	289.1	389.8	437.9	488.4	513.1	652.6
Surplus	1.6	7.7	101.5	188.2	163.5	87.0
Surplus as a percentage of liabilities	0.6%	2.0%	23.2%	38.5%	31.9%	13.3%

*2001 results updated to reflect 2002 pension improvement

Table 4
Solvency Basis
($ millions as at 31 December)

	1992	1995	1998	2001	2001*	2004
Assets	291.2	422.3	582.0	679.0	679.0	776.2
Liabilities	280.5	357.2	415.5	440.8	482.4	685.2
Surplus	10.7	65.1	166.5	238.2	196.6	91.0
Surplus as a percentage of liabilities	3.8%	18.2%	40.1%	54.0%	40.8%	13.3%

*2001 results updated to reflect 2002 pension improvement

Table 5
Accounting Basis
($ millions as at 31 December)

	2001	2002	2003	2004*
Assets	679.0	626.0	710.2	778.1
Liabilities	467.0	581.7	631.6	708.6
Surplus	212.0	44.3	78.6	69.5
Surplus as a percentage of liabilities	45.4%	7.6%	12.4%	9.8%

*As presented in the 2004 Bank of Canada *Annual Report*

This method uses a discount rate that is determined using a market bond rate, as prescribed by the Canadian Institute of Chartered Accountants. There is no direct impact on member contributions or benefits, but there is an impact on the sponsor's financial statements.

What is an actuarial surplus?

An actuarial surplus occurs when the assets in the Fund are greater than the projected liabilities. Because a number of assumptions are used to determine the liability number, a funding excess is more of a gauge of the Plan's health than an exact amount. Emerging experience will result in gains and losses that will be revealed and considered in future actuarial valuations.

The Funding Status of the Plan

Results of the 2004 triennial valuation indicate that the Fund remains in an actuarial surplus position on all three valuation bases, although the amount of the surplus has decreased since the last valuation.

Actual economic and demographic outcomes (relative to what had been assumed at the time of the last valuation), together with the changes in assumptions for the current valuation, account for the change in funding status as at 1 January 2005.

About the assumptions

Demographic factors were a major contributor to the decrease in the surplus. Over the past three years, members have been retiring earlier and living longer than predicted, decreasing the surplus by close to $19 million.

Other factors relative to the original economic assumptions that contributed to the decrease in the surplus were changes to the Income Tax Act maximums in the 2002 and 2005 federal budgets ($6.3 million) and higher indexation ($2.3 million).

Also of note, interest on the surplus over the past three years ($31 million) approximately equalled the Bank's mandatory contribution holiday ($33 million).

Based on advice from our actuaries and the Pension Committee's assessment of economic and financial trends, the real rate of return and real wage assumptions for the current valuation have been revised compared with the previous valuation. The real rate of return assumption has been reduced to 3.5 per cent from 4 per cent, and the real wage assumption has been lowered to 1.5 per cent from 2 per cent.

Together, adjustments to these last two assumptions reduce the actuarial surplus by nearly $42 million. The largest impact of these changes in assumptions comes about because of the lowered discount rate, which increases Fund liabilities.

Financial Statements

FINANCIAL REPORTING RESPONSIBILITY

The accompanying Financial Statements of the Bank of Canada Registered Pension Plan (the Plan) have been prepared by the Bank's management in accordance with Canadian generally accepted accounting principles and contain certain items that reflect estimates and judgment of management. The integrity and reliability of the data in these financial statements are management's responsibility.

In support of its responsibility, management has developed and maintains financial and management control systems and practices to provide reasonable assurance that transactions are properly authorized and recorded, that financial information is reliable, that the assets are safeguarded and liabilities recognized, and that the operations are carried out effectively. Internal controls are reviewed and evaluated by internal audit programs, which are subject to scrutiny by the external auditors.

The Pension Committee is responsible for the administration of the Plan and has overall responsibility for the financial information presented in the Financial Statements. The Pension Committee meets with management and with the external auditors to review the scope of the audit, to review their findings and to satisfy themselves that their responsibilities have been properly discharged. In addition, Mercer Human Resource Consulting Limited, a firm of consulting actuaries, conducts a formal actuarial valuation of the Plan at least every three years, as required under the Pension Benefits Standards Act.

Deloitte & Touche LLP, the Plan's external auditors, appointed by the Pension Committee, has conducted an independent examination of the financial statements in accordance with Canadian generally accepted auditing standards, performing such tests and procedures as they consider necessary to express an opinion in their report to the Pension Committee. The external auditors have full, unrestricted access to the Pension Committee to discuss their audit and related findings as to the integrity of the Plan's financial reporting and the adequacy of internal control systems.

W. P. Jenkins

Paul Jenkins
Senior Deputy Governor and Chair, Pension Committee

S. Vokey

Sheila Vokey, CA
Chief Accountant and Member, Pension Committee

19 May 2005

ACTUARY'S OPINION

Mercer Human Resource Consulting Limited was retained by the Bank of Canada to perform an actuarial assessment of the going concern assets and accrued pension benefits of the Bank of Canada Registered Pension Plan as of 31 December 2004 for inclusion in the Plan's financial statements.

The objective of the financial statements is to fairly present the financial position of the Plan as of 31 December 2004 as a going concern. While the actuarial assumptions used to estimate accrued pension benefits for the Plan's financial statements represent management's best estimate of future events, and while in our opinion these assumptions are reasonable, the Plan's future experience will inevitably differ, perhaps significantly, from the actuarial assumptions. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations, and will affect the financial position of the Plan at that time, as well as the contributions required to fund it.

As part of our assessment, we examined the Plan's recent experience relative to the economic and non-economic assumptions and presented our findings to management. In addition, we provided management with statistical, survey and other information used to develop its long-term assumptions.

Our assessment of the Plan's going concern assets and accrued pension benefits was based on:

- the results of our 1 January 2005 actuarial valuation of the Plan's going concern liabilities,
- pension fund data provided by the Bank of Canada as of 31 December 2004,
- methods prescribed by the Canadian Institute of Chartered Accountants for pension plan financial statements, and
- assumptions about future events that have been developed by management and Mercer Human Resource Consulting Limited and are considered management's best estimate of these events.

We have tested the membership and pension fund data reasonableness and consistency, and we believe it to be sufficient and reliable for the purposes of the valuation. We also believe that the assumptions and methods employed in the valuation are, on the whole, appropriate. Our opinions have been given and our valuation performed in accordance with accepted actuarial practice.

François Lemire
Fellow of the Canadian Institute of Actuaries
Fellow of the Society of Actuaries

Sylvain Poirier
Fellow of the Canadian Institute of Actuaries
Fellow of the Society of Actuaries

Mercer Human Resource Consulting Limited

Ottawa, Canada
19 May 2005

AUDITORS' REPORT

To the Bank of Canada Pension Committee

We have audited the statement of net assets available for benefits, accrued pension benefits and funding excess of the Bank of Canada Registered Pension Plan as of 31 December 2004 and the statements of changes in net assets available for benefits and of changes in accrued pension benefits for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the net assets available for benefits, accrued pension benefits and funding excess of the Bank of Canada Registered Pension Plan as at 31 December 2004 and the changes in net assets available for benefits and accrued pension benefits for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

DELOITTE & TOUCHE LLP
Chartered Accountants

Ottawa, Canada
19 May 2005

STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS, ACCRUED PENSION BENEFITS AND FUNDING EXCESS

As at 31 December 2004

	2004	**2003**
Assets		
Investments (note 3)	**$ 773,657,411**	$ 711,569,534
Accrued investment income	**2,798,746**	2,860,266
Accounts receivable	**-**	2,832
Accrued employees' contributions	**89,000**	50,000
	776,545,157	714,482,632
Liabilities		
Accounts payable and accrued liabilities	**316,630**	596,035
Net assets available for benefits	**776,228,527**	713,886,597
Actuarial asset value adjustment	**(36,608,000)**	(544,000)
ACTUARIAL VALUE OF NET ASSETS AVAILABLE FOR BENEFITS	**739,620,527**	713,342,597
ACTUARIAL VALUE OF ACCRUED PENSION BENEFITS (note 4)	**652,636,051**	557,904,878
FUNDING EXCESS	**$ 86,984,476**	$ 155,437,719

On behalf of the Board of Directors of the Bank of Canada and the Pension Committee

W. P. Jenkins

Paul Jenkins
Senior Deputy Governor and Chair, Pension Committee

S Vokey

Sheila Vokey, CA
Chief Accountant and Member, Pension Committee

Jean-Guy Desjardins
Member, Board of Directors of the Bank of Canada and Pension Committee

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

Year ended 31 December 2004

	2004	2003
Increase in assets		
Investment income	$ 24,882,585	$ 24,430,661
Current-year change in fair value of investments (note 3)	61,494,835	88,686,751
	86,377,420	113,117,412
Employees' contributions—current services	4,681,003	4,312,306
Employees' contributions—past services	249,928	301,213
Transfers from other plans	2,612,544	171,363
	7,543,475	4,784,882
	93,920,895	117,902,294
Decrease in assets		
Benefits paid	24,475,055	23,280,059
Refunds and transfers	4,643,284	2,070,479
Administrative expenses (note 5)	2,460,626	3,198,333
	31,578,965	28,548,871
Net increase in net assets	62,341,930	89,353,423
NET ASSETS AVAILABLE FOR BENEFITS BEGINNING OF YEAR	713,886,597	624,533,174
NET ASSETS AVAILABLE FOR BENEFITS END OF YEAR	$ 776,228,527	$ 713,886,597

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STATEMENT OF CHANGES IN ACCRUED PENSION BENEFITS

Year ended 31 December 2004

	2004	2003
Increase in accrued pension benefits		
Benefits earned	**$ 17,807,101**	$ 14,245,111
Interest cost	**33,442,864**	32,353,772
Experience loss	**28,305,634**	-
Change of assumptions	**41,670,679**	-
Changes in income tax regulation	**2,623,234**	4,625,892
	123,849,512	51,224,775
Decrease in accrued pension benefits		
Benefits paid	**24,475,055**	23,280,059
Refunds and transfers	**4,643,284**	2,070,479
Amendment to Plan	**-**	3,124,492
Experience gain	**-**	3,370,596
	29,118,339	31,845,626
Net increase in actuarial value of accrued pension benefits	**94,731,173**	19,379,149
ACTUARIAL VALUE OF ACCRUED PENSION BENEFITS BEGINNING OF YEAR	**557,904,878**	538,525,729
ACTUARIAL VALUE OF ACCRUED PENSION BENEFITS END OF YEAR	**$ 652,636,051**	$ 557,904,878

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2004

1. DESCRIPTION OF THE REGISTERED PENSION PLAN

The following description of the Bank of Canada Registered Pension Plan (the Plan) is a summary only. For more complete information, reference should be made to the text of the Plan (Bank Bylaw 15) as amended.

a) General

The Plan was established under the provisions of the Bank of Canada Act, 1934, and has remained in accordance with the Act as subsequently amended. Responsibility for administration and investment of the Plan resides with the Pension Committee, including adherence to the guidelines established in the Statement of Investment Policy and Procedures that is approved annually by the Bank's Board of Directors.

The Plan is a contributory defined-benefit pension plan covering substantially all employees of the Bank of Canada. The Plan provides for service pensions, survivors' pensions, and refunds occasioned by termination of employment or death. The Plan's registration number with the Office of the Superintendent of Financial Institutions is 55116.

The Plan is a Registered Pension Trust as defined in the Income Tax Act and, consequently, is not subject to income taxes. The Plan's registration number for income tax purposes is 0349233.

In 1992, a Supplementary Pension Arrangement (SPA) was introduced to supplement the pensions of those employees who contribute above the maximum prescribed for registered pension plans by Canada Revenue Agency. A separate trust fund has been established to support the SPA and, therefore, the net assets available for benefits and the accrued pension benefits are not included in these financial statements.

b) Benefits

A lifetime service pension is available to Plan members based on the number of years of credited service, the average salary of the five highest-paid continuous years of service, and the member's age at retirement.

Death benefits are available on the death of an active member or of a retired member. The benefits may take the form of a refund of the contributions plus interest or a survivor pension.

Upon termination of employment, a Plan member has the option of taking a deferred pension for service rendered or of taking the commuted value of the pension benefit.

c) Funding policy

Contributions to the Plan are determined by actuarial valuations that are made every three years. The most recent actuarial valuation of the Plan for funding purposes was made on 1 January 2005. These valuations are made in accordance with legislative requirements and with the recommendations of the Canadian Institute of Actuaries for the valuation of pension plans. Employees are required to contribute to the Plan each year, to a maximum of 35 years of credited service, a percentage of their pensionable salary, which is 5.7 per cent up to the year's maximum pensionable earnings (YMPE) ($40,500 in 2004 and $39,900 in 2003) and 7.5 per cent of salary in excess of the YMPE.

d) Indexation

Pension benefits are indexed to reflect the changes in the consumer price index on the date that payment begins and each 1 January thereafter.

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

These financial statements are prepared in accordance with Canadian generally accepted accounting principles on the going-concern basis and present the financial position of the Plan as a separate financial reporting entity independent of the sponsor and Plan members. They are prepared to assist Plan members and others in reviewing the activities of the Plan for the fiscal period, but they do not portray the funding requirement of the Plan or the benefit security of individual Plan members.

b) Investments

Investments are recorded as of the trade date and are stated at fair value (see note 3). Fair value is the amount of the consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Cost represents the original cost less write-downs to reflect other than temporary declines in fair value.

c) Accrual of income

Interest income, dividends, and contributions are recognized on an accrual basis.

d) Current-year change in fair value of investments

The current-year change in fair value of investments is the difference between the fair value and the cost of investments at the beginning and end of each year, adjusted for realized gains and losses during the year.

e) Foreign currency translation and forward currency agreements

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rates prevailing at year-end. Income and expenses are translated at the rate of exchange prevailing at the time of the transactions. Forward currency agreements are measured at fair value as at the reporting date. Gains and losses from translation and forward currency agreements are included in the current-year change in the fair value of investments.

f) Measurement uncertainty

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimated.

g) Accrued pension benefits

Accrued pension benefits are based on an actuarial valuation prepared by a firm of independent actuaries. The accrued pension benefits in the inter-valuation periods are determined by extrapolating the results of the previous formal valuation that had been performed using the projected-benefit method prorated on service and management's estimate of future events affecting the Plan (note 4).

h) Actuarial value of net assets available for benefits

The actuarial value of assets available for benefits has been determined based on the market value of assets as at 31 December for each year adjusted to average out gains and losses resulting from the difference between the actual return on Plan assets and management's target rate of return. The annual excess (shortfall) of investment earnings, realized and unrealized capital gains over the target investment return is amortized over five years.

3. INVESTMENTS

a) General

The Plan invests in money market instruments, bonds, equities, price-index-linked assets, and real estate in accordance with its policy of asset diversification. The following table shows the fair value and the cost of the investments at year-end, as well as the current-year change in fair value of investments and related income. Foreign trust funds are recorded net of unrealized gains and losses on hedges. Investment income includes interest and dividends earned during the year, as well as income from real estate.

2004 INVESTMENTS

	Fair value	Cost	Current-year change in fair value of investments	Investment income	Total return
Money market instruments					
Cash and short-term investment	$ 8,664,478	$ 8,664,535	$ 87	$ 245,549	$ 245,636
Bonds					
Provincial	110,724,428	101,005,078	1,170,353	5,955,503	7,125,856
Municipal	25,326,387	22,698,635	123,483	1,528,444	1,651,927
Corporate	77,684,980	71,359,509	375,725	4,255,435	4,631,160
	213,735,795	195,063,222	1,669,561	11,739,382	13,408,943
Equities					
Canadian trust funds	229,510,995	209,358,992	26,045,808	2,846,239	28,892,047
Foreign trust funds	232,394,979	187,292,582	23,736,644	6,212,855	29,949,499
	461,905,974	396,651,574	49,782,452	9,059,094	58,841,546
Price-index-linked assets					
Canadian marketable bonds	59,964,814	49,710,692	9,349,572	2,081,608	11,431,180
Mortgages	14,706,060	14,706,060	-	1,082,133	1,082,133
	74,670,874	64,416,752	9,349,572	3,163,741	12,513,313
Real estate funds	14,680,290	11,017,553	693,163	674,819	1,367,982
TOTAL	$ 773,657,411	$ 675,813,636	$ 61,494,835	$ 24,882,585	$ 86,377,420

2003 INVESTMENTS

	Fair value	Cost	Current-year change in fair value of investments	Investment income	Total return
Money market instruments					
Cash and short-term investment	$ 9,638,836	$ 9,638,979	$ (141)	$ 353,689	$ 353,548
Bonds					
Provincial	109,171,500	100,573,023	1,245,729	6,292,193	7,537,922
Municipal	25,345,445	22,841,176	(14,497)	1,915,572	1,901,075
Corporate	60,975,195	54,620,955	1,514,687	4,110,023	5,624,710
	195,492,140	178,035,154	2,745,919	12,317,788	15,063,707
Equities					
Canadian trust funds	202,118,947	205,134,556	42,926,813	2,943,302	45,870,115
Foreign trust funds	221,949,426	180,954,044	38,569,238	4,621,980	43,191,218
	424,068,373	386,088,600	81,496,051	7,565,282	89,061,333
Price-index-linked assets					
Canadian marketable bonds	54,296,260	46,303,215	3,861,354	1,995,341	5,856,695
Mortgages	14,978,858	14,978,858	-	1,093,134	1,093,134
	69,275,118	61,282,073	3,861,354	3,088,475	6,949,829
Real estate funds	13,095,067	10,061,140	583,568	1,105,427	1,688,995
TOTAL	$ 711,569,534	$ 645,105,946	$ 88,686,751	$ 24,430,661	$ 113,117,412

b) Determination of fair values

i) Money market instruments

Cash and short-term investments, which consist mainly of treasury bills, are valued at cost, which approximates fair value.

ii) Bonds, equities, price-index-linked assets, and real estate

Bonds consist mainly of provincial, municipal, and corporate bonds and are valued using published market quotations.

Equity investments consist mainly of Canadian and foreign equity pooled funds managed by external managers. Investment valuations are received from the various external managers and are verified using published market quotes.

Price-index-linked assets consist mainly of Government of Canada Real Return Bonds and index-linked mortgages guaranteed by the Canada Mortgage and Housing Corporation. Investments are valued using published market quotes and values provided by the mortgage sponsors.

Real estate investments consist mainly of diversified pooled funds of commercial, industrial, and office real estate in several major centres across Canada. They are recorded at estimated fair value and are subject to independent appraisals on a regular basis.

c) Investment risk

The Plan's Statement of Investment Policies and Procedures provides for a diversified asset mix to achieve the long-term investment objective and to control the level of risk. The diversification of assets serves to lower the variations in the expected return performance of the portfolio.

The Plan's performance is subject to a number of risks, which are managed using various tools and techniques. Some of these risks are discussed below.

i) Interest rate risk

Interest rate risk refers to the adverse consequences of changes in interest rate on the Plan's cash flows, investment income, and financial position.

The value of the Plan's assets, particularly the fixed-income allocation, is affected by changes in the nominal interest rate. As at 31 December 2004, a 1 per cent increase in the nominal interest rate would result in a decline in the value of the Plan's fixed-income securities of about 5.0 per cent.

Accrued pension benefits are sensitive to changes in inflation and to salary escalation rates. Changes in these parameters, as well as in interest rates, will have a different effect on the values of the assets and pension benefits, leading to mismatch risk. Given the nature of pension benefits and the differences in the timing and amount of cash flows related to the Plan's assets and pension benefits, such risks cannot be eliminated, but they are managed through the funding and investment policy of the Plan.

ii) Credit risk

a) Credit risk is the risk that a borrower or counterparty will fail to meet its contractual obligations in accordance with agreed terms and cause the other party to incur a financial loss.

The Plan's credit risk is managed by setting maximum limits on exposure to various fixed-income issuers and securities held in the bond portfolio, as well as by setting minimum credit-rating requirements for holdings in the bond portfolio.

Credit risk in derivative contracts is limited by entering into contracts with creditworthy counterparties and by setting limits on the allowable amount of exposure to each of these counterparties.

In the equity portfolio, various concentration limits have been established to limit the concentration of equities in particular corporate sectors.

b) Concentration of credit risk exists when a significant proportion of the portfolio is invested in the securities of individual issuers, which tend to react similarly to economic, political, or other conditions. As at 31 December 2004, the Plan's most significant concentration of credit risk is with the Canadian and provincial governments.

iii) Foreign currency and exposure risk

Foreign currency exposure arises from the Plan's holdings of investments denominated in foreign currency. Such risk is managed by limiting these investments to, at most, a market value representing 35 per cent of the Plan's assets; moreover a narrower band with a midpoint of 29 per cent has been set to further limit the maximum amount of foreign currency risk. Note that the Income Tax Act limits foreign investments to a maximum of 30 per cent of the value of the Plan's total cost.

To further limit the foreign exchange risk arising from this exposure, the Plan has entered into off-statement commitments in the form of foreign exchange contracts for the sale of various currencies for the purpose of hedging assets denominated in a foreign currency. The Plan's net foreign currency exposure in Canadian dollars after giving effect to the hedged positions as at 31 December 2004 is presented below.

	2004			2003
	Foreign currency exposure	**Net foreign currency hedge**	**Net foreign currency exposure**	**Net foreign currency exposure**
Foreign trust funds				
U.S. dollars	$ 123,763,002	$ 119,592,575	$4,170,427	$ 6,849,361
Euros	36,268,227	32,870,250	3,397,977	1,430,762
Pound sterling	32,175,949	31,141,600	1,034,349	1,389,151
Japanese yen	15,239,884	12,687,428	2,552,456	446,405
Swiss francs	9,107,024	8,291,874	815,150	147,461
Australian dollars	3,206,741	3,704,000	(497,259)	(712,826)
Other currencies	17,324,918	-	17,324,918	17,340,066
Total	$ 237,085,745	$ 208,287,727	$ 28,798,018	$ 26,890,380

iv) Securities lending

The Plan lends securities as a means of generating incremental income or of supporting the normal practice with regard to investment strategies. Securities are loaned only against collateral representing at least 105 per cent of the value of the securities. As at 31 December 2004, the Plan's investments included loaned securities with a fair value of $19,897,997 ($23,734,756 in 2003). The fair value of collateral received in respect of these loans was $21,225,910 ($25,472,948 in 2003).

4. ACCRUED PENSION BENEFITS

Under the Pension Benefits Standards Act, actuarial valuations are required at least every three years. An actuarial valuation was made as of 1 January 2005 by Mercer Human Resource Consulting Limited, a firm of consulting actuaries. The assumptions used to determine the actuarial value of accrued pension benefits were developed by referencing to expected long term market conditions. Significant long-term actuarial assumptions used in the valuation are:

	2004	2003
Asset rate of return	5.50%	6.00%
Interest rate	5.50%	6.00%
Salary-escalation rate	3.50% + merit	4.00% + merit
Inflation rate	2.00%	2.00%

5. ADMINISTRATIVE EXPENSES

	2004	2003
Investment management fees	$ 1,274,606	$ 1,030,950
Audit and actuarial fees	9,024	42,453
Other administration fees	1,176,996	2,124,930
Total	$ 2,460,626	$ 3,198,333

GLOSSARY

Actuary

A business professional who applies mathematics, probability, statistics, and risk theory to evaluate how much money is required in a pension trust fund to pay the promised benefits. An actuary is a Fellow of the Canadian Institute of Actuaries.

Annual earnings rate

Your earnings from the Bank expressed as an annual rate, including market adjustment, temporary assignment, and performance pay, but excluding taxable benefits and all other allowances.

Average salary

Your average salary is one-fifth of the total annual earnings rate for your five highest-paid continuous years while you are a member of the Pension Plan. If you have been a member of the Plan for less than five years, the average of your actual annual earnings rate is used, instead of an average over five years.

Bank of Canada Pensioners' Association

Membership in the Association is voluntary. It is not a Bank-sponsored organization.

Beneficiary

Under the Bank's Plan, if you have an eligible spouse and children, they automatically receive Plan benefits in the event of your death. If you do not have an eligible spouse or children when you complete the enrolment form, you can designate any beneficiary: individuals or organizations. This designation will become ineffective if, when your pension payments begin or you die—whichever occurs first—you have a spouse or children that meet the Plan's definition. If you do not have an eligible spouse or children and do not designate a beneficiary, Plan benefits will be paid to your estate.

CPI (consumer price index)

A comparative measure of the price for a "basket" of goods, against a base year of 1992, when the basket cost $100. The CPI is computed by Statistics Canada on over 600 consumer items.

Deferred pension

If you leave the Bank before you are entitled to an immediate, unreduced pension, your pension can be deferred. A deferred pension is based on your years of service, how long you have been an active member of the Pension Plan, and your average salary on the date that you leave the Bank.

Lifetime pension

The pension that is paid to you from the day you retire until your death, or to your spouse until their death (excluding the temporary bridge pension). Your lifetime pension consists of 1.5 per cent of your average salary up to the average YMPE, plus 2 per cent of your average salary above the average YMPE, multiplied by your years of pensionable service. If you have service before 1966, your lifetime pension will equal 2 per cent of your average salary for each of those years of service.

Spouse

Your spouse is the person you are married to, or the person of the opposite or same sex who, as of the date your pension payments begin, or of your death, whichever occurs first, is cohabiting with you in a conjugal relationship and has done so for a period of at least one year. Your spouse can also be a person who is party to a void marriage with you. A void marriage refers to a situation in which at least one of the parties who enters into the marriage contract is legally prohibited from doing so.

Transfer value

The value of your future pension expressed as a lump sum in today's dollars.

YMPE (year's maximum pensionable earnings)

The earnings ceiling used by the government to determine contributions to and benefits from the Canada and Quebec Pension Plans. The government revises this amount every year, based on increases in average Canadian industrial wages.