



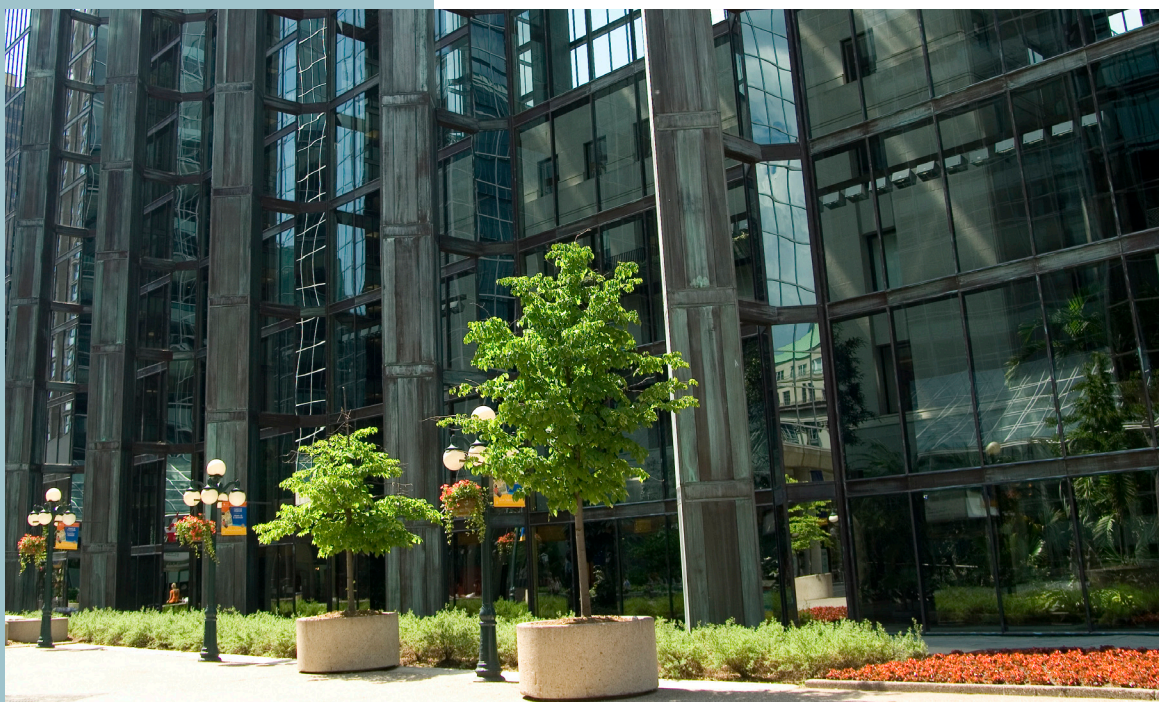
BANK OF CANADA  
BANQUE DU CANADA

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# Registered Pension Plan

## Annual Report 2007



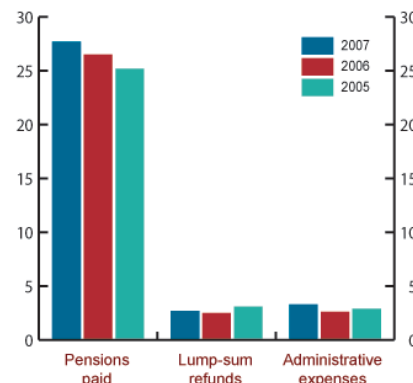
# PLAN HIGHLIGHTS

## Your Plan at a Glance

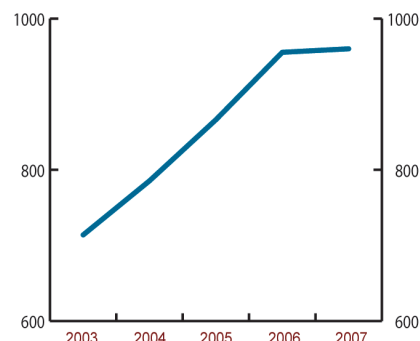
- The Pension Plan had 3,146 members at the end of 2007 (Figure 1).
- Payments from the Pension Trust Fund over the past three years have increased slightly (Figure 2).
- The Fund's net assets were \$960.1 million at the end of 2007 (Figure 3).
- On a going-concern basis, the funding status of the Plan was an actuarial surplus of \$116 million as at 31 December 2007 (Figure 4).
- On a solvency basis, the funding status of the Plan was an actuarial surplus of \$90 million as at 31 December 2007 (Figure 4).
- The Fund's rate of return was 3.6 per cent in 2007, 0.6 per cent below the policy benchmark, which returned 4.2 per cent<sup>1</sup> (Figure 6, page 7).

1. The Fund's benchmark is a combination of equity and fixed-income market indexes weighted in accordance with the Fund's Statement of Investment Policies and Procedures.

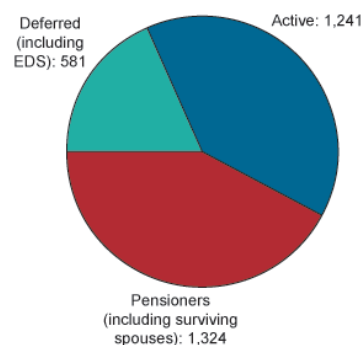
**Figure 2**  
Payments from the Fund in 2007  
(\$ millions)



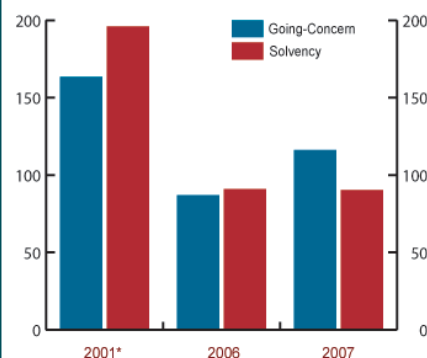
**Figure 3**  
Net Assets of the Fund 2003-2007  
(\$ millions)



**Figure 1**  
Membership  
(as at 31 December 2007)



**Figure 4**  
Actuarial Surplus Position  
(\$ millions)



\* 2001 results updated to reflect 2002 pension improvements

# 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 2007. As has been the case in the past, this year's report focuses on new or updated information. *Pension News*—our annual newsletter, which is distributed in the autumn—is another source of information about your pension.

## Our Commitment to Communication

Last November, we surveyed Plan members about the Bank's pension-related communications. Over 285 of you responded, with an equal representation of active employees and pensioners. Thank you to everyone who took the time to complete the survey, especially those who provided us with additional comments, questions, and suggestions. We have benefited from those comments during the production of this year's *Registered Pension Plan Annual Report*, as well as during the preliminary planning for the upcoming issue of *Pension News*.

## Litigation Update

A group of pensioners commenced a class action against the Bank in 2004 with respect to the payment of pension administration expenses out of the Bank's Pension Fund. Following a motion by the Bank, the Ontario Superior Court of Justice issued an order in February 2006 that disallowed the plaintiffs' claims for direct payment to them. The court also declared that the action should not proceed as a class action but rather as a representative action.

The plaintiffs subsequently appealed this decision, and the Ontario Court of Appeal confirmed in March 2007 the disallowance of plaintiffs' claim for the direct payment of damages. The Court of Appeal also ruled that the action could proceed to a determination by the Superior Court of Justice as to whether it should be certified as a class action.



In June 2007, the Court of Appeal further ruled that the plaintiffs and the Bank were each entitled to have \$60,000 of their costs in the motion and the appeal, to be paid out of the Pension Fund. Pursuant to this ruling, this amount was paid out of the Fund to the plaintiffs, but the Bank declined to pay its own costs out of the Fund. It is up to the plaintiffs to take the next step in the litigation, which is an application to the Court to have the action certified as a class action.

## The Plan's Position

The Bank has just completed its triennial actuarial valuation of the Registered Pension Plan. As at 31 December 2007, results indicate that the Plan remains in a surplus position on both valuation bases (i.e., going-concern and solvency). In accordance with the Income Tax Act, the Bank will continue to be prohibited from making contributions to the Fund.

I invite you to read more about contributions on page 8. As well, for more details on the actuarial valuation, please see pages 8-9.

## **Governance**

Of course, good governance remains a priority. To help ensure that we keep up to date with the issues facing pension administrators in Canada, we invite Pension Committee members to an annual training session. This year's session focused on alternative investments and changing rules for phased retirement.

## **What's New**

This spring we welcomed a number of new faces to the pension-related committees and we said goodbye to several key contributors.

Terri Cugno, our Pension Plan Director for the past four years, has left the Bank. I would like to thank her for her many contributions. We have refocused the Pension Plan Director's responsibilities—with more emphasis now being placed on administration and governance—and I am pleased to welcome Claude Gagné to the Bank as he takes on this role.

On the Pension Fund Investment Committee, Jake De León has moved on to an international assignment, and we welcome Meyer Aaron in his place. On the Pension Administration Committee, Thérèse Couture from our Financial Services Department has replaced Heather Woermke, who had temporarily replaced Doug Sinclair when he retired in 2007.

From our Board of Directors, Brian Henley, Richard McGaw, and Michael O'Brien have joined the Pension Committee. It should also be noted that the following Directors moved off the Pension Committee in the past year: David Barnard, Jean-Guy Desjardins, Paul Dicks, and Carol Hansell.

You can find a complete list of the members of the pension-related committees on page 3.

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

I invite you to read more in the pages that follow, and I hope you find the report informative.



Paul Jenkins  
Senior Deputy Governor and  
Chair, Pension Committee



# PENSION ADMINISTRATION

The Bank's Pension Plan is administered by the Pension Committee and the two committees that report to it—the Pension Administration Committee (PAC) and the Pension Fund Investment Committee (PFIC). Within their respective mandates, these committees make decisions on matters related to the Plan and, among other responsibilities, regularly monitor investments and the performance of service providers, including investment managers. The Pension Committee reports semi-annually to the Board of Directors of the Bank.

## Administrative Expenses

Administrative expenses (Table 1) are composed of administrative and consultant services provided by external suppliers; the salaries of four full-time internal staff; and fees paid to external managers and the Plan's custodian (CIBC Mellon) to direct the investment of the Fund and to hold Fund assets.

The three pension committees take considerable care to ensure that only reasonable costs directly attributable to services that benefit Plan members are charged to the Fund.

While annual administrative expenses are subject to varying activities in any given year, the pension committees always strive to ensure that the Fund gets the best possible value for the money spent. As

**Table 1**  
**Pension Fund Administration Expenses**  
(\$ thousands)

	2005	2006	2007
Investment-management and custodian fees	1,411	1,663	2,214
Pension administration fees	678	449	574
Other administration fees	788	520	518
<b>Total expenses</b>	<b>2,877</b>	<b>2,632</b>	<b>3,306</b>
Net assets	866,273	952,422	960,082
Expenses as a percentage of total fund assets	0.332%	0.276%	0.344%

## Who is a member of the Bank's pension-related committees?

### Pension Committee

- Paul Jenkins, Senior Deputy Governor (Chair)
- David Barnard (Director) until March 2008
- Jean-Guy Desjardins (Director) until March 2008
- Paul Dicks (Director) until March 2008
- Carol Hansell (Director) until March 2008
- Brian Henley (Director) from April 2008
- Richard McGaw (Director) from April 2008
- Mike O'Brien (Director)
- Sheryl Kennedy, Deputy Governor
- Mark Jewett, General Counsel and Corporate Secretary
- Sheila Vokey, Chief, Financial Services
- Rob Turnbull, Assistant General Counsel (Secretary)

### Pension Fund Investment Committee

- George Pickering, Adviser
- Miville Tremblay, Financial Markets
- Jacobo De León, Financial Markets reassigned March 2008
- Meyer Aaron, Financial Markets joined committee April 2008
- Grahame Johnson, Financial Markets
- Terri Cugno, Pension Plan Director, ex officio left the Bank March 2008
- Claude Gagné, Pension Plan Director, ex officio joined the Bank April 2008

### Pension Administration Committee

- Sheila Niven, Corporate Services
- Frances Boire-Carrière, Corporate Services
- Doug Sinclair, Financial Services retired from the Bank September 2007
- Heather Woermke, Financial Services from October 2007 to March 2008
- Thérèse Couture Financial Services from April 2008
- Jeanne Meredith-Pallascio, Corporate Services
- Ken Ross, Communications
- Terri Cugno, Pension Plan Director, ex officio left the Bank March 2008
- Claude Gagné, Pension Plan Director, ex officio joined the Bank April 2008

shown in Table 1, both investment-management and pension administration fees increased in 2007. Total expenses paid from the Fund in 2007 amounted to 0.344 per cent of total Fund assets, or the equivalent of 34.4 basis points.

Investment-management and custodian fees increased owing to the adoption of a more active management investment approach. Higher long-term returns associated with this approach are expected to more than offset the increased fees. Pension administration fees are higher because of member use of specific features, such as retirement calculations, pension portability, and reciprocal transfers, as well as additional outsourced services. Although other administration fees remained constant in 2007, they will increase next year owing to the work done in 2008 associated with the triennial actuarial valuation.

### **Pension Audit**

As noted in last year's annual report, in keeping with best practices and on the advice of the Plan's external auditors, Deloitte & Touche, an audit of pensions currently being paid out was started in 2007. A Declaration Form was sent out in June 2007 to all pensioners who were receiving a pension on 31 December 2006.

This initiative was undertaken by the Bank in the spirit of prudent management of the Pension Plan. Although this is the first time this kind of effort has been undertaken on behalf of the Bank's Pension Plan, such verification processes are not uncommon and are considered to be a sound management practice and, as such, an important component of good overall governance of the Plan.

A number of letters and telephone calls were received questioning the purpose of the audit or the limited categories of acceptable witnesses on the Declaration Form. In response to this feedback, the list of possible witnesses was expanded.

As of the publication date of this report, the response rate to the survey stands at over 90 per cent. The Bank will continue to follow up.

### **Communications**

Results from the 2007 pension communications questionnaire have been tabulated and questions and concerns noted. In general, respondents felt that communications related to the Plan were either excellent or good. Frequently asked questions—covering issues such as retirement planning, information about the firms hired to manage the Fund, and how the Fund is performing against the market—will be addressed in future issues of the member newsletter, *Pension News*.

# PENSION ASSETS AND INVESTMENTS

The Bank's Pension Fund is invested in a diversified portfolio of five main asset categories: equities, nominal fixed income, index-linked assets, real estate, and cash (Figure 5). Most of these assets are invested through external managers. The current asset allocation is expected to achieve the Fund's long-term investment objectives while managing the investment risks in a prudent manner. Risk is lowered through the diversification afforded by investing in a mix of assets, which enhances the performance of the portfolio because different asset classes perform differently from year to year.

The Fund's investment activities are evaluated within an asset/liability management framework. This involves assessing the Fund's potential future financial positions based on the projected values of its assets and liabilities. The projected value of the liabilities is based on regular updates provided by the Plan's actuary. A *proxy* of the Fund's liabilities is used to simulate the current market value of the liabilities.

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*A proxy is a portfolio of bonds that accurately models the duration characteristics of a plan's liabilities.*

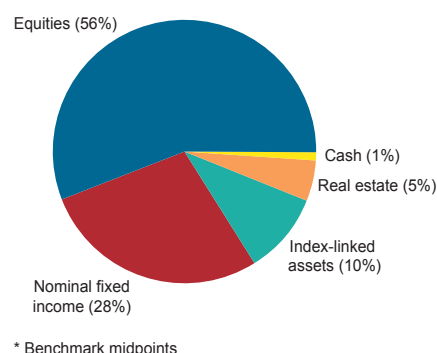
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## Investment Approach

The Fund's day-to-day investment activity is overseen by the PFIC, which in turn reports to the Pension Committee on a quarterly basis. To guide its actions, the PFIC adheres to the Plan's *Statement of Investment Policy and Procedures*. This document sets out broad ranges (bands) for the asset allocations that are permissible in each of the five asset categories. The Pension Committee establishes narrower bands.

Over long-term horizons, the Fund's investment performance is assessed on an asset/liability basis—that is, on the ability of the Plan to meet its obligations. Over short-term horizons, however,

**Figure 5**  
The Five Main Asset Categories  
in the Fund's Portfolio, 2007\*  
(as at 31 December 2007)



performance is measured as a comparison against the performance of a benchmark portfolio. This benchmark portfolio is based on the performance of the market index of each of the asset categories in the Fund, held at neutral weights (midpoint of the Fund's five bands).

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*The Pension Plan's Statement of Investment Policy and Procedures outlines the broad ranges of allowable Fund investments. This document is reviewed annually by the Pension Committee and the Board of Directors before being filed with the Office of the Superintendent of Financial Institutions (OSFI).*

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Because the value of individual assets varies over time, the actual percentage of the Fund's assets in each category may vary from the benchmark weighting. The PFIC meets each month to review these movements and to rebalance the portfolio, if necessary, to ensure that asset holdings remain within the permissible bands.

## **Equities**

All of the equity investments are managed externally by portfolio managers who are regularly monitored and who undergo a formal annual review by the PFIC.

Since 2006, the investment strategy for Canadian and U.S. equity investments has incorporated an approach that includes additional modest levels of risk in exchange for higher expected returns. This is usually referred to as a more *active* management approach to a portfolio. Prior to this, the Fund invested in an indexed manner.

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*Active management refers to investment strategies that seek to generate returns in excess of those provided by a specified benchmark index. This is in contrast to passive, or index, management, where the goal is to replicate the performance of the benchmark index as closely as possible. Active management strategies seek to outperform their benchmark indices through research, market forecasts, and judgment. Over time, the use of skilled active managers in certain asset classes is expected to provide the fund with additional incremental returns above those of the benchmark indexes.*

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In keeping with the view that managers in certain other sectors can add value against the index, the external managers of a portfolio of small-capitalization Canadian stocks and a large portion of foreign equities have been given greater investment discretion.

## **Nominal fixed income**

Most of the fixed-income investments are managed externally against an index mandate, benchmarked by the Scotia Capital long-bond index. A small portion of the bond portfolio is managed internally in case of an unexpected liquidity need and to implement risk-management strategies to mitigate duration risk in the portfolio. The duration of the bond portfolio was extended several years ago to provide a better match to the liability profile of the Fund.

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*Currency hedging is an investment strategy that negates the effect of currency fluctuations on the domestic value of international investments.\* The Pension Fund is partially hedged at 50 per cent. This position is considered the most neutral within the investment consultant community.*

*\* Source: Barclays Global Investors*

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## **Index-linked assets**

About 80 per cent of the holdings in this asset class are in the form of index-linked Government of Canada bonds (Real Return Bonds). Other holdings include inflation 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 this reason, these assets are not traded on a regular or frequent basis.

## **Real estate**

The Fund's real estate holdings consist of investments in closed-end pooled funds, whereby external managers have 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 minimize the administrative burden of participating in the real estate asset class.

During 2007, the Fund's real estate holdings continued to increase marginally from the level of previous years, as planned commitments were taken up by the real estate managers and the Fund's target level for this asset class was reached.

## **Cash**

The Fund also maintains a prudent level of liquidity in the form of cash deposits and Government of Canada treasury bills sufficient to meet anticipated payments and investment commitments.



## Supplementary Trust Fund

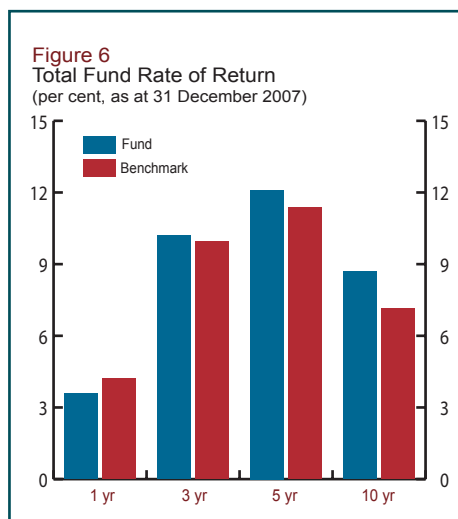
The Supplementary Pension Arrangement (SPA) was introduced in 1992 to supplement the pensions of those employees who contribute above the maximum prescribed for registered pension plans by the Income Tax Act. The SPA is fully indexed, and while it is not governed by the investment regulations of the Pension Benefits Standards Act, a separate trust fund has been established to support it: the Supplementary Trust Fund (STF). STF investments are directed by the Pension Committee and the PFIC.

## Performance of the Fund

The one-year return, ending on 31 December 2007, was 3.6 per cent, which is somewhat below the return on the policy benchmark of 4.2 per cent. The return was also below the long-term investment objective of achieving the actuarial target rate of return, which is currently set at 3.5 per cent plus the rate of inflation<sup>2</sup> net of expenses (approximately 30 basis points). The Fund outperformed the liability proxy, which returned 2.4 per cent.

Returns in 2007 were lower for most pension funds since the level of returns in the major asset classes was markedly lower. The Fund's return is regarded as relatively high when compared with that of other funds: the median return among comparable pension funds was below 2 per cent.

2. The target rate of return incorporates the effects of inflation, net of expenses, since benefits paid out under the Plan are increased to keep pace with inflation each year.



# ACTUARIAL VALUATION

An actuarial valuation estimates at a point in time the total value of the benefits expected to be paid to members, and it is meant to measure the funding position of the Plan.

The valuation monitors contributions and the actual experience of the Plan (e.g., asset returns, terminations, and retirements) against economic and demographic assumptions. If the Plan's cumulative experience is more favourable than the assumptions allowed for, the Plan will be in an actuarial surplus. If the cumulative experience is less favourable, the Plan 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 contributions to the Plan. When this happens, it is called a contribution holiday. The Bank has been prohibited from making contributions to the Fund since 1999.

## How an Actuarial Valuation Is Performed

Actuarial valuations measure assets and liabilities, which 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 previous experience at the Bank. For other assumptions, such as mortality rates, the Bank's

experience cannot be used to derive credible assumptions. 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 insurance companies. The mortality rates are also projected into the future to take into account future improvements in mortality rates.

### Economic Assumptions

Economic assumptions reflect long-term expectations of economic and financial conditions. The actuary takes into account various economic factors, such as interest rates and increases in yearly maximum pensionable earnings (YMPE), as well as changes in the consumer price index and Income Tax Act maximums.

### *Plan actuarial liability*

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

## Common Bases for Performing an Actuarial Valuation

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

### *Funding or going-concern basis*

The funding or going-concern basis (Table 2) assumes that the Plan will continue to operate indefinitely. Therefore, the actuary must estimate the actuarial liabilities and determine whether there are sufficient assets to meet those liabilities. The Bank's actuary uses the five-year actuarially smoothed value of the assets.

**Table 2**  
**Funding Basis**  
(\$ millions as at 31 December)

	1992	1995	1998	2001*	2004	2007
Actuarially smoothed value of assets	290.7	397.5	539.4	676.6	739.6	907.2
Liabilities	289.1	389.8	437.9	513.1	652.6	791.1
Surplus	1.6	7.7	101.5	163.5	87.0	116.1
Surplus as a percentage of liabilities	0.6	2.0	23.2	31.9	13.3	14.7

\* 2001 results updated to reflect 2002 pension improvement

One key assumption is the interest rate that is used to discount the expected cash flows in order to determine the present value of future benefits. The rate is based on the expected long-term return of the Fund less an allowance for investment and administrative expenses and a margin for adverse deviations. If, on a going-concern basis, the Fund is in a deficit position—which means that the actuarial 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 set in Bylaw 15. The Bank is responsible for any deficiencies in the Fund.

### ***Solvency basis***

The solvency basis (Table 3) assumes that the Plan will be wound up on the valuation date. Since this approach assumes that the Plan is winding up immediately, there is no need to assume future salary increases nor when employees will terminate their membership in the Plan. Also, a pure 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.

## **The Funding Status of the Plan**

Results of the triennial valuation (as at 31 December 2007) indicate that the Plan remains in an actuarial surplus position on the two bases prescribed by the federal Pension Benefits Standards Act. The funding excess has grown from \$87 million to \$116 million, resulting in a funding ratio of 115 per cent versus 113 per cent at the end of 2004. The solvency excess remained about the same, at \$90 million, whereas the solvency ratio decreased from 113 per cent to 110 per cent, mostly because of a change in the prescribed solvency basis and lower market interest rates, both of which increased the solvency liability.

Actual economic and demographic outcomes (relative to what had been assumed at the time of the last valuation at 31 December 2004), together with changes in assumptions for the current valuation, account for the change in funding status as at 31 December 2007.

An actuarial surplus occurs when the assets in the Fund are greater than the actuarial liabilities. Because a number of assumptions are used to determine the actuarial liability, a funding excess is more of a gauge of the Plan's health than an exact amount.

**Table 3**  
**Solvency Basis**  
(\$ millions as at 31 December)

	1992	1995	1998	2001*	2004	2007
Assets*	291.2	422.3	582.0	679.0	776.2	959.3
Liabilities	280.5	357.2	415.5	482.4	685.2	869.0
Surplus	10.7	65.1	166.5	196.6	91.0	90.3
Surplus as a percentage of liabilities	3.8	18.2	40.1	40.8	13.3	10.4

\* 2001 results updated to reflect 2002 pension improvement

### ***Source of changes in the funding surplus***

There were three main contributors to the changes in the Plan's surplus on a going-concern basis.

- Investment returns in excess of the long-term assumptions over the past three years, which were more than double the Bank's mandatory contribution holiday (\$102 million versus \$49 million).
- Members have been retiring earlier and living longer than anticipated in the previous actuarial valuation, thereby decreasing the surplus by \$16 million.
- Based on advice from our actuaries, the termination and retirement rates, as well as the assumptions for merit and promotion salary increases, for the current valuation have been revised as compared with the previous valuation to reflect recent experience. Together, adjustments to these last two assumptions reduced the actuarial surplus by nearly \$38 million.



# FINANCIAL STATEMENTS

As at 31 December 2007



## 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 (Canada) 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**  
Senior Deputy Governor and Chair,  
Pension Committee



**S. Vokey, CA**  
Chief Accountant and Member,  
Pension Committee

15 May 2008

## ACTUARY'S OPINION

Mercer (Canada) 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 2007 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 2007 on a going-concern basis. 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 their long-term assumptions.

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

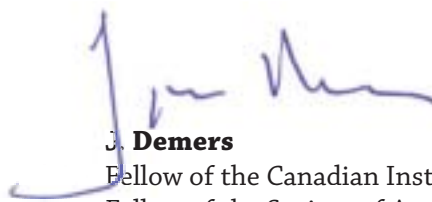
- the results of our 1 January 2008 actuarial valuation of the Plan's going-concern liabilities,
- pension fund data provided by the Bank of Canada as of 31 December 2007,
- methods prescribed by the Canadian Institute of Chartered Accountants for pension plan financial statements, and
- assumptions about future events that have been developed by management and Mercer (Canada) Limited.

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



**F. Lemire**

Fellow of the Canadian Institute of Actuaries  
Fellow of the Society of Actuaries



**J. Demers**

Fellow of the Canadian Institute of Actuaries  
Fellow of the Society of Actuaries

**Mercer (Canada) Limited**

Ottawa, Canada  
15 May 2008

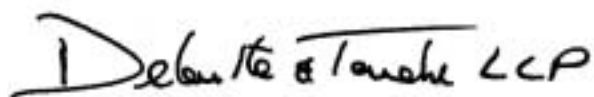
## AUDITORS' REPORT

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 2007 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 as to 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 2007 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.



Chartered Accountants  
Licensed Public Accountants

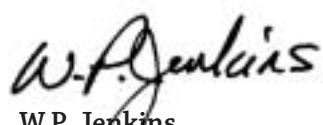
Ottawa, Canada  
15 May 2008

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

As at 31 December

	2007	2006
<b>ASSETS</b>		
Investments (note 3)	\$ 960,118,556	\$ 952,195,871
Accrued investment income	599,640	547,611
Accrued employees' contributions	138,800	97,000
	960,856,996	952,840,482
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities	775,000	418,400
<b>Net assets available for benefits</b>	960,081,996	952,422,082
Actuarial Asset Value Adjustment (note 4)	(52,852,104)	(117,339,468)
<b>ACTUARIAL VALUE OF NET ASSETS AVAILABLE FOR BENEFITS</b>	907,229,892	835,082,614
<b>ACTUARIAL VALUE OF ACCRUED PENSION BENEFITS</b> (note 5)	791,084,308	706,682,148
<b>FUNDING EXCESS</b>	\$ 116,145,584	\$ 128,400,466

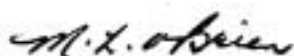
On behalf of the Board of Directors of the Bank of Canada and the Pension Committee



**W.P. Jenkins**  
Senior Deputy Governor and Chair,  
Pension Committee



**S. Vokey, CA**  
Chief Accountant and Member,  
Pension Committee



**M.L. O'Brien, FCA**  
Member, Board of Directors of the Bank of Canada and Pension Committee

See accompanying notes to the financial statements.

## STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

Year ended 31 December

	2007	2006
<b>INCREASE IN ASSETS</b>		
Investment income	\$ 32,637,976	\$ 27,952,117
Current-year change in fair value of investments (note 3)	1,261,067	83,873,266
	33,899,043	111,825,383
Employees' contributions—current services	5,233,234	5,059,408
Employees' contributions—past services	550,362	278,469
Transfers from other plans	1,698,045	637,637
	7,481,641	5,975,514
	41,380,684	117,800,897
<b>DECREASE IN ASSETS</b>		
Benefits paid	27,730,381	26,496,641
Refunds and transfers	2,684,193	2,523,653
Administrative expenses (note 6)	3,306,196	2,631,460
	33,720,770	31,651,754
Net increase in net assets	7,659,914	86,149,143
<b>NET ASSETS AVAILABLE FOR BENEFITS BEGINNING OF YEAR</b>	952,422,082	866,272,939
<b>NET ASSETS AVAILABLE FOR BENEFITS END OF YEAR</b>	<u>\$ 960,081,996</u>	<u>\$ 952,422,082</u>

See accompanying notes to the financial statements.



## STATEMENT OF CHANGES IN ACCRUED PENSION BENEFITS

Year ended 31 December

	2007	2006
<b>INCREASE IN ACCRUED PENSION BENEFITS</b>		
Benefits earned	\$ 21,695,701	\$ 19,567,920
Interest cost	39,018,636	37,441,943
Experience loss	15,631,824	-
Change in assumptions	38,470,573	-
	114,816,734	57,009,863
<b>DECREASE IN ACCRUED PENSION BENEFITS</b>		
Benefits paid	27,730,381	26,496,641
Refunds and transfers	2,684,193	2,523,653
	30,414,574	29,020,294
Net increase in actuarial value of accrued pension benefits	84,402,160	27,989,569
<b>ACTUARIAL VALUE OF ACCRUED PENSION BENEFITS BEGINNING OF YEAR</b>	706,682,148	678,692,579
<b>ACTUARIAL VALUE OF ACCRUED PENSION BENEFITS END OF YEAR</b>	<b>\$ 791,084,308</b>	<b>\$ 706,682,148</b>

See accompanying notes to the financial statements.

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2007

### 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, refer 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

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 performed on 1 January 2008. These valuations are performed 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) (\$43,700 in 2007 and \$42,100 in 2006) 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 requirements of the Plan or the benefit security of individual Plan members.

### **b) Investments**

Investments are recorded as of the trade date net of transaction costs, 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 writedowns 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 the reporting date. 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. Income and expenses are translated at the rate of exchange prevailing at the time of the transactions.

### **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 5).

### **h) Contributions**

Employees' contributions for current service are recorded in the year in which the related payroll costs are incurred. Contributions for past service are recorded in the year received.

The Bank is responsible for contributing whatever amount is needed above the employees' contributions and the investment income earned by the Fund in order to meet its pension payment obligations to members and their beneficiaries. The Income Tax Act requires that the Bank temporarily stop making regular contributions to the Plan when it is in a surplus that exceeds 110 per cent of the current value of the Plan's liabilities on a going-concern basis. The Bank has been prohibited from making contributions since 1999.

### **i) Future accounting changes**

On 1 December 2006, the CICA issued new accounting standards that will be effective for the Bank of Canada Registered Pension Plan on 1 January 2008: Handbook Section 1535, Capital Disclosures, Handbook Section 3862, Financial Instruments – Disclosures and Handbook Section 3863, Financial Instruments – Presentation.

Section 1535 specifies the disclosures of (i) an entity's objectives, policies, and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

### 3. INVESTMENTS

#### a) General

The Plan invests in money market instruments, bonds, equities, 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 the reporting date, as well as the current-year change in the fair value of investments and related income. Foreign equity funds are recorded net of unrealized gains on hedges of \$2,707,855 (losses of \$1,963,685 in 2006). Investment income includes interest and dividends earned during the year, as well as income from real estate.

#### 2007 INVESTMENTS

	Fair value	Cost	Current-year change in fair value of investments <sup>1</sup>	Investment income	Total return
<b>Money market instruments</b>					
Cash and short-term investment	\$ 4,108,914	\$ 4,104,671	\$ 4,655	\$ 359,756	\$ 364,411
<b>Bonds</b>					
Provincial	50,446,960	53,637,624	(2,761,347)	4,797,348	2,036,001
Fixed income fund	224,514,459	219,703,422	(3,486,523)	10,838,675	7,352,152
	274,961,419	273,341,046	(6,247,870)	15,636,023	9,388,153
<b>Equities</b>					
Canadian equity funds	260,235,590	267,347,482	19,207,260	6,048,911	25,256,171
Foreign equity funds	280,317,708	255,767,741	(15,094,765)	6,039,285	(9,055,480)
	540,553,298	523,115,223	4,112,495	12,088,196	16,200,691
<b>Index-linked assets</b>					
Government of Canada	75,412,300	58,119,912	(455,752)	1,426,698	970,946
Corporate	3,049,178	1,935,003	(145,284)	127,406	(17,878)
Mortgages	14,259,888	13,135,761	(799,189)	937,548	138,359
	92,721,366	73,190,676	(1,400,225)	2,491,652	1,091,427
<b>Real estate funds</b>	47,773,559	35,783,084	4,792,012	2,062,349	6,854,361
<b>Total</b>	<b>\$ 960,118,556</b>	<b>\$ 909,534,700</b>	<b>\$ 1,261,067</b>	<b>\$ 32,637,976</b>	<b>\$ 33,899,043</b>

1. The 2007 change in the fair value of investments includes \$961,206 of unrealized losses on foreign exchange.



## 2006 INVESTMENTS

	Fair value	Cost	Current-year change in fair value of investments <sup>1</sup>	Investment income	Total return
<b>Money market instruments</b>					
Cash and short-term investment	\$ 2,718,115	\$ 2,718,527	\$ 328	\$ 255,437	\$ 255,765
<b>Bonds</b>					
Provincial	49,057,820	49,487,137	(2,143,887)	4,182,821	2,038,934
Fixed income fund	212,162,307	202,273,887	2,340,402	7,120,077	9,460,479
	261,220,127	251,761,024	196,515	11,302,898	11,499,413
<b>Equities</b>					
Canadian equity funds	267,163,045	272,271,630	40,903,102	4,178,851	45,081,953
Foreign equity funds	300,605,475	212,549,242	42,533,392	7,940,481	50,473,873
	567,768,520	484,820,872	83,436,494	12,119,332	95,555,826
<b>Index-linked assets</b>					
Government of Canada	65,797,560	48,049,420	(3,526,083)	1,575,424	(1,950,659)
Corporate	3,217,268	1,957,809	(119,428)	124,989	5,561
Mortgages	15,633,302	13,709,985	(185,814)	1,019,538	833,724
	84,648,130	63,717,214	(3,831,325)	2,719,951	(1,111,374)
<b>Real estate funds</b>	35,840,979	28,642,516	4,071,254	1,554,499	5,625,753
<b>Total</b>	<b>\$ 952,195,871</b>	<b>\$ 831,660,153</b>	<b>\$ 83,873,266</b>	<b>\$ 27,952,117</b>	<b>\$111,825,383</b>

1. There were no unrealized gains or losses on foreign exchange in the 2006 change in the fair value of investments.

### b) Determination of fair values

#### i) Money market instruments

Money market instruments consist of cash and treasury bills, which are valued using published market quotations.

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

Bonds consist mainly of an investment in a pooled fund, made up of Government of Canada, provincial, municipal, and corporate bonds, managed by an external manager. Investment valuations are received from the manager and are verified 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 quotations.

Index-linked assets consist mainly of Government of Canada bonds, corporate bonds, and mortgages guaranteed by the Canada Mortgage and Housing Corporation. Investments are valued using published market quotations and values provided by a mortgage valuator.

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 is the risk that the value or future cash flows of a financial instrument will fluctuate due to changes in the market interest rates.

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 2007, a 1 percentage point increase in the nominal interest rate would result in a decline in the value of the Plan's fixed-income securities of about 15 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 counterparty to a financial contract will fail to discharge its obligations in accordance with agreed-upon terms.

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 2007, the Plan's most significant concentration of credit risk is with the provincial governments.

### iii) Foreign currency and exposure risk

Foreign currency exposure arises from the Plan's holdings of investments denominated in foreign currency. At present, the market value of these investments can represent up to 33 per cent of the Plan's assets, with a midpoint target of 30 per cent. To further limit the foreign exchange risk arising from this exposure, the Plan has entered into off-balance-sheet commitments in the form of foreign exchange forward 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 2007, is presented in the following table.

	2007			2006
	Foreign currency exposure	Net foreign currency hedge	Net foreign currency exposure	Net foreign currency exposure
<b>Foreign equity funds</b>				
U.S. dollars	\$ 146,547,734	\$ 72,913,400	\$ 73,634,334	\$ 74,695,179
Euros	36,499,588	20,158,200	16,341,388	23,395,566
Pound sterling	30,366,719	15,601,500	14,765,219	20,526,915
Japanese yen	12,352,282	6,498,932	5,853,350	8,030,913
Swiss francs	11,674,003	6,352,664	5,321,339	6,202,168
Australian dollars	2,089,224	1,056,240	1,032,984	1,527,142
Other currencies	38,080,302	-	38,080,302	35,281,679
<b>Total</b>	<b>\$ 277,609,852</b>	<b>\$ 122,580,936</b>	<b>\$ 155,028,916</b>	<b>\$ 169,659,562</b>

### 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 2007, the Plan's investments included loaned securities with a fair value of \$26,187,826 (\$11,422,087 in 2006). The fair value of collateral received in respect of these loans was \$27,512,995 (\$12,307,385 in 2006).

## 4. ACTUARIAL ASSET VALUE ADJUSTMENT

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, and realized and unrealized capital gains over the target investment return, is amortized over five years.

The following table summarizes the composition of the actuarial asset value adjustment.

	Unamortized (gains)/ losses	Actuarial asset value adjustment Unamortized (gains)/losses to be recognized in				Unamortized (gains)/ losses
	2007	2008	2009	2010	2011	2006
2003	\$ –	\$ –	\$ –	\$ –	\$ –	\$ (14,829,196)
2004	(8,117,457)	(8,117,457)	–	–	–	(16,234,913)
2005	(24,352,830)	(12,176,415)	(12,176,415)	–	–	(36,529,245)
2006	(37,309,586)	(12,436,529)	(12,436,529)	(12,436,528)	–	(49,746,114)
2007	16,927,769	4,231,942	4,231,942	4,231,942	4,231,943	–
	<u>\$ (52,852,104)</u>	<u>\$ (28,498,459)</u>	<u>\$ (20,381,002)</u>	<u>\$ (8,204,586)</u>	<u>\$ 4,231,943</u>	<u>\$ (117,339,468)</u>

## 5. ACCRUED PENSION BENEFITS

Under the Pension Benefits Standards Act, actuarial valuations are required at least every three years. An actuarial valuation was performed as of 1 January 2008 by Mercer (Canada) Limited, a firm of consulting actuaries. The economic assumptions used to determine the actuarial value of accrued pension benefits were developed by referencing to expected long-term market conditions. Significant long-term economic actuarial assumptions used in the valuation are:

	2007	2006
Asset rate of return	5.50%	5.50%
Interest rate	5.50%	5.50%
Salary-escalation rate	3.50% + merit	3.50% + merit
Inflation rate	2.00%	2.00%

In 2007, there were net experience losses of \$15,631,824 as revealed by the actuarial valuation conducted as at 1 January 2008. Changes in the actuarial assumptions pertaining to merit and promotion, and termination and retirement resulted in an increase in the Accrued Pension Benefits of \$38,470,573.

## 6. ADMINISTRATIVE EXPENSES

	2007	2006
Investment management fees	\$ 2,214,354	\$ 1,662,528
Pension administration fees	574,082	448,674
Audit and actuarial fees	33,957	22,688
Other administration fees	483,803	497,570
	<u>\$ 3,306,196</u>	<u>\$ 2,631,460</u>

See accompanying notes to the financial statements.

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*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.*

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For pension or post-retirement questions and requests, contact the Bank of Canada Benefits and Pension Administration Centre:



08:00 to 18:00 (Eastern Time)  
Monday to Friday



active employees: 1 888 903-3308  
retirees: 1 888 588-6111



[bank-banque-canada@mercerc.com](mailto:bank-banque-canada@mercerc.com)



The Bank of Canada Benefits and  
Pension Administration Centre  
Mercer (Canada) Limited  
1981 McGill College Avenue  
Suite 800  
Montréal, Quebec  
H3A 3T5

For payroll questions, customer service complaints, or to request pension-related information, contact HR Centre:



10:00 to 16:00 (Eastern Time)  
Monday to Friday



7766 (internal), 1 613 782-7766 (Ottawa),  
or  
1 866 404-7766



[hrcentre@bankofcanada.ca](mailto:hrcentre@bankofcanada.ca)



HR Centre  
Bank of Canada  
12th Floor, West Tower  
234 Wellington Street  
Ottawa, Ontario  
K1A 0G9