✚ ANNEX 3

Strengthening and Modernizing Canada's Financial Sector

Canadians expect and deserve a stable financial system that safeguards their savings and investments. They want technology to make everyday banking easier, to provide them with up to date and accurate information. At the same time, they want to know information is secure, products and services offered meet the highest standard of quality and safety, and that the fees they are paying for products and services are fair.

In this spirit, the Government proposes to advance measures that will strengthen financial sector stability, support innovation and competition in the financial sector; and bolster consumer protection.

Ensuring a Safe and Sound Financial System

Modernizing the Deposit Insurance Framework

Deposit insurance contributes to maintaining public confidence in the financial system by protecting depositors' savings in the unlikely event that a deposit taking institution fails. The Department of Finance Canada held public consultations on changes considered to the deposit insurance framework in the fall of 2016.

Budget 2018 proposes to introduce legislative amendments to the *Canada Deposit Insurance Corporation Act* to modernize and enhance the Canadian deposit insurance framework to ensure it continues to meet its objectives. These changes would modernize the scope of deposit insurance coverage to better reflect products currently offered in the market, address the complexity of trust deposits, help protect depositors and improve understanding of insurance coverage, and ultimately better support financial stability.

Financial Market Infrastructure Resolution

Financial Market Infrastructures (FMIs) facilitate the clearing, settling, or recording of payments, securities, derivatives, and other financial transactions among participating institutions and financial brokers. They act as a hub for financial transactions. FMIs allow consumers and firms to safely and efficiently purchase goods and services, make financial investments, and transfer funds, playing a vital role in the financial sector and the economy as a whole.

Under the *Payment Clearing and Settlement Act*, FMIs that are considered to have the potential to pose systemic or payments system risk can be designated, and are subject to the Bank of Canada's oversight for risk management. In a worse case scenario, the disorderly failure of a systemically important FMI could result in severe market disruption, contagion to other FMIs (and the financial system more broadly) with the potential to negatively impact the Canadian economy.

Based on collaborative work with FMIs and provincial regulators, Budget 2018 proposes to introduce legislative amendments that would implement a resolution framework for Canada's systemically important FMIs. The objectives of the FMI resolution regime are to maintain the critical services of the FMI, promote financial stability, and reduce potential public exposure to loss.

Maintaining a Robust Currency Regime

Canadians need secure bank notes that they can use with confidence and pride.

Payment technologies continue to evolve, but cash remains a resilient payment instrument. However, large denominations facilitate illicit activities such as counterfeiting, money laundering and tax evasion.

The Government proposes to introduce legislative amendments to facilitate the maintenance of high-quality bank notes in the money supply and to provide greater clarity on the bank notes that can be used as legal tender. These changes would allow the Government to better manage the money supply so that it is safe and secure for Canadians.

Following these legislative amendments, the Government intends to initiate the process to remove the legal tender status of bank note denominations no longer issued by the Bank of Canada (i.e., $1000, $500, $25, $2 and $1). The Bank of Canada would continue to honour these bank notes and exchange them at their face value.

In addition, legislation governing the declaration of currency and monetary instruments is in place to protect Canadians and the integrity of the Canadian financial system, while supporting the efficient flow of travellers at the border. The Government will propose targeted amendments to ensure that this legislation remains up to date.

Fostering Innovation and Competition

Review of Open Banking

Financial technology (fintech) is driving change in the financial sector, and has the potential to increase innovation and competition, providing Canadians with more affordable and useful services, and increasing financial inclusion as specific customers or markets (e.g. small and medium sized businesses) are better served.

Within this overall context, a number of international jurisdictions are implementing open banking platforms. At its core, open banking is about empowering consumers to share their financial data between their financial institution and other third party providers through secure data sharing platforms. This in turn enables financial service providers to offer more tailored products and services, on a more competitive and innovative basis. Open banking also has the potential to provide consumers with greater transparency on the products and services offered by financial institutions, thus allowing them to make more informed decisions, and makes it easier for consumers to move and manage their money.

Recognizing these potential benefits, the Government proposes to undertake a review of the merits of open banking in order to assess whether open banking would deliver positive results for Canadians with the highest regard for consumer privacy, data security and financial stability.

Supporting an Innovative Retail Payments System

Innovative, well-functioning retail payments systems allow consumers and businesses to transfer payments smoothly and efficiently. The Government is undertaking consultations with stakeholders, including provinces and territories, on a proposed oversight framework that aims to ensure that retail payment services continue to be reliable and safe for Canadians and the providers of such services can continue to develop faster, cheaper and more convenient methods of payments.

The framework would strengthen the reliability of the payment system for consumers when they purchase goods and services or transfer money, and foster innovation in the payments sector.

Budget 2018 announces the Government's intention to introduce legislative amendments to implement a new framework for the oversight of retail payments following the conclusion of consultations. In the coming months, the Government also proposes to launch a review of the *Canadian Payments Act* to ensure that Payments Canada is well positioned to continue to fulfill its public policy objectives of ensuring the efficiency, safety and soundness of its systems. The review will include consultations with stakeholders, including provinces and territories.

Modernizing the Financial Sector Framework

To ensure the financial sector keeps pace with global developments and the changing needs of businesses and consumers, Budget 2016 announced consultations with stakeholders as part of a financial sector legislative review. Stakeholders indicated that the financial sector legislative framework is functioning well, but called for targeted updates to adapt to innovations and sectoral developments.

Budget 2018 proposes to introduce legislative amendments to implement targeted proposals from the review. Priority amendments would adapt the legislative framework and facilitate greater partnering in response to the emergence of financial technology (fintech). Proposed changes would include:

- greater flexibility for financial institutions to undertake and leverage broader fintech activities that enable the delivery of financial services in new and innovative ways;
- permitting life and health insurance companies to make long-term and predictable investments in infrastructure;
- providing prudentially regulated deposit-taking institutions, such as credit unions, flexibility to use generic bank terms, subject to disclosure; and,
- renewing the sunset date in the federal financial institutions statutes.

Additional legislative amendments will be proposed to position the federal framework for the future. These include modernizing financial institutions' corporate governance, providing for the continued clarity and prudential integrity of federal financial sector legislation, as well as targeted updates to streamline the federal framework and to ensure that it continues to support a stable, competitive and resilient financial sector.

To further enhance Canada's private pension policy framework, the Government will shortly launch public consultations on a regime to address unclaimed pension balances. Following the consultations, the Government may introduce legislative and regulatory amendments.

Enhancing Consumer Protection in Banking

Canadians expect strong consumer protection standards in their dealings with banks. The Government takes the protection of financial consumers very seriously and intends to ensure that all Canadians benefit from strong consumer protection standards.

Over the last year the Government has undertaken a comprehensive review of the consumer protection framework. Budget 2018 proposes to introduce legislation that would strengthen the Financial Consumer Agency of Canada's tools and mandate and continue to advance consumers' rights and interests when dealing with their banks. New legislation will be developed through targeted consultations with stakeholders, including provinces and territories.

Treasury Management

The Exchange Fund Account is mainly composed of liquid foreign currency assets, and represents the largest component of Canada's official international reserves. The Government proposes to introduce legislative amendments to support the administration of the exchange fund account and ensure continuity of related Bank of Canada authorities. Additionally, in January 2019, new International Financial Reporting Standards will come into effect that impact how variety of leases are reported, measured, presented and disclosed. Accordingly, the Government intends to introduce legislative amendments to ensure that Crown corporations are able to implement these new standards without exceeding their statutory authorities or borrowing limits.

Debt Management Strategy for 2018–19

Introduction

The *Debt Management Strategy* sets out the Government of Canada's objectives, strategy and borrowing plans for its domestic debt program and the management of its official international reserves. Borrowing activities support the ongoing refinancing of government debt coming to maturity, the execution of the budget plan and the financial operations of the Government. The *Debt Management Strategy for 2018–19* reflects Budget 2018 fiscal projections.

The *Financial Administration Act* requires that the Government table in Parliament, prior to the start of the fiscal year, a report on the anticipated borrowing to be undertaken in the year ahead, including the purposes for which the money will be borrowed. The *Debt Management Strategy* fulfills this requirement.

Outlook for Government of Canada Debt

The Government of Canada continues to receive triple-A credit ratings, with a stable outlook, from major rating agencies that evaluate its financial position.

Those rating agencies indicate that Canada's triple-A credit ratings are supported by strong political institutions, economic resilience and economic diversity, well-regulated financial markets, monetary and fiscal flexibility, as well as the country's effective, stable and predictable policy-making.

Canada's general government gross debt and net debt positions also remain favourable. According to the International Monetary Fund (IMF), Canada's net debt-to-GDP (gross domestic product) ratio is the lowest in the Group of Seven (G7), reflecting significant holdings of financial assets.

Planned Borrowing Activities for 2018–19

Borrowing Authority

The Minister of Finance is required to seek Parliamentary approval to borrow on behalf of Her Majesty in Right of Canada (i.e., the Government). The authority to manage public debt flows from the *Borrowing Authority Act* and Part IV of the *Financial Administration Act*, which together allow the Minister of Finance to borrow money up to a maximum amount as approved by Parliament.

Parliament granted its approval via the *Borrowing Authority Act*, which came into force on November 23, 2017. With that Act, Parliament authorized a maximum stock of outstanding government and Crown corporation market debt of $1,168 billion. The Government does not expect to exceed this limit in 2018–19 and therefore is not required to seek renewed Parliamentary approval. Outstanding government and Crown corporation market debt is projected to reach $1,066 billion in 2018–19, including $755 billion in projected year-end government market debt and an anticipated Crown corporation market debt stock of approximately $311 billion.

The projected sources and uses of borrowings are presented in Table A3.1. Actual borrowings and uses of funds for the upcoming fiscal year compared with the projections will be reported in the *Debt Management Report for 2018–19*, and detailed information on outcomes will be provided in the *Public Accounts of Canada 2019*.

Sources of Borrowings

The aggregate principal amount of money to be borrowed by the Government in 2018–19 is projected to be $258 billion. All borrowing will be sourced from domestic and foreign wholesale markets (Table A3.1).

Table A3.1
Projected Sources and Uses of Borrowings for 2018–19
billions of dollars

Sources of Borrowings	
Payable in Canadian currency	
Treasury bills[1]	138
Bonds[2]	113
Total payable in Canadian currency	251
Payable in foreign currencies	7
Total cash raised through borrowing activities	258
Uses of Borrowings	
Refinancing needs	
Payable in Canadian currency	
Treasury bills	125
Bonds	94
Of which:	
Switch bond buybacks	1
Cash management bond buybacks	35
Retail debt	1
Total payable in Canadian currency	220
Payable in foreign currencies	7
Total refinancing needs	227
Financial source/requirement	
Budgetary balance	18
Non-budgetary transactions	
Pension and other accounts	-2
Non-financial assets	3
Loans, investments and advances	
Enterprise Crown corporations	6
Other	1
Total loans, investments and advances	6
Other transactions[3]	9
Total non-budgetary transactions	17
Total financial source/requirement	35
Net Increase or Decrease (-) in Cash	0
Adjustment for risk[4]	-3
Other unmatured debt transactions[5]	0
Total uses of borrowings	258

Note: Numbers may not add due to rounding. A negative sign denotes a financial source.

1 Treasury bills issued with maturities of less than 12 months are rolled over, or refinanced, a number of times during the year. This results in a larger number of new issues per year than the stock outstanding at the end of the fiscal year, which is presented in the table. Any issuance of ultra-long bonds will reduce the stock of treasury bills.

2 Total bond borrowings presented here is on a cash basis. Including non-cash adjustments of switch buyback issuance and additional debt that accrues as a result of the inflation adjustments to Real Return Bonds, gross bond issuance is expected to be $115 billion.

3 Other transactions primarily comprise the conversion of accrual transactions to cash inflows and outflows for taxes and other accounts receivable, provincial and territorial tax collection agreements, amounts payable to taxpayers and other liabilities, and foreign exchange accounts.

4 The adjustment included in the budgetary deficit for prudent fiscal planning purposes is removed to increase the accuracy of borrowing needs. Debt issuance can be altered during the year to adjust for unexpected changes in financial requirements.

5 Includes cross-currency swap revaluation, unamortized discounts on debt issues and obligations related to capital leases and other unmatured debt.

Use of Borrowings

The Government's borrowing needs are driven by the Government's projected financial requirements, the refinancing of maturing debt and projected changes in the Government's cash balances.

Financial requirements measure the net cash flow attributed to the Government's budgetary and non-budgetary transactions.[1] If the Government has a net cash inflow (financial source), it can use the cash to decrease the total debt stock. However, as is currently the case, if a net cash outflow (financial requirement) is projected, the Government must meet that requirement by increasing the total debt stock or by drawing down cash balances.

In 2018–19, the financial requirement is projected to be approximately $35 billion, the refinancing of maturing debt is projected to be $227 billion, and the Government's cash balances are not projected to change as new borrowings are expected to meet all borrowing requirements.

Actual borrowings for the year may differ due to uncertainty associated with economic and fiscal projections, the timing of cash transactions, and other factors such as changes in foreign reserve needs and Crown corporation borrowings. To adjust for unexpected changes in financial requirements, debt issuance can be altered during the year—typically through changes in the bi-weekly treasury bill issuance and through slight changes in cash balances for smaller adjustments. It should be noted that the $3 billion budgetary risk adjustment included in the budgetary deficit for prudent fiscal planning purposes is subtracted from the calculation of borrowing needs to increase the forecast accuracy.

[1] Budgetary transactions include government revenues and expenses. Non-budgetary transactions include changes in federal employee pension accounts; changes in non-financial assets; investing activities through loans, investments and advances; and changes in other financial assets, including foreign exchange activities.

Debt Management Strategy for 2018–19

Objectives

The fundamental objectives of debt management are to raise stable and low-cost funding to meet the financial needs of the Government of Canada and to maintain a well-functioning market for Government of Canada securities. Achieving stable, low-cost funding involves striking a balance between the cost and risk associated with the debt structure as funding needs change and market conditions vary. Having access to a well-functioning government securities market ensures that funds can be raised efficiently over time to meet the Government's needs. Moreover, to support a liquid and well-functioning market for Government of Canada securities, the Government strives to promote transparency and consistency.

Debt Structure Planning

The *Debt Management Strategy for 2018–19* is informed by an analysis of several debt structures over a wide range of economic and interest rate scenarios and forecasts over a medium-term horizon.

The Government seeks to strike a balance between keeping funding costs low and mitigating risks, as measured by metrics such as debt rollover and the variation in annual debt-service charges.

Market Consultations

As in previous years, market participants were consulted as part of the process of developing the debt management strategy.

Market participants indicated that markets for Government of Canada bonds and treasury bills have, for the most part, functioned well throughout the past year. Further details on the views expressed during consultations for the *Debt Management Strategy for 2018–19* can be found on the Bank of Canada's website (http://www.bankofcanada.ca/content_type/press/notices/?post_type%5B0%5D=post&post_type%5B1%5D=page).

Composition of Market Debt

The stock of total market debt is projected to reach $755 billion by the end of 2018–19 (Table A3.2).

Table A3.2
Change in Composition of Market Debt
billions of dollars, end of fiscal year

	2014–15 Actual	2015–16 Actual	2016–17 Actual	2017–18 Estimated	2018–19 Projected
Domestic bonds[1]	488	504	536	578	598
Treasury bills	136	138	137	125	138
Foreign debt	20	22	18	16	17
Retail debt	6	5	5	4	2
Total market debt	649	670	695	723	755

Note: numbers may not add due to rounding.

[1] Includes switch buyback issuance and additional debt that accrues during the fiscal year as a result of the inflation adjustments to Real Return Bonds.

Over the next decade, the share of domestic market debt outstanding with original terms to maturity of 10 years or more is projected to stay at about the current level (i.e., around 40 per cent). Additionally, the average term to maturity of domestic market debt is projected to remain relatively stable at around 5.5 to 6.5 years over the medium term.

The Government of Canada continues to follow prudent debt management practices compared to global peers. Canada's level of federal market debt as a proportion of GDP is the lowest among G7 countries. Despite this, Canada has continued to prudently issue debt across different maturity sectors and has maintained a weighted average term to maturity similar to that of most G7 countries.

2018–19 Treasury Bill Program

Borrowing requirements in 2017–18 were lower than projected in Budget 2017 due to a convergence of factors, including increased tax revenues from higher-than-projected economic activity throughout 2017–18. Accordingly, the size of bi-weekly treasury bill auctions declined in response to lower financial requirements, as treasury bills are typically used as the main shock absorber to adjust cash flows according to the evolution and timing of the Government's borrowing needs. Reflecting this, the stock of treasury bills is projected to decline to $125 billion by the end of 2017–18, $6 billion less than projected in Budget 2017.

In response to feedback from market participants, adjustments are being made in 2018–19 to increase the projected year-end stock of treasury bills. This is consistent with the medium-term objective of maintaining a treasury bill stock that is large enough to support a liquid and well-functioning market for Canadian federal government treasury bills, while also managing debt rollover risk.

Bi-weekly issuance of 3-, 6- and 12-month maturities will be continued in 2018–19, with bi-weekly auction sizes projected to be largely in the $8 billion to $14 billion range. Cash management bills (i.e., short-dated treasury bills) help manage government cash requirements in an efficient manner. These instruments will also continue to be used in 2018–19.

2018–19 Bond Program

In 2018–19, gross bond issuance is projected to be around $115 billion (Table A3.3). This approach balances liquidity requirements in both the treasury bill and core benchmark bond sectors necessary to promote market well-functioning, while also satisfying the Government's objective of achieving stable, low-cost funding.

Table A3.3
Bond Issuance Plan for 2018–19
billions of dollars, end of fiscal year

	2014–15 Actual	2015–16 Actual	2016–17 Actual	2017–18 Estimated	2018–19 Projected
Gross bond issuance[1]	99[3]	93[3]	135[3]	138	115[4]
Bond buybacks on a switch basis	-1	-1	-1	-1	-1
Net issuance	98	93	134	138	114
Maturing bonds and adjustments[2]	-84	-78	-103	-95	-94
Change in bond stock	15	16	32	43	20

Note: numbers may not add due to rounding

1 Includes switch buyback issuance and additional debt that accrues during the fiscal year as a result of the inflation adjustments to Real Return Bonds.

2 Includes cash management bond buybacks.

3 Historic bond issuances are accounted for at market value.

4 Unlike the $113 billion in bond issuance presented in Table A3.1, gross bond issuance includes $800 million in switch buybacks and $1.2 billion in additional debt that accrues during the fiscal year as a result of the inflation adjustments to Real Return Bonds.

Maturity Date Cycles and Benchmark Bond Target Range Sizes

For 2018–19, slight decreases in benchmark bond target ranges are planned relative to fiscal year 2017–18 (Table A3.4).

Table A3.4
Maturity Date Patterns and Benchmark Size Ranges
billions of dollars

	Feb.	Mar.	May	June	Aug.	Sept.	Nov.	Dec.
2-year	10-16		10-16		10-16		10-16	
3-year[1]		4-9				4-9		
5-year		11-17				11-17		
10-year				10-16				
30-year[2]								10-16
Real Return Bonds[2,3]								10-16
Total	10-16	15-26	10-16	10-16	10-16	15-26	10-16	10-16[2]

Note: These amounts do not include coupon payments

1 Issuance in the 3-year sector will be fungible with the previous 5-year benchmark bonds. The benchmark size range for the 3-year sector presented here is in addition to fungible outstanding previous 5-year benchmark bonds.

2 The 30-year nominal bond and Real Return Bond do not mature each year or in the same year as each other.

3 Includes estimate for inflation adjustment.

Bond Auction Schedule

In 2018–19, there will be quarterly auctions of 2-, 3-, 5- and 10-year bonds, and 30-year Real Return Bonds. Some of these bonds may be issued multiple times per quarter. The number of planned auctions in 2018–19 for each bond sector is shown in Table A3.5. The actual number of auctions that occur may be different than the planned number of auctions due to unexpected changes in borrowing requirements.

Table A3.5
Number of Planned Bond Auctions for 2018–19

Sector	Planned Bond Auctions
2-year	16
3-year	6
5-year	8
10-year	5
30-year	3
30-year switch buyback	2
Real Return Bond	4

The dates of each auction will continue to be announced through the *Quarterly Bond Schedule* that is published on the Bank of Canada's website prior to the start of each quarter (www.bankofcanada.ca/stats/cars/results/bd_auction_schedule.html).

Ultra-Long Bond Issuance

The Government will continue to issue ultra-long bonds subject to favourable market conditions and with consideration for the Government's debt strategy objective of achieving stable, low-cost funding. Potential ultra-long bond issuance dates included in the *Quarterly Bond Schedule* published on the Bank of Canada's website would represent a possibility but not a commitment to hold an ultra-long bond auction. An auction would be held only if a *Call for Tenders* is released confirming the date and size of the auction, and would be posted on the Bank of Canada's website in the preceding week. Alternatively, a market notice would be released in the preceding week in lieu of a *Call for Tenders* should the Government decide not to issue an ultra-long bond on the listed date.

Bond Buyback Programs

The Government plans to continue conducting regular bond buybacks on a switch basis and cash management bond buybacks.

Two bond buyback operations on a switch basis are planned for 2018–19. These operations would occur for bonds that were originally issued with terms to maturity of 30 years. The dates of each operation will continue to be announced through the *Quarterly Bond Schedule* that is published on the Bank of Canada's website prior to the start of each quarter.

The cash management bond buyback program helps to manage government cash requirements by reducing large bond maturities. Weekly cash management bond buyback operations will be continued in 2018–19. A pilot project to increase the flexibility in the maximum repurchase amount was introduced in January 2017 and will remain in place until further notice.

Management of Canada's Official International Reserves

The Exchange Fund Account (EFA), which is held in the name of the Minister of Finance, represents the largest component of Canada's official international reserves. It is a portfolio of Canada's liquid foreign exchange reserves and special drawing rights (SDRs)[2] used to aid in the control and protection of the external value of the Canadian dollar and to provide a source of liquidity to the Government. In addition to the EFA, Canada's official international reserves include Canada's reserve position held at the IMF.

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2 SDRs are international reserve assets created by the IMF whose value is based on a basket of international currencies.

The Government borrows to invest in liquid reserves, which are maintained at a level at or above 3 per cent of nominal GDP. Funding requirements for 2018–19 are estimated to be around US$10 billion, but may vary as a result of movements in foreign interest rates and exchange rates.

The mix of funding sources used to finance the liquid reserves in 2018–19 will depend on a number of considerations, including relative cost, market conditions and the objective of maintaining a prudent foreign-currency-denominated debt maturity structure. Potential funding sources include a short-term US-dollar paper program (Canada bills), medium-term notes, cross-currency swaps involving the exchange of Canadian dollars for foreign currency to acquire liquid reserves, and the issuance of global bonds.

Further information on foreign currency funding and the foreign reserve assets is available in the *Report on the Management of Canada's Official International Reserves* (www.fin.gc.ca/purl/efa-eng.asp) and in *The Fiscal Monitor* (www.fin.gc.ca/pub/fm-rf-index-eng.asp).

Cash Management

The core objective of cash management is to ensure the Government has sufficient cash available at all times to meet its operating requirements.

Cash consists of moneys on deposit with the Bank of Canada, chartered banks and other financial institutions. Cash with the Bank of Canada includes operational balances and balances held for prudential liquidity. Cash balances are projected to remain stable at $37 billion at the end of the fiscal year. Periodic updates on the liquidity position are available in *The Fiscal Monitor (*www.fin.gc.ca/pub/fm-rf-index-eng.asp*)*.

Prudential Liquidity

The Government holds liquid financial assets in the form of domestic cash deposits and foreign exchange reserves to safeguard its ability to meet payment obligations in situations where normal access to funding markets may be disrupted or delayed. The Government's overall liquidity levels cover at least one month of net projected cash flows, including coupon payments and debt refinancing needs.