



House of Commons
CANADA

Standing Committee on Finance

FINA • NUMBER 012 • 2nd SESSION • 40th PARLIAMENT

EVIDENCE

Thursday, March 5, 2009

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Chair

Mr. James Rajotte

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• (0900)

[English]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): I call the 12th meeting of the Standing Committee on Finance to order.

This is our second meeting continuing our study of measures to enhance credit availability and the stability of the Canadian financial system.

We have one witness for an hour and a half here this morning. It is Mr. Pierre Duguay, Deputy Governor of the Bank of Canada.

Welcome, sir. You will have up to ten minutes for an opening statement, and then we'll go to questions from members. You may begin at any time.

Mr. Pierre Duguay (Deputy Governor, Bank of Canada): Thank you, Mr. Chairman.

[Translation]

Good morning everyone. Thank you for inviting me here to discuss the Bank of Canada's perspective on the stability of the Canadian financial system.

As we have consistently emphasized, stabilization of the global financial system is a precondition for economic recovery, both globally and in Canada. To that end, policy-makers around the globe have acted aggressively and creatively by initiating a series of unprecedented actions aimed at stabilizing the global financial system. Central banks throughout the world, including the Bank of Canada, have provided unprecedented liquidity to keep the financial system functioning.

Because the crisis we are facing is global in nature and began outside our borders, most solutions must be found at the international level. We are taking part in discussions with our international colleagues on ways to strengthen financial stability globally. I would note that there has been a great deal of interest worldwide in the resilience of Canada's financial institutions in the face of the global economic crisis. Unlike their counterparts in other major economies, Canadian banks have not been materially affected by the financial crisis. They have managed to raise capital during this troubled period to support continued lending and to make up for some of the decline in the demand for securitized products as well as the exit of non-bank lenders which had relied on securitization for financing their activities. In contrast, banks in most other major economies have suffered significant losses and have required significant capital injections from their governments.

Thus, Canada has maintained much healthier credit conditions since the onset of this global recession than have been seen in other major countries. Still, the Canadian financial sector has felt the effects of the global turmoil which has increased funding needs while at the same time raising the costs and the uncertainty of term funding. In response, the Bank of Canada has made significant efforts to support liquidity in financial markets.

[English]

Now, our actions aimed at stabilizing the Canadian financial system since the global crisis began 18 months ago have been unprecedented and significant. The Bank of Canada has moved aggressively by expanding the provision of term purchase and resale agreements to a total of \$41 billion, at its peak in December, and \$35 billion currently.

The term purchase and resale agreements, or PRAs, as we call them, provide liquidity to key market participants for terms of up to three months against a wide range of securities. The bank has widened the range of assets that it will accept in these operations, and it has extended the range of counterparties with whom it will transact. I should point out that these PRAs are as an auction, so there is kind of a market price to the yields on these term loans.

We've also introduced a new term-loan facility for those financial institutions that participate directly in the large value transfer system and the payment system, taking their non-mortgage loan portfolio as collateral. And that, in a sense, frees up other collateral for them.

Last week the bank announced a new term PRA facility for private sector instruments that extends on the private sector term PRA facility that we had set up last autumn for the money market instruments. The new facility is open to a broader range of participants against a broader range of eligible securities, which would include corporate bonds, and it is available for a longer term and at a lower minimum bid rate than is the facility that it replaces. The liquidity from this new facility should provide indirect support to credit growth in Canada by improving the secondary market liquidity and increasing the demand for corporate securities.

I would like to point out that these facilities have been financed not by expanding the supply of central bank money to the financial system, but rather through the sale of treasury bills, either from the bank's own portfolio or from new issues, the proceeds of which, in turn, are held on deposit at the Bank of Canada. I would note that, on a consolidated basis, the Government of Canada earns net income from these operations. That net income is represented by the spread between the yield on our own term PRAs that we offer and the yield that we could have gotten on treasury bills or that the government is paying on treasury bills. Furthermore, there is little risk to the taxpayer in these operations because we require participants to pledge collateral with a value greater than the amount of money that they borrow from us.

These liquidity operations have resulted in a significant reduction in the spreads at the short end of the market—for example the CDOR, the Canadian deposit offering rate, which is the Canadian equivalent of the LIBOR, the London interbank offering rate, which is the offered rate on bankers' acceptances, essentially. So the CDOR minus OIS, or overnight indexed swap, spreads—the OIS is the expectation of what a future Bank of Canada rate would be—have narrowed substantially since last fall, when conditions were extremely negative. The improvements are especially notable at shorter-term maturities, such as one month, and are largely attributable to the liquidity facilities that have been put in place. But there have also been improvements at the three-month spread, which peaked at about 125 basis points in Canada. This is now close to a more normal level, which is about 25 basis points. That's kind of the new normal. We don't expect to go back to the pre-August 2007 spreads that were abnormally narrow.

While the Bank of Canada's liquidity operations have focused on the short-term financing, I would like to note that the Government of Canada has introduced measures aimed at supporting the long-term financing for businesses and consumers, and I would like to highlight two among the numerous measures.

● (0905)

One measure is the insured mortgage purchase program, which allows financial institutions to fund new financing by selling pools of insured residential mortgages to Canada Mortgage and Housing Corporation. Another is the Canadian secured credit facility, under which the Business Development Bank of Canada will buy term asset-backed securities, which are securities that are backed by loans and leases on vehicles and equipment. It will essentially target this segment of the market, for which financing is unavailable now.

All these measures together are certainly helping to meet the rising demand from businesses and individuals who have been finding it very difficult in this environment to raise adequate funds. We have all heard reports of ongoing tightening in both the availability and pricing of credit. We've heard anecdotes. Our own surveys of businesses and surveys of senior lending officers confirm that. Nevertheless, when you look at the data, our latest figures show continued strong growth in total household credit—9.6% in January—compared with the same period one year earlier. In part, we've seen limited deceleration in the growth of total business credit, although this was more pronounced in January. There is volatility in these numbers from month to month. Total business credit, overall, stood at 4.2% in January compared with the same period one year

earlier. What we've seen is accelerating growth in bank lending that has helped offset, or at least partially offset, a contraction in market financing. We will continue to closely monitor credit growth and credit conditions in Canada. We just got the January numbers last week. We are monitoring that very closely.

In conclusion, as we are all well aware, the Canadian economy is feeling the effects of the global turmoil and recession. The authorities, of course, have put a lot of fiscal and monetary stimulus in place in Canada and globally to support the recovery. However, as I noted at the outset, stabilization of the global financial system remains a precondition of the global and Canadian economic recoveries.

Investor and public confidence has been badly shaken. It will recover with the timely implementation of the ambitious plans in some major countries to address their toxic assets and to recapitalize financial institutions. However, if these national and multilateral measures are not timely, bold, and well executed, Canada's economic recovery will be both attenuated and delayed.

I would now be pleased to answer your questions, Mr. Chairman.

● (0910)

The Chair: Thank you very much for your presentation, Mr. Duguay.

We'll go to Mr. McCallum, for seven minutes.

[*Translation*]

Hon. John McCallum (Markham—Unionville, Lib.): Good morning, Mr. Duguay.

Unfortunately, it seems that the economic situation continues to deteriorate. When the Governor of the Bank of Canada appeared recently before this committee, I told him that he was optimistic. He answered that he was not optimistic, but realistic.

[*English*]

To be fair to the governor, his fairly optimistic forecast, he made very clear, was predicated on the situation in the United States improving and on everything working. It seems that there is little confidence in the United States, at this moment, that the crisis of the banking system will be fixed expeditiously.

You probably don't want to come out with a number, but compared with the earlier view that we would snap back and have 3.8% growth in 2010, how would you characterize your current position? How has it evolved since that time?

Mr. Pierre Duguay: Thank you, Mr. McCallum.

As we pointed out in our latest interest rate announcement when we lowered rates by another 50 basis points, the data has been weaker than expected. We knew that in the first half of this year there would be a string of bad news—we mentioned that. As you point out, the recovery that we projected starting in the second half of this year is very much predicated on confidence rebounding as the financial situation improves and is resolved. That's a precondition to recovery and the recovery of confidence that comes with it.

We said in our report that the first half of this year would be weaker than expected and the contraction of output would be stronger. Potential delays in stabilizing the global financial system, together with larger than anticipated confidence and wealth effect on domestic demand in Canada, could mean that the output gap will not begin to close until early in 2010.

In our monetary policy report update we had growth above potential output, as you may remember, starting in the fourth quarter of this year. I think we're delaying that. We're saying it won't happen until the beginning of 2010.

We don't have a complete projection at this point. We will have a complete projection. We will be coming out with the monetary policy report in mid-April.

• (0915)

Hon. John McCallum: Thank you.

Some Canadians have the impression that with the interest rate now approaching zero, monetary policy has become powerless. I know that monetary policy is not necessarily powerless, because the central bank can acquire assets like corporate bonds and commercial paper market—direct actions of that kind. I know you've started on that path.

I'd like you to perhaps reassure Canadians that monetary policy is not totally weak or powerless, and describe the nature of other things monetary policy can do and additional measures you could do if necessary.

Mr. Pierre Duguay: Those are very good questions.

As we said in our press release, we are refining our approach to how we provide additional monetary stimulus, if required, through credit and quantitative easing—the sorts of things you've been talking about.

At this point I'm not really in a position to give details. In our April monetary policy report we will outline the framework for the possible use of such measures. It would be premature at this point to give an indication of what we will be doing.

The Chair: You may ask one last question.

Hon. John McCallum: We had BDC here this week, and the budget says that some \$8 billion is authorized to flow in credit through BDC and EDC. At the time I said that a number of people in the business community had expressed concern that nothing much was happening and there was little sense of urgency in this money getting out of the door. I tried to get BDC to give us some idea of how long it would take to get the \$8 billion out the door. I didn't really get anywhere.

I don't expect you to criticize BDC or comment directly, but would you agree, given the overall credit situation in Canada, that there is a degree of urgency for funding that was allocated in the budget to move expeditiously? If you are saying the recovery's going to be under way in 2010, then surely the money is needed in 2009, and therefore it's not business as usual. There should be a sense of urgency by both BDC and EDC to actually use the money they have been allocated.

• (0920)

The Chair: Very briefly, Mr. Duguay.

Mr. Pierre Duguay: Very briefly.

I would agree that there is a sense of urgency. Very clearly, we will be hit by a string of bad news in the coming months. What is absolutely critical is to maintain business and public confidence, and clearly, access to credit is essential in that situation. So yes, I would say that there is a sense of urgency. It will not speak for BDC, of course.

The Chair: Thank you.

Thank you, Mr. McCallum.

Monsieur Laforest.

[*Translation*]

Mr. Jean-Yves Laforest (Saint-Maurice—Champlain, BQ): Thank you, Mr. Chair.

Good morning, Mr. Duguay.

We are experiencing an economic crisis that began with a financial crisis. I wish to discuss, among a few other things, the Caisse de dépôt et placement du Québec, which has suffered colossal losses. In Quebec, these losses have been the only thing people are talking about for the last two weeks. One of the factors that led to these losses was the purchase of commercial paper by the Caisse. Of course, one cannot know everything that really happened. Many people bought commercial paper and were relying on ratings issued by special agencies such as the DBRS, and various other securities rating agencies. We do know that many types of commercial paper were given a high rating. All of this looks like a scam. People were told that this paper would yield a good return. Some people were perhaps too gullible in believing this, but the agencies do nonetheless share part of the responsibility.

What kind of assessment does the Bank of Canada give these ratings agencies?

Mr. Pierre Duguay: Obviously, we are not directly responsible for ratings agencies. Generally speaking, as regards the commercial paper crisis, there were problems with ratings agencies. Commercial paper was greatly lacking in transparency. Certain structured products were very opaque, and few people knew what they truly were. Ratings agencies were specifically assessing what we call credit risk, and not liquidity. After the losses, investors who were buying up ABCP like hot cakes suddenly decided that they did not want any of it anymore.

As concerns the Caisse de dépôt, their ABCP was issued by third parties, and not banks. These ABCP were structured in a particular way. In this specific Canadian case, the credit margins accompanying this ABCP were very imperfect. In fact, several ratings agencies simply refused to rate those securities. In a certain way, investors understood that they were only using one highly subjective rating. It is always preferable to have two credit ratings.

• (0925)

Mr. Jean-Yves Laforest: The Bank of Canada was in a position to observe everything that was going on. Your job is to conduct monetary policy, but you also have to observe everything that is going on in financial markets. The Bank of Canada takes action based on the state of the markets.

Why were you not able to issue any warnings?

Mr. Pierre Duguay: We issued warnings, specifically in our *Financial System Review*. That was in 2005, I believe. We indicated that there were difficulties and risks associated with the liquidity of this ABCP. Ultimately, however, the decision is made by investors, who have the responsibility of doing their homework. In the case of the Caisse de dépôt et placement du Québec, their investors are very sophisticated.

Mr. Jean-Yves Laforest: You are saying then that you issued a warning, but that people did not listen to it.

Mr. Pierre Duguay: Exactly.

Mr. Jean-Yves Laforest: On the first page of your document, you say that Canadian banks have managed to raise capital during this troubled period to support continued lending and to make up for some of the decline in the demand. You are drawing a comparison with what is happening elsewhere, specifically in the United States. You state that we are doing rather well, but I still feel that you are providing a rosy outlook. Credit conditions have tightened significantly in the past year for both consumers and businesses.

Don't you find this slightly contradictory? In the last paragraph of your statement, it reads, and I quote:

Investor and public confidence has been badly shaken, but will recover with the timely implementation of ambitious plans in some major countries to address toxic assets and recapitalize financial institutions.

If countries are recapitalizing their financial institutions, it is because their balance sheets have taken a huge hit. Are you excluding Canada from this trend?

Mr. Pierre Duguay: Yes, absolutely, because Canadian banks are very well capitalized. It is the main reason why our system is the envy of the world. Significant losses were suffered mainly in the United States and in Europe. As I said in my opening statement, this crisis began abroad and most solutions must be applied at the international level. In the United States and in Europe, there is a clear and distinct need to recapitalize institutions, including public funds; however, this is not the case in Canada.

[English]

The Chair: Merci.

We'll go to Mr. Menzies, please.

Mr. Ted Menzies (Macleod, CPC): Thank you, Mr. Chair.

Thank you, Mr. Duguay. You're a brave man to come all by yourself to appear in front of this distinguished committee, which, I might add, actually has female representatives on both sides of the table today, which is a great thing in this old boys' club, where it's refreshing to have some women here with us.

Anyway, thank you for your comments and your reflections today. One comment of yours that I picked up on was that a precondition for recovery is improvement in the world's economic stability. If I can follow up on that, we had finance department officials here who talked about the role Canada is playing in this G-20 leaders' action plan. I know that the Governor of the Bank of Canada, and I'm not sure who else, takes part in these G-20 conferences.

Can you share with us, as much as you can, what role the Bank of Canada plays with other central banks in the G-20, and are you part of this leaders' action plan as well?

● (0930)

Mr. Pierre Duguay: The G-20 has what is called the ministers and governors, who meet before the leaders. And of course the ministers and governors, having discussed the situation, will be informing their leaders individually and probably making a recommendation. And the leaders will be deciding in early April on a course of action.

What we are doing, in a sense, is preparing the ground. Below the governors and the ministers, of course, there are meetings of the deputies. One of our deputy governors, John Murray, and Tiff Macklem, from the Department of Finance, who was here yesterday, are G-20 deputies.

As Tiff told you yesterday, there is a diversity of opinion. There are a wide range of solutions that have been contemplated. There are two issues. In the short term, what more do we do, given that the situation has deteriorated. I think the plans to resolve the financial crisis are just about the right plans, and the question here is the execution and the timeliness, so it is imperative to go forward on that.

The second part is that once you win the war, you have to think about the reconstruction and how you prevent something like that from happening again, talking about the regulation of the financial system. That's where, in a sense, there are a variety of views. But I think there is a coming together that some things are important, such as macro provincial regulation and having capital regulations where capital is built up during the upside of the cycle so there is a buffer that can be used to absorb shocks when they happen.

We also want to avoid pro-cyclicality. There is a sense in financial systems that things tend to get amplified by the reactions of people. So we're asking if there is anything that can be done from a regulatory point of view to limit this amplification, which is a part of nature. When things are good, you're optimistic; you understate risk. When things turn bad, all of a sudden the irrational exuberance gives rise to panic. So just as the risk is understated in one case, when you get a string of bad news, risk gets overstated. So how do you try to set a financial system that would be robust to that?

And the third point that's important is, in a sense, the alignment of incentives. Regulation always sets incentives to bypass it, so ensuring that there is a system-wide approach so that the incentives are aligned.... For example, in the ABCP there was a misalignment of incentives because of the original distribution model: the people who were making the loans did not keep any. They were just making loans, sending them, and had no incentive to do a verification of the credit quality of the loan. So alignment of incentive is important, and of course transparency and clear disclosure.

● (0935)

In the context of the ABCP crisis, one of the big problems, as we discussed earlier with Monsieur Laforest, is that disclosure was not adequate.

Mr. Ted Menzies: The point I wanted to make—and I think you said it earlier in answering a question—is that Canada is viewed in a leadership role, and I think that Canadians need to hear that again, that our system is sound and that other countries are coming to us, looking to us as a leader.

Thank you for your answer.

The Chair: Okay. Thank you.

We'll go to Mr. Mulcair.

[Translation]

Mr. Thomas Mulcair (Outremont, NDP): Thank you, Mr. Chair.

I will take the last comment made by our colleague, Mr. Menzies, as my starting point. Indeed, many of Canada's actions in regulating our banking system can be envied.

Yesterday, I had the opportunity to meet with John Rodriguez, who is the mayor of Sudbury, Ontario. In the past, Mr. Rodriguez waged the epic battle led by the New Democratic Party at a time when Canadian banks were doing everything possible to free their restraints and were complaining that they did not have the right to do the same as our American neighbours south of the border. At the time, certain people were blaming us for not seeing the big picture and not understanding that if we just let the banks do what they wanted, they could work wonders, just like the Americans. It feels great to acknowledge the historic role played by people like Mr. Rodriguez, whose actions are the reason why we now have a system which is the envy of many.

We have had one round of questions and addressed various subjects. My time is relatively limited, and therefore restricted to focusing on one topic, a topic that was alluded to, but not really explored. Given the context, it is rather important. Mr. Menzies talked about one of the « preconditions » at the international level. You yourself used the term « precondition », whereas I would prefer to use the term « prerequisite condition » or « condition precedent ». You talked about confidence being a precondition to successful recovery of our economy. I must admit that we are rather spoiled to have a man of Mr. Mark Carney's calibre at the helm during a time of crisis. He has our total confidence. He gave what Mr. McCallum called a rather optimistic outlook. Yet, I myself have always read into Mr. Carney's optimism an attempt to instill confidence in better times ahead.

You also talked about—and I made note of this—the requirement for transparency and what you referred to as clear disclosure. Of course, this applies in the context of asset-backed commercial paper. Do you not believe that this clear disclosure must be a condition fulfilled in the public interest as the government introduces measures to stimulate the economy? Is this approach to guarantee accountability in the clearest, most transparent, most straightforward way possible, not part and parcel of all legitimate efforts to revive the economy?

Mr. Pierre Duguay: Absolutely.

I spoke about transparency and ABCP, but clearly transparency goes far beyond asset-backed commercial paper. As you know, when it comes to monetary policy, the Bank of Canada is committed to being transparent and accountable for its actions. This applies to both

monetary policy and all our other initiatives. When one is trying to maintain confidence, transparency and frank, honest and open communications are of the utmost importance.

As for our forecast, which intended to maintain confidence, the governor said that it was neither optimistic nor pessimistic, but rather, it was realistic. Of course, the forecast depends on many factors. It bears witness to a great deal of uncertainty. Recent data has been weaker than what was forecast in the update of the monetary policy report. We indicated that there were some risks relating to the 3.8% rate. Nevertheless, we are of the opinion that this forecast is realistic. To give people confidence, we must explain what is behind this forecast, that is to say, a monetary and financial stimulus. We are reminding people that it takes time for these stimuli to be felt. There will be a series of negative numbers, but it is important to look to the future and consider the fact that there are many stimuli within the system.

Furthermore, with regard to confidence, I must specify that the Bank of Canada has a framework for formulating monetary policy. Our target is an inflation rate of 2%, and we will do everything in our power to reach this target. We have the ammunition to do so. We are not short of ammunition.

● (0940)

Mr. Thomas Mulcair: You have anticipated my second and last question. We only have a limited amount of time, Mr. Duguay.

Réal Caouette and Camil Samson must be laughing somewhere, as they watch the Americans print all this money. For decades, everyone made fun of the *créditistes*. People would say that their only goal was to print more money. These days, the situation is such that we are having a hard time finding the right terminology in French. The English word trillion is actually *un billion* in French. The newscasters have started to speak of one thousand billion because so few people know that a trillion is actually *un billion* in French.

In any event, trillions of dollars are being printed. In the final analysis, is it possible that such a flow of money into the system may not produce an inflation rate clearly above the 2% that you just mentioned?

Mr. Pierre Duguay: No, because we would not let that happen.

First of all, the trillions of dollars that we are talking about show an increase in debt, not an increase in monetary supply. In a way, the increase in the money supply will be in keeping with the public's needs. During a crisis, when people are fearful, there may be an increased demand for currency.

Mr. Thomas Mulcair: What you're saying applies to Canada, but not to the United States.

The Chair: Thank you.

Thank you, Mr. Mulcair.

[English]

Mr. McKay is next, please, for five minutes.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you, witness.

It seems to me that the 800-pound gorilla in the room is the Caisse de dépôt. Recently it announced losses of something in the order of about 25% of its portfolio, about \$40 billion, an enormous amount of money—\$12 billion to \$14 billion of which was asset-backed commercial paper. Much of the loss was due to a fairly aggressive lending strategy, which has certainly backfired in this particular economy.

The losses are so massive and the pension plan so at risk that certainly the people of Quebec are at risk. But presumably, with the expanded list of assets that you will purchase from pension plans and others—the counterparties, as they're called—you will be asked to purchase some assets from Caisse de dépôt to stabilize its situation. Can you advise us whether any conversations have been held to that effect, and whether that analysis, namely, that this is a massive loss, will require intervention on the part of the Bank of Canada?

• (0945)

Mr. Pierre Duguay: Sorry, will require...?

Hon. John McKay: Will require intervention by the Bank of Canada.

Mr. Pierre Duguay: The losses at the Caisse de dépôt are, of course, from ABCP, but are basically losses on the stock market. The stock markets have declined. Just as there was some exuberance earlier, fears are currently being reflected in the markets. The point is that over time, some recovery in the stock market will be expected. So it's not clear that those losses per se are necessarily putting pensions at risk, because the pensions have a long horizon to recover some of the losses.

Now, what the Bank of Canada doesn't do is to provide capital. If there is any need for capital, it would have to come from government. As I said, in Canada we don't see the need for capital; but the Bank of Canada would not, in any case, be providing capital. The Bank of Canada is providing financing, it's providing liquidity, providing loans, in a sense.

If you were to look at our new facility, for example, which we just announced last week, we will be taking a number of securities—corporate bonds, for example, or commercial paper, and some bank-sponsored ABCP—and we will be providing liquidity against those, basically to meet the liquidity needs of institutions, which could be pension funds—

Hon. John McKay: You, or the government, I suppose, have already picked up a \$3.5-billion contingent liability for the asset-backed commercial paper. So the question really is, are you anticipating being asked to provide similar sorts of asset purchases in order to stabilize the demands on the pension plan?

Mr. Pierre Duguay: The short answer is no. The \$3.5 billion you talked about is not from the Bank of Canada, but from the Government of Canada, which provides those guarantees. As I said, the Bank of Canada does not provide guarantees; the Bank of Canada does not provide capital. This is a fiscal issue, in a sense. Our mandate is to provide liquidity, to create money as needed, in order to achieve our monetary policy objective.

Hon. John McKay: So would the overall pension system, primarily led by the Caisse, effectively require you to start printing money?

Mr. Pierre Duguay: No. Printing of money is done for monetary policy purposes; it's not done to address specific losses of any investors. We would be printing money if there were a demand for money to make the economy go around, if I may put it that way.

Hon. John McKay: But that is liquidity.

Thank you.

The Chair: Thank you, Mr. McKay.

Monsieur Carrier.

[*Translation*]

Mr. Robert Carrier (Alfred-Pellan, BQ): Thank you, Mr. Chairman.

Good morning, Mr. Duguay. I'm pleased to see you today.

In Quebec, these infamous asset-backed commercial papers have had a tremendous impact on our large financial institutions and, to a large extent, have resulted in their losses. Earlier, my colleague referred to the Caisse de dépôt et placement. Quebecers put their savings in this caisse in order to watch their money grow. Many other financial institutions have been affected as well, including the Mouvement Desjardins and the Banque Nationale. This is a very serious topic. We have yet to receive a full explanation regarding the shakeout of these assets. And yet, the rating agencies gave these securities a very high grade. That is one aspect.

My question will therefore be about the rating agencies. I thought that these agencies came under the jurisdiction of the government. Recently, I asked a Department of Finance deputy minister a question on this issue. I was told that these agencies are not subject to government regulation. You said that you rated these commercial papers very negatively. However, I didn't see this anywhere.

You are deeply concerned by the current financial crisis and therefore I would ask you whether there is any need to reform the rating agencies. To whom do they report? Right now, I do not know. It is not the government. I do not know whether the Bank of Canada plays a role in this matter. In addition, these agencies receive funding from the securities issuers. So there is a type of conflict of interest. The problem is very serious.

Are you going to be suggesting that we change the financial regulation of these agencies?

• (0950)

Mr. Pierre Duguay: Thank you very much, Mr. Carrier.

Indeed, the bank already published an article on rating agencies in the *Financial System Review*, in December 2007 or June 2008. A small number of rating agencies operate internationally. They provide an opinion, and, for us, it is important that this opinion be clear. The rating agency simply provides an opinion based on an analysis. As far as the asset-backed commercial paper crisis is concerned, investors gave far too much weight to the rating agencies and, to some extent, did not do their homework. Investors have a responsibility to understand what they're buying and to ask questions about transparency. With respect to a situation of conflict of interest, the rating agencies need to maintain their reputation with investors, because although they are paid by the securities issuers, they will not get paid for nothing if they do not do what is deemed to be useful work, because the investors will no longer consider the opinion given by such rating agencies. I think that the rating agencies have a good incentive. Indeed, they have responded to the criticism levelled by investors, they have changed the way they do things.

Is there need for regulation? The Financial Stability Forum has made recommendations along that line for the international scene. There are some clearly different opinions, but a consensus does appear to be forming. I do not think that we will necessarily be looking to a regulation of rating agencies, but there certainly is talk about an international securities commission organization, which will establish a code of conduct for the rating agencies.

• (0955)

The Chair: Thank you.

[English]

We'll go to Mr. Kramp, please.

Mr. Daryl Kramp (Prince Edward—Hastings, CPC): Thank you, Chair.

I was just thinking, when I listened to Mr. McKay's characterization of the Caisse de dépôt as an 800-pound gorilla, that perhaps the citizens of Quebec would have been better served if they were operating under national securities regulators. Maybe then it would have been only a chimpanzee.

We're really not faced with soaring inflation or even imminent deflation. In your discussions with Mr. Mulcair I heard the figure 2% come up. I'd like to know how you would actually decide what rate would be your target rate. What factors would go into that, and why would that be a healthy range? What are your predetermining factors for that?

Mr. Pierre Duguay: Well, in part 2% is the result of history. We started from very high inflation, and when we adopted the inflation target, inflation in Canada had been 4% and rising and we felt that it was too high. That's not price stability, and the 2% inflation target was jointly agreed to by the government and the Bank of Canada.

In difficult times, when the purpose is to get inflation down first, then of course in the early 1990s, following the recession, the recovery was slow. So in the end, when it came time to renew, although at first we had said that we'd get inflation down to 2% and then define price stability later on and decide whether we keep it or go lower, systematically we've renewed the target at 2% on our last renewal. And the Bank of Canada has done a lot of work on what would be the desirable rate of inflation. There are a number of

arguments saying that it should be lower. There are not many arguments that would justify raising it. We've summarized some of that research in the past, but the last time we agreed with the government on maintaining the 2% figure we did point out that we would be very thoroughly examining what our next target should be, and we will be coming up with the results of our research before 2011.

It's premature at this point to talk about this research, but there is vibrant discussion going on. We have set up a website called inflationtargeting.ca, where some of the research papers are presented, and there is a wiki also where we get feedback from people.

Mr. Daryl Kramp: Okay.

So it would be a fair assessment, then, to say that the Government of Canada and the Bank of Canada appear to be working hand in glove to deal with this inflationary targeting in an acceptable manner.

Mr. Pierre Duguay: Absolutely, because by the Bank of Canada Act, the government and the Bank of Canada, the governor, are jointly responsible for monetary policy, and the inflation target is jointly determined by the bank and the government. We are working hand in hand.

We are also, I must say, working hand in hand through this credit crisis. I did point out, for example, that in the liquidity provision we've done, we focus on the short end; the government has focused on the long-term end. At the short end, we're providing financing, but because it's not money that we're creating, the government is issuing treasury bills to finance it and depositing the proceeds at the Bank of Canada. So there is a close coordination, yes.

• (1000)

Mr. Daryl Kramp: All right. Thank you very much.

Just to allay a perception—

The Chair: This will be the last question.

Mr. Daryl Kramp: —what's the reality of the source of capital for our financial institutions, our big five charter banks? There's a perception that they get all of their money from the Bank of Canada at next to zero and then they're getting a massive infusion of government money, and yet they're charging exorbitant rates. Could you allay that perception for the general public?

Mr. Pierre Duguay: Yes. The money that the financial institutions are getting from the Bank of Canada is about \$35 billion. The assets of the banking system, I don't have the figure with me, but they're in the trillions. So that's a very small part of their money.

Banks basically raise money by raising deposits, they make loans, they issue short-term and longer-term debt. The longer-term debt that they're issuing, of course, is more expensive because markets are not very receptive.

However, Canadian banks have been able to raise capital, they've been able to raise preferred shares, and they've been able to raise five-year money on the markets. And another source of money of course is through the IMPP, the insured mortgage purchase program, which so far is about \$40 billion, but there is potentially \$225 billion. Again, that is a small proportion of their total assets. Their big funding is that they borrow money and it costs them something.

The Chair: Thank you.

I just want to remind members—and it was a very good question—when I say 20 seconds, if you ask a very good question that takes longer than that to answer, it puts the chair in a bit of a bind. So I appreciate the question, but 20 seconds means 20 seconds, unfortunately. But we may come back to that in later rounds.

Mr. Pacetti, please.

Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.): Thank you, Mr. Chair.

[*Translation*]

Thank you, Mr. Duguay.

[*English*]

Just a couple of quick questions.

Deterioration is obviously going on in different sectors at different times. We seem to be following what's happening in the United States, so we see they've had trouble in their financial sector, with the banks and insurance companies in particular, and real estate. In Canada, we haven't had the effects of the real estate sector.

I notice the last round of liquidity did not include any transfers for mortgage loans. Is the Bank of Canada going to be involved in mortgage loans? I understand there's some involvement when in your presentation you talk about securing some of the CMHC.... Can you just explain how that works, how you treat the different sectors, whether it's real estate or non-real-estate securities?

Mr. Pierre Duguay: Right now, in terms of our purchase and resale agreement facilities, if we start with the Bank of Canada facility, we take a large number of assets that are eligible to get this financing. That includes government securities, of course. We allow the bank-sponsored ABCP, especially the ones that meet our standards of transparency. That's a small way in which we try to help that market. We also accept mortgage-backed securities. At times banks would provide us with mortgage-backed securities against these loans, but that really is a decision of the banks themselves or the financial institution. I say banks, but more than banks are involved. It's the decision of financial institutions to decide what they pledge as assets against the liquidity they're getting from us.

The insured mortgage purchase program is more specific to the mortgage. The issue here is it is really a way of providing liquidity to the banks, reducing their cost of funding generally by taking an asset, which does not add to the government risk, because the government is already guaranteeing these residential mortgages through CMHC. It's a vehicle to provide liquidity, and by providing liquidity, by reducing the cost of funds of banks, we're making room for banks to do some lending. Now, where they do their lending in a sense—

• (1005)

Mr. Massimo Pacetti: That's the question, the liquidity. What is going to happen if there's a deterioration in the real estate market and if there are some problems with some of the companies going under and there is going to have to be some pension support, whether it be private pensions or public pensions?

Mr. McKay brought up the Caisse. How is that going to affect the liquidity of the market and affect the way the Bank of Canada operates?

There are other sectors. I understand you're also backing the loans and leases on vehicles and equipment. But if you look at what's happening in the States with the insurance companies, huge amounts of money are being invested, and some of the fallback, or some of what is being said, is that when you're throwing \$60 billion to support AIG, and a couple of months later people are saying it was a waste of money, and they need another \$15 billion, it has to affect the way the Government of Canada operates.

We had the officials from the Department of Finance. My understanding was they don't really have a plan if something were to happen. Now I'm asking the Bank of Canada if you have a plan. You must have a feeling for which sector is going to deteriorate and is going to need some help, whether it be from the Bank of Canada or the Government of Canada, and how you're going to help so the markets don't get affected in a worse fashion than they are already being affected.

Mr. Pierre Duguay: Thank you.

Yes, we are in a recession. There will be losses. There will be difficulties, and obviously a larger number of sectors will be in difficulties, in a sense.

To the extent that there are losses that have to be absorbed, that will have an effect on confidence and an effect on markets. The markets may be more reluctant to lend. Typically, yes, risk premium —

Mr. Massimo Pacetti: Do we have a magic number, if the real estate is going to go down 15% or 20% or 25%, and you know, if we have a certain number of dollars, where pensions are going to need to be supported? Do we have any of those numbers available?

Mr. Pierre Duguay: No, not to my knowledge. We have looked at the Bank of Canada in our December financial system review. We have looked at the household sector. As you know, the household sector is very indebted or has increased its debt considerably. Most of that, of course, is mortgage debt and most of that is insured debt but we have looked at the implication of a very bad outcome for the household sector, what the implication of that would be on the banks, and you can look at the report.

The Chair: Thank you.

Thank you, Mr. Duguay. I'm sorry, Mr. Pacetti is out of time.

We'll go to Mr. Dechert, please.

Mr. Bob Dechert (Mississauga—Erindale, CPC): Thank you, Chair.

Thank you, Mr. Duguay, for your presentation today. I just want to take a moment to recognize the very important work you and your colleagues do at the Bank of Canada. I think the relative strength of the Canadian economy and the Canadian financial system is due in no small part to your guidance and that of your colleagues over the years. So I want to acknowledge that.

This morning you described in your remarks the many things the Bank of Canada has been doing over the last few years to stabilize and increase liquidity in Canada for business and consumer lending. You pointed out there has been strong growth, in fact, in total household credit and there has been limited deceleration in the growth of total business credit. But business and consumers are not borrowing and consuming as much as our economy needs to spark a recovery at this point in time. So psychology is obviously very important.

As you pointed out, the 2009 budget contains a number of stimulus measures designed to encourage consumer and business spending. This morning I heard Mayor Francis of Windsor, Ontario, commenting that his community needs stimulus now, in regard to layoffs at Chrysler. They need it immediately, as soon as possible. Could you comment on the timing of the injection of the stimulus by the government, the non-monetary stimulus measures in the budget, and the effects of waiting too long to put that stimulus into the economy?

• (1010)

Mr. Pierre Duguay: Thank you.

Yes, the recession is now, and obviously the sooner the stimulus comes, the better, because in part when people hear bad news, that does affect confidence and the effect on confidence can certainly amplify the problems. When consumers are nervous about their employment prospects, they stop spending. At that point, it doesn't matter much whether credit is available or not; they prefer not to go into debt.

So it's very important to get the stimulus now, to cut this off at the pass, if you wish, so that the people can see that the recovery is coming, that the recession is going to be temporary, and that they don't need to worry excessively about the future. That is important. As I said, it's the confidence-boosting effect of fiscal policy, and monetary policy for that matter, that is helpful here.

Mr. Bob Dechert: Thank you very much. Obviously you would agree it's important for those of us here in Parliament to do everything in our power to move this stimulus into the economy as soon as possible. I can give you my personal assurance that I'm going to do everything I can to make sure that happens.

You also mentioned the Canadian secured credit facility that is proposed in the budget. I'm very interested in that. I'd like you to comment on how it should be structured and how important that facility is to our economy in terms of enabling business and consumer consumption that will drive the recovery of our economy. Again, how quickly do we need to move on that facility?

Mr. Pierre Duguay: The importance to the economy is that, as you know, leasing companies are having difficulties; they cannot raise capital easily on the market, and leasing is an important part. Business owners, if they cannot buy equipment, would lease it. Many consumers prefer to lease a car instead of buying. To ensure

that the system functions, it is important that leasing be available. That's the part of it.

In terms of how that is restructured, as Tiff or Jeremy mentioned yesterday, they are currently in the process of consulting with the industry, with the major stakeholders. I know the Bank of Canada is involved in that. It's not me personally, but we are providing some advice.

I cannot give you more details. I'm sorry.

Mr. Bob Dechert: Thank you.

The Chair: Thank you.

Thank you, Mr. Dechert.

We'll go to Mr. McKay, please.

Hon. John McKay: Thank you, Mr. Chairman.

The assets of the Bank of Canada have basically flipped in the last year. If you looked at your asset portfolio last year, it was mainly government bonds, T-bills, stuff like that, rock solid. Now you've flipped it and it's much less government bills and T-bills and now it's a bunch of arguably still half-decent stuff.

In the process of that we all get poor, and certainly the quality is not there. In the provision of liquidity into the market, are you anticipating that the quality of your asset portfolio will maintain that trend of being other than T-bills, Government of Canada bills, things of that nature?

• (1015)

Mr. Pierre Duguay: Thank you for that question.

Yes, our assets have changed considerably. For the committee I'll mention that our assets are normally about \$50 billion, about \$20 billion in treasury bills, \$30 billion in bonds. With the last operations we've done we've increased our lending through PRA to financial institutes by \$35 billion. To make room for that we sold about \$10 billion to \$12 billion of our treasury bills. The government has sold treasury bills and put some deposits in the bank for the rest. Our total balance sheet has gone up from \$50 billion to a little less than \$80 billion.

The quality of our assets is still very high. In terms of the purchase and resale agreement, yes, we are purchasing less liquid assets than the government. So banks are pledging that to us. It's not a purchase per se, it's a term purchase and resale. So the institution that is pledging that asset to us has an obligation to come and buy it back from us. In a sense, we can look at this as kind of a loan, if you wish.

Secondly, the assets we accept are longer-term government securities, some commercial papers, bankers' acceptances, mortgage-backed securities. The assets that we accept are still very high-quality assets. And we are having our cut on that, so the lending is less than the value of the assets.

Hon. John McKay: Did you say you're losing money on that part of your portfolio?

Mr. Pierre Duguay: No, we're not losing money on that. In fact, we're earning money on that part of the portfolio because the rate at which we lend to the bank is larger than the rate we would have gotten on treasury bills, and the rate the government has on treasury bills.

Hon. John McKay: So you're dealing with banks, insurance companies, pension plans...?

Mr. Pierre Duguay: At this point, no. We're dealing with investment dealers, the primary dealers. We're dealing with the members of the payment system, the large-value transfer system—the banks and large deposit-taking financial institutions.

Now, the facility that we announced last week will be dealing with insurance companies, with—

Hon. John McKay: So who are you dealing with this year that you weren't dealing with last year?

Mr. Pierre Duguay: The term PRAs were done with the primary dealers only before, and now they're done with every member of the large-value transfer system. So that's a key point, in terms of extension.

Hon. John McKay: I don't understand the difference between a primary dealer and a secondary dealer. What's the difference?

Mr. Pierre Duguay: The primary dealers are the ones that are the market-makers, market-makers in the Government of Canada debt, the large investment dealers.

The Chair: Okay. Thank you.

We'll go to Mr. Wallace, please.

Mr. Mike Wallace (Burlington, CPC): Thank you, Mr. Chairman. I'll be sharing my time with Ms. Block.

I have one question for you, Mr. Duguay, and I thank you for coming this morning.

In the *Calgary Herald* this morning, Heather Douglas, president and CEO of the Calgary Chamber of Commerce, talks about, as she calls it, the "wise persons" committee that looked at a single regulatory agency for the stock markets across the country. I want just a yes or a no, or tell me if she's missed something in this thing. She writes:

Here's what the chamber suggests will happen by appointing a single securities regulator:

Immediately enhance Canada's excellent reputation for prudent fiscal management and attract global investment capital.

Enable critical and timely decisions with coordinated actions to rebuild investor and public confidence.

Simplify regulatory compliance and save fees when member companies and all regulated entities no longer operate in as many as 13 jurisdictions.

Use sound policy-making to ensure the needs of the jurisdictions are integrated into a cohesive and responsive set of securities regulations.

You talked earlier about regulations. Does the bank have a position on a single securities regulator?

• (1020)

Mr. Pierre Duguay: We have to make a decision. To us the substance is more important than the form, and we've mentioned that a number of times. Because we have a unified capital market, it's important that the rules be the same across the country, because there

are sectoral differences or differences in the size of firms. That doesn't mean the same rule applies to everybody, but the same rule applies across the country to like bodies, if you wish. That's important. Uniformity of enforcement is important.

We've highlighted the principles, and all the principles enunciated are very good ones, but we don't have—

Mr. Mike Wallace: A stated policy on it.

Mr. Pierre Duguay: —a stated policy, in terms of the form that would take.

Mr. Mike Wallace: Thank you very much, and I'll share my time with Ms. Block.

The Chair: That's great.

You have about two and a half minutes.

Mrs. Kelly Block (Saskatoon—Rosetown—Biggar, CPC): Thank you very much, Mr. Chair.

I would like to turn the discussion just a little bit to the deficit. Of course, no one likes to see a deficit.

I'd appreciate your perspective on how you see Canada's long-term fiscal situation. Specifically, I would be interested in hearing your views on Canada's debt-to-GDP ratio over the coming years. Can you place that in an international context for me, please?

Mr. Pierre Duguay: Thank you very much for that question.

I would argue that the longer-term debt-to-GDP ratio, in a sense, is the responsibility of this group and your successors. But what is important is that we are going through a recession; we are going through a period when, because of fear, businesses are spending less, consumers are spending less. And it is absolutely critical, in a sense, to stabilize the economy, to keep the economy functioning near potential output. Clearly, fiscal policy has an important role to play to stimulate the economy, just as monetary policy does.

There are automatic stabilizers, obviously, in a recession. There will be less tax revenue, so one should not be panicking at seeing a deficit. It reflects the fact that the only way people can save more is that somebody has to use the savings, somebody has to run a deficit. And if there is not investment because businesses are not running the deficit, then the government does, and that helps stabilize the economy.

This is a cyclical deficit. This is a temporary situation. What is important for the long-term fiscal health of the Canadian economy is that it remains temporary, and that the decision-makers' policies stabilize the debt-to-GDP ratio.

In terms of where we are, Canada has probably the lowest debt-to-GDP ratio certainly among the G-7 countries, and beyond that, among many industrial countries. We are in a very, very strong fiscal position with very little risk of long-term deterioration.

The Chair: Thank you.

Thank you, Ms. Block.

We'll go to Monsieur Mulcair.

[Translation]

Mr. Thomas Mulcair: Thank you, Mr. Chairman. I'm going to continue on where we left off earlier. Mr. Duguay stated that there had been no increase in the money supply and that the Bank of Canada was going to work very hard to keep inflation under the 2% mark. We are, naturally, talking about the situation here, in Canada. We were not saying that there has been no increase in the money supply in the United States.

• (1025)

Mr. Pierre Duguay: There was a slight increase in the money supply in the United States, but not in a way to ensure, if you like, the billion-dollar assistance that was mentioned.

There is a difference between injecting capital into the economy, which for the American government means an increase in the national debt. Nevertheless, an increase in the U.S. government debt does not necessarily mean more money in the economy.

Mr. Thomas Mulcair: But the rule for debt is that, sooner or later, you have to pay it back.

Mr. Pierre Duguay: Sooner or later, you have to pay it back. Exactly.

Mr. Thomas Mulcair: One of the proven ways to pay back this tremendous debt—we saw this after the Vietnam War—is to pay it back through inflation. Hence the money borrowed at a certain rate is paid back more quickly with money that has been subject to considerable inflation.

Mr. Pierre Duguay: What this exercise taught us during the 1970s and 1980s is that inflation creates very serious problems for the economy. This is not a very good way of dealing with a debt problem.

Mr. Thomas Mulcair: You seem optimistic to me, but time will tell.

Mr. Chairman, I would also like to give the witness an opportunity to explain...

[English]

I'm going to do it in English so that Mr. Kramp can understand me.

Through you, Mr. Chairman, I would like to invite Mr. Kramp to explain to us how, in his thinking, a national securities regulator would somehow have changed the situation at the Caisse de dépôt. Actually, not only was I a member of the national assembly at the time the law was changed, but I was a member of cabinet. I can talk to him about what happened in the House. I cannot talk to him about what happened in cabinet, but I can tell him that it is on the public record that the rules for the Caisse de dépôt were changed so that the only thing they were looking at was *rendement*—profitability, how fast the money was being...

So for the asset-backed commercial paper, I was here when Julie Dickson, our so-called Superintendent of Financial Institutions, came in. She denied all responsibility for it. None of the structures in place took care of ABCPs.

Does he really think that ABCPs would be something that a national securities regulator would have taken care of? What about

the Criminal Code, which is simply not applied right now? It has all sorts of provisions on fraud. What about the fact that the federal government never took a single prosecution in the Liberal sponsorship scandal? The only prosecutions were taken provincially in Quebec. Someone like Vincent Lacroix is in the slammer right now because provincial securities regulators applied their rules, but the federal government has laid several thousand criminal complaints, and not the first hour of the first day of the first trial on the first charge has ever been held.

So how is this magic national securities regulator going to change the situation at the Caisse de dépôt et placement? I notice the solicitude of our friend Mr. McKay, who wants to bring in the Caisse before his committee, because he's decided that he knows how to handle this 800-pound gorilla. That's going to be fun to watch. But I want to understand from Mr. Kramp what in his mind, in his thinking—if he accepts to respond on my time, Mr. Chairman—a national securities regulator would have changed.

The Chair: It's an unusual practice to ask another member a question, but a member can share his time with another member if that member so wishes.

Mr. Thomas Mulcair: I'm offering him the chance. He made the statement before, and on my time I'd like to give him the chance to answer.

The Chair: Mr. Kramp, you have about a minute of Mr. Mulcair's time if you wish to respond.

Mr. Daryl Kramp: I really thank Mr. Mulcair for that courtesy.

I will readily admit that I'm not the expert in everything that he is. However, I do readily acknowledge that I take my licence and my opinions from many witnesses and testimonies, and you just have to read international papers and/or listen to testimony from across this country to know that they have collectively suggested that there would definitely be an advantage to having one system. It would be well recognized internationally. Our respect and consideration in the world economic markets, whether it's G-7 or G-20, would be readily recognized for the fact that we are speaking with one voice here, and we're not sitting with systems that either might be complementary or might be contradictory.

That is just one very quick response, sir.

The Chair: Go ahead, very briefly.

[Translation]

Mr. Thomas Mulcair: Mr. Chairman, I am very pleased to see that what I had been thinking is in fact true, namely, that there was no reason to state that by having something like this exist, the situation at the caisse would have changed in any way.

However, I would also like to tell him that the passport system in Canada is a national securities regulator system, and that it is proving itself. The G7 recognized it as one of the most effective systems in the world. This wishful thinking on the part of the senior public service to want to always control everything has always been supported by the Conservatives and the Liberals, but not by the NDP.

Thank you.

•(1030)

[*English*]

The Chair: Merci.

That was unusual. I'm not used to presiding over question period, but that was an interesting discussion.

Mr. Duguay, I want to thank you very much for being with us here today. I'm sorry that in some cases I did have to shut you off. It was in the interests of allowing all members time for questions. We very much appreciate your responses.

There's one thing I would ask you to provide a written response for. In my riding, when the Bank of Canada lowers its rate by 50

basis points, consumers and businesses have a perception that the lower rate is not passed on fully to them by the financial institutions. I know this will be a question we'll have for the banks when they appear before us, but if you can provide a written response to me as the chair, I'll share that with all the members. I know we don't have time right now.

We appreciate your time here today. Thank you.

Members, we will suspend for a minute or two, and then we'll deal with future business.

[*Proceedings continue in camera*]

Published under the authority of the Speaker of the House of Commons

Publié en conformité de l'autorité du Président de la Chambre des communes

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