ONTARIO
Financing Authority

1996
Annual Report

Ontario

Profile

On behalf of the Province, its Crown corporations and other public bodies, the Ontario Financing Authority:

- coordinates borrowing and financial risk management activities;
- offers short-term investment management services; and
- advises on project financing.

The Authority also operates the Province of Ontario Savings Office, which offers deposit-taking services to the public.

Finally, the Province relies on the Authority to provide centralized finance and cash-management services to ministries.

As an agency of the Province, the Authority reports to the Minister of Finance through its Chair, Michael Gourley, the Deputy Minister of Finance.

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Message from the Chair

Since taking office in June 1995, the Government has introduced measures that will lead the Province to a balanced budget by 2000-01. The Finance Minister's message is quite clear – budgetary deficits will be eliminated, and Provincial debt will stabilize.

However, even as requirements for new financing decline steadily, Ontario will remain in the capital markets as the refinancing of maturing debt assumes greater emphasis within the borrowing program. In 1995-96, maturities were $2.1 billion. In 1996-97, maturities will be approximately $6 billion and will remain at comparable levels over the next few years.

In raising and managing funds on behalf of the Province and other public sector organizations, the Ontario Financing Authority will continue to play the central role. Having said this, important changes are being made to its operations to reflect the recommendations of the Ontario Financial Review Commission. Appointed by the Minister of Finance on July 25, 1995, the Commission was charged with reviewing financial management and accountability practices across the Ontario Government. Upon receipt of the Commission's report, the Government acted swiftly to adopt most of its proposals.

Recommendations addressed to the Ontario Financing Authority relate to corporate governance, and the adoption of certain "best practices" as found in the private sector, such as articulation of a multi-year business plan.

Corporate Governance: Our corporate governance framework is described along with an overview of the 1995 Board of Directors in an Appendix to this Report. One of the Commission's key recommendations was to expand the Board to include private sector appointments. Our plan is to address this recommendation in 1996-97.

Best Practices: As mentioned, another of the Commission's recommendations proposed that the Authority develop a business plan – articulating its goals and priorities – on a multi-year basis. We have done so. Core elements of our plan are reflected in this report. Subsequent annual reports will provide an account of our performance in relation to our goals and benchmarks.

Another measure adopted in parallel with the best of industry standards is the clear separation of risk control from the risk management function. Performed by two distinct groups, at arm's length from one another, Ontarians can be assured of the Authority's adherence to strict debt risk management policies and practices.

In essence, the recommendations of the Ontario Financial Review Commission were intended to ensure that the Authority has the necessary expertise, systems and processes in place to ensure its continued success in achieving its mandate, and to safeguard the public interest.

As we look to the future, other initiatives having a bearing on the operations of the Ontario Financing Authority are found in the 1996 Ontario Budget. In 1996, we will take responsibility for the borrowing, investing, cash management and other financial activities of a number of ministries and Crown agencies that currently carry out these activities on their own.

In closing, I am encouraged by developments occurring in recent months. The Government's demonstrated commitment to its balanced budget plan coupled with strong fundamentals in the province's economy bode well for the Ontario credit.

Since signing on as Chair, I have enjoyed working with the other members of the Board and with staff of the Authority. Led by Tony Salerno, I am confident that the Province is well served by the skills and professionalism of the women and men at the Ontario Financing Authority.

Michael L. Gourley
Chair

CEO's Remarks

In the months since my appointment (effective January 1, 1996), I have participated in a number of sessions with investors, investment dealers and others having a general interest in Ontario's debt financing activities. Topical in nature, various questions raised during these sessions are worth reviewing here.

The Authority's primary objective is to strike a balance between the interests of Ontarians — in achieving cost-effective financing — and the interests of our investors by designing products that meet portfolio management strategies. As CEO, aspects of my role in furthering this objective are to plan and execute the Province's borrowing program; oversee Ontario's investor outreach initiatives; and contribute business intelligence on market trends and viewpoints to government's policy development process.

Another key responsibility of the CEO is to safeguard the Provincial credit. On an operational basis this means several things. Foremost, I ensure coordinated market access among the Authority, Ontario Hydro and other agencies accessing capital markets under the Provincial guarantee. As part of this responsibility, my staff and I review the business plans of various public sector entities and, as necessary, incorporate agency requirements into the Authority's overall financing plan. The 1996 Budget initiative centralizing borrowing and other financial management activities under the auspices of the Authority will enhance our ability to discharge these responsibilities.

Equally important to safeguarding the Provincial credit is managing the risks inherent to the Province's financing activities. Here, as CEO, I ensure that the Authority operates within the policy framework approved by the Board of Directors and the Minister of Finance, and that the proper checks and balances are in place.

Often I am asked to explain why the Authority's risk management policies are more restrictive than industry practices generally.

Faced with sizeable requirements, the Authority raises funds in both domestic and international capital markets. We do this to manage costs, ensure liquidity and diversify our investor base. These are the benefits. However, certain risks, such as foreign currency exposure, are inherent to borrowing in international markets. Protecting against adverse movements in the capital markets, we are vigilant in adhering to standards more prudent, or cautious, than the norm. For example, our only use of derivative instruments is for hedging purposes and to minimize debt interest costs.

Inside the organization, I personally oversee the activities of our risk control group. Separate from the trading desk, the group serves as a watchdog, monitoring financial risks associated with the Authority's borrowing, investment and risk management activities. Interest rate, credit, currency and liquidity exposures are monitored daily to ensure compliance to risk policies and procedures.

Before describing some of our plans for 1996-97, I would like to touch briefly on some of the events that distinguished the past year.

Despite restricted windows of opportunity leading up to the Ontario election and later, the Quebec referendum, the Authority was successful in raising over $12 billion in 1995-96.

Another hallmark for the year was our review of financial activities currently conducted elsewhere in the government. The review determined that investment returns could be improved and costs reduced by consolidating the management of these activities within the Authority. In the 1996 Budget, the Government endorsed the move to centralize these functions under the Ontario Financing Authority.

Turning to the coming year:

- Together with the risk control group, I will spearhead a review of the Authority's current risk management policies and procedures in the context of regulatory requirements and "best" private sector practices. The objective of this project is to remain at the forefront of industry standards with respect to our own practices.

- We will move to consolidate financial management activities (financing, banking and cash management) within our operations.

- Also, I look forward to further opportunities to build on Ontario's relationships with fixed-income investors.

Planned public market borrowing for 1996-97 is $10.0 billion. The proceeds from our second Ontario Savings Bonds campaign are included in this figure.

In terms of the borrowing program, a priority will be to seek opportunities to smooth our maturity profile.

Finally, within the organization, my aim is to create an environment that draws on the best talents of staff to deliver quality performance.

Tony Salerno

Tony Salerno
Vice-Chair and Chief Executive Officer

Ontario Economic Review

During the 1995 calendar year, the Ontario economy recorded solid growth of 3.2%, well above the 2.3% growth in the national economy. This followed on the heels of outstanding growth (4.7%) in the previous year. Compared to steady growth performance throughout 1994, Ontario's economy performed inconsistently in 1995. The first half of the year saw declines in both employment and output, as the 400 basis point run-up in interest rates over the course of 1994 took its toll on both domestic spending and export markets. The second half of 1995 saw a solid rebound in jobs and output, led by the export sector as interest rates eased and the slide in global demand ended.

As a result of exchange rate adjustments, healthy productivity growth and the absence of cost pressures, the Province's competitive position has improved dramatically. Since 1991, export-oriented producers of autos, auto parts, computer-oriented capital goods and related business services have led growth. During the same period, unit labour costs in Ontario's manufacturing sector (measured in U.S. dollars) declined by 19.2%. Owing to these factors, the performance of Ontario exporters continued to impress markets throughout 1995, as international exports expanded 14.8%, following 20.4% growth in 1994.

For 1996, declining interest rates, rising employment and lower taxes will provide momentum to private domestic demand.

- By mid-October 1996, one-year mortgage rates declined to 5.6% from a 1995 peak of 10% while five-year rates fell to 7.4% from 10.75%.

- Private sector employment over the first nine months of 1996 was up 90,000 from year-earlier levels, more than offsetting a 14,000 decline in public sector employment.

- The first step in Ontario's 30% reduction in personal income tax rates was announced to take effect on July 1, 1996.

These developments contributed to strengthening consumer confidence and continuing improvement in the housing market and consumer spending.

Public sector restructuring provides an essential base for the longer-term health of the Ontario and Canadian economies. As the International Monetary Fund recently reported, governments in Canada are reducing their deficits faster than those in any other major industrialized country. Recognition of Canada's improving fiscal position and sustained low inflation has translated into strong demand for Canadian assets and a sharp drop of Canadian interest rates relative to U.S. rates.

Conditions are in place in Ontario to achieve sustained, non-inflationary economic growth.

- The economy is highly competitive and well placed in key industries.
- Cost pressures are minimal.
- The fiscal situation is improving rapidly.
- The tax competitiveness of the economy is improving with income and payroll tax cuts.

S Dorey

Steve Dorey
Chief Economist
Province of Ontario

Management's Discussion and Analysis

CAPITAL MARKETS ACTIVITIES

Fixed-Income Markets

Nineteen ninety-five was a positive year for both domestic and international bond markets. Growth in North America and Europe slowed, while the Japanese economy continued to languish for most of the year. In Europe, consumer spending remained fragile in an environment of stubborn unemployment and tight fiscal policy. In the United States, a mild correction to previously strong capital and consumer spending teamed up with special one-time factors (the fall 1995 Boeing strike and federal spending deferrals due to the budget battle) to slow recorded growth. Central banks in Europe and Japan achieved significant monetary easing through declining interest rates throughout much of 1995. In North America, stable-to-declining dollar exchange rates moderated the economic impact of stable-to-lower real interest rates. Nominal interest rates, meanwhile, fell worldwide, as global inflation was stable, creating an excellent environment for financial assets. The U.S. Federal Reserve lowered the key federal funds rate three times from mid-1995 to early 1996, while the Bank of Japan reduced its short rates to record lows in an effort to revive the Japanese economy and ameliorate the pressure in its financial sector.

Early in 1996, growing concerns about the aging of the U.S. expansion were brought to a head by the jump in U.S. non-farm payroll employment figures for February, released in March. Fixed-income markets corrected sharply, reversing about half the gains made in 1995.

In Canada, markets responded positively to the strong fiscal measures introduced by federal and provincial governments and to the low and steady inflation picture. Over the year, 10-year Government of Canada bond yields fell from 8.5% in April 1995 to 7.6% at the end of March 1996 and the Canadian dollar improved from a low of U.S. 71 cents recorded in April 1995 to over U.S. 73 1/2 cents by March 1996. Short rates plummeted, from a high of 8.2% in April 1995 to close the fiscal year at 5%, as the Bank of Canada eased. Consequently the Canadian yield curve moved from very flat to very steep, duelling at the short end with the U.S. curve for the lowest territory.

Volatility in interest and exchange rates was also evident, particularly as the Canadian dollar swung through much of the year from confident to threatened status, trading for several months in a wide 2 to 2 1/2 cents range. Long yields backed up twice, once in mid-summer and again in the fall.

Volatility was most noticable in the period surrounding Quebec's referendum on sovereignty in October 1995. The Canadian dollar temporarily dipped as low as U.S. 72.90 cents, having traded as strong as U.S. 75.10 cents earlier in the year. Short rates spiked nearly 80 basis points, from 6.4% in the week before the referendum to 7.2%. Despite the close referendum result, rates subsequently renewed their downward trend, dropping below 6% by the beginning of November. At the same time the U.S./Canada 10-year spread differential narrowed to about 130 basis points at the end of the fiscal year, following a pre-referendum high of 189 basis points. The Canadian dollar stabilized, trading in March 1996 in the U.S. 73 to 73 1/2 cents range.

1995-96 Financing Program

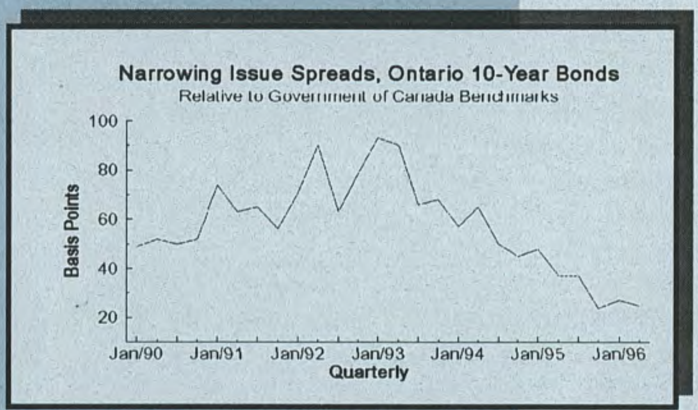
For the fiscal year ending March 31, 1996, the Authority borrowed over $12 billion, consisting of $6.7 billion to fund the Province's cash requirements including $500 million borrowed on behalf of agencies, $2.1 billion for maturing debt and an increase in liquid reserves of $3 billion. The $500 million raised on behalf of agencies was applied principally to the Ontario Transportation Capital Corporation for Highway 407, a major new toll highway north of Toronto.

The Canadian market remained Ontario's primary source of funds in 1995-96, accounting for $5.2 billion of total financing. Taking advantage of a strengthening Canadian dollar in early 1996, the Authority launched its first Canadian Dollar Global bond since 1994. This issue alone accounted for $1.25 billion of funds raised in the Canadian market. A new product was Ontario's first "retirement bond" ($107 million). Aimed at investors looking for monthly income as they plan for retirement, this 10-year bond pays no interest for the first five years and then pays monthly interest at an annual rate of 17.25% for the remaining five years.

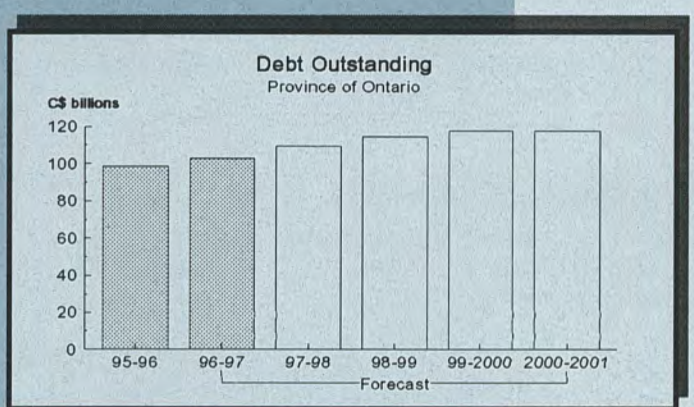
Other markets were accessed also as the Authority continued to diversify its use of financing instruments and broaden the Province's investor base. U.S. Dollar Global, Swiss Franc, and Deutsche Mark bonds were issued for a total of $4.1 billion. $1.3 billion in Canadian, U.S., and Australian dollar bonds were placed with Japanese retail investors, while $1.4 billion was raised through private placements with domestic and foreign investors.

The Authority was able to take advantage of lower interest rates and narrower spread differentials relative to comparable Government of Canada benchmarks (as shown in Graph A, page 10) throughout much of 1995-96. Lower interest rates during 1995 enabled the Authority to reduce interest costs for new issues and refinancing. For instance, some maturing debt had interest rates as high as 13%; this debt was refinanced with long-term Canadian interest rates as low as 7.5%.

Graph A



Graph B



During 1995-96 Ontario bond spreads over Canada's narrowed to their lowest levels in five years (Graph A). Three factors contributed to narrower spreads: aggressive actions to cut spending, the Province's declining deficit outlook, and Hydro's lower borrowing requirements. These factors are reflected in investors' favourable perceptions of the Ontario credit.

Total financing requirements for 1996-97 are $14.9 billion. As of March 31, 1996, planned public market borrowing stood at $10.0 billion. Remaining requirements will be met by drawing down liquid reserves. The Authority will continue to meet the Province's financing requirements by targeting financial products attractive to fixed-income investors in both the domestic and international markets. Funding for 1996-97 has also been raised by offering the second issue of Ontario Savings Bonds to Ontario residents in June 1996.

RISK CONTROL AND REPORTING

In the previous fiscal year, the Authority moved to establish a separate control operation. The process culminated in the past year with the creation of the "Risk Control Division." The Division is responsible for ensuring adherence to policy and for measuring and monitoring financial risks associated with the Authority's borrowing and risk management activities. It encompasses three different but complementary sections — Risk Policy and Analysis, Credit Analysis and Rating Relations, and Information Systems Support — and undertakes the following functions:

- Operates the reporting system with respect to the Authority's risk positions to ensure accurate analyses and prudent management of existing debt and potential exposures to currency, interest rate and counterparty (credit) risk;
- Measures the performance of the Authority's borrowing, investment and risk management activities;
- Coordinates Public Debt Interest (PDI) forecasting and monitoring for use in the Provincial Budget and Fiscal Updates;
- Develops and recommends amendments to risk management policies to maintain risk management activities within the approved risk tolerance levels and to ensure consistency with regulatory and current industry practices;
- Monitors the credit ratings and analyzes the credit quality of existing and potential counterparties;
- Manages the Province's relationships with domestic and international credit rating agencies.

The Director of the Risk Control Division reports directly to the Chief Executive Officer and provides positions and risk exposures daily to the Risk Management Committee. The Risk Management Committee consists of the CEO, Executive Director of Capital Markets, and the Directors of Risk Control and Risk Management. The Director of Risk Control also provides similar information biweekly to the Authority's Borrowing Strategy Committee (senior management of the Authority).

During 1995-96 the Division established a credit risk exposure monitoring system. The Authority has always minimized credit risk by dealing with highly rated counterparties and by monitoring nominal credit exposures to ensure compliance to credit limits. The implementation of a mark-to-market system for derivative instruments enables the Authority to quantify credit exposures to counterparties based on daily market conditions.

The Division has several new initiatives for implementation in 1996-97, including:

Updating risk management policies and procedures to ensure comparability with financial industry and regulatory practices. The growing complexity, diversity and volume of derivative products bring additional challenges to the field of risk management. The Authority will track industry developments on a continuous basis with the aim of applying the best industry practices to the Authority's own operations. Current policies, practices and procedures will be reviewed to ensure consistency with those advocated by domestic and international regulatory and advisory bodies such as the Bank for International Settlements (BIS), the Canadian Deposit Insurance Corporation (CDIC) and the Office of the Superintendent of Financial Institutions (OSFI).

Enhancing credit exposure policies and their application. Enhanced policies and procedures are necessary due to the increased size of the Province's debt portfolio and the subsequent increased use of derivative instruments for hedging purposes. The policies and procedures governing the selection of counterparties and unwinding of swaps will be reviewed to ensure that the Authority has the appropriate amount of flexibility for risk management. At the same time, the Authority will intensify its monitoring of its least highly rated counterparties. In conjunction with these procedural changes, the Authority is considering the use of various "credit enhancement techniques" such as collateralization agreements, whereby the Authority secures collateral from a counterparty to be applied against the amount owing, in the event of default.

Expanding the use of performance measures for borrowing and risk management activities. The plan is to apply a wider variety of analytical techniques for benchmarking and risk measurement.

Performance Benchmarks
It is important to track performance of the Authority's borrowing and risk management programs to determine whether the objective of minimizing borrowing costs within approved risk levels is being achieved. However, performance measures for debt issuance and related risk management activities are much less standardized than for investment management. Thus, the Authority is developing its own benchmarks in consultation with external advisors, and, to the extent possible, drawing from existing industry practices. In constructing these performance benchmarks, the Authority is taking a pragmatic approach. Specifically:

- Only the more important activities in terms of dollar impact will be evaluated;

- More than one benchmark will be developed since there is a wide range of activities and no all-inclusive benchmark is appropriate; and
- The newly developed performance measures will be refined as systems are routinely upgraded and as the Authority gains more experience in performance measurement.

Benchmarking is a complex process for the Authority because there is a wide range of activities to be evaluated, many of which are interrelated. In addition, the effectiveness of some strategies can only be fully evaluated over long periods. Nevertheless, establishing acceptable performance measures is a top priority for the Authority, and these measures will be implemented in 1996-97.

CORPORATE FINANCE

The Corporate Finance Division took lead responsibility for drafting the 1996-97 Ontario Financing Authority Corporate Plan. The plan was prepared in response to a recommendation by the Ontario Financial Review Commission that the Authority establish performance objectives to assist the Province in the evaluation of the Authority's performance by measuring actual results against expected results.

In 1995-96, the Corporate Finance Division began a review of financing activities currently conducted by individual government ministries, agencies, boards and commissions. Phase I of this review has been completed and is now being implemented. Agencies whose financing activities were reviewed were the Liquor Control Board of Ontario, the Ontario Lottery Corporation and the Ministry of Municipal Affairs and Housing.

Based on the recommendations of the Authority, the Minister of Finance announced in his Budget that the Ontario Financing Authority would be taking responsibility for financial activities that had been carried out previously by a number of ministries and agencies. Phase II of this review will be completed in the first part of 1996-97.

In its advisory capacity, the Authority continued to provide financing advice to the Ontario Transportation Capital Corporation on the feasibility of privatizing Highway 407, and provided advice regarding alternative methods of financing for a western extension of the highway.

The Authority worked with the Ontario Clean Water Agency to review financing options for its loan portfolio, as well as with other ministries and agencies to assist them with the review of projects. For example, the Authority assisted Management Board Secretariat and the City of Windsor in the financial analysis of a combined Provincial Courthouse and Municipal Police Headquarters in the City of Windsor. As well, the Authority has been working with the Ministry of Transportation and Metropolitan Toronto to review financing alternatives for new subway cars.

Finally, the Authority provided analysis for the Province on proposals from the private sector for the privatization of Provincially owned assets including Ontario Hydro and the Liquor Control Board of Ontario.

In 1996-97, the Corporate Finance Division will continue to develop alternatives to traditional debt financing, particularly as they relate to self-supporting capital projects. To assist in this, the Division will develop a framework for the identification and evaluation of project financing opportunities. The Division anticipates an ongoing role in the evaluation of privatization proposals.

FINANCIAL MANAGEMENT SERVICES

In keeping with its role to provide financial services to other public sector bodies, a number of initiatives were implemented in the past year.

- A pilot project wherein several ministries accepted debit (bank) cards as a means of payment for services was successfully completed; this initiative will be fully implemented across other ministries in 1996-97.
- Also completed was a study identifying several areas in Crown agencies where banking fees could be reduced and duplication eliminated by changing the banking services structure and consolidating a number of banking tenders under the Province's umbrella.
- Other uses of banking technologies were introduced resulting in savings of approximately $200,000. Banking technologies were used to:
  - simplify ministries' reconciliation functions and increase response time to customers using credit cards;
  - reduce paper processes and manual keying efforts regarding tax receipts;
  - shorten the cheque production cycle through the use of electronic signatures.

In addition, an extensive review of cash-flow patterns was undertaken with a view to improving cash management and consolidating certain deposit-processing activities in the Ministry of Finance.

As noted, the Authority's financial services responsibilities will increase in line with the 1996-97 Provincial Budget announcement.

PROVINCE OF ONTARIO SAVINGS OFFICE

The mandate of the Province of Ontario Savings Office (POSO) is to supply financing to the Province while providing competitively priced financial services to the public. Both aspects of the mandate have been achieved by focusing on the delivery of personal customer service while being cost-conscious.

POSO provides deposit-taking services to the public through a network of 23 branches and five agencies. At year end, these deposits totalled $2.2 billion. Details of POSO's financial results are contained in the Summary of Financial Results.

In accordance with the Ontario Financial Review Commission's recommendations, POSO's activities are now disclosed on a segregated basis in the Authority's 1995-96 Financial Statements.

RISK MANAGEMENT

The objective of risk management is to minimize the interest costs associated with the Province's outstanding debt and new borrowing, while strictly adhering to approved policies, borrowing plans and risk limits. As a government agency, the Authority has a risk-averse orientation and maintains a prudent and cautious approach in managing the Province's financial risks.

Major responsibilities include the planning and execution of financial transactions for risk management purposes, as well as short-term borrowing, through the Province's treasury bill and U.S. commercial paper programs and through the use of liquid reserves.

Currency Risk

Currency risk is the risk of increased debt servicing costs and principal payments due to fluctuations in foreign exchange rates. The policy covering currency risk stipulates that unhedged foreign exchange exposure cannot exceed 2% of total debt. Net foreign currency exposure was 1.3% of total debt as of March 31, 1996, with most of the currency exposure in U.S. dollars. The increase in exposure (from the 0.03% reported in last year's Annual Report) is attributable to a portion of the February 14, 1996 US$ Global bond that was not hedged fully at the time of issue to take advantage of cost-minimization opportunities offered by a managed exposure position in prevailing market conditions.

Credit Risk

Credit risk is the risk of financial loss due to the default or failure of capital, money or derivatives markets participants to meet their financial commitments. This risk is reduced by dealing with highly rated counterparties (the Authority requires its swap counterparties to have a Single A or greater rating); it is the Authority's practice to enter into agreements with counterparties that hold an "AA-" rating or better. When there is concern over the outlook for specific counterparties, the Authority responds in one of two ways: exposures are transferred to other highly rated parties, or exposures are adjusted via contractual arrangements designed to reduce risk levels. Credit exposures are monitored daily to ensure compliance with credit and risk limits.

At year-end, 95% of the notional amount of swaps outstanding were with financial institutions holding an "AA-" or higher rating.

Counterparties for money market and foreign exchange transactions must have at least an "R-1 mid" rating by Dominion Bond Rating Service or an "A-1+ or A-1" or "P-1" rating by Standard and Poor's and Moody's, respectively.

Concentration risk, which is risk that exists when a significant proportion of the credit risk is held by one or a small group of counterparties, is reduced by setting limits for exposure based on credit ratings for each corporate counterparty. For the 1995-96 fiscal year, swap, money market and foreign exchange exposure was spread over 50 institutions.

Interest Rate Risk
Interest rate risk is the risk of increased debt servicing costs due to changes in interest rates. The policy specifies that floating rate exposure cannot exceed 15% of total debt. As of March 31, 1996, the percentage of floating rate debt to total debt stood at 9.5%.

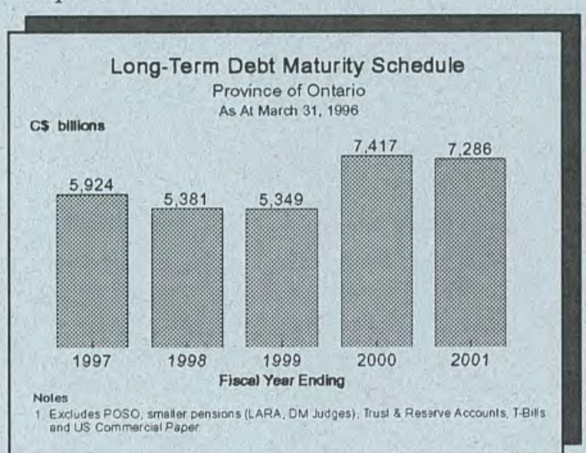
Liquidity Risk
Liquidity risk is the risk of having insufficient cash to meet current financial commitments. The Authority manages liquidity risk with the use of liquid reserves and short-term borrowing. During 1995-96, the Province's liquid reserves increased by approximately $3 billion. The increase took advantage of favourable market conditions and lower interest rates at the beginning of the 1996 calendar year. As noted previously, lower interest rates enabled the Authority to reduce interest costs for new issues and refinancings.

Liquidity risk is also minimized by the Province's Treasury Bill and U.S. Commercial Paper programs of $6.0 billion and $2.5 billion, respectively. As a back-up facility to the programs, the Authority also has US$4 billion in syndicated bank lines of credit involving 45 banks worldwide.

Refinancing Risk
Refinancing risk is the risk of replacing maturing debt with new debt at a higher cost. During 1995-96, the refinancing of debt maturities amounted to $2.1 billion. In 1996-97, this amount increases to approximately $6 billion and will remain at comparable levels over the next few years (see Graph C). To mitigate refinancing risk, term selection for the borrowing program considers the existing debt maturity profile. Where possible, the Authority issues with the aim of extending the maturity schedule.

Risk Management Activities
At March 31, 1996 the total swap portfolio had a notional value of $73 billion. The volume of transactions during the course of 1995-96 totalled $46 billion in bonds, $19 billion in interest rate and currency swaps, $11 billion in futures contracts, $23 billion in forward rate and currency agreements, and $2 billion in interest and currency options. Further details of the Authority's risk management transactions are included in the Appendices to this report.

Graph C



Financial Statements

Summary of Financial Results

The Authority's main source of revenue continues to be derived from the operations of the Province of Ontario Savings Office (POSO), which accepts deposits from the general public. Total funds held on deposit by POSO at March 31, 1996 increased by $131 million, or 6% over the year ended March 31, 1995. The increase in funds is composed of an increase in demand and short-term GIC deposits of $226 million, offset by a decrease in long-term GIC deposits of $95 million. The increase in short-term funds reflects the introduction in May 1995 of a new product — short-term deposits (30 to 364 days) — and, as expected in periods of declining interest rates, a trend to shorter maturities within the one- to five-year GIC market. Funds held in short-term deposits at March 31, 1996 amounted to $88.4 million.

Interest paid on deposits increased by approximately 10% over last year largely due to the new short-term GIC deposits and higher average GIC balances. The effective rate of interest paid on deposits increased modestly from 5.4% in 1994-95 to 5.7% in 1995-96.

Interest is earned by the POSO division in respect of its contributions to the Consolidated Revenue Fund. These earnings increased by 7% over the prior year, a lower rate than the increase in interest paid to depositors, due to a narrowing spread between the interest paid and received on demand deposits.

Miscellaneous revenue decreased by $0.4 million from the prior year. Last year, POSO earned commissions on the sale of the 1995 Ontario Savings Bonds. The 1996 Savings Bond campaign is in June 1996, thus commissions will not be received until the 1996-97 fiscal year.

POSO administrative costs declined by 11% in 1995-96 as a result of the elimination of excise tax amounting to savings of $267,000 and certain one-time costs incurred in 1994-95. These one-time costs included leasing costs related to data processing equipment of $144,000, and the installation of alarm systems amounting to $102,000.

Operations of the Ontario Financing Authority (excluding POSO) experienced an increase of 12% in salaries and benefits, as a result of additional staff including those in the newly formed Risk Control Division. Severance costs were also higher in 1995-96 due to staff retirements and the departures of three senior staff.

Administrative and general costs in the corporate Authority declined by 15% as a result of a decrease in the use of outside professional consultants. The Authority used professional consultants for various initiatives in 1994-95 as it was still in the early stages of its formation.

Amortization of $0.8 million on fixed assets of $3.4 million (1995 — $2.8 million) was charged for the first time in 1995-96, in accordance with Note 1 (ii) to the financial statements. Total purchases of $0.6 million were made in 1995-96 of which $0.4 million related to computer hardware. Note 4 to the financial statements provides a breakdown by asset groupings.

In 1995-96, the Authority continued to act as a financial intermediary between the Province and the USH sector (universities, colleges, school boards and hospitals), capital corporations and other entities as described in note 6 (ii) to the financial statements, for the loan-based financing program. Under loan-based financing, funds were advanced by the Authority to various entities on behalf of the Province, the repayment of which was to be financed by the Province. On October 11, 1995, the Management Board of Cabinet decided to terminate practices related to loan-based financing and to convert the remaining loan-based capital advances to grants, effective on or about December 1, 1995. As a result of that decision, advances from the Province to the Authority were forgiven and the above entities were in turn released from their indebtedness to the Authority.

As agent for the Province, the Authority makes loans to related parties, the repayment of which is to be funded through third-party revenues. These loans are reported in note 6 (iii) to the financial statements and consist of loans to the Ontario Transportation Capital Corporation, the Metro Toronto Convention Centre and Humber College.

The Authority also continues to administer the loans payable and receivable of the former Ontario Municipal Improvement Corporation (OMIC). OMIC's assets of $81.3 million consist of debentures receivable from various municipalities and an equal amount of liabilities payable mainly to the Canada Pension Plan and to the Province. Similar to the 1994-95 year, $1.1 million of loans receivable from municipalities matured during the year, and a corresponding amount of related debt was repaid. Interest earned and paid on these loans in 1995-96 amounted to $8 million. This is also the expected amount of interest to be earned and paid annually by OMIC up to 2011, when CPP loans start maturing.

The Authority continued to provide investment management services to the Ontario Clean Water Agency in 1995-96, managing funds in the range of $13 million to $74 million on its behalf.

Responsibility for Financial Reporting

The accompanying financial statements of the Ontario Financing Authority have been prepared in accordance with accounting principles generally accepted in Canada and are the responsibility of management. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to May 31, 1996.

Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit Committee of the Board of Directors.

The Board of Directors, through the Audit Committee, is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal controls. The Audit Committee meets periodically with management, the internal auditors and the external auditor to deal with issues raised by them and to review the financial statements before recommending approval by the Board of Directors.

The financial statements have been audited by the Provincial Auditor. The Provincial Auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The Auditor's Report, which appears on the following page, outlines the scope of the Auditor's examination and opinion.

On behalf of Management:

Tony Salerno

Tony Salerno
Vice-Chair & Chief Executive Officer

Office of the
Provincial Auditor
of Ontario

Bureau du
vérificateur provincial
de l'Ontario

AUDI ALTERAM PARTEM

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Auditor's Report

To the Ontario Financing Authority
and to the Minister of Finance

I have audited the balance sheet of the Ontario Financing Authority as at March 31, 1996 and the statements of net income and retained earnings and changes in financial position for the year then ended. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

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

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at March 31, 1996 and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles.

Erik Peters

Toronto, Ontario
May 31, 1996

Erik Peters, FCA
Provincial Auditor

Balance Sheet

(in thousands of dollars)	Corporate	POSO	Total March 31, 1996	Total March 31, 1995
ASSETS				
Current assets				
Cash and temporary investments (note 2)	$ 31,059	20,368	51,427	$ 16,792
Accounts receivable	2,131	35,842	37,973	35,125
Receivable from the Province of Ontario	24,547	2,221,330	2,245,877	2,109,179
Total current assets	$ 57,737	2,277,540	2,335,277	$ 2,161,096
Fixed assets (note 4)	971	1,590	2,561	2,783
Loans receivable	81,259	—	81,259	82,409
Total assets	$ 139,967	2,279,130	2,419,097	$ 2,246,288
LIABILITIES AND RETAINED EARNINGS				
Current liabilities				
Accounts payable and accrued liabilities	$ 3,218	35,161	38,379	$ 36,437
Short-term notes payable to the Province	—	—	—	500
Current portion of long-term debt (note 5)	461	—	461	1,017
Funds on deposit (notes 3 & 6 iv)	55,000	1,797,279	1,852,279	1,595,578
Total current liabilities	$ 58,679	1,832,440	1,891,119	$ 1,633,532
Long-term debt				
Due to the Province of Ontario (note 5)	$ 1,787	—	1,787	$ 2,381
Due to the Canada Pension Plan (note 5)	79,021	—	79,021	79,021
Funds on deposit (note 3)	—	422,743	422,743	518,206
Total liabilities	$ 139,487	2,255,183	2,394,670	$ 2,233,140
Retained earnings	480	23,947	24,427	13,148
Total liabilities and retained earnings	$ 139,967	2,279,130	2,419,097	$ 2,246,288

See accompanying notes to financial statements

Approved on behalf of the Board:

Michael L. Gourley
Chair

Tony Salerno
Vice-Chair & Chief Executive Officer

Statement of Net Income and Retained Earnings

(in thousands of dollars)	Corporate	POSO	Total March 31, 1996	Total March 31, 1995
REVENUE				
Interest revenue	$ 10,451	144,520	154,971	$ 144,175
Cost recovery from the Province	7,713	947	8,660	7,691
Miscellaneous revenue	—	1,135	1,135	1,536
Total revenue	$ 18,164	146,602	164,766	$ 153,402
EXPENDITURES				
Interest on short-term debt	$ 2,394	92,111	94,505	$ 79,636
Interest on long-term debt	8,041	30,341	38,382	40,476
Salaries, wages and benefits (note 7)	5,751	7,869	13,620	13,148
Administrative and general	1,708	4,437	6,145	6,994
Amortization	254	581	835	—
Total expenditures	$ 18,148	135,339	153,487	$ 140,254
Net income for the period	$ 16	11,263	11,279	$ 13,148
Retained earnings, beginning of period	464	12,684	13,148	—
Retained earnings, end of period	$ 480	23,947	24,427	$ 13,148

See accompanying notes to financial statements

Statement of Changes in Financial Position

(in thousands of dollars)	Total March 31, 1996	Total March 31, 1995
Funds provided by (used in):		
Operating activities		
Net income for the period	$ 11,279	$ 13,148
Adjustments to cash provided by operating activities		
Amortization	835	—
Increase in accounts payable and accrued liabilities	1,942	9,381
Increase in accounts receivable	(2,848)	(8,243)
Funds provided by operating activities	$ 11,208	$ 14,286
Financing activities		
Increase in funds on deposit	$ 161,238	$ 54,210
Decrease in indebtedness	(1,650)	(1,440)
Funds provided by financing activities	$ 159,588	$ 52,770
Investing activities		
Increase in receivable from the Province of Ontario	$ (136,698)	$ (63,481)
Decrease in loans receivable	1,150	1,433
Purchase of fixed assets	(613)	(2,783)
Funds used in investing activities	$ (136,161)	$ (64,831)
Net increase in cash and temporary investments during the period	$ 34,635	$ 2,225
Cash and temporary investments at beginning of period	16,792	14,567
Cash and temporary investments at end of period	$ 51,427	$ 16,792

See accompanying notes to financial statements

Notes to Financial Statements

Notes to Financial Statements

Background

The Ontario Financing Authority (the "Authority") was established as an agency of the Crown on November 15, 1993, under the authority of the Capital Investment Plan Act, 1993 (the "Act"). In accordance with the Act, the Authority's objects are:

- to assist public bodies and the Province of Ontario to borrow and invest money;
- to develop and carry out financing programs, issue securities, manage cash, currency and other financial risks;
- to provide such other financial services as are considered advantageous to the Province or any public body;
- to operate offices as provided under the Province of Ontario Savings Office Act, as agent for the Minister of Finance; and
- any additional objects as directed by the Lieutenant Governor in Council.

In accordance with the provisions of the Act, the Authority is incorporated under the laws of Ontario. The Authority is exempt from federal and provincial income taxes under section 149(1)(d) of the Income Tax Act of Canada.

1. Significant Accounting Policies

(i) General: The financial statements are prepared in accordance with generally accepted accounting principles prescribed by the Canadian Institute of Chartered Accountants.

(ii) Fixed assets: Fixed assets are stated at cost. Amortization is provided using the straight-line method over the estimated useful life of the asset as listed below. Amortization is not taken in the year of acquisition.

Furniture and equipment	5 years
Computer hardware	3 years
Leasehold improvements	remaining life of lease

(iii) Temporary Investments: Temporary investments are stated at the lower of cost or market value.

2. Cash and Temporary Investments

Cash and temporary investments at March 31 are as follows:

	1996	1995
Cash	$20,480	$16,792
Temporary investments	30,947	—
	$51,427	$16,792

3. Province of Ontario Savings Office

The Authority operates the Province of Ontario Savings Office (POSO). POSO accepts deposits from the general public, which form part of the Consolidated Revenue Fund of the Province. At March 31, 1996, funds on deposit amounted to $2.2 billion (March 31, 1995 – $2.1 billion), composed of deposits held for less than one year of $1.8 billion (March 31, 1995 – $1.6 billion) and long-term deposits of $0.4 billion (March 31, 1995 – $0.5 billion). The average rate of interest paid to depositors in 1995-96 was 5.68% (year ended March 31, 1995 – 5.35%).

Long-term funds on deposit with POSO (guaranteed investment certificates) at March 31, 1996 are as follows:

Year Ended March 31	Principal Maturing	Effective Average Interest Rate (%)
1998	$168,084	7.18
1999	95,681	6.77
2000	111,972	8.24
2001	47,006	7.08
Total	$422,743	

4. Fixed Assets

The balance of fixed assets, net of amortization is as follows:

	Cost as at March 31, 1996		Amortization		Net Balance	
	Corp.	POSO	Corp.	POSO	March 31, 1996	March 31, 1995
Furniture and equipment	$112	$867	$20	$159	$800	$895
Computer hardware	1,087	273	232	82	1,046	942
Leasehold improvements	26	1,031	2	340	715	946
	$1,225	$2,171	$254	$581	$2,561	$2,783

5. Ontario Municipal Improvement Corporation

In accordance with the Capital Investment Plan Act, 1993, the Ontario Municipal Improvement Corporation (OMIC) ceased to exist and its assets and liabilities were transferred to the Authority on November 15, 1993. OMIC received loans from the Canada Pension Plan (CPP) and the Province that it used to make loans to municipalities and school boards under the same terms as its debt.

The terms of the long-term debt due to CPP and to the Province at March 31, 1996 are as follows:

Year Ended March 31	Principal Maturing	Effective Average Interest Rate (%)
1997	$461	12.02
1998	325	12.65
1999	318	13.06
2000	319	13.38
2001	329	13.51
1 - 5 years	1,752	
6 - 20 years	79,517	9.61
Total	$81,269	

6. Related Party Transactions

(i) **The Province:** Advances from the Province to the Authority were made under two credit facilities of $1.6 billion and $3.5 billion each. Repayments of advances under each of the facilities can be made in whole or in part at any time provided that they are fully repaid by January 31, 1996 and August 31, 1996 respectively. The second facility can be used as a revolving credit line, allowing for successive advances of money to be repaid under the loan. All advances made under either facility bear interest at the 90-day Province of Ontario Treasury Bill rate, reset every 90 days. (March 31, 1996 – 5.086%; March 31, 1995 – 8.233%). Advances described in paragraphs (ii) and (iii) below were made under these credit facilities. As of March 31, 1996, advances under the first credit facility had been repaid.

(ii) **Loan-Based Capital Advances:** The Authority, functioning as an intermediary, received funds from the Province and advanced funds to capital corporations; universities, colleges, school boards and hospitals ("USH sector"); and others, the repayment of which was to be financed from the Province. When the Authority received payments from these entities, it forwarded them to the Province. These transactions, undertaken by the Authority, are not reflected in these financial statements.

On October 11, 1995, the Management Board of Cabinet decided to terminate practices related to loan-based financing and to convert the remaining loan-based capital advances for 1995-96 to grants, effective on or about December 1, 1995. As a result, advances from the Province to the Authority and from the Authority to USH sector entities and capital corporations for purposes of loan-based financing were either forgiven and released or repaid to the Authority.

	Amounts released on or about December 1, 1995	Outstanding at March 31,1995
Ontario Clean Water Agency	$ 431,064	$ 279,925
Ontario Transportation Capital Corporation	1,625,329	936,915
Ontario Realty Corporation	891,913	767,357
Ontario Science Centre	4,559	—
Ontario Legal Aid Plan	—	10,000
Universities, Colleges, School Boards and Hospitals	1,388,257	1,119,198
	$4,341,122	$3,113,395
Metro Toronto Convention Centre - repaid to the Authority in April 1996	$ 75,000	$ 22,443

(iii) **Lending to Related Parties:** Acting as agent for the Province, the Authority provides financing to various public bodies, the repayment of which is expected from third-party sources. The funds for these loans are borrowed from the Province. These transactions are not reflected in these financial statements.

The following amounts represent funds advanced by the Authority, including capitalized interest and financing costs to March 31:

	1996	1995
Ontario Transportation Capital Corporation - Hwy 407	$684,418	$194,358
Metro Toronto Convention Centre	7,345	—
Humber College	6,002	5,520
	$697,765	$199,878

(iv) **Investing for Related Parties:** In the normal course of operations, the Authority provided investment management services to the Ontario Clean Water Agency (OCWA) in 1995-96, managing funds in the range of $13 million to $74 million on their behalf. Funds held on deposit on behalf of OCWA at March 31, 1996 amounted to $55 million (March 31, 1995 – $25 million).

(v) **Other:** Ontario Transportation Capital Corporation and Ontario Clean Water Agency are capital corporations incorporated under the "Capital Investment Plan Act." A capital corporation is an agent of the Province. The Board of Directors, the Chair and Vice-Chair of the Board are appointed by the Lieutenant Governor in Council.

The Metro Toronto Convention Centre Corporation (MTCC) is a Crown agency of the Province within the meaning of the "Crown Agency Act." The majority of directors on the MTCC board are appointed by the Lieutenant Governor in Council.

Humber College is a Schedule III agency of the Province of Ontario. The College's Board of Governors is appointed by the Ontario Council of Regents, which in turn is appointed by the Lieutenant Governor in Council.

7. Pension Plan

The Authority provides pension benefits for its employees through participation in two pension plans of the Ontario Public Service established by the Province of Ontario: the Ontario Public Service Employees' Union Pension Plan and the Public Service Pension Plan.

The Authority's contributions related to the pension plans for the year were $299,755 (March 31, 1995 – $326,000).

Salaries, wages and benefits are paid by the Province and charged to the Authority.

8. Comparative Figures

Certain of the comparative figures have been reclassified to conform with the current year presentation.

9. Salaries

Provincial legislature requires disclosure of Ontario public sector employees paid an annual salary in excess of $100,000 in 1995. The individuals are listed as follows:

Name	**Position**	**Salary Paid**	**Taxable Benefits**
Madden, John*	ADM, Office of the Treasury and C.E.O.	$187,888.95	0.00
Mayman, Gadi	Executive Director, Capital Markets Division	$107,764.96	320.82

**Mr. Madden departed the post in December 1995.*

10. Exchange Listings

The Province is listed on the following stock exchanges:

- Amsterdam Stock Exchange
- Frankfurt Stock Exchange
- The Stock Exchange of Hong Kong Ltd.
- Stock Exchange of Singapore
- London Stock Exchange
- Luxembourg Stock Exchange
- Switzerland Stock Exchange (Zurich, Basle and Geneva Stock Exchange)
- Commission des Opérations de Bourse (the "Paris Stock Exchange")

Appendices

Appendix 1

Corporate Governance

Corporate governance at the Ontario Financing Authority consists of the processes for supervision and management of the Authority by the responsible officials including the Authority's senior management, its Board of Directors and the Minister of Finance. Various corporate governance processes are in place for the Authority. Others are being developed. These processes will be updated on an ongoing basis.

The Authority's accountability framework flows from its governing statute, the Capital Investment Plan Act, 1993 and from a Memorandum of Understanding between the Authority and the Minister of Finance. Together they provide that the Minister of Finance is accountable to Cabinet for the activities of the Authority. The Chief Executive Officer reports to the Board of Directors. In turn, the Board reports to the Minister.

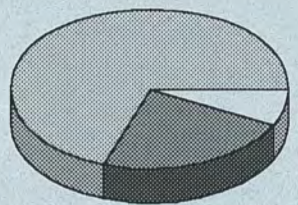
The Minister of Finance supervises the Authority with the aid of information reporting requirements set out in the Memorandum of Understanding as well as provisions for the Minister to approve the Authority's annual corporate plan and annual report. The Minister of Finance also recommends the appointment of Board members, provides policy direction, and receives information through the Deputy Minister of Finance, who is also the Chair of the Board.

Appointed by the Lieutenant Governor in Council, the Board of Directors supervises the business of the Authority through a number of processes. For example, it approves the Authority's corporate plan. The corporate plan sets out the Authority's major objectives and the strategies for achieving them, and is revised annually. The Board also approves key policies applied by the Authority in capital market transactions and management of the Province's debt and investment portfolios. The Board Audit Committee reviews the financial statements of the Authority, including the auditor's report, for recommendation to the Board, oversees internal audits and receives the advice of internal auditors and the Provincial Auditor regarding the adequacy of internal controls.

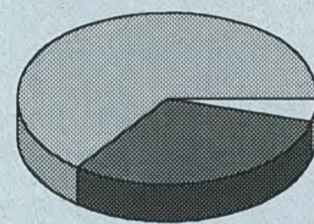
Financing Program Overview

New Debt Issues by Currency

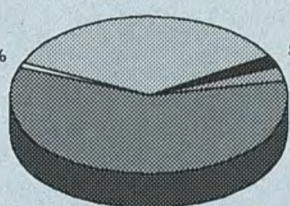
1990-91
Total New Debt Issues: $3.02B



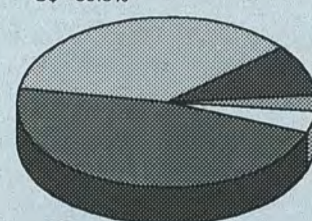
1991-92
Total New Debt Issues: $9.80B



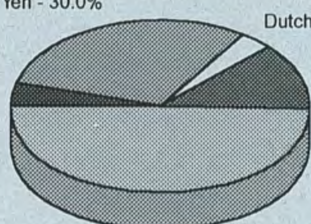
1992-93
Total New Debt Issues: $14.9B



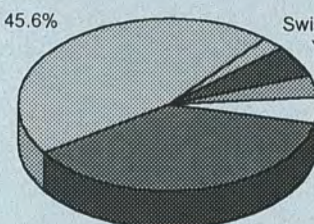
1993-94
Total New Debt Issues: $12.0B



1994-95
Total New Debt Issues: $11.0B



1995-96
Total New Debt Issues: $11.4B



Footnote to Charts:
Reflects long-term provincial debt and excludes Treasury Bills, US Commercial Paper, the Province of Ontario Savings Office and other liabilities, Ontario Housing Corporation and the 1994-95 pension restructuring. 1995-96 figures unaudited at the time of publication.

Board of Directors as of March 31, 1996

Ontario Financing Authority Board

The Board of Directors is composed of five members, all of whom are senior Ontario Civil Servants and, with the exception of the Authority's Chief Executive Officer, all are independent from the Authority's management team.

MICHAEL L. GOURLEY, Chairman of the Ontario Financing Authority and Deputy Minister of Finance since June 1995, has held leadership posts in fields ranging from academia (the University of Western Ontario), to television (TVOntario), to the railway industry (Canadian National Railway). Michael has also held positions in both the Ontario and Quebec public service.

TONY SALERNO, Vice-Chair and Chief Executive Officer of the Ontario Financing Authority and Assistant Deputy Minister, Office of the Treasury, in the Ministry of Finance; B.A., Economics; M.B.A., York University; M.A., University of Western Ontario; has held various senior posts within the Ontario public service. Prior to joining the Authority, Tony held the position of Executive Vice President of the Ontario Transportation Capital Corporation.

DAVID GUSCOTT*, Assistant Deputy Minister, Policy and Planning Division, Ministry of Transportation. In addition to his service with the Ministries of Transportation and Environment, David has held positions with the Ministries of Municipal Affairs, and Treasury and Economics.; B.A., Urban and Regional Planning. University of Waterloo; M.A., Public Administration, Queen's University.

STEVE DOREY*, Assistant Deputy Minister, Office of Economic Policy, and Chief Economist for the Ministry of Finance. Joined the Ministry of Finance in 1988. Prior to becoming Chief Economist, Steve was Director of the Macroeconomic Analysis and Policy Branch. Steve has taught macroeconomics and public finance at the University of Regina for five years and, as a consultant and civil servant, has advised several provincial and territorial governments on macroeconomic, trade and economic development policies.

PHYLLIS CLARK*, Assistant Deputy Minister, Corporate Policy and Planning Division, Management Board Secretariat (resigned from the Board as of March 1, 1996).

***Members of the Audit Committee:** Through the Audit Committee, the Authority's Board of Directors ensures that staff adhere to appropriate standards of internal controls and management practices.

Directors and Officers as of March 31, 1996

David Brand
Director, Risk Control

Mike Manning
Director, Risk Management

Gadi Mayman
Executive Director, Capital Markets Finance

Christine Moszynski
Director, Capital Markets Treasury

Bill Ralph
Director, Corporate Finance

Qaid Silk
Director, Province of Ontario Savings Office

Corey Simpson
Legal Advisor and Board Secretary

Risk Management Transactions

Derivative Portfolio Notional Value

at March 31, 1996
($ millions)

Table A

Maturity in Fiscal Year	1997	1998	1999	2000	2001	6 - 10 Years	Over 10 Years	Total
Swaps:								
Cross Currency	$2,308	2,543	2,839	4,217	5,194	21,793	945	$39,839
Interest Rate	652	4,901	1,024	3,990	4,192	17,947		32,706
Forward Foreign Exchange Contracts	2,519							2,519
Forward Rate Agreements	1,258							1,258
Futures	1,742							1,742
	$8,479	7,444	3,863	8,207	9,386	39,740	945	$78,064

Note:
1. The notional amounts represent the balance of outstanding transactions and are not indicative of the credit or market risk of these contracts. The notional amount represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

Counterparty Credit Risk Exposure

at March 31,
($ millions)

Table B

	1996
Interest Rate Contracts:	
Swaps	$ 591
Forward Rate Agreements	
Futures	5
Foreign Exchange Contracts:	
Swaps	1,841
Forward Foreign Exchange Agreements	6
Gross Credit Risk Exposure	$ 2,443
Less: Netting Arrangements	(1,778)
Net Credit Risk Exposure	$ 665

Note:

Counterparty credit risk is measured through the replacement value of derivative contracts. Replacement value represents the cost of replacing the contracts, at year end market rates, should the counterparties default on their obligations to the Province. The replacement value will fluctuate over time as a result of changes in foreign exchange rates, interest rates and terms to maturity.

Credit risk exists where the contract has a positive replacement value, as the value indicates the amount the counterparty would owe to the Province. The table above shows the credit risk of derivative financial instruments at March 31, 1996.

Where the contract has a zero or negative replacement value, the Province has no credit risk, as this represents the amount the Province would owe to the counterparty. As a result, there would be no loss to the Province should the counterparty default on its contractual obligations. Derivative contracts with a total negative replacement value with a counterparty are not included above and at March 31, 1996, these amounts totalled $945 million.

Glossary

All-In Cost: The cost of issuing debt, inclusive of all fees and commissions.

Bank for International Settlements (BIS): The BIS is an independent body that serves as a forum for monetary cooperation among the major central banks of Europe, the United States and Japan. It monitors and collects data on international banking activity, and serves as the clearing agent for the European Monetary System. The BIS has no regulatory authority but designs standards for use by banks worldwide.

Banker's Acceptance (BA): A draft drawn and accepted by banks that is based upon funds that will pay its face value at maturity. Essentially short-term bank credit.

Basis Point: One one-hundredth of one percent of yield, it is the smallest measure used in quoting yields on bonds and notes. For example, an addition of 40 basis points to a yield of 7.50% would increase the yield to 7.90%.

Bond: A certificate of debt whereby an issuer contracts to pay the owner a fixed principal amount on a stated future date. Typically there are also interest payments over the life of the bond.

Canada Deposit Insurance Corporation (CDIC): The CDIC is a federal agency that insures deposits of financial institutions. The CDIC also promotes the development of standards of sound business and financial practices for member institutions.

Canadian-Dollar Market: The markets for bonds denominated in Canadian dollars including the domestic, Euro, and Global bond markets.

Commercial Paper (CP): Short-term note or draft typically issued by a government or corporation on a discount basis. In the United States, CP is limited to terms of 1 to 270 days and is usually supported by a back-up bank line of credit.

Domestic Bonds: Debt securities issued in the domestic market, clearing through a domestic clearing system.

Euro-Bonds: Debt securities issued in the international (non-domestic) markets, and clearing through agencies such as Euroclear or Cedel. "Euro Can" bonds are the Canadian dollar-pay version.

Fiscal Year: The Province operates on a fiscal year basis each year commencing April 1 and ending March 31.

Floating Rate Notes (FRN): Debt instruments that bear a variable rate of interest. Coupons are linked to a floating interest rate index, and pay out at a predetermined yield spread to the index.

Forward Rate Agreement: An agreement between two parties to set future borrowing/lending rates in advance.

Future: A contract that confers an obligation to buy/sell a commodity at a specific price on a specific date.

Global Bonds: Debt securities issued simultaneously in the international and domestic markets, settling through various worldwide clearing systems. Can be issued in a variety of currencies including Canadian and U.S. dollars.

Hedging: Making or "entering into" offsetting commitments to minimize the impact of market fluctuations.

Issuance Spread: The difference between yield required by investors on a given bond issue and the yield on a relevant benchmark bond.

Mark-to-Market: The revaluing of a security, commodity or futures contract according to its current market value.

Medium-Term Notes (MTNs): Debt instruments with maturities generally ranging from one to 15 years, offered under a Program for the Issuance of Debt Instruments. MTNs are often structured to meet specific investor needs.

Non-Public Debt: Debt with covenants restricting the transferability of that instrument.

Office of the Superintendent of Financial Institutions (OSFI): The OSFI is a regulatory agency for federally incorporated financial institutions.

Option: Contract that confers the right, but not the obligation, to buy/sell a specific amount of a commodity at a specific price on a certain future date.

Private Placements: A debt issue that is offered to a single or a few investors as opposed to being publicly offered.

Public Debt: Any debt that is free to be publicly offered.

Repurchase Agreement (REPO): An agreement between two parties to sell and subsequently repurchase a security at a specified price on a specified date.

Revenue Bond: A bond secured by revenue from tolls, user charges or rents derived from the facility financed.

Self-Supporting Debt: Debt that finances a project, where the revenues will be adequate to pay off the bonds.

Spread: In terms of swaps, the basis points added to benchmark government bond yields to determine the all-in swap cost.

Swap: An exchange of payment streams between two counterparties. Swaps vary in terms of underlying securities, such as currency, interest rate, equity and commodity.

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ISSN 1201-2106

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Telephone (416) 325-0918

Enquiries regarding the Province of Ontario's prospectuses or other documentation filed with securities regulators should be directed to:

Linda Smith, Manager, Documentation
Telephone (416) 325-8142

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