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Caution regarding forward-looking statements
From time to time, we make written and oral forward-looking statements, included in this Annual Report, in other filings with Canadian regulators or the U.S. Securities and Exchange Commission, in reports to shareholders and in other communications, which are made pursuant to the "safe harbor" provisions of the United States *Private Securities Litigation Reform Act of 1995*. These forward-looking statements include, among others, statements with respect to our objectives for 2003, and the medium and long terms, and strategies to achieve those objectives, as well as statements with respect to our beliefs, plans, expectations, anticipations, estimates and intentions. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "anticipate," "estimate," "expect," "intend," "plan," and words and expressions of similar import are intended to identify forward-looking statements.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution readers not to place undue reliance on these statements as a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. These factors include, but are not limited to, the strength of the Canadian economy in general and the strength of the local economies within Canada in which we conduct operations; the strength of the United States economy and the economies of other nations in which we conduct significant operations; the effects of changes in monetary and fiscal policy, including changes in interest rate policies of the Bank of Canada and the Board of Governors of the Federal Reserve System in the United States; changes in trade policy; the effects of competition in the markets in which we operate; inflation; capital market and currency market fluctuations; the timely development and introduction of new products and services in receptive markets; the impact of changes in the laws and regulations regulating financial services (including banking, insurance and securities); changes in tax laws; technological changes; our ability to complete strategic acquisitions and to integrate acquisitions; unexpected judicial or regulatory proceedings; unexpected changes in consumer spending and saving habits; the possible impact on our businesses of international conflicts and other developments including those relating to the war on terrorism; and our anticipation of and success in managing the risks implicated by the foregoing.

We caution that the foregoing list of important factors is not exhaustive. When relying on our forward-looking statements to make decisions, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. We do not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on our behalf.

We evaluate our performance on a reported basis (i.e., as reported in our consolidated financial statements prepared in accordance with United States generally accepted accounting principles (GAAP)) as well as on a core basis (i.e., excluding special items). We view special items as transactions that are not part of normal day-to-day business operations or are unusual in nature, thereby obscuring or distorting our analysis of trends. The special items in 2001, shown in Table 6 on page 27, total $204 million and include gains on dispositions, a U.S. retail banking restructuring charge, income tax related to these items, and a tax expense resulting from enactments of tax rate reductions. There were no special items in 2002. Certain earnings measures, such as core earnings, do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other companies. Our recent U.S. acquisitions include RBC Centura Banks, Inc. (now includes Eagle Bancshares, Inc., RBC Mortgage and what was previously Security First Network Bank (SFNB)), RBC Liberty Insurance and RBC Dain Rauscher (includes Tucker Anthony Sutro Corporation). We present information on a core basis because some investors may also find it useful in evaluating financial performance and analyzing trends in our businesses.

The analysis and discussion that follows on pages 22 to 66 contains comparisons to 2001 that are generally based on the 2001 core numbers (i.e., excluding special items shown on page 27). The consolidated financial statements prepared in accordance with U.S. GAAP are on pages 67 to 96.

Our fiscal year-end is October 31. All dollar amounts in management's discussion and analysis are in Canadian dollars, unless otherwise specified.

Overview

TABLE 1 Net income

(C$ millions, except percentage amounts)	% change	2002	2001
Net income (1)	19%	**$ 2,898**	$ 2,435
Impact of special items (2)		–	(204)
Core net income	30%	**$ 2,898**	$ 2,231

(1) Net income includes goodwill amortization expense of $250 million in 2001 (nil in 2002).
(2) Special items are shown in Table 6 on page 27.

TABLE 2 Diluted earnings per share (EPS)

(C$, except percentage amounts)	% change	2002	2001
EPS (1)	16%	**$ 4.12**	$ 3.55
Impact of special items (2)		–	(.31)
Core EPS	27%	**$ 4.12**	$ 3.24

(1) EPS includes goodwill amortization expense of $.39 per share in 2001 (nil in 2002).
(2) Special items are shown in Table 6 on page 27.

As shown in the tables above, full year net income increased $463 million or 19% (16% on a per share basis). Excluding special items of $204 million ($.31 per share) in 2001 detailed on page 27, full year net income was up $667 million or 30% and EPS were up 27%. Excluding special items and goodwill amortization expenses of $250 million in 2001, net income was up $417 million or 17% and EPS were up $.49 or 13% in 2002 compared to 2001. This $417 million growth was largely driven by a $153 million increase in net income from recent U.S. acquisitions (excluding goodwill amortization expenses in 2001), cost savings of approximately $200 million after-tax from operations other than our recent U.S. acquisitions and lower provisions for credit losses of approximately $37 million after-tax.

On November 1, 2001, we adopted new accounting standards regarding business combinations under which goodwill is no longer amortized and is instead assessed for impairment at least annually. Accordingly, we did not incur goodwill amortization expense this year, whereas, in 2001, we incurred goodwill amortization expense of $250 million after-tax ($.39 per share).

Net income from our recent U.S. acquisitions was $232 million in 2002, up from $(80) million in 2001 ($(23) million excluding special items), partially reflecting the cessation of goodwill amortization this year, which accounted for $102 million of the net income improvement.

Excluding special items and goodwill amortization expenses, recent U.S. acquisitions resulted in an increase in net income of $153 million, largely reflecting the acquisition of Centura Banks, Inc. on June 5, 2001, which contributed seven more months of earnings in 2002 compared to 2001, synergies achieved from the integration of Tucker Anthony Sutro (acquired on October 31, 2001) into RBC Dain Rauscher, and stronger performance from RBC Dain Rauscher's fixed income business.

The lower growth rate in EPS than in net income reflected 32 million additional average common shares outstanding in 2002 as compared to last year. This largely reflects the issuance of common shares in last year's third quarter in connection with the share exchange for the acquisition of Centura Banks, partially offset by share repurchases during 2002.

As shown in Table 3 below, in 2002, U.S. and Other International revenues were $5.9 billion or 37% of total revenues, up from $4.2 billion or 29% in 2001. Recent U.S. acquisitions resulted in U.S. revenues increasing to $4.4 billion or 28% of total revenues, from $2.9 billion or 20% in 2001.

Total U.S. net income improved to $210 million from $(138) million in 2001 ($(81) million excluding special items), despite higher provisions for credit losses this year, largely for the reasons described above.

TABLE 3 Earnings by geographic segment

	2002				2001			
(C$ millions, taxable equivalent basis)	Canada	United States	Other International	Total	Canada	United States	Other International	Total
Net interest income	**$ 5,550**	**$ 1,262**	**$ 379**	**$ 7,191**	$ 5,595	$ 485	$ 449	$ 6,529
Non-interest revenue	**4,318**	**3,125**	**1,136**	**8,579**	4,862	2,404	889	8,155
Gross revenues	**9,868**	**4,387**	**1,515**	**15,770**	10,457	2,889	1,338	14,684
Provision for credit losses	**529**	**440**	**96**	**1,065**	757	379	(17)	1,119
Non-interest expense	**5,747**	**3,670**	**827**	**10,244**	6,214	2,712	715	9,641
Income taxes (1)	**1,442**	**67**	**54**	**1,563**	1,529	(64)	24	1,489
Net income	**$ 2,150**	**$ 210**	**$ 538**	**$ 2,898**	$ 1,957	$ (138)	$ 616	$ 2,435
Core net income (2)	**$ 2,150**	**$ 210**	**$ 538**	**$ 2,898**	$ 1,696	$ (81)	$ 616	$ 2,231

(1) Includes non-controlling interest and taxable equivalent adjustment.
(2) Excludes special items in 2001, which are described in Table 6 on page 27. There were no special items in 2002.

Outlook

We are targeting growth in diluted earnings per share of 10–15% and a return on common equity of 17–19% in fiscal 2003 based on the expectations that our cost management efforts will allow expenses to grow at a lower rate than revenues and that capital market activity will pick up somewhat in 2003.

Financial priorities

Revenue growth and diversification

In 2002, revenues increased 7%, primarily reflecting recent U.S. acquisitions. Operating, or core, revenues (i.e., excluding special items in 2001) increased 11%, also primarily reflecting recent U.S. acquisitions, and were higher than our objective of core revenue growth of 7–10%. Excluding recent U.S. acquisitions, operating revenues were flat. Detailed discussion follows on pages 38 to 41.

Cost control

Non-interest expense increased 6% and operating non-interest expense (which excludes special items, the costs of Stock Appreciation Rights (SARs) and retention compensation associated with acquisitions) increased 8%, reflecting recent U.S. acquisitions. Operating expenses excluding recent U.S. acquisitions were down 5%. A full description is provided on pages 42 to 44.

Strong credit quality

Provisions for credit losses and nonaccrual loans declined this year despite further deterioration in the telecommunication sector. The allocated specific provision for credit losses ratio was .50% (.48% net of effect of credit derivatives) in 2002 compared to .52% in 2001, while the nonaccrual loans ratio was 1.27% versus 1.36% in 2001. During the year, net charge-offs were .71% of average loans and acceptances compared to .55% in 2001. Detailed discussion and tables are provided on pages 45 to 52.

Balance sheet and capital management

Total assets were $382 billion at October 31, 2002, up $19.5 billion or 5% from October 31, 2001. At October 31, 2002, using Superintendent of Financial Institutions Canada (OSFI) guidelines and Canadian GAAP financial information, our Tier 1 capital ratio was 9.3% versus 8.7% at October 31, 2001, while the Total capital ratio was 12.7% versus 11.8% at October 31, 2001. Both ratios were above our medium-term (3–5 year) capital goals of 8% for Tier 1 capital and 11–12% for Total capital. More details are provided on pages 58 to 60.

Factors that may affect future results

There are numerous factors, many beyond our control, that could cause results to differ significantly from our expectations. Some of these factors are described below. Other factors, including credit, market, liquidity, insurance, operational and other risks are described in the Risk management section beginning on page 53.

By their very nature, and as noted in the "Caution regarding forward-looking statements" on page 21, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution readers not to place undue reliance on such statements in this management discussion and analysis as a number of important factors could cause actual results to differ materially from the plans, objectives, goals, targets, expectations, estimates and intentions expressed in such forward-looking statements.

Industry and non-company factors

As an integrated financial services company conducting business in Canada, the United States and other countries, our revenues and earnings are affected by the health of the economic, business and capital markets environments specific to the geographic regions in which we conduct business.

Factors such as interest rates, inflation, exchange rates, consumer spending, business investment, government spending, the health of the capital markets and terrorism impact the business and economic environment and, ultimately, the amount of business we conduct in a specific geographic region. For example, in an economic downturn characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment and consumer spending, the demand for our loan and other products would be adversely affected and the provision for credit losses would likely increase, resulting in lower earnings. Similarly, a continuation or worsening of the current prolonged downturn in the equity markets could cause a further reduction in new issue and investor trading activity, assets under management (AUM) and assets under administration (AUA), resulting in lower fee, commission and other revenues.

Our earnings are affected by the monetary policies of the Bank of Canada and the Board of Governors of the Federal Reserve System in the United States.

Changes in the supply of money and the level of interest rates can impact our profitability. A decline in interest rates would result in a decrease in the net interest income earned on our non-trading portfolio and an increase in the value of our long principal positions of securities subject to interest rate risk. Conversely, an increase in interest rates would result in an increase in the net interest income earned on our non-trading portfolio and a decrease in the value of our long principal positions of securities subject to interest rate risk. For a more complete discussion of interest rate risk and its potential impact on our non-trading portfolio, please refer to the discussion of asset/liability management activities in our non-trading portfolio on page 61. For a more complete discussion of interest rate risk and its potential impact on the value of principal position of securities subject to interest rate risk, please refer to the discussion of trading activities on page 55.

Our performance can be influenced by the degree of competition in the markets in which we operate.

The competition for clients among financial services companies in the consumer and business markets in which we operate is intense. Customer loyalty and retention can be influenced by a number of factors, including relative service levels, the prices of products or services and changes in the attributes of a product or service. Customer loyalty and retention can also be compromised as a result of the client being "cross sold" by a competitor firm. Non-financial companies can provide consumers with the option to pay bills and transfer funds without involving banks. Such disintermediation could reduce fee revenues.

Changes in the statutes, regulations and regulatory policies that govern activities in our various business lines could impact our results.
Regulations are in place to protect the financial and other interests of our clients. Changes to statutes, regulations or regulatory policies, including changes in the interpretation or implementation of statutes, regulations or regulatory policies, could affect us by increasing the ability of competitors to compete with the products and services we provide. In addition, our failure to comply with applicable statutes, regulations or regulatory policies could result in sanctions and financial penalties by regulatory agencies that could adversely impact our reputation and earnings.

Although we take reasonable measures to ensure compliance with governing statutes, laws, regulations and regulatory policies in the jurisdictions in which we conduct business, there is no assurance that we will always be in compliance or deemed to be in compliance. Accordingly, it is possible that we could receive a judicial or regulatory body judgment that results in fines, damages and other costs that would have a negative impact on our earnings.

Company specific factors

Our financial performance will be influenced by our ability to execute our U.S. expansion and integration strategy.
The first phase of our U.S. expansion strategy entailed putting together the original building blocks by acquiring businesses largely in the personal and commercial banking, insurance and wealth management areas. The second phase entails building scale by adding to these original building blocks through additional strategic acquisitions, increasing revenues through greater market penetration, new product and service offerings, heightened marketing and sales initiatives and through more client referrals between the companies operating in our different business lines. The second phase also entails achieving cost synergies through the integration of the back office and head office functions of our business units. Although we regularly explore opportunities for strategic acquisitions of companies in our lines of business, there is no assurance that we will be able to continue to complete acquisitions on terms and conditions that satisfy our investment criteria. Further, although results to date have met or exceeded our targets, there is no assurance we will continue to achieve anticipated cost synergies from the integration of acquired companies. Our performance is contingent on retaining the clients and key employees of acquired companies, although there can be no assurance that we will always succeed in doing so.

Our business depends on attracting and retaining key employees.
Our success as an integrated financial services company depends to a large extent on our ability to attract and retain key employees. The competition for talented people in the financial services sector is intense. There is no assurance that we will be able to continue to attract and retain key employees, although our policies and practices are geared towards doing so and attrition at the management level is low.

Other factors

Other factors that may affect future results include changes in trade policy, the timely development and introduction of new products and services in receptive markets, changes in tax laws, technological changes, unexpected judicial or regulatory proceedings, unexpected changes in consumer spending and saving habits, the possible impact on our businesses of international conflicts and other developments including those relating to the war on terrorism, and our anticipation of and success in managing the risks implicated by the foregoing.

We caution that the foregoing discussion of factors that may affect future results is not exhaustive. When relying on forward-looking statements to make decisions with respect to Royal Bank of Canada, investors and others should carefully consider the foregoing factors, other uncertainties and potential events, and other external and company specific factors that may adversely impact future results and the market valuation placed on our common shares. We do not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by Royal Bank of Canada, or on our behalf.

Critical accounting policies

Our significant accounting policies are outlined in Note 1 on pages 72 to 75. Certain of these policies require us to make estimates or assumptions that in some cases may relate to matters that are inherently uncertain. These policies include determining the allowance for credit losses, reporting the fair value of certain financial instruments, accounting for securitizations, determining the cost and obligations associated with pensions and postretirement benefits, and valuing goodwill and other intangibles.

Allowance for credit losses

The allowance for credit losses reflects management's estimate of probable losses in our loan and off-balance sheet portfolios at the balance sheet date. We determine and maintain an allowance based on a comprehensive and systematic review of our lending and off-balance sheet portfolios. As mentioned in Note 1 on page 73, our evaluation focuses on identifying and evaluating problem accounts and estimating probable losses that may exist on the remaining portfolio.

Allocated specific allowances are maintained to absorb losses on both specifically identified borrowers and other more homogeneous loans that have been recognized as nonaccrual. The losses relating to identified large business and government debtors are estimated based on the present value of expected payments on an account-by-account basis. Management's judgment is required when forecasting the amount and timing of expected payments. The losses relating to other portfolio-type products, excluding credit cards, are based on historical net charge-off experience. This amount represents the average percentage lost on nonaccrual balances and is based on past history and management's judgment.

The allocated general allowance represents the best estimate of probable losses within the portfolio that have not been specifically identified as nonaccrual. Estimates of portfolio losses are largely dependent on portfolio quality and economic conditions. In addition to the statistical analysis performed, management's judgment is required in determining the following inputs into the models employed:

- Expected default frequency
- Loss severity
- Charge-off trends
- Economic conditions, including duration of current cycle

We determine and hold an unallocated allowance, which explicitly reflects the subjective and judgmental elements involved in our determination of credit risk and the resulting loss estimates. In determining this allowance, management considers general economic and business conditions, regulatory requirements, recent loan loss experience and trends in credit quality and concentration.

The use of different estimates or assumptions in determining the allowance for credit losses may produce significantly different provisions for credit losses and financial results.

Fair value of financial instruments

We hold financial assets and liabilities, which are carried at fair value. These financial instruments comprise assets and liabilities held in our trading portfolio, securities that are available for sale and derivative financial instruments. Fair value for a majority of financial instruments in our portfolios is determined based on quoted market prices and provides the best evidence of value since it is the result of two willing parties transacting in an open market. Note 21 on pages 95 and 96 contains disclosure regarding the estimated fair value of financial instruments.

If quoted market prices are not available for certain assets or liabilities, we use financial valuation models to determine their fair value. A provision is made in situations where we believe there is the potential the amount realized on sale will be less than the estimated fair value due to insufficient liquidity over a short period of time. We also maintain a provision for model risk, which may occur when the estimated value does not reflect the true value under certain stress market conditions. All significant financial valuation models are vetted by our risk management function, which is not involved in trading the assets and liabilities and is able to provide an independent perspective. Our internal financial valuation models for accounting are strictly controlled and regularly recalibrated, and require the approval of our risk management function. The assumptions used in the financial models are subject to management's judgment, and different assumptions may produce significantly different fair values and financial results.

As outlined in Note 1 on page 72, changes in the fair value of trading account assets and liabilities are recognized in earnings. Changes in the value of available for sale securities are recognized in other comprehensive income, which is a component of shareholders' equity. Writedowns to reflect other than temporary impairment are recognized in earnings. We regularly assess whether other than temporary impairment exists.

For derivative financial instruments, we determine fair value using various methodologies including quoted market prices, prevailing market values for similar instruments, and net present value of future cash flows and other pricing models. In determining the assumptions used in our pricing and valuation models, where appropriate, we look to external market inputs including factors such as interest rate yield curves, currency rates and price and rate volatilities for options and other derivatives. The use of methodologies, models and assumptions in pricing and valuing derivatives is subjective and requires management's judgment. The use of different methodologies, models and assumptions may result in significantly different fair values and financial results.

Securitizations

Securitization is a process by which we sell loans or other financial assets to a special purpose entity (SPE), which funds the purchase by issuing securities to investors. The return to investors is derived from the cash flows of the loans or other financial assets purchased by the SPE. Details of our securitization activities are contained in Note 7 on pages 81 and 82. A discussion of our involvements with SPEs can be found on pages 64 and 65.

The calculation of the gain or loss on our securitization transactions involves the use of estimates and assumptions including expected credit losses, payment rates, discount rates and estimated future excess spread. The use of different estimates and assumptions may produce significantly different results reported in earnings.

Pensions and postretirement benefits

We offer various pension plans and postretirement benefit plans to our employees. Note 15 on page 88 contains accounting disclosure concerning our obligations with respect to these plans. The determination of obligations under our pension and other postretirement plans and related expense requires the use of actuarial valuation methods and assumptions. Assumptions typically used in determining these amounts include, as applicable, mortality rates, rate of employee turnover, future claims costs, discount rates, future salary and benefit levels, return on plan assets and future medical costs. The fair value of plan assets is determined using market values or approximations of market values for assets where market values are not readily available. Actuarial valuations and the determination of certain market value approximations are subject to management judgment and, as a result, the prepaid benefit asset (obligation) and pension and postretirement expense may differ significantly if different assumptions are used.

Goodwill and other intangibles

As outlined in Note 4 on page 78, we adopted the Statement of Financial Accounting Standard, *Goodwill and Other Intangibles Assets* (FAS 142). Under this accounting standard, goodwill is no longer amortized but is tested at least annually for impairment at the reporting unit level. Impairment is determined by comparing the fair value of a reporting unit to its carrying value. The fair value of a reporting unit and assets and liabilities within a reporting unit may be determined using a number of market valuation methods including quoted market prices, discounted cash flows and net realizable values. Inherent in each of these valuation techniques is the use of assumptions and estimates. Both the valuation method and the assumptions and estimates used therein are based on management's judgment. The use of different judgments and estimates may produce significantly different results in applying the goodwill impairment test.

Economic Profit

In addition to using traditional measures of financial performance such as net income, EPS and return on common equity (ROE), we also evaluate our performance based on the amount of Economic Profit earned. Economic Profit measures each business segment's cash operating earnings after providing for the cost of capital committed to the segment.

Cash operating earnings is net income available to common shareholders excluding the after-tax impact of special items and amortization of goodwill and other intangibles. The equity capital charge is derived by applying the cost of common equity, which is our proxy for the after-tax return required by shareholders for the use of their capital, to the amount of average common equity, commonly referred to as Economic Capital (EC). The estimated cost of equity is reviewed annually. As the result of a decline in longer-term bond yields since the last review, the cost of common equity was reset mid-year to 11.5% from 12.5%. The average cost of common equity in 2002 was 12%.

Economic Profit does not have any standardized meaning prescribed by GAAP, and therefore the Economic Profit information that we provide is unlikely to be comparable to similar measures presented by other companies. We present information on an Economic Profit basis as it is used by our management and because some investors may also find it useful in evaluating our financial performance and analyzing trends in our businesses.

To create shareholder value from an Economic Profit point of view, one must generate cash operating earnings in excess of the common equity capital charge. Positive Economic Profit adds to shareholder value while negative Economic Profit erodes shareholder value.

Economic Profit measures the change in value created for shareholders over time, and we believe it is an effective planning tool to focus attention on shareholder value growth opportunities. In order to maximize Economic Profit, one must seek to:

- Increase cash operating earnings without tying up more capital
- Target investments in projects that yield positive economic returns
- Improve overall effectiveness of invested capital through re-allocation from less effective uses
- Improve the risk-return profiles of the lines of business

We believe that Economic Profit analysis strengthens risk management discipline, as business segments are attributed capital based on their credit, market, operational and other risks. This discipline has resulted in controlled growth and a focus on returns commensurate with risks. Furthermore, Economic Profit encourages redistribution of resources from weaker to stronger performing businesses.

As shown in Table 4 below, we had record Economic Profit of $838 million in 2002, up from $583 million in 2001. This increase is the result of cash operating earnings growing at a faster rate than the capital charge. The Economic Profit amounts for the business segments in 2002 and 2001 are shown in the tables on pages 28, 30, 32, 34 and 36.

TABLE 4 **Economic Profit** (1)

(C$ millions, except percentage amounts)	**2002**	2001	2000	1999	1998
Net income available to common shareholders	**$ 2,800**	$ 2,300	$ 2,074	$ 1,568	$ 1,627
Adjustment for special items (after-tax)	**–**	(204)	–	88	17
Adjustment for amortization of goodwill and other intangibles (after-tax)	**64**	286	88	67	66
Cash operating earnings	**2,864**	2,382	2,162	1,723	1,710
Capital charge	**(2,026)**	(1,799)	(1,448)	(1,386)	(1,249)
Economic Profit (1)	**$ 838**	$ 583	$ 714	$ 337	$ 461
Economic Profit growth	**44%**	(18)%	112%	(27)%	23%
Average common equity	**$ 16,880**	$ 13,899	$ 10,725	$ 10,268	$ 9,255
Cost of common equity (2)	**12.0%**	12.9%	13.5%	13.5%	13.5%

(1) Economic Profit is cash operating earnings (i.e., net income available to common shareholders excluding the after-tax impact of special items and amortization of goodwill and other intangibles) less a charge for the cost of common equity.
(2) Average for the year.

Line of business results

Overview

Table 5 on page 27 shows our results by business segment in 2002. Our 2001 results include several special items, shown in Table 6 and described below. There were no special items in 2002.

Special items increased net income by $204 million in 2001. There were three items that increased non-interest revenues – an $89 million gain on the formation of the Moneris Solutions merchant card processing joint venture with Bank of Montreal, a $43 million gain on the sale of the Group Retirement Services group pension benefits administration business and a $313 million gain on the sale of RT Capital Management's institutional money management business. Non-interest expense increased due to a $91 million restructuring charge related to integration and cost-saving initiatives in the U.S. retail banking platform. Income taxes were increased by a tax expense of $101 million, reflecting a writedown of deferred tax assets due to reductions in tax rates.

We attribute common equity to our business segments based on an assessment of their credit, market, operational and other risks. Common equity in the Other segment includes equity attributed to specific functional units that are reported in Other, as well as any differences between our total common equity and common equity attributed to our businesses or our functional units. We implemented a number of changes to refine our capital attribution methodologies in early 2002, resulting in higher common equity being attributed to RBC Capital Markets and RBC Investments and lower common equity to RBC Banking and RBC Insurance compared to a year ago. However, the inclusion of a full year of operations of RBC Centura Bank in 2002, as compared to 2001, resulted in more common equity being attributed to RBC Banking. The amount of common equity attributed to the Other segment increased in 2002, largely as the result of internal capital generation outstripping the need to attribute additional common equity to the other five segments, based on an assessment of their risk profiles. Our attribution of capital to the business segments involves various assumptions and judgments.

RBC Banking produced an ROE of 19.2% and generated 53% of our net income in 2002. Net income increased 32% from 2001 and core net income (net income excluding the special items in Table 6) increased $276 million or 22%, as discussed on page 28. This improvement partially reflected higher core earnings from U.S. acquisitions (which include RBC Centura acquired on June 5, 2001, and RBC Mortgage), which rose to $206 million from $21 million ($73 million excluding goodwill amortization expense) a year ago.

RBC Insurance produced an ROE of 25.7% and generated 7% of our net income in 2002. Net income increased 10% from 2001, as discussed on page 30. RBC Liberty Insurance (acquired on November 1, 2000) contributed net income of $23 million in 2002 compared to $29 million ($39 million excluding goodwill amortization expense) in 2001.

RBC Investments produced an ROE of 11.1% and generated 12% of our net income in 2002. Net income declined by 32% while core net income increased $112 million or 48%, as discussed on page 32. RBC Dain Rauscher (acquired on January 10, 2001) made a profit of $3 million in 2002 compared to a loss of $73 million ($(33) million excluding goodwill amortization) last year.

RBC Capital Markets produced an ROE of 10.5% and generated 15% of our net income in 2002. Net income increased 26% and core net income increased 17%, as discussed on page 34.

RBC Global Services produced an ROE of 28.7% and generated 6% of our net income in 2002. Net income declined by 35% while core net income declined by 8%, as discussed on page 36.

The Other segment produced an ROE of 25.0% and generated 7% of our net income in 2002. Its 2001 results are shown in Note 3 on page 77. The ineffectiveness arising from certain derivatives used as cash flow hedges, in accordance with Statement of Financial Accounting Standards, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133), and gains from the securitization of mortgages contributed to the growth in earnings.

TABLE 5 Results by business segment

(C$ millions, taxable equivalent basis, except per share and percentage amounts)	2002 RBC Banking	RBC Insurance	RBC Investments	RBC Capital Markets	RBC Global Services	Other (1)	Total	2001 Core	2001 Reported
Net interest income	$ 5,576	$ 223	$ 371	$ 553	$ 136	$ 332	$ 7,191	$ 6,529	$ 6,529
Non-interest revenue	2,090	357	3,276	2,142	672	42	8,579	7,710	8,155
Gross revenues	7,666	580	3,647	2,695	808	374	15,770	14,239	14,684
Provision for credit losses	626	–	(1)	465	10	(35)	1,065	1,119	1,119
Non-interest expense	4,520	399	3,144	1,627	548	6	10,244	9,550	9,641
Income taxes	947	(9)	158	143	77	99	1,415	1,200	1,350
Non-controlling interest	8	–	–	–	–	100	108	107	107
Taxable equivalent adjustment	19	–	–	21	–	–	40	32	32
Net income	$ 1,546	$ 190	$ 346	$ 439	$ 173	$ 204	$ 2,898	$ 2,231	$ 2,435
Net income									
As a % of total	53%	7%	12%	15%	6%	7%	100%	100%	100%
% growth over prior year	32%	10%	(32)%	26%	(35)%	n.m.	19%		10%
% core growth over prior year	22%	10%	48%	17%	(8)%	n.m.	30%	1%	
Return on common equity	19.2%	25.7%	11.1%	10.5%	28.7%	25.0%	16.6%	15.1%	16.6%
Economic Profit (2)	$ 614	$ 100	$ (14)	$ (55)	$ 100	$ 93	$ 838	$ 583	$ 583
Diluted EPS							$ 4.12	$ 3.24	$ 3.55

(1) Represents other activities, which mainly comprise Corporate Treasury, Corporate Resources, Systems & Technology and Real Estate Operations.
(2) Economic Profit is cash operating earnings (i.e., net income available to common shareholders excluding the after-tax impact of special items and amortization of goodwill and other intangibles) less a charge for the cost of common equity.
n.m. not meaningful

TABLE 6 Special items affecting business segment results in 2001 (1)

(C$ millions, taxable equivalent basis, except per share amounts)	RBC Banking	RBC Insurance	RBC Investments	RBC Capital Markets	RBC Global Services	Other (2)	Total
Non-interest revenue							
Gain on formation of Moneris Solutions joint venture	$ –	$ –	$ –	$ –	$ 89	$ –	$ 89
Gain on sale of Group Retirement Services	7	–	36	–	–	–	43
Gain on sale of RT Capital Management	–	–	313	–	–	–	313
	7	–	349	–	89	–	445
Non-interest expense							
U.S. retail banking restructuring charge	91	–	–	–	–	–	91
Total impact (pre-tax)	(84)	–	349	–	89	–	354
Income taxes							
On items listed above	(33)	–	70	–	12	–	49
Enactment of change in tax rates	45	–	5	27	–	24	101
Total impact (after-tax)	$ (96)	$ –	$ 274	$ (27)	$ 77	$ (24)	$ 204
Impact on diluted EPS							$ .31

(1) There were no special items in the RBC Insurance segment in 2001. No special items at all in 2002.
(2) Represents other activities, which mainly comprise Corporate Treasury, Corporate Resources, Systems & Technology and Real Estate Operations.

RBC Banking

Business profile
RBC Banking serves over 11 million individuals, small and medium-sized businesses, and mid-market commercial clients in Canada, the U.S., the Caribbean and the Bahamas. Our distribution capabilities include a network of branches, business banking centres and other sales units, accredited financial planners, mobile sales representatives, automated banking machines, and telephone and Internet banking channels. We deliver a wide range of financial services including deposit accounts, investments and mutual funds, financial planning and advice, credit and debit cards, business and personal loans, and residential and commercial mortgages.

Industry profile
In Canada, personal and commercial banking is a mature industry dominated by the five largest Canadian banks, although competition is fierce and niche players are increasing their presence in select businesses such as credit cards. The U.S. market is more fragmented, although many regional markets are highly competitive. Many banks have expanded their focus to include offering investment products and financial advice and planning to affluent and other targeted clients. Critical success factors, in our opinion, include providing a differentiated client experience and maintaining rigorous credit and operational risk management practices and expense control.

Our strengths
- Customer relationship management (CRM) combined with strong client contact capabilities and specialized sales forces
- Established Canadian retail banking brand
- Comprehensive product, service and physical and alternative distribution capabilities compared to niche players
- Highest client household penetration ratio in personal segments, and lead product market share in business markets among Canadian banks
- Among the strongest efficiency ratios of the Big 5 Canadian banks
- Acquisition integration capabilities in the U.S. market

Our strategy
Our vision is to grow profitable relationships with each one of our business and personal clients by creating a tailored client experience for our clients across North America, while reducing costs, and effectively managing risk and capital.

We plan to achieve our vision through the following strategic priorities:
- Ensure strong revenue growth in Canada by maximizing client retention, deepening client relationships, capturing intergenerational wealth transfer opportunities and building on our financial planning and advice capabilities
- Create a differentiated customer experience, providing a valued and superior level of service tailored to customer segment needs that builds customer loyalty and clearly differentiates us from the competition
- Accelerate U.S. revenue and earnings growth by expanding our footprint in the southeastern U.S. and building a scalable platform
- Reinforce cost management and risk mitigation through effective use of technology, strengthened low cost delivery capabilities, and rigorous management of credit, operational, regulatory and compliance risk
- Cross-platform leverage by increasing referrals and cost efficiencies across RBC in Canada and the U.S.

Outlook for 2003
Based on our expectation of rising interest rates in Canada in 2003, we anticipate that the spread compression on deposits will ease. This, combined with reasonable loan growth, should have positive implications for revenue growth in our Canadian business. In the U.S., we anticipate branch openings and the acquisitions of Eagle Bancshares in July 2002 and of Admiralty Bancorp, Inc. (expected to close in January 2003) to have a positive impact on revenues. We also expect that the realization of a full year of cost synergies from the Eagle Bancshares acquisition will contribute to net income growth at RBC Centura. Overall, we expect solid earnings growth for this segment based on our continued focus on cost containment and credit and operational risk management and the benefits of a recovering economy.

Financial performance
Net income was up 32% from last year while core net income was up $276 million or 22%. Earnings from the segment's U.S. acquisitions rose to $206 million in 2002 from $(36) million last year or $21 million excluding costs related to U.S. retail bank restructuring in 2001 ($73 million further excluding goodwill amortization expense in 2001). The higher U.S. earnings reflected the acquisition of Centura Banks on June 5, 2001, integration cost savings and revenue growth. Core net income excluding U.S. acquisitions grew 7% due to continued cost management initiatives. Core ROE increased to 19.2% in 2002 from 18.3% despite higher average common equity attributed to this segment due to U.S. acquisitions and additional business activity.

Revenues increased $444 million or 6% from 2001, reflecting the contribution of RBC Centura (including RBC Mortgage) and the acquisition of Eagle Bancshares, which was completed on July 22, 2002. Revenues from U.S. acquisitions increased $635 million in 2002, without which the segment's revenues would have decreased 3% due to narrower net interest margins and lower lending volumes.

Non-interest expense increased $132 million or 3% from last year, while the efficiency ratio declined 180 basis points, as revenues grew faster than expenses. Core non-interest expense (which excludes $91 million of costs related to U.S. retail bank restructuring in 2001) increased $223 million or 5%. U.S. acquisitions contributed $330 million of the core expense growth. Excluding U.S. acquisitions, core expenses fell 3%, reflecting ongoing cost management.

The total provision for credit losses fell 14% from last year, largely in the commercial loan portfolio. Nonaccrual loans decreased by $144 million or 11%, reflecting improvements in both the Canadian consumer and Canadian commercial loan portfolios.

Results

(C$ millions, taxable equivalent basis, except percentage amounts)	% change	2002	2001
Net interest income	4%	**$ 5,576**	$ 5,349
Non-interest revenue	12	**2,090**	1,873
Gross revenues	6	**7,666**	7,222
Provision for credit losses			
Allocated specific	(5)	**626**	662
Allocated general and unallocated	n.m.	**–**	70
Total	(14)	**626**	732
Non-interest expense (1)	3	**4,520**	4,388
Net income before income taxes	20	**2,520**	2,102
Income taxes	4	**947**	912
Non-controlling interest	(20)	**8**	10
Taxable equivalent adjustment	217	**19**	6
Net income	32	**$ 1,546**	$ 1,174
U.S. net income	n.m.	**$ 206**	$ (36)
Net income as a % of total bank net income	500 bp	**53%**	48%
ROE	240 bp	**19.2%**	16.8%
Economic Profit	47%	**$ 614**	$ 419
Net interest margin	(18)bp	**3.56%**	3.74%
Efficiency ratio	(180)bp	**59.0%**	60.8%
Operating efficiency ratio (2)	(70)bp	**58.8%**	59.5%
Average assets	9%	**$ 156,500**	$ 143,000
Average loans and acceptances	7	**144,400**	135,400
Average deposits	10	**122,900**	111,400
Average common equity	16	**7,800**	6,700
Core results (3)			
Gross revenues	6	**7,666**	7,215
Non-interest expense	5	**4,520**	4,297
Net income	22	**1,546**	1,270
U.S. net income	881	**206**	21
ROE	90 bp	**19.2%**	18.3%
Credit information			
Nonaccrual loans	(11)%	**$ 1,157**	$ 1,301
Net charge-offs	3	**744**	724
Net charge-offs as a % of average loans and acceptances	(1)bp	**.52%**	.53%
Number of employees (full-time equivalent)	–	**35,014**	34,845

(1) Includes goodwill amortization expense of $54 million in 2001 (nil in 2002).
(2) Efficiency and operating efficiency ratios are defined on page 104.
(3) Excluding special items in 2001 detailed in Table 6 on page 27. Only the lines affected by special items are shown here.
n.m. not meaningful

Strategy by division

Financial highlights by division

Canada

Operating in Canada under the RBC Royal Bank brand, we serve individuals, small and medium-sized businesses, and commercial clients in all provinces and territories. We offer our clients extensive physical and alternative distribution choices. We continue to strengthen our channel distribution capabilities, including significant reinvestment in our branch network and staff, and in our electronic banking capabilities.

We offer a wide range of financial services and advice, as detailed in our business profile on page 28, and products and expertise in specialized areas such as foreign exchange and venture capital financing. We also provide individual and business clients with a full choice of Visa credit card products, debit cards and other smart card applications. We provide merchants with credit and debit card acceptance services, point-of-sale capabilities and Internet-secure electronic transaction solutions through Moneris Solutions, a joint venture in which we participate equally with Bank of Montreal, managed through RBC Global Services.

Our goal is to grow profitable relationships with each one of our business and personal clients, using our expertise in customer relationship management, sales management and client segmentation. We will drive revenue growth by creating a tailored client experience, leveraging client life events and providing financial planning and advice to broaden client relationships using the full capabilities of RBC.

We will continue to reinforce our cost management focus by leveraging e-enabled technology and cross-platform economies of scale. We will continue to rigorously focus on the management of credit, operational and compliance risk, including fraud management initiatives and strengthened credit-scoring capabilities.

Revenues from the domestic business decreased $201 million or 3% from 2001, primarily due to continued spread compression on core deposits and lower personal and business lending volumes. These decreases more than offset higher residential mortgage and deposit balances and wider net interest margin earned on mortgages and credit cards. Mortgage balances increased as the low interest rate environment encouraged home purchases. Deposit balances grew while lending volumes declined, reflecting consumer and business uncertainty regarding the economy and capital markets.

Results

(C$ millions, taxable equivalent basis)	% change	**2002**	2001
Gross revenues	(3)%	**$ 6,109**	$ 6,310
Average residential mortgages	5	**68,200**	64,800
Average personal loans	(4)	**23,600**	24,500
Average personal deposits	2	**74,400**	72,900
Average business loans and acceptances	(5)	**34,100**	36,000
Average business deposits	9	**30,500**	28,100
Average card balances	3	**6,200**	6,000
Card spending volumes	2	**26,700**	26,300
Number of:			
Employees (full-time equivalent)	1	**29,716**	29,554
Automated banking machines	(2)	**4,151**	4,236
Branches	(1)	**1,117**	1,125
Online clients	23	**2,311,915**	1,876,358

United States

RBC Centura serves as the focal point of our personal and commercial banking businesses in the U.S. Headquartered in Rocky Mount, North Carolina, RBC Centura serves individual and business clients in the southeastern U.S. RBC Centura also includes RBC Mortgage, a Chicago-based national retail mortgage originator, and RBC Builder Finance, a Houston-based financing division for home builders and developers. RBC Centura's footprint expanded in 2002 with the acquisition of Eagle Bancshares, which operated 14 branches in the Atlanta, Georgia metropolitan area. RBC Centura has also announced a definitive merger agreement with Admiralty Bancorp, which currently operates 10 branches in Florida, expected to close in January 2003.

Our U.S. priorities include:

- Expanding in the southeastern U.S. through targeted acquisitions and a build/buy branch expansion strategy
- Rapidly building a scalable platform to support growth
- Accelerating introduction of sales and marketing initiatives
- Growing national niche lines of business such as builder finance and residential mortgages
- Realizing synergies from functional integration and cross-selling opportunities across RBC's entire platform

Revenues increased $635 million due mainly to a full year of RBC Centura results in 2002 compared to 5 months in 2001, as well as the contribution of Eagle Bancshares since July 22, 2002. Growth in average balances also largely reflects the inclusion of a full year of RBC Centura. Strong growth in mortgage originations and volumes at RBC Mortgage reflected high refinance activity resulting from the favourable interest rate environment.

Results

(C$ millions, taxable equivalent basis)	% change	**2002**	2001
Gross revenues	94%	**$ 1,314**	$ 679
Average residential mortgages	81	**2,900**	1,600
Average personal loans	154	**3,300**	1,300
Average personal deposits	121	**8,600**	3,900
Average business loans and acceptances	126	**8,800**	3,900
Average business deposits	93	**5,400**	2,800
Average card balances	–	**100**	100
Card spending volumes	100	**400**	200
Mortgage originations ($ billions)	50	**33.7**	22.5
Number of:			
Employees (full-time equivalent)	1	**4,181**	4,126
Automated banking machines	7	**275**	258
Branches (1)	1	**245**	242
Online clients	18	**89,434**	75,887

(1) Excludes RBC Mortgage and RBC Builder Finance sales offices of 252 in 2002 and 264 in 2001.

Caribbean and the Bahamas

Operating under the brand name RBC Royal Bank of Canada, we provide a broad range of personal and commercial banking products and services to individual and business clients in the Bahamas, Barbados, the Cayman Islands and Eastern Caribbean Islands through a network of branches and automated banking machines.

Revenues increased $10 million or 4% from 2001, aided by the sale of property in the Cayman Islands, which accounted for approximately half of the increase.

Results

(C$ millions, taxable equivalent basis)	% change	**2002**	2001
Gross revenues	4%	**$ 243**	$ 233
Number of:			
Employees (full-time equivalent)	(4)	**1,117**	1,165
Automated banking machines	11	**60**	54
Branches	10	**43**	39

RBC Insurance

Business profile

Operating as RBC Insurance, we provide a wide range of creditor, life, health, travel, home, auto and reinsurance products and services to more than five million clients in Canada, the U.S. and internationally. These products and services are offered through a wide variety of distribution channels, including the telephone, independent brokers, travel agents, a proprietary sales force and the Internet.

Industry profile

The Canadian insurance industry generates almost $60 billion in premiums annually from more than 100 life insurance companies and more than 200 property and casualty insurers. Our U.S. business is focused in the life insurance sector, which is both competitive and fragmented and includes over 1,200 national and regional companies. The international reinsurance industry is dominated by several global players but also includes a number of niche companies.

Across all of our business lines, we are seeing a number of key trends, including consolidation, increased government regulation, shifting distribution opportunities, the convergence of insurance and investment products and increased globalization.

Our strengths

- A diverse set of products designed to meet a wide range of consumer needs
- Multiple distribution channels, which are supported by strong infrastructure and sales expertise
- A strong brand. As part of RBC Financial Group, we have access to a broad range of financial services, distribution channels and client base
- Market leadership in a number of Canadian insurance markets, including travel and individual life insurance

Our strategy

We are focused on growing our insurance organization by offering a wide range of products and services through multiple distribution channels in Canada, as well as in select U.S. and international markets. To accomplish this we will seek to:

- Ensure as many RBC clients as possible have an insurance relationship with RBC Insurance
- Target reinsurance activities that support and enhance the overall profitability of the insurance operations
- Continue to expand in the U.S. by utilizing existing scale and expanding the platform, entering new markets and focusing on cross-platform initiatives across RBC
- Build an integrated North American insurance platform by leveraging cross-border synergies where permitted, including the implementation of common administrative and technology systems

Outlook for 2003

Our expectation of reasonable economic growth in both Canada and the U.S. should have a favourable impact on the insurance business in 2003. Our outlook is for strong revenue growth across our operations, driven by expansion into new markets as discussed in our strategy, and the pending acquisition of the U.S. life insurance operation of Business Men's Assurance Company of America (BMA). The acquisition of BMA is subject to regulatory approvals and other customary closing conditions. We anticipate that cost reductions from the realization of cross-border synergies will also help to drive net income growth.

Financial performance

Net income increased 10% from last year and, excluding goodwill amortization expenses in 2001, was up 1%. Earnings in 2001 were adversely affected by claims resulting from the World Trade Center tragedy. RBC Liberty Insurance contributed $23 million to net income in 2002, down from $29 million ($39 million excluding goodwill amortization) last year. The decline in RBC Liberty Insurance earnings was largely related to higher policy surrenders and lower earnings at its outsourcing divisions. Excluding RBC Liberty Insurance, net income increased 16%, largely reflecting strong growth in the Canadian and reinsurance businesses.

ROE improved to 25.7% from 20.0% in 2001, reflecting higher net income, as well as lower average common equity, which reflected a revised methodology for attributing capital to our insurance operations.

Premiums & deposits were up 12% from last year and revenues were up 7%, due largely to higher revenues from RBC Liberty Insurance. RBC Liberty Insurance reported 13 months of results in 2002 versus 11 months in 2001, as its reporting period was changed from September 30 to October 31 to be consistent with our fiscal year. Excluding these additional months of RBC Liberty Insurance, premiums & deposits grew 8% and revenues were flat.

Expenses grew $24 million or 6%, largely due to the two additional months of RBC Liberty Insurance and an increase in the number of employees, partly offset by the cessation of goodwill amortization this year. Excluding the additional months of RBC Liberty Insurance, expenses fell 2%.

Results

(C$ millions, except percentage amounts)	% change	2002	2001
Premiums & deposits	12%	**$ 2,023**	$ 1,812
Non-interest revenue			
Earned premium	10	**1,564**	1,419
Fee revenue/Other	38	**179**	130
Less: Policy benefits	10	**1,081**	985
Less: Acquisition costs	34	**305**	228
	6	**357**	336
Net interest income	8	**223**	206
Gross revenues	7	**580**	542
Non-interest expense (1)	6	**399**	375
Net income before income taxes	8	**181**	167
Income taxes	n.m.	**(9)**	(6)
Net income	10%	**$ 190**	$ 173
U.S. net income	(10)	**$ 35**	$ 39
Net income as a % of total bank net income	–	**7%**	7%
ROE	570 bp	**25.7%**	20.0%
Economic Profit	39%	**$ 100**	$ 72
Average assets	10	**6,900**	6,300
Average common equity	(12)	**700**	800
Number of employees (full-time equivalent)	2%	**2,641**	2,583

(1) Includes goodwill amortization expense of $15 million in 2001 (nil in 2002).

Strategy by division

Financial highlights by division

Life

Our life business provides a wide range of individual and group life and health insurance products to both individual and business clients in Canada and the U.S., as well as life reinsurance and retrocession to businesses around the world.

In Canada, life and health insurance products are distributed through a network of more than 7,000 independent brokers, over 550 proprietary insurance representatives and a direct sales unit. In the U.S., Greenville, South Carolina-based Liberty Life Insurance Company provides life and health insurance products through a proprietary sales force of over 600 agents and also offers select products through direct channels.

Our goal is to continue to grow our life businesses by expanding our client base and range of products and services offered, as well as by enhancing our distribution networks.

Premiums & deposits for the life business increased 10% in 2002, partially due to 2 additional months of RBC Liberty Insurance as it reported 13 months of results in 2002 versus 11 months in 2001. Without these additional months, premiums & deposits would have been up 5%, reflecting the continued strength of both the Canadian and reinsurance businesses. Lower investment income due to the low interest rate environment, as well as higher policy surrenders at RBC Liberty Insurance, contributed to the 5% decline in revenues.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Premiums & deposits	10%	**$ 1,529**	$ 1,393
Gross revenues	(5)	**429**	450
Average assets	8	**5,700**	5,300
Number of:			
Life and health policies in force in Canada (thousands)	11	**2,930**	2,645
Life policies in force in the U.S. (thousands)	(11)	**2,325**	2,600
Assets under management in the U.S.	(2)	**367**	375
U.S. sales agents	(4)	**690**	718

Non-life

Our non-life business includes home, auto, travel and property reinsurance for individual and business clients in Canada and select international markets.

We provide Canadians with a wide range of auto and home insurance products, offering them to individual clients and employee and affinity groups through direct sales and face-to-face channels. Travel products, which are sold through travel agents, the Internet and bank channels in Canada, include trip cancellation insurance, out-of-country medical and baggage insurance.

We participate in the property reinsurance business by accepting a share of the risk on property policies issued by other insurance companies. The majority of our current business is generated from insurance companies in the U.S. and Europe.

Our goal is to grow our non-life business by continuing to build our domestic home and auto business, entering new travel insurance markets and effectively managing our property reinsurance portfolio.

Revenues from our non-life business were higher in 2002 due to stronger performance in our property reinsurance and travel businesses as last year's revenues were adversely affected by claims resulting from the World Trade Center tragedy.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Premiums & deposits	14%	**$ 413**	$ 363
Gross revenues	88	**47**	25
Average assets	–	**700**	700
Number of:			
Home and auto – personal lines policies in force (thousands)	37	**93**	68
Travel – coverages (thousands)	(7)	**2,339**	2,510

Fee businesses

We are involved in a number of other key insurance and related activities that generate fee income, including travel assistance services, structured reinsurance, the administration of bank creditor insurance programs and a proprietary sales distribution network.

Our travel and emergency assistance services include co-ordinating the delivery of emergency health, evacuation and transportation services when clients have a travel emergency, while our structured reinsurance business provides solutions to help corporations better manage financial risk.

In the U.S., our fee businesses include outsourcing services and administration and software systems provided through Liberty Insurance Services Corporation (LIS). The Business Process Outsourcing division of LIS provides services such as underwriting, billing and collection, and claims processing for nearly 4 million policies under administration. The Software Solutions division develops Web-enabled software for life, health, annuity and reinsurance administration. Together, these divisions have more than 200 client sites and serve domestic, international and multinational insurers worldwide.

Our goal is to continue to leverage our existing infrastructure and technology to enhance existing programs and grow these businesses.

The substantial growth in premiums & deposits was attributable to structured reinsurance premium increases, which offset slower growth at our outsourcing divisions in the U.S. The increase in revenues reflected the stronger performance in structured reinsurance and the reporting of two additional months of RBC Liberty Insurance. Our career sales force grew substantially in 2002, reflecting increased investment in our proprietary sales distribution network.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Premiums & deposits	45%	**$ 81**	$ 56
Gross revenues	55	**104**	67
Average assets	67	**500**	300
Number of:			
Career sales – agents	22	**554**	455
Assistance services – calls (thousands)	(3)	**681**	699
Policies under administration in the U.S. (thousands)	(6)	**4,100**	4,342

RBC Investments

Business profile

RBC Investments provides full-service and self-directed brokerage, financial planning, investment counselling, personal trust, private banking and investment management products and services primarily to private clients in Canada, the U.S. and internationally. Products and services are delivered through the RBC Royal Bank branch network across Canada, RBC Investments offices, RBC Dain Rauscher branches in the U.S., private banking offices and other locations worldwide. Services are also delivered via the Internet and telephone. In September 2002, we realigned parts of our Canadian distribution channels under a single management structure to enhance the client experience by offering seamless, comprehensive solutions.

Industry profile

Wealth management is a highly competitive business with numerous large and boutique firms serving the affluent and high net worth client. Many of these firms have recently developed strategies focused on attracting the high net worth market. Volatile markets and the rising costs of managing the risks inherent in the business are changing the approach and profitability of some of the players. Consolidation in the mutual fund industry has not significantly altered the competitive landscape as distribution channels continue to be expanded by all players. Self-directed brokerage businesses have come under increased pressure due to reduced transaction volumes in light of market conditions, and clients using non-revenue generating services such as research, quotes and online asset mix calculators.

Our strengths

- Relationship management capabilities from experienced people and technology applications
- Ability to deliver the choice of products and services clients need to meet their financial goals
- Multiple distribution channels for client convenience
- Ability to access entire RBC client base
- Solutions designed for specific investment strategies and client risk tolerance

Our strategy

Our goal is to be a leading provider of personalized, comprehensive investment solutions for private clients worldwide, aligning them with client needs and the markets where we serve them.

In Canada:

- Match distribution channel and type of service to client needs and preferences
- Seek lifelong and intergenerational relationships with clients by offering products and services for each stage of their wealth management needs

In the United States:

- Grow through broadening and deepening relationships with existing clients as well as through targeted acquisitions over time in order to generate greater market share and scale

Internationally:

- Provide specialized global services to clients located around the world
- Offer solutions and provide advice and choice in an increasingly transparent international business

Outlook for 2003

Based on our expectation that investor confidence and capital markets performance will begin improving only by the third quarter of 2003, we expect moderate revenue growth in 2003. Cost containment efforts should help to keep the rate of expense growth below that of revenue growth. Retention compensation costs relating to recent U.S. acquisitions are forecast to be approximately $40 million lower in 2003, further contributing to net income growth.

Financial performance

Net income was down 32% while core net income was up 48%. The growth in core net income was due to higher earnings from RBC Dain Rauscher, as well as the cessation of goodwill amortization this year (goodwill amortization was $110 million in 2001). RBC Dain Rauscher's net income was $3 million in 2002, compared to a loss of $73 million last year ($33 million loss excluding goodwill amortization). The improvement in RBC Dain Rauscher's net income occurred despite higher retention compensation costs and reflected the acquisition of Tucker Anthony Sutro on October 31, 2001 (since integrated into RBC Dain Rauscher) and strong performance from its fixed income division. Excluding RBC Dain Rauscher, core net income would have grown 12%, largely due to the cessation of goodwill amortization in 2002. ROE was largely unchanged from last year, excluding the gain on the sale of RT Capital Management.

Revenues were up 12% from 2001, or 26% excluding special items in 2001. Revenue growth reflected the acquisition of Tucker Anthony Sutro and strong results from the fixed income division of RBC Dain Rauscher. Excluding RBC Dain Rauscher's revenue growth of $875 million, core revenues were down 6% due to weak client trading volumes in 2002.

Expenses increased 25% over a year ago, reflecting the acquisition of Tucker Anthony Sutro and higher retention compensation related to U.S. acquisitions, which increased to $107 million from $88 million in 2001, with $45 million attributable to Tucker Anthony Sutro. RBC Dain Rauscher contributed $774 million of the expense growth in 2002. Excluding RBC Dain Rauscher, expenses fell 9%, reflecting the cessation of goodwill amortization this year, higher expenses in 2001 from a $38 million writedown of goodwill relating to Connor Clark, and good expense management.

Results

(C$ millions, except percentage amounts)	% change	2002	2001
Net interest income	(3)%	$ **371**	$ 384
Non-interest revenue	15	**3,276**	2,859
Gross revenues	12	**3,647**	3,243
Provision for credit losses			
Allocated specific	(150)	**(1)**	2
Total	(150)	**(1)**	2
Non-interest expense (1)	25	**3,144**	2,510
Net income before income taxes	(31)	**504**	731
Income taxes	(29)	**158**	223
Net income	(32)%	$ **346**	$ 508
U.S. net income	n.m.	$ **(1)**	$ (81)
Net income as a % of total bank net income	(900)bp	**12%**	21%
ROE	(1,590)bp	**11.1%**	27.0%
Economic Profit	(114)%	$ **(14)**	$ 97
Average common equity	67	**3,000**	1,800
Core results (2)			
Gross revenues	26	**3,647**	2,894
Net income	48	**346**	234
ROE	(80)bp	**11.1%**	11.9%
Number of employees (full-time equivalent)	14%	**12,001**	10,512

(1) Includes goodwill amortization expense of $110 million in 2001 (nil in 2002).
(2) Excluding special items in 2001 detailed in Table 6 on page 27. Only the lines affected by special items are shown here.
n.m. not meaningful

Strategy by division

Canada

Financial Planning

The new financial planning platform is operated jointly with RBC Banking. This group serves branch-based clients typically with more than $50,000 in investable assets of which a portion must include mutual funds or managed assets. Financial planning has 1,100 relationship financial planners and 550 commission-based investment and retirement planners who are also financial planners and licensed mutual fund salespeople.

Canadian & International Brokerage group

This group includes our private client division (full-service brokerage) and RBC Action Direct (self-directed brokerage) and serves both investors requiring advisor-based comprehensive financial solutions and self-managed investors. Services are provided by over 1,420 investment advisors, over 180 investment representatives, as well as via telephone and the Internet. This group also includes the International Advisory Group, which has both Canadian and internationally-based employees serving international clients. Our goal is to maintain our market position in Canada by continuing to build and enhance existing client relationships.

RBC Global Private Banking (Canada)

Our private counsel, personal trust and private banking groups serve high net worth clients across Canada, and offer a relationship management approach for the client in need of sophisticated solutions. This group works with RBC Global Private Banking (international) to ensure we can serve clients who have interests in Canada as well as around the world. In Canada, 60 investment counsellors, 80 trust officers and 200 private bankers are in locations across the country.

Global Asset Management

This unit includes RBC Global Investment Management and RBC Funds, Canada's second largest mutual fund company. We directly manage more than $40 billion of assets in mutual and pooled funds as well as other client assets. We provide proprietary and externally-managed investment management products and advisory services through RBC Royal Bank, RBC Investments' distribution businesses and external distributors to private and institutional clients in Canada and worldwide. Our family of mutual funds and other pooled products encompass a broad range of investment solutions including money market, fixed income, balanced and Canadian, U.S. and global equity funds, as well as alternative investments. In 2003, our goal is to continue the strategy, first implemented in 2001, to broaden the distribution channels for investment management services and mutual fund products. This strategy has contributed to a 12% increase in our share of the Canadian mutual fund market over the past two years.

United States

RBC Dain Rauscher

Minneapolis-based RBC Dain Rauscher comprises a full-service brokerage subsidiary and a fixed income business. RBC Dain Rauscher plans to grow through broadening and deepening relationships with existing clients by understanding their needs and the potential profitability of the client relationship. We also plan to grow by focusing on opportunities which generate greater market share and scale within our existing markets. The integration of Boston-based Tucker Anthony Sutro was completed in 2002 and made RBC Dain Rauscher the 9th-largest full-service securities firm in the U.S., with close to 2,000 financial consultants serving individual clients from coast to coast and a fixed income business with 280 investment bankers, sales representatives and traders serving institutional and retail clients nationwide.

International

RBC Global Private Banking

This internationally-focused unit provides private banking, trust and investment counselling solutions to high net worth clients in more than 100 countries. Our goal is to provide specialized global services to high net worth clients with assets of more than $1 million. In 2003, we intend to grow revenues by leveraging CRM capabilities within the group, by exploring potential European and North and South American acquisitions, and by building alliances in markets where we already have a presence. The addition of non-proprietary money management capabilities will expand our value proposition to clients.

Financial highlights by division

RBC Investments' revenues grew 12% from last year for the reasons mentioned on page 32. The decline in revenues from the Canadian & International Brokerage group was due to lower transaction- and fee-based revenues, reflecting continued weakness in capital markets. Global Asset Management's revenues declined 57% as revenues in 2001 included a $313 million gain on the sale of RT Capital Management and 10 months of results from that business that did not recur in 2002.

Revenues

(C$ millions)	% change	2002	2001
Canadian & International Brokerage	(9)%	$ 984	$ 1,076
RBC Dain Rauscher (1)	106	1,702	827
RBC Global Private Banking (2)	5	678	643
Global Asset Management (3)	(57)	286	660
Other (4)	(108)	(3)	37
	12%	$ 3,647	$ 3,243

(1) 2002 revenues include Tucker Anthony Sutro acquired on October 31, 2001.
(2) Includes both Canadian and international businesses and Financial Planning.
(3) 2001 revenues included RT Capital Management until August 15, 2001 and a $313 million gain on the sale of RT Capital Management.
(4) 2001 revenues included a $36 million gain on the sale of Group Retirement Services. Excluding this gain, 2001 revenues were $1 million.

Despite difficult capital market conditions, our Canadian & International Brokerage group was able to grow its assets, with much of the growth coming from fee-generating assets. Higher AUA in RBC Global Private Banking were related to an increase in new business, the acquisition of the assets of Barclays Bank PLC's private banking operations in the Americas and a 5% increase in the value of the British pound against the Canadian dollar. These increases largely offset lower AUA at RBC Dain Rauscher, due to declines in market values, as well as an expected decrease related to broker attrition resulting from weak market conditions and the integration of Tucker Anthony Sutro into RBC Dain Rauscher.

Assets under administration

(C$ millions)	% change	2002	2001
Personal			
Canadian & International Brokerage	3%	$ 111,340	$ 107,760
RBC Dain Rauscher	(18)	132,930	161,740
RBC Global Private Banking	21	82,390	67,990
	(3)	326,660	337,490
Institutional – RBC Global Private Banking	14	69,730	61,010
	(1)%	$ 396,390	$ 398,500

The decline in personal AUM largely reflected lower asset values due to weak capital market conditions. As part of the integration of Tucker Anthony Sutro into RBC Dain Rauscher, a non-core asset management business which was acquired as part of Tucker Anthony Sutro was divested, contributing to the decrease in personal AUM. Much of the increase in institutional AUM was related to the accumulation of new assets in RBC Global Private Banking and at RBC Dain Rauscher. Mutual fund asset levels remained relatively stable with lower market values offset by strong net sales driven by a successful RRSP campaign.

Assets under management

(C$ millions)	% change	2002	2001
Personal	(23)%	$ 35,660	$ 46,620
Institutional	9	18,410	16,940
Mutual funds	(1)	34,230	34,550
	(10)%	$ 88,300	$ 98,110

RBC Capital Markets

Business profile

RBC Capital Markets provides wholesale financial services to large corporate, government and institutional clients in North America and in specialized product and industry sectors globally. Headquartered in Toronto, RBC Capital Markets has key centres of expertise in Minneapolis, New York and London, and offices in 27 other cities.

Industry profile

The Canadian wholesale financial services market is mature and, as a result, many Canadian firms are seeking growth opportunities outside of their domestic market, primarily in the U.S. The U.S. capital markets are dominated by several large global investment banks whose principal focus is on the top tier of companies forming the S&P 500. However, we believe significant opportunities exist for specialized players targeting the lower end of the S&P 500. To succeed in the North American context requires the ability to provide clients with innovative, value-added solutions that reflect a keen understanding of both the company and industry sector. Increasingly, new business opportunities will accrue to those firms with a reputation for adhering to high ethical standards.

Our strengths

- Top-tier market shares in virtually all lines of business in Canada
- Established reputation as a premier Canadian investment dealer as evidenced by our market share leadership
- Superior origination and distribution capability as measured by our standings in underwriting league tables
- Expertise and market knowledge in a broad array of industries

Our strategy

Our goals are to be recognized as the leading corporate and investment bank in Canada based on external rankings and to build a successful integrated North American business, while continuing to expand our specialized global businesses.

Key strategies for RBC Capital Markets include the following:

- In Canada, to maintain our position as a leading full-service provider in all of our markets by continuing to leverage the breadth of our long-standing client relationships, the depth of our trading, research and sales capabilities, and the strength of our brand and reputation in the Canadian market
- In the U.S., to provide value-added solutions by offering clients a broad product portfolio delivered through specialized industry teams, with the goal of building an integrated North American franchise. We will leverage the depth of our research and advisory capabilities in targeted North American industry sectors, specifically energy, technology, communications, health care, consumer products, and mid-size financial institutions
- Continue to expand our global specialized businesses by providing clients with customized, value-added solutions in the areas of bonds, money markets, foreign exchange, structured finance and equity and credit derivatives

Outlook for 2003

Given our expectations for reasonable economic growth in both Canada and the U.S. and a moderate capital markets recovery in 2003, we are anticipating modest revenue growth in 2003. Our outlook is based on the expectation of a recovery in trading volumes, merger and acquisition activities and new issue and advisory mandates to more normalized levels. We intend to maintain our focus on strategic cost management and to keep the rate of expense growth below that of revenue growth. We also plan to continue to proactively manage the credit risk associated with our corporate loan portfolio.

Financial performance

Net income increased 26%, or 17% on a core basis, as expenses fell far more than did revenues. Core ROE was unchanged from 2001, with higher net income offset by $700 million of additional common equity attributed to the segment compared to last year, reflecting a change in methodology for attributing capital relating to credit risk.

Revenues declined $86 million or 3% from last year, due largely to lower trading revenues in our platform resulting from continued weakness in capital markets and lower lending revenues due to targeted reductions in the corporate loan portfolio.

Non-interest expense fell $177 million or 10% due to a lower number of employees and reduced variable compensation costs. Retention compensation costs related to the acquisition of Dain Rauscher Wessels, fully integrated into RBC Capital Markets since early 2002, were also lower, falling to $51 million from $88 million in 2001.

The provision for credit losses increased by $58 million or 14% from 2001, due primarily to certain telecommunication, cable and energy accounts that were classified as nonaccrual during the year. The increase in the provision for credit losses was partially offset by related credit derivative gains which were recorded in non-interest revenue. Nonaccrual loans were down $20 million or 2% from last year, reflecting charge-offs in the corporate loan portfolio.

The decline in income taxes was attributable to the tax rate differentials in various jurisdictions, as well as higher income taxes in 2001 resulting from a special $27 million income tax expense shown in Table 6 on page 27.

Results

(C$ millions, taxable equivalent basis, except percentage amounts)	% change	2002	2001
Net interest income	29%	**$ 553**	$ 429
Non-interest revenue	(9)	**2,142**	2,352
Gross revenues	(3)	**2,695**	2,781
Provision for credit losses			
Allocated specific	14	**465**	407
Total	14	**465**	407
Non-interest expense (1)	(10)	**1,627**	1,804
Net income before income taxes	6	**603**	570
Income taxes	(28)	**143**	200
Taxable equivalent adjustment	–	**21**	21
Net income	26%	**$ 439**	$ 349
U.S. net income	n.m.	**$ (36)**	$ (77)
Net income as a % of total bank net income	100 bp	**15%**	14%
ROE	90 bp	**10.5%**	9.6%
Economic Profit	n.m.	**$ (55)**	$ (44)
Average assets	13%	**180,700**	159,500
Average loans and acceptances	(6)	**28,800**	30,700
Average deposits	10	**81,100**	73,600
Average common equity	21	**4,000**	3,300
Core results (2)			
Net income	17	**439**	376
ROE	–	**10.5%**	10.5%
Credit information			
Nonaccrual loans	(2)%	**$ 1,094**	$ 1,114
Net charge-offs	120	**510**	232
Net charge-offs as a % of average loans and acceptances	101 bp	**1.77%**	.76%
Number of employees (full-time equivalent)	(1)%	**2,938**	2,954

(1) Includes goodwill amortization expense of $43 million in 2001 (nil in 2002).
(2) Excluding special items in 2001 detailed in Table 6 on page 27. Only the lines affected by special items are shown here.
n.m. not meaningful

Strategy by division

Financial highlights by division

Capital Markets Services

This division was formed in November 2001, combining the equity research, sales and trading businesses with the corporate and investment banking businesses. We offer a full range of credit and corporate finance products, including debt and equity underwriting, mergers & acquisitions (M&A) advice and execution, and expertise in research and equity sales and trading activities.

In Canada, we will build on our key strengths – expert knowledge of the Canadian markets, breadth and longevity of client relationships, depth in trading, research and sales and a long-standing reputation as a top-ranked domestic investment bank – to continue to be a full-service provider to all industries.

On a North American basis, we will be industry-focused – specifically technology, telecommunication, heath care, energy, consumer products and mid-size financial institutions. By leveraging our research and advisory capabilities, we expect to differentiate ourselves on our ability to provide superior knowledge of investment opportunities and market-based solutions for our target clients.

Revenues were up 3% from 2001. Factors contributing to this increase include strong performance in Canadian equity new issue and M&A business and credit derivative gains related to accounts that were classified as impaired during the year. These factors offset lower sales and trading revenues, weak performance in U.S. equity new issue and M&A business and a 9% decline in core lending revenues. Core lending revenues decreased due to tightened spreads and the targeted reduction in the corporate loan portfolio, which is also reflected in the 13% decline in average assets.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Gross revenues	3%	**$ 1,064**	$ 1,033
Average assets	(13)	**13,600**	15,700

Global Financial Products

This division was formed in November 2001 to address the continuing convergence of financial products available to clients. Its formation brought together the business activities involving the origination, syndication, securitization, trading and distribution of debt products globally. These products include loans, bonds and derivatives at both the investment grade and sub-investment grade levels. As well, Global Financial Products provides leveraged product asset management capabilities and is the centre of expertise for RBC Capital Markets' proprietary trading activities. The combination of these businesses provides the ability to maximize internal expertise and deliver a broad array of value-added ideas and solutions to clients.

We intend to continue to focus on identifying opportunities where we can build from our existing strengths to provide solutions-based approaches to structuring transactions for our clients.

Revenues were up 5% in 2002. Favourable interest rate trading environments during the year helped to fuel revenue and asset growth from our traditional bond and derivative businesses, as well as revenue growth from new initiatives developed in securitization, leveraged finance and asset management. Revenues from our proprietary trading activities were down slightly from 2001 levels. Overall, this business achieved strong performance despite difficult markets and business limitations resulting from the displacement of our New York operations after the events of September 11th.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Gross revenues	5%	**$ 883**	$ 839
Average assets	41	**70,700**	50,200

Global Treasury Services

Global Treasury Services combines our money markets and foreign exchange businesses and provides global clients with foreign exchange, commodities, derivatives and interest rate products, as well as currency risk management and advisory services. These products and services are delivered through our extensive global sales and trading network, operating from centres that include Toronto, London and New York. Recognized as a market leader in foreign exchange e-commerce solutions, we also deliver services through our Internet trading platform, FX Direct, and are a member of the multi-bank global trading platform, FXall. We will continue to invest in innovative electronic delivery channels that offer sophisticated and flexible products and services.

Revenues were down 19% from 2001, which was a record year. The foreign exchange businesses experienced increased volatility in foreign exchange rates and decreased volumes, while economic and interest rate uncertainty negatively affected the money markets businesses. However, the derivative-based businesses performed well and we continued to grow revenues through e-commerce channels.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Gross revenues	(19)%	**$ 510**	$ 627
Average assets	5	**78,500**	75,100

Global Credit

Global Credit provides centralized management of all credit exposure associated with our loan portfolio. While wholesale lending is fundamental to the attraction and expansion of high-margin client businesses, lending must be strategic in order to maximize the returns to shareholders. Our portfolio and transaction management specialists use sophisticated risk management and analytical tools designed to ensure that the pricing on loans is commensurate with the associated risk and reflects the value of all products and services a client has with RBC.

Our transaction specialists use appropriate structures to provide clients with value-added, as opposed to commoditized, credit solutions. We work closely with our distribution teams to further reduce the size of our corporate lending base, while continuing to enhance the quality of earnings from this source.

Global Credit's 29% decline in revenues was mainly driven by net negative mark-to-market adjustments on credit derivatives and other financial instruments and targeted reductions in our non-core lending portfolio, which is reflected in the 25% decline in average assets. These decreases offset revenue growth from our structured lending business and our successful efforts to transition towards higher-value loan transactions with greater liquidity.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Gross revenues	(29)%	**$ 142**	$ 201
Average assets	(25)	**10,100**	13,500

Alternative Investments

Alternative Investments was formed in June 2002 with a mandate to expand our wholesale asset management capabilities, which today include operations in hedge funds and private equity. The alternative asset business provides non-traditional investment opportunities to high net worth individuals, corporations and institutional clients. These investment options include private equity and hedge funds, and can extend to other vehicles such as leveraged buyouts, Collateralized Debt Obligations (CDOs) and managed futures. We are uniquely positioned to leverage our existing infrastructure and our superior product knowledge across other businesses within RBC who have strong relationships with our target client base.

Revenues were up 19%, with strong results from our hedge fund business, which accounts for the majority of our revenues, and stable results from proprietary trading offsetting lower revenues from the Canadian equity derivatives business. Revenues from our merchant banking business were also lower due to lower capital gains and the writedowns of certain investments.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Gross revenues	19%	**$ 96**	$ 81
Average assets	56	**7,800**	5,000

RBC Global Services

Business profile

RBC Global Services offers specialized transaction processing services to business, commercial, corporate and institutional clients in domestic and select international markets. Key businesses include investment administration, correspondent banking, cash management, payments and trade finance. Our 50% interest in the Moneris Solutions merchant card processing joint venture is reported under RBC Global Services.

Industry profile

The industry is characterized by increasing consolidation as certain segments become more global. Monoline specialists and new market entrants compete against traditional financial institutions. Scale is increasingly important to support the significant investment in technology required to introduce new products and services, accommodate industry-driven infrastructure changes and enhance operational efficiencies.

Our strengths

- We have a leadership position in Canada in these businesses as measured by AUA and market share of number of client relationships
- We have strong client relationships as evidenced by our high rate of client retention and new business generated from existing clients
- We are recognized for quality of service as evidenced by our top rankings in third-party client surveys
- We continue to develop and deploy new technology and client service solutions
- We are able to leverage our market position by aligning the resources within RBC Global Services with the expertise of other RBC platforms to offer a superior integrated service to the market

Our strategy

Our goal is to maintain and enhance our leadership position in Canada while continuing to develop a competitive international presence. To meet our goal, we will:

- Build upon existing client relationships to develop new business in select domestic and international markets
- Grow the business through key alliances, acquisitions and partnerships and continue to leverage the Moneris Solutions joint venture
- Drive revenue growth by developing new products and selling higher-margin value-added services, such as securities lending and trade advisory
- Enhance our processing and systems platforms to deliver new capabilities, improve efficiencies and drive economies of scale
- Continue the shift to electronic payment products and services focusing on Web-based solutions.

Outlook for 2003

Although we expect interest rates to rise in the second half of 2003, they will likely remain low in historical terms, which will continue to have an unfavourable impact on our revenue growth in 2003. As our revenues earned on deposits and cash balances are highly dependent upon the interest rate environment, our net interest income growth may be adversely affected. At the same time, the expectation of a modest recovery in capital markets beginning in the second half of 2003 should have a favourable impact on revenues from foreign exchange and on fee revenues from higher AUA.

Financial performance

Net income declined 35% while core net income, excluding the gain on the formation of the Moneris Solutions joint venture in 2001, declined 8% from last year, partially reflecting an increase in the provision for credit losses.

ROE was 28.7% compared to core ROE of 34.7% in 2001. The decline in ROE reflects lower net income as well as a $100 million increase in average common equity attributed to this segment in 2002. The higher common equity reflects the 50% interest in the Moneris Solutions joint venture and higher capital attribution for operating risk.

Revenues were down 6% from last year, reflecting lower interest income due to the low interest rate environment, as well as lower foreign exchange revenues, which more than offset a 10% increase in fee income. Core revenues (which exclude an $89 million gain on the formation of the Moneris Solutions joint venture) were up 5%. Revenues were positively affected by the acquisition of Perpetual Fund Services (an Australian custody, investment administration and unit registry business) on July 31, 2001 and a change pertaining to the classification of services provided by us to Moneris Solutions, effective November 2001. Payments for services provided to Moneris Solutions are now being treated as revenues, whereas previously they were treated as cost recoveries. Excluding these factors, revenue decreased by 3%.

Expenses were $63 million or 13% higher in 2002 due to the inclusion of a full year of Perpetual Fund Services as well as continued investments in technology. Excluding the acquisition of Perpetual Fund Services and the change in the classification of services provided by us to Moneris Solutions discussed above, expenses increased by 2%.

The increases in both the provision for credit losses and nonaccrual loans were associated with Argentine loans classified as nonaccrual during the year.

Results

(C$ millions, except percentage amounts)	% change	2002	2001
Net interest income	(8)%	$ 136	$ 148
Non-interest revenue	(5)	672	710
Gross revenues	(6)	808	858
Provision for credit losses			
Allocated specific	n.m.	10	(2)
Total	n.m.	10	(2)
Non-interest expense (1)	13	548	485
Net income before income taxes	(33)	250	375
Income taxes	(29)	77	109
Net income	(35)%	$ 173	$ 266
U.S. net income	(47)	$ 9	$ 17
Net income as a % of total bank net income	(500)bp	6%	11%
ROE	(2,060)bp	28.7%	49.3%
Economic Profit	(18)%	$ 100	$ 122
Average common equity	20	600	500
Core results (2)			
Gross revenues	5	808	769
Net income	(8)	173	189
ROE	(600)bp	28.7%	34.7%
Credit information			
Nonaccrual loans	275%	$ 30	$ 8
Net charge-offs	(114)	(1)	7
Net charge-offs as a % of average loans and acceptances	(40)bp	(.05)%	.35%
Number of employees (full-time equivalent)	1%	2,571	2,557

(1) Includes goodwill amortization expense of $8 million in 2001 (nil in 2002).
(2) Excluding special items in 2001 detailed in Table 6 on page 27. Only the lines affected by special items are shown here.
n.m. not meaningful

Strategy by division

Institutional & Investor Services

Institutional & Investor Services is Canada's largest custodian as measured by AUA, and a leading provider of investment administration services to corporate and institutional investors worldwide. We operate from 13 locations throughout the world, with a global custody network spanning 80 markets.

We plan to continue to leverage our leadership position in the Canadian market to expand internationally, with a focus on serving fund managers, financial institutions and private banks.

We expect to achieve growth in our fee-based revenue streams by:

- Selling newly developed products and services to existing clients
- Expanding our client offerings in Europe and Asia-Pacific
- Further exploring alliance and acquisition opportunities

Financial highlights by division

Revenues grew $3 million or 1% in 2002, as the positive impact of the Perpetual Fund Services acquisition and higher fee income offset lower revenues from foreign exchange and interest income, due to the low interest rate environment. AUA increased by 3% from 2001 due to new business, but the effect of equity market declines largely offset the additions.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Gross revenues	1%	**$ 401**	$ 398
Assets under administration	3	**963,200**	936,700

Financial Institutions

A comprehensive range of correspondent banking services is provided to banks globally and to broker-dealers within Canada, including cash management, payments, clearing, trade, foreign exchange, derivatives lending, securities lending, custody and settlement, and structured financing.

Our goal is to leverage our leadership position in the Canadian dollar clearing market and our client relationships by:

- Identifying differentiated value-added solutions that address the unique needs of the different market segments
- Adding new revenue streams by introducing service offerings that integrate the new product developments of RBC Global Services with those of other business platforms

We will continue to monitor and actively manage our exposure to higher risk markets.

Revenues fell $15 million or 13% from last year, primarily due to a decrease in interest income associated with the low interest environment. In addition, certain fee revenues were transferred from RBC Global Services to RBC Capital Markets in 2002, contributing to the decline in revenues. The decrease in average assets reflected strategic reductions in the size of our Latin American loan portfolio, which now totals $146 million.

Results

(C$ millions, taxable equivalent basis)	% change	2002	2001
Gross revenues	(13)%	**$ 98**	$ 113
Average assets	(15)	**1,700**	2,000
Average deposits	–	**1,700**	1,700

Treasury Management & Trade

Treasury Management & Trade provides cash management, payment and trade services to business, commercial, corporate and public sector segments. Our trade team provides Canadian and foreign importers and exporters with a variety of trade products, services and counsel. Our cash management group provides a range of solutions to clients that allow for more effective cash flow and integration with client processing. Through Moneris Solutions we provide merchants with credit and debit card transaction processing services.

Our goal is to continue to be the leading provider in Canada by retaining profitable client relationships and growing market share in strategic markets by:

- Introducing a market segmentation approach that accommodates the diverse needs of business markets
- Expanding the functionality of our Web-based delivery channel for both cash management and trade services
- Introducing new trade products and services as well as expanding trade alliances to meet clients' international trade requirements while effectively managing risk
- Leveraging our cash management sales and service leadership position

Revenues decreased $38 million or 11% from 2001. Excluding the $89 million gain on the formation of the Moneris Solutions joint venture in 2001, revenues increased $51 million or 20%. This increase primarily reflected a change pertaining to the classification of services provided by us to Moneris Solutions, effective November 2001. Payment for services provided to Moneris Solutions are now being treated as revenues, whereas previously they were treated as cost recoveries. Excluding this factor, revenues increased 5%, reflecting growth in fee income.

Results

(C$ millions, taxable equivalent basis, volumes in thousands)	% change	2002	2001
Gross revenues	(11)%	**$ 309**	$ 347
Core gross revenues (1)	20	**309**	258
Average deposits	6	**6,350**	6,000
Payment volumes (2)	12	**7,440**	6,670
Payment errors (per 10,000 payments)	(40)	**.33**	.55

(1) Excluding special items in 2001 detailed in Table 6 on page 27.
(2) Restated to include payment types not previously included in 2001.

Financial priority: Revenue growth and diversification

Highlights

- Revenues up 7%
- Operating (core) revenues up 11%, reflecting acquisitions
- Excluding recent U.S. acquisitions, operating revenues unchanged
- Net interest income up 10%
- Net interest margin of 1.93%, down four basis points
- Non-interest revenue up 5% and core non-interest revenues up 11%
- Non-interest revenue 54% of total revenues

TABLE 7 Operating revenues

(C$ millions, taxable equivalent basis)	2002	2001	2002 vs 2001 Increase (decrease)	
Net interest income	$ 7,191	$ 6,529	$ 662	10%
Non-interest revenue	8,579	8,155	424	5
Total revenues (reported)	15,770	14,684	1,086	7
Less: Special items (1)	–	(445)	(445)	n.m.
Operating revenues	15,770	14,239	1,531	11
Less: Revenues of recent U.S. acquisitions (2)	(3,265)	(1,735)	1,530	88
Operating revenues, excluding recent U.S. acquisitions	$ 12,505	$ 12,504	$ 1	–%

(1) Special items in 2001 are described in Table 6 on page 27. There were no special items for 2002.
(2) Represents revenues of RBC Centura (now includes Eagle Bancshares, RBC Mortgage for the purposes of this discussion and analysis and what was previously SFNB), RBC Liberty Insurance and RBC Dain Rauscher (includes Tucker Anthony Sutro) and excludes Dain Rauscher Wessels, which was integrated into RBC Capital Markets in early 2002.
n.m. not meaningful.

Total revenues were up $1.1 billion or 7% from 2001. Operating, or core, revenues (which exclude $445 million of gains from special items recorded in 2001) were up $1.5 billion or 11% from a year ago.

As shown in the table above, revenues from recent U.S. acquisitions accounted for all of the growth in operating revenue. Excluding recent U.S. acquisitions, operating revenues were unchanged from a year ago. This compared to a decline in operating expenses of 5% (discussed in the Cost control section on page 42).

Net interest income

Net interest income was up 10% from 2001 to $7.2 billion. The majority of the increase stemmed from recent U.S. acquisitions. If these acquisitions are excluded, net interest income would have been up 2% due to an increase in the amount of interest-earning assets, particularly residential mortgages, which more than offset a narrower spread on deposits.

As shown in Table 8 below, the net interest margin decreased by four basis points from last year to 1.93%, reflecting a narrower spread between the prime rate and core deposit funding costs resulting from a reduction in the average Canadian prime rate to 4.15% from 6.55% in 2001.

TABLE 8 Net interest income and margin

(C$ millions, except percentage amounts)	2002	2001	2000
Average assets	$ 371,700	$ 331,600	$ 284,100
Net interest income (1)	7,191	6,529	5,307
Net interest margin (2)	1.93%	1.97%	1.87%

(1) Taxable equivalent basis.
(2) Net interest income, on a taxable equivalent basis, as a percentage of average assets.

Outlook

We are targeting core revenue growth of 5–8% in fiscal 2003, based on our expectations that capital market activity will pick up somewhat, interest rates in Canada will rise and the Canadian and U.S. economies will grow somewhat faster than in 2002.

TABLE 9 Net interest income on average assets and liabilities

(C$ millions, taxable equivalent basis, except percentage amounts)	Average balances (1)			Interest (2)			Average rate		
	2002	2001	2000	**2002**	2001	2000	**2002**	2001	2000
Assets									
Deposits with banks									
Canada	**$ 331**	$ 427	$ 612	**$ 6**	$ 18	$ 22	**1.81%**	4.22%	3.59%
International	**15,395**	16,168	13,888	**476**	813	802	**3.09**	5.03	5.77
	15,726	16,595	14,500	**482**	831	824	**3.06**	5.01	5.68
Securities									
Trading account	**66,631**	53,477	40,669	**1,945**	2,143	1,519	**2.92**	4.01	3.74
Available for sale (3)	**25,583**	21,623	19,471	**1,170**	1,170	1,107	**4.57**	5.41	5.69
Held to maturity	**–**	–	1,057	**–**	–	71	**–**	–	6.72
	92,214	75,100	61,197	**3,115**	3,313	2,697	**3.38**	4.41	4.41
Assets purchased under reverse repurchase agreements	**35,463**	29,591	21,729	**651**	1,163	1,078	**1.84**	3.93	4.96
Loans (4)									
Canada									
Residential mortgage	**65,901**	62,449	59,860	**3,903**	4,087	3,891	**5.92**	6.54	6.50
Personal	**26,631**	28,089	26,949	**1,734**	2,325	2,290	**6.51**	8.28	8.50
Credit card	**4,354**	4,586	3,559	**519**	556	405	**11.92**	12.12	11.38
Business and government	**30,217**	33,890	34,381	**1,291**	1,281	1,506	**4.27**	3.78	4.38
	127,103	129,014	124,749	**7,447**	8,249	8,092	**5.86**	6.39	6.49
International	**41,846**	33,232	24,927	**3,016**	3,783	3,446	**7.21**	11.38	13.82
	168,949	162,246	149,676	**10,463**	12,032	11,538	**6.19**	7.42	7.71
Total interest-earning assets	**312,352**	283,532	247,102	**14,711**	17,339	16,137	**4.71**	6.12	6.53
Non-interest-bearing deposits with banks	**1,753**	1,188	930						
Customers' liability under acceptances	**8,515**	9,890	10,281						
Other assets	**51,365**	39,025	27,724						
Allowance for credit losses	**(2,285)**	(2,035)	(1,937)						
Total assets	**$ 371,700**	$ 331,600	$ 284,100	**$ 14,711**	$ 17,339	$ 16,137	**3.96%**	5.23%	5.68%
Liabilities and shareholders' equity									
Deposits (5)									
Canada	**$ 111,880**	$ 110,228	$ 107,533	**$ 2,964**	$ 4,712	$ 5,060	**2.65%**	4.27%	4.71%
International	**108,849**	90,459	71,024	**2,745**	4,000	3,997	**2.52**	4.42	5.63
	220,729	200,687	178,557	**5,709**	8,712	9,057	**2.59**	4.34	5.07
Obligations related to securities sold short	**19,563**	16,358	14,195	**797**	654	656	**4.07**	4.00	4.62
Obligations related to assets sold under repurchase agreements	**19,630**	19,892	11,873	**414**	894	653	**2.11**	4.49	5.50
Subordinated debentures	**7,089**	6,972	5,129	**406**	410	344	**5.73**	5.88	6.71
Other interest-bearing liabilities	**5,546**	3,042	3,042	**194**	140	120	**3.50**	4.60	3.94
Total interest-bearing liabilities	**272,557**	246,951	212,796	**7,520**	10,810	10,830	**2.76**	4.38	5.09
Non-interest-bearing deposits	**21,540**	20,732	17,509						
Acceptances	**8,515**	9,890	10,281						
Other liabilities	**50,526**	38,092	30,811						
	353,138	315,665	271,397	**7,520**	10,810	10,830	**2.13**	3.42	3.99
Shareholders' equity									
Preferred	**1,682**	2,036	1,978						
Common	**16,880**	13,899	10,725						
Total liabilities and shareholders' equity	**$ 371,700**	$ 331,600	$ 284,100	**$ 7,520**	$ 10,810	$ 10,830	**2.02%**	3.26%	3.81%
Net interest income as a % of total average assets	**$ 371,700**	$ 331,600	$ 284,100	**$ 7,191**	$ 6,529	$ 5,307	**1.93%**	1.97%	1.87%
Net interest income as a % of total average interest-earning assets									
Canada	**$ 199,066**	$ 186,480	$ 180,429	**$ 6,537**	$ 5,324	$ 4,796	**3.28%**	2.85%	2.66%
International	**113,286**	97,052	66,673	**654**	1,205	511	**.58**	1.24	.77
Total	**$ 312,352**	$ 283,532	$ 247,102	**$ 7,191**	$ 6,529	$ 5,307	**2.30%**	2.30%	2.15%

(1) Calculated on a daily basis.
(2) Interest income includes loan fees of $321 million (2001 – $328 million; 2000 – $274 million). The taxable equivalent adjustment is based on the Canadian tax rate of 38.5% (2001 – 41.5%; 2000 – 42.8%) and U.S. federal tax rate of 39.5%.
(3) Tax-exempt securities had average balances of $6,729 million (2001 – $6,752 million; 2000 – $2,848 million), interest earned of $233 million (2001 – $141 million; 2000 – $63 million) and average rates of 3.46% (2001 – 2.09%; 2000 – 2.21%).
(4) Average balances include nonaccrual loans.
(5) Deposits include savings deposits with average balances of $39 billion (2001 – $38 billion; 2000 – $34 billion), interest expense of $.3 billion (2001 – $.6 billion; 2000 – $.7 billion) and average rates of .69% (2001 – 1.58%; 2000 – 2.06%). Deposits also include time deposits with average balances of $47 billion (2001 – $44 billion; 2000 – $38 billion), interest expense of $1.3 billion (2001 – $2.0 billion; 2000 – $2.0 billion) and average rates of 2.85% (2001 – 4.55%; 2000 – 5.26%).

TABLE 10 **Change in net interest income**

(C$ millions, taxable equivalent basis)	2002 vs 2001 Increase (decrease) due to changes in average volume (1)	average rate (1)	Net change	2001 vs 2000 Increase (decrease) due to changes in average volume (1)	average rate (1)	Net change
Assets						
Deposits with banks						
Canada	$ (3)	$ (9)	$ (12)	$ (7)	$ 3	$ (4)
International	(37)	(300)	(337)	122	(111)	11
Securities						
Trading account	459	(657)	(198)	507	117	624
Available for sale	196	(196)	–	118	(55)	63
Held to maturity	–	–	–	(71)	–	(71)
Assets purchased under reverse repurchase agreements	197	(709)	(512)	339	(254)	85
Loans						
Canada						
Residential mortgage	218	(402)	(184)	169	27	196
Personal	(116)	(475)	(591)	95	(60)	35
Credit card	(28)	(9)	(37)	123	28	151
Business and government	(147)	157	10	(21)	(204)	(225)
International	832	(1,599)	(767)	1,016	(679)	337
Total interest income	$ 1,571	$ (4,199)	$ (2,628)	$ 2,390	$ (1,188)	$ 1,202
Liabilities						
Deposits						
Canada	$ 70	$ (1,818)	$ (1,748)	$ 124	$ (472)	$ (348)
International	701	(1,956)	(1,255)	962	(959)	3
Obligations related to securities sold short	130	13	143	93	(95)	(2)
Obligations related to assets sold under repurchase agreements	(12)	(468)	(480)	377	(136)	241
Subordinated debentures	7	(11)	(4)	112	(46)	66
Other interest-bearing liabilities	94	(40)	54	–	20	20
Total interest expense	990	(4,280)	(3,290)	1,668	(1,688)	(20)
Net interest income	$ 581	$ 81	$ 662	$ 722	$ 500	$ 1,222

(1) Volume/rate variance is allocated on the percentage relationship of changes in balances and changes in rates to the total net change in net interest income on a taxable equivalent basis.

Non-interest revenue

As shown in Table 11 on page 41, non-interest revenue was up $424 million, or 5%, from 2001, while core non-interest revenues, which exclude special items shown in Table 6 on page 27, were up $869 million or 11%, both reflecting recent U.S. acquisitions. Core non-interest revenues were up 12% in RBC Banking, 6% in RBC Insurance and 31% in RBC Investments, largely reflecting acquisitions. Core non-interest revenues were up 8% in RBC Global Services but were down 9% in RBC Capital Markets.

Excluding the impact of recent U.S. acquisitions, core non-interest revenues were down $133 million or 2%.

Partially driven by recent U.S. acquisitions, capital market fees (consisting of fees from full-service brokerage, discount brokerage and the institutional business) were up 23%, deposit and payment service charges were up 17% and investment management and custodial fees were up 8%. Mortgage banking revenues (which relate to mortgages originated in the U.S.) rose 17%, mutual fund revenues were up 4% and securitization revenues were up 38%, reflecting $3.7 billion of residential mortgage securitizations during the year. Card service revenues declined 2%. Despite contributions from recent U.S. acquisitions, trading revenues were down 3%. Insurance revenues were also down 3% while credit fees declined 6%. Other non-interest revenue was up $255 million, or 68%, partially as a result of a $77 million increase in fee revenue at RBC Dain Rauscher for the provision of back office services to other brokerage firms and a $61 million increase in mark-to-market gains for derivative and hedging activities. These mark-to-market gains are determined in accordance with Statement of Financial Accounting Standards, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133).

Excluding the effect of recent U.S. acquisitions, deposit and payment service charges increased by $82 million, securitization revenues increased by $47 million, insurance revenues increased by $16 million, mutual fund revenues increased by $8 million, credit fees declined by $17 million, capital market fees declined by $23 million, investment management and custodial fees declined by $77 million and trading revenues declined by $302 million.

Non-interest revenues accounted for 54% of total revenues, unchanged from 2001.

TABLE 11 Non-interest revenue

(C$ millions, except percentage amounts)	2002	2001	2000	2002 vs 2001 Increase (decrease)	
Capital market fees	**$ 1,866**	$ 1,523	$ 1,538	**$ 343**	**23%**
Trading revenues	**1,766**	1,820	1,540	**(54)**	**(3)**
Investment management and custodial fees	**1,179**	1,096	860	**83**	**8**
Deposit and payment service charges	**1,041**	887	756	**154**	**17**
Mutual fund revenues	**723**	692	624	**31**	**4**
Card service revenues	**285**	290	420	**(5)**	**(2)**
Foreign exchange revenues, other than trading	**277**	300	299	**(23)**	**(8)**
Insurance revenues	**255**	263	151	**(8)**	**(3)**
Mortgage banking revenues	**240**	206	–	**34**	**17**
Credit fees	**223**	237	212	**(14)**	**(6)**
Securitization revenues	**172**	125	104	**47**	**38**
Gain (loss) on disposal of premises and equipment	**15**	22	(16)	**(7)**	**(32)**
Loss on sale of securities	**(95)**	(128)	(11)	**33**	**26**
Other	**632**	377	203	**255**	**68**
Total core	**8,579**	7,710	6,680	**869**	**11**
Special items (1)	**–**	445	–	**(445)**	**n.m.**
Total	**$ 8,579**	$ 8,155	$ 6,680	**$ 424**	**5%**

(1) Special items in 2001 are described in Table 6 on page 27. There were no special items for 2000 and 2002.
n.m. not meaningful

TABLE 12 Trading revenues

(C$ millions)	2002	2001	2000
Net interest income (1)	**$ 127**	$ (68)	$ (365)
Non-interest revenue (2)	**1,766**	1,820	1,540
Total	**$ 1,893**	$ 1,752	$ 1,175
By product			
Equity	**$ 753**	$ 684	$ 495
Fixed income and money markets (3)	**876**	726	378
Foreign exchange contracts (4)	**263**	340	301
Commodity and precious metals	**1**	2	1
Total	**$ 1,893**	$ 1,752	$ 1,175

(1) Includes interest earned on trading securities and other cash instruments held in the trading portfolios less funding costs associated with trading-related derivative and security positions.
(2) Primarily includes realized and unrealized gains and losses on trading securities, derivative instruments and foreign exchange trading activities.
(3) Includes Canadian government securities and corporate debt instruments, swaps, interest rate options, interest rate futures, forward rate agreements.
(4) Includes foreign exchange spot, forward, futures and options contracts.

Trading revenues

Trading revenues include gains and losses on securities and derivatives that arise from market-making, sales and principal trading activities. These securities and derivative positions are marked-to-market on a daily basis. A description of trading revenues included in net interest income and non-interest revenue is provided in footnotes (1) and (2) in Table 12 above.

As shown in Table 12, total trading revenues were up $141 million or 8% in 2002. This was partially due to the acquisition of Tucker Anthony Sutro on October 31, 2001. Proprietary trading activities are strictly managed in accordance with VAR and trading limits and we continue to conduct the majority of client-related trading in the major G7 markets and currencies.

Fixed income and money market trading revenues increased by $150 million, or 21%, largely from increases in fixed income trading volumes due to the favourable interest rate environment provided by successive central bank rate cuts and increases in derivative trading activities. Equity trading revenues increased by $69 million, or 10%, primarily due to the inclusion of revenues from Tucker Anthony Sutro. Foreign exchange contract trading revenues declined by $77 million, or 23%, in part due to lower trading volumes caused by increased volatility in the foreign exchange markets.

Financial priority: Cost control

Highlights

- Non-interest expense up 6% from 2001 and core non-interest expense up 7%, reflecting recent U.S. acquisitions
- Operating non-interest expense excluding recent U.S. acquisitions down 5%, reflecting continued cost control efforts

As shown in the table below, non-interest expense was up $603 million or 6% and core non-interest expense (i.e., excluding special items shown in Table 6 on page 27) was up $694 million or 7% from 2001.

Operating non-interest expense (which excludes the special items mentioned in Table 6 on page 27, the costs of SARs and retention compensation associated with acquisitions) was up $708 million or 8% in 2002.

Non-interest expense of recent U.S. acquisitions was $2.7 billion, up $1.1 billion in 2002. The large increase is primarily due to the inclusion of a full year of expenses for RBC Centura, which was acquired on June 5, 2001, and expenses relating to the acquisition of Tucker Anthony Sutro, which was acquired on October 31, 2001. Excluding recent U.S. acquisitions, operating non-interest expense was down $411 million or 5% from 2001. Further excluding goodwill amortization expense not associated with recent U.S. acquisitions, operating non-interest expense was down $261 million, or 3%, in 2002.

From a segment perspective, by excluding expenses of recent U.S. acquisitions, operating expenses for RBC Investments would have been down $133 million or 8%, for RBC Banking down $113 million or 3% and for RBC Insurance down $10 million or 5%. The decline in RBC Banking's expenses reflects ongoing success with its cost control initiatives initially implemented in 1999, while the reduction in RBC Investments largely reflects lower variable compensation in the weaker capital markets environment and cost control efforts. The decrease in RBC Insurance expenses partially reflects the cessation of goodwill amortization on November 1, 2001.

Operating expenses for RBC Capital Markets were down $140 million or 8%, whereas operating expenses at RBC Global Services were up $63 million or 13%. The reductions at RBC Capital markets, similar to the reductions at RBC Investments, were the result of lower variable compensation and continuing cost control. The increase in RBC Global Services costs was affected by a change that became effective November 2001, pertaining to the classification of services provided by us to Moneris Solutions, a card processing joint venture in which we have a 50% interest. Payments for services provided to Moneris Solutions are now being treated as revenues, whereas previously they were treated as cost recoveries. Also, expenses were impacted by the July 2001 acquisition of Perpetual Fund Services. Excluding this acquisition, and the change in classification of services provided to Moneris Solutions, operating expenses at RBC Global Services increased by 2%.

Human resources costs increased by $589 million or 10% in 2002, largely the result of a $464 million or 17% increase in salaries expense and a $100 million or 14% increase in benefits expense. The increase in salaries expense is primarily due to the acquisition of RBC Centura and Tucker Anthony Sutro. Pension benefit expense increased by $129 million this year primarily due to a decrease in the fair value of plan assets due to weak equity markets, settlement costs on pension-related matters with Royal Trust pension plan members and increases in the interest cost on the benefit obligation. Furthermore, our defined contribution pension expenses were higher due to changes to our U.S. plan design and the launch of our Canadian defined contribution plan.

Other postretirement benefits expense decreased by $39 million this year primarily as a result of an $87 million charge that was taken in 2001 following the review of certain pension and other related future benefit plans. No similar charge was taken this year.

Retention compensation costs declined by $18 million to $158 million despite the addition of $45 million of retention compensation costs pertaining to Tucker Anthony Sutro. We expect total retention compensation costs to fall to approximately $87 million in 2003 and $53 million in 2004. SAR expenses rose slightly during the year. SARs are discussed in Note 16 on page 89, and their costs are determined based upon the change in our share price and the vesting, which occurs over time.

Communications costs increased by $111 million or 16%, equipment costs were up $81 million or 12% and occupancy costs increased by $72 million or 10%. These increases largely relate to the inclusion of a full year of expenses for RBC Centura Bank, which was acquired on June 5, 2001 and Tucker Anthony Sutro, which was acquired on October 31, 2001.

Excluding expenses from recent U.S. acquisitions, equipment costs would have been up $51 million or 9%, human resource costs down $147 million or 3%, amortization of goodwill and other intangibles down $147 million or 87%, other costs down $121 million or 12%, occupancy costs down $24 million or 4%, professional fees down $23 million or 7% and communications costs would have been unchanged.

TABLE 13 Operating non-interest expense

(C$ millions)	2002	2001	2002 vs 2001 Increase (decrease)	
Non-interest expense	$ 10,244	$ 9,641	$ 603	6%
Less: Special items (1)	–	(91)	(91)	n.m.
Core non-interest expense	10,244	9,550	694	7
Less: Costs of SARs	(27)	(23)	4	17
RBC Dain Rauscher retention compensation (2)	(158)	(176)	(18)	(10)
Operating expenses	10,059	9,351	708	8
Less: Non-interest expense of recent U.S. acquisitions (3)	(2,725)	(1,606)	1,119	70
Operating expenses, excluding recent U.S. acquisitions	7,334	7,745	(411)	(5)
Less: Amortization of goodwill not associated with recent U.S. acquisitions	–	(150)	(150)	n.m.
Operating expenses, excluding recent U.S. acquisitions and goodwill amortization	$ 7,334	$ 7,595	$ (261)	(3)%

(1) Special items in 2001 are described in Table 6 on page 27. There were no special items in 2002.
(2) Includes Dain Rauscher Wessels for both periods and Tucker Anthony Sutro in 2002 only.
(3) Represents non-interest expense of RBC Centura (now includes Eagle Bancshares, RBC Mortgage for the purposes of this discussion and analysis and what was previously SFNB), RBC Liberty Insurance and RBC Dain Rauscher (includes Tucker Anthony Sutro) including goodwill amortization expense of $102 million in 2001 (nil in 2002), but excluding retention compensation costs and Dain Rauscher Wessels, which was integrated into RBC Capital Markets in early 2002.
n.m. not meaningful.

Outlook

In 2003, we expect to grow operating expenses at a lower rate than operating revenues.

TABLE 14 Non-interest expense

(C$ millions, except percentage amounts)	2002	2001	2000	2002 vs 2001 Increase (decrease)	
Human resources					
Salaries	$ 3,189	$ 2,725	$ 2,319	$ 464	17%
Variable compensation	2,095	2,056	1,839	39	2
Acquisition related retention compensation	158	176	–	(18)	(10)
Benefits	794	694	485	100	14
SARs	27	23	52	4	17
	6,263	5,674	4,695	589	10
Occupancy					
Net premises rent	587	553	384	34	6
Premises repairs and maintenance	70	55	68	15	27
Depreciation	103	91	81	12	13
Property taxes	11	6	15	5	83
Energy	17	11	22	6	55
	788	716	570	72	10
Equipment					
Office and computer rental and maintenance	467	375	376	92	25
Depreciation	285	296	288	(11)	(4)
	752	671	664	81	12
Communications					
Telecommunication	350	283	225	67	24
Marketing and public relations	211	180	173	31	17
Postage and courier	121	108	170	13	12
Stationery and printing	108	108	127	–	–
	790	679	695	111	16
Professional fees	419	390	267	29	7
Amortization of goodwill	–	252	80	(252)	n.m.
Amortization of other intangibles	72	36	11	36	100
Other					
Business and capital taxes	129	171	134	(42)	(25)
Travel and relocation	144	121	85	23	19
Employee training	46	43	38	3	7
Donations	41	35	26	6	17
Other	800	762	363	38	5
	1,160	1,132	646	28	2
Total core	10,244	9,550	7,628	694	7
Special items (1)	–	91	–	(91)	n.m.
Total	$ 10,244	$ 9,641	$ 7,628	$ 603	6%

(1) Special items in 2001 are described in Table 6 on page 27. There were no special items for 2000 and 2002.
n.m. not meaningful

Continuing our focus on cost control

The cost control initiatives undertaken in 2002 and in prior years are continuing to yield favourable results as reflected in the 5% decline in operating expenses, excluding recent U.S. acquisitions, shown in Table 13.

RBC Banking surpassed its stated objective of no non-interest expense growth in 2002, reducing non-interest expense by $107 million or 3%, excluding recent U.S. acquisitions. Its success is due to favourable results from a number of initiatives, including the following.

Increasing focus on fraud prevention. This led to over $50 million of savings realized this year.

Eliminating duplication and other process inefficiencies. As the result of integrating the credit card business into RBC Royal Bank's product and sales structure, over $10 million in cost savings were realized during 2002.

Integration of certain functions of SFNB, RBC Builder Finance and RBC Mortgage into RBC Centura. The successful integration of certain functions resulted in the realization of 100% of the three-year cost savings target of US$70 million, nearly two years ahead of schedule.

Integration of certain functions of RBC Centura into RBC Royal Bank. A portion of RBC Centura call centre services has been reallocated to the RBC Royal Bank call centres in Canada, whereby over half of RBC Centura inbound calls are now handled by call centres in Canada. RBC Centura is also expecting to realize over $7 million of cost savings in 2003 from the integration of certain operations of Eagle Bancshares.

Moving into 2003, RBC Banking is developing a common business framework enabled by e-technologies. We believe that this streamlined model will drive transformational cost reductions by providing standardized and flexible solutions across segments, channels and products. This initiative is expected to generate cost savings commencing in 2004.

During 2002, RBC Insurance realized cost savings by insourcing the provision of technology and infrastructure support to the RBC Systems & Technology group and by outsourcing its payroll function to an external payroll service provider. Also, RBC Liberty Insurance completed the migration and consolidation of the business insurance software and outsourcing assets acquired from Genelco Incorporated, resulting in cost eliminations. RBC Liberty Insurance is also in the process of migrating to the desktop and server operating environments used by the rest of our enterprise. These changes will result in lower costs and will leverage best practices.

RBC Investments' cost-cutting program, initiated in 2001 to offset the effects of market weakness, will continue into 2003. This segment continues to seek ways to permanently reduce non-interest expense. For example, by working with the Institutional & Investor Services unit of RBC Global Services, RBC Global Private Banking was able to realize cost savings through the sourcing of its fund management processing.

RBC Dain Rauscher achieved cost savings from the continued integration of Tucker Anthony Sutro. Cost savings are being realized through a number of initiatives, including reducing overlapping positions and leveraging scale opportunities that already exist in RBC Dain Rauscher's platform. RBC Dain Rauscher also achieved cost savings through the rationalization of parts of its business in response to poor market conditions. To date, cost savings realized from these initiatives have exceeded US$30 million. Cost savings pertaining to the completion of the integration of Tucker Anthony Sutro into RBC Dain Rauscher are expected to be another US$30 million in 2003.

RBC Capital Markets maintained a focused cost control effort in 2002 in response to the continued weak market conditions. Expense reductions were achieved through the execution of a number of initiatives including continued integration of Capital Market Services businesses in Canada and the U.S., targeted reductions in costs associated with the management of our loan portfolio, technology support and technology capital expenditures. In 2003, RBC Capital Markets will continue its focus on cost control.

RBC Global Services is a scale business with relatively high fixed costs. To achieve cost savings, this segment is focusing on improving operational efficiency by increasing revenue to achieve economies of scale and through continued improvements in its technology infrastructure. Revenue increases will be achieved through organic revenue growth and targeted acquisitions. Acquisitions will provide opportunities for cost savings through integration.

In addition to each platform undertaking its own cost containment initiatives, we have an E^2 (efficiency and effectiveness) effort underway for RBC Financial Group. The primary thrust of the E^2 initiative is to eliminate duplication between platforms and to identify centres of expertise that can be leveraged to enhance operational efficiency and revenue growth. To date, this initiative has identified over 55 projects that could result in cost savings and additional revenue.

TABLE 15 Taxes

(C$ millions, except percentage amounts)	**2002**	2001	2000
Income taxes			
Consolidated statement of income	**$ 1,415**	$ 1,350	$ 1,412
Taxable equivalent adjustment	**40**	32	28
	1,455	1,382	1,440
Other taxes			
Goods and services and sales taxes	**224**	221	208
Payroll taxes	**245**	237	188
Provincial capital taxes	**107**	146	108
Property taxes (1)	**11**	6	16
Business taxes	**22**	25	26
Insurance premium taxes	**22**	21	11
	631	656	557
Total	**$ 2,086**	$ 2,038	$ 1,997
Effective income tax rate (2)	**32.0%**	34.7%	38.8%
Effective total tax rate (3)	**41.0%**	44.5%	47.3%

(1) Includes amounts netted against non-interest revenue regarding investment properties.
(2) Income taxes reported in the consolidated statement of income, as a percentage of net income before income taxes.
(3) Total income taxes and other taxes as a percentage of net income before income taxes and other taxes expressed on a taxable equivalent basis.

Income and other taxes

Income and other taxes shown in Table 15 above were $2,086 million in 2002, comprising income taxes of $1,455 million (including a taxable equivalent adjustment) and other taxes of $631 million. Income taxes increased by $73 million from 2001, largely due to higher net income before tax. Other taxes declined by $25 million largely as a result of a decrease in the amount of provincial capital taxes paid.

As shown above, the effective income tax rate decreased from 34.7% in 2001 to 32.0% in 2002, reflecting a reduction in federal and provincial tax rates in Canada.

In addition to the income and other taxes reported in the consolidated statement of income, the bank recorded income tax benefits of $7 million in 2002 ($451 million in 2001) in shareholders' equity as shown in Note 14 on page 87.

Financial priority: Strong credit quality

Highlights

- Business and government loans and acceptances decreased from 42% of total loans and acceptances in 2001 to 39%
- Nonaccrual loans down 7%
- Nonaccrual loans to total loans and acceptances down from 1.36% to 1.27%
- Provision for credit losses stable at $1.1 billion
- Allocated specific provision ratio of .50%, down slightly from .52%
- Net charge-offs ratio of .71%, up from .55%
- Allowance for credit losses down slightly from $2.4 billion to $2.3 billion

Loan portfolio

During 2002, the loan portfolio performed well in a very challenging environment, reflecting changes we have made in credit practices over the last two years. In 2002, we continued our strategy of moving towards a lower-risk portfolio mix, which includes more residential mortgage loans and less corporate loans, which are riskier and more capital intensive. As shown in the charts below, business and government loans and acceptances decreased to 39% of total loans and acceptances in 2002 from 48% in 1998. This compares to a ratio of 42% in 2001.

We buy credit protection to offset losses that may result from the potential credit deterioration of particular counterparties and to manage exposure. As at October 31, 2002, we had $1 billion of credit protection in place including $.2 billion in each of the telecommunication, energy and financial services sectors.

The portion of our business and government credit exposure rated investment grade increased slightly during 2002 from 69% to 70%. Business and government includes our small business portfolio, which is generally rated lower than larger businesses.

Table 16 on page 47 and Table 21 on page 52 provide a detailed breakdown of loans and acceptances. Business and government loans and acceptances declined $5.6 billion in Canada and $1.4 billion internationally, with a $2.3 billion reduction outside of the U.S., partially offset by a $.9 billion increase in the U.S. The overall decrease is driven by the ongoing business strategy of exiting non-core client relationships in RBC Capital Markets. We do not engage in subprime lending in the U.S.

In Canada, there were no significant increases in any of the sectors other than the automotive sector where the increase was due to the reclassification of approximately $.8 billion of loans from transportation and environment. The largest reduction was in energy ($1.4 billion).

In the U.S., portfolio increases took place in energy ($1.1 billion) and commercial real estate ($.8 billion), partially offset by a decrease in industrial products ($.5 billion). The largest share of the increase in the energy sector was in power generation. The commercial real estate increase includes $.2 billion of loans acquired as a result of the Eagle Bancshares acquisition.

Outside North America, loans decreased by $2.3 billion, including reductions in financial services, energy and industrial products. The overall reductions reflect focused de-marketing of Asia-Pacific loans, including Japan.

Telecommunication loans outstanding globally decreased by 22% to $1.7 billion at October 31, 2002. Non-investment grade telecommunication loans were $.9 billion, down from 59% of the portfolio to 49%. Currently seven telecommunication loans are classified as nonaccrual, compared to six at October 31, 2001. Approximately 90% of the original nonaccrual amount has been charged-off or specifically provided for. This results in a nonaccrual amount of $41 million, net of allowances, at the end of 2002.

At October 31, 2002, loans outstanding to the power generation sub-sector within the energy sector were $2.0 billion, of which 48% were investment grade. The nonaccrual amount of $74 million (net of allowances) related to three accounts.

For additional discussion of loans, see the Balance sheet and capital management section on page 58.

Nonaccrual loans

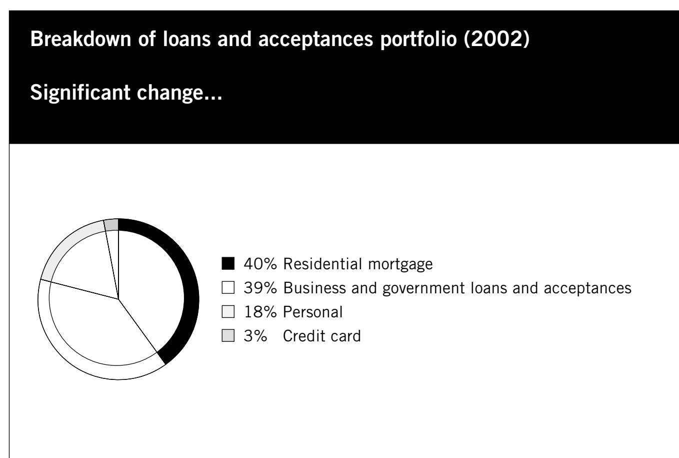
Loans are generally classified as nonaccrual, meaning the accrual of interest is discontinued, under conditions described in Note 1 on page 72.

As indicated in Table 17 on page 48, nonaccrual loans decreased $177 million during the year to $2,288 million. This decline reflects a slowdown in net additions ($1,280 million versus $1,912 million in 2001) and increased charge-offs ($1,457 million versus $1,125 million in 2001).

Nonaccrual loans decreased in both the consumer and the business and government loan portfolios.

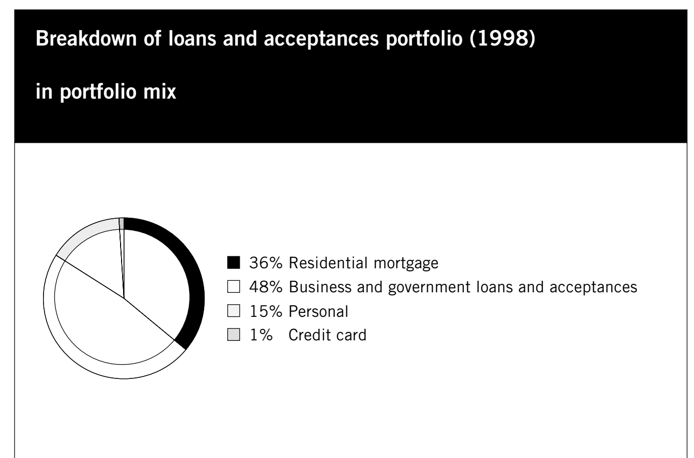
Breakdown of loans and acceptances portfolio (2002)

Significant change...



Breakdown of loans and acceptances portfolio (1998)

in portfolio mix



In the consumer portfolio, nonaccrual loans decreased by $67 million to $437 million. Canada saw a large decrease ($75 million), resulting from overall portfolio improvement due to recent initiatives such as the implementation of an advanced risk modeling technology in order to optimize risk-reward and the optimization of credit policies and procedures (including the implementation of new origination models and new credit management and collection procedures).

Business and government nonaccrual loans fell $110 million to $1,851 million. This consisted of reductions in Canada ($276 million) and the U.S. ($50 million), offsetting increases in other international ($216 million). Nonaccrual loans in the Canadian transportation and environment sector fell $136 million due to a significant single name returning to performing status. There were also decreases in commercial real estate loans ($72 million) and small business loans ($56 million). The U.S. saw a net decrease resulting from reductions in the telecommunication sector ($195 million), driven by significant charge-offs. This decrease was partially offset by an increase in the energy and media and cable sectors. Each of these two sectors was impacted by single individual accounts. New nonaccrual loans in Argentina contributed to an increase in other international.

Nonaccrual loans as a percentage of related loans and acceptances (before deducting the allowance for loan losses) decreased from 1.36% to 1.27%.

Provision for credit losses

The provision for credit losses is charged to income by an amount necessary to bring the allowance for credit losses to a level determined appropriate by management, as discussed in the Allowance for credit losses section below.

The provision for credit losses was $1,065 million in 2002, down $54 million from 2001, as shown in Table 18 on page 49.

We acquire credit protection on portions of our portfolio by entering into credit derivative contracts. We also provide protection through credit derivatives to various counterparties. This year's provision for credit losses included amounts related to a telecommunication account and an energy account that were classified as nonaccrual and were partially offset by gains of $102 million and $13 million, respectively, on related credit derivatives. These amounts were recorded in non-interest revenues in accordance with FAS 133. We had also provided credit protection through derivatives to counterparties with respect to a large U.S. telecommunication company, which defaulted during the year, leading to a mark-to-market loss of $69 million.

In the consumer portfolio, the allocated specific provision increased by $25 million to $430 million. Business and government loans showed a slight decrease of $9 million to $635 million. This comprises decreases in Canada of $166 million, partially offset by increases in the U.S. of $52 million and other international of $105 million. The decreases in Canada are spread across various industries. In the U.S., there was an increase in the energy and information technology sectors, partially offset by decreases in commercial real estate and telecommunication. The increase in U.S. energy ($107 million) is due to a single account.

The allocated specific provision amounted to .50% (.48% net of effect of credit derivatives) of average loans, acceptances and reverse repurchase agreements, down from .52% in 2001. Under Canadian GAAP, the ratio was .51%, down from .53% in 2001 and compared to a 2002 objective of .45–.55%.

Outlook

In light of the continued economic and global political uncertainty that we face, we expect a specific provision for credit losses ratio of .45–.55% (using Canadian GAAP) in 2003, which is unchanged from our 2002 objective.

Allowance for credit losses

The allowance for credit losses is maintained at a level that management believes is sufficient to absorb probable losses in the loan and off-balance sheet portfolios. The individual elements as well as the overall allowance are evaluated on a quarterly basis. This evaluation is based on continuing assessments of problem accounts, recent loss experience and changes in other factors, including the composition and quality of the portfolio, economic conditions and regulatory requirements. The allowance is increased by the provision for credit losses, which is charged to income, and decreased by the amount of charge-offs net of recoveries.

The determination of the allowance for credit losses is based upon estimates derived from historical analysis, adjusted to take into account management's judgment relating to current assumptions. Therefore, the allowance for credit losses will inevitably differ from actual losses incurred in the future. To minimize these differences, management assesses the methodology and all significant assumptions on a regular basis.

The allowance for credit losses comprises three components – allocated specific, allocated general and unallocated – as described in Note 1 on page 73.

As shown in Table 19 on page 50, the allowance for credit losses decreased $78 million or 3% between 2001 and 2002 to $2,314 million. During the year, charge-offs, net of recoveries, were $1,259 million or .71% of average loans and acceptances, versus $940 million or .55% a year ago. The allocated country risk allowance of $31 million has been eliminated as the result of the charge-off of the related fully provisioned loans.

In 2000, we entered into an agreement with an AAA rated reinsurer to provide capital if exceptional losses occur in the bank's loan portfolio. During the year, the reinsurer was downgraded from AAA. Based on this development and an internal review by management, the agreement was not renewed for fiscal 2003.

Credit risk concentrations

Concentration risk exists if a number of clients are engaged in similar activities, are located in the same geographic region or have comparable economic characteristics such that their ability to meet contractual obligations would be similarly affected by changes in economic, political or other conditions. Strategies to minimize concentration risk are discussed further under portfolio diversification in the Risk management section on page 55. In terms of geographic risk, Table 16 on page 47 shows that the largest domestic geographic exposure is in Ontario, comprising 35% of total loans and acceptances. Internationally, the largest concentration is in the U.S. where we have 16% of our total loans and acceptances.

As shown in Table 16 on page 47, excluding small business, the largest sector concentrations are in financial services, commercial real estate and energy, with 5%, 4% and 4% of loans and acceptances, respectively.

Table 20 on page 51 illustrates geographic risk concentrations of contractual amounts with clients outside of Canada. Only 11% of contractual amounts with clients are outside Canada and the U.S.

TABLE 16 Loans and acceptances (1)

(C$ millions, except percentage amounts)	2002	2001	2000	1999	1998	2002	1998
Canada							
Atlantic provinces (2)	$ 9,770	$ 9,654	$ 9,690	$ 8,840	$ 8,052	5.4%	5.1%
Quebec	15,190	13,863	16,191	14,936	14,066	8.5	8.9
Ontario	63,627	70,164	60,999	54,724	51,977	35.5	33.0
Prairie provinces (3)	26,989	25,192	29,402	25,521	23,288	15.0	14.8
British Columbia	23,367	22,696	25,118	23,141	22,295	13.0	14.2
Total Canada	138,943	141,569	141,400	127,162	119,678	77.4	76.0
Consumer							
Residential mortgage	67,700	64,066	61,444	58,524	55,836	37.7	35.5
Personal	25,918	27,202	27,207	24,353	21,814	14.5	13.9
Credit card	4,740	4,110	4,666	2,666	1,945	2.6	1.2
	98,358	95,378	93,317	85,543	79,595	54.8	50.6
Business and government loans and acceptances							
Small business (4)	9,470	9,788	11,701	10,334	8,452	5.3	5.4
Agriculture	4,427	4,758	4,931	4,217	3,851	2.5	2.5
Financial services	3,015	3,010	2,218	1,567	1,718	1.7	1.1
Energy	2,911	4,293	3,754	3,350	3,442	1.6	2.2
Commercial mortgages	2,468	2,635	2,961	2,635	2,434	1.4	1.5
Commercial real estate	2,393	2,325	2,594	2,400	2,523	1.3	1.6
Consumer goods	2,238	2,447	2,874	2,086	2,802	1.2	1.8
Industrial products	1,569	2,174	2,470	2,301	2,241	.9	1.4
Transportation and environment (5)	1,450	2,138	1,519	1,562	1,392	.8	.9
Automotive (5)	1,370	864	673	611	698	.8	.4
Government	1,039	1,597	1,385	2,105	1,951	.6	1.2
Media and cable (6)	994	1,510	1,120	1,135	959	.5	.6
Forest products	954	1,275	1,362	1,151	1,728	.5	1.1
Telecommunication	487	677	1,008	525	361	.3	.2
Mining and metals	361	636	897	845	750	.2	.5
Information technology	191	203	210	191	204	.1	.1
Other	5,248	5,861	6,406	4,604	4,577	2.9	2.9
	40,585	46,191	48,083	41,619	40,083	22.6	25.4
Total Canada	138,943	141,569	141,400	127,162	119,678	77.4	76.0
International							
United States	29,192	25,944	13,415	13,060	13,717	16.3	8.7
Europe, Middle East and Africa	6,340	7,918	6,544	6,617	13,174	3.5	8.4
Caribbean	2,018	1,856	2,059	1,502	1,573	1.1	1.0
Latin America	1,400	1,680	1,842	2,309	3,875	.8	2.5
Asia	1,004	1,328	1,781	2,417	4,550	.5	2.9
Australia and New Zealand	677	805	771	983	825	.4	.5
Total international	40,631	39,531	26,412	26,888	37,714	22.6	24.0
Consumer							
Residential mortgage	5,142	3,378	1,540	718	632	2.9	.4
Personal	6,038	5,309	812	902	947	3.3	.6
Credit card	174	173	–	–	–	.1	–
	11,354	8,860	2,352	1,620	1,579	6.3	1.0
Business and government loans and acceptances							
Financial services	6,542	9,347	7,912	6,937	10,896	3.6	6.9
Energy	3,731	2,994	3,051	3,887	4,702	2.1	3.0
Commercial real estate	5,124	4,082	271	464	862	2.9	.6
Consumer goods	1,383	1,699	1,111	1,411	2,756	.8	1.8
Industrial products	1,199	2,116	1,749	1,325	1,881	.7	1.2
Transportation and environment	2,442	1,571	1,487	1,975	2,296	1.4	1.5
Automotive	411	527	513	878	2,264	.2	1.4
Government	130	128	167	773	492	.1	.3
Media and cable (6)	1,321	1,380	2,033	1,909	2,270	.7	1.4
Forest products	417	385	468	549	609	.2	.4
Telecommunication	1,246	1,558	2,244	1,206	1,756	.7	1.1
Mining and metals	1,192	1,071	901	881	1,323	.6	.8
Information technology	180	396	433	709	1,212	.1	.8
Other	3,959	3,417	1,720	2,364	2,816	2.2	1.8
	29,277	30,671	24,060	25,268	36,135	16.3	23.0
Total international	40,631	39,531	26,412	26,888	37,714	22.6	24.0
Total loans and acceptances	179,574	181,100	167,812	154,050	157,392	100%	100%
Allowance for loan losses	(2,203)	(2,278)	(1,871)	(1,884)	(2,026)		
Total	$ 177,371	$ 178,822	$ 165,941	$ 152,166	$ 155,366		

(1) Based on residence of borrower.
(2) Includes Newfoundland and Labrador, Prince Edward Island, Nova Scotia and New Brunswick.
(3) Includes Manitoba, Saskatchewan and Alberta.
(4) Small business loans in 2002 comprises the following industries: commercial real estate of $1,737 million (2001 – $1,788 million); consumer goods of $1,583 million (2001 – $1,665 million); industrial products of $887 million (2001 – $916 million); transportation and environment of $552 million (2001 – $605 million); automotive of $377 million (2001 – $434 million); forest products of $278 million (2001 – $296 million); energy of $125 million (2001 – $157 million); information technology of $93 million (2001 – $133 million); mining and metals of $69 million (2001 – n.a.); financial services of $132 million (2001 – $96 million); media and cable of $77 million (2001 – $84 million); telecommunication of $34 million (2001 – $45 million); and other of $3,526 million (2001 – $3,569 million).
(5) Commencing in 2002, certain amounts were reclassified from transportation and environmental sector grouping to the automotive group.
(6) Includes cable loans of $267 million in Canada in 2002 (2001 – $330 million; 2000 – $262 million; 1999 – $169 million; 1998 – $164 million) and $634 million internationally in 2002 (2001 – $625 million; 2000 – $1,321 million; 1999 – $850 million; 1998 – $1,221 million).

TABLE 17 Nonaccrual loans

(C$ millions, except percentage amounts)	2002	2001	2000	1999	1998
Canada					
Atlantic provinces (1)	**$ 107**	$ 124	$ 115	$ 77	$ 60
Quebec	**90**	282	198	259	261
Ontario	**471**	621	572	438	543
Prairie provinces (2)	**177**	143	129	198	161
British Columbia	**427**	453	355	415	485
Total Canada	**1,272**	1,623	1,369	1,387	1,510
Consumer					
Residential mortgage	**102**	142	185	173	166
Personal	**275**	310	247	236	217
	377	452	432	409	383
Business and government					
Small business (3)	**205**	261	248	232	130
Agriculture (3)	**141**	111	53	62	47
Financial services	**–**	7	20	16	121
Energy	**1**	27	–	38	6
Commercial mortgages	**17**	22	16	25	22
Commercial real estate	**23**	95	90	186	182
Consumer goods	**47**	11	37	43	55
Industrial products	**23**	45	28	19	25
Transportation and environment	**138**	274	185	21	13
Automotive	**10**	18	5	1	1
Media and cable	**18**	43	36	42	29
Forest products	**199**	195	184	233	383
Telecommunication	**20**	–	–	2	1
Mining and metals	**–**	1	–	–	–
Information technology	**6**	11	8	13	13
Other	**47**	50	27	45	99
	895	1,171	937	978	1,127
Total Canada	**1,272**	1,623	1,369	1,387	1,510
International					
United States	**584**	626	145	41	18
Latin America	**217**	14	9	10	4
Europe, Middle East and Africa	**115**	79	46	58	59
Caribbean	**71**	55	48	47	62
Australia and New Zealand	**26**	23	–	–	–
Asia	**3**	14	33	127	308
	1,016	811	281	283	451
LDCs	**–**	31	28	34	40
Total international	**1,016**	842	309	317	491
Consumer					
Residential mortgage	**29**	37	14	14	15
Personal	**31**	15	–	–	–
	60	52	14	14	15
Business and government					
Financial services	**77**	83	41	89	90
Energy	**242**	3	14	23	31
Commercial real estate	**75**	81	4	5	12
Consumer goods	**10**	19	2	18	119
Industrial products	**30**	10	83	38	76
Transportation and environment	**68**	91	56	–	1
Automotive	**29**	33	–	5	43
Media and cable (4)	**56**	–	–	–	–
Telecommunication	**77**	272	–	–	–
Mining and metals	**128**	40	11	11	8
Information technology	**48**	76	–	–	–
Other	**116**	82	84	114	96
	956	790	295	303	476
Total international	**1,016**	842	309	317	491
Total (5), (6)	**$ 2,288**	$ 2,465	$ 1,678	$ 1,704	$ 2,001

(1) Includes Newfoundland and Labrador, Prince Edward Island, Nova Scotia and New Brunswick.
(2) Includes Manitoba, Saskatchewan and Alberta.
(3) Includes government guaranteed portions of nonaccrual loans of $64 million in small business in 2002 (2001 – $95 million; 2000 – $101 million; 1999 – $79 million) and $10 million in agriculture (2001 – $6 million; 2000 – $6 million; 1999 – $5 million). Prior to 1999, only the non-guaranteed portion was considered nonaccrual.
(4) Consists entirely of cable nonaccrual loans.
(5) Includes foreclosed assets of $32 million in 2002 (2001 – $37 million; 2000 – $16 million; 1999 – $26 million; 1998 – $28 million).
(6) Past due loans greater than 90 days not included in nonaccrual loans was $217 million in 2002 (2001 – $245 million).

TABLE 18 Provision for credit losses

(C$ millions, except percentage amounts)	**2002**	2001	2000	1999	1998
Canada					
Atlantic provinces (1)	**$ 59**	$ 63	$ 58	$ 32	$ 35
Quebec	**(5)**	43	22	71	63
Ontario	**330**	398	342	52	144
Prairie provinces (2)	**86**	81	64	95	53
British Columbia	**59**	104	40	192	132
Total Canada	**529**	689	526	442	427
Consumer					
Residential mortgage	**3**	8	–	4	9
Personal	**266**	265	301	172	171
Credit card	**135**	125	102	55	28
	404	398	403	231	208
Business and government					
Small business	**110**	164	105	113	48
Agriculture	**22**	20	4	2	4
Financial services	**(27)**	(9)	–	5	113
Energy	**4**	17	(8)	12	1
Commercial mortgages	**(5)**	7	2	8	6
Commercial real estate	**(15)**	15	(17)	9	(30)
Consumer goods	**19**	2	7	11	23
Industrial products	**(7)**	14	2	(10)	(6)
Transportation and environment	**(19)**	13	56	7	(27)
Automotive	**–**	17	–	–	–
Media and cable	**(7)**	13	12	8	4
Forest products	**4**	7	(36)	81	76
Telecommunication	**59**	–	(1)	(32)	(29)
Mining and metals	**(1)**	–	(1)	1	–
Information technology	**3**	3	8	8	5
Other	**(15)**	8	(10)	(12)	31
	125	291	123	211	219
Total Canada	**529**	689	526	442	427
International					
United States	**440**	377	99	45	(7)
Latin America	**57**	5	2	2	(2)
Europe, Middle East and Africa	**38**	(1)	(9)	21	10
Caribbean	**6**	(6)	3	–	3
Australia and New Zealand	**5**	4	–	–	–
Asia	**(10)**	(19)	(50)	20	124
Total international	**536**	360	45	88	128
Consumer					
Residential mortgage	**7**	–	–	1	1
Personal	**15**	5	–	–	–
Credit card	**4**	2	–	–	–
	26	7	–	1	1
Business and government					
Financial services	**21**	(3)	(21)	2	36
Energy	**141**	(8)	(2)	–	21
Commercial real estate	**4**	65	1	2	(2)
Consumer goods	**(2)**	–	(7)	(10)	(5)
Industrial products	**5**	3	34	31	9
Transportation and environment	**21**	8	42	–	(1)
Automotive	**1**	7	(8)	(2)	29
Media and cable	**–**	3	–	–	–
Telecommunication	**202**	272	–	–	–
Mining and metals	**28**	–	2	15	–
Information technology	**41**	7	–	3	–
Other	**48**	(1)	4	46	40
	510	353	45	87	127
Total international	**536**	360	45	88	128
Allocated specific provision	**1,065**	1,049	571	530	555
Allocated country risk provision	**–**	–	–	–	(80)
Allocated general provision (3)	**(22)**	205	73	n.a.	n.a.
Total allocated provision (3)	**1,043**	1,254	644	n.a.	n.a.
Unallocated provision (3)	**22**	(135)	47	n.a.	n.a.
Total	**$ 1,065**	$ 1,119	$ 691	$ 760	$ 575

(1) Includes Newfoundland and Labrador, Prince Edward Island, Nova Scotia and New Brunswick.
(2) Includes Manitoba, Saskatchewan and Alberta.
(3) The allocated general provision and the unallocated provision together totalled $230 million in 1999 and $100 million in 1998. These were not separated into the allocated general and unallocated components.

TABLE 19 Allowance for credit losses

(C$ millions, except percentage amounts)	2002	2001	2000	1999	1998
Allowance at beginning of year	**$ 2,392**	$ 1,975	$ 1,900	$ 2,066	$ 2,118
Provision for credit losses	**1,065**	1,119	691	760	575
Charge-offs					
Canada					
Residential mortgage	**(11)**	(15)	(11)	(14)	(17)
Personal	**(381)**	(394)	(372)	(236)	(163)
Credit card	**(172)**	(169)	(150)	(65)	(52)
Business and government	**(330)**	(296)	(225)	(524)	(250)
	(894)	(874)	(758)	(839)	(482)
International					
Residential mortgage	**(1)**	(9)	–	–	–
Personal	**(17)**	(7)	–	–	–
Credit card	**(6)**	(2)	–	–	–
Business and government	**(506)**	(233)	(81)	(229)	(29)
LDC exposures	**(33)**	–	–	(4)	(325)
	(563)	(251)	(81)	(233)	(354)
	(1,457)	(1,125)	(839)	(1,072)	(836)
Recoveries					
Canada					
Residential mortgage	**–**	–	–	2	6
Personal	**68**	66	44	31	26
Credit card	**37**	44	48	10	24
Business and government	**72**	58	48	66	80
	177	168	140	109	136
International					
Personal	**2**	1	–	–	–
Credit card	**1**	–	–	–	–
Business and government	**18**	16	22	5	8
	21	17	22	5	8
	198	185	162	114	144
Net charge-offs	**(1,259)**	(940)	(677)	(958)	(692)
Acquisition of Centura Banks	**–**	157	–	–	–
Acquisition of Eagle Bancshares	**18**	–	–	–	–
Adjustments	**98**	81	61	32	65
Allowance at end of year	**$ 2,314**	$ 2,392	$ 1,975	$ 1,900	$ 2,066
Allocation of allowance (1)					
Canada					
Residential mortgage	**$ 35**	$ 45	$ 46	$ 53	$ 50
Personal	**429**	447	403	344	156
Credit card	**147**	147	88	60	–
Business and government	**711**	791	664	748	604
	1,322	1,430	1,201	1,205	810
International					
Residential mortgage	**6**	4	11	9	7
Personal	**36**	33	–	–	–
Credit card	**5**	5	–	–	–
Business and government	**583**	581	322	380	359
	630	623	333	389	366
Allocated allowance for loan losses (2)	**1,952**	2,053	1,534	1,594	n.a.
Unallocated allowance for loan losses (2)	**251**	225	337	290	n.a.
Total allowance for loan losses	**2,203**	2,278	1,871	1,884	2,026
Allowance for off-balance sheet and other items (3)	**109**	109	98	–	–
Allowance for tax-exempt securities	**2**	5	6	16	40
Total allowance for credit losses	**$ 2,314**	$ 2,392	$ 1,975	$ 1,900	$ 2,066
Percentage of loans and acceptances to total loans and acceptances (4)					
Canada					
Residential mortgage	**38%**	35%	37%	38%	36%
Personal	**14**	15	16	16	14
Credit card	**3**	2	3	2	1
Business and government	**21**	24	28	28	28
	76	76	84	84	79
International	**24**	24	16	16	21
Total	**100%**	100%	100%	100%	100%

(1) As a result of a change in methodology in 1999, the allowance for loan losses in 2002, 2001, 2000 and 1999 includes amounts for the allocated general allowance, which have been allocated to loan categories. These amounts total $1,060 million (2001 – $1,076 million; 2000 – $765 million; 1999 – $790 million) and have been allocated as follows: for Canada – residential mortgage $20 million (2001 – $21 million; 2000 – $18 million; 1999 – $11 million), personal $266 million (2001 – $266 million; 2000 – $207 million; 1999 – $174 million), credit card $147 million (2001 – $147 million; 2000 – $88 million; 1999 – $60 million), business and government $386 million (2001 – $385 million; 2000 – $321 million; 1999 – $370 million), and for International – residential mortgage $3 million (2001 – $2 million; 2000 and 1999 – nil), personal $22 million (2001 – $26 million; 2000 and 1999 – nil), credit card $5 million (2001 – $5 million; 2000 and 1999 – nil), business and government $211 million (2001 – $224 million; 2000 – $131 million; 1999 – $175 million). The amounts prior to 1999 do not include the allocated general allowance.

(2) The allocated general and the unallocated allowance totalled $850 million in 1998. These were not separated into the allocated general and unallocated components prior to October 31, 1999.

(3) Commencing in 2000, the allowance for off-balance sheet and other items was separated and reported under other liabilities. Previously, the amount was included in the allowance for loan losses.

(4) Loans and acceptances in Canada include all loans and acceptances booked in Canada, regardless of the currency or residence of the borrower.

TABLE 20 Foreign outstandings (1)

(C$ millions, except percentage amounts)	2002	2002 % of total assets	2001	2001 % of total assets	2000	2000 % of total assets
United States – Banks	**$ 5,838**		$ 7,186		$ 5,462	
Government	**3,257**		3,834		889	
Other	**62,210**		49,172		30,034	
	71,305	**18.67%**	60,192	16.61%	36,385	12.38%
Western Europe						
United Kingdom – Banks	**7,179**		6,275		4,347	
Government	**295**		153		26	
Other	**5,719**		5,256		5,791	
	13,193	**3.45**	11,684	3.22	10,164	3.46
France – Banks	**2,061**		2,378		2,379	
Government	**86**		68		45	
Other	**831**		1,176		1,552	
	2,978	**.78**	3,622	1.00	3,976	1.35
Germany – Banks	**5,344**		5,952		5,471	
Government	**318**		173		1	
Other	**381**		559		643	
	6,043	**1.58**	6,684	1.84	6,115	2.08
Netherlands	**2,271**	**.59**	2,218	.61	1,300	.44
Switzerland	**1,714**	**.45**	1,362	.38	1,687	.57
Other	**5,658**	**1.49**	5,244	1.45	4,305	1.47
	31,857	**8.34**	30,814	8.50	27,547	9.37
Central/Eastern Europe, Middle East and Africa	**247**	**.06**	469	.13	645	.22
Latin America						
Argentina	**146**	**.04**	193	.06	324	.11
Brazil	**38**	**.01**	71	.02	75	.02
Chile	**800**	**.21**	836	.23	751	.26
Mexico	**493**	**.13**	696	.19	343	.12
Other	**42**	**.01**	174	.05	212	.07
	1,519	**.40**	1,970	.55	1,705	.58
Caribbean						
Bahamas	**1,453**	**.38**	1,520	.42	1,549	.53
Other	**485**	**.13**	1,902	.52	1,952	.66
	1,938	**.51**	3,422	.94	3,501	1.19
Asia						
Japan – Banks	**321**		53		634	
Government	**2,426**		1,663		1,599	
Other	**64**		988		1,000	
	2,811	**.74**	2,704	.75	3,233	1.10
Singapore	**229**	**.06**	217	.06	336	.11
South Korea	**405**	**.11**	449	.12	338	.11
Other	**38**	**.01**	145	.04	188	.07
	3,483	**.92**	3,515	.97	4,095	1.39
Australia and New Zealand	**2,842**	**.74**	2,335	.64	1,775	.60
Allowance for loan losses (2)	**(760)**	**(.20)**	(728)	(.20)	(441)	(.15)
Total	**$ 112,431**	**29.44%**	$ 101,989	28.14%	$ 75,212	25.58%

(1) Includes contractual amounts with clients in a foreign country related to: loans, accrued interest, acceptances, interest-bearing deposits with banks, securities, other interest-earning investments and other monetary assets including net revaluation gains on foreign exchange and derivative products. Local currency outstandings, whether or not hedged or funded by local currency borrowings, are included in country exposure outstandings. Foreign outstandings are reported based on location of ultimate risk.

(2) The allowance for loan losses includes the international component of the allocated specific, allocated general and unallocated allowance. For years prior to 2002, the allowance for loan losses also includes the allocated country risk allowance.

TABLE 21 U.S. loans and acceptances and loan quality information (1)

	Loan balance			Nonaccrual loans			Provision for credit losses		
(C$ millions)	**2002**	2001	2000	**2002**	2001	2000	**2002**	2001	2000
Consumer									
Residential mortgage	**$ 4,353**	$ 2,666	$ 845	**$ 16**	$ 24	$ –	**$ 7**	$ 8	$ –
Personal	**5,269**	4,621	78	**31**	15	–	**15**	5	–
Credit card	**125**	128	–	**–**	–	–	**4**	2	–
	9,747	7,415	923	**47**	39	–	**26**	15	–
Business and government loans and acceptances									
Financial services	**3,770**	4,104	4,521	**46**	30	–	**11**	7	–
Energy	**2,680**	1,613	1,582	**95**	–	–	**107**	–	–
Commercial real estate	**4,531**	3,773	44	**75**	81	4	**5**	66	2
Consumer goods	**958**	1,172	435	**10**	9	–	**4**	2	–
Industrial products	**974**	1,513	1,107	**30**	8	68	**8**	3	40
Transportation and environmental	**484**	788	469	**36**	48	56	**5**	(4)	42
Automotive	**409**	408	221	**29**	33	–	**1**	6	–
Government	**19**	23	–	**–**	–	–	**–**	–	–
Media and cable (2)	**1,107**	1,038	1,782	**56**	–	–	**–**	3	–
Forest products	**223**	98	181	**–**	–	–	**–**	–	–
Telecommunication	**689**	835	1,131	**77**	272	–	**202**	272	–
Mining and metals	**70**	45	104	**–**	–	–	**–**	–	–
Information technology	**177**	299	374	**48**	76	–	**41**	7	–
Other	**3,354**	2,820	541	**35**	30	17	**30**	–	15
	19,445	18,529	12,492	**537**	587	145	**414**	362	99
	$ 29,192	$ 25,944	$ 13,415	**$ 584**	$ 626	$ 145	**$ 440**	$ 377	$ 99

(1) Based on residence of the borrower.
(2) Includes cable loans of $522 million (2001 – $455 million; 2000 – $1,162 million) and cable gross nonaccrual loans of $56 million in 2002.

TABLE 22 Risk profile

(C$ millions, except percentage amounts)	**2002**	2001	2000	1999	1998
Nonaccrual loans					
Beginning of year	**$ 2,465**	$ 1,678	$ 1,704	$ 2,001	$ 1,819
Net additions	**1,280**	1,912	813	743	628
Charge-offs and adjustments	**(1,457)**	(1,125)	(839)	(1,040)	(446)
End of year	**$ 2,288**	$ 2,465	$ 1,678	$ 1,704	$ 2,001
As a % of related loans and acceptances (1)					
Canada					
Residential mortgage	**.15%**	.22%	.30%	.30%	.30%
Personal	**1.06**	1.14	.91	.97	.99
Business and government	**2.36**	2.75	1.97	2.24	2.52
	.93	1.18	.97	1.07	1.21
International	**2.34**	1.95	1.15	1.28	1.49
Total	**1.27%**	1.36%	1.00%	1.11%	1.27%
Allowance for credit losses					
Allocated specific	**$ 894**	$ 951	$ 747	$ 786	$ 1,176
Allocated country risk	**–**	31	28	34	40
Allocated general (2), (4)	**1,169**	1,185	863	790	n.a.
Total allocated (2)	**2,063**	2,167	1,638	1,610	n.a.
Unallocated (2)	**251**	225	337	290	n.a.
Total	**$ 2,314**	$ 2,392	$ 1,975	$ 1,900	$ 2,066
As a % of loans and acceptances	**1.2%**	1.3%	1.1%	1.2%	1.3%
As a % of loans, acceptances and reverse repurchase agreements	**1.0%**	1.0%	1.0%	1.1%	1.1%
As a % of nonaccrual loans (coverage ratio), excluding LDCs	**96%**	93%	112%	112%	103%
Provision for credit losses					
Allocated specific	**$ 1,065**	$ 1,049	$ 571	$ 530	$ 555
Allocated country risk	**–**	–	–	–	(80)
Allocated general (3)	**(22)**	205	73	n.a.	n.a.
Total allocated (3)	**1,043**	1,254	644	n.a.	n.a.
Unallocated (3)	**22**	(135)	47	n.a.	n.a.
Total	**$ 1,065**	$ 1,119	$ 691	$ 760	$ 575
Allocated specific provisions as a % of average loans, acceptances and reverse repurchase agreements	**.50%**	.52%	.31%	.30%	.31%
Provision as a % of average loans, acceptances and reverse repurchase agreements	**.50**	.55	.38	.43	.32
As a % of related average loans and acceptances					
Canada					
Residential mortgage	**–%**	.01%	–%	.01%	.02%
Personal	**1.00**	.94	1.12	.71	.76
Credit card	**3.10**	2.73	2.87	2.39	1.39
Business and government	**.32**	.67	.28	.49	.51
	.39	.50	.39	.35	.35
International	**1.28**	1.08	.18	.31	.37
Total allocated specific provision	**.60%**	.61%	.36%	.34%	.36%
Total provision for credit losses	**.60**	.65	.43	.49	.37
Net charge-offs (excluding LDCs) as a % of average loans and acceptances	**.69%**	.55%	.42%	.61%	.24%
Net charge-offs as a % of average loans and acceptances	**.71%**	.55%	.42%	.62%	.45%

(1) Loans and acceptances in Canada include all loans and acceptances booked in Canada, regardless of the currency or residence of the borrower.
(2) The allocated general and the unallocated amounts totalled $850 million in 1998. These were not separated into the allocated general and unallocated components. The amounts prior to 1999 do not include the allocated general allowance.
(3) The allocated general provision and the unallocated provision totalled $230 million in 1999, $100 million in 1998. These were not separated into the allocated general and unallocated components.
(4) Includes the allowance for off-balance sheet and other items.

Risk management

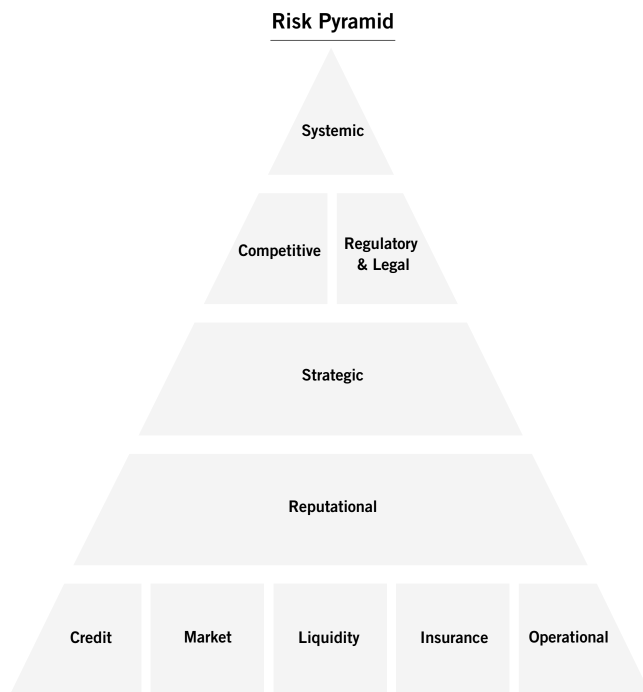
Overview

The risk management function strives to build shareholder value through leadership in the strategic management of risk. Priorities include:

- Enhancing communication on risk and risk appetite throughout the organization
- Aligning the risk management function with our business segments
- Investing in our capabilities to better measure, understand and manage risk
- Strengthening the efficiency, accessibility and responsiveness of key risk processes and practices
- Attracting, developing and retaining a team of highly performing professionals

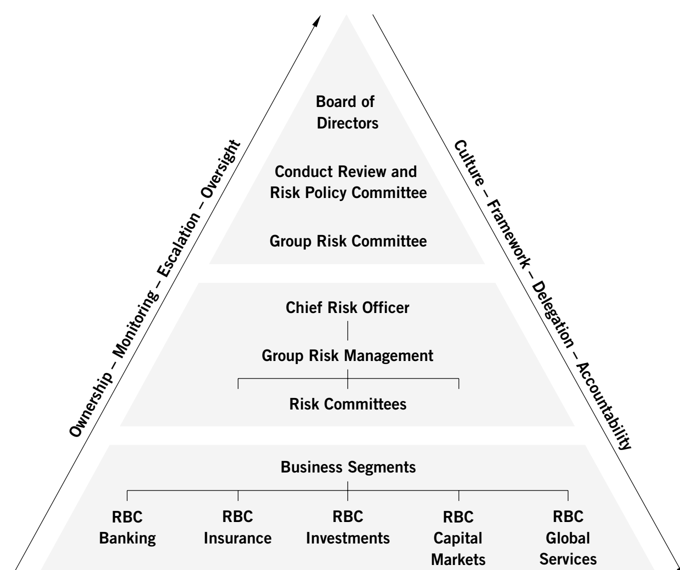
Our business activities expose us to the risks outlined in the risk pyramid below. We use the risk pyramid as the primary tool to identify and assess risk across the organization. It provides a common language for evaluating risk in business reviews, new business, new products, new initiatives, acquisitions or alliances. We pay particular attention to the more controllable risks along the bottom of the pyramid.

Risk Pyramid



- **Credit risk** is the risk of loss due to a counterparty's inability to fulfill its payment obligations. It also refers to a loss in market value due to the deterioration of a counterparty's financial position. A counterparty may be an issuer, debtor, borrower, policyholder, reinsurer or guarantor.
- **Market risk** is the risk of loss that results from changes in interest rates, foreign exchange rates, equity prices and commodity prices.
- **Liquidity risk** is the risk that we are unable to generate or obtain sufficient cash or equivalents on a cost-effective basis to meet our commitments as they fall due.
- **Insurance risk**, relative to our insurance platform, is the risk inherent in the development, issuance and administration of insurance policies, and includes product design and pricing risk, claims administration risk, underwriting risk and liability risk.
- **Operational risk** is the risk of direct or indirect loss resulting from inadequate or failed technology, human performance, processes or external events. The impact of operational risk can be financial loss, loss of reputation, loss of competitive position or legal and regulatory proceedings.

The Risk Pyramid: An organizational perspective



An organizational perspective

The cornerstone of effective risk management is a strong risk management culture, supported by numerous strategy and policy development processes, run jointly by risk management professionals and the business segments. This partnership is designed to ensure strategic alignment of business, risk and resource issues.

Risk management professionals work in partnership with the business segments and functional units to identify risks, which are then measured, monitored and managed. In line with a group-wide portfolio management approach, portfolio analytical techniques are employed in an effort to optimize the risk-reward profile and ensure the efficient allocation of capital.

A structure of management and board committees provides oversight of the risk management process.

The Board of Directors and Group Risk Committee

The top level of the organizational perspective risk pyramid on page 53 comprises the Board of Directors, the Conduct Review and Risk Policy Committee and Group Risk Committee. Key responsibilities are to:

- Shape, influence and communicate the organization's risk culture
- Determine and communicate the organization's risk appetite
- Define the organizational structure for Group Risk Management
- Review and approve policies for controlling risk
- Review and monitor the major risks being assumed by, or facing, the organization, providing direction as required
- Ensure there are sufficient and appropriate risk management resources across the organization against the risks being taken

Risk management

The middle level of the organizational perspective risk pyramid on page 53 comprises the Chief Risk Officer, Group Risk Management and the various Risk Committees. The Risk Committees include the Asset/Liability Committee, U.S. Corporate Governance Committee, the Ethics and Compliance Committee, Risk Management Committee and other committees responsible for areas such as interest rate risk and trading risk. During 2002, the SPE Risk Committee was established with a mandate to review and report on the activities of SPEs. This Committee reports jointly to the Chief Risk Officer and the Chief Financial Officer to ensure compliance with SPE policies and procedures across the enterprise. See page 64 for further discussion of SPEs.

Key responsibilities are to:

- Implement and maintain an integrated enterprise-wide risk measurement, management and reporting framework
- Establish a comprehensive risk assessment and approval process including enterprise-wide policies and procedures
- Establish guidelines and risk limits to ensure appropriate risk diversification and optimization of risk-return on both a portfolio and transactional basis
- Advise the board and executive management of major risks being assumed by, or facing, the organization
- Partner with the business segments in identifying, understanding, measuring, mitigating and monitoring the risks being taken

Economic Capital

Economic Capital (EC) is an estimate of the amount of equity required to underpin risks. It is calculated by determining the level of capital that is necessary to cover risks consistent with our desired solvency standard and debt ratings. EC analysis is intended to represent the shareholder's perspective and drives the optimization of shareholder returns. Calculation of EC involves a number of judgments and assumptions, and changes to them may result in different amounts of EC being computed.

EC is attributed to provide directly comparable performance measurements for each of our business activities and assist senior management in strategic planning, resource allocation and performance measurement. Capital attribution methodologies are continuously monitored to ensure risks are being consistently quantified utilizing all available information. Periodically, enhancements are made to these methodologies with the changes applied prospectively.

EC attribution methodology aims to:

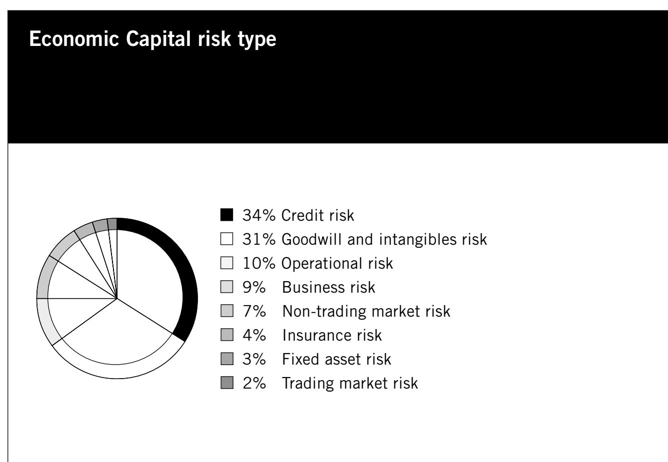
- Cover all risks
- Ensure that a dollar of capital represents the same amount of risk wherever attributed
- Determine capital requirements in an unbiased accurate manner
- Create economically rational incentives for business managers

EC is a component in the calculation of Economic Profit (see page 26). Capital attribution strengthens risk management discipline. EC is calculated for the following eight distinct risk types: credit risk, goodwill and intangibles risk, operational risk, business risk, non-trading market risk, insurance risk, fixed asset risk and trading market risk. Credit, market insurance and operational risk are further detailed in the following sections. Business risk is the risk of loss due to variances in volumes, prices and costs caused by competitive forces, regulatory changes, and reputational and strategic risks. Goodwill and intangibles and fixed asset risks are defined as the risk that the value of these assets will be less than their net book value at a future date.

The combination of risk factors between and within risk categories and lines of business leads to some risk reduction, called diversification. These diversification benefits are passed on to our businesses. Therefore, Economic Profit and return on equity calculations are based on EC levels that include these diversification effects.

The following chart represents the proportionate EC levels by risk type for fiscal 2002.

Economic Capital risk type



The following sections discuss how we manage the major controllable risks including credit, market, liquidity, insurance and operational risk.

Credit risk

Credit risk is attributed to both on-balance sheet financial instruments such as loans and acceptances and credit equivalent amounts related to off-balance sheet financial instruments.

Our approach to credit risk management preserves the independence and integrity of risk assessment while being integrated into business management processes. Policies and procedures, which are communicated throughout the organization, guide the day-to-day management of credit risk exposure and are an essential part of our business culture. The goal of credit risk management is to evaluate and manage credit risk in order to further enhance this strong credit culture.

As discussed in the credit quality section on pages 45 to 52, we have significantly enhanced our loan mix. This improvement is being achieved through our strategy of reducing exposure to non-core corporate client relationships while increasing the size of the consumer portfolio, including residential mortgages, which have very low loss rates.

We are continually adding to and improving the analytical tools used to analyze, measure and manage credit risk. This includes the use of third-party modeling tools, increased use of stress testing and enhanced management information systems.

Risk ratings

Corporate borrowers are assigned an internal risk rating based on a detailed examination of the organization. This examination considers industry sector trends, market competitiveness, overall company strategy,

financial strength, access to funds, financial management and any other risks facing the organization. Our rating system is based on a 22-point scale.

Credit scoring models are utilized to determine a credit score for consumer and certain small business lending. The credit scores measure the relative risk of the initial extension of credit and any further increases. Consumer credit risk is monitored using statistical scoring models and payment history in order to predict portfolio behaviour.

The internal risk ratings and credit scores are assessed and updated on a regular basis.

Portfolio diversification

Portfolio diversification is our overriding principle, therefore, our credit policies and limits are structured to ensure we are not overexposed to any given client, industry sector or geographic area.

To avoid excessive losses if any particular counterparty is unable to fulfill its payment obligations, we have established single name limits that are set according to risk ratings. In certain cases loans are syndicated in order to reduce overall exposure to a single name.

Limits are also in place to manage exposure to any particular country or sector. Each country and sector is assigned a risk rating. This risk rating considers factors common to all entities in a given country or sector yet outside the control of any individual entity. Limits are determined based on the risk rating along with our overall risk appetite and business strategy.

Risk mitigation

In order to mitigate risk on portions of our portfolio we enter into credit derivative contracts. As at October 31, 2002, credit mitigation was in place to cover $1.0 billion in corporate credit exposure. We also provided protection through credit derivatives to various counterparties totalling $.3 billion as at October 31, 2002.

Loan sales are also used to mitigate risk. We seek to identify and sell loans we have made to borrowers whose risk and reward profile and borrower ratings are no longer desirable to us.

In order to respond proactively to credit deterioration and mitigate risk, a problem loan workout group with specialized expertise handles the management and collection of nonaccrual loans as well as certain accrual loans.

Market risk

The level of market risk to which we are exposed varies continually, reflecting changing market conditions, expectations of future price and market movements and the composition of our trading and non-trading portfolios. We have established risk management policies and limits for our trading and asset/liability management activities that allow us to monitor and control the exposure to market risk resulting from these activities. We conduct trading activities over-the-counter and on exchanges in the spot, forward, futures and options markets and also participate in structured derivative transactions.

Interest rate risk

Interest rate risk is the potential adverse impact on our earnings and economic value due to changes in interest rates. In addition to the following discussion on trading activities please see the Non-trading portfolio section on page 61.

Credit spread risk

Credit spread risk is the potential adverse impact on our earnings and economic value due to changes in credit worthiness of persons we have credit exposure to both specifically and market-wide. We are exposed to credit spread risk through our holdings of bonds and credit derivatives. In the trading portfolio, credit spread risk arises from market-making activity as well as through proprietary trading in our credit derivatives trading unit.

Foreign exchange rate risk

Foreign exchange rate risk is the potential adverse impact on our earnings and economic value due to currency rate movements. We are exposed to foreign exchange rate risk in both the spot and forward foreign exchange markets and in the derivative market.

Equity risk

Equity risk is the potential adverse impact on our earnings due to movements in individual equity prices or general movements in the value of the stock market. We are exposed to equity risk from the buying and selling of equities as a principal in our brokerage business and our investment activities. Equity risk also results from our trading activities, including the providing of tailored equity derivative transactions to clients, arbitrage trading and proprietary trading.

Trading activities

Market risks associated with trading activities are a result of market-making, positioning and sales and arbitrage activities in the interest rate, foreign exchange and equity markets. Our trading operation primarily acts as a market-maker or jobber, executing transactions that meet the financial requirements of our clients and transferring the market risks to the broad financial market. We also act as principal and take market risk proprietary positions within the authorizations granted by our Board of Directors.

We recently completed a major upgrade of our enterprise market risk management system as part of our continuous renewal process to implement best practices and enhance our risk oversight capabilities. This represents a significant milestone in our ability to assess potential for loss using modeling techniques across all risk classes in a consistent and timely manner. In November 2002, we received regulatory approval to use an internal models approach for the regulatory capital requirement on specific risk of investment grade debt portfolios.

Value-At-Risk

Market risks associated with trading activities are managed primarily through the use of Value-At-Risk (VAR) methodology. VAR is a generally accepted risk measurement concept that uses statistical models and historical market price information to estimate within a given level of confidence the maximum loss in market value that we would experience in our trading portfolios from an adverse one-day movement in market rates and prices. Our VAR measure is based on a 99% confidence level and is an estimate of the maximum potential trading loss in 99 out of every 100 days. We use a historical simulation of the previous 500 trading day scenarios to determine VAR for our trading portfolio. The graph on page 56 shows the daily net trading revenue compared to the global trading VAR amounts for the year ended October 31, 2002. Net trading revenue is defined as the sum of the mark-to-market adjustments booked on trading positions and net interest income accrued from trading assets. During fiscal 2002, we experienced only four days of net trading losses, and we did not experience a single day with net trading losses in excess of the VAR estimate for that day.

Table 23 on the following page shows the year-end, high, average and low VAR by major risk category for our combined trading activities for the years ended October 31, 2002 and 2001. The table also shows our global VAR, which incorporates the effects of correlation in the movements of interest rates, exchange rates, equity prices and commodity prices and the resulting benefits of diversification within our trading portfolio. As the table illustrates, the average VAR in 2002 was $11 million, the same as the average VAR in 2001. An increase in the interest rate VAR (due to the inclusion of credit spread risk within the VAR model) was offset by a reduction in risk within the equity trading portfolio.

TABLE 23 **Market risk measures – Trading activities** (1)

(C$ millions)	2002 Year-end	2002 High	2002 Average	2002 Low	2001 Year-end	2001 High	2001 Average	2001 Low
Global VAR by major risk category								
Equity	**$ 7**	**$ 12**	**$ 8**	**$ 6**	$ 8	$ 16	$ 10	$ 6
Foreign exchange and commodity	**2**	**9**	**3**	**1**	2	6	3	1
Interest rate	**11**	**14**	**6**	**2**	3	9	4	2
Global VAR (2)	**$ 13**	**$ 18**	**$ 11**	**$ 7**	$ 8	$ 18	$ 11	$ 6

(1) Amounts are presented on a pre-tax basis and represent one-day VAR at a 99% confidence level.
(2) Global VAR reflects the correlation effect from each of the risk categories through diversification.

The Group Risk Management function, which is independent of the trading operations, is responsible for the daily measuring of global trading risk exposures. The function uses our VAR methodology to compare actual exposures to the limits established, to assess global risk-return trends and to alert senior management of adverse trends or positions. The function also develops and implements comprehensive risk measurement policies and risk limits that apply to trading activities.

We recognize that VAR is not an absolute measure of market risk and has its limitations since it is based on historical information only. In such circumstances, we implement other limits in order to control market liquidity risks, net position gap, term and volume for all products. This comprehensive market risk management framework is designed to ensure that an appropriate diversification of risks through policies is adopted on a global basis.

Back-testing
Back-testing against hypothetical profit and loss is used to monitor the statistical validity of VAR models. Hypothetical profit and loss is calculated by determining the impact of the actual one-day change in market rate or price movements on a given portfolio held constant for one day. Back-testing is performed daily across all trading portfolios. The results are submitted to OSFI on a quarterly basis. In fiscal 2002, there were two instances of the hypothetical net profit and loss exceeding the VAR. This is within the expected statistical range and supports the validity of the VAR model.

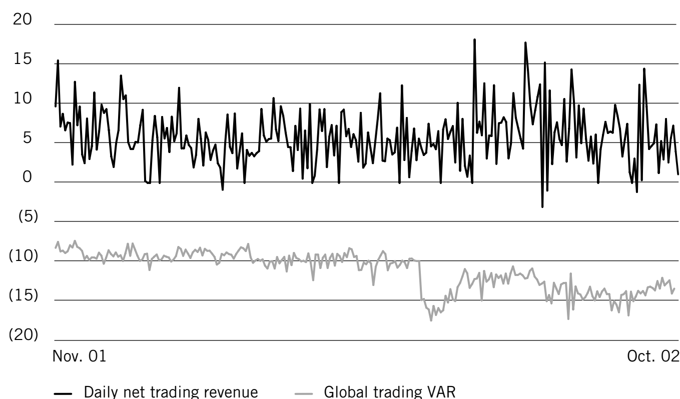
Stress testing
We also perform analysis on the potential trading losses due to stress events as a supplementary control on our market risk exposure. This is accomplished through applying historical and internally developed scenarios to the daily trading positions to monitor the effect of extreme market movements on the value of our portfolio.

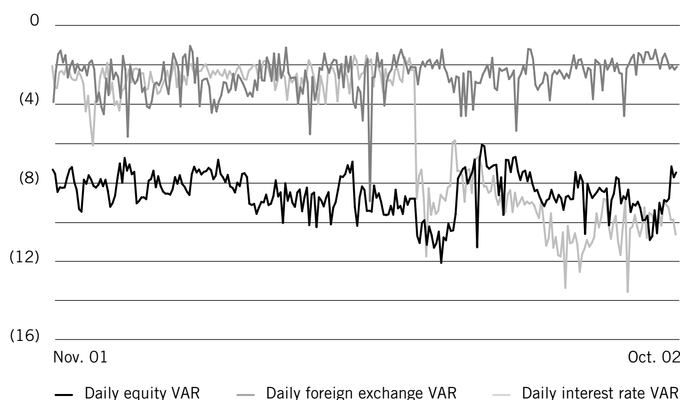
Liquidity risk

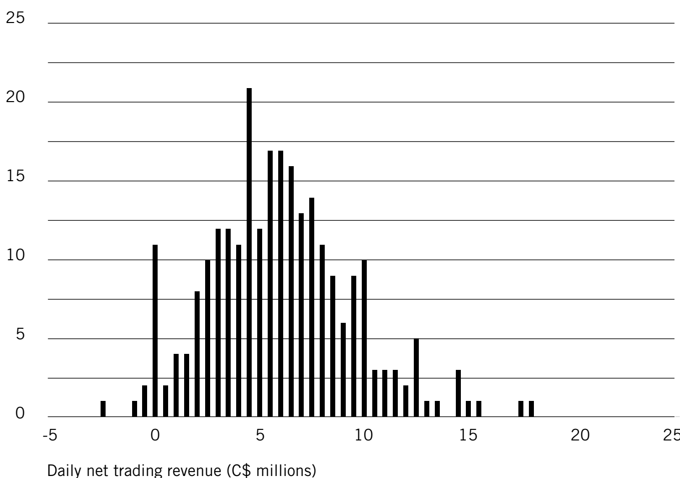
The objective of liquidity management is to ensure we have the ability to generate or obtain sufficient cash or its equivalents on a timely and cost-effective basis to meet our commitments as they fall due. The management of liquidity risk is crucial to protecting our capital, maintaining market confidence and ensuring that we can expand into profitable business opportunities.

Liquidity risk is managed dynamically, exposures are continually measured, monitored and appropriately mitigated. We have developed and implemented a comprehensive liquidity management framework comprising policies, procedures, methodologies and measurements.

The Group Risk Committee and the Asset/Liability Committee provide guidance and oversight to our liquidity risk management program with the Audit Committee of the board approving our liquidity management framework and significant related policies. Corporate Treasury has global responsibility for developing liquidity management policies, strategies and contingency plans and for recommending and monitoring limits and coordinating subsidiary activities.







We have a Liquidity Crisis Team, composed of a cross-section of our senior executives. This team is responsible for the development, maintenance and success of our liquidity contingency plan. This plan would be activated in the event of a general market disruption or adverse economic developments that could destabilize our ability to meet obligations. This team meets regularly to review potential crisis scenarios and to update related action plans. Contingent liquidity exposures are identified and provisions are made to minimize possible damage through maintenance of a pool of unencumbered, high quality assets. These assets are marketable and can be immediately sold or pledged for secured borrowing and represent a dedicated and reliable source of emergency funding. In addition, a segregated portfolio of eligible securities is continuously available to support our participation in Canadian payment and settlement systems. For further information on liquidity see the Liquidity management section on page 62.

Insurance risk

Insurance risk includes product design and pricing risk, claims administration risk, underwriting risk and liability risk.

Product design and pricing risk

The process of designing and pricing products includes the estimation of many factors including future investment yields, mortality, morbidity, claims experience, expenses, policy lapse rates and taxes. Product design and pricing risk is the risk that actual experience will not match the assumptions made at the time pricing was determined and to the extent they differ, financial gains or losses will occur.

This risk is managed through detailed experience studies to support pricing assumptions and independent verification of scenario testing by our actuaries. In addition a portion of the policy benefit liabilities held on the balance sheet provides for misestimation and deterioration of assumptions from those assumed in the pricing. Risk is also mitigated through reinsurance, primarily for life insurance mortality and property and casualty catastrophe risks.

Claims administration risk

Claims administration risk is the exposure to higher than expected claims due to administrative practices in settling claims. Policies and procedures are in place that are designed to ensure that trained staff properly handle claims. There are approval limits in place to ensure that large dollar claims are handled and reviewed by experienced staff.

Underwriting risk

Underwriting risk is the exposure to financial losses resulting from the inappropriate selection and acceptance of the risks to be insured. Establishing policy retention limits that vary by market and geographic location mitigates exposure to large claims.

Liability risk

Liability risk exists when the attributes of a specific type of risk are misunderstood and improperly quantified and the liabilities established for this type of risk are inadequate. Actuaries review the assumptions used in the calculation of policy benefit liabilities on a quarterly basis.

Operational risk

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed technology, human performance, processes or external events.

We endeavour to minimize operational losses by ensuring that effective infrastructure, controls, systems, and individuals are in place throughout our organization. We employ dedicated professionals who are proactive in developing and implementing new methodologies for the identification, assessment and management of operational risk.

We have developed and are currently implementing two new processes aimed at monitoring and mitigating operational risks in the organization.

Risk and control self-assessment (RCSA)

RCSA is a formal process of proactively identifying, documenting, assessing and managing our operational risks. Each business segment and functional unit is divided into its component activities, which become entities to be assessed. Each entity completes a workshop-based, self-assessment to determine their key risks, mitigating controls, the potential impact and likelihood of a problem occurring and the acceptability of the residual risk after existing controls are considered.

Where residual risk is deemed unacceptable, the group will agree on an action plan and timeline. The findings of the various RCSAs conducted are documented, aggregated, analyzed and reported on a group-wide basis.

Loss event database (LED)

LED refers to a centralized database aimed at capturing information about operational losses. The losses tracked are mapped to the entities identified in the RCSA process.

Information such as the frequency, severity and nature of operational losses are captured. This data capture will allow analysis at the business segment and enterprise level. This will lead to a better understanding of the root causes of operational losses and improved risk mitigation strategies.

Ongoing development

Research and development efforts in the areas of quantification methodologies and key risk indicators will continue as we strive to stay at the forefront of risk management best practices.

Financial priority: Balance sheet and capital management

Highlights

- Consumer loans up 5%
- Deposits up 4%
- Internally generated capital of $1.8 billion
- Capital ratios strengthened further
- Common share repurchases of $764 million
- Redeemed US$200 million of Series I and $150 million of Series E preferred shares
- Redeemed $400 million and issued US$400 million of subordinated debentures

Total assets were $382 billion at October 31, 2002, up $19.5 billion or 5% from October 31, 2001.

Compared to October 31, 2001, securities were up $14.3 billion or 18% and cash resources up $3.8 billion or 22%. The growth in securities partially reflected higher levels of activity in our global equity derivatives business, which holds long and short positions in equity securities.

Total loans were up $.4 billion or .2% from October 31, 2001, with the acquisition of Eagle Bancshares, in July 2002, contributing $1.1 billion in loans and the acquisition of the private banking business of Barclays in June 2002, contributing $.6 billion in loans. Consumer loans (residential mortgage, personal and credit card loans) were up $5.5 billion or 5%. Residential mortgages were up $5.4 billion or 8% (net of $3.7 billion of mortgage securitizations during the year) and personal loans were down $.5 billion or 2%. Credit card balances increased $.6 billion or 15%, largely reflecting the maturity of $.4 billion of credit card securitization term notes during the year. Business and government loans were down $5.1 billion or 8%, largely reflecting planned reductions in the Canadian and U.S. corporate loan portfolios to enhance the quality of the business loan portfolio.

The $1.0 billion increase in Other assets was largely driven by a $2.6 billion increase in derivative-related amounts. This increase in derivative-related amounts was largely offset by a $1.9 billion decrease in acceptances. Other – Other assets of $13.5 billion includes $805 million (US$517 million) of receivables due from Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Rabobank), relating to a derivative contract that is the subject of litigation with Rabobank. While the outcome of any litigation cannot be predicted with certainty, we expect to recover this amount in its entirety and accordingly have not recorded any provision for loss (for further information see Note 18 on page 91).

Total deposits were $245 billion, up $9.4 billion or 4% from October 31, 2001. Interest-bearing deposits were up $8.0 billion and non-interest-bearing deposits up $1.4 billion. Personal deposits were up $.5 billion, business and government deposits were up $12.3 billion or 11% and bank deposits were down $3.4 billion or 13%. Further details on deposits are provided in Note 10 on page 83.

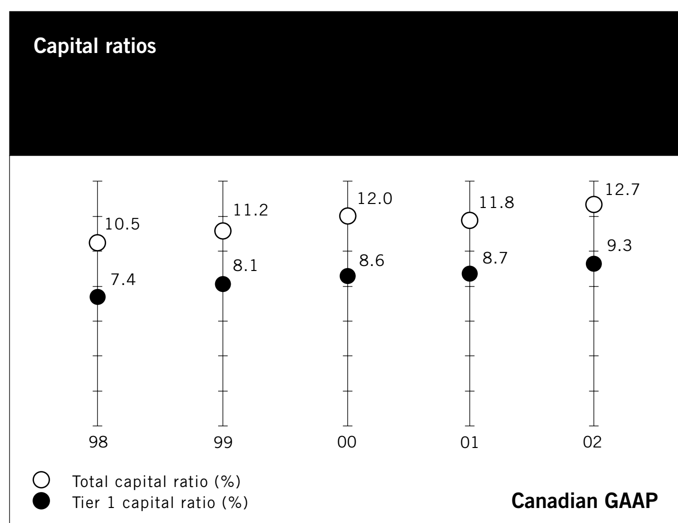
The fair value of loans and deposits differs from the respective book value due to changes in the levels of interest rates and changes in credit status. The estimated fair value of loans due from clients exceeded book values by $2.2 billion at October 31, 2002 and $4.4 billion at October 31, 2001. The estimated fair value of deposits owed to clients exceeded book values by $1.5 billion at October 31, 2002 and $2.4 billion at October 31, 2001. The net of the fair value excess of loans due from clients and the fair value excess of deposits due to clients was $.8 billion at October 31, 2002, as shown in Note 21 on page 95. The estimated fair value of loans and deposits were in excess of book values largely due to a decline in interest rates.

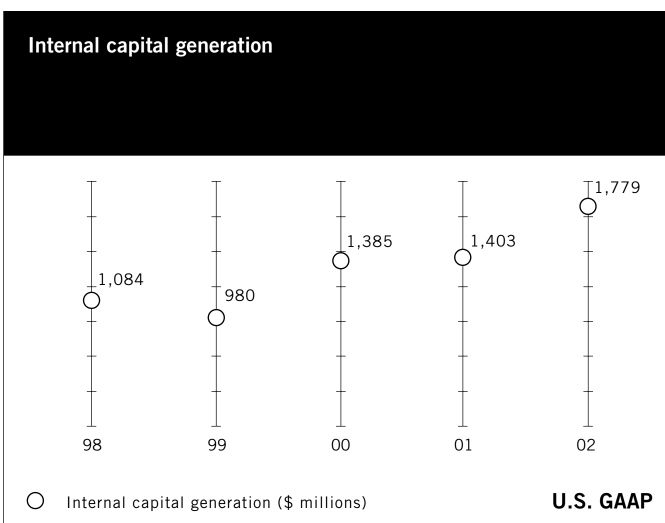
RBC Capital Trust, a closed-end trust, has a total of $1.4 billion of transferable trust units (RBC TruCS) outstanding. RBC TruCS are reported as non-controlling interest in subsidiaries on the consolidated balance sheet and are included in Tier 1 capital under guidelines issued by OSFI.

Total balance sheet capital, which includes shareholders' equity and subordinated debentures, was $25.7 billion at October 31, 2002, up $.6 billion or 3% from a year ago. The most significant factor behind the increase in capital over 2001 was internal capital generation of $1.8 billion, partially offset by net capital redemptions and net share repurchases of $.9 billion during 2002.

As required by Statement of Financial Accounting Standards, *Employers' Accounting for Pensions* (FAS 87), we recognized in Other comprehensive income an additional pension obligation of $276 million, net of related income taxes. The increase in additional pension obligation is primarily due to the fair value of plan assets being less than the accumulated benefit obligation for certain plans this year. Asset values declined due to weak equity markets.

We fund the pension plans in accordance with regulatory requirements, which require funding when there is a deficit on a funding basis. Different assumptions and methods are prescribed for regulatory funding purposes versus accounting purposes. Our pension plans are in a surplus position for regulatory funding purposes. Note 15 on page 88 describes the funding position for accounting purposes.





Capital management

Capital management requires balancing the desire to maintain strong capital ratios and high debt ratings with the need to provide competitive returns to shareholders. In striving for this balance, we consider expected levels of risk-adjusted assets and balance sheet assets, future investment plans and the costs and terms of current and potential capital issues.

We are committed to maintaining strong capital ratios through internal capital generation, the issuance of capital instruments when appropriate, and controlled growth in risk-adjusted assets. We were able to achieve strong levels of internal capital generation despite weaker capital market conditions during the past year. The market environment and planned reductions of corporate loan exposures also contributed to slower growth in risk-adjusted assets, enabling us to continue repurchasing shares and redeeming some of our outstanding capital instruments. Our debt ratings continue to enhance our ability to raise capital at competitive prices.

Capital management activity

In fiscal 2002, we repurchased 14.3 million common shares, of which 4.5 million shares were repurchased for $229 million under a normal course issuer bid that expired in June 2002, and 9.8 million shares were repurchased for $513 million under a normal course issuer bid that allows for the repurchase of up to 20 million common shares, representing approximately 3% of outstanding common shares, between June 24, 2002 and June 23, 2003. During the fourth quarter of 2001, we entered into an agreement with an independent third party to execute an accelerated repurchase of six million common shares. This agreement resulted in an additional repurchase cost of $22 million this year. In total, we spent $764 million in connection with our share repurchases during 2002.

In November 2001, we redeemed US$200 million of First Preferred Shares Series I and, in October 2002, redeemed $150 million of First Preferred Shares Series E.

In November 2001, we issued US$400 million of subordinated debentures through our European Medium Term Note Programme. In September 2002, we redeemed $400 million of subordinated debentures.

Regulatory capital

Capital levels for Canadian banks are regulated pursuant to guidelines issued by OSFI, based on standards issued by the Bank for International Settlements (BIS). Regulatory capital is allocated into two tiers. Tier 1 capital comprises the more permanent components of capital. The components of Tier 1 and Tier 2 capital are shown in Table 24 below.

Regulatory capital ratios are calculated by dividing Tier 1 and Total capital by risk-adjusted assets based on Canadian GAAP financial information. Risk-adjusted assets, as shown in Table 25 on page 60, are determined by applying OSFI prescribed risk weights to balance sheet assets and off-balance sheet financial instruments according to the credit risk of the counterparty. Risk-adjusted assets also include an amount for the market risk exposure associated with our trading portfolio.

Our policy is to remain well capitalized so as to provide a safety net for the variety of risks to which we are exposed to in the conduct of our business. In 1999, OSFI formally established risk-based capital targets for deposit-taking institutions in Canada. These targets are a Tier 1 capital ratio of 7% and a Total capital ratio of 10%. As at October 31, 2002, our Tier 1 and Total capital ratios were 9.3% and 12.7%, respectively, compared to 8.7% and 11.8% at October 31, 2001. We maintained capital ratios that exceeded our medium-term goals of 8.0% for the Tier 1 ratio and 11–12% for the Total capital ratio. Effective November 1, 2002, we have raised our medium-term Tier 1 capital ratio goal to 8–8.5% from 8%. Our capital ratios on a U.S. basis, calculated using guidelines issued to U.S. banks by the Board of Governors of the Federal Reserve System and using U.S. GAAP financial information, are provided in Table 24 below.

Pending developments

In 1999, BIS issued a proposal for a new capital adequacy framework to replace the previous Capital Accord of 1988, under which we are currently regulated. This proposal continues to be at the discussion phase. Implementation of the final proposal is not likely to occur prior to fiscal 2006.

TABLE 24 **Capital ratios** (1)

(C$ millions, except percentage amounts)	**2002**	2001	2000
Tier 1 capital			
Common equity	**$ 17,238**	$ 16,141	$ 11,504
Non-cumulative preferred shares	**1,545**	2,024	2,037
Non-controlling interest in subsidiaries			
RBC TruCS	**1,400**	1,400	650
Other	**29**	28	23
Goodwill	**(4,832)**	(4,742)	(647)
	15,380	14,851	13,567
Tier 2 capital			
Permanent subordinated debentures	**467**	477	457
Other subordinated debentures (2)	**6,147**	5,935	5,138
General allowance (3)	**1,420**	1,410	1,188
Non-controlling interest in subsidiaries	**–**	–	1
	8,034	7,822	6,784
Investment in insurance subsidiaries	**(2,014)**	(2,107)	(960)
Other substantial investments	**(368)**	(387)	(342)
First loss facility	**(20)**	(8)	(5)
Total capital	**$ 21,012**	$ 20,171	$ 19,044
Risk-adjusted assets	**$ 165,559**	$ 171,047	$ 158,364
Capital ratios (4)			
Common equity to risk-adjusted assets	**10.4%**	9.4%	7.3%
Tier 1 capital to risk-adjusted assets	**9.3%**	8.7%	8.6%
Total capital to risk-adjusted assets	**12.7%**	11.8%	12.0%
Assets-to-capital multiple (5)	**17.3**	17.2	15.3
U.S. basis (4), (6)			
Tier 1 capital to risk-adjusted assets	**8.5%**	8.1%	7.8%
Total capital to risk-adjusted assets	**11.9%**	11.2%	11.3%
Equity to assets (7)	**4.9%**	5.3%	4.5%

(1) Using guidelines issued by the Superintendent of Financial Institutions Canada and Canadian GAAP financial information except as noted in footnote (6).
(2) Subordinated debentures that are within five years of maturity are subject to straight-line amortization to zero during their remaining term and, accordingly, are included above at their amortized value.
(3) The general allowance for credit losses may be included in Tier 2 capital up to a maximum of .875% (2001 – .875%; 2000 – .75%) of risk-adjusted assets.
(4) On November 26, 2001, we redeemed US$200 million of Non-cumulative First Preferred Shares Series I, which reduced Tier 1 capital by the same amount. On November 8, 2001, we issued US$400 million of subordinated debentures, which increased Total capital by the same amount. Had these transactions taken place as at October 31, 2001, the 2001 pro forma capital ratios would have been: Tier 1 capital ratio – 8.5% and Total capital ratio – 12.0%. Using guidelines issued by the Board of Governors of the Federal Reserve System in the United States and U.S. GAAP financial information, the pro forma U.S. basis capital ratios would have been Tier 1 capital ratio – 7.9% and Total capital ratio – 11.4%.
(5) Total assets and specified off-balance sheet financial instruments, as prescribed by the Superintendent of Financial Institutions Canada, divided by Total capital.
(6) Using guidelines issued by the Board of Governors of the Federal Reserve System in the United States and U.S. GAAP financial information.
(7) Average total shareholders' equity divided by average total assets.

TABLE 25 Risk-adjusted assets (1)

(C$ millions, except percentage amounts)			Balance sheet amount	Weighted average of risk weights (2)	Risk-adjusted balance 2002	Risk-adjusted balance 2001
Balance sheet assets						
Cash resources			$ 21,323	11%	**$ 2,284**	$ 1,515
Securities						
Issued or guaranteed by Canadian or other OECD governments			27,712	0%	**36**	–
Other			66,088	11%	**7,137**	7,341
Residential mortgages (3)						
Insured			33,849	1%	**379**	383
Conventional			38,950	52%	**20,168**	18,511
Other loans and acceptances (3)						
Issued or guaranteed by Canadian or other OECD governments			18,448	17%	**3,098**	1,810
Other			121,893	74%	**89,836**	97,553
Other assets			48,693	12%	**5,692**	6,114
			$ 376,956		**$ 128,630**	$ 133,227
	Contract amount	Credit conversion factor	Credit equivalent amount			
Off-balance sheet financial instruments						
Credit instruments						
Guarantees and standby letters of credit						
Financial	$ 10,393	100%	$ 10,393	82%	**$ 8,560**	$ 8,629
Non-financial	3,217	50%	1,609	100%	**1,609**	1,422
Documentary and commercial letters of credit	772	20%	154	97%	**150**	148
Securities lending	23,967	100%	23,967	3%	**646**	393
Commitments to extend credit						
Original term to maturity of 1 year or less	40,931	0%	–	–	**–**	–
Original term to maturity of more than 1 year	34,115	50%	17,058	92%	**15,638**	18,821
Uncommitted amounts	45,978	0%	–	–	**–**	–
Note issuance/revolving underwriting facilities	23	50%	12	100%	**12**	66
	$ 159,396		$ 53,193		**$ 26,615**	$ 29,479
	Notional amount	Gross positive replacement cost (4)	Credit equivalent amount (5)			
Derivatives (6)						
Interest rate contracts						
Forward rate agreements	$ 198,845	$ 178	$ 299	21%	**$ 64**	$ 114
Swaps	862,264	19,608	24,357	26%	**6,323**	5,617
Options purchased	55,293	563	914	28%	**258**	123
	1,116,402	20,349	25,570		**6,645**	5,854
Foreign exchange contracts						
Forward contracts	544,719	6,802	13,049	28%	**3,685**	3,881
Swaps	84,055	1,781	6,341	23%	**1,445**	1,261
Options purchased	56,204	809	1,491	29%	**439**	441
	684,978	9,392	20,881		**5,569**	5,583
Credit derivatives (7)	52,151	861	2,963	29%	**858**	369
Other contracts (8)	13,126	849	1,701	31%	**529**	617
Total derivatives before netting	$ 1,866,657	31,451	51,115		**13,601**	12,423
Impact of master netting agreements		(20,861)	(26,930)		**(7,132)**	(6,339)
Total derivatives after netting		$ 10,590	24,185		**6,469**	6,084
Total off-balance sheet financial instruments			$ 77,378		**$ 33,084**	$ 35,563
General market risk					**3,845**	2,257
Total risk-adjusted assets					**$ 165,559**	$ 171,047

(1) Using guidelines issued by the Superintendent of Financial Institutions Canada and Canadian GAAP financial information.
(2) Represents the weighted average of counterparty risk weights within a particular category.
(3) Amounts are shown net of allowance for loan losses.
(4) Represents the total current replacement value of all outstanding contracts in a gain position, before factoring in the impact of master netting agreements. Exchange-traded instruments are subject to daily margin requirements. Such instruments are excluded from the calculation of risk-adjusted assets as they are deemed to have no additional credit risk. The fair value of $194 million (2001 – $194 million) is excluded at October 31, 2002. Written options are excluded as they represent our obligations and as such do not attract credit risk.
(5) Consists of (i) the total positive replacement value of all outstanding contracts, and (ii) an amount for potential future credit exposure.
(6) The notional amount of $5,593 million (2001 – $1,693 million) and replacement cost of $93 million (2001 – $49 million) of derivatives embedded in financial instruments, certain warrants and loan commitments considered as derivatives are excluded from the amounts in this table.
(7) Comprises default swaps, total return swaps and credit default baskets.
(8) Comprises precious metals, commodity and equity-linked derivative contracts.

Asset/liability management

Overview

Asset/liability management comprises the evaluation, monitoring and management of our non-trading portfolio, liquidity management and funding. It is important to note that liquidity and capital resources are likely to be affected by many of the same factors which are detailed in this section of Management's discussion and analysis, the Factors discussion on pages 23 to 24 and the Risk management discussion on pages 53 to 57. Additionally, off-balance sheet financing arrangements are often integral to both liquidity and capital resources, and are discussed in detail on pages 64 to 65 of this section.

Non-trading portfolio

Traditional banking activities, such as deposit taking and lending, expose us to market risk, of which interest rate risk, as described on page 55, is the largest component.

We actively manage the interest rate risk for the North American non-trading balance sheet and oversee all other non-trading units that have been delegated interest rate risk limits. We endeavour to adopt industry best practices and carry out the following functions:

Policy

The Conduct Review and Risk Policy Committee of the Board of Directors approves the global policies governing interest rate risk management. The policies define the acceptable limits within which risks to net interest income over a 12-month horizon and the economic value of equity are to be managed. These ranges are based on immediate and sustained ± 200 basis points parallel shifts of the yield curve. The limit for net interest income risk is 6% of projected net interest income and for economic value of equity risk is 12% of projected common equity.

Interest rate funds transfer pricing

We use a funds transfer pricing mechanism to centralize interest rate risk within Corporate Treasury and to ensure an economic allocation of interest income to the various business units. Funds transfer pricing at the transaction level ensures that interest rate risk is appropriately transferred to Corporate Treasury for management. The funds transfer pricing rates are market-based and aligned with risk management principles. They are supported by empirical research into client behaviour and are an integral input to the retail business pricing decisions.

Applied research

We are dedicated to investigating best practices in instrument valuation, econometric modeling and new hedging techniques. These investigations range from evaluation of traditional asset/liability management processes to application of recent developments in quantitative methods to our processes.

We focus on developing retail product valuation models that incorporate consumer behaviour. These valuation models are typically derived through econometric estimation of consumer exercise of options embedded in retail products. The most significant embedded options are mortgage rate commitments and prepayment options. On the liability side of the balance sheet, we tend to focus on modeling administered rates and the sensitivity of liability balances to interest rate changes.

Risk measurement

We continue to make significant investment in new technology to facilitate measurement and timely management of our interest rate risk position. A range of static and dynamic scenarios is used every week to measure our risk position based on client rates as well as funds transfer pricing rates.

Static scenarios allow us to analyze our risk at a particular point in time under various interest rate assumptions. These assumptions comprise parallel shocks as well as twists to the current yield curve. Static scenarios are employed for assessing the economic value of equity risk as well as the net interest income risk. Dynamic scenarios simulate our interest income in response to various combinations of business and market factors. Business factors include assumptions about future pricing strategies and volume and mix of new business, whereas market factors include assumptions such as changes in interest rate levels and changes in the shapes of yield curves.

We measure our risk positions for the Canadian non-trading balance sheet every week and are capable of identifying the various sources of interest rate risk.

Interest rate risk management

Our goal is to manage interest rate risk of the non-trading balance sheet to a targeted level, on a continual basis. We modify the risk profile of the balance sheet through proactive hedging activity.

The interest rate risk can be disaggregated into linear risk and non-linear risk based on the varying responses of the balance sheet to different interest rate movements. The linear risk is primarily managed through interest rate swaps. The non-linear risk arises mainly from embedded options in our products that allow clients to modify the maturities of their loans or deposits. Examples are a client pre-paying a personal loan or a prospective client getting a committed rate on a new mortgage before the mortgage loan takes effect. Embedded options are modeled using assumptions based on empirical research and are managed by either purchasing options or by a dynamic hedging strategy.

The performance of interest rate risk management function within Corporate Treasury is benchmarked on a total return basis. A by-product of this benchmarking exercise is a methodology that controls model risk by continuously back-testing model assumptions against actual client behaviour.

Table 26 below presents the potential impacts of 100 and 200 basis point increases and decreases in interest rates on our economic value of equity and on current earnings on our non-trading portfolio. These measures are as of October 31, 2002, and are based on assumptions made by management and validated by empirical research. The methodology assumes that no further hedging is undertaken. We have defined a risk neutral balance sheet as one where net residual assets representing equity are evenly invested over a five-year horizon. As a result of this decision, our interest rate risk profile has slightly faster re-pricing of assets than of liabilities with the duration of equity at about 2.5 years.

All interest rate measures in this section are based upon our interest rate exposures at a specific time. The exposures change continually as a result of day-to-day business activities and our risk management initiatives.

TABLE 26 **Market risk measures – Non-trading activities** (1)

	2002		2001	
(C$ millions)	**Economic value of equity risk**	**Net interest income risk**	Economic value of equity risk	Net interest income risk
100bp increase	**$ (309)**	**$ 104**	$ (390)	$ 96
100bp decrease	**145**	**(151)**	256	(108)
200bp increase	**$ (662)**	**$ 190**	$ (842)	$ 179
200bp decrease	**345**	**(327)**	466	(294)

(1) Amounts are presented on a pre-tax basis as at October 31.

Liquidity management

Our liquidity management framework is designed to ensure that reliable and cost-effective sources of cash are available to satisfy current and prospective commitments, both on and off-balance sheet. The primary goals of this framework are the preservation of a large base of core client deposits, ongoing access to diversified sources of wholesale funding and the maintenance of a dedicated pool of unencumbered marketable securities that provide ready access to cash.

The Corporate Treasury function has global responsibility for the development of liquidity management policies, strategies and contingency plans and for recommending and monitoring limits within this framework. Our principal regional trading and funding platforms provide transactional support for liquidity management policies and strategies. The Group Risk Management Committee and the Asset/Liability Committee share management oversight of liquidity management and receive regular reports detailing compliance with limits and guidelines. The Audit Committee of the Board of Directors approves our liquidity management framework and significant related policies and is informed on a periodic basis about our current and prospective liquidity condition. Additionally, we have a liquidity contingency plan in place, which is maintained and administered by the Liquidity Crisis Team. Subsidiaries are responsible for managing their own liquidity in compliance with policies, practices and governing regulatory requirements.

We measure and monitor our liquidity condition from structural, tactical and contingent perspectives. The assessment of our liquidity position based on these measures reflects management estimates and judgments pertaining to the behaviour of our clients and future market conditions.

Structural liquidity risk management

Existing balance sheet composition can create liquidity exposure due to mismatches in effective maturities between assets and liabilities. Structural liquidity risk management addresses this type of exposure, which is measured and monitored through ongoing stress testing of our balance sheet.

We recently adopted the cash capital model to assist in the evaluation of balance sheet liquidity and in the determination of the appropriate term structure of our debt financing. This methodology provides a comprehensive, formula-based approach for the assessment of balance sheet integrity and our ability to continue as a going concern during a prolonged liquidity event, such as an unexpected withdrawal of short-term funding. The application of this model entails assigning liquidity discounts or "haircuts" to our balance sheet assets based on our assessment of the cash-generating characteristics of each asset category in the context of a sustainable business model. The illiquid component of our balance sheet assets can be determined by this analysis. Liabilities are arrayed along a stability continuum, ranging from core to volatile, on the basis of both contractual and behavioural properties in order to identify the constant elements of our funding. This analysis of our balance sheet enables us to more accurately estimate our exposure to a protracted loss of unsecured funding and to quantify our longer-term financing requirements.

Tactical liquidity risk management

Tactical liquidity risk management addresses our normal day-to-day funding requirements and is managed by imposing limits on net funds outflows for specified periods, particularly for key short-term time horizons. Scenario analysis is performed periodically on the assumed behaviour of cash flows under varying conditions to assess funding requirements and, as required, to update assumptions and limits. Detailed reports on our principal short-term asset/liability mismatches are monitored on a daily basis to ensure compliance with the prudential limits established for overall group exposure and by major currency and geographic location. Corporate Treasury issues procedural directives to the individual units engaged in executing policy to ensure consistent application of cash flow management principles across the entire organization.

Contingent liquidity risk management

The liquidity contingency plan identifies comprehensive action plans that would be implemented in the event of general market disruptions or adverse economic developments that could jeopardize our ability to meet commitments. Four different market scenarios, of varying duration and severity, are addressed in the liquidity contingency plan to highlight potential liquidity exposures and requisite responses. The Liquidity Crisis Team, comprising senior individuals from business and functional units, meets regularly to review and update implementation plans and to consider the need for activation in view of developments in Canada and globally.

To address potential liquidity exposures identified by our scenario analyses, we maintain a pool of segregated and unencumbered marketable securities. These high-quality assets can be readily sold or pledged for secured borrowing and represent a dedicated and reliable source of emergency funding. In addition, we maintain a separate portfolio of eligible assets to support our participation in Canadian payment and settlement systems. Liquid assets and assets purchased under reverse repurchase agreements (before pledging as detailed below) totalled $155 billion or 41% of total assets at October 31, 2002 as compared to $137 billion or 38% respectively at October 31, 2001. Canadian dollar liquid assets are primarily marketable securities while a material portion of our foreign currency liquid assets are issued by highly rated foreign banks. As at October 31, 2002, $10 billion of assets had been pledged as collateral, up from $9 billion at October 31, 2001. We have another $39 billion in obligations related to assets sold under repurchase agreements or securities sold short at October 31, 2002, compared to $37 billion at October 31, 2001. For further details, see Note 18 on page 92.

Funding strategy

Diversification of funding sources is a crucial component of our overall liquidity management strategy since it expands funding flexibility, minimizes funding concentration and dependency and generally lowers financing costs. Core funding, comprising capital, longer-term liabilities and a diversified pool of personal and, to a lesser extent, commercial deposits, is the foundation of our strong structural liquidity position.

Credit ratings

Our ability to access unsecured funding markets and our financing costs in such markets are primarily dependent upon maintaining acceptable credit ratings, which in turn is largely determined by the quality of our earnings, the adequacy of our capital and the effectiveness of our risk management programs. While our estimates suggest that a minor downgrade would not materially influence our funding capacity or costs, we recognize the importance of avoiding such an event and are committed to actions that should reinforce existing external assessments of the bank's financial strength. A series of downgrades could have an adverse impact on our funding capacity and on the results of our operations.

Deposit profile

Personal deposits remain the prime source of funding for our Canadian dollar balance sheet while most foreign currency deposits originate from unsecured, "wholesale" sources, including large corporate and institutional clients and foreign commercial and central banks. Our personal deposit franchise constitutes a principal source of predictable and dependable funding. Certain commercial and institutional client groups also maintain relational balances with relatively low volatility profiles, a portion of which are considered core funding for structural liquidity purposes. Relational balances are typically maintained by commercial and corporate clients to facilitate their daily operating requirements. In some businesses, collective balances are substantial and exhibit a high degree of relative stability. We promote wholesale funding diversity and regularly review sources of short-term funds to ensure maintenance of wide

diversification by provider, product and geographic origin. In addition, we maintain an ongoing presence in different funding markets, constantly monitoring market developments and trends in order to identify opportunities or risks and to take appropriate pre-emptive actions. For further details see Note 10 on page 83.

Term funding sources

Long-term funding strategy is integrated with our current and estimated structural liquidity position as reflected in our cash capital position. Liquidity objectives, as well as market conditions, interest rates, credit spreads and desired financial structure, influence annual long-term funding activities, including currency mix and market concentration. Diversification into new markets and untapped investor segments is constantly evaluated against relative issuance costs. Our long-term funding sources are managed to minimize concentration by geographic location, investor segment, and currency and maturity profile. During fiscal 2002, we continued to expand our long-term funding base by issuing $2.6 billion of senior deposit notes in various currencies and markets. Total unsecured long-term funding outstanding at October 31, 2002 was $13.2 billion, compared with $12.6 billion at October 31, 2001.

We use asset securitization programs as an alternative source of funding, to provide liquidity and for asset/liability management purposes. In particular, $1.7 billion in new financing was provided during the year by the securitization and sale of government guaranteed residential mortgages (MBS). Our total outstanding MBS sold at year-end was $2.4 billion. In addition, $1.7 billion of our credit card receivables have been securitized through notes issued by a securitization SPE (see page 64, Special purpose entities – securitization for more details).

Off-balance sheet

In the normal course of business, we engage in a variety of financial transactions that, under GAAP, are either not recorded on our balance sheet or are recorded on our balance sheet in amounts that differ from the full contract or notional amounts. These transactions involve, among other risks, varying degrees of market, credit and liquidity risk, which are discussed in the Risk management section on pages 53 to 57. Off-balance sheet transactions are either proprietary or client transactions, and are generally undertaken for risk management, capital management and/or funding management purposes. The types of off-balance sheet activities we undertake include issuance of credit instruments and lease commitments, derivative financial instruments and transactions with SPEs. Each of these types of activities is discussed below.

Credit instruments

We provide credit instruments to our clients to help them meet their financing needs. Guarantees and standby letters of credit carry the same credit risk as loans and represent irrevocable assurances that we will make payments in the event that a client cannot meet its obligations to third parties. On behalf of clients, we also undertake written documentary and commercial letters of credit, authorizing a third party to draw drafts from us to a stipulated amount and typically having underlying shipments of goods as collateral. We make commitments to extend credit, which may represent unused portions of authorizations to extend credit in the form of loans, acceptances, guarantees and letters of credit. We have uncommitted amounts, which represent revocable offers by us to extend credit to a borrower, but not obligations to extend credit. We are also party to note issuance facilities (including revolving facilities), which represent underwriting agreements that enable a borrower to issue short-term debt securities. Table 27 below provides a detailed summary of our off-balance sheet credit instruments.

Lease commitments

We have made minimum future rental commitments for premises and equipment under long-term non-cancellable leases, which are detailed for each of the next five years and thereafter in Table 27 below. Our lease agreements do not contain any covenants that restrict our ability to pay dividends, engage in debt or equity financing transactions, or enter into additional lease agreements.

Derivative financial instruments

As a part of our institutional sales and trading activities, we act as counterparty to clients in transactions involving derivative financial instruments. We undertake this role to assist our clients in managing their exposure to various types of risk. We also engage in transactions involving derivative financial instruments with other counterparties to manage our exposure to interest rate, currency, credit and market risks (market risks are discussed on page 55). All derivatives are recorded at fair value on our balance sheet (fair value assumptions are discussed on page 25). Although derivative transactions are measured in terms of their notional amounts, these amounts are not recorded on our balance sheet, as the notional amounts serve as points of reference for calculating payments, and are not the actual amounts that are exchanged. Table 25 on page 60 details the notional amount, credit equivalent amount and risk-adjusted balances by derivative contract type. Note 19 on pages 93 and 94, details the notional amount of derivatives by reference to term to maturity and replacement cost, respectively.

To the extent that one or more of the derivative financial transactions we undertake involve amounts owing from third-party counterparties, we are exposed to counterparty credit risk (credit risk is discussed in more detail on page 54). Total credit risk as represented by the fair value of all derivatives that have a positive market value amounted to $10.6 billion as at October 31, 2002, and is recorded at replacement cost on our balance sheet. Additionally, Notes 1 and 19 on pages 73 to 74 and 92 to 94, respectively, provide more detail on the accounting for derivatives.

TABLE 27 Lease commitments and credit instruments

(C$ millions)	Within 1 year	1 to 3 years	Over 3 to 5 years	Over 5 years	Total
Lease commitments	$ 364	$ 630	$ 470	$ 754	$ 2,218
Credit instruments					
Guarantees and standby letters of credit	4,159	6,247	1,526	1,678	13,610
Documentary and commercial letters of credit	378	236	118	40	772
Commitments to extend credit	44,832	10,624	4,233	15,357	75,046
Uncommitted amounts	814	41,121	2,835	1,208	45,978
	50,183	58,228	8,712	18,283	135,406
Total	$ 50,547	$ 58,858	$ 9,182	$ 19,037	$ 137,624

Special purpose entities

Special purpose entities (SPEs) are principally used to securitize financial and other assets in order to obtain access to funding, to mitigate credit risk and to manage capital. SPEs are an important part of the financial markets, providing market liquidity by facilitating investors' access to specific portfolios of assets and risks in a form that meets their investment criteria. We use SPEs to securitize a portion of our credit card receivables. We provide SPE repackaging services to clients who seek access to financial assets in a form different than what is conventionally available. We also act as an intermediary or agent for clients who want to use SPEs to securitize their own financial assets.

SPEs are typically set up for a single, discrete purpose, have a limited life and serve to legally isolate the financial assets held by the SPE from the selling organization. SPEs are not operating entities and usually have no employees. The typical SPE structure involves a company selling assets to the SPE. The SPE funds the purchase of those assets by issuing securities to investors in the form of certificates, commercial paper or other notes of indebtedness. The financial interests of investors in SPEs are usually limited to interests in the assets of the SPE, and to various forms of credit enhancement accompanying the SPE assets, which may include conditional access to a cash collateral account, overcollateralization in the form of excess assets in the SPE or a line of credit facility. Liquidity and credit facilities as well as interest rate and other swaps may be provided by financial institutions to address mismatches between the cash flows of the underlying assets and the indebtedness issued by the SPE.

We provide services to SPEs in a number of different capacities including administration of the SPEs and the underlying asset pools, as a trustee for SPEs' assets, as a liquidity or credit enhancement provider, or as a counterparty in transactions involving derivative financial instruments or as collateral manager.

We manage and monitor our direct involvement with SPEs through our SPE Risk Committee, which is comprised of representatives from functional areas including risk management, corporate treasury, finance, subsidiary governance office, law, taxation, subsidiary banking groups and human resources. This committee's key activities include formulating policies governing SPEs, reviewing new and unusual SPE transactions and monitoring the ongoing activities of SPEs.

The Financial Accounting Standards Board is currently drafting new accounting standards on the consolidation of SPEs. Since these new standards are still being drafted their impact on our balance sheet is not quantifiable but could result in us consolidating certain assets and liabilities held in our SPEs.

Securitization of credit card receivables

We securitize some of our credit card receivables through an SPE. The SPE is funded through the issuance of senior and subordinated notes collateralized by the underlying credit card receivables. The primary economic purpose of this activity is to diversify our sources of funding and to enhance our liquidity position. Although these credit card receivables are no longer on our balance sheet, we maintain the client account and retain the relationship.

The transfer of the credit card receivables to the custodian of those assets is a sale from a legal perspective. In addition, our credit card securitization structure qualifies for sale treatment from an accounting perspective. Under FAS 140, the receivables are removed from our balance sheet resulting in a gain or loss reported in non-interest revenue. Note 7 on pages 81 and 82 provides information on our key securitization activities, including key assumptions. This SPE meets the Statement of Financial Accounting Standard, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140) criteria for a Qualifying SPE (QSPE) and, accordingly, as the transferor of the credit card receivables, we are precluded from consolidating this SPE.

We continue to service the credit card receivables sold to the QSPE. In addition, we perform an administrative role for the QSPE in which we are responsible for ensuring that the ongoing public filings of the QSPE are performed, as required, and that the investors in the QSPE's asset-backed securities receive interest and principal payments on a timely basis.

We provide first loss protection to the QSPE in two forms. Our interest in the excess spread from the QSPE is subordinate to the QSPE's obligation to the holders of its asset-backed securities. Excess spread is the residual net interest income after all other trust expenses have been paid. Therefore, our excess spread serves to absorb losses with respect to the credit card receivables before payments to the QSPE's noteholders are affected. The present value of this excess spread is reported as a retained interest within available for sale securities on our consolidated balance sheet. In addition, we provide loans to the QSPE to pay up-front expenses. These loans rank subordinate to all notes issued by the QSPE.

At October 31, 2002, total credit card receivables securitized and held off-balance sheet amounted to $1.7 billion, compared to $2.1 billion at October 31, 2001. The carrying value of our retained interests in securitized credit card receivables at October 31, 2002, was $15.1 million compared to $19.5 million in 2001, and amounts receivable under subordinated loan agreements were $5.2 million compared to $8.5 million in 2001.

Securitization of client financial assets

Within our global securitization group, our principal relationship with SPEs comes in the form of administering multi-seller asset-backed commercial paper conduit programs (multi-seller SPEs). We currently administer five multi-seller SPEs – three in Canada and two in the U.S. These five multi-seller SPEs have purchased financial assets from our clients totalling $20.6 billion. Under current accounting standards, the five multi-seller SPEs that we administer are not consolidated on our balance sheet.

We are involved in the multi-seller SPE markets because our clients value these transactions, they offer a growing source of revenue and they generate a favorable risk-adjusted return for us. Our clients primarily utilize multi-seller SPEs to diversify their financing sources and to reduce funding costs by leveraging the value of high quality collateral.

The multi-seller SPEs purchase various financial assets from clients and finances those purchases by issuing highly rated asset-backed commercial paper. The multi-seller SPEs typically purchase the financial assets as part of a securitization transaction by our clients. In these situations, the sellers of the financial assets continue to service the respective assets and generally provide some amount of first-loss protection on the assets. We do not maintain any ownership or retained interest in these multi-seller SPEs. Instead, we provide or retain certain services such as transaction structuring and administration as specified by the multi-seller SPE's program documents and based on rating agency criteria. In addition, we provide backstop liquidity facilities and partial credit enhancement to the multi-seller SPEs. We receive market-based fee revenue from such services, which is reported as non-interest revenue. We also have no rights to, or control of, the assets owned by the multi-seller SPE.

The table below summarizes the financial assets owned by the multi-seller SPEs at fiscal years ended October 31.

Asset class

(C$ millions)	2002	2001
Credit cards	$ 4,671	$ 3,785
Auto loans and leases	3,615	4,298
Equipment receivables	2,509	2,159
Trade receivables	2,479	2,094
Residential mortgages	2,004	1,682
Other loans	1,275	843
Dealer floor plan receivables	1,208	1,275
Consumer loans	1,196	1,114
Asset-backed securities	926	487
Other	706	579
	$ 20,589	$ 18,316

The commercial paper issued by each multi-seller SPE is in the SPE's own name with recourse to the financial assets owned by the multi-seller SPE. The multi-seller SPE commercial paper is non-recourse to us and non-recourse to the other multi-seller SPEs that we administer. Each multi-seller SPE is largely prohibited from issuing medium-term notes or other forms of indebtedness to finance the asset purchases. Consequently, each multi-seller SPE's commercial paper liabilities are generally equal to the assets owned by that multi-seller SPE. The small difference between each of the multi-seller SPE's assets and liabilities balances is mostly related to the discount or interest costs attributable to the commercial paper. As of October 31, 2002, the total face amount of commercial paper issued by the multi-seller SPE's equaled $20,589 million generating $20,534 million of cash proceeds with the difference between these amounts representing the commercial paper discount.

At fiscal years ended October 31, total commitments and amounts outstanding under liquidity and credit facilities were as shown in the following table:

Liquidity and credit facilities

	2002		2001	
(C$ millions)	Committed	Outstanding	Committed	Outstanding
Liquidity facilities	$ 22,593	$ –	$ 20,614	$ –
Credit facilities	7,211	–	3,856	–
	$ 29,804	$ –	$ 24,470	$ –

We provide backstop liquidity facilities to the multi-seller SPEs as an alternative source of financing in the event that such SPEs are unable to access commercial paper markets, or in limited circumstances, when pre-determined performance measures of the financial assets owned by the multi-seller SPEs are not met. The terms of the backstop liquidity facilities do not require us to advance money to the multi-seller SPEs in the event of bankruptcy or to purchase non-performing or defaulted assets. None of the backstop liquidity facilities that we have provided has ever been drawn upon.

The partial credit enhancement that we provide to the multi-seller SPEs is in place to protect commercial paper investors in the event that the credit enhancement supporting the asset pools proves to be insufficient to prevent a default of one or more of the asset pools. Each of the asset pools is structured to achieve a high investment grade credit profile through credit enhancement related to each transaction. As a result, we believe that the program credit enhancements that we provide to the multi-seller SPEs present a modest amount of credit risk.

The economic exposure that we assume when we provide backstop liquidity commitments and partial credit enhancement is contingent in nature. We manage these exposures within our risk management functions in the same manner that we manage other contingent and non-contingent risk exposures. Our risk management process considers the credit, liquidity and interest rate exposure related to each of the assets. The risk exposure of each of these components individually and taken as a whole is deemed to be acceptable. All transactions are reviewed by external rating agencies. The weighted average credit quality of the assets supported by our backstop liquidity and partial credit enhancement is among the highest quality rating levels based on our internal risk rating system, which is described on page 54. The liquidity risk to us is deemed to be low based on the historical performance and high credit quality of the multi-seller SPEs' assets. Interest rate exposure is deemed to be low and is generally managed at the transaction level by passing on the funding cost variability to the securitization structures. Corporate Treasury scrutinizes contingent balance sheet risk, in effect monitoring the risk of drawdown under any of the credit facilities.

Creation of investment products

We use repackaging SPEs to create unique credit products to meet the needs of investors with specific requirements. As part of this process, we may enter into derivative contracts with these SPEs in order to convert various risk factors such as yield, currency or credit risk of underlying assets to meet the needs of our clients. In this role as derivative counterparty to the SPE, we assume the associated counterparty credit risk of the SPE. In order to enter into these transactions we establish an internal risk rating of the SPE and provide ongoing risk assessment and monitoring of the SPE's credit risk. As with all counterparty credit exposures, these exposures are put in place and reviewed pursuant to our normal risk management process in order to effectively manage and monitor this credit risk profile.

These SPEs often issue notes. Those notes may also be rated by external rating agencies, as well as listed on a stock exchange and are generally traded via recognized bond clearing systems. While the majority of the notes that are created in repackagings are expected to be sold on a 'buy & hold' basis, we may on occasion act as market-maker. We do not, however, provide any repackaging SPE with any guarantees or other similar support commitments. There are many functions required to create a repackaged product. We fulfill some of these functions and independent third parties or specialist service providers fulfill the remainder. Currently we act as sole arranger and swap provider for SPEs where we are involved, and in most cases as paying and issuing agent as well.

Asset management

We act as collateral manager for several collateralized debt obligation (CDO) SPEs, which invest in leveraged bank-initiated term loans, high-yield bonds and mezzanine corporate debt. As collateral manager, we are engaged by the CDO SPE, pursuant to a Collateral Management Agreement, to advise the SPE on the purchase and sale of collateral assets it holds. For these advisory services, we are paid a pre-determined market-based fee, which is a percentage of assets held by the SPE.

The notional amount of the CDOs we managed at the end of fiscal 2002 was US$1.6 billion (2001 – US$1.3 billion). Although we have a nominal investment of US$9.5 million in the "first-loss" tranche of a US$300 million CDO, we provide no liquidity or credit support to these SPEs beyond this investment. The CDOs we manage may from time-to-time purchase collateral assets originated by us or other affiliates. The program documents covering the formation and operation of the individual CDOs provide strict guidelines for the purchase of such assets.

We recognize fee income from collateral management services and, where indicated, interest income from investments in individual CDOs.

2001 compared to 2000

The following discussion and analysis provides a comparison of our results of operations for the years ended October 31, 2001 and 2000. This discussion should be read in conjunction with the consolidated financial statements and related Notes on pages 67 to 96. This portion of the management's discussion and analysis is based on amounts reported in the consolidated financial statements and does not exclude special items.

Business segment results

Net income from RBC Banking increased 10% to $1,174 million in 2001 from $1,064 million in 2000. ROE decreased 270 basis points to 16.8%.

Net income from RBC Insurance was up 68% to $173 million in 2001, reflecting acquisitions. ROE decreased from 38.6% to 20.0% due to higher allocation of capital in light of recent acquisitions.

Net income from RBC Investments was up 23% from 2000 to $508 million. ROE declined by 2,080 basis points to 27.0% due to higher allocation of capital as a result of recent acquisitions.

Net income from RBC Capital Markets decreased 30% to $349 million, reflecting a large increase in the provision for credit losses. ROE declined by 1,120 basis points to 9.6%, reflecting lower net income and the higher allocation of capital for recent acquisitions.

Net income from RBC Global Services was up 44% to $266 million reflecting fee growth from new business and value-added services added in the investor services business. ROE increased 980 basis points to 49.3%.

Other segment's net income improved to $(35) million from $(59) million in 2000. ROE decreased 1,600 basis points to (5.3)%.

Net interest income

Net interest income increased 23% to $6.5 billion in 2001 from $5.3 billion in 2000 partially due to the acquisition of Centura Banks, in June 2001 which added more interest-bearing assets and liabilities to the balance sheet.

Non-interest revenue

Non-interest revenue increased 22% to $8.2 billion in 2001, accounting for 56% of total revenue.

Non-interest expense

Non-interest expense increased 26% to $9.6 billion, partially reflecting the contribution of expenses from acquisitions and an increase of goodwill amortization expenses associated with these acquisitions.

Taxes

Our income taxes for 2001 were $1.4 billion, for an effective income tax rate of 34.7%. Income taxes were $1.4 billion in 2000, reflecting an effective income tax rate was 38.8%.

Provision for credit losses

The provision for credit losses increased 62% to $1,119 million in 2001 from $691 million in 2000, largely reflecting increases in business and government provisions for credit losses. The total allowance for loan losses was $2.3 billion or 1.3% of total loans and acceptances up from 1.1% in 2000.

Quarterly financial information

Selected financial information for the eight most recently completed quarters is shown on page 102.