

# Consolidated Financial Statements

## Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of Royal Bank of Canada were prepared by management, which is responsible for the integrity and fairness of the information presented, including the many amounts that must of necessity be based on estimates and judgments. These consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles, including the accounting requirements of the Superintendent of Financial Institutions Canada. Financial information appearing throughout this Annual Report is consistent with these consolidated financial statements. Management has also prepared consolidated financial statements for Royal Bank of Canada in accordance with United States generally accepted accounting principles, and these consolidated financial statements have also been provided to shareholders.

In discharging its responsibility for the integrity and fairness of the consolidated financial statements and for the accounting systems from which they are derived, management maintains the necessary system of internal controls designed to ensure that transactions are authorized, assets are safeguarded and proper records maintained. These controls include quality standards in hiring and training of employees, policies and procedure manuals, a corporate code of conduct and accountability for performance within appropriate and well-defined areas of responsibility.

The system of internal controls is further supported by a compliance function, which ensures that the bank and its employees comply with securities legislation and conflict of interest rules, and by an internal audit staff, which conducts periodic audits of all aspects of the bank's operations.

The Board of Directors oversees management's responsibilities for financial reporting through an Audit Committee, which is composed entirely of directors who are neither officers nor employees of the bank.

## Auditors' Report

To the Shareholders of Royal Bank of Canada

We have audited the consolidated balance sheet of Royal Bank of Canada as at October 31, 2000 and 1999, and the consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended October 31, 2000. These consolidated financial statements are the responsibility of the bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

This Committee reviews the consolidated financial statements of the bank and recommends them to the board for approval. Other key responsibilities of the Audit Committee include reviewing the bank's existing internal control procedures and planned revisions to those procedures, and advising the directors on auditing matters and financial reporting issues. The bank's Compliance Officer and Chief Internal Auditor have full and unrestricted access to the Audit Committee.

At least once a year, the Superintendent of Financial Institutions Canada, makes such examination and enquiry into the affairs of the bank as deemed necessary to ensure that the provisions of the *Bank Act*, having reference to the safety of the depositors and shareholders of the bank, are being duly observed and that the bank is in sound financial condition.

Deloitte & Touche LLP and PricewaterhouseCoopers LLP, independent auditors appointed by the shareholders of the bank upon the recommendation of the Audit Committee, have performed an independent audit of the financial statements and their report follows. The shareholders' auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings.

John E. Cleghorn  
Chairman & Chief Executive Officer

Peter W. Currie  
Vice-Chairman & Chief Financial Officer

Toronto, November 21, 2000

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the bank as at October 31, 2000 and 1999, and the results of its operations and its cash flows for each of the years in the three-year period ended October 31, 2000, in accordance with Canadian generally accepted accounting principles, including the accounting requirements of the Superintendent of Financial Institutions Canada.

We also reported separately on November 21, 2000, to the shareholders of the bank on our audit, conducted in accordance with Canadian generally accepted auditing standards, where we expressed an opinion without reservation on the October 31, 2000 and 1999, consolidated financial statements, prepared in accordance with United States generally accepted accounting principles.

Deloitte & Touche LLP  
PricewaterhouseCoopers LLP  
Chartered Accountants

Toronto, November 21, 2000

**Consolidated Balance Sheet**

As at October 31 (\$ millions)

	2000	1999
<b>Assets</b>		
<b>Cash resources</b>		
Cash and deposits with banks	\$ 947	\$ 2,460
Interest-bearing deposits with other banks	18,659	20,582
	<b>19,606</b>	<b>23,042</b>
<b>Securities</b> (note 3)		
Trading account	43,016	32,984
Investment account	13,529	17,040
Loan substitute	465	535
	<b>57,010</b>	<b>50,559</b>
<b>Loans</b> (note 4)		
Residential mortgage	62,984	59,242
Personal	28,019	25,255
Credit card	4,666	2,666
Business and government	60,546	57,676
Assets purchased under reverse repurchase agreements	18,303	20,272
	<b>174,518</b>	<b>165,111</b>
Allowance for loan losses	(1,871)	(1,884)
	<b>172,647</b>	<b>163,227</b>
<b>Other</b>		
Derivative-related amounts	19,155	15,151
Customers' liability under acceptances	11,628	9,257
Premises and equipment (note 5)	1,249	1,320
Goodwill	648	611
Other intangibles	208	–
Other assets	7,589	7,483
	<b>40,477</b>	<b>33,822</b>
	<b>\$ 289,740</b>	<b>\$ 270,650</b>
<b>Liabilities and shareholders' equity</b>		
<b>Deposits</b>		
Personal	\$ 89,632	\$ 87,359
Business and government	93,618	86,223
Bank	19,646	14,315
	<b>202,896</b>	<b>187,897</b>
<b>Other</b>		
Acceptances	11,628	9,257
Obligations related to securities sold short	13,419	17,885
Obligations related to assets sold under repurchase agreements	9,005	9,396
Derivative-related amounts	18,574	15,219
Other liabilities	14,149	13,682
	<b>66,775</b>	<b>65,439</b>
<b>Subordinated debentures</b> (note 6)	<b>5,825</b>	<b>4,596</b>
<b>Non-controlling interest in subsidiaries</b>	<b>703</b>	<b>103</b>
<b>Shareholders' equity</b>		
Capital stock (note 7)		
Preferred	2,037	2,009
Common (shares issued and outstanding – 602,397,936 and 617,767,562)	3,076	3,065
Retained earnings	8,428	7,541
	<b>13,541</b>	<b>12,615</b>
	<b>\$ 289,740</b>	<b>\$ 270,650</b>

John E. Cleghorn  
Chairman & Chief Executive Officer

Robert B. Peterson  
Director

**Consolidated Statement of Income**

For the year ended October 31 (\$ millions)

	2000	1999	1998
<b>Interest income</b>			
Loans	\$ 12,616	\$ 11,287	\$ 11,643
Securities	2,518	2,075	1,842
Deposits with banks	975	841	822
	<b>16,109</b>	14,203	14,307
<b>Interest expense</b>			
Deposits	9,057	7,636	7,732
Other liabilities	1,429	1,161	1,172
Subordinated debentures	344	286	339
	<b>10,830</b>	9,083	9,243
<b>Net interest income</b>	<b>5,279</b>	5,120	5,064
<b>Other income</b>			
Capital market fees	1,810	1,209	1,118
Trading revenues	1,540	1,106	748
Deposit and payment service charges	756	688	664
Investment management and custodial fees	684	547	495
Mutual fund revenues	528	479	447
Card service revenues	420	362	305
Securitization revenues	115	222	218
Gain (loss) on sale of securities	(11)	28	343
Other	890	839	647
	<b>6,732</b>	5,480	4,985
<b>Gross revenues</b>	<b>12,011</b>	10,600	10,049
<b>Provision for credit losses</b>	<b>691</b>	760	575
	<b>11,320</b>	9,840	9,474
<b>Non-interest expenses</b>			
Human resources	4,651	4,013	3,594
Occupancy	570	564	508
Equipment	665	677	585
Communications	695	699	665
Other	1,000	1,107	1,047
	<b>7,581</b>	7,060	6,399
<b>Net income before income taxes</b>	<b>3,739</b>	2,780	3,075
Income taxes (note 8)	1,445	1,015	1,175
<b>Net income before non-controlling interest</b>	<b>2,294</b>	1,765	1,900
Non-controlling interest in net income of subsidiaries	20	8	76
<b>Net income</b>	<b>\$ 2,274</b>	\$ 1,757	\$ 1,824
Preferred share dividends	134	157	145
<b>Net income available to common shareholders</b>	<b>\$ 2,140</b>	\$ 1,600	\$ 1,679
Average number of common shares (in thousands)	<b>606,389</b>	626,158	617,324
<b>Earnings per share</b> (in dollars) (note 11)	<b>\$ 3.53</b>	\$ 2.55	\$ 2.72
Average number of fully diluted common shares (in thousands)	<b>624,328</b>	649,300	644,040
<b>Fully diluted earnings per share</b> (in dollars) (note 11)	<b>\$ 3.47</b>	\$ 2.51	\$ 2.65

**Consolidated Statement of Changes in Shareholders' Equity**

For the year ended October 31 (\$ millions)

	2000	1999	1998
<b>Preferred shares</b>			
Balance at beginning of year	\$ 2,009	\$ 2,144	\$ 1,784
Issued (note 7)	–	296	300
Redeemed for cancellation (note 7)	–	(400)	–
Translation adjustment on shares denominated in foreign currency	28	(31)	60
Balance at end of year	2,037	2,009	2,144
<b>Common shares</b>			
Balance at beginning of year	3,065	2,925	2,907
Issued (note 7)	109	192	18
Purchased for cancellation (note 7)	(98)	(52)	–
Balance at end of year	3,076	3,065	2,925
<b>Retained earnings</b>			
Balance at beginning of year	7,541	6,823	5,699
Net income	2,274	1,757	1,824
Preferred share dividends	(134)	(157)	(145)
Common share dividends	(689)	(588)	(543)
Premium paid on common shares purchased for cancellation (note 7)	(562)	(281)	–
Issuance costs	(4)	(9)	(7)
Unrealized foreign currency translation gains and losses, net of hedging activities and related income taxes (note 8)	2	(4)	(5)
Balance at end of year	8,428	7,541	6,823
<b>Shareholders' equity at end of year</b>	<b>\$ 13,541</b>	<b>\$ 12,615</b>	<b>\$ 11,892</b>

**Consolidated Statement of Cash Flows**

For the year ended October 31 (\$ millions)

	2000	1999	1998
<b>Cash flows from operating activities</b>			
Net income	\$ 2,274	\$ 1,757	\$ 1,824
Adjustments to determine net cash provided by (used in) operating activities			
Provision for credit losses	691	760	575
Depreciation	370	389	342
Restructuring	–	153	68
Amortization of goodwill and other intangibles	87	66	62
Gain on sale of assets	(4)	(95)	–
Change in accrued interest receivable and payable	78	(81)	95
Net loss (gain) on sale of investment securities	11	(28)	(343)
Changes in operating assets and liabilities			
Deferred income taxes	(193)	127	144
Current income taxes payable	(434)	487	66
Unrealized gains and amounts receivable on derivative contracts	(4,004)	15,262	(15,637)
Unrealized losses and amounts payable on derivative contracts	3,355	(14,151)	14,638
Trading account securities	(10,032)	(4,437)	(9,807)
Securities sold with recourse	(312)	(239)	(337)
Obligations related to securities sold short	(4,466)	3,481	3,252
Other	711	1,021	1,465
<b>Net cash provided by (used in) operating activities</b>	<b>(11,868)</b>	<b>4,472</b>	<b>(3,593)</b>
<b>Cash flows from investing activities</b>			
Change in loans	(11,713)	1,632	(8,297)
Proceeds from sale of investment securities	10,439	5,163	4,432
Proceeds from the maturity of investment securities	16,769	10,839	12,377
Purchases of investment securities	(23,708)	(20,921)	(15,084)
Decrease in loan substitute securities	70	224	63
Change in interest-bearing deposits with other banks	1,927	(6,596)	5,406
Net acquisitions of premises and equipment	(281)	(301)	(518)
Net proceeds from sale of real estate	–	815	–
Change in assets purchased under reverse repurchase agreements	1,969	(365)	(1,265)
Net cash used in acquisition of subsidiaries	(323)	(133)	(7)
<b>Net cash used in investing activities</b>	<b>(4,851)</b>	<b>(9,643)</b>	<b>(2,893)</b>
<b>Cash flows from financing activities</b>			
Issue of RBC Trust Capital Securities (RBC TruCS)	650	–	–
Increase in deposits	14,882	7,892	6,057
Issue of subordinated debentures	1,200	700	500
Subordinated debentures matured	(20)	(123)	(72)
Issue of preferred shares	–	296	300
Preferred shares redeemed for cancellation	–	(400)	–
Issuance costs	(4)	(9)	(7)
Issue of common shares	59	17	18
Common shares redeemed for cancellation	(660)	(333)	–
Dividends paid	(791)	(735)	(662)
Change in securities sold under repurchase agreements	(391)	(1,868)	1,806
Change in liabilities of subsidiaries	281	(215)	(315)
<b>Net cash provided by financing activities</b>	<b>15,206</b>	<b>5,222</b>	<b>7,625</b>
<b>Net change in cash and deposits with banks</b>	<b>(1,513)</b>	<b>51</b>	<b>1,139</b>
Cash and deposits with banks at beginning of year	2,460	2,409	1,270
<b>Cash and deposits with banks at end of year</b>	<b>\$ 947</b>	<b>\$ 2,460</b>	<b>\$ 2,409</b>
<b>Supplemental disclosure of cash flow information</b>			
Amount of interest paid in year	\$ 10,698	\$ 8,989	\$ 9,163
Amount of income taxes paid in year	\$ 2,007	\$ 542	\$ 604

## Note 1: Significant Accounting Policies

Pursuant to the *Bank Act*, these consolidated financial statements of Royal Bank of Canada are prepared in accordance with Canadian generally accepted accounting principles (GAAP), including the accounting requirements of the Superintendent of Financial Institutions Canada. The bank has also prepared consolidated financial statements in accordance with United States GAAP and these have also been provided to shareholders.

GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Actual results could differ from those estimates. Note 17 of the consolidated financial statements describes and reconciles the differences between Canadian and United States GAAP.

Certain comparative amounts have been reclassified to conform with the current year's presentation. The significant accounting policies followed in the preparation of these consolidated financial statements are summarized below:

### Basis of Consolidation

The consolidated financial statements include the assets and liabilities and results of operations of all subsidiaries after elimination of inter-company transactions and balances. The bank has accounted for the acquisition of subsidiaries using the purchase method. The equity method is used to account for investments in associated corporations in which the bank has significant influence. These investments are reported in Other assets. The bank's share of earnings from these associated corporations is included in interest income from securities. Gains and losses realized on dispositions of these investments are included in Other income. The proportionate consolidation method is used to account for investments in which the bank exercises joint control, whereby the bank's pro rata share of the assets, liabilities, income and expenses are consolidated.

### Translation of Foreign Currencies

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates prevailing on the balance sheet date; income and expenses are translated at average rates of exchange for the year.

Unrealized foreign currency translation gains and losses (net of hedging activities and related income taxes) on investments in foreign branches, subsidiaries and associated corporations where the functional currency is other than the Canadian dollar are recorded in Retained earnings. On disposal of such investments, the accumulated net translation gain or loss is included in Other income. Other foreign currency translation gains and losses (net of hedging activities) are included in Other income.

### Securities

Securities are classified at the time of purchase, based on management's intentions, as Trading account or Investment account.

Trading account securities, which are purchased for resale over a short period of time, are stated at estimated current market value. Obligations to deliver trading securities sold but not yet purchased are recorded as liabilities and carried at fair value. Realized and unrealized gains and losses on these securities are recorded in Trading revenues in Other income. Interest income accruing on Trading account securities is recorded in Interest income from securities. Interest expense accruing on interest-bearing securities sold short is recorded in Interest expense.

Investment account securities include securities that may be sold in response to or in anticipation of changes in interest rates and resulting prepayment risk, changes in funding sources or terms, or to meet liquidity

needs. Equity securities are stated at cost and debt securities at amortized cost. Premiums and discounts on debt securities are amortized to Interest income from securities using the yield method over the period to maturity of the related securities. Gains and losses realized on disposal of securities, which are calculated on an average cost basis, and writedowns to reflect other than temporary impairment in value are included in Gain on sale of securities in Other income.

Loan substitute securities are customer financings that have been structured as after-tax investments rather than conventional loans in order to provide the issuers with a borrowing rate advantage. Such securities are accorded the accounting treatment applicable to loans and, if required, are reduced by an allowance for credit losses.

### Loans

Loans are stated net of an allowance for loan losses and unearned income, which is comprised of unearned interest and unamortized loan fees.

Loans are classified as impaired when there is no longer reasonable assurance of the timely collection of principal and interest. Whenever a payment is 90 days past due, loans other than credit card balances are classified as impaired unless they are fully secured or collection efforts are reasonably expected to result in repayment of debt. Credit card balances are written off when a payment is 180 days in arrears. When a loan is identified as impaired, the accrual of interest is discontinued and any previously accrued but unpaid interest on the loan is charged to the provision for loan losses. Interest received on impaired loans is credited to the allowance for loan losses on that loan. Impaired loans are returned to performing status when all amounts including interest have been collected, all charges for loan impairment have been reversed and the credit quality has improved such that there is reasonable assurance of timely collection of principal and interest.

When a loan has been identified as impaired, the carrying amount of the loan is reduced to its estimated realizable amount, measured by discounting the expected future cash flows at the effective interest rate inherent in the loan. In subsequent periods, recoveries of amounts previously written off and any increase in the carrying value of the loan is credited to the provision for loan losses in the consolidated income statement. Where a portion of a loan is written off and the remaining balance is restructured, the new loan is carried on an accrual basis when there is no longer any reasonable doubt regarding the collectibility of principal and interest, and payments are not 90 days past due.

Collateral is obtained if, based on an evaluation of the customer's creditworthiness, it is considered necessary for the customer's overall borrowing facility. Collateral would normally be in the form of assets such as cash, government securities, shares, accounts receivable, inventory or fixed assets.

Assets acquired in respect of problem loans are recorded at the lower of their fair value or the carrying value of the loan at the date of transfer. Any excess of the carrying value of the loan over the fair value of the assets acquired is recognized by a charge to the provision for loan losses.

Fees that relate to such activities as originating, restructuring or renegotiating loans are deferred and recognized on a straight-line basis as Interest income over the expected term of such loans. Where there is reasonable expectation that a loan will result, commitment and standby fees are also recognized as Interest income over the expected term of the resulting loan. Otherwise, such fees are recorded as Other liabilities and amortized to Other income over the commitment or standby period.

### Allowance for Credit Losses

The allowance for credit losses is maintained at a level that management considers adequate to absorb identified credit-related losses in the portfolio as well as losses that have been incurred, but are not yet identifiable. The allowance for credit losses reflects management's best estimate of losses existing in the credit portfolio at the balance sheet date. The allowance relates primarily to loans but also to deposits with other banks, derivatives, loan substitute securities and other credit instruments such as acceptances, guarantees and letters of credit. The allowance is increased by the provision for credit losses, which is charged to income, and decreased by the amount of write-offs, net of recoveries.

The allowance is determined based on management's identification and evaluation of problem accounts; estimated probable losses that exist on the remaining portfolio; and on other factors including the composition and quality of the portfolio, and changes in economic conditions.

#### *Specific*

Specific allowances are maintained to absorb losses on both specifically identified borrowers and other more homogeneous loans that have become impaired. 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. The losses relating to other portfolio-type products, excluding credit cards, are based on net write-off experience over an economic cycle. For credit cards, no specific allowance is maintained as balances are written off if no payment has been received after 180 days. Personal loans are generally written off at 150 days past due. Write-offs for other loans are generally recorded when there is no realistic prospect of full recovery.

#### *Country Risk*

Country risk allowances are maintained with respect to exposures to a number of less developed countries (LDCs) based on an overall assessment of the underlying economic conditions in those countries.

#### *General Allocated*

The general allocated allowance represents the best estimate of probable losses within the portion of the portfolio that has not yet been specifically identified as impaired. This amount is established through the application of expected loss factors to outstanding and undrawn facilities. The general allocated allowance for large business and government loans and acceptances is based on the application of expected default and loss factors, determined by statistical loss migration analysis, delineated by loan type and rating. For more homogeneous portfolios, such as residential mortgages, small business loans, personal loans and credit cards, the determination of the general allocated allowance is done on a product portfolio basis. The losses are determined by the application of loss ratios determined through the analysis of loss migration and write-off trends over an economic cycle, adjusted to reflect changes in the product offerings and credit quality of the pool.

#### *General Unallocated*

The general unallocated allowance is based on management's assessment of probable, unidentified losses in the portfolio that have not been captured in the determination of the specific, the country risk or the general allocated allowances. This assessment includes consideration of general economic and business conditions and regulatory requirements affecting key lending operations, recent loan loss experience, and trends in credit quality and concentrations. This allowance also reflects model and estimation risks. This allowance does not represent future losses or serve as a substitute for other allowances.

### Assets Purchased under Reverse Repurchase Agreements and Sold under Repurchase Agreements

The bank enters into short-term purchases of securities under agreements to resell (reverse repurchase agreements) and sales of securities under agreements to repurchase (repurchase agreements). These agreements are treated as collateralized lending and borrowing transactions and are carried on the consolidated balance sheet at the amounts at which the securities were initially acquired or sold. Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements are included in Interest income and Interest expense, respectively.

### Acceptances

Acceptances are short-term negotiable instruments issued by the bank's customers to third parties, which are guaranteed by the bank. The potential liability under acceptances is reported as a liability in the consolidated balance sheet. The recourse against the customer in the case of a call on these commitments is reported as a corresponding asset of the same amount under Other assets. Fees earned are reported in Other income.

### Derivatives

Derivatives are used in sales and trading activities to provide clients with the ability to manage their market risk exposures. Derivatives are also used to manage the bank's own exposures to interest, currency and other market risks. The most frequently used derivative products are foreign exchange forward contracts, interest rate and currency swaps, foreign currency and interest rate futures, forward rate agreements, and foreign currency and interest rate options.

When used in sales and trading activities, the realized and unrealized gains and losses on these derivatives are recognized in Other income. Market values are determined using pricing models that incorporate current market and contractual prices of the underlying instruments, time value of money, yield curve and volatility factors. A portion of the market value is deferred within Derivative-related amounts in Other liabilities and amortized to income over the life of the instruments to cover credit considerations and ongoing direct servicing costs. Unrealized gains and unrealized losses are generally reported on a gross basis as Derivative-related amounts in Other assets and Other liabilities, except where the bank has both the legal right and intent to settle these amounts simultaneously in which case they are presented on a net basis. Margin requirements and premiums paid are also included in Derivative-related amounts in Other assets, while premiums received are shown in Derivative-related amounts in Other liabilities.

When derivatives are used to manage the bank's own exposures, the income or expense is recognized over the life of the transaction as an adjustment to interest income or expense. Where derivatives have been designated and function effectively as hedges, realized gains and losses are deferred and amortized over the life of hedged assets or liabilities as adjustments to Interest income or Interest expense.

### Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is recorded principally on the straight-line basis over the estimated useful lives of the assets, which are 25 to 50 years for buildings, 3 to 10 years for hardware, 3 to 5 years for software, 7 to 10 years for furniture, fixtures and other equipment, and lease term plus first option period for leasehold improvements. Gains and losses on disposal are recorded in Other income.

**Note 1: Significant Accounting Policies** (continued)**Goodwill and Other Intangibles**

Goodwill represents the excess of the price paid for the acquisition of subsidiaries over the fair value of the net assets acquired and is amortized over appropriate periods of up to 20 years, except where a writedown is required to reflect permanent impairment. Identifiable, reliably measurable Other intangible assets, such as client lists, resulting from acquisition of subsidiaries are also amortized over appropriate periods of up to 20 years. An impairment review on unamortized goodwill and other intangibles is performed periodically. Such evaluation is based on various analyses including undiscounted cash flow; market value is used if a sale or disposition is being considered.

**Income Taxes**

The bank uses the asset and liability method whereby income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities for book purposes compared with tax purposes. Accordingly, a deferred income tax asset or liability is determined for each temporary difference based on the tax rates that are expected to be in effect when the underlying items of income and expense are expected to be realized. Income taxes on the consolidated statement of income include the current and deferred portions of the expense. Income taxes applicable to items charged or credited to Retained earnings are netted with such items.

Deferred income taxes accumulated as a result of temporary differences are included in Other assets. A valuation allowance is established to reduce deferred income tax assets to the amount expected to be realized. In addition, the consolidated statement of income contains items that are non-taxable or non-deductible for income tax purposes and, accordingly, cause the income tax provision to be different than what it would be if based on statutory rates.

**Postretirement Benefits**

The bank maintains a defined benefit pension plan that is available to substantially all employees after two years of service or at age 25, on a contributory or a non-contributory basis. The plan provides pensions based on years of service, contributions and average earnings at retirement. Employees of subsidiaries of the bank are generally covered by separate pension plans that offer comparable benefits. It is the bank's funding policy to annually contribute to its pension funds, the actuarially determined amounts needed to satisfy employee benefit laws. Investments held by the pension funds are primarily comprised of equity securities, bonds and debentures.

Actuarial valuations are performed each year to determine the present value of the accrued pension benefits, based on projections of employees' compensation levels to the time of retirement.

Pension expense consists of the aggregate of (a) the actuarially computed cost of pension benefits provided in respect of the current year's service, (b) imputed interest on the funding excess or deficiency of the plan and (c) the amortization of the funding excess existing at the date the current accounting policy commenced, experience gains and losses, and amounts arising as a result of changes in assumptions and plan amendments over the expected average remaining service life of employees.

The cumulative excess of pension fund contributions over the amounts recorded as an expense is reported in Other assets.

The bank also provides health and dental care benefits and life insurance coverage to employees who retire after 10 years of service, and to their dependents. Costs of providing these benefits are charged to income as expenditures are incurred.

**Assets under Administration and Assets under Management**

The bank administers and manages assets owned by clients that are not reflected on the consolidated balance sheet. Asset management fees are earned for providing investment management services and mutual fund products. Asset administration fees are earned for providing trust, estate administration and custodial services. Fees are recognized and reported in Other income as the services are provided.

**Loan Securitization**

The bank periodically securitizes loans by selling loans to special-purpose vehicles or trusts that in turn issue securities to investors. These transactions are accounted for as sales when the significant risks and rewards of ownership have been transferred and there is reasonable assurance regarding the measurement of the consideration derived from the sale. Gains on these transactions are recognized in Other income, provided there is no recourse to the bank for the consideration derived from the sale. To the extent that there is recourse to the bank on the transaction, any gain on sale would be deferred until the cash is collected and there is no recourse.

Fees earned by the bank to service the securitized loans are recognized as services are provided and reported in Securitization revenues in Other income.

**Insurance Operations**

Earned premium, fees, claims and changes in actuarial reserves are included in Other income. Investments are primarily included in Investment account securities and actuarial reserves are included in Other liabilities. Investment income is included in Interest income on securities and administrative expenses are included in Non-interest expenses.

**Future Accounting Changes**

The Canadian Institute of Chartered Accountants new standard on *Employee Future Benefits* changes the accounting for pension and other types of employee future benefits. The new standard requires the bank to accrue the costs of employee future benefits other than pensions over the working lives of employees in a manner similar to pension costs. Under current practice, such costs are charged to income as incurred. The new standard also requires a change in the discount rate used to value the future benefit obligation from an estimated long-term rate to a market-based interest rate. The bank will adopt the recommendations of this standard effective November 1, 2000. The cumulative impact of this change will result in a decrease in Retained earnings of \$221 million and an increase in deferred tax assets of \$157 million. In future years, the annual expense of employee future benefits will increase by approximately \$60 million.

## Note 2: Results by Business and Geographic Segments

2000	Personal & Commercial Financial Services	Wealth Management	Corporate & Investment Banking	Transaction Processing	Other	Total	Canada	International
Net interest income on taxable equivalent basis	\$ 4,789	\$ 359	\$ 43	\$ 160	\$ (44)	\$ 5,307	\$ 4,796	\$ 511
Taxable equivalent adjustment	7	–	21	–	–	28	28	–
Net interest income	4,782	359	22	160	(44)	5,279	4,768	511
Other income	1,769	2,138	2,287	514	24	6,732	5,311	1,421
Gross revenues	6,551	2,497	2,309	674	(20)	12,011	10,079	1,932
Provision for credit losses	649	(1)	91	(21)	(27)	691	703	(12)
Non-interest expenses	3,833	1,838	1,445	459	6	7,581	6,423	1,158
Net income before income taxes	2,069	660	773	236	1	3,739	2,953	786
Income taxes	803	244	265	102	31	1,445	1,344	101
Non-controlling interest	5	–	–	–	15	20	15	5
Net income	\$ 1,261	\$ 416	\$ 508	\$ 134	\$ (45)	\$ 2,274	\$ 1,594	\$ 680
Total average assets	\$131,800	\$ 8,000	\$ 131,900	\$ 1,600	\$ 8,600	\$281,900	\$197,900	\$ 84,000

1999	Personal & Commercial Financial Services	Wealth Management	Corporate & Investment Banking	Transaction Processing	Other	Total	Canada	International
Net interest income on taxable equivalent basis	\$ 4,457	\$ 267	\$ 402	\$ 168	\$ (139)	\$ 5,155	\$ 4,405	\$ 750
Taxable equivalent adjustment	8	–	27	–	–	35	35	–
Net interest income	4,449	267	375	168	(139)	5,120	4,370	750
Other income	1,536	1,684	1,588	459	213	5,480	4,284	1,196
Gross revenues	5,985	1,951	1,963	627	74	10,600	8,654	1,946
Provision for credit losses	575	–	223	6	(44)	760	672	88
Non-interest expenses	3,832	1,540	1,295	436	(43)	7,060	5,973	1,087
Net income before income taxes	1,578	411	445	185	161	2,780	2,009	771
Income taxes	618	131	138	78	50	1,015	856	159
Non-controlling interest	4	–	–	–	4	8	4	4
Net income	\$ 956	\$ 280	\$ 307	\$ 107	\$ 107	\$ 1,757	\$ 1,149	\$ 608
Total average assets	\$123,800	\$ 8,900	\$127,300	\$ 1,800	\$ 8,100	\$269,900	\$187,800	\$ 82,100

1998	Personal & Commercial Financial Services	Wealth Management	Corporate & Investment Banking	Transaction Processing	Other	Total	Canada	International
Net interest income on taxable equivalent basis	\$ 4,192	\$ 336	\$ 530	\$ 202	\$ (159)	\$ 5,101	\$ 4,409	\$ 692
Taxable equivalent adjustment	13	–	24	–	–	37	37	–
Net interest income	4,179	336	506	202	(159)	5,064	4,372	692
Other income	1,336	1,570	1,150	450	479	4,985	3,717	1,268
Gross revenues	5,515	1,906	1,656	652	320	10,049	8,089	1,960
Provision for credit losses	305	1	206	178	(115)	575	527	48
Non-interest expenses	3,514	1,478	1,030	429	(52)	6,399	5,441	958
Net income before income taxes	1,696	427	420	45	487	3,075	2,121	954
Income taxes	690	158	139	17	171	1,175	953	222
Non-controlling interest	3	12	49	–	12	76	72	4
Net income	\$ 1,003	\$ 257	\$ 232	\$ 28	\$ 304	\$ 1,824	\$ 1,096	\$ 728
Total average assets	\$111,300	\$ 11,700	\$125,000	\$ 3,200	\$ 10,100	\$261,300	\$179,700	\$ 81,600

For management reporting purposes, the operations of the bank are grouped into the business segments of Personal & Commercial Financial Services, Wealth Management, Corporate & Investment Banking and Transaction Processing with the Other segment comprised mainly of Corporate Treasury, Systems & Technology and Real Estate Operations.

The business segments operate on an arm's-length basis with respect to the purchase and sale of intra-group services. Transfer pricing of funds sold or purchased, commissions, or charges and credits for services rendered are generally at market rates.

For geographic reporting purposes, Canadian-based activities of international money market units are included in International.

## Note 3: Securities

	Term to maturity (1)					2000 Total	1999 Total
	Under 1 year	1 to 5 years	5 to 10 years	Over 10 years	With no specific maturity		
<b>Trading account (2)</b>							
Canadian government debt (3)	\$ 4,745	\$ 2,788	\$ 1,477	\$ 1,284	\$ –	\$ 10,294	\$ 9,040
U.S. Treasury and other U.S. agencies	385	1,433	122	64	–	2,004	721
Other OECD government debt	380	543	140	77	–	1,140	2,174
Mortgage-backed securities	29	22	4	13	–	68	45
Other debt	9,139	2,888	1,532	2,164	–	15,723	7,775
Equities	–	–	–	–	13,787	13,787	13,229
<b>Total trading account</b>	<b>14,678</b>	<b>7,674</b>	<b>3,275</b>	<b>3,602</b>	<b>13,787</b>	<b>43,016</b>	<b>32,984</b>
<b>Investment account (2)</b>							
Canadian government debt (3)							
Amortized cost	2,296	281	95	179	–	2,851	7,531
Estimated market value	2,290	282	94	177	–	2,843	7,544
Yield (4)	5.9%	6.4%	6.5%	6.8%	–	6.1%	5.3%
U.S. Treasury and other U.S. agencies							
Amortized cost	83	4	–	–	–	87	1
Estimated market value	83	4	–	–	–	87	1
Yield (4)	5.9%	6.8%	–	–	–	6.0%	4.3%
Other OECD government debt							
Amortized cost	1,226	307	41	–	–	1,574	586
Estimated market value	1,227	305	41	–	–	1,573	584
Yield (4)	1.0%	6.4%	6.3%	–	–	2.1%	5.6%
Mortgage-backed securities							
Amortized cost	198	3,774	42	77	–	4,091	4,140
Estimated market value	197	3,700	42	76	–	4,015	4,021
Yield (4)	5.9%	5.2%	5.8%	7.0%	–	5.3%	5.2%
Other debt							
Amortized cost	1,847	1,253	704	162	71	4,037	4,138
Estimated market value	1,846	1,240	636	163	67	3,952	4,094
Yield (4)	5.4%	6.6%	9.1%	6.9%	6.5%	6.5%	6.4%
Equities							
Cost	–	–	–	–	889	889	644
Estimated market value	–	–	–	–	968	968	655
<b>Total investment account</b>							
Amortized cost	5,650	5,619	882	418	960	13,529	17,040
Estimated market value	5,643	5,531	813	416	1,035	13,438	16,899
<b>Loan substitute (5)</b>	<b>64</b>	<b>159</b>	<b>237</b>	<b>–</b>	<b>5</b>	<b>465</b>	<b>535</b>
<b>Total carrying value of securities (2)</b>	<b>\$20,392</b>	<b>\$13,452</b>	<b>\$ 4,394</b>	<b>\$ 4,020</b>	<b>\$14,752</b>	<b>\$57,010</b>	<b>\$50,559</b>
<b>Total estimated market value of securities</b>	<b>\$20,385</b>	<b>\$13,364</b>	<b>\$ 4,325</b>	<b>\$ 4,018</b>	<b>\$14,827</b>	<b>\$56,919</b>	<b>\$50,418</b>

(1) Actual maturities may differ from contractual maturities shown above, since borrowers may have the right to prepay obligations with or without prepayment penalties.

(2) Trading account securities are carried at estimated current market values. Investment account securities are carried at amortized cost for debt securities and at cost for equity securities.

(3) Canadian government debt is comprised of securities issued or guaranteed by Canadian federal, provincial or municipal governments.

(4) The weighted average yield is based on the carrying value at the end of the year for the respective securities.

(5) The market value of loan substitute securities approximates carrying value.

**Unrealized Gains and Losses on Investment Account**

	2000				1999			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated market value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated market value
Canadian government debt (1)	\$ 2,851	\$ 5	\$ (13)	\$ 2,843	\$ 7,531	\$ 27	\$ (14)	\$ 7,544
U.S. Treasury and other U.S. agencies	87	–	–	87	1	–	–	1
Other OECD government debt	1,574	1	(2)	1,573	586	3	(5)	584
Mortgage-backed securities	4,091	2	(78)	4,015	4,140	3	(122)	4,021
Other debt	4,037	36	(121)	3,952	4,138	25	(69)	4,094
Equities	889	102	(23)	968	644	30	(19)	655
	<b>\$13,529</b>	<b>\$ 146</b>	<b>\$ (237)</b>	<b>\$13,438</b>	<b>\$17,040</b>	<b>\$ 88</b>	<b>\$ (229)</b>	<b>\$16,899</b>

(1) Canadian government debt consists of securities issued or guaranteed by Canadian federal, provincial or municipal governments.

## Note 4: Loans

	2000	1999
<b>Canada</b> (1)		
Residential mortgage	\$ 61,444	\$ 58,524
Personal	27,207	24,353
Credit card	4,666	2,666
Business and government	48,294	47,166
<b>Total Canada</b>	<b>141,611</b>	<b>132,709</b>
<b>International</b> (1)		
Residential mortgage	1,540	718
Personal	812	902
Business and government	30,555	30,782
<b>Total international</b>	<b>32,907</b>	<b>32,402</b>
<b>Total loans</b> (2)	<b>174,518</b>	<b>165,111</b>
<b>Allowance for loan losses</b>	<b>(1,871)</b>	<b>(1,884)</b>
<b>Total loans net of allowance for loan losses</b>	<b>\$ 172,647</b>	<b>\$ 163,227</b>

(1) Loans in Canada include all loans booked in Canada, regardless of currency or residence of borrower.

(2) Loans are net of unearned income of \$121 million (1999 – \$144 million).

**Impaired Loans**

	2000					1999	
	Gross	Specific allowance	Country risk allowance	General allowances	Net	Net	Net
Residential mortgage	\$ 185	\$ (28)	\$ –	\$ –	\$ 157	\$ 131	\$ 131
Personal	247	(196)	–	–	51	66	66
Business and government (1)	1,246	(523)	(28)	–	695	687	687
General allowances for loan losses	–	–	–	(1,102)	(1,102)	(1,080)	(1,080)
	\$ 1,678	\$ (747)	\$ (28)	\$ (1,102)	\$ (199)	\$ (196)	\$ (196)

(1) Includes specific allowances related to loan substitute securities of \$6 million (1999 – \$16 million).

**Allowance for Loan Losses**

	2000						1999	
	Balance at beginning of year	Write-offs	Recoveries	Provision for credit losses	Other	Balance at end of year	Balance at end of year	
Residential mortgage	\$ 53	\$ (11)	\$ –	\$ 6	\$ (2)	\$ 46	\$ 53	
Personal	344	(372)	44	344	43	403	344	
Credit card	60	(150)	48	130	–	88	60	
Business and government (1)	1,153	(306)	70	164	20	1,101	1,153	
General unallocated allowance	290	–	–	47	–	337	290	
	\$ 1,900	\$ (839)	\$ 162	\$ 691	\$ 61	\$ 1,975	\$ 1,900	
Specific allowances	\$ 786	\$ (839)	\$ 162	\$ 571	\$ 67	\$ 747	\$ 786	
Country risk allowances	34	–	–	–	(6)	28	34	
General allowance								
General allocated	790	–	–	73	–	863	790	
General unallocated	290	–	–	47	–	337	290	
Total general allowance for credit losses	1,080	–	–	120	–	1,200	1,080	
Total allowance for credit losses	\$ 1,900	\$ (839)	\$ 162	\$ 691	\$ 61	\$ 1,975	\$ 1,900	
Allowance for off-balance sheet and other items (2)						(98)	–	
Allowance for loan substitute securities						(6)	(16)	
<b>Total allowance for loan losses</b>						<b>\$ 1,871</b>	<b>\$ 1,884</b>	

(1) Includes \$6 million (1999 – \$16 million) related to loan substitute securities and \$98 million related to off-balance sheet and other items.

(2) During 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.

## Note 5: Premises and Equipment

	2000			1999
	Cost	Accumulated depreciation	Net book value	Net book value
Land	\$ 93	\$ –	\$ 93	\$ 111
Buildings	458	(207)	251	242
Hardware and software	1,389	(953)	436	442
Furniture, fixtures and other equipment	614	(409)	205	218
Leasehold improvements	707	(443)	264	307
	<b>\$ 3,261</b>	<b>\$ (2,012)</b>	<b>\$ 1,249</b>	<b>\$ 1,320</b>

## Note 6: Subordinated Debentures

The debentures are unsecured obligations and are subordinated in right of payment to the claims of depositors and certain other creditors. All repurchases, cancellations and exchanges of subordinated debentures

are subject to the consent and approval of the Superintendent of Financial Institutions Canada.

Maturity	Rate		Denominated in foreign currency	2000	1999
July 1, 2000	11.00%			\$ –	\$ 20
January 31, 2001	11.75%			27	27
August 15, 2001	10.75%			15	15
January 11, 2002	11.00%			41	41
March 1, 2002	10.50%			60	60
July 29, 2005	(1)	Callable (2)	US\$350	533	516
September 3, 2007	5.40% (3)	Callable (4)		400	400
September 3, 2008	5.45% (5)	Callable (4)		100	100
April 12, 2009	5.40% (6)	Callable (4)		350	350
June 11, 2009	5.10% (7)	Callable (4)		350	350
July 7, 2009	6.05% (8)	Callable (4)		175	175
October 12, 2009	6.00% (9)	Callable (4)		150	150
August 15, 2010	6.40% (10)	Callable (4)		700	–
April 26, 2011	8.20% (11)	Callable (12)		100	100
September 12, 2011	6.50% (13)	Callable (4)		350	350
October 24, 2011	6.75% (14)	Callable (2)	US\$300	457	441
June 4, 2012	6.75% (15)	Callable (4)		500	500
November 14, 2014	10.00%			200	200
January 25, 2015	7.10% (16)	Callable (4)		500	–
June 8, 2023	9.30%			110	110
October 1, 2083	(17)	Callable (18)		250	250
June 6, 2085	(19)	Callable (2)	US\$300	457	441
				<b>\$ 5,825</b>	<b>\$ 4,596</b>

(1) Interest at a rate of .0625% above the U.S. dollar 1-month LIBOR.

(2) Callable at the principal amount.

(3) Interest at a rate of 5.40% until September 3, 2002, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(4) Callable at the greater of (i) the yield of Government of Canada bonds plus 5 basis points, or (ii) the principal amount.

(5) Interest at a rate of 5.45% until September 3, 2003, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(6) Interest at a rate of 5.40% until April 12, 2004, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(7) Interest at a rate of 5.10% until June 11, 2004, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(8) Interest at a rate of 6.05% until July 7, 2004, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(9) Interest at a rate of 6.00% until October 12, 2004, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(10) Interest at a rate of 6.40% until August 15, 2005, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(11) Interest at a rate of 8.20% until April 26, 2006, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(12) Callable at the greater of (i) the yield of Government of Canada bonds plus 10 basis points, or (ii) the principal amount.

(13) Interest at a rate of 6.50% until September 12, 2006, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(14) Interest at a rate of 6.75% until October 24, 2006, and thereafter at a rate of 1.00% above the U.S. dollar 6-month LIBOR.

(15) Interest at a rate of 6.75% until June 4, 2007, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(16) Interest at a rate of 7.10% until January 25, 2010, and thereafter at a rate of 1.00% above the 90-day Bankers' Acceptance rate.

(17) Interest at a rate of .40% above the 30-day Bankers' Acceptance rate.

(18) Callable at an amount not exceeding 100.5% of the principal amount plus accrued and unpaid interest up to the date of redemption.

(19) Interest at a rate of .25% above the U.S. dollar 3-month LIMEAN. In the event of a reduction of the annual dividend declared by the bank on its Common Shares, the interest payable on the debentures is reduced pro rata to the dividend reduction and the interest reduction is payable with the proceeds from the sale of Common Shares.

### Repayment Schedule

The aggregate maturities of the debentures, assuming the earliest possible dates of maturity under the terms of issue, are as follows:

2001	\$ 42
2002	101
2003	–
2004	–
2005	533
2006 to 2010	2,225
Thereafter	2,924
	<b>\$ 5,825</b>

## Note 7: Capital Stock

### Authorized Capital Stock

**Preferred** – An unlimited number of First Preferred Shares and Second Preferred Shares without nominal or par value, issuable in series; the aggregate consideration for which all the First Preferred Shares and all the Second Preferred Shares that may be issued may not exceed \$5 billion in each case.

**Common** – An unlimited number of shares without nominal or par value, provided that the aggregate consideration for which all common shares may be issued shall not exceed \$10 billion.

### Issued and Outstanding Capital Stock

	2000			1999			1998		
	Number of shares (000s)	Amount	Dividends declared per share	Number of shares (000s)	Amount	Dividends declared per share	Number of shares (000s)	Amount	Dividends declared per share
<b>First Preferred</b>									
Non-cumulative Series E	1,500	\$ 150	\$ 5.38	1,500	\$ 150	\$ 4.69	1,500	\$ 150	\$ 5.00
Non-cumulative Series F (1)	–	–	–	–	–	2.25	6,000	150	2.25
Non-cumulative Series G (1)	–	–	–	–	–	2.13	10,000	250	2.13
Non-cumulative Series H	12,000	300	2.25	12,000	300	2.25	12,000	300	2.25
US\$ Non-cumulative Series I	8,000	304	US 1.91	8,000	294	US 1.91	8,000	308	US 1.91
Non-cumulative Series J	12,000	300	1.78	12,000	300	1.78	12,000	300	1.78
US\$ Non-cumulative Series K	10,000	381	US 1.58	10,000	368	US 1.58	10,000	386	US 1.58
Non-cumulative Series N	12,000	300	1.18	12,000	300	1.18	12,000	300	0.68
Non-cumulative Series O	6,000	150	1.38	6,000	150	0.58	–	–	–
US\$ Non-cumulative Series P	4,000	152	US 1.44	4,000	147	US 0.61	–	–	–
		\$ 2,037			\$ 2,009			\$ 2,144	
<b>Common (2)</b>									
Balance at beginning of year	617,768	\$ 3,065		617,581	\$ 2,925		616,671	\$ 2,907	
Issued under the Stock Option Plan	2,700	59		953	17		910	18	
Issued on the acquisition of Richardson Greenshields Limited (3)	1,667	50		9,580	170		–	–	
Issued on the acquisition of RBC Dominion Securities Limited (4)	–	–		140	5		–	–	
Purchased for cancellation (5)	(19,737)	(98)		(10,486)	(52)		–	–	
Balance at end of year	602,398	\$ 3,076	\$ 1.14	617,768	\$ 3,065	\$ 0.94	617,581	\$ 2,925	\$ 0.88

### Terms of Preferred Shares

	Dividend per share (6)	Redemption date (7)	Redemption price (8)	Conversion dates	
				At the option of the bank (7), (9)	At the option of the holder (10)
<b>First Preferred</b>					
Non-cumulative Series E (11)	(11)	September 2, 2002	\$100.00	Not convertible	Not convertible
Non-cumulative Series H	\$0.562500	August 24, 2001	25.00	August 24, 2001	November 24, 2001
US\$ Non-cumulative Series I	US 0.476563	November 24, 2001	US 25.00	November 24, 2001	February 24, 2002
Non-cumulative Series J	0.443750	May 24, 2003	25.00	May 24, 2003	November 24, 2003
US\$ Non-cumulative Series K	US 0.393750	May 24, 2003	US 25.00	May 24, 2003	November 24, 2003
Non-cumulative Series N	0.293750	August 24, 2003	26.00	August 24, 2003	August 24, 2008
Non-cumulative Series O	0.343750	August 24, 2004	26.00	August 24, 2004	Not convertible
US\$ Non-cumulative Series P	US 0.359375	August 24, 2004	US 26.00	August 24, 2004	Not convertible

- On October 31, 1999, the bank redeemed the First Preferred Shares **Series F and G**.
- On October 5, 2000, the bank paid a stock dividend of one Common Share on each of its issued and outstanding Common Shares. The effect is the same as a two-for-one share split. All Common Share numbers have been restated to reflect the stock dividend.
- During the year the bank exchanged 4,701 (1999 – 4,606,341) Class B shares and 8,008,712 (1999 – nil) Class C shares issued by its wholly owned subsidiary, Royal Bank DS Holding Inc., on the acquisition of Richardson Greenshields Limited for 1,667,334 (1999 – 9,579,166) Common Shares.
- On November 1, 1998, the bank acquired all of the outstanding participating preferred shares of RBC Dominion Securities Limited in exchange for 140,000 Common Shares.
- During the year the bank repurchased 19,736,880 (1999 – 10,485,800) Common Shares pursuant to a normal course issuer bid announced in May 1999 and amended in February 2000. Purchases were made in the open market at market prices through the facilities of the Toronto and Montreal Stock Exchanges, and in accordance with stock exchange requirements. The amount and timing of purchases were determined by the bank. Premiums paid above the average carrying value of the Common Shares were charged to retained earnings. The cost of Common Shares repurchased was \$660 million (1999 – \$333 million), common stock was reduced by \$98 million (1999 – \$52 million) and retained earnings were reduced by \$562 million (1999 – \$281 million).
- Non-cumulative preferential dividends on First Preferred Shares **Series E** are payable, as and when declared by the Board of Directors, on the 12th day of every month. Non-cumulative preferential dividends on **Series H, I, J, K, N, O** and **P** are payable quarterly, as and when declared by the Board of Directors, on or about the 24th day of February, May, August and November.
- Subject to the consent of the Superintendent of Financial Institutions Canada and the requirements of the *Bank Act*, the bank may, on or after the dates specified above, redeem First Preferred Shares. All dollar figures relating to **Series I, K** and **P** should be read as U.S. dollars. First Preferred Shares may be redeemed (i) for cash, in the case of **Series E, H, I, J, and K** equal to the redemption price as stated above, in the case of **Series N** at a price per share of \$26, if redeemed during the 12-months commencing August 24, 2003, and decreasing by \$0.25 each 12-month period thereafter to a price per share of \$25 if redeemed on or after August 24, 2007, and in the case of **Series O** and **P** at a price per share of \$26 if redeemed during the 12-months commencing August 24, 2004, and decreasing by \$0.25 each 12-month period thereafter to a price per share of \$25 if redeemed on or after August 24, 2008, or (ii) by conversion, in the case of **Series H, I, J, and K** into that number of Common Shares determined by dividing the then-applicable redemption price by the greater of \$2.50 and 95% of the weighted average trading price of Common Shares at such time.
- Subject to the consent of the Superintendent of Financial Institutions Canada and the requirements of the *Bank Act*, the bank may purchase First Preferred Shares for cancellation at a purchase price, in the case of the **Series E, H, I, J, and K**, not exceeding the then-applicable redemption price specified above plus all declared and unpaid dividends, and, in the case of the **Series N, O, and P** at the lowest price or prices at which, in the opinion of the Board of Directors, such shares are obtainable.
- Subject to the approval of the Toronto and Montreal Stock Exchanges, the bank may, on or after the dates specified above, convert First Preferred Shares **Series N, O** and **P** into Common Shares of the bank. All dollar figures relating to **Series P** should be read as U.S. dollars. First Preferred Shares may be converted into that number of Common Shares determined by dividing the then-applicable redemption price by the greater of \$2.50 and 95% of the weighted average trading price of Common Shares at such time.
- Subject to the right of the bank to redeem or to find substitute purchasers, the holder may, on or after the dates specified above, convert First Preferred Shares into Common Shares of the bank. All dollar figures relating to **Series I** and **K** should be read as U.S. dollars. **Series H, I, J, K, and N** may be converted, quarterly, into that number of Common Shares determined by dividing the then-applicable redemption price by the greater of \$2.50 and 95% of the weighted average trading price of Common Shares at such time.
- The rights, privileges, restrictions and conditions attaching to the First Preferred Shares **Series E** were amended in 1997. Holders are entitled to receive, as and when declared by the Board of Directors, a monthly non-cumulative cash dividend that (i) floats in relation to the bank's Canadian prime rate and (ii) is adjusted upwards or downwards based on changes in market trading value. The annual dividend rate applicable to any month will in no event be less than the sum of .25% plus 55% of the average prime rate or greater than the sum of .25% plus 75% of the average prime rate.

**Note 7: Capital Stock** (continued)**Regulatory Capital**

The bank is subject to the regulatory capital requirements defined by the Superintendent of Financial Institutions Canada (OSFI), which includes the use of Canadian GAAP. Two measures of capital strength established by OSFI, based on standards issued by the Bank for International Settlements (BIS), are risk-adjusted capital ratios and the assets-to-capital multiple.

OSFI requires Canadian banks to maintain a minimum Tier 1 and Total capital ratio of 4% and 8%, respectively. However, OSFI has also formally established risk-based capital targets for deposit-taking institutions in Canada. These targets are a Tier 1 capital ratio of at least 7% and a Total capital ratio of at least 10%. At October 31, 2000, the bank's Tier 1 and Total capital ratios were 8.6% and 12.0%, respectively (1999 – 8.1% and 11.2%, respectively).

In the evaluation of the bank's assets-to-capital multiple, OSFI specifies that total assets, including specified off-balance sheet financial instruments, should be no greater than 20 times Total capital. At October 31, 2000, the bank's assets-to-capital multiple was 15.3 times (1999 – 16.5 times).

During the year, the bank issued \$650 million of Trust Capital Securities (RBC TruCS), a form of innovative Tier 1 capital, which are reported as Non-controlling interest in a subsidiary on the consolidated balance sheet.

**Other Developments**

On October 27, 2000, the bank entered into a five-year agreement with a AAA rated reinsurer, which requires the reinsurer to purchase up to \$200 million of Non-cumulative first preferred shares at the October 27, 2000 market price should the general allowance for credit losses be drawn down below a certain level. If these shares had been issued today they would qualify as Tier 1 capital.

On October 30, 2000, the bank filed a preliminary prospectus providing for an issuance of a second series of innovative Tier 1 capital, Trust Capital Securities (RBC TruCS), of up to \$750 million.

## Note 8: Income Taxes

	2000	1999	1998
<b>Provision for income tax in income</b>			
Current			
Canada – Federal	\$ 799	\$ 580	\$ 501
Provincial	349	234	302
International	258	176	153
	1,406	990	956
Deferred			
Canada – Federal	60	38	191
Provincial	20	(3)	28
International	(41)	(10)	–
	39	25	219
	\$ 1,445	\$ 1,015	\$ 1,175
<b>Income tax expense (benefit) in shareholders' equity</b>			
Unrealized foreign currency translation gains and losses, net of hedging activities	(37)	213	(299)
<b>Total income taxes</b>	\$ 1,408	\$ 1,228	\$ 876

**Deferred Income Taxes (temporary differences)**

	2000	1999	1998
<b>Deferred income tax asset</b> <sup>(1)</sup>			
Allowance for credit losses	\$ 514	\$ 509	\$ 364
Premises and equipment	83	–	118
Deferred income	81	62	–
Deferred compensation	78	19	7
Tax loss carryforwards	72	19	233
Other	223	335	277
	1,051	944	999
<b>Deferred income tax liability</b>			
Pension expense	(119)	(141)	(128)
Deferred expense	(59)	–	–
Premises and equipment	–	(29)	–
Other	(77)	(171)	(141)
	(255)	(341)	(269)
<b>Net deferred income tax asset</b>	\$ 796	\$ 603	\$ 730

(1) The bank has determined that it is more likely than not that its deferred income tax asset will be realized through a combination of future reversals of temporary differences and taxable income.

**Reconciliation to Statutory Tax Rate**

	2000		1999		1998	
Income taxes at Canadian statutory tax rate	\$ 1,600	42.8%	\$ 1,194	43.0%	\$ 1,319	42.9%
Increase (decrease) in income taxes resulting from						
Lower average tax rate applicable to subsidiaries	(311)	(8.3)	(199)	(7.1)	(167)	(5.4)
Tax-exempt income from securities	(7)	(.2)	(10)	(.4)	(10)	(.4)
Other	163	4.3	30	1.0	33	1.1
Income taxes reported in income/effective tax rate	\$ 1,445	38.6%	\$ 1,015	36.5%	\$ 1,175	38.2%

Foreign earnings of certain subsidiaries would be taxed only upon their repatriation to Canada. The bank has not recognized a deferred tax liability for these undistributed earnings as management does not currently expect them to be repatriated. Taxes that would be payable if all foreign

subsidiaries' accumulated unremitted earnings were repatriated are estimated at \$737 million as at October 31, 2000 (1999 – \$729 million; 1998 – \$696 million).

## Note 9: Employee Benefit Plans

**Pension Plan**

	2000	1999
<b>Change in adjusted market value of plan assets</b>		
Adjusted market value of plan assets at beginning of year	\$ 4,076	\$ 3,631
Actual return on plan assets	326	350
Company contributions	13	77
Plan participant contributions	18	19
Benefits paid	(197)	(183)
Experience gains	112	235
Foreign currency exchange rate changes	(12)	(12)
Change in valuation allowance	(4)	(1)
Transfers to other plans	(11)	(40)
Adjusted market value of plan assets at end of year (1)	\$ 4,321	\$ 4,076
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	\$ 3,583	\$ 3,315
Service cost	107	99
Interest cost	254	240
Plan participant contributions	18	19
Actuarial loss	88	125
Benefits paid	(197)	(183)
Transfers to other plans	(4)	(34)
Plan amendments	15	11
Foreign currency exchange rate changes	(15)	(9)
Benefit obligation at end of year	\$ 3,849	\$ 3,583
<b>Funded status</b>		
Overfunded status at end of year	\$ 472	\$ 493
Unrecognized net actuarial gain	(184)	(163)
Unrecognized transition obligation	(23)	(25)
Other	(4)	4
Prepaid benefit expense	\$ 261	\$ 309
<b>Weighted average assumptions as at October 31</b>		
Discount rate	7.0%	7.0%
Assumed long-term rate of return on plan assets	7.0%	7.0%
Rate of increase in future compensation	4.4%	4.4%

(1) Pension fund assets are carried at adjusted market values, where adjustments are made to bring the value of the assets to market value over a three-year period. The actual market value of the assets at October 31, 2000, is \$4,519 million (1999 – \$4,135 million).

**Pension Benefit Expense (1)**

	2000	1999	1998
Service cost	\$ 107	\$ 116	\$ 86
Interest cost	254	240	228
Expected return on plan assets	(288)	(274)	(254)
Amortization of transition asset	(2)	–	10
Amortization of prior service cost	22	22	–
Amortization of net pension surplus	–	(1)	–
Recognized net actuarial loss	(33)	(27)	(1)
Change in valuation allowance	4	1	14
<b>Pension benefit expense</b>	<b>\$ 64</b>	<b>\$ 77</b>	<b>\$ 83</b>

(1) An assumed discount rate of 7.0% (1999 – 7.0%; 1998 – 7.5%) was used to determine pension costs.

(2) Postretirement health and dental care and life insurance benefits cost was \$11 million in 2000 (1999 – \$11 million; 1998 – \$12 million).

## RESSOP

The bank offers a Royal Employee Savings and Share Ownership Plan (RESSOP) to its employees, whereby the bank contributes 50% of employees' contributions to a maximum of 3% of the employee's salary in the form of common shares.

The bank contributed \$39 million (1999 – \$40 million; 1998 – \$38 million), under the terms of RESSOP, towards the purchase of common shares. As at October 31, 2000, an aggregate of 16,475,698 common shares were held under RESSOP.

### Deferred Share Unit Plan

A Deferred Share Unit Plan is offered to certain senior executive officers and non-employee directors of the bank. Under this plan, each officer may choose to receive all or a percentage of their annual incentive bonus in the form of deferred share units (DSUs). This election to participate in the plan must be made prior to the beginning of the fiscal year. The DSUs attract dividends in the form of additional DSUs at the same rate as dividends on the common shares. Officers and directors are not allowed to convert the DSUs until termination or retirement. The value of the DSUs, when converted to cash, will be equivalent to the market value of the common shares at the time the conversion takes place. The value of the DSUs as at October 31, 2000, was \$26 million (1999 – \$20 million).

### Deferred Bonus Plan – Corporate & Investment Banking

A Deferred Bonus Plan is offered to certain key employees of the bank. Under this plan, a percentage of each employee's annual incentive bonus is deferred and attracts dividends at the same rate as dividends on common shares. The value of the deferred bonus paid will be equivalent to the original deferred bonus adjusted for dividends and changes in the market value of common shares at the time the bonus is received. The employee will receive the deferred bonus in equal amounts on the three year-end dates following. The value of the deferred bonus as at October 31, 2000, was \$81 million (1999 – \$26 million).

### Stock Option Plan

A Stock Option Plan is offered to certain key employees and non-employee directors of the bank. Under this plan, options are periodically granted to purchase common shares at prices not less than the market

price of such shares immediately prior to the grant date. The options vest over a 4-year period and are exercisable for periods not exceeding 10 years.

For all options issued prior to 2000, the bank uses the intrinsic value method of accounting. There is no compensation expense recognized for the options since on the day of the grant the options exercise price is not less than the market price of the underlying stock. When the options are exercised, the proceeds received are credited to common shares.

Beginning in 2000, the Stock Option Plan was amended and predominantly all new stock option grants have a Stock Appreciation Right (SAR) attached. This entitles a participant to elect to exercise either an option or the corresponding SAR. SARs can be exchanged for a cash amount equal to the difference between the exercise price and the closing price of the common shares on the day immediately preceding the day of exercise. Up to 100% of vested options can be exercised as SARs. The bank expects the SARs to be settled in cash and therefore accrues compensation expense on SARs over the vesting period equal to the excess of quoted market price at the balance sheet date over exercise price. The compensation expense recorded for the year ended October 31, 2000, in respect of this plan was \$52 million.

Of the total options outstanding at October 31, 2000, 1,931,182 options, all of which are exercisable, have exercise prices ranging from \$14.46 to \$15.68, or \$15.61 on average (\$15.61 exercisable), and an average remaining contractual life of 5.9 years; 11,647,448 options (2,497,648 exercisable) have exercise prices ranging from \$24.80 to \$36.90, or \$30.58 on average (\$25.36 exercisable), and an average remaining contractual life of 9.1 years; and 12,298,400 options (4,452,600 exercisable) have exercise prices ranging from \$38.22 to \$43.59, or \$39.32 on average (\$39.43 exercisable), and an average remaining contractual life of 8.5 years.

The fair value of options granted in 2000, 1999 and 1998 is estimated using an option pricing model with the following assumptions: i) risk-free interest rate of 6.04% (1999 – 5.10%; 1998 – 4.75%), ii) expected option life of 10 years, iii) expected volatility of 22% (1999 and 1998 – 23%) and iv) expected dividends of 2.60% (1999 – 2.80%; 1998 – 2.78%). The fair value of each option granted in 2000 was \$10.26 (1999 – \$10.93; 1998 – \$10.70).

### Stock Options

	2000		1999		1998	
	Number of options (000s)	Weighted average exercise price	Number of options (000s)	Weighted average exercise price	Number of options (000s)	Weighted average exercise price
Outstanding at beginning of year	20,966	\$ 32.42	15,422	\$ 28.66	10,010	\$ 20.70
Granted	8,286	33.09	6,828	39.01	6,458	39.64
Exercised	(2,700)	22.05	(953)	17.83	(910)	18.86
Cancelled	(675)	36.10	(331)	35.50	(136)	30.15
Outstanding at end of year	25,877	\$ 33.62	20,966	\$ 32.42	15,422	\$ 28.66
Exercisable at end of year	8,881	\$ 30.29	5,988	\$ 25.29	2,898	\$ 18.84
Available for grant	26,502		9,113		14,310	

## Note 10: Restructuring Charges

There were no restructuring charges in 2000. As at October 31, 2000, the remaining accrual balance in Other liabilities was \$49 million, of which \$22 million relates to staff reductions, \$21 million relates to

Occupancy, \$2 million relates to dispositions of equipment and \$4 million relates to Other expenses.

	Accrual balance 1999	Amount utilized	Accrual balance 2000
Human resources	\$ 54	\$ 32	\$ 22
Occupancy	71	50	21
Equipment	5	3	2
Other	17	13	4
<b>Total restructuring charges</b>	<b>\$ 147</b>	<b>\$ 98</b>	<b>\$ 49</b>

## Note 11: Earnings per Share

	2000	1999	1998
<b>Basic earnings per share</b>			
Net income	\$ 2,274	\$ 1,757	\$ 1,824
Dividends on preferred shares	(134)	(157)	(145)
Net income available to common shareholders	\$ 2,140	\$ 1,600	\$ 1,679
Average number of common shares outstanding	606,389	626,158	617,324
	\$ 3.53	\$ 2.55	\$ 2.72
<b>Fully diluted earnings per share</b>			
Net income available to common shareholders	\$ 2,140	\$ 1,600	\$ 1,679
Imputed income (1)	24	27	27
Net income adjusted for diluted computation	\$ 2,164	\$ 1,627	\$ 1,706
Weighted average number of shares outstanding	606,389	626,158	617,324
Convertible Class B and C shares (2)	–	2,708	12,082
Stock options (1)	17,939	20,434	14,634
Weighted average fully diluted number of shares outstanding	624,328	649,300	644,040
	\$ 3.47	\$ 2.51	\$ 2.65

- (1) The dilutive effect of stock options was computed by assuming the issuance of the weighted average number of stock options outstanding at the end of the period. Included in the net income is an imputed income amount, which comprises (a) the after-tax return of investing the proceeds from options exercised at an assumed investment rate, and (b) the dividends calculated for the Class B and C shares identified in the note below.
- (2) The convertible shares include the Class B and C shares issued by the bank's wholly owned subsidiary Royal Bank DS Holding Inc., on the acquisition of Richardson Greenshields Limited on November 1, 1996. The Class B shares are exchangeable into Royal Bank of Canada Common Shares, while the exchange of the Class C shares is determined based on the bank's average Common Share price during the 20 days prior to the date the exchange is made. During the year the bank exchanged 4,701 (1999 – 4,606,341) Class B shares and 8,008,712 (1999 – nil) Class C shares for 1,667,334 (1999 – 9,579,166) Common Shares. The remaining Class B and C shares outstanding are excluded from the weighted average number of shares calculation in 2000, as they are anti-dilutive.

## Note 12: Commitments and Contingencies

### Financial Instruments with Contractual Amounts Representing Credit Risk

The primary purpose of these commitments is to ensure that funds are available to a customer as required. The bank's policy for requiring collateral security with respect to these instruments and the types of collateral security held is generally the same as for loans.

Guarantees and standby letters of credit, which represent irrevocable assurances that the bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the bank on behalf of a customer authorizing

a third party to draw drafts on the bank up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods to which they relate.

In securities lending transactions, the bank acts as an agent for the owner of a security, who agrees to lend the security to a borrower for a fee, under the terms of a pre-arranged contract. The borrower must fully collateralize the security loan at all times.

Commitments to extend credit represent unused portions of authorizations to extend credit in the form of loans, bankers' acceptances, guarantees or letters of credit.

### Financial Instruments with Contractual Amounts Representing Credit Risk

	2000	1999
Guarantees and standby letters of credit	\$ 13,658	\$ 14,130
Documentary and commercial letters of credit	456	585
Securities lending	20,333	19,833
Commitments to extend credit		
Original term to maturity of 1 year or less	97,966	83,425
Original term to maturity of more than 1 year	41,599	45,761
Note issuance/revolving underwriting facilities	155	125
	<b>\$ 174,167</b>	<b>\$ 163,859</b>

### Lease Commitments

Minimum future rental commitments for premises and equipment under long-term non-cancellable leases for the next five years and thereafter are shown below.

#### Lease Commitments

2001	\$ 249
2002	217
2003	188
2004	170
2005	157
Thereafter	921
Total	<b>\$ 1,902</b>

### Litigation

Various legal proceedings are pending that challenge certain practices or actions of the bank and its subsidiaries. Many of these proceedings are loan-related and are in reaction to steps taken by the bank and its subsidiaries to collect delinquent loans and enforce rights in collateral securing such loans. Management considers that the aggregate liability resulting from these proceedings will not be material.

### Pledged Assets

Securities with a carrying value of \$27.6 billion (1999 – \$30.3 billion) have been pledged as collateral for various types of funding transactions including obligations related to assets sold under repurchase agreements and obligations related to securities sold short. Included in the above amount are assets with a carrying value of \$2.4 billion (1999 – \$1.3 billion) that have been deposited as collateral in order to participate in clearing and payment systems and depositories or to have access to the facilities of central banks in foreign jurisdictions.

### Acquisitions

#### *Liberty Life Insurance Company and Liberty Insurance Services Corporation*

On June 19, 2000, the bank announced it had reached an agreement to acquire Liberty Life Insurance Company and Liberty Insurance Services Corporation, which are the insurance subsidiaries and certain other subsidiaries of Liberty Corporation. Under the agreement, Liberty Corporation will receive proceeds of approximately US\$650 million consisting of a dividend from Liberty Life Insurance Company of up to US\$70 million and the balance in cash from the bank. This transaction closed on November 1, 2000, and will be accounted for using the purchase method. The excess of the purchase price over the estimated fair value of the net tangible assets acquired, which is approximately US\$110 million, will first be allocated to identifiable intangible assets, with the residual excess allocated to Goodwill. Goodwill amortization will be on a straight-line basis over 15 years.

#### *Dain Rauscher Corporation*

On September 28, 2000, the bank and Dain Rauscher Corporation (Dain Rauscher) announced that they signed a definitive merger agreement by which the bank will acquire Dain Rauscher. Dain Rauscher will be renamed RBC Dain Rauscher Wessels.

As a result of the merger, each Dain Rauscher common share will convert into the right to receive US\$95 in cash. The transaction is valued at US\$1.456 billion. The transaction will be accounted for using the purchase method and the excess of the purchase price over the estimated fair value of the net tangible assets acquired, which is approximately US\$947 million, will first be allocated to identifiable intangible assets, with the residual excess allocated to Goodwill. Goodwill amortization will be on a straight-line basis over 20 years. The merger, which is subject to regulatory approval, approval from the stockholders of Dain Rauscher and other customary closing conditions, is expected to be completed during the bank's first quarter of fiscal 2001.

## Note 13: Derivative Financial Instruments

Derivative financial instruments are financial contracts whose value is derived from an underlying interest rate, foreign exchange rate, equity or commodity instrument or index.

### Derivative Product Types

The bank uses the following derivative financial instruments for both trading and non-trading purposes.

Swaps are transactions in which two parties exchange cash flows on a specified notional amount for a predetermined period. For interest rate swaps, fixed and floating interest payments are exchanged based on a notional amount. Cross currency swaps involve the exchange of fixed or floating interest payments in one currency for the receipt of fixed or floating interest payments in another currency. Cross currency interest rate swaps involve the exchange of both interest and principal amounts in two different currencies.

Forwards and futures are contractual obligations to buy or sell a financial instrument on a future date at a specified price. Forward contracts are effectively tailor-made agreements that are transacted between counterparties in the over-the-counter market, whereas futures are standardized contracts that are transacted on regulated exchanges.

Options are contractual agreements under which the seller (writer) grants the purchaser the right, but not the obligation, either to buy (call option) or sell (put option), by or at a set date, a specified amount of a financial instrument at a predetermined price. The seller receives a premium from the purchaser for this right.

### Derivatives Held or Issued for Trading Purposes

Most of the bank's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers at competitive prices to enable them to transfer, modify or reduce current or expected risks. Trading involves market-making, positioning and arbitrage activities. Market-making involves quoting bid and offer prices to other market participants with the intention of generating revenues based on spread and volume. Positioning involves managing market risk positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage activities involve identifying and profiting from price differentials between markets and products. The bank does not deal, to any significant extent, in leveraged derivative transactions. These transactions contain a multiplier which, for any given change in market prices, could cause the change in the transaction's fair value to be significantly different from the change in fair value that would occur for a similar derivative without the multiplier.

### Derivatives Held or Issued for Non-Trading Purposes

The bank also uses derivatives in connection with its own asset/liability management activities, which include hedging and investment activities.

Interest rate swaps are used to adjust exposure to interest rate risk by modifying the repricing or maturity characteristics of existing and/or anticipated assets and liabilities. As at October 31, 2000, the level of interest rate derivatives in place to hedge anticipated transactions, and accounted for as a hedge, was insignificant. Purchased interest rate options are used to hedge redeemable deposits and other options embedded in consumer products. Written options are used in the bank's asset/liability management activities when specifically linked to a purchased option in the form of a collar. The amount of the bank's deferred gains and losses associated with non-trading derivatives hedging anticipated transactions was insignificant.

### Derivatives – Notional Amounts and Replacement Cost

The tables following provide the notional amounts and gross positive replacement cost of the bank's derivative transactions. Notional amounts, which are off-balance sheet, serve as a point of reference for calculating payments and are a common measure of business volume. The gross replacement cost of derivatives represents the total current replacement value of all outstanding transactions in a gain position, before factoring in the impact of master netting agreements.

### Derivative-Related Credit Risk

Credit risk from derivative transactions is generated by the potential for the counterparty to default on its contractual obligations when one or more transactions have a positive market value to the bank. This market value is referred to as replacement cost since it is an estimate of what it would cost to replace transactions at prevailing market rates if a default occurred.

For internal risk management purposes, the credit risk arising from a derivative transaction is defined as the sum of the replacement cost plus an add-on that is an estimate of the potential change in the market value of the transaction through to maturity. The add-on is determined by statistically based models that project the expected volatility of the variable(s) underlying the derivative, whether interest rate, foreign exchange rate, equity or commodity price. Both the replacement cost and the add-on are continually re-evaluated over the life of each transaction to ensure that sound credit risk valuations are used.

Netting is a technique that can reduce credit exposure from derivatives and is generally facilitated through the use of master netting agreements. The two main categories of netting are close-out netting and settlement netting. Under the close-out netting provision, if the counterparty defaults, the bank has the right to terminate all transactions covered by the master agreement at the then-prevailing market values and to sum the resulting market values, offsetting negative against positive values, to arrive at a single net amount owed by either the counterparty or the bank. Under the settlement netting provision, all payments and receipts in the same currency and due on the same day between specified pairs of bank and counterparty units are netted, generating a single payment in each currency, due either by the bank or the counterparty unit. The bank actively encourages counterparties to enter into master netting agreements. However, measurement of the bank's credit exposure arising out of derivative transactions is not reduced to reflect the effects of netting unless the enforceability of that netting is supported by appropriate legal analysis as documented in bank policy.

To further manage derivative-related counterparty credit exposure, the bank enters into agreements containing mark-to-market cap provisions with some counterparties. Under such provisions, the bank has the right to request that the counterparty pay down or collateralize the current market value of its derivatives position with the bank. The use of collateral does not currently represent a significant credit mitigation technique for the bank in managing derivative-related credit risk.

The bank subjects its derivative-related credit risks to the same credit approval, limit and monitoring standards that it uses for managing other transactions that create credit exposure. This includes evaluation of counterparties as to creditworthiness, and managing the size, diversification and maturity structure of the portfolio. Credit utilization for all products is compared with established limits on a continual basis and is subject to a standard exception reporting process. The bank utilizes a

single internal rating system for all credit risk exposure. In most cases, these internal ratings approximate the external risk ratings of public rating agencies. The table below shows replacement cost, both before and after the impact of netting, of the bank's derivatives by risk rating and by counterparty type. During 2000 and 1999, neither the bank's actual credit losses arising from derivative transactions nor the level of impaired derivative contracts were significant.

### Replacement Cost of Derivative Financial Instruments by Risk Rating and by Counterparty Type

As at October 31, 2000	Risk rating (1)					Counterparty type (2)			
	AAA, AA	A	BBB	BB or lower	Total	Banks	OECD governments	Other	Total
Gross positive replacement cost (3)	\$ 11,588	\$ 6,693	\$ 1,692	\$ 590	\$ 20,563	\$ 13,035	\$ 1,846	\$ 5,682	\$ 20,563
Impact of master netting agreements	(7,313)	(2,583)	(346)	(256)	(10,498)	(9,006)	-	(1,492)	(10,498)
Replacement cost (after netting agreements)	\$ 4,275	\$ 4,110	\$ 1,346	\$ 334	\$ 10,065	\$ 4,029	\$ 1,846	\$ 4,190	\$ 10,065
Replacement cost (after netting agreements) – 1999	\$ 4,336	\$ 2,758	\$ 762	\$ 485	\$ 8,341	\$ 4,535	\$ 1,390	\$ 2,416	\$ 8,341

(1) The bank's internal risk ratings for major counterparty types approximate those of public rating agencies. Ratings of AAA, AA, A and BBB represent investment grade ratings and ratings of BB and lower represent non-investment grade ratings.

(2) Counterparty type is defined in accordance with the capital adequacy requirements of the Superintendent of Financial Institutions Canada.

(3) Represents the total current replacement value of all outstanding contracts in a gain position, before factoring in the impact of master netting agreements.

### Notional Amount of Derivatives by Term to Maturity and Replacement Cost

	Term to maturity				2000			1999		
	Within 1 year	1 to 5 years	Over 5 years (1)	Total	Trading	Other than trading	Replacement cost (2)	Trading	Other than trading	Replacement cost (2)
<b>Over-the-counter (OTC) contracts</b>										
Interest rate contracts										
Forward rate agreements	\$ 15,966	\$ 552	\$ -	\$ 16,518	\$ 16,518	\$ -	\$ 7	\$ 28,822	\$ -	\$ 19
Swaps	157,262	280,770	92,620	530,652	477,038	53,614	4,517	394,090	77,796	4,475
Options purchased	20,876	6,658	4,161	31,695	31,564	131	168	41,444	2,170	230
Options written	19,951	8,068	4,619	32,638	32,306	332	-	44,155	2,783	-
Foreign exchange contracts										
Forward contracts	526,672	25,699	2,496	554,867	540,790	14,077	10,878	616,867	8,379	8,336
Cross currency swaps	708	2,144	2,436	5,288	4,836	452	180	3,812	390	123
Cross currency interest rate swaps	19,146	23,965	14,649	57,760	49,186	8,574	2,456	36,457	11,491	1,371
Options purchased	45,251	2,149	-	47,400	47,212	188	934	46,425	29	826
Options written	51,179	2,243	41	53,463	53,275	188	-	55,599	29	-
Other contracts (3)	11,038	3,694	1,683	16,415	16,415	-	1,423	11,608	-	892
<b>Exchange-traded contracts</b>										
Interest rate contracts										
Futures – long positions	12,218	2,750	6	14,974	14,544	430	-	20,971	1,897	-
Futures – short positions	16,542	4,196	11	20,749	19,949	800	-	15,458	880	-
Options purchased	12,117	-	-	12,117	12,117	-	-	6,192	-	-
Options written	18,909	-	-	18,909	18,909	-	-	6,087	-	-
Foreign exchange contracts										
Futures – long positions	534	1	-	535	535	-	-	53	-	-
Futures – short positions	15	2	-	17	17	-	-	610	-	-
Other contracts (3)	34,905	14,120	-	49,025	49,025	-	-	21,191	-	-
	\$ 963,289	\$ 377,011	\$ 122,722	\$ 1,463,022	\$ 1,384,236	\$ 78,786	\$ 20,563	\$ 1,349,841	\$ 105,844	\$ 16,272
Impact of master netting agreements										
With intent to settle net or simultaneously (4)							\$ (27)			(18)
Without intent to settle net or simultaneously (5)							(10,471)			(7,913)
							\$ 10,065			\$ 8,341

(1) Includes contracts maturing in over 10 years with a notional value of \$12,390 million and related gross positive replacement cost of \$329 million.

(2) 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 contracts are excluded from this presentation as the credit risk associated with these instruments is minimal since they are settled in cash on a daily basis. Written options are excluded as they represent obligations of the bank and as such do not attract credit risk.

(3) Comprised of precious metals, commodity and equity-linked contracts.

(4) Impact of offsetting credit exposures on contracts where the bank has both a legally enforceable master netting agreement in place and intends to settle the contracts on either a net basis or simultaneously.

(5) Additional impact of offsetting credit exposures on contracts where the bank has a legally enforceable master netting agreement in place but does not intend to settle the contracts on a net basis or simultaneously.

## Note 14: Concentrations of Credit Risk

Concentrations of credit risk exist if a number of customers are engaged in similar activities, or 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. Concentrations of credit risk indicate the relative sensitivity of the bank's performance to developments affecting a particular industry or geographic location. Management does not believe that the concentrations described below are unusual.

### On-Balance Sheet Assets

Of the \$186 billion (1999 – \$174 billion) in total loans and acceptances before loan allowances, 83% (1999 – 81%) relates to borrowers located in Canada with the largest provincial concentrations being Ontario – 39% (1999 – 39%) and British Columbia – 14% (1999 – 13%). No industry or foreign jurisdiction accounts for more than 10% of total loans.

### Off-Balance Sheet Financial Instruments

*Financial instruments with contractual amounts representing credit risk*  
Of the \$174 billion (1999 – \$164 billion) in off-balance sheet financial instruments with contractual amounts representing credit risk as at October 31, 2000, approximately 51% relates to Canada, 33% to the United States and 11% to Europe (1999 – 49%, 34% and 14%, respectively).

Included in the \$174 billion of these credit instruments are commitments to extend credit totalling \$140 billion (1999 – \$129 billion), of which 49% relates to Canada, 33% to the United States and 11% to Europe (1999 – 46%, 35% and 16%, respectively). Of the commitments to extend credit, the largest industry concentration relates to financial institutions (37%), mining and energy (13%), transportation (11%) and manufacturing (10%) (1999 – 32%, 16%, 12% and 13%, respectively). No other industry sector accounts for more than 10% of the total.

### Derivatives

Credit risk represents the current replacement value of all outstanding over-the-counter derivative contracts in a gain position without factoring in the impact of master netting agreements or the value of any collateral. Credit risk totalled \$20.6 billion and \$16.3 billion as at October 31, 2000 and 1999, respectively. Based on the location of the ultimate counterparty, 42% of this credit risk amount relates to Europe, 28% to the United States, 22% to Canada and 7% to Asia Pacific (1999 – 41%, 24%, 22% and 12%, respectively).

The largest concentration by counterparty type of this credit risk exposure is with banks at 61% (1999 – 68%).

## Note 15: Estimated Fair Value of Financial Instruments

The estimated fair values are designed to approximate values at which these instruments could be exchanged in a current transaction between willing parties. However, many of the financial instruments lack an available trading market and therefore, fair values are based on estimates using net present value and other valuation techniques, which are significantly affected by the assumptions used concerning the amount and timing of estimated future cash flows and discount rates, which reflect varying degrees of risk. Furthermore, due to the use of subjective judgment

and uncertainties, the aggregate fair value amounts should not be interpreted as being realizable in an immediate settlement of the instruments.

The estimated fair values disclosed below do not reflect the value of assets and liabilities that are not considered financial instruments such as "premises and equipment." In addition, the values of other non-financial assets and liabilities, such as intangible values of customer relationships, have been excluded.

### Financial Instruments

	2000			1999		
	Book value	Fair value	Difference	Book value	Fair value	Difference
<b>Financial assets</b>						
Cash resources (1)	\$ 19,606	\$ 19,606	\$ –	\$ 23,042	\$ 23,042	\$ –
Securities (2)	57,010	56,919	(91)	50,559	50,418	(141)
Loans (3)	172,647	173,552	905	163,227	163,231	4
Customers' liability under acceptances (1)	11,628	11,628	–	9,257	9,257	–
Other assets (4)	25,680	25,788	108	21,720	21,717	(3)
<b>Financial liabilities</b>						
Deposits (5)	202,896	204,386	(1,490)	187,897	189,209	(1,312)
Acceptances (1)	11,628	11,628	–	9,257	9,257	–
Obligations related to securities sold short (1)	13,419	13,419	–	17,885	17,885	–
Obligations related to assets sold under repurchase agreements (1)	9,005	9,005	–	9,396	9,396	–
Other liabilities (4)	32,723	32,723	–	28,901	28,901	–
Subordinated debentures (6)	5,825	5,809	16	4,596	4,523	73

(1) Due to their short-term maturity, the carrying values of certain on-balance sheet financial instruments are assumed to approximate their fair values.

(2) The estimated fair values are provided in the Securities note to the consolidated financial statements (note 3). These are based on quoted market prices, when available. If quoted market prices are not available, fair values are estimated using quoted market prices of similar securities.

(3) For certain variable rate loans that reprice frequently, fair values are assumed to be equal to the carrying values. The fair values of other loans are estimated through a discounted cash flow calculation that applies market interest rates currently charged for similar new loans to expected maturity amounts.

(4) The carrying values of Other assets and Other liabilities approximate their fair values with the exception of amounts relating to derivative financial instruments held or issued for other than trading purposes. The net fair value over book value for these instruments is shown in Other assets.

(5) The fair values of deposits with no stated maturity are assumed to be equal to their carrying values. The estimated fair values of fixed rate deposits are determined by discounting the expected cash flows, using market interest rates currently offered for deposits of similar remaining maturities (adjusted for early redemptions where appropriate).

(6) The fair values of the debentures are based on quoted market prices for similar issues, or current rates offered to the bank for debt of the same remaining maturity.

## Derivative Financial Instruments (1)

	2000				1999	
	Average fair value for the year ended (2)		Year-end fair value		Year-end fair value	
	Positive	Negative	Positive	Negative	Positive	Negative
<b>Held or issued for trading purposes</b>						
Interest rate contracts						
Forward rate agreements	\$ 10	\$ 9	\$ 7	\$ 4	\$ 19	\$ 27
Swaps	3,952	4,545	3,845	4,574	3,723	4,337
Options purchased	192	–	168	–	227	–
Options written	–	161	–	136	–	203
	4,154	4,715	4,020	4,714	3,969	4,567
Foreign exchange contracts						
Forward contracts	8,620	8,185	10,683	9,722	8,272	7,857
Cross currency swaps	127	121	91	125	122	109
Cross currency interest rate swaps	1,644	1,163	2,164	1,830	1,270	955
Options purchased	723	–	934	–	826	–
Options written	–	654	–	950	–	733
	11,114	10,123	13,872	12,627	10,490	9,654
Other contracts	1,143	1,182	1,423	1,178	892	1,094
	\$ 16,411	\$ 16,020	\$ 19,315	\$ 18,519	\$ 15,351	\$ 15,315
<b>Held or issued for other than trading purposes</b>						
Interest rate contracts						
Swaps			\$ 672	\$ 256	\$ 752	\$ 301
Options purchased			–	–	3	–
Options written			–	7	–	8
			672	263	755	309
Foreign exchange contracts						
Forward contracts			195	310	64	43
Cross currency swaps			89	89	1	29
Cross currency interest rate swaps			292	252	101	334
			576	651	166	406
			\$ 1,248	\$ 914	\$ 921	\$ 715
<b>Total gross fair values before netting</b>			20,563	19,433	\$ 16,272	\$ 16,030
Impact of master netting agreements						
With intent to settle net or simultaneously (3)			(27)	(27)	(18)	(18)
Without intent to settle net or simultaneously (4)			(10,471)	(10,471)	(7,913)	(7,913)
<b>Total</b>			\$ 10,065	\$ 8,935	\$ 8,341	\$ 8,099

(1) The fair values of derivatives are presented on a gross basis before the impact of legally enforceable master netting agreements. The fair values of derivatives are determined using various methodologies including: quoted market prices, where available; prevailing market rates for instruments with similar characteristics and maturities; net present value analysis or other pricing models as appropriate.

(2) Average fair value amounts are calculated based on monthly balances.

(3) Impact of offsetting credit exposures on contracts where the bank has both a legally enforceable master netting agreement in place and intends to settle the contracts on either a net basis or simultaneously.

(4) Additional impact of offsetting credit exposures on contracts where the bank has a legally enforceable master netting agreement in place but does not intend to settle the contracts on a net basis or simultaneously.

## Note 16: Contractual Repricing and Maturity Schedule

The table below details the bank's exposure to interest rate risk as defined and prescribed by the Canadian Institute of Chartered Accountants handbook Section 3860, *Financial Instruments – Disclosure and Presentation*. On- and off-balance sheet financial instruments are reported based on the earlier of their contractual repricing date or maturity date. Effective interest rates have been disclosed where applicable. The effective rates shown represent historical rates for fixed rate instruments carried at amortized cost and current market rates for floating rate instruments or instruments carried at fair value.

The table below does not incorporate management's expectation of future events where expected repricing or maturity dates differ significantly from the contractual dates. The bank incorporates these assumptions in the management of its interest rate risk exposure. These assumptions include expected repricing of trading instruments and certain loans and deposits. Taking into account these assumptions on the consolidated contractual repricing and maturity schedule at October 31, 2000, would result in a change in the under-1-year gap from (\$27.8) billion to (\$12.1) billion (1999 – (\$26.9) billion to (\$5.3) billion).

### Carrying Amount by Earlier of Contractual Repricing or Maturity Date

	Immediately rate-sensitive	Under 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years	Non-interest- sensitive	Total
<b>Assets</b>								
Cash resources	\$ –	\$ 16,458	\$ 615	\$ 1,579	\$ 61	\$ –	\$ 893	\$ 19,606
Effective interest rate		5.00%	6.27%	6.94%	7.00%			
Securities								
Trading account	–	10,012	3,253	2,396	7,393	6,013	13,949	43,016
Effective interest rate		5.98%	6.04%	6.12%	6.04%	6.25%		
Investment account and loan substitute	–	4,209	1,936	997	5,038	989	825	13,994
Effective interest rate		5.82%	6.11%	6.49%	6.30%	8.12%		
Loans	37,718	53,553	8,573	11,186	57,694	4,478	(555)	172,647
Effective interest rate		7.58%	7.28%	7.35%	7.01%	7.70%		
Other assets	–	–	–	–	–	–	40,477	40,477
	37,718	84,232	14,377	16,158	70,186	11,480	55,589	289,740
<b>Liabilities</b>								
Deposits	68,353	78,132	12,768	18,104	24,459	1,080	–	202,896
Effective interest rate		5.71%	5.52%	5.67%	5.67%	5.59%		
Obligations related to securities sold short	–	319	95	383	4,427	4,210	3,985	13,419
Effective interest rate		6.21%	5.92%	6.10%	6.14%	6.20%		
Obligations related to assets sold under repurchase agreements	–	7,977	739	50	173	66	–	9,005
Effective interest rate		6.34%	6.20%	5.98%	6.03%	6.17%		
Other liabilities	–	–	–	–	–	–	44,351	44,351
Effective interest rate								
Subordinated debentures	–	1,267	–	15	2,326	2,217	–	5,825
Effective interest rate		5.74%		10.75%	5.98%	7.27%		
Non-controlling interest in subsidiaries	–	–	–	–	–	650	53	703
Effective interest rate						7.88%		
Shareholders' equity	150	–	–	300	1,135	300	11,656	13,541
Effective interest rate				9.00%	6.76%	4.70%		
	68,503	87,695	13,602	18,852	32,520	8,523	60,045	289,740
<b>On-balance sheet gap</b>	<b>(30,785)</b>	<b>(3,463)</b>	<b>775</b>	<b>(2,694)</b>	<b>37,666</b>	<b>2,957</b>	<b>(4,456)</b>	<b>–</b>
<b>Off-balance sheet financial instruments (1)</b>								
Derivatives used for asset liability management purposes								
Pay side instruments	–	(25,878)	(1,715)	(1,498)	(19,462)	(3,363)	–	(51,916)
Effective interest rate		5.96%	5.71%	6.68%	5.95%	6.24%		
Receive side instruments	–	27,619	2,992	5,105	11,796	4,404	–	51,916
Effective interest rate		6.34%	5.55%	6.20%	6.21%	6.42%		
Derivatives used for trading purposes	–	14,915	(3,203)	(9,985)	4,382	163	(6,272)	–
Effective interest rate		5.83%	5.83%	5.94%	5.94%	6.03%		
	–	16,656	(1,926)	(6,378)	(3,284)	1,204	(6,272)	–
<b>Total gap</b>	<b>\$ (30,785)</b>	<b>\$ 13,193</b>	<b>\$ (1,151)</b>	<b>\$ (9,072)</b>	<b>\$ 34,382</b>	<b>\$ 4,161</b>	<b>\$ (10,728)</b>	<b>\$ –</b>
Canadian dollar	(18,165)	(1,998)	4,484	(636)	32,951	2,649	(14,437)	4,848
Foreign currency	(12,620)	15,191	(5,635)	(8,436)	1,431	1,512	3,709	(4,848)
<b>Total gap</b>	<b>\$ (30,785)</b>	<b>\$ 13,193</b>	<b>\$ (1,151)</b>	<b>\$ (9,072)</b>	<b>\$ 34,382</b>	<b>\$ 4,161</b>	<b>\$ (10,728)</b>	<b>\$ –</b>
Canadian dollar – 1999	(18,044)	4,055	345	1,677	25,535	3,392	(12,769)	4,191
Foreign currency – 1999	(11,154)	(2,749)	(54)	(968)	4,899	6,038	(203)	(4,191)
<b>Total gap – 1999</b>	<b>\$ (29,198)</b>	<b>\$ 1,306</b>	<b>\$ 291</b>	<b>\$ 709</b>	<b>\$ 30,434</b>	<b>\$ 9,430</b>	<b>\$ (12,972)</b>	<b>\$ –</b>

(1) Represents net notional amounts.

## Note 17: Reconciliation of Canadian and United States Generally Accepted Accounting Principles

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP), including the accounting requirements of the Superintendent of Financial

Institutions Canada. As required by the United States Securities and Exchange Commission, material differences between Canadian and United States GAAP are described below.

### Summary of Reconciliation to U.S. GAAP

	2000			1999			1998		
	Net income	Shareholders' equity	Assets	Net income	Shareholders' equity	Assets	Net income	Shareholders' equity	Assets
Canadian GAAP	\$ 2,274	\$ 13,541	\$ 289,740	\$ 1,757	\$ 12,615	\$ 270,650	\$ 1,824	\$ 11,892	\$ 274,399
Reclassification of securities (1)	–	(56)	(46)	–	(85)	(85)	–	56	56
Postretirement benefits other than pensions (2)	(35)	(163)	123	(37)	(128)	97	(33)	(91)	70
Pension benefits (3)	–	(27)	(27)	(6)	(27)	(27)	(21)	(21)	(20)
Trade date accounting (4)	–	–	419	–	–	2,327	–	–	6,520
Merger consummation costs (5)	–	–	–	14	–	–	(14)	(14)	(23)
Insurance accounting (6)	(29)	(13)	416	16	16	283	–	–	–
Other (7)	(2)	15	3,429	(19)	17	53	16	36	72
<b>U.S. GAAP</b>	<b>\$ 2,208</b>	<b>\$ 13,297</b>	<b>\$ 294,054</b>	<b>\$ 1,725</b>	<b>\$ 12,408</b>	<b>\$ 273,298</b>	<b>\$ 1,772</b>	<b>\$ 11,858</b>	<b>\$ 281,074</b>
<b>Earnings per share</b>	<b>\$ 3.42</b>			<b>\$ 2.50</b>			<b>\$ 2.64</b>		
<b>Fully diluted earnings per share</b>	<b>\$ 3.40</b>			<b>\$ 2.48</b>			<b>\$ 2.58</b>		

- Under U.S. GAAP, Securities are classified as trading account (carried at estimated current market value), Available for sale (carried at estimated current market value) or Held to maturity (carried at amortized cost). The net unrealized gain (loss) on Available for sale securities, net of hedging activities and related income taxes, is reported as Other comprehensive income within Shareholders' equity. Under Canadian GAAP, Securities are classified as Investment account (carried at amortized cost) or Trading account (carried at estimated current market value). Classifying Securities in accordance with U.S. GAAP would decrease Securities by \$97 million, increase the related Deferred income taxes included in Other assets by \$43 million, increase Other assets by \$8 million and Other liabilities by \$10 million as a result of marking to market the instruments that hedge Available for sale securities, and decrease Shareholders' equity by \$56 million as at October 31, 2000.
- Under U.S. GAAP, the costs of postretirement benefits other than pensions are accrued over the working lives of employees in a manner similar to pension costs. Under Canadian GAAP, these costs are charged to income as incurred. The after-tax cost of providing postretirement benefits other than pensions in excess of the expenditures recognized under Canadian GAAP would decrease Net income under U.S. GAAP by \$35 million for the year ended October 31, 2000. The cumulative pre-tax cost would increase Other liabilities by \$286 million, the related Deferred income taxes would increase Other assets by \$123 million and Shareholders' equity would decrease by \$163 million as at October 31, 2000.
- Under U.S. GAAP, the assumed discount rate used to determine pension costs reflects the rate at which the pension benefit obligation could effectively be settled at the beginning of the fiscal year. Under Canadian GAAP, a long-term weighted average discount rate is used to determine pension costs. The cumulative pre-tax cost resulting from the application of U.S. GAAP to the bank's pension accounting would decrease Other assets by \$48 million, the related Deferred income taxes would increase Other assets by \$21 million and Shareholders' equity would decrease by \$27 million as at October 31, 2000.
- Under U.S. GAAP, trade date accounting for Securities is used for both the consolidated balance sheet and the consolidated income statement. The bank's practice under Canadian GAAP is settlement date accounting for the consolidated balance sheet and trade date accounting for the consolidated income statement. The application of trade date accounting to the bank's consolidated balance sheet would increase Securities by \$156 million, Other assets by \$263 million and Other liabilities by \$419 million as at October 31, 2000.
- Under U.S. GAAP, costs incurred to effect a business combination accounted for as a pooling of interests are expensed as incurred. As a result, merger consummation costs of \$24 million incurred in 1998 to effect the proposed merger with Bank of Montreal would be charged to income in 1998 under U.S. GAAP. Under Canadian GAAP, these costs were deferred as Other assets, and were to be charged directly to Retained earnings when the merger was consummated. Following the rejection of the proposed merger by the Minister of Finance in December 1998, the deferred costs amounting to \$24 million plus additional costs of \$12 million were charged to income in 1999 under Canadian GAAP. The \$36 million charged to income under Canadian GAAP exceeded, by \$24 million, the \$12 million that would be charged to income under U.S. GAAP in 1999. This would result in Net income under U.S. GAAP being \$14 million higher for the year ended October 31, 1999.
- There are differences between U.S. and Canadian GAAP with respect to life insurance premiums, investment accounting and actuarial reserving. These lead to timing differences in the charging or releasing of actuarial reserves to income and in the recognition of realized gains and losses on investments. The application of U.S. GAAP to the bank's insurance operations would decrease Net income by \$29 million for the year ended October 31, 2000. Also, excluding the effects of reclassification of Securities which are included in footnote (1) above, Other assets and Other liabilities would increase by \$402 million and \$429 million respectively, the related Deferred income taxes would increase Other assets by a further \$14 million and Shareholders' equity would decrease by \$13 million as at October 31, 2000.
- Other differences between U.S. and Canadian GAAP relate to the right of offset and other minor items. The net of these items would decrease Net income under U.S. GAAP by \$2 million for the year ended October 31, 2000, and would increase Shareholders' equity by \$15 million, Assets by \$3,429 million and liabilities by \$3,414 million as at October 31, 2000.

### Future Accounting Changes

Financial Accounting Standards Board Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133), as amended by FAS 138, is effective for the bank's fiscal year beginning November 1, 2000. Under the current accounting policy for derivatives, as described in note 1, only derivatives used in sales and trading activities are recorded on the balance sheet at fair value. FAS 133 will require that all derivative instruments be recorded on the consolidated balance sheet at fair value including derivatives embedded in financial instruments or contracts that are not clearly and closely related to the economic characteristics of the host financial instrument or contract. Changes in the fair value of derivatives will be recorded in Net income or, if the derivative is designated as a cash flow hedge, in Other comprehensive income within Shareholders' equity.

For fair value hedge transactions, in which the bank is hedging changes in the fair value of an asset, liability or firm commitment, changes in the fair value of the derivative instrument will generally be

offset in Net income by changes in the fair value of the hedged item relating to the risk being hedged. For cash flow hedge transactions, in which the bank is hedging the variability in cash flows related to a variable rate asset, liability or a forecasted transaction, the effective portion of the changes in the fair value of the derivative instrument will be reported in Other comprehensive income. The gains and losses on the derivative instrument that will be reported in Other comprehensive income will be reclassified to Net income in the periods in which Net income is affected by the variability in the cash flows of the hedged item. The ineffective portion of all hedges will be recognized in Net income.

On November 1, 2000, the bank will record a cumulative transition adjustment recognizing after-tax gains of \$20 million in Net income and \$60 million in Other comprehensive income. Assets will increase by \$540 million and liabilities by \$460 million as a result of recording all derivative instruments and all fair value hedged items on the consolidated balance sheet at fair value.