Annual Report 2013

NATIONAL BANK

AT A GLANCE

National Bank of Canada is an integrated provider of financial services to retail, commercial, corporate and institutional clients. It operates in three business segments—Personal and Commercial, Wealth Management and Financial Markets—with total assets in excess of $188 billion as at October 31, 2013.

Through its nearly 20,000 employees, National Bank offers a complete range of services: banking and investment solutions, securities brokerage, insurance and wealth management.

National Bank is the leading bank in Quebec and the partner of choice for small and medium-sized enterprises. It is also the sixth largest bank in Canada with branches in almost every province. Clients in the United States, Europe and other parts of the world are served through a network of representative offices, subsidiaries and partnerships.

Its head office is located in Montreal and its securities are listed on the Toronto Stock Exchange.

HIGHLIGHTS

The Bank's consolidated financial statements were prepared in accordance with the International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board and set out in the CPA Canada Handbook.

	2013	2012	% change
Operating Results			
(millions of Canadian dollars)			
Total revenues	$ 5,163	$ 5,313	(3)
Net income	1,554	1,634	(5)
Net income attributable to the Bank's shareholders	1,479	1,561	(5)
Return on common shareholders' equity	20.6 %	24.5 %	
Per Common Share *(dollars)*			
Earnings – Basic	$ 8.87	$ 9.40	(6)
Earnings – Diluted	8.80	9.32	(6)
EXCLUDING SPECIFIED ITEMS[1]			
Operating Results			
(taxable equivalent basis)[1]			
(millions of Canadian dollars)			
Total revenues	$ 5,242	$ 5,087	3
Net income	1,491	1,396	7
Net income attributable to the Bank's shareholders	1,416	1,323	7
Return on common shareholders' equity	19.7 %	20.7 %	
Per Common Share *(dollars)*			
Earnings – Basic	$ 8.48	$ 7.93	7
Earnings – Diluted	8.41	7.86	7
Per Common Share *(dollars)*			
Dividends declared	$ 3.40	$ 3.08	
Book value	45.81	40.04	
Stock trading range			
High	90.48	81.27	
Low	72.35	63.27	
Close	90.48	77.18	

Financial Position *(millions of Canadian dollars)*	As at October 31, 2013	As at October 31, 2012	% change
Total assets	$ 188,204	$ 177,903	6
Loans and acceptances	97,338	90,922	7
Deposits	101,886	93,249	9
Subordinated debt and equity	11,587	10,710	8
Capital ratios under Basel III[2]			
Common Equity Tier 1 (CET1)	8.7 %	7.3 %	
Tier 1	11.4 %	10.1 %	
Total	15.0 %	14.1 %	
Impaired loans, net of total allowances	(183)	(190)	
As a % of loans and acceptances	(0.2) %	(0.2) %	
Interest coverage	11.47	12.23	
Asset coverage	3.84	3.45	
Other Information			
Number of common shares at year-end *(thousands)*	162,991	161,308	
Number of common shareholders on record	22,737	23,180	
Market capitalization *(millions of Canadian dollars)*	14,747	12,450	
Assets under administration and under management *(millions of Canadian dollars)*	258,010	232,027	
Number of employees	19,691	19,920	(1)
Number of branches in Canada	453	451	–
Number of banking machines	937	923	2

(1) See the Financial Reporting Method section on page 12.
(2) The October 31, 2013 ratios are calculated using the "all-in" methodology and the October 31, 2012 ratios are presented on a pro forma basis.

MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

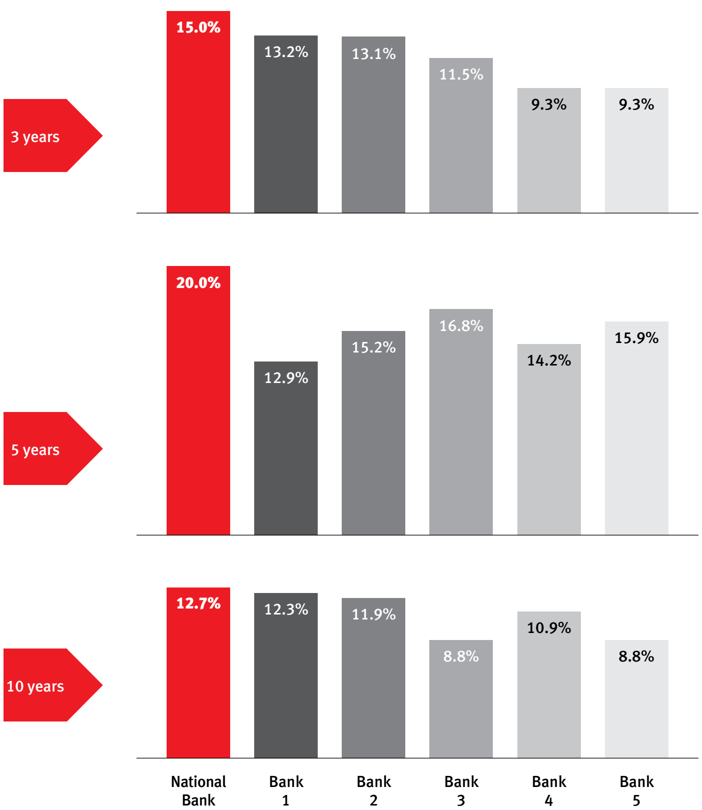
We are pleased to report another year of strong financial results and continued progress in positioning National Bank for sustainable growth and top-tier shareholder returns in the years to come.

Our net income excluding specified items for the year ended October 31, 2013 increased 7% to $1,491 million compared to $1,396 million in 2012, and diluted earnings per share rose 7% to $8.41. Total revenues excluding specified items were 3% higher at $5,242 million, compared to $5,087 million in the prior year. Our adjusted net income, diluted earnings per share and total revenues have now increased for 11 consecutive years.

Including dividends and share appreciation, which reached a record level in 2013, shareholders benefited from an attractive total return this year, as they have over the past three, five and ten years. Across all of these time horizons, National Bank ranks favourably among its Canadian peers in rewarding shareholders for their investment.

In light of the record 2013 results and a positive outlook, the Board of Directors increased the quarterly dividend rate by 6% to $0.92 per share, effective February 1, 2014. The Board also approved a two-for-one stock split, which will be effected by means of a stock dividend in early 2014. Both of these decisions reflect our confidence in the future of National Bank and our determination to maximize returns for shareholders.

Total Shareholder Return



How We Create Value

Our approach to creating shareholder value essentially has four components.

The first is to target annual earnings growth at or above the average rate of our Canadian peers. The remaining three support the achievement of our financial objectives. They are tight cost and risk management, discipline in managing capital for shareholders and aiming for the highest standards of client service and social responsibility.

Every year, we expect each of our three business segments to contribute to earnings growth. We rely on the strength of our business mix and the revenue diversification in each of our segments to compensate for activities that may be unable to contribute their full measure due to the economic environment. Our track record of significant value creation on a consistent basis validates our approach and our view that National Bank's business mix provides a solid foundation for growth.

Personal and Commercial

Over the past three years, our Personal and Commercial segment has been a good performer, with compound annual growth in earnings of 6%. In 2013, we again surpassed consensus estimates through strong loan growth, tight expense control and the outstanding quality of our credit portfolio.

In 2014, we will benefit from last year's rollout of one of North America's best-in-class mortgage platforms, which enables one-meeting approval for 75% of applications, across our entire Quebec network of branches, call centres and mobile sales force. The rapid response time gives us a competitive edge in mortgage loans, and the resulting time savings will allow us to allocate more resources to other revenue-generating activities and to reduce costs.

We are also reshaping our distribution channels in response to evolving client preferences in order to provide the access and convenience they expect while being positioned to offer them timely financial information and advice regardless of the channel they choose. Online and mobile banking are growing and we are adapting our website, branches, call centres and mobile sales force to offer the best service to our clients. By being in tune with our clients, we are gaining market share in Quebec today and building momentum for the future.

We continue to grow our pan-Canadian footprint in deliberate fashion. In addition to our branches, we have longstanding relationships with third-party mortgage brokers and partnerships with non-bank financial services providers to drive client acquisition and volume growth. The deployment of our mortgage platform outside Quebec next year will support mortgage lending growth across the country and we will continue to implement targeted initiatives to expand market penetration.

Wealth Management

Revenues for our Wealth Management segment are derived about equally from Quebec and from our extensive pan-Canadian footprint. Over the past three years, this business has generated compound annual growth in earnings and revenues of 5% and 8%, respectively, and is positioned for market share gains across Canada in the coming years.

Our pan-Canadian expansion has been and will continue to be highly targeted. In recent years, we have opened several offices and made and successfully integrated two major acquisitions—Wellington West Holdings Inc. and the full-service investment advisory business of HSBC Securities (Canada) Inc. With these and other actions, our direct coverage of major Canadian centres is much broader and our revenue potential much greater than is generally recognized. The improvement in this segment's 2012 and 2013 results largely reflects the growth in business volume outside Quebec and we expect this trend to continue.

In November 2013, we completed the acquisition of TD Waterhouse Institutional Services, a transaction that significantly strengthens the position of National Bank Correspondent Network as the leading provider of securities processing services to independent advisory firms across Canada, with over 480,000 client accounts. This transaction, which is immediately accretive to earnings, increases our presence in fee-based managed assets, a growing market, and offers multiple cross-selling opportunities within Wealth Management and with Personal Banking.

In Quebec, successful initiatives in the high net worth segment and in other fee-based services have resulted in market share gains and we are positioned to sustain our growth going forward.

Financial Markets

Financial Markets will continue to be a key driver of our performance, as it has been in the past. This business has generated compound annual growth in revenues and earnings of 6% and 17%, respectively, over the past three years. It now generates about 30% of its client-driven revenues from Quebec, where we hold the number one market position, compared to 70% outside the province. Canada-wide, we are a leader in structured products and federal and provincial government debt underwriting, with strong positions in corporate and investment banking. Diversification of revenue streams as well as close collaboration and good balance between divisions help us sustain performance through capital markets cycles, allowing for relative consistency in revenues and earnings that is unique in the financial services industry.

Going forward, we will continue to focus on Canadian-based corporations and client-driven activities, while pursuing international opportunities that are consistent with our current business and expertise. Through the opening of a Hong Kong office and the consolidation of our presence in London and New York, we are expanding our capacity to sell Canadian products abroad while maintaining a window on global capital market trends and opportunities.

Client Service

Our business strategies and initiatives are entirely client-driven. The overarching objective of our *One client, one bank* initiative is to increase our ability to provide superior client service in a multi-channel environment.

The many actions implemented over the past five years have made us more client-centric and we have embarked on the next step in our journey towards excellence. We want clients to be at the heart of every decision and action taken by our employees, across all of our distribution channels, and we have a detailed roadmap to do so. Our client promise—*the Bank that truly takes care of its clients*—will guide us towards offering the best client experience and a competitive advantage.

Technology will be a key enabler. We are already benefiting from our advanced mortgage platform. Several technology and process enhancements will be rolled out in 2014 and subsequent years to support our employees in their efforts.

Cost and Risk Management

The same technology platforms are also powerful allies in reducing costs and increasing efficiencies. As new platforms replace legacy systems in the years ahead, we expect measurable efficiency gains in the Personal and Commercial segment. The discipline and agility that are part of our culture also help us to maintain tight cost control. In the Wealth Management segment, we are beginning to see major improvements as a result of increased scale, and our Financial Markets segment now ranks among the industry leaders in efficiency ratio.

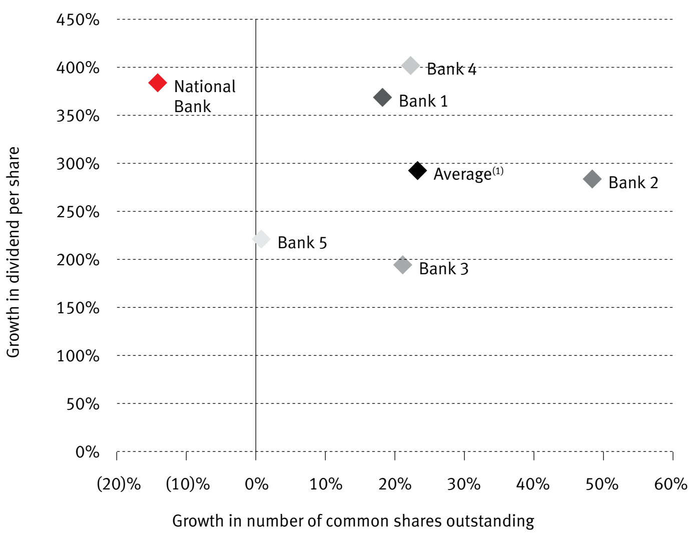
Our proficiency in risk management has contributed significantly to our financial performance. Year after year, we maintain the highest credit quality compared to peers and have one of the industry's lowest loan loss experiences in our Personal and Commercial portfolios. In Wealth Management, our focused and disciplined approach has served us well in acquisition negotiations and integration. Our Financial Markets business, with its focus on client-driven activities and Canadian expertise, has a strong track record in managing risk. Sound risk management is an enduring value that is deeply ingrained in National Bank culture.

Capital Management

In recent years, we have funded organic growth and several strategic acquisitions while returning increasing amounts of capital to shareholders through dividends and share buybacks.

Repurchases through normal course issuer bids in the past three years have totalled 7.2 million common shares. By virtue of these buybacks—and no recent equity issues—we are in the enviable position of having fewer common shares outstanding today than in early 2000. By way of comparison, as illustrated hereafter, our Canadian peers have increased their share count over this same period by 20% on average.

Capital Return



(1) Average for the six largest Canadian banks.

At the same time, through our prudent and disciplined approach, we have substantially increased our capital ratios to meet the more stringent requirements imposed by Canadian and international regulators. Even stricter capital standards are taking effect over the coming years, and we are confident in our ability to satisfy regulators while continuing to manage capital for the benefit of our shareholders.

Social Responsibility

Being socially responsible is good for business and our success has allowed us to play an even more prominent economic and social role in the communities we serve.

Each year, we provide substantial support to communities through our donations and sponsorships. As an ardent supporter of higher education throughout Canada, in 2013 we made the largest-ever donation towards entrepreneurship education with a $10 million grant to the Campus Montreal fundraising campaign. We also expanded our *One for Youth* program for young people up to age 25. Twelve regional committees were created across Canada in 2013 to choose from among 1,600 youth projects and, in 2014, we will donate $1 million towards those selected.

Many other youth-oriented initiatives were supported last year, alongside our traditional giving to organizations in the fields of health, education, arts and culture, and community outreach. This corporate giving was complemented, as it is every year, by the generosity and actions of National Bank employees in aid of causes in their communities across Canada.

Successful Business Model

Our approach to value creation and our super-regional model have allowed us to deliver excellent shareholder returns, but we recognize that past performance does not guarantee future success.

Numerous challenges—including slow economic growth, consumer debt levels and technological changes—and growth opportunities lie ahead. We will remain disciplined and focused in adapting to current market conditions, while continuing to implement our long-term strategy. In everything we do and regardless of where we are in the economic cycle, we aim to take a measured and balanced approach guided by our client-centric focus and strong risk management culture.

Going forward, we will also strive to communicate the strengths of our business model more effectively. In autumn 2013, we hosted Investor Day, which focused exclusively on our Financial Markets segment. In order to demonstrate the high quality of earnings generated by this business, we disclosed key revenue, operating earnings and other data for the first time. Analysts and investors applauded our transparency, which raised the bar for disclosure, and recent valuations suggest we may have made some progress.

Two additional Investor Days are scheduled for 2014, for Wealth Management in the spring and Personal and Commercial Banking in the fall. Our stated objective is to demonstrate convincingly that our super-regional model can continue to drive industry-leading total shareholder returns.

Acknowledgements

In closing, I would like to thank our nearly 20,000 employees for their dedication and contribution to our success and my colleagues in the Office of the President for their leadership. I also welcome Dominique Fagnoule, who joined us in 2013 as Executive Vice-President, Information Technology and Organizational Performance.

Our Chairman of the Board, Jean Douville, is stepping down as of the 2014 Annual Meeting after more than two decades of service. As Chairman during 10 of those years, he skillfully presided through the most sweeping regulatory changes in recent history, a financial crisis and a senior management succession, among other events. The Bank and all who sought his counsel have benefited greatly from his poise and wisdom and, on behalf of our shareholders and employees, I extend our heartfelt gratitude and wish him health and happiness in retirement.

Louis Vachon
President and Chief Executive Officer

MESSAGE FROM THE CHAIRMAN OF THE BOARD

National Bank's business strategies and initiatives continued to bear fruit in 2013, resulting in a solid financial performance and another year of attractive shareholder returns. The Board of Directors is pleased with the Bank's progress and confident that its success is built on a sustainable foundation.

Over the past several years, the Board of Directors has closely monitored the deployment of the *One client, one bank* strategy, a key driver of the Bank's competitive positioning and earnings growth. The frequency of presentations to the Board by members of the Office of the President has increased during this time, providing directors with timely insight into business issues and the opportunity to evaluate and comment on management's strategies and initiatives. We have also carefully examined the rationale and expected benefits of several acquisitions, including the purchase of TD Waterhouse Institutional Services, which closed in November 2013. Shareholders can be assured that the Board is vigilant in its oversight of the Bank's strategic orientations.

As part of our thorough assessment of business strategies and transactions, we are always careful to ensure that they are consistent with the Bank's risk tolerance. The Board devotes considerable time each year towards understanding the nature of the risks faced by the Bank and its business segments, and making sure that appropriate systems and controls are in place to effectively manage them. In line with emerging best practices and regulatory changes, in 2013 we divided the Audit and Risk Management Committee into two separate committees, each with specific responsibilities.

Sound Governance Practices

The creation of distinct audit and risk management committees is a matter of governance, which has seen continuous evolution in recent years, so much so that Board members receive information on regulations and best governance practices on an ongoing basis to assist them in exercising their responsibilities. The Bank's sound governance practices provide assurance to all stakeholders that our institution is managed rigorously, with integrity and in a sustainable manner. The Board has devoted considerable attention to governance matters in recent years and will continue to ensure that we comply with all applicable regulations and adhere to best practices.

Solid Succession Plan

Succession planning is a high priority for the Board on an ongoing basis. Our objective is to ensure that the Bank attracts and retains the best senior management talent, and maintains adequate succession plans. As part of its mandate, the Board regularly reviews the Bank's approach to compensation as well as its executive succession plans. In this regard, shareholders approved the Bank's executive compensation for the fourth year in a row with 97% of votes cast in favour this year.

The Board also reviewed the Bank's pension plans, and was pleased to note that they are well-funded and in a strong financial position.

Over the years, we have been implementing the succession plan developed in 1998–updated every year since–in order to renew the Board membership in line with the Bank's term limits policy. As we evaluate potential candidates, we are guided by regulatory requirements, the Bank's Charter of Expectations for directors, best practices and our long-term commitment to strive for gender parity in nominations for new directors. In this regard, I am pleased to inform you that one new female director will be nominated for election at the 2014 Annual Meeting of Shareholders.

Acknowledgements

After many years of service as a director, Paul Gobeil is stepping down in 2014. On behalf of the Board, I wish to acknowledge his contribution to our deliberations and thank him for his dedication to the Bank's progress. I also welcome Richard Fortin, who joined the Board during the year, and who will be nominated for election as director at the 2014 Annual Meeting.

Lastly, after more than 20 years as a director, including ten as Chairman of the Board, I will not be seeking a renewal of my mandate. My successor will be appointed by the Board following the election of directors by shareholders at the 2014 Annual Meeting.

It has been an honour and a privilege to serve the Bank's shareholders during these years. I have appreciated working with my fellow directors and senior management towards our common objective of building a successful financial institution and it has been gratifying to witness its steady growth, improving profitability and mounting contribution to the collective well-being.

The future is full of promise. The Bank is well-positioned and in good hands. In particular, I wish to salute the Bank's nearly 20,000 employees for their commitment towards its continued success.

Jean Douville
Chairman of the Board of Directors

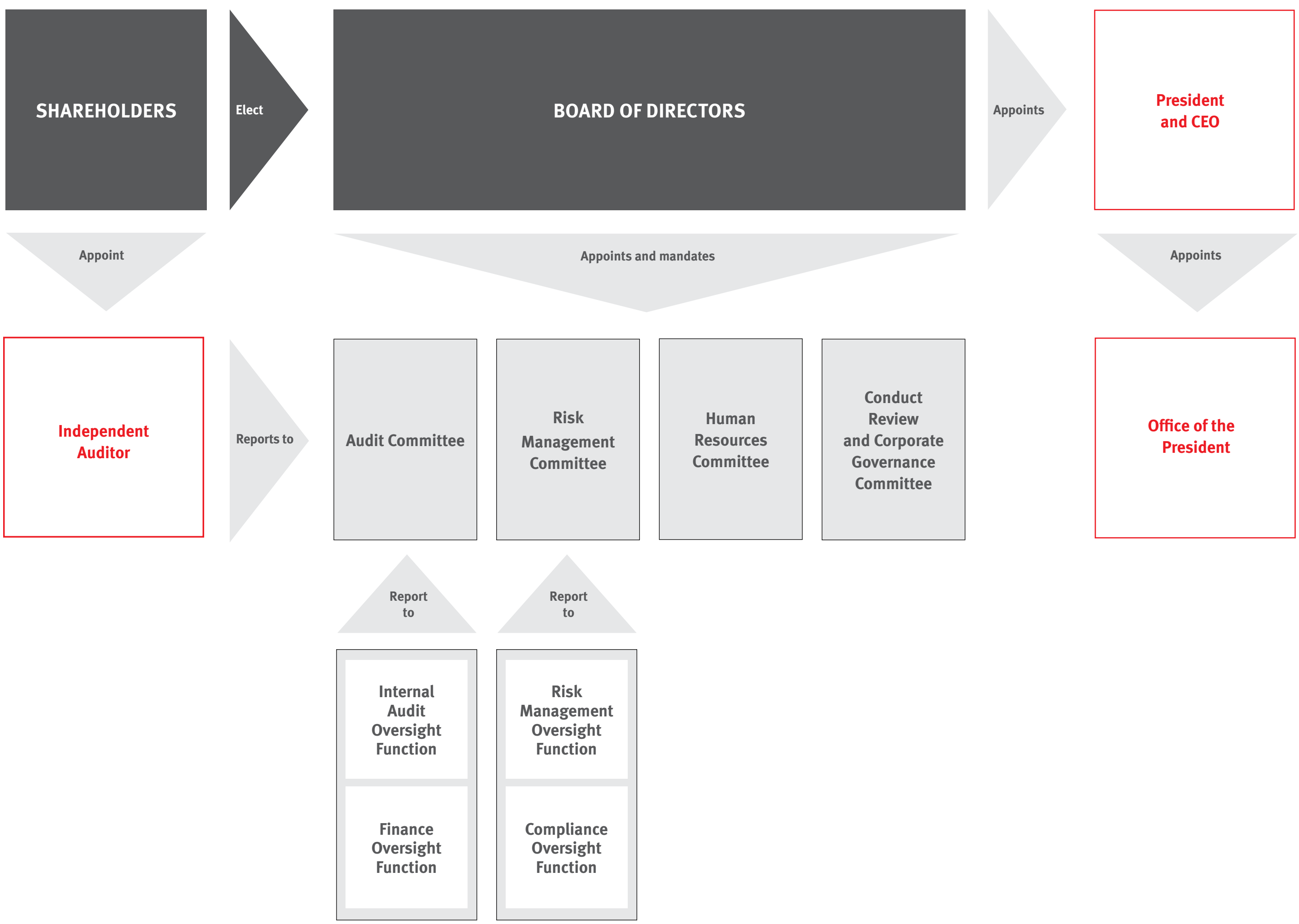
GOVERNANCE ARCHITECTURE

The Bank's Board of Directors (the Board) is responsible for providing stewardship for the Bank. The Board's main duties include setting directions for the Bank, overseeing its management and operations, safeguarding its assets and ensuring its viability, profitability and development. As part of its responsibilities, the Board reviews and approves the Bank's strategic plan, business plan and budget primarily by considering the business environment in which the Bank operates and the risks it faces. The Board promotes a culture of ethical business practices and integrity throughout the Bank and reviews the processes that ensure the Bank remains compliant with applicable legislation and regulations. It reviews and approves the Bank's risk appetite framework, recognizes and understands the main risks to which the Bank is exposed and ensures that appropriate systems are in place to effectively manage those risks. Furthermore, the Board reviews and approves the Bank's consolidated financial statements and the related Independent Auditor's Report and Management's Discussion and Analysis and makes sure that policies for communicating and disclosing information to shareholders, investors and the general public are developed and applied. The Board also evaluates management's performance and approves the Bank's total compensation programs and policies, including those of senior management. Finally, it oversees the succession planning process for management positions.

The Board benefits from the recommendations of four oversight functions (Internal Audit, Risk Management, Compliance, and Finance) to carry out its duties. These oversight functions support the Board by verifying whether controls within the operating units are effective and if operations, results and risk exposures are reliably reported.

On May 24, 2013, the Board approved a move to divide the Audit and Risk Management Committee into two separate committees: the Audit Committee and the Risk Management Committee. Each of these committees is made up entirely of independent members, just like the other two committees that support the Board: the Conduct Review and Corporate Governance Committee and the Human Resources Committee. This Annual Report reflects the governance architecture in effect as at October 31, 2013.

Additional information on the Bank's governance architecture can be found in the *Management Proxy Circular for the 2014 Annual Meeting of Holders of Common Shares*, which will soon be available on the Bank's website at **nbc.ca** and on SEDAR's website at **sedar.com**. The mandates of the Board and its committees are available in their entirety at **nbc.ca**.



KEY RESPONSIBILITIES OF COMMITTEES

Audit Committee:

Jean Houde *(Chair)*, André Caillé, Bernard Cyr, Richard Fortin, Paul Gobeil, Louise Laflamme

- Examines the Bank's financial statements, reports and other significant financial communications and recommends their approval by the Board.
- Ensures that suitable procedures are in place to oversee financial reporting to the public.
- Reviews, evaluates and approves appropriate internal control mechanisms.
- Oversees the work of independent auditors and the work of the Finance Oversight Function and the Internal Audit Oversight Function.

Risk Management Committee:

Paul Gobeil *(Chair)*, Maryse Bertrand, Pierre Boivin, Richard Fortin, Jean Houde, Louise Laflamme, Pierre Thabet

- Reviews the Bank's risk appetite framework and recommends its approval by the Board; oversees the control methods used to manage the main risks to which the Bank is exposed, in particular strategic risk, credit risk, market risk, liquidity risk, operational risk, regulatory risk, reputation risk and environmental risk.
- Monitors capital, liquidity and funding management, stress testing and capital adequacy assessment.
- Approves credit applications of clients that are outside the scope of management's powers.
- Oversees the work of the Risk Management Oversight Function and the Compliance Oversight Function.
- Oversees procedures to fight money laundering and terrorist financing.

Human Resources Committee:

André Caillé *(Chair)*, Pierre Boivin, Gérard Coulombe, Gillian H. Denham, Lino A. Saputo jr

- Examines and approves the Bank's total compensation policies and programs, taking into consideration the risk management framework applicable at the time of development, review and implementation, and recommends their approval by the Board.
- Sets annual objectives and key performance indicators for the President and Chief Executive Officer, recommends their approval by the Board, and evaluates said performance and the corresponding achievements.
- Recommends Board approval for the compensation of the President and Chief Executive Officer and the members of the Office of the President.
- Oversees the management succession plan.

Conduct Review and Corporate Governance Committee:

Gérard Coulombe *(Chair)*, Maryse Bertrand, André Caillé, Jean Houde, Roseann Runte

- Makes sure that governance rules, procedures and policies are implemented and followed.
- Periodically reviews the size and composition of the Board and its committees, develops the candidate criteria for selecting directors to the Board, and plans the succession of directors.
- Develops and reviews the mandates of the Board, the Board Committees, the Chair of the Board and the committee chairs.
- Oversees the processes for managing and monitoring related party transactions.
- Ensures that the Bank's directors, officers and employees are compliant with the standards of business conduct and ethical behaviour.
- Evaluates the performance and effectiveness of the Board and its members.

BOARD OF DIRECTORS

The Board of Directors is responsible for providing stewardship for the Bank. Its main duties include providing direction for the Bank, overseeing its management, safeguarding its assets, and ensuring its viability, profitability and development. The Board carries out this role through a governance architecture that includes a strict set of structures, policies and processes that meets all of the legislative and regulatory requirements governing the Bank. The majority of Board members, including its Chairman, are independent under Canadian Securities Administrators criteria.

Jean Douville
Bedford, Quebec, Canada
Corporate Director
Director since November 1991

Pierre Boivin
Montreal, Quebec, Canada
President and Chief Executive Officer
Claridge Inc.
Director since April 2013

Bernard Cyr
Shediac Cape, New Brunswick, Canada
President, Cyr Holdings Inc.
Director since August 2001

Paul Gobeil
Montreal, Quebec, Canada
Corporate Director
Director since February 1994

Roseann Runte
Ottawa, Ontario, Canada
President and Vice-Chancellor
Carleton University
Director since April 2001

Louis Vachon
Beaconsfield, Quebec, Canada
President and Chief Executive Officer
National Bank of Canada
Director since August 2006

Maryse Bertrand
Montreal, Quebec, Canada
Vice-President, Real Estate Services, Legal Services and General Counsel, CBC/Radio-Canada
Director since April 2012

André Caillé
Lac-Brome, Quebec, Canada
Corporate Director
Director since October 2005

Gillian H. Denham
Toronto, Ontario, Canada
Corporate Director
Director since October 2010

Jean Houde
Montreal, Quebec, Canada
Chairman of the Board
Gaz Metro inc.
Director since March 2011

Lino A. Saputo jr
Montreal, Quebec, Canada
Chief Executive Officer
Saputo Inc.
Director since April 2012

Lawrence S. Bloomberg
Toronto, Ontario, Canada
Advisor, National Bank Financial
Director since August 1999

Gérard Coulombe
Sainte-Marthe, Quebec, Canada
Partner, Lavery, de Billy, LLP
Director since February 1994

Richard Fortin
Longueuil, Quebec, Canada
Corporate Director
Director since August 2013

Louise Laflamme
Rosemère, Quebec, Canada
Corporate Director
Director since November 2008

Pierre Thabet
St-Georges, Quebec, Canada
President, Boa-Franc s.e.n.c.
Director since March 2011

OFFICE OF THE PRESIDENT

The Office of the President, which is composed of the President and Chief Executive Officer and the officers responsible for the Bank's main functions and business units, is mandated to define the Bank's culture and philosophy, approve and monitor the strategic growth initiatives of the Bank as a whole, manage risks that could have a strategic impact, assume stewardship of technology, manage the officer succession process, and ensure a balance between employee commitment and client and shareholder satisfaction.

The Office of the President carries out its responsibilities as a team, thereby ensuring consistency as well as information- and knowledge-sharing among the Bank's business units.

Louis Vachon
President and Chief Executive Officer

Stéphane Bilodeau
Executive Vice-President,
Operations and Strategic Initiatives Office

William Bonnell
Executive Vice-President,
Risk Management

Dominique Fagnoule
Executive Vice-President,
Information Technology and
Organizational Performance

Diane Giard
Executive Vice-President,
Personal and Commercial Banking

Lynn Jeanniot
Executive Vice-President,
Human Resources and Corporate Affairs

Karen Leggett
Executive Vice-President,
Marketing

Luc Paiement
Executive Vice-President,
Wealth Management, and Co-President and
Co-Chief Executive Officer, National Bank Financial

Ghislain Parent
Chief Financial Officer and
Executive Vice-President,
Finance and Treasury

Ricardo Pascoe
Executive Vice-President,
Financial Markets, and Co-President and Co-Chief
Executive Officer, National Bank Financial

RISK DISCLOSURES

In May 2012, the Financial Stability Board (FSB) formed a working group, the Enhanced Disclosure Task Force (EDTF), that was mandated to develop principles for enhancing the risk disclosures of major banks, to recommend improvements to current risk disclosures, and to identify risk disclosure best practices used by major financial institutions. On October 29, 2012, the EDTF published a report entitled *Enhancing the Risk Disclosures of Banks*, which contains 32 recommendations. As at October 31, 2013, the Bank has made every effort to ensure overall compliance with those recommendations and is continuing to enhance its risk disclosures to meet the best practices on an ongoing basis. The risk disclosures required by the EDTF are provided in this Annual Report and in the document entitled *Supplementary Financial Information* available on the Bank's website at **nbc.ca**.

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 3, 2013

The following Management's Discussion and Analysis (MD&A) presents the financial condition and operating results of National Bank of Canada (the Bank). This analysis was prepared in accordance with the requirements set out in National Instrument 51-102, *Continuous Disclosure Obligations*, released by the Canadian Securities Administrators (CSA). It is based on the audited consolidated financial statements for the year ended October 31, 2013 and prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB) and set out in the CPA Canada Handbook. This MD&A should be read in conjunction with the audited consolidated financial statements for the year ended October 31, 2013. Additional information about the Bank, including the *Annual Information Form*, can be obtained from the Bank's website at **nbc.ca** and SEDAR's website at **sedar.com**.

Caution Regarding Forward-Looking Statements

From time to time, National Bank of Canada (the Bank) makes written and oral forward-looking statements, such as those contained in the Major Economic Trends and the Outlook for National Bank sections of this Annual Report, in other filings with Canadian securities regulators, and in other communications, for the purpose of describing the economic environment in which the Bank will operate during fiscal 2014 and the objectives it has set for itself for that period. These forward-looking statements are made in accordance with current securities legislation. They include, among others, statements with respect to the economy—particularly the Canadian and U.S. economies—market changes, observations regarding the Bank's objectives and its strategies for achieving them, Bank projected financial returns and certain risks faced by the Bank. These forward-looking statements are typically identified by future or conditional verbs or words such as "outlook," "believe," "anticipate," "estimate," "project," "expect," "intend," "plan," and similar terms and expressions.

By their very nature, such forward-looking statements require assumptions to be made and involve inherent risks and uncertainties, both general and specific. Assumptions about the performance of the Canadian and U.S. economies in 2014 and how that will affect the Bank's business are among the main factors considered in setting the Bank's strategic priorities and objectives and in determining its financial targets, including provisions for credit losses. In determining its expectations for economic growth, both broadly and in the financial services sector in particular, the Bank primarily considers historical economic data provided by the Canadian and U.S. governments and their agencies.

There is a strong possibility that express or implied projections contained in these forward-looking statements will not materialize or will not be accurate. The Bank recommends that readers not place undue reliance on these statements, as a number of factors, many of which are beyond the Bank's control, could cause actual future results, conditions, actions or events to differ significantly from the targets, expectations, estimates or intentions expressed in the forward-looking statements. These factors include strategic risk, credit risk, market risk, liquidity risk, operational risk, regulatory risk, reputation risk, and environmental risk (all of which are described in greater detail in the Risk Management section that begins on page 60 of this Annual Report); the general economic environment and financial market conditions in Canada, the United States and certain other countries in which the Bank conducts business, including the effects of uncertainty surrounding U.S. government debt negotiations; regulatory changes affecting the Bank's business, capital and liquidity; the situation with respect to the restructured notes of the master asset vehicle (MAV) conduits, in particular the realizable value of underlying assets; changes in the accounting policies the Bank uses to report its financial condition, including uncertainties associated with assumptions and critical accounting estimates; tax laws in the countries in which the Bank operates, primarily Canada and the United States; and changes to capital and liquidity guidelines and to the manner in which they are to be presented and interpreted.

The foregoing list of risk factors is not exhaustive. Additional information about these factors can be found in the Risk Management and Other Risk Factors sections of this Annual Report. Investors and others who base themselves on the Bank's forward-looking statements should carefully consider the above factors as well as the uncertainties they represent and the risk they entail. The Bank also cautions readers not to place undue reliance on these forward-looking statements.

The forward-looking information contained in this document is presented for the purpose of interpreting the information contained herein and may not be appropriate for other purposes.

FINANCIAL REPORTING METHOD

The Bank uses certain measurements that do not comply with IFRS to assess results. Moreover, the Bank has adjusted certain specified items to make the data from fiscal 2013 and 2012 comparable. These adjustments are presented in the table hereafter.

Reconciliation of Measures Not Compliant With IFRS

The table below provides a reconciliation of published results with results presented in the Management's Discussion and Analysis.

	Personal and Commercial	Wealth Management	Financial Markets	Other	2013	2012
Net interest income	1,614	272	576	(13)	2,449	2,338
Taxable equivalent[1]	–	–	209	–	209	172
Financing cost relating to holding restructured notes[2]	–	–	–	9	9	–
Net interest income on a taxable equivalent basis and excluding specified items	1,614	272	785	(4)	2,667	2,510
Non-interest income	985	865	594	270	2,714	2,975
Revenues related to holding restructured notes[2]	–	–	–	(151)	(151)	(155)
Revenues related to the Natcan transaction[3]	–	6	–	–	6	(243)
Acquisition-related revenues[4]	–	–	–	6	6	–
Non-interest income excluding specified items	985	871	594	125	2,575	2,577
Total revenues on a taxable equivalent basis and excluding specified items	2,599	1,143	1,379	121	5,242	5,087
Non-interest expenses	1,435	846	657	227	3,165	3,173
Charges related to the Natcan transaction[3]	–	–	–	–	–	(16)
Charges related to acquisitions[5]	–	(27)	–	–	(27)	(38)
Impairment losses on intangible assets[6]	–	–	–	(39)	(39)	(18)
Severance pay[7]	–	–	–	(12)	(12)	(80)
Vacant premises and lease terminations[8]	–	–	–	(16)	(16)	(4)
Non-interest expenses excluding specified items	1,435	819	657	160	3,071	3,017
Contribution on a taxable equivalent basis and excluding specified items	1,164	324	722	(39)	2,171	2,070
Provisions for credit losses	192	3	(14)	–	181	180
Income before income taxes on a taxable equivalent basis and excluding specified items	972	321	736	(39)	1,990	1,890
Income taxes	259	76	(14)	(58)	263	326
Taxable equivalent[1]	–	–	209	–	209	172
Income taxes on revenues related to holding restructured notes[2]	–	–	–	(38)	(38)	(42)
Income taxes on items related to the Natcan transaction[3]	–	1	–	–	1	(29)
Income taxes on items related to the acquisitions[4][5]	–	8	–	2	10	11
Income taxes on intangible asset impairment losses[6]	–	–	–	10	10	5
Income taxes on severance pay[7]	–	–	–	3	3	21
Income taxes on vacant premises and lease terminations[8]	–	–	–	4	4	1
Reversal of provisions for income tax contingencies[9]	–	–	–	37	37	29
Income taxes on a taxable equivalent basis and excluding specified items	259	85	195	(40)	499	494
Net income excluding specified items	713	236	541	1	1,491	1,396
Specified items after income taxes	–	(24)	–	87	63	238
Net income	713	212	541	88	1,554	1,634
Non-controlling interests	–	–	8	67	75	73
Net income attributable to the Bank's shareholders	713	212	533	21	1,479	1,561

(1) The Bank uses the taxable equivalent basis to calculate net interest income and income taxes. This calculation method consists of grossing up certain tax-exempt income (particularly dividends) by the income tax that would have been otherwise payable. An equivalent amount is added to income taxes. This adjustment is necessary in order to perform a uniform comparison of the return on different assets regardless of their tax treatment.

(2) During the year ended October 31, 2013, the Bank recorded $9 million in financing costs ($7 million net of income taxes) related to holding restructured notes as well as $151 million in revenues ($111 million net of income taxes) to reflect a rise in the fair value of the notes. During the year ended October 31, 2012, the Bank had recorded $155 million in revenues ($113 million net of income taxes), of which $111 million came from a rise in the fair value of restructured notes, $34 million from a rise in the fair value of commercial paper not included in the Pan-Canadian restructuring plan and $10 million from gains following capital repayments of restructured notes classified as *Available-for-sale securities*.

(3) During the year ended October 31, 2013, the Bank recorded $6 million ($5 million net of income taxes) for its share of the integration costs incurred by Fiera Capital Corporation (Fiera). During the year ended October 31, 2012, a $246 million gain ($212 million net of income taxes) had been recorded following the sale of the operations of Natcan Investment Management Inc. (Natcan). This gain had consisted of a $275 million sale price, from which $29 million in goodwill, intangible assets and direct charges was deducted. A total of $16 million ($11 million net of income taxes) in other charges related to this transaction had been recorded. The Bank had also recorded $3 million ($3 million net of income taxes) for its share of the integration costs incurred by Fiera.

(4) During the year ended October 31, 2013, the Bank recorded an amount of $6 million ($4 million net of income taxes) for its share in the integration costs and the intangible asset amortization of its interest in TMX Group Limited.

(5) During the year ended October 31, 2013, the Bank recorded $27 million in charges ($19 million net of income taxes), consisting mainly of retention bonuses related to the acquisitions of Wellington West Holdings Inc. and the full-service investment advisory business of HSBC Securities (Canada) Inc. (2012: $38 million, $27 million net of income taxes).

(6) During the year ended October 31, 2013, the Bank recorded $39 million ($29 million net of income taxes) in intangible asset impairment losses on internal technology developments (2012: $18 million, $13 million net of income taxes).

(7) During the year ended October 31, 2013, the Bank recorded $12 million in severance pay ($9 million net of income taxes) for the streamlining of certain activities. During the year ended October 31, 2012, the Bank had recorded $80 million ($59 million net of income taxes) in severance pay following an optimization of certain organizational structures.

(8) During the year ended October 31, 2013, the Bank recorded $16 million in charges ($12 million net of income taxes) related to vacant premises. During the year ended October 31, 2012, the Bank had recorded a $4 million charge ($3 million net of income taxes) for lease terminations following an optimization of certain organizational structures.

(9) During the year ended October 31, 2013, the Bank reversed $37 million (2012: $29 million) in tax provisions following a revaluation of contingent income tax liabilities.

The Bank's consolidated financial statements have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board (IASB) and set out in the CPA Canada Handbook. Unless otherwise stated, all amounts presented in this MD&A are expressed in Canadian dollars.

Securities regulators require companies to caution readers that net income and any other measurements adjusted using non-IFRS criteria have no standard meaning under IFRS and cannot be easily compared with similar measurements used by other companies.

Like many other institutions, the Bank uses the taxable equivalent basis to calculate net interest income and income taxes. This calculation method consists of grossing up certain tax-exempt income (particularly dividends) by the income tax that would have been otherwise payable. An equivalent amount is added to income taxes. This adjustment is necessary in order to perform a uniform comparison of the return on different assets regardless of their tax treatment.

FINANCIAL DISCLOSURE

Disclosure Controls and Procedures

The Bank's financial information is prepared with the support of a set of disclosure controls and procedures (DC&P) that are implemented by the President and Chief Executive Officer (CEO) and by the Chief Financial Officer (CFO) and Executive Vice-President of Finance and Treasury. During the year ended October 31, 2013, in accordance with *Regulation 52-109 respecting Certification of Disclosure in Issuers' Annual and Interim Filings* (Regulation 52-109), released by the CSA, the design and operation of these controls and procedures were evaluated to determine their effectiveness.

As at October 31, 2013, the CEO and the CFO confirmed the effectiveness of the DC&P. These controls are designed to provide reasonable assurance that the information disclosed in annual and interim filings and in other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified by that legislation. These controls and procedures are also designed to ensure that such information is accumulated and communicated to the Bank's management, including its signing officers, as appropriate, to allow timely decisions regarding disclosure.

This Annual Report was reviewed by the Annual and Quarterly Information Disclosure Committee, the Audit Committee, and the Board of Directors (the Board), which approved it prior to publication.

Internal Controls Over Financial Reporting

The internal controls over financial reporting (ICFR) are designed to provide reasonable assurance that the financial information presented is reliable and that the financial statements were prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB) and set out in the CPA Canada Handbook. Due to inherent limitations, ICFR may not prevent or detect all misstatements in a timely manner.

The CEO and the CFO oversaw the evaluation work performed on the design and operation of the Bank's ICFR in accordance with Regulation 52-109. These controls were evaluated in accordance with the control framework of the *Committee of Sponsoring Organizations of the Treadway Commission* (COSO — 1992) for financial controls and in accordance with the control framework of the *Control Objectives for Information and Related Technologies* (COBIT) for general Information Technology (IT) controls.

Based on the evaluation results, the CEO and CFO concluded, as at October 31, 2013, that there are no material weaknesses, that the ICFR are effective and provide reasonable assurance that the financial reporting is reliable, and that the Bank's audited consolidated financial statements were prepared in accordance with IFRS.

Changes to Internal Controls Over Financial Reporting

The CEO and CFO also undertook work under which they were able to conclude that, during the year ended October 31, 2013, no changes were made to the ICFR that have materially affected, or are reasonably likely to materially affect, the design or operation of the ICFR.

Annual and Quarterly Information Disclosure Committee

The Annual and Quarterly Information Disclosure Committee assists the CEO and CFO by ensuring that disclosure controls and procedures and internal control procedures for financial reporting are implemented and operational. In so doing, the Committee ensures that the Bank is meeting its disclosure obligations under current regulations and that the CEO and CFO are producing the requisite certifications.

OVERVIEW

Consolidated Results

Year ended October 31 (taxable equivalent basis)[1] (millions of Canadian dollars)	2013	2012	2011	2013-12 % change	2012-11 % change
Excluding specified items[1]					
Total revenues	**5,242**	5,087	4,833	**3**	5
Non-interest expenses	**3,071**	3,017	2,844	**2**	6
Provisions for credit losses	**181**	180	199	**1**	(10)
Income before income taxes	**1,990**	1,890	1,790	**5**	6
Income taxes	**499**	494	485	**1**	2
Net income excluding specified items	**1,491**	1,396	1,305	**7**	7
Specified items after taxes[1]	**63**	238	(9)		
Net income	**1,554**	1,634	1,296	**(5)**	26
Net income attributable to					
Preferred shareholders	**40**	43	87	**(7)**	(51)
Common shareholders	**1,439**	1,518	1,137	**(5)**	34
Bank shareholders	**1,479**	1,561	1,224	**(5)**	28
Non-controlling interests	**75**	73	72	**3**	1
	1,554	1,634	1,296	**(5)**	26
Average assets	**193,505**	181,344	165,942	**7**	9
Risk-weighted assets[2][3]	**61,251**	62,190	55,374	**(2)**	12
Average loans and acceptances	**92,398**	84,009	73,575	**10**	14
Average deposits	**101,803**	96,164	89,885	**6**	7
Impaired loans, net of total allowances	**(183)**	(190)	(201)		
Efficiency ratio excluding specified items	**58.6 %**	59.3 %	58.8 %		
FINANCIAL INDICATORS					
Diluted earnings per share	**$8.80**	$9.32	$6.92	**(6)**	35
Return on common shareholders' equity (ROE)	**20.6 %**	24.5 %	20.2 %		
Capital ratios under Basel III[2][3]					
Common equity Tier 1	**8.7 %**	7.3 %	7.6 %		
Tier 1	**11.4 %**	10.1 %	10.8 %		
Total	**15.0 %**	14.1 %	14.3 %		
Dividend payout ratio[4]	**38 %**	33 %	39 %		
Excluding specified items[1]					
Diluted earnings per share	**$8.41**	$7.86	$7.18	**7**	9
Return on common shareholders' equity (ROE)	**19.7 %**	20.7 %	20.9 %		
Dividend payout ratio[4]	**40 %**	39 %	38 %		

(1) See the Financial Reporting Method section on page 12.
(2) Figures for 2011 have not been restated to reflect the changeover to IFRS.
(3) The October 31, 2013 figures are presented on an "all-in" basis and the October 31, 2012 and 2011 figures are presented on a pro forma basis.
(4) Last four quarters.

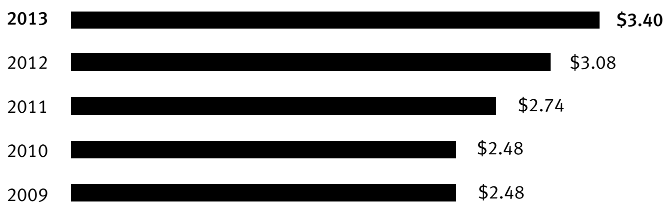
In 2013, the Bank recorded $1,554 million in net income compared to $1,634 million in 2012. Diluted earnings per share for 2013 stood at $8.80 versus $9.32 in 2012, and ROE was 20.6% in 2013 versus 24.5% in 2012. Excluding the 2013 and 2012 specified items, the Bank's net income was up 7% to total $1,491 million, and diluted earnings per share was $8.41 versus $7.86, also up 7%. Similarly, ROE was 19.7% in 2013 versus 20.7% in 2012.

In 2013, the Bank's results, excluding specified items, met its medium-term objectives for net income growth and diluted earnings per share growth. It also achieved the objectives for ROE and the Basel III Common Equity Tier 1 ratio. Excluding specified items, the Bank's results were also in line with the target dividend payout ratio.

Dividends

For 2013, the Bank declared $552 million in dividends to common shareholders, representing 40% of net income attributable to common shareholders, excluding specified items.

Annual Dividend



High Quality Loans Portfolio

The Bank maintained sound credit quality. Provisions for credit losses remained unchanged between 2013 and 2012. The provisions for personal credit losses were up $13 million, mainly related to consumer loans. Provisions for commercial credit losses stood at $44 million for 2013, rising $5 million mainly due to energy sector loans. Provisions for credit losses on Corporate Banking loans were down $17 million as a result of substantial recoveries in 2013. Overall, the 2013 provisions for credit losses represented 0.20% of average loans and acceptances compared to 0.21% in 2012, which is an improvement and relatively low given the current economic environment. Impaired loans, net of total allowances, experienced a slight $7 million increase year over year.

Risk Profile

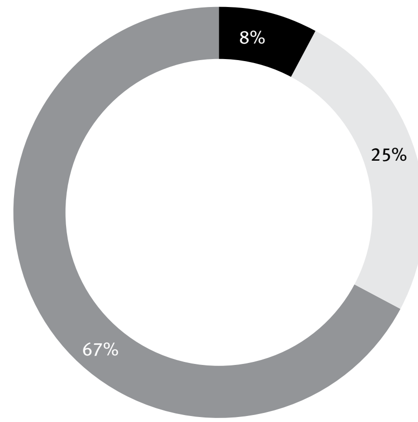
(millions of Canadian dollars)	2013	2012
Provisions for credit losses	181	180
Provisions for credit losses as a % of average loans and acceptances	0.20 %	0.21 %
Net impaired loans	183	179
Gross impaired loans as a % of tangible equity	6.5 %	7.5 %
Individual and collective allowances as a % of impaired loans	53.7 %	53.7 %
Collective allowance on non-impaired loans	366	369
Impaired loans, net of total allowances	(183)	(190)

Overall Composition of the Loan and Acceptance Portfolio

Breakdown of the Loan and Acceptance Portfolio

As at October 31, 2013

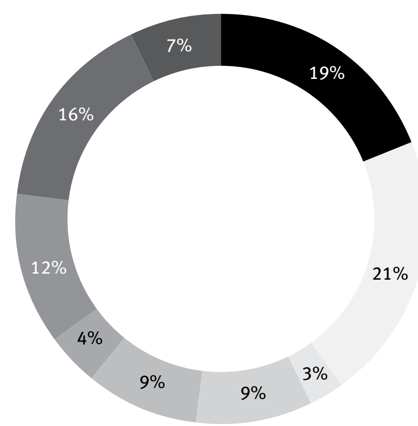
- Corporate (2012: 7%)
- Commercial (2012: 26%)
- Personal (2012: 67%)



Business Loans and Acceptances by Borrower Category

(as a % of the portfolio)
As at October 31, 2013

- Primary (2012: 20%)
- Construction and real estate (2012: 19%)
- Transportation (2012: 3%)
- Public services and government (2012: 10%)
- Manufacturing (2012: 9%)
- Communications (2012: 4%)
- Commerce (2012: 14%)
- Other services (2012: 16%)
- Other (2012: 5%)



Prudent Capital Management

A bank's capital covers the risks associated with its various activities, such as credit risk, negative changes in financial markets, or unfavourable operating events. Capital management consists of maintaining the capital required to cover risks, complying with the regulatory capital ratios defined by the Office of the Superintendent of Financial Institutions (Canada) (OSFI) and assessing the economic capital required for the Bank's operations. Capital management takes into account regulatory obligations, economic and market conditions, Bank objectives and the creation of shareholder value. As required under the Basel framework, risk-weighted assets (RWA) are calculated for each of the following risks: credit risk, market risk, and operational risk. The Bank uses the Advanced Internal Rating-Based Approach for credit risk and the Standardized Approach for operational risk. For market risk, it primarily uses an approach based on internal models but uses the Standardized Approach for certain exposures. In 2013, the Bank maintained its prudent capital management approach in order to protect itself against potential market deterioration and to foster sound business growth.

A Solid Financial Foundation

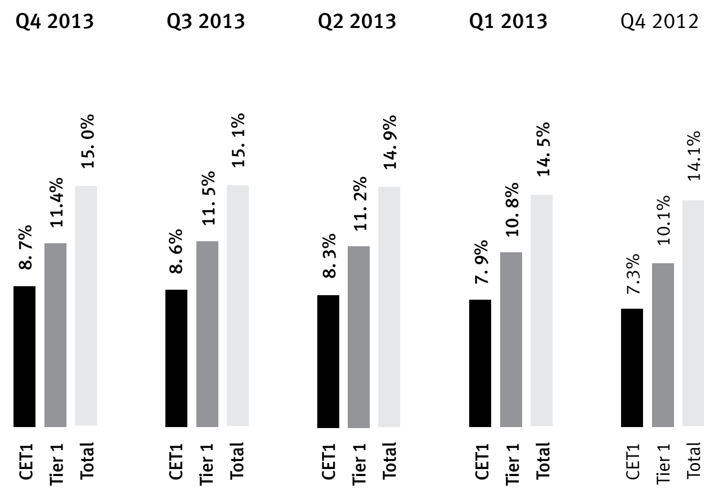
OSFI requires Canadian banks to maintain a Common Equity Tier 1 (CET1) capital divided by their risk-weighted assets of at least 7.0%. Minimum Tier 1 capital and total capital ratios of, respectively, 8.5% and 10.5% will be enforced beginning 2014, as required by OSFI's new rules for Basel III. Ratios must be calculated according to OSFI's "all-in" methodology. The "all-in" ratios include all of the regulatory adjustments that will be required by 2019 while retaining the phase-out rules for non-qualifying capital instruments. For additional information on the calculation of capital ratios, refer to the Capital Management section of this Annual Report.

CET1, Tier 1 and total capital ratios stood, in that order, at 8.7%, 11.4% and 15.0%, as at October 31, 2013, well above regulatory requirements, compared to pro forma ratios of, respectively, 7.3%, 10.1% and 14.1% a year earlier. The pro forma ratios had included, however, a Credit Valuation Adjustment (CVA) charge that was subsequently postponed to 2014. The higher capital ratios were essentially due to net income, net of dividends, to the delay in applying the new CVA charge and to the common share issuance related primarily to the exercised stock options.

In March 2013, OSFI designated Canada's six largest banks, which include National Bank, as Domestic Systemically Important Banks (D-SIBs). A 1% surcharge will apply to the capital ratios of these banks as of January 1, 2016.

Owing to its strong capital base combined with its internally generated capital, the Bank is in a good position to face the new Basel III requirements. In light of the D-SIB status of the Bank, management has decided that the Bank will aim to reach a CET1 ratio higher than 8.75% by the end of fiscal 2014 or before, that is, if there are no significant changes in market conditions or in regulation requirements or if the Bank does not make any acquisition until then.

Evolution of Regulatory Capital Ratios Under Basel III(1)



(1) The ratios are calculated using the "all-in" methodology and the ratios as at October 31, 2012 are presented on a pro forma basis.

Allocation of Economic Capital and Regulatory RWA

Economic capital is the internal measure used by the Bank to determine the capital required for its solvency and to pursue its business operations. Economic capital takes into consideration the credit, market, operational, business and other risks to which the Bank is exposed, as well as the risk diversification effect among them and among the business segments. Economic capital thus helps the Bank to determine the equity capital required to protect itself against such risks and ensure its long-term viability. The by-segment allocation of economic capital and regulatory RWA is done on a stand-alone basis. The method used to assess economic capital is reviewed regularly in order to accurately quantify these risks.

The Risk Management section provides comprehensive information about the main types of risk. The "Other risks" presented below include risks such as strategic risk and structural interest rate risk in addition to the benefit of diversification among types of risk.

Allocation of Risks by Business Segment

As at October 31, 2013

NATIONAL BANK OF CANADA

Business segments	**Personal and Commercial**	**Wealth Management**	**Financial Markets**	**Treasury**
Major activities	Banking services Credit services Financing Investment solutions Insurance	Investment solutions Trust services Banking services Credit services Wealth management solutions	Banking services Investment banking services Financing solutions to institutional clients Trading and investment solutions	Treasury operations Liquidity management Bank funding Asset and liability management
Economic capital by type of risk	Credit 75% Operational 16% Other risks 9%	Credit 27% Operational 22% Other risks 51%	Credit 63% Market 15% Operational 10% Other risks 12%	Credit 40% Market 2% Operational 1% Other risks 57%
Risk-weighted assets	Credit 87% Operational 13%	Credit 58% Operational 42%	Credit 74% Market 15% Operational 11%	Credit 73% Market 25% Operational 2%

MAJOR ECONOMIC TRENDS

Global Economy

Generally speaking, the economic indicators of developed countries have offered positive surprises in recent months, while emerging economies, having lost some momentum, nevertheless continue to grow. In fact, for the first time, the world's three largest economic regions posted simultaneous increases in economic activity in the summer of 2013. The United States, China and the euro zone are now reporting an expansion in manufacturing. Global GDP is therefore expected to grow 3% in 2013 and approximately 3.5% in 2014 thanks to accommodative monetary policies.

Renewed geopolitical tensions will have to be watched closely, as credit supply in the euro zone has yet to be fully restored and remains a source of risk. In China, Beijing is still seeking to balance its efforts to shift the economy towards consumer-driven growth without triggering excessive debt levels. At the same time, the U.S. Congress remains undecided about the size of its budget cuts for 2014.

United States

The U.S. economy recovered at a less than impressive pace in 2013, but a growth rate of nearly 2%—despite significant budget cuts, tax increases, and the budget stalemate in Congress—says much about the vitality of the private sector. Consumers in particular have done their part to keep the economy on track, supported by respectable job creation, low interest rates and a wealth effect created by an over 10% rise in residential real estate prices. Households continue to strengthen their balance sheets and their debt-service ratio remains at a 30-year low.

Consumers will enjoy good leeway to begin borrowing again in the coming quarters, and businesses will also likely contribute to growth as continued development of oil and gas production in the United States is stimulating new investment in manufacturing capacity. The rate of real GDP growth is expected to be 2.6% in 2014 versus 1.6% in 2013.

Canada

The Canadian economy undershot its potential in the first three quarters of 2013 and growth will undoubtedly remain tepid in 2014. Although exports should improve as the U.S. economy picks up steam, consumption will come up against household efforts to reduce debt.

The debt reduction that has already occurred in the United States and Europe has not yet begun in Canada. Moreover, since house prices are not rising as quickly as in the past, the wealth effect from residential real estate will play a lesser role in supporting consumption. Residential construction, which has had a significant impact on GDP growth in recent years, appears to be returning to previous levels and having a dampening effect. Although this component of GDP will remain weak, we shouldn't expect a collapse in house prices that seems to concern some observers.

Sound credit quality, factors that favour repayment (e.g., secured mortgage loans) and demographics are benefiting the real estate market in Canada. Furthermore, weak inflation and unused capacity are weighing against the Bank of Canada raising interest rates in the near future. The economy is expected to grow by 1.6% in Canada in 2013 and by 2.2% in 2014.

In Quebec, real GDP is expected to rise from a disappointing 1% in 2013 to approximately 2% in 2014.

OUTLOOK FOR NATIONAL BANK

Strategic Priorities

The Bank's objective is to deliver stable returns to its shareholders that match or exceed those of its Canadian peers. To achieve this objective, the Bank aims for 5% to 10% annual net income growth. Successful execution of revenue growth initiatives, active capital management, sound risk management practices and sustained improvement to productivity are some of the levers for the Bank's financial performance growth. The Bank prides itself as an institution with a strong financial foundation, providing its clients with value-added products and services and adapting quickly to frequent changes in the economy and competitive environment.

To support its long-term growth objectives, the Bank continues to execute its strategic transformation program, which is designed to increase market share, enhance client satisfaction and optimize operations. The primary objective of this program, which involves significant investments, is to ensure that the Bank remains a modern, dynamic institution supported by a skilled workforce and diversified funding base while continuously improving productivity.

The Bank's strong presence in Quebec remains a source of sustained revenue growth. In addition to its current activities, geographic diversification is an important lever for the Bank's long-term growth in that it will be able to benefit from the potential of targeted new niches across Canada. The Bank thus plans to raise the revenue and earnings contributions generated by the Personal and Commercial and Wealth Management segments.

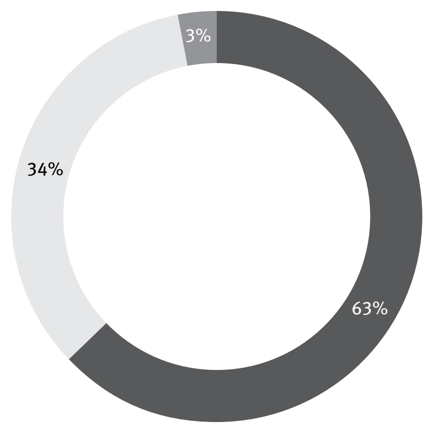
As a super-regional institution with a solid balance sheet, the Bank is also well-positioned to complement organic growth with acquisitions and strategic partnerships. These revenue growth opportunities are supported by all of the Bank's employees and are subject to a very stringent planning, review and implementation process intended to quickly maximize earnings.

Levers for the Bank's Financial Growth

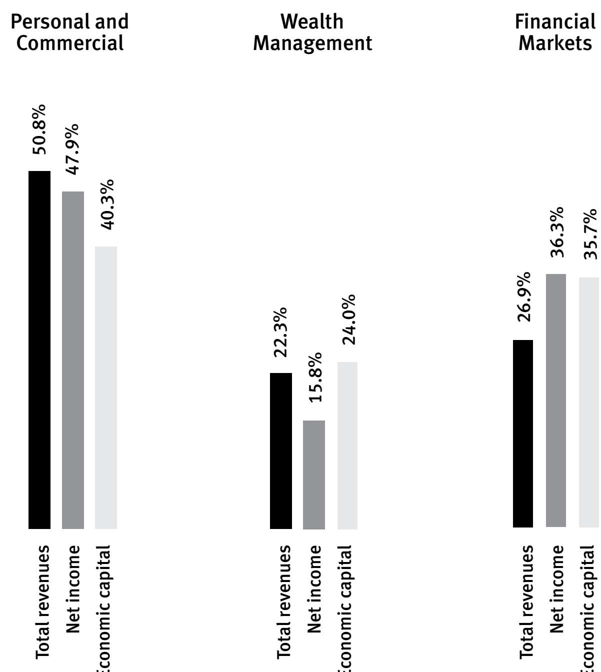
- Client-centric culture
- Revenue growth initiatives
- Active capital management
- Upholding sound risk management practices
- Sustained improvement to productivity

Geographic Distribution of Total Revenues(1)
Year ended October 31, 2013

- Quebec (2012: 61%)
- Other provinces (2012: 34%)
- International and unallocated (2012: 5%)



Business Mix(1)
(Taxable equivalent basis)(2)
Year ended October 31, 2013



(1) Excluding specified items.
(2) See the Financial Reporting Method section on page 12.

Strategic Transformation Program

The Bank's strategy is essentially rooted in its *One client, one bank* initiative. The overarching purpose of this initiative is to transform the Bank into a leader in client experience, with the ability to provide best-in-class financial advice, solutions, and service to clients, regardless of their point of entry into the Bank. All of the Bank's teams are actively involved in the various transformation initiatives, whether at the identification, design or implementation stages.

The Bank's strategy has a long-term focus and is driven by four priorities:

- align distribution with client needs across the Bank;
- simplify processes and deploy a new sales and service platform;
- improve the efficiency of support functions; and
- instill a culture of collaboration, accountability and performance.

Over the past five years, the Bank's notable progress on several performance indicators relating to clients, productivity and financial results validates the strategic transformation program. The Bank has successfully implemented a true "client-centric" culture and deployed high-quality tools and services, while bolstering capital, liquidity and earnings. The Bank is playing its full part in the economies of Quebec and Canada at the individual, business and government levels.

Substantial changes to the banking environment in Canada, including new regulations, new technologies, changing client behaviour and slower economic growth require innovative development methods and the ongoing strategic transformation of the Bank. With the expertise of its employees, capacity for innovation and financial strength, the Bank has the assets needed to confidently address these challenges.

Priorities for 2014

For 2014, the Bank has set three priorities:

- maximize the benefits of the Client Value Proposition strategy launched in 2012 and the new, recently deployed mortgage loan platform in Quebec;
- continue the MAX program and other major initiatives; and
- develop business in Central, Western and Atlantic Canada.

Client Value Proposition

The Client Value Proposition is a natural extension of the *One client, one bank* transformation that began in 2008. Its purpose is to ensure that clients receive an uncompromising service experience and to raise their loyalty by making client satisfaction the ultimate priority. It is achieved by proposing the service offering that best suits the client, when the need arises and via the client's preferred distribution channel.

A key trend in the global banking industry—not to mention in Canada and with the Bank's clients in particular—is the growing demand for "digital" banking. While some clients continue to prefer in-branch banking, an increasing number of clients are using our "digital" offering to access products and services. This trend is being closely examined and will require innovation from the Bank on the marketing, technological, operational and cultural levels.

The Bank has also strengthened and differentiated its brand image over the past two years, particularly through advertising campaigns targeting its personal and commercial clients.

MAX Program and Other Major Initiatives

The MAX program is central to the simplification and streamlining of the Bank's business processes, with key components consisting of the deployment of a new sales and service platform, optimization of operational sites and many other complementary actions. In 2013, a new mortgage loan platform was deployed in the Bank's branches and mortgage developer network in Quebec. Deployment will continue in 2014 such that the platform will be available to mortgage development managers and branches outside of Quebec.

The new platform allows the Bank to realize important business advantages and efficiency gains while diminishing administrative workload and freeing up more time for front-line staff to build client relationships. Among other benefits, the platform can already be used to provide clients with an immediate response at their very first and only meeting as well as to offer and activate the other products and services appropriate to their needs. The Bank has started to closely track the benefits expected from these technological enhancements.

In 2014, the Bank will pursue the design and implementation of other major initiatives to increase revenue and cut costs.

Central, Western and Atlantic Canada

The Bank will deploy several initiatives to develop business in Central, Western and Atlantic Canada. In Personal Banking, the Bank will optimize its branch network and, in Commercial Banking, it will offer attractive proposals by targeting industries for which it is able to provide a value-added experience. The Bank will integrate recently acquired TD Waterhouse Institutional Services, and the Wealth Management segment will deploy the Private Wealth 1859 business model in Western Canada. As for Financial Markets, it will expand its international presence by opening a business office in Hong Kong. Furthermore, the Bank will remain on the lookout for business and portfolio acquisition opportunities.

Culture

A satisfying client experience and the Bank's success lie ultimately with its 20,000 employees. Effective execution requires a strong culture of collaboration, accountability, and performance at all levels of the organization. The Bank is continuing to strengthen its management practices, which, in concrete terms, will translate into greater team work and the introduction of exemplary communication and transparency practices.

Productivity

One of the levers for the Bank's financial performance is the continuous improvement to productivity. The Bank reviews how work is executed in key areas of its activities, seeking to reduce or limit cost increases and promote greater agility. Processes are reviewed and optimized progressively across the Bank.

To support its business development, technology and operational initiatives, the Bank focuses on strengthening its ability to execute and obtain quick benefits. This is a fundamental objective of the development process, the main stages of which consist of selecting, planning, implementing and following up on initiatives.

BUSINESS SEGMENT ANALYSIS

PERSONAL AND COMMERCIAL

OVERVIEW

The Personal and Commercial segment meets the financial needs of some 2.4 million retail banking clients and approximately 130,000 business clients throughout Canada. These clients entrust the Bank to manage, invest and safeguard their assets and finance their projects. Personal Banking offers everyday transaction solutions, mortgage loans and home equity lines of credit, consumer loans, payment solutions, savings options and tailored investment solutions as well as a diverse range of insurance products through specialized subsidiaries. Commercial Banking offers a full line of services, including credit, deposit and investment solutions, international trade, foreign exchange transactions, payroll, cash management, insurance, electronic transactions and complementary services.

To obtain advice and service, clients turn to our experienced advisors who take time to understand their specific realities and help them reach their financial goals. And thanks to the Bank's remote distribution network, 453 branches and 937 banking machines across Canada, clients can do their daily banking whenever and wherever they wish.

Segment Results – Personal and Commercial(1)

Year ended October 31 (millions of Canadian dollars)	2013	2012	2011	2013-12 % change	2012-11 % change
Excluding specified items(2)					
Net interest income	**1,614**	1,581	1,520	**2**	4
Non-interest income	**985**	950	944	**4**	1
Total revenues	**2,599**	2,531	2,464	**3**	3
Non-interest expenses	**1,435**	1,420	1,389	**1**	2
Contribution	**1,164**	1,111	1,075	**5**	3
Provisions for credit losses	**192**	174	202	**10**	(14)
Income before income taxes	**972**	937	873	**4**	7
Income taxes	**259**	251	244	**3**	3
Net income excluding specified items	**713**	686	629	**4**	9
Specified items after taxes(2)	**–**	(11)	–		
Net income	**713**	675	629	**6**	7
Net interest margin	**2.28 %**	2.42 %	2.61 %	**(6)**	(7)
Average assets	**76,696**	70,524	62,205	**9**	13
Average deposits	**40,558**	38,379	36,776	**6**	4
Average loans and acceptances	**76,344**	70,163	62,000	**9**	13
Net impaired loans	**181**	137	159	**32**	(14)
Net impaired loans as a % of average loans and acceptances	**0.2 %**	0.2 %	0.3 %		
Efficiency ratio excluding specified items(2)	**55.2 %**	56.1 %	56.4 %		

(1) The distribution of banking products through independent networks has been reclassified from the Personal and Commercial segment to the Wealth Management segment. Banking activities with energy sector companies have been transferred from the Financial Markets segment to the Personal and Commercial segment. The Bank made this change on November 1, 2012 to better reflect how management monitors performance. Prior period results have been restated to reflect this change.
(2) See the Financial Reporting Method section on page 12.

Financial Results

In the Personal and Commercial segment, net income excluding specified items totalled $713 million in 2013, up 4% from $686 million in 2012. Total revenues rose $68 million or 3% due to growth in net interest income that was driven primarily by notable increases in personal and commercial loan volumes, which more than offset the narrowing net interest margins. The segment's net interest margin narrowed to 2.28% in 2013 compared to 2.42% in 2012 and 2.61% in 2011.

Excluding specified items, non-interest expenses stood at $1,435 million in 2013, up 1% from last year. A higher marketing expense, resulting from several ad campaigns, was tempered by a decline in other expenses related to optimizing the segment's expense structure. Thanks to positive operating leverage, the contribution was up 5% year over year. As for the efficiency ratio, it improved to 55.2% in 2013 compared to 56.1% in 2012 and 56.4% in 2011.

At $192 million, the provisions for credit losses were raised $18 million from $174 million in 2012, particularly because of growth in both personal and commercial loan volumes.

Personal Banking

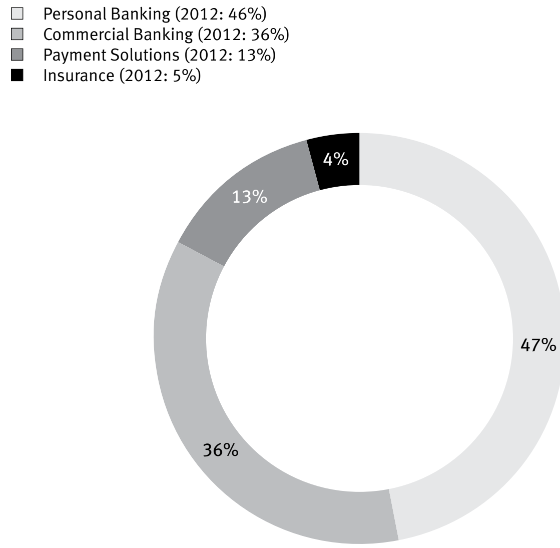
In 2013, Personal Banking revenues amounted to $1,656 million compared to $1,609 million in 2012, a 3% increase owing mainly to growth in loan and deposit volumes. Lending activity rose 10% compared to 2012, mainly due to secured credit, particularly mortgages and home equity lines of credit, as well as to consumer loans. This growth was partly offset by a lower net interest margin.

The Bank continued to expand the scope of its insurance business, achieving 6% revenue growth through an increase in gross premium revenues tempered by an increase in benefits paid to clients. MasterCard-related revenues rose 6% on higher volume, mitigated by a higher cost of loyalty programs for certain types of credit cards.

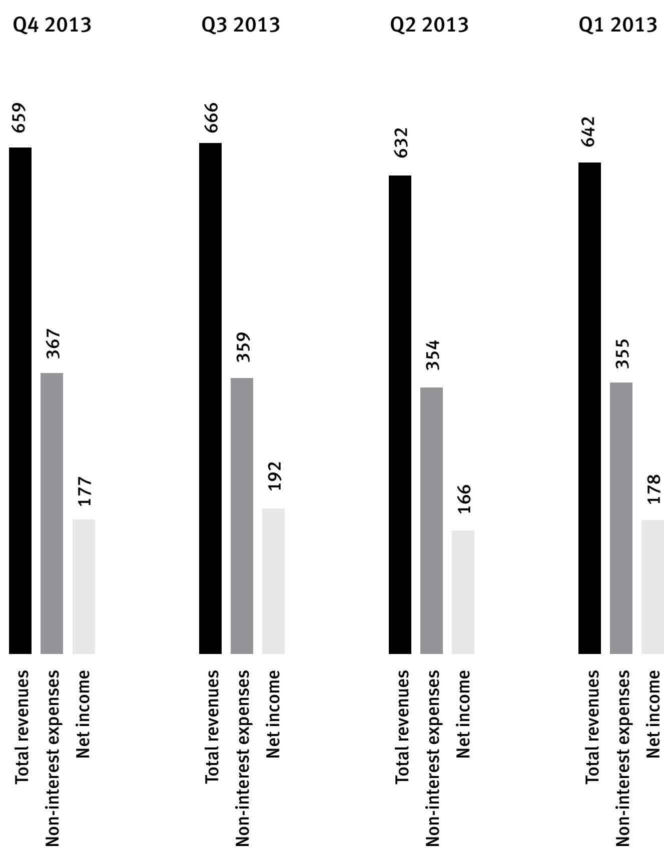
Commercial Banking

In 2013, Commercial Banking revenues totalled $943 million versus $922 million in 2012, a 2% increase that stems mainly from growth in revenues from acceptances, which rose 11% in 2013 given the appeal for this type of financing. The growth in loan and deposit volumes was tempered by a narrower net interest margin. Revenues from other activities, which include international services, decreased 8% due to a decline in foreign exchange transactions.

Total Revenues by Category
Year ended October 31, 2013



Quarterly Results
(millions of Canadian dollars)



Main Issues and Challenges in 2013

The issues and challenges faced by the Personal and Commercial segment were both numerous and varied in 2013. The main ones, as identified by the segment's managers, were as follows:

- economic growth remained moderate and below average, resulting in a slowdown in mortgage lending;
- competition among financial institutions intensified as consumers and borrowers learned to better manage their debt load. Such factors favour loan quality but also reduce new lending; and
- speculation about when and to what extent interest rates will rise has caused significant uncertainty and concern in the markets.

Strategies

The segment's 2013 initiatives were in line with the Bank's overall strategic priorities, with the same focus of delivering consistently outstanding service and effectively meeting client needs. The focal points of the 2013 strategy consisted of the following.

Bolstering the Technological Infrastructure
A key lever for enhancing service quality is improving technology and business processes, as the resulting efficiencies bring benefits to both clients and employees.

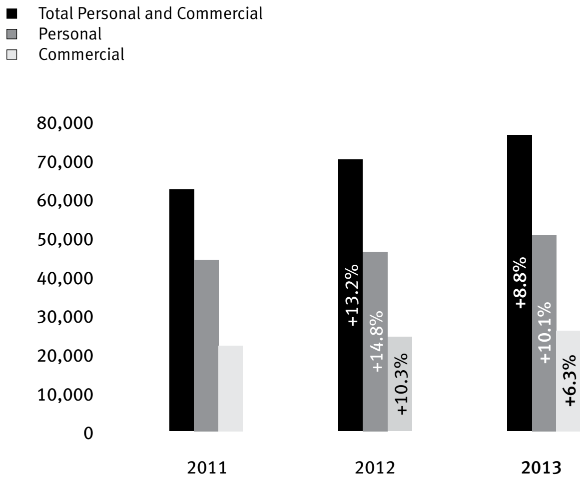
Transforming and Deploying the Client Approach
In 2013, as part of the Client Value Proposition program introduced in 2012, the Bank adopted an integrated approach and guidelines for investing resources in the areas that matter most to clients. The strategy calls for a shift in the Bank's client approach culture, namely, providing a more personal client approach and doing so by moving towards a sales and service culture that features simplified, standardized tools and processes for processing client requests.

Accelerating Deposit and Investment Growth
This strategic decision, a key priority for the Personal and Commercial segment in 2013, required the deployment of several initiatives that produced results.

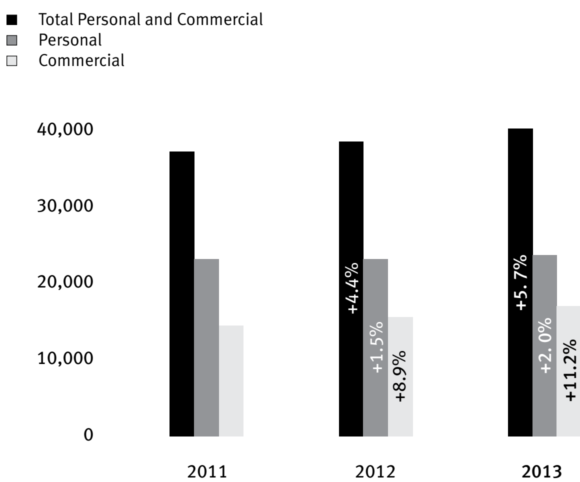
Promoting the "Businesses' Bank" Image
To drive growth in this market, the Bank defined three strategic priorities that focus on service to SMEs, specialized advisory services and standardizing business development.

Developing the Full Potential Outside Quebec
The focus is primarily on the markets of Central, Western and Atlantic Canada. To this end, the Bank relies on cooperation and networking among its segments.

Loan and Acceptance Volumes
(millions of Canadian dollars)
(% of year-over-year growth)



Deposit Volumes
(millions of Canadian dollars)
(% of year-over-year growth)



Achievements

Bolstering Technology and Improving Process Efficiency

This year, the Bank rolled out a new mortgage financing process supported by a sales and service platform used by the entire retail distribution network, the insurance segment, and product support and development. With robust technology and efficient processes, clients can more quickly secure the ideal mortgage solution for their needs and gain easier access to additional financing and customized insurance coverage.

The centralization and standardization of Bank operations by major business process, which began in 2011, continued through 2013 and will be completed in 2014. By simplifying and automating certain operational activities, this initiative aims to further improve client service delivery.

Delivering on the Client Value Proposition

As part of its Client Value Proposition program, the Bank introduced several initiatives aimed directly at improving client satisfaction:

– a monthly client-experience performance measure was applied to each branch, the purpose being to keep performance at a high level and to quickly adjust behaviour if necessary;
– Personal Banking managers received guidelines on optimizing branch hours and effectively responding to market changes;
– branch employees were given greater latitude to reimburse banking fees in order to more quickly resolve instances of client dissatisfaction;
– measures were deployed to further strengthen advisor-client relationships, thereby helping advisors to better understand clients and offer solutions tailored to their needs; and
– a proactive approach was adopted for mortgage renewals, including personalized mortgage conditions for every client, to facilitate client decision-making and promote loyalty.

Continuing to Transform the Client Service Culture

At the beginning of the year, the Bank rolled out a new, simplified and more flexible distribution structure to help build closer relationships with its Personal and Commercial clients. It also consolidated, by creating appropriate groupings, its specialized distribution network for retail mortgage lending to better respond to all of its clients' needs. Managers are now fully equipped to develop and deploy their teams' sales and service skills for increased client satisfaction.

The segment also realigned its performance measures to better focus on priority actions. The sales force is now evaluated on four performance criteria—each equally important—that are directly tied to reaching business development, client satisfaction, employee development and operational quality objectives.

In addition, all sales managers apply a standard process that maximizes the leverage effect on sales and client experience. This planned process involves sales facilitation, coaching, follow-up and recognition.

Accelerating Deposit and Investment Growth

Several initiatives were implemented in line with this priority. Several sales activities addressing deposit and investment products helped to mobilize teams throughout the year, encouraging proactive management of Personal and Commercial clients.

To satisfy the client need for both savings performance and accessibility, the Bank launched a high-interest savings account with competitive features. Accompanied by an attractive introductory offer, this product significantly enhances the range of savings products and contributes to the growth of the deposit portfolio.

In order to provide expert investment advice, financial planners saw their role evolve to strengthen their relationships with high net worth clients. All savings clients have access to advisors and services tailored to their needs, whenever and wherever they want.

Promoting our "Businesses' Bank" Image

To continue growing in the Canadian commercial market, the Bank defined three strategic priorities. These strategies translated into several achievements in 2013 and will continue to guide initiatives aimed at commercial clients in the years ahead.

First, the Bank aims to raise the satisfaction levels of SME clients. It standardized the process for granting credit for amounts up to $500,000 and automated credit decisions for this segment for speedier loan application processing. To further meet the needs of these clients, the Bank also began simplifying this segment's product offering.

Second, the Bank offers specialized niche services and has developed leading expertise in such areas as agrifood, film and television, health, high technology, real estate financing and factoring. It also advises companies that operate internationally and clients seeking to transfer their business. This approach, which fosters client loyalty and satisfaction, was strengthened by a pooling of specialized teams.

Lastly, in its commitment to offer consistently superior service quality and address all of the needs of its Commercial Banking clients, the Bank introduced a standardized sales process for managers assigned to these clients. For each step in the sales cycle, the manager knows the activities, best practices and group of specialists that can provide value-added advice.

In this context, the Bank is successfully creating synergy between its major segments and its expertise pool in order to propose innovative solutions to large-scale projects. Multidisciplinary teams made up primarily of specialized financing and risk management specialists are brought in to meet the complex needs of clients.

The "businesses' bank" is also very visible and active in its marketplace. A television, newspaper, Internet and in-branch advertising campaign featured client testimonials about their relationship with the Bank. In addition, the National Bank SME Awards program, which celebrates exceptional performance by Quebec businesses, recognized 16 winners in six categories this year. The Bank also sponsors *Dans l'oeil du dragon*, a television series showcasing entrepreneurs and their projects.

Developing the Potential of Markets in Central, Western and Atlantic Canada

This development initiative is characterized by an integrated financial services offering to the clients in these markets. This year, the Bank opened the first financial centres in the downtown Toronto and Richmond Hill branches. These centres provide personal and commercial services in addition to wealth management services through National Bank Financial.

To maximize the impact of this launch, the Bank provided training for financial centre employees and launched a marketing and visibility campaign in the two target communities.

Priorities and Outlook for 2014

In 2014, the Personal and Commercial segment's priorities will address three business objectives:

- continue its growth in its primary markets;
- develop the Central, Western and Atlantic Canada markets; and
- offer the Bank's services to customers introduced through recent acquisitions.

In support of these objectives, a key initiative will be to deploy new financing processes by adding products and financing types to the existing platform for Quebec users. Furthermore, this improved version of the platform will be deployed in the Central, Western and Atlantic Canada distribution networks and in other target regions.

Client satisfaction will continue to guide the segment's activities with a view to increasing accessibility to products and services, simplifying business processes and providing intelligent, customized advice.

BUSINESS SEGMENT ANALYSIS

WEALTH MANAGEMENT

OVERVIEW

The Wealth Management segment deploys a strategy that centres on the principle of delivering an exceptional, professional client experience to its investors.

In line with its mission, the segment continues to be recognized for its industry-leading products and services that are delivered by one of the best teams of investment professionals in the country. By leveraging its internal and third-party distribution channels as well as its product manufacturers, it has assumed a leadership position in Quebec and will continue to grow its market share in the rest of Canada. The segment will continue to distinguish its brand by offering its unique business model characterized by the superior level of professionalism that is at the heart of its culture.

Segment Results – Wealth Management(1)

Year ended October 31 (millions of Canadian dollars)	**2013**	2012	2011	**2013-12** **% change**	2012-11 % change
Excluding specified items(2)					
Net interest income	**272**	255	229	**7**	11
Fee-based revenues	**555**	520	446	**7**	17
Transaction-based and other revenues	**316**	305	314	**4**	(3)
Total revenues	**1,143**	1,080	989	**6**	9
Non-interest expenses	**819**	819	698	**–**	17
Contribution	**324**	261	291	**24**	(10)
Provisions for credit losses	**3**	3	2	**–**	50
Income before income taxes	**321**	258	289	**24**	(11)
Income taxes	**85**	70	76	**21**	(8)
Net income excluding specified items	**236**	188	213	**26**	(12)
Specified items after taxes(2)	**(24)**	165	(14)		
Net income	**212**	353	199	**(40)**	77
Non-controlling interests	**–**	1	4		
Net income attributable to the Bank's shareholders	**212**	352	195	**(40)**	81
Average assets	**8,159**	7,980	7,861	**2**	2
Average deposits	**21,477**	19,454	19,788	**10**	(2)
Efficiency ratio excluding specified items(2)	**71.7 %**	75.8 %	70.6 %		

(1) The distribution of banking products through independent networks has been reclassified from the Personal and Commercial segment to the Wealth Management segment. The Bank made this change on November 1, 2012 to better reflect how management monitors performance. Prior period results have been restated to reflect this change.
(2) See the Financial Reporting Method section on page 12.

Financial Results

In the Wealth Management segment, net income excluding specified items totalled $236 million in 2013, up 26% from $188 million in 2012. Total revenues amounted to $1,143 million in 2013 versus $1,080 million in 2012, up 6% owing to growth across all revenue categories. Specifically, net interest income was up 7% on the performance of the CashPerformer account and Immigrant Investor Program. Fee-based revenues rose 7% owing to growth in assets under administration and under management. In addition, transaction-based and other revenues increased 4% on the strength of business growth. At $258.0 billion, assets under administration and under management grew 11% on strong performance by the Private Wealth 1859 division and also due to a rise in stock markets.

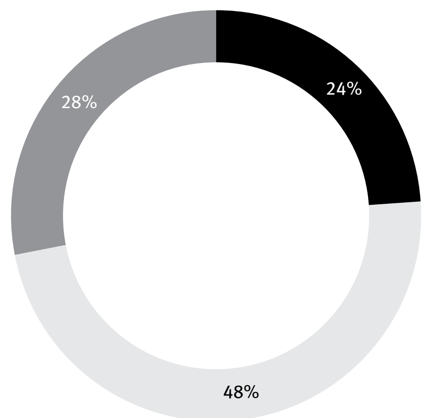
Excluding specified items, non-interest expenses remained stable owing essentially to stringent cost control measures. Lastly, the efficiency ratio was 71.7% in 2013 versus 75.8% in 2012 and 70.6% in 2011.

At $236 million in 2013, net income excluding specified items posted strong year-over-year growth, the main drivers being favourable synergies resulting from the segment's recent transactions as well as growth in assets under administration. For 2013, specified items totalling $24 million, net of income taxes, had an adverse affect on net income and consisted mainly of acquisition-related costs. In 2012, the specified items had had a $165 million positive impact on Wealth Management's net income and had consisted of a $212 million net gain on the sale of Natcan's operations combined with the acquisition of a 35% interest in Fiera, acquisition-related costs of $41 million, net of income taxes, and a net amount of $6 million in severance pay resulting from an optimization of the segment's structure.

Total Revenues by Category

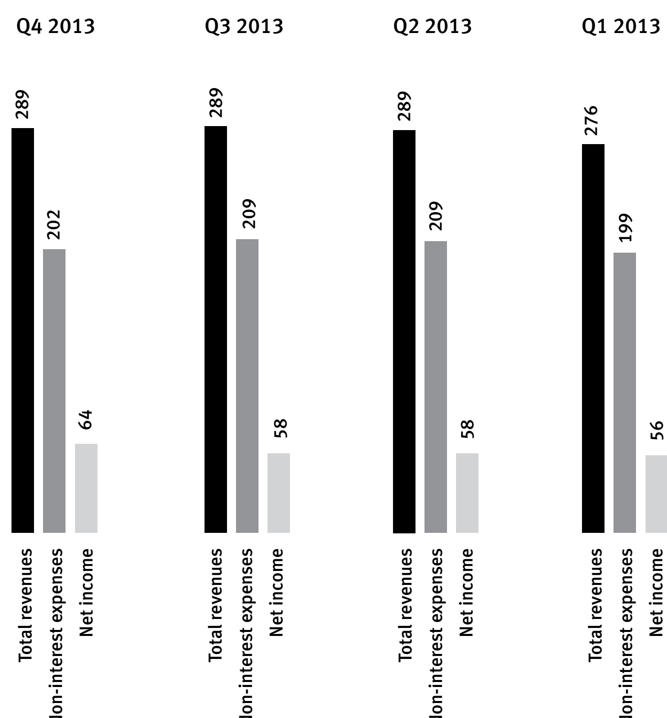
Year ended October 31, 2013

- Net interest income (2012: 24%)
- Fee-based services (2012: 48%)
- Transaction-based and other revenues (2012: 28%)



Quarterly Results(1)

(millions of Canadian dollars)



(1) Excluding specified items. See the Financial Reporting Method section on page 12.

Subsidiaries, Associates, Specialized Business Units, Internal and Third-Party Partners

Full-Service Advisory — The wealth management division of the full-service brokerage subsidiary, National Bank Financial (NBF), offers comprehensive, holistic financial advice, a broad and deep suite of financial products and services, transaction execution and securities custody to more than 350,000 Canadians, for whom some 960 advisors administer and manage $76 billion in assets.

Self-Directed Brokerage — National Bank Direct Brokerage Inc. (NBDB) provides self-directed investors with an innovative technological platform featuring an intuitive client interface, research from a number of widely respected sources, interactive modeling tools and peerless securities transaction execution and custody services.

Services for High and Ultra-High Net Worth Individuals — Private Wealth 1859 offers a comprehensive planning-based suite of wealth management services specifically designed to meet the needs of affluent individuals, families and small businesses.

Investment Product Manufacturing — National Bank Securities Inc. (NBS) manufactures a full suite of mutual fund solutions that are distributed within the Bank's branch network, by its full-service, direct brokerage and high net worth subsidiaries, as well as by many other financial institutions across the country.

Trust Services — National Bank Trust Inc. (NBT) provides a comprehensive menu of trust services to individual clients of the Bank and of its wealth management distribution channels, as well as to institutional clients. Moreover, NBT has a team of tax and estate planning consultants to serve both trust service clients as well as high and ultra-high net worth clients of Private Wealth 1859 and NBF.

Intermediary Business Solutions — The Bank's Intermediary Business Solutions division provides branded and white-labelled transactional banking and credit products to a number of Canada's large financial institutions for redistribution to their clients, and it wholesales a selection of the Bank-manufactured investment and deposit products through third-party distribution channels. This business unit is also the largest supplier of settlement and custodial services to the financial services industry in Canada.

Assets Under Administration or Under Management – Wealth Management

As at October 31 (millions of Canadian dollars)	2013	2012	2011	2013-12 % change	2012-11 % change
Assets under administration	**216,727**	196,403	186,524	**10**	5
Assets under management					
Institutional	**–**	–	25,449		
Individual	**24,650**	20,597	17,363	**20**	19
Mutual funds	**16,633**	15,027	13,659	**11**	10
	41,283	35,624	56,471	**16**	(37)
Assets under administration and under management	**258,010**	232,027	242,995	**11**	(5)

As at October 31, 2013, total assets under administration and under management amounted to $258.0 billion, up $26.0 billion or 11% from October 31, 2012 and up 6% from October 31, 2011.

As at October 31, 2013, assets under administration totalled $216.7 billion, a $20.3 billion or 10% increase from October 31, 2012 that came mainly from a rise in stock markets. The assets under management of individual clients totalled $24.7 billion as at October 31, 2013 versus $20.6 billion as at October 31, 2012, a strong 20% increase owing to the results produced by the Wealth Management acquisitions and also to business growth at Private Wealth 1859.

The assets under management of institutional clients were nil as at October 31, 2013 and 2012, as the operations of Natcan Investment Management Inc. (Natcan) were sold, resulting in institutional clients being transferred to Fiera Capital Corporation (Fiera). Mutual funds totalled $16.6 billion as at October 31, 2013, rising 11% as clients showed greater interest in this type of savings and because of a rise in stock markets.

Main Issues and Challenges in 2013

The Wealth Management segment identified the following issues and challenges as being the most significant to its activities in 2013:

- the environment in which this segment does business has been less than favourable;
- poor returns have prompted clients to reconsider investing;
- asset disbursements were up due to an increase in new retirees; and
- higher operating costs and product and service fees narrowed profit margins.

Strategies

All of Wealth Management's strategic priorities are guided by a commitment to growing sales and revolve around a series of focal points.

Greater Emphasis on Organic Growth

In the past few years, Wealth Management has carried out three major transactions that have significantly raised the Bank's profile in the financial services market. The need to properly absorb the long-term impact of these transactions and harness the resulting synergies means that, for 2013 and the immediate future, emphasis will be placed on organic growth rather than on contributions from new external acquisitions.

That said, there is no denying that the Canadian trend towards consolidation in financial services encourages acquisitions, and Wealth Management fully intends to remain alert to compelling new acquisition opportunities for the Bank, as was the case for the acquisition of TD Waterhouse Institutional Services.

Prioritizing a Financial Advisory Approach to Distribution

The segment remains very confident in the high-growth potential of applying an advice-based approach to the distribution of financial products and services. This optimism is supported by trends in Canadian demographics and by a growing number of high net worth households and clients. These trends, which are not expected to soon reverse, have increased the need for customized financial advice, as clients are facing important questions and financial decisions that have become increasingly complex.

However, the segment's focus on this area of wealth management in no way diminishes the importance of other categories of services. It is understood that the growth strategies implemented by the segment apply to every category of its product and service offering.

Importance of Partnerships and Associations to the Overall Strategy

A unique feature of Wealth Management's business model and strategy is the strong emphasis placed on strategic partnerships and associations. Such arrangements provide clear mutual benefits that the Bank can leverage to optimize its capacity to design financial products and use its operational platforms. The partnerships and associations that have been concluded are integral to Wealth Management's market expansion strategies. Therefore, notwithstanding the greater emphasis on organic growth in 2013, the segment will continue to examine partnership opportunities likely to further expand the Bank's reach into the area of wealth management. Maintaining the positive leverage created through these arrangements is essential to the segment's targeted growth.

Capitalizing on Growth Prospects in the Bank's Developing Markets

The segment sees excellent opportunities to develop wealth management services in areas of Canada where the Bank is less established. Like the Bank's other major business segments, Wealth Management is concentrating on expanding into regions of Central, Western and Atlantic Canada where the Bank is already active.

Achievements

Given its recent acquisitions, 2013 was a transition year for the Wealth Management segment. Generally speaking, this led to an even greater emphasis on the need for prudent management and control over operating costs in all of the segment's business units.

Realizing Synergies From Recent Transactions

In 2013, Wealth Management maximized the synergies resulting from the recent transactions completed between July 2011 and April 2012, namely, the acquisitions of Wellington West Holdings Inc. (Wellington West), the full-service investment advisory business of HSBC Securities (Canada) Inc. and the sale of Natcan's operations to Fiera followed by an acquisition of an interest in Fiera. Because these transactions are so recent, to date the focus has been on integrating the new business lines into the existing service offering and maximizing the full potential of our ownership in Fiera. The transition work following these three major transactions was essentially completed in 2013 and the positive synergies can now be fully tapped.

Operations resulting from the Wellington West acquisition by NBF have been fully integrated for a full year now, helping the Bank to benefit from streamlined operating costs. The segment benchmarked the main business parameters where notable market differentiation could be achieved, particularly the business and risk management culture, best practices in use and the product and service offering. This exercise helped to identify leading industry practices and characteristics. Furthermore, thanks to synergies resulting from the integration process, the Bank was able to cross-sell its products to new clients and appreciate the contribution of several products previously developed by Wellington West. The geographic footprint of NBF expanded considerably, particularly in Central and Western Canada, resulting in various benefits: development of the brand, recruitment of investment professionals, and economies of scale.

The operations of the full-service investment advisory business of HSBC Securities (Canada) Inc. were merged with the segment's existing operations in the early part of fiscal 2013, meaning the merged operations have been in place for a little less than a year. The transaction synergies have essentially taken the form of operating cost savings resulting from operational integration. In addition, the products and services catalogues of the former firm and NBF Wealth Management were merged and standardized, and, as with the above-described acquisition, a benchmarking exercise was completed to determine leading practices in corporate culture and risk management, best practices in use, and product and service offering.

The transaction whereby the Bank sold Natcan's operations to Fiera and acquired a 35% interest in Fiera has to date produced the expected results. Thanks to the professionalism and expertise of its team of asset managers, Fiera delivered very good performance on the investment mandates assigned to it by the Bank. The Bank also leveraged this expertise to create a number of innovative financial products. Lastly, as a result of both its organic growth and the impact of the new acquisitions, Fiera put much effort into managing the growth of its assets under management, and this growth was recognized by the financial markets, translating into a significant increase in the value of the Bank's interest in the corporation.

Boosting the Productivity and Professionalism of the Sales Teams
The segment benefited from a sizable increase in the number of investment professionals with the certification required to take on discretionary portfolio management mandates.

Substantial work was done with the sales teams to promote "wealth manager" certification and wealth management training for employees. Additional management tools were developed to stimulate performance and boost results.

Implementing Intermediary Business Solutions
The segment restructured NBCN inc. (NBCN), a Bank subsidiary that handles securities operations (delivery, custody, etc.). A new executive was hired to oversee this entity.

During the year, the Bank entered into an agreement to acquire the institutional services of Toronto-Dominion Bank known as TD Waterhouse Institutional Services. Through this acquisition, the Bank will further improve its geographic representation and deepen its expertise and, moreover, better balance NBCN's client base through a greater number of portfolio management firms relative to introducing brokers.

Exceptional and Professional Client Experience
According to the latest study by marketing information firm J.D. Power, clients of NBDB are the most satisfied self-directed investors in the Canadian brokerage industry. NBDB's ranking is all the more enviable because the popularity of brokerage services for self-directed investors continues to grow in Canada.

A survey by an independent firm on the satisfaction of NBF's clients with regard to their investment advisors and the organization shows that our client satisfaction rating is above the financial service industry average and has been rising steadily over the 10 years the survey has been conducted.

For the first time since the creation of Private Wealth 1859, a broad client satisfaction study was conducted showing that over 84% of our clients are satisfied or very satisfied with the services they receive from their advisors, a notch above the financial service industry average of 80%.

Priorities and Outlook for 2014

For 2014, Wealth Management's priorities will address four business objectives:

- integrate TD Waterhouse Institutional Services into Wealth Management's existing service offering;
- focus primarily on developing a financial advisory approach to distribution;
- leverage partnerships and associations to further extend the Bank's market reach; and
- focus on internally generated growth, prioritizing Central, Western, and Atlantic Canada.

In pursuing these objectives, the segment will place greater emphasis on seeking technological improvements that raise productivity, on further strengthening professionalism and the wealth management approach, in particular through certifications, and on deploying the product and service offering using both the advice-based approach and through partners, in particular in markets outside Quebec.

BUSINESS SEGMENT ANALYSIS

FINANCIAL MARKETS

OVERVIEW

The Financial Markets segment offers clients a full suite of products and services to meet their specific needs—from debt and equity securities to bank credit and risk management products. The segment also delivers comprehensive advisory services in the areas of mergers and acquisitions and financing. Access to the Canadian capital markets is provided through its fixed income, equities and derivatives business lines. Clients of the segment include large and mid-sized corporations, the public sector and institutions. The Financial Markets segment is Canada-focused and employs a client-centric approach to ensure that all clients benefit from the full breadth of its capabilities.

Financial Markets is an investment banking leader in Quebec with a strong presence across Canada. In fixed income and equities, the Bank is a major Canadian player, providing origination, underwriting, distribution, liquidity through secondary market activities and macro economic and issuer focused research. The Financial Markets segment provides corporate lending to large and mid-sized Canadian corporate clients and risk management services to these clients.

Through offices in New York and London (UK), the Financial Markets segment markets Canadian debt and equity securities to institutional investors in the United States and internationally. The Financial Markets segment has strong expertise in investing and managing distressed consumer debt portfolios through its specialty finance Credigy Ltd. subsidiary, which operates exclusively outside of Canada.

Segment Results – Financial Markets(1)

Year ended October 31 (taxable equivalent basis)(2) (millions of Canadian dollars)	**2013**	2012	2011	**2013-12**	2012-11
				% change	% change
Excluding specified items(2)					
Net interest income	**785**	584	579	**34**	1
Non-interest income	**594**	719	641	**(17)**	12
Total revenues	**1,379**	1,303	1,220	**6**	7
Non-interest expenses	**657**	669	665	**(2)**	1
Contribution	**722**	634	555	**14**	14
Provisions for (recoveries of) credit losses	**(14)**	3	(5)		
Income before income taxes	**736**	631	560	**17**	13
Income taxes	**195**	170	166	**15**	2
Net income excluding specified items	**541**	461	394	**17**	17
Specified items after taxes(2)	**–**	(28)	(5)		
Net income	**541**	433	389	**25**	11
Non-controlling interests	**8**	3	(1)		
Net income attributable to the Bank's shareholders	**533**	430	390	**24**	10
Average assets	**87,063**	76,084	72,613	**14**	5
Average deposits	**6,541**	4,160	6,066	**57**	(31)
Average loans and acceptances (Corporate only)	**7,081**	5,855	4,899	**21**	20
Net impaired loans	**–**	40	16		
Net impaired loans as a % of average loans and acceptances	**– %**	0.7 %	0.3 %		
Efficiency ratio excluding specified items(2)	**47.6 %**	51.3 %	54.5 %		

(1) Banking activities with energy sector companies have been transferred from the Financial Markets segment to the Personal and Commercial segment. The Bank made this change on November 1, 2012 to better reflect how management monitors performance. Prior period results have been restated to reflect this change.
(2) See the Financial Reporting Method section on page 12.

Financial Results

In the Financial Markets segment, net income totalled $541 million in 2013, up $108 million or 25% from 2012. Excluding specified items, net income totalled $541 million in 2013, rising $80 million or 17% from $461 million in 2012. On a taxable equivalent basis, total revenues amounted to $1,379 million, up $76 million from 2012 and up $159 million from 2011.

Trading activity revenues saw an $82 million or 15% year-over-year increase due to higher client-driven trading revenues across all products. Banking service revenues rose 23%, particularly due to greater financing needs among clients. Revenues from financial market fees declined $23 million or 8%, mainly due to less merger and acquisition activity and a slowdown in new capital issuances. Net gains on available-for-sale securities, at $26 million, decreased by $23 million as larger gains had been recorded in 2012. Other revenues were down slightly given a lower contribution from associate Maple Financial Group Inc., partly offset by higher revenues arising from receivables purchased by the Credigy Ltd. subsidiary.

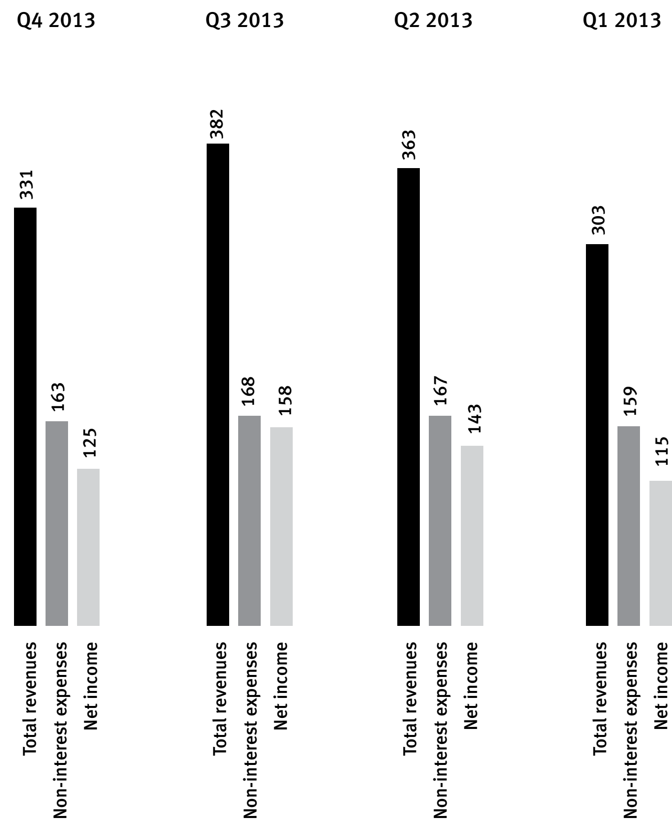
Excluding the specified items of 2012, non-interest expenses stood at $657 million, a $12 million year-over-year decrease that was mainly due to lower variable compensation as a result of sound cost management and a change in the business mix. The efficiency ratio was 47.6% in 2013 versus 51.3% in 2012. The specified items for 2012, amounting to $38 million, had consisted mainly of severance payments incurred to optimize the segment's structure and streamline certain operations.

The segment recorded $14 million in recoveries of credit losses in 2013, whereas in 2012, it had recorded $3 million in provisions for credit losses.

Average assets rose to $87.1 billion in 2013 from $76.1 billion in 2012 and $72.6 billion in 2011. Corporate loan volume saw a 20% year-over-year increase owing to greater client demand.

Quarterly Results(1)(2)

(taxable equivalent basis)(2)
(millions of Canadian dollars)



(1) Excluding specified items.
(2) See the Financial Reporting Method section on page 12.

Revenue Breakdown – Financial Markets(1)

Year ended October 31 (taxable equivalent basis)(2) (millions of Canadian dollars)	2013	2012	2011	2013-12 % change	2012-11 % change
Trading activity revenues					
Equities	**288**	246	234	**17**	5
Fixed-income	**237**	212	130	**12**	63
Commodities and foreign exchange	**88**	73	92	**21**	(21)
	613	531	456	**15**	16
Financial market fees	**257**	280	292	**(8)**	(4)
Gains on available-for-sale securities, net	**26**	49	62	**(47)**	(21)
Banking services	**234**	191	190	**23**	1
Other	**249**	252	220	**(1)**	15
Total	**1,379**	1,303	1,220	**6**	7

(1) Banking activities with energy sector companies have been transferred from the Financial Markets segment to the Personal and Commercial segment. The Bank made this change on November 1, 2012 to better reflect how management monitors performance. Prior period results have been restated to reflect this change.
(2) See the Financial Reporting Method section on page 12.

Strategies and Achievements

One Client, One Bank

In 2013, the Financial Markets segment stayed the course with its *One client, one bank* strategy of delivering the Bank's full capabilities to all its clients. It achieves this by employing a collaborative, partnership approach amongst its business lines and with the Bank's Wealth Management and Personal and Commercial segments. Regardless of a client's initial point of contact, Financial Markets offers its full expertise to ensure client needs are met. Throughout the year, the segment successfully leveraged its strengths to build and grow its leadership positions in its chosen areas of focus.

The following transactions highlight the Financial Markets segment's ability to deliver a diverse and integrated set of solutions to its clients:

- The Financial Markets segment provided acquisition-related credit facilities and co-led on the dual-tranche bond acquisition financing related to the $5.8 billion acquisition by Sobey's Inc. of Canada Safeway. The segment also provided Sobey's Inc. with risk management solutions.
- Financial Markets was engaged by Whitecap Resources Inc. as lead arranger, sole bookrunner and administrative agent on a $520 million corporate financing and co-led two equity capital markets transactions, and provided M&A advisory and risk management solutions.
- Financial Markets was engaged by Cogeco Cable Inc. to advise on its acquisition of PEER 1 Network Enterprises, Inc. for $635 million as well as to underwrite a $650 million acquisition financing to effect the transaction. Financial Markets also provided risk management solutions related to the transaction.
- Financial Markets was retained as financial advisor to the special committee of Astral Media Inc. on the sale of the company to BCE Inc. for $3.4 billion.

Maintaining Focus on Mid-Market Companies

By providing mid-market clients with advisory services, holistic solutions for accessing the capital markets and a comprehensive range of risk management products, in 2013, the Financial Markets segment continued to expand its national presence in the mid-market. In addition to mid-market Energy and Mining, the segment expanded its focus into other industries including Industrial Products, Transportation, Consumer and Retail. For the 12 months ended April 30, 2013, Financial Markets was ranked third in Canadian mid-market investment banking by Brendan Wood International.

During the year, the segment advised on 39 publicly-announced transactions and led or co-led 70 equity offerings on behalf of corporate issuers.

Leveraging Market Leadership in Quebec

As the market leader in Quebec, the Financial Markets segment continued to deepen its presence throughout the province. The segment maintained its dominant position in investment banking, corporate lending and government financing. Financial Markets participated in 52 syndicated loans involving Quebec borrowers and led 32 of these transactions, with a market share of 19.2%. The segment also translated its traditional stronghold in Quebec government debt underwriting to leadership across Canada, ranking first for the third year in a row.

Financial Markets ranked first for participations in public equity offerings of Quebec issuers, having been involved in 19 offerings for an aggregate value of over $2 billion. The segment led 13 of those financings, with a market share of 17.6%. It also ranked among the top three merger and acquisition advisers, having been involved in transactions aggregating $4.0 billion in value. Financial Markets took advantage of the IPO market recovery as it participated in all three IPOs involving Quebec-based companies, while acting as lead or co-lead underwriter on two of them. In 2013, Financial Markets also strengthened its commitment to earlier stage companies in the province and has put in place a dedicated team focused on this segment. Transaction highlights for Quebec-based issuers included:

- Financial Markets acted as lead on the $40 million IPO of Manac Inc.
- Financial Markets acted as co-lead underwriter on the $153 million IPO of KP Tissue Inc., a subsidiary of Kruger Inc., and on the $237.4 million equity financing of Industrial Alliance Insurance and Financial Services Inc.

Maintaining Leadership in Fixed Income

The Financial Markets segment's fixed-income group maintained its status as top tier dealer reaching a 22.4% market share for first overall ranking in Canadian government debt underwriting by *Bloomberg* magazine for the Bank's 2012 and 2013 fiscal years. The group also continues to increase its secondary market share in provincial and Canadian bonds.

Demonstrating its mission to leverage existing leadership positions, the fixed-income team has grown and is now a top tier corporate dealer, participating in 111 corporate deals and leading 29.

The fixed-income team also possesses a strong infrastructure finance capability, a leader in revenues earned, deals closed and funding committed to client bids in the Public Private Partnership (P3) market in Canada for 2013. In 2013, the Canadian Council for Public Private Partnership recognized its Ottawa light rail unrated bond transaction as the P3 Project Finance deal of the year. Infrastructure will be an area of continued focus and growth in the coming years. The segment will also employ this expertise to support its clients in the U.S. market.

A strategic focus continues to be the distribution of Canadian products in international markets. The group has a solid presence in New York and the largest Canadian focused desk in the UK.

Fixed-Income Highlights

Public sector: *Led or joint-led 47 underwritten and agency medium-term notes issues of government securities for a total of $38.9 billion, including:*

- Canadian-dollar global issues of Canada Mortgage Bonds;
- Domestic syndicated offerings by the Province of Quebec, Hydro-Québec and Financement Québec, the governments of Ontario, British Columbia and Alberta, the municipalities of Montreal and Peel, and the Municipal Finance Authority of British Columbia;
- Domestic sole or joint agency medium-term notes issues by Ontario and British Columbia; and
- U.S. dollar global issue for Manitoba.

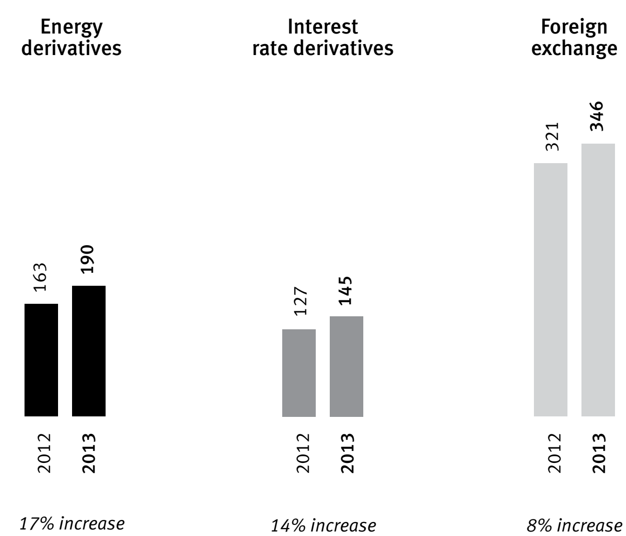
Corporate debt: *Led or joint-led managed $10.9 billion, including:*

- $400 million: Videotron Ltd.
- $750 million: Cominar Real Estate Investment Trust
- $1.0 billion: Bell Canada
- $1.3 billion: Alimentation Couche-Tard Inc.
- $1.0 billion: TMX Group Ltd.
- $650 million: Manulife Bank of Canada
- $200 million: Pembina Pipeline Corporation
- $475 million: EnerCare Solutions Inc.

Continued Leadership in Deploying Risk Management Products to the Bank's Clients

Financial Markets continued to leverage its derivatives trading and structuring skills to develop innovative risk management solutions to assist clients in managing their risks across all asset classes. The group achieved significant growth in the number of active clients using risk management products and the number of clients using more than one risk management product. This has translated into strong revenue growth.

Number of Corporate Clients

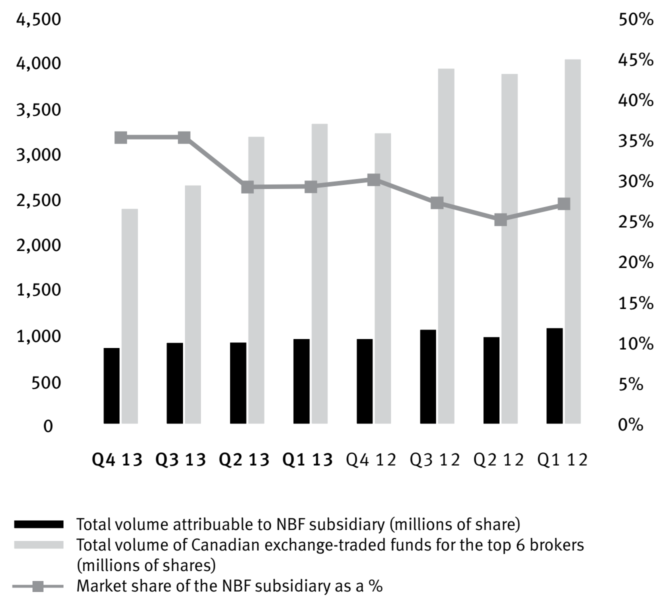


Remained Top-Tier Provider of Equity and Structured Products

The group continues to provide over-the-counter derivatives and structuring services on all asset classes for exchange traded fund (ETF), structured note and managed retail product (MRP) issuers. The group also provides liquidity to investors and offers research on all investment products.

Highlights – Exchange Traded Funds (ETF) and Structured Notes

- The group is the largest market maker of ETFs in Canada (by volume) (*Bloomberg*).
- The group provided liquidity for all ETFs and were designated market maker for 52% of all listed ETFs in Canada.
- Sales volumes of structured notes rose by 68% over the past six years.



Delivering Clients Industry Leading Capabilities

Further confirmation of Financial Markets' commitment to providing clients with top-tier services is demonstrated by the following achievements:

- The Research Team placed in the top three with the most award-winning analysts in Canada in the 2013 StarMine Analyst Awards for stock picking and earnings projections.
- The Bank's chief economist and strategist was the only Canadian economist to be ranked in *Bloomberg's* 2013 Top Forecasters of the U.S. Economy (for the two-year period ending April 2013).

Strength in Specialty Finance through Credigy Ltd.

Credigy Ltd. is the Financial Markets segment's speciality finance arm. The Bank acquired an 80% interest in Credigy Ltd. in 2006. Credigy Ltd. purchases performing and non-performing consumer-related asset portfolios and optimizes collections through its data analytics and modeling expertise to achieve target returns. It is also a lender to other large buyers of similar assets.

Credigy Ltd. is internationally focused, purchasing portfolios in the United States, Puerto Rico, Brazil and most recently in Spain. The group is also diversified by asset class. Between 2012 and 2013, Credigy Ltd. achieved growth in revenues and income before income taxes of 13% and 38%, respectively.

Priorities and Outlook for 2014

In 2014, the Financial Markets segment will continue to focus on its client driven, Canada-focused strategy, developing innovative, integrated solutions to meet the needs of its clients and respond to market opportunities. This consistent business model and strategy will continue to drive growth in 2014 and beyond.

Strategic priorities include consolidating its top tier positioning, continuing to diversify its revenue mix and leverage its leadership positions into new areas. The segment will also continue to explore selective growth opportunities in areas such as the mid-market, distributing Canadian securities abroad and through its Credigy subsidiary.

BUSINESS SEGMENT ANALYSIS

OTHER

OVERVIEW

The *Other* heading reports on Treasury operations, including the Bank's asset and liability management, certain non-recurring items and the unallocated portion of corporate units. Corporate units include Information Technology and Organizational Performance, Risk Management, Operations, Marketing, Human Resources and Corporate Affairs, and Finance and Treasury.

Segment Results – Other

Year ended October 31
(taxable equivalent basis)(1)
(millions of Canadian dollars)

	2013	2012	2011
Excluding specified items(1)			
Net interest income	(4)	90	178
Non-interest income	125	83	(18)
Total revenues	121	173	160
Non-interest expenses	160	109	92
Income before income taxes	(39)	64	68
Income taxes	(40)	3	(1)
Net income excluding specified items	1	61	69
Specified items after income taxes(1)	87	112	10
Net income	88	173	79
Non-controlling interests	67	69	69
Net income attributable to the Bank's shareholders	21	104	10
Average assets	21,587	26,756	23,263

(1) See the Financial Reporting Method section on page 12.

Financial Results

For the *Other* heading of segment results, net income excluding specified items totalled $1 million in 2013 versus $61 million in 2012, a year-over-year decrease attributable to a lower contribution from Corporate Treasury combined with higher non-interest expenses. The year-over-year increase in non-interest expenses came from the addition of the compensatory tax and from costs incurred for process improvement projects. For 2013, the specified items, net of income taxes, consisted of $104 million in revenues related to holding restructured notes, net of the financing costs of holding these notes, $21 million in severance pay and vacant premises charges, $29 million in intangible asset impairment losses, and $4 million in charges related to the Bank's interest in TMX Group Ltd.

For 2012, the specified items, net of income taxes, had consisted of $113 million in revenues related to a rise in fair value of restructured notes, $17 million in severance pay and lease terminations incurred to optimize certain organizational structures, and $13 million in intangible asset write-offs. Reversals of provisions for income tax contingencies of $37 million and $29 million were recorded in 2013 and 2012, respectively.

Corporate Units

The Information Technology and Organizational Performance unit is responsible for, on the one hand, maintaining the Bank's technological assets so as to provide its clients and employees with reliable computer services and, on the other, ensuring those services evolve smoothly in order to support the Bank's business objectives and comply with changes in regulatory requirements. Managing technology risk, whether it involves data security, obsolescence prevention, or the recovery plan, is also part of this unit's responsibilities.

The Risk Management unit is responsible for identifying, measuring, and monitoring—independently and within an integrated framework—the various risks to which the Bank is exposed and for promoting a sound risk management culture. The Risk Management team helps the Board and management understand and monitor the main risks (see the Risk Management section for additional information). The unit also develops, maintains and communicates the risk appetite framework while overseeing the integrity and reliability of risk measures.

The Operations unit is a robust and reliable strategic business partner that creates wealth by ensuring efficient delivery of financial products and services to clients. In particular, the unit ensures leadership of the Business Process Management (BPM) Centre of Excellence, whose mandate is to manage the Bank's major business processes end-to-end and ensure performance growth on an ongoing basis. The unit is also responsible for the Bank's Strategic Initiatives Office, which advises the Office of the President on its strategic investment decisions. As such, the Operations team is a lever for the Bank's growth and a source of a differentiated client experience.

The Marketing unit manages and delivers the Bank's distinctive client experience through business and electronic distribution strategies tailored to the needs and expectations of retail and commercial clients, a strong brand image, competitive and distinctive business solutions, and by proactively managing client satisfaction. The Marketing team helps the business segments meet their strategic objectives by creating conditions conducive to developing successful, long-term relationships with clients, communities and external stakeholders.

The Human Resources and Corporate Affairs unit provides expertise to all of the Bank's units and contributes to the organization's performance, growth and continued status as an employer of choice by deploying strategies meant to attract, develop and retain the best talent. The unit implements practices that promote employee mobilization and helps cultivate a work environment where everyone can develop to their full potential. The mandate of Corporate Affairs includes reducing the organization's legal risks, providing sound guidance with respect to regulatory, governance and commercial litigation issues, supporting Board-related activities, and maintaining the Bank's reputation in its markets.

The Finance and Treasury unit is responsible for optimizing management of financial resources (capital, liquidity, financing and equipment), actively ensuring asset/liability management, and ensuring sound governance of accounting and financial information. It also participates in strategic and operational decision-making and supervises the activities of pension plan fund for Bank employees. It helps the business segments and support functions in their financial performance, ensures compliance with regulatory requirements, and handles reporting to shareholders and to the various units, entities and subsidiaries of the Bank. Finally, for administrative purposes, Internal Audit reports to Finance and Treasury.

FINANCIAL ANALYSIS

Analysis of Consolidated Results

Total Revenues

For 2013, total revenues on a taxable equivalent basis amounted to $5,372 million, down $113 million from 2012 (Table 2, page 88). Excluding specified items recorded in 2013 and 2012, total revenues on a taxable equivalent basis rose $155 million or 3% from last year. The 2013 and 2012 specified items include items related to holding restructured notes and, in 2012, the most significant specified item had been the gain on the sale of the operations of Natcan Investment Management Inc. (Natcan).

Net interest income

For 2013, net interest income on a taxable equivalent basis totalled $2,658 million, up $148 million from $2,510 million in 2012 (Table 3, page 88). In the Personal and Commercial segment, net interest income totalled $1,614 million, up $33 million or 2% year over year. Average loan and deposit volumes experienced steady growth compared to 2012, rising 9% and 6%, respectively, coming from residential mortgages and home equity lines of credit. This increase was tempered, however, by a narrowing net interest margin, which was 2.28% in 2013 compared to 2.42% in 2012. In the Wealth Management segment, net interest income totalled $272 million, rising $17 million on higher volumes in the CashPerformer account and Immigrant Investor Program. In the Financial Markets segment, net interest income increased $201 million year over year, mainly due to trading activities, and should be analyzed with the other items of trading activity revenues. In the *Other* heading, net interest income was down, mainly attributable to Treasury operations.

Non-interest income

For 2013, non-interest income totalled $2,714 million compared to $2,975 million last year (Table 4, page 89). Trading revenues recorded in non-interest income totalled $186 million compared to $233 million in 2012. Including the portion recorded in net interest income, trading revenues amounted to $825 million in 2013 (Table 5, page 89), a $136 million year-over-year increase attributable to market conditions that favoured growth across all categories of trading activity revenues and to items related to holding restructured notes. Net gains on available-for-sale securities decreased in 2013, as more significant gains had been recorded in 2012.

As shown in Table 4 on page 89, mutual fund revenues and trust service revenues totalled $533 million, rising $53 million thanks to higher fee-based revenues and growth in assets under administration. Underwriting and advisory fees were down 5% due to a decline in transactions, while securities brokerage commissions decreased by 2% due to a migration to fee-based services. Revenues from acceptances, letters of credit and letters of guarantee increased, rising $23 million on a higher volume of this type of financing for commercial clients. Foreign exchange revenues, other than trading, were down year over year as transaction volume decreased.

The Bank's share in the net income of associates and joint ventures decreased slightly owing to a smaller contribution from Maple Financial Group Inc. At $296 million, the *Other* item of *Non-interest income* was down $237 million, mainly because, in 2012, a gain had been recorded on the sale of Natcan's operations, partly offset by higher revenues arising from receivables purchased by the Credigy Ltd. subsidiary.

Provisions for Credit Losses

Provisions for credit losses remained stable in 2013 (Table 6, page 90). The provisions for personal credit losses were $13 million higher than last year and related mostly to consumer loans, mainly due to growth in loan volume. At $44 million for 2013, provisions for commercial credit losses were $8 million higher than in 2012, especially for loans to energy sector companies. Provisions for credit losses on Corporate Banking loans were $17 million less as a result of substantial recoveries in 2013. Overall, the 2013 provisions for credit losses represented 0.20% of average loans and acceptances compared to 0.21% in 2012, which is an improvement and relatively low given the current economic environment.

Non-Interest Expenses

Non-interest expenses stood at $3,165 million in 2013, down $8 million from last year (Table 7, page 91). Excluding the specified items recorded in 2013 and 2012, non-interest expenses increased $54 million or 2%.

At $1,858 million, compensation and employee benefits saw a 5% year-over-year decrease that was due to higher severance pay recorded last year, a decrease in variable compensation, and a workforce reduction resulting from an optimization of business processes.

Technology expense, including amortization, increased mainly because of higher intangible asset impairment losses in 2013 compared to 2012. As for occupancy expense, including amortization, the increase came from a provision for vacant premises recognized in 2013. At $221 million, professional fees for 2013 increased by $26 million, due to technology investments. Lastly, advertising and external relations expenses were up $7 million as a result of marketing initiatives.

Income Taxes

Detailed information about the Bank's income taxes is provided on pages 180 and 181 in Note 23 to the consolidated financial statements. For 2013, income taxes stood at $263 million, for an effective tax rate of 14%, compared to $326 million and an effective tax rate of 17% in 2012. This lower effective income tax rate came from a higher amount of tax-exempt income from securities in 2013 than in 2012 and from a $37 million reversal of provisions for income tax contingencies in 2013 compared to $29 million in 2012.

Quarterly Financial Information

Several trends and factors have an impact on quarterly net income, revenues and non-interest expenses. Results for the past 12 quarters have been summarized and provided in Table 1 on pages 86 and 87. Results for the past eight quarters were affected by various favourable and unfavourable factors.

- In the second quarter of 2013, net income was higher as revenues were recognized to reflect an increase in the fair value of restructured notes.
- Record net income was reported in two of the four quarters of 2013.
- In the fourth quarter of 2012, the Bank recorded revenues to reflect an increase in the fair value of restructured notes in addition to significant expenses related to severance pay, lease terminations and intangible asset write-offs.
- Net income for the third quarters of 2013 and 2012 included reversals of tax provisions.
- In the second quarter of 2012, the Bank had realized a significant gain on the sale of the Natcan subsidiary.

Over the past eight quarters, consolidated net income has been positive, with certain quarters posting record net income, reflecting sustained performance by the business segments combined with effective cost management.

Net interest income has remained relatively stable over the past eight quarters. Growth in Personal and Commercial loan volume has been tempered by lower net interest margins.

In the fourth quarter of 2013, the year-over-year decrease came mainly from the fact that, in 2012, revenues had been recorded to reflect an increase in the fair value of restructured notes and, in the second quarter of 2013, the year-over-year decrease came from the fact that, in the second quarter of 2012, a gain had been recorded on the sale of Natcan's operations.

Provisions for credit losses have been relatively low for the last eight quarters owing to an excellent quality loan portfolio and substantial recoveries of corporate loan losses in the first quarter of 2013.

Quarterly non-interest expenses decreased in 2013 mainly as a result of strict cost control by the Bank's various segments and the recognition of higher severance pay in 2012.

Non-controlling interests have remained stable for the eight quarters of 2013 and 2012.

Income tax rates have remained stable over the past eight quarters, except for the third quarters of 2013 and 2012, when they decreased considerably due to reversals of provisions for income tax contingencies.

For additional information about the fourth quarter of 2013, visit the Bank's website at **nbc.ca** or the SEDAR website at **sedar.com** to consult the Bank's *Press Release for the Fourth Quarter of 2013*, released on December 4, 2013.

Analysis of the Consolidated Balance Sheet

As at October 31, 2013, the Bank had total assets of $188.2 billion compared to $177.9 billion at year-end 2012, a 6% increase that stems mainly from loan growth of $6.4 billion and securities purchased under reverse repurchase agreements and securities borrowed, which rose $5.9 billion (see the Consolidated Balance Sheets on page 98).

Cash and Deposits with Financial Institutions

At $3.6 billion as at October 31, 2013, cash and deposits with financial institutions rose $0.4 billion from the same date last year. The Bank's liquidity risk management practices are described on pages 76 to 82 of this MD&A.

Securities

As at October 31, 2013, securities totalled $53.7 billion (29% of total assets), down $1.2 billion from $54.9 billion as at October 31, 2012. Securities at fair value through profit or loss decreased $0.5 billion since last year, due to the disposal of securities issued or guaranteed by the Government of Canada, partly offset by the acquisition of equity securities. Available-for-sale securities, i.e., securities generally held long-term, totalled $9.7 billion at year-end, down $0.7 billion since October 31, 2012, the decrease being attributable to a $0.3 billion decrease in securities issued or guaranteed by provincial governments and a $0.4 billion decrease in other debt securities. The Bank's market risk management policies are described on pages 71 to 76 of this MD&A. Securities purchased under reverse repurchase agreements and securities borrowed totalled $21.4 billion as at October 31, 2013, a $5.9 billion increase since year-end 2012 that is related to activities in the Financial Markets segment.

Master Asset Vehicles

As at October 31, 2013, the face value of the restructured notes of the master asset vehicle (MAV) conduits and of the other restructured notes held by the Bank was $1,727 million ($1,933 million as at October 31, 2012), of which $1,506 million was designated as *Securities at fair value through profit or loss* under the fair value option, and an amount of $221 million was classified in *Available-for-sale securities* ($1,647 million designated as *Securities at fair value through profit or loss* and $286 million classified in *Available-for-sale securities* as at October 31, 2012). The change in the face value of the restructured notes of the MAV conduits during fiscal 2013 was mainly due to capital repayments and disposals.

The following table provides a breakdown of the face value of the restructured notes of the MAV conduits held by the Bank.

As at October 31 (millions of Canadian dollars)	2013
MAV I	
Class A-1	478
Class A-2	553
Class B	94
Class C	39
IA tracking notes for ineligible assets	12
Total MAV I	1,176
MAV II	
Class A-1	101
Class A-2	80
Class B	14
Class C	6
IA tracking notes for ineligible assets	16
Total MAV II	217
MAV III	
TA tracking notes for traditional assets	9
IA tracking notes for ineligible assets	186
Total MAV III	195
Commercial paper not included in the Pan-Canadian restructuring plan	139
Total	1,727

The Bank has committed to contribute $886 million to a margin funding facility related to the MAV conduits in order to finance potential collateral calls. As at October 31, 2013, no amount had been advanced by the Bank.

Establishing Fair Value

The carrying value of the restructured notes of the MAV conduits and of the other restructured notes held by the Bank in an investment portfolio as at October 31, 2013, designated as *Securities at fair value through profit or loss*, was $1,293 million, and $68 million was classified in *Available-for-sale securities* ($1,269 million designated as *Securities at fair value through profit or loss* and $69 million classified in *Available-for-sale securities* as at October 31, 2012). The notes held in an investment portfolio with one or more embedded derivatives were designated as *Securities at fair value through profit and loss* under the fair value option, and the other notes were classified in *Available-for-sale securities*.

The following table provides a breakdown of the carrying value of the restructured notes held by the Bank and their residual contractual maturities.

Carrying Value of Notes and Residual Contractual Maturities

As at October 31 (millions of Canadian dollars)				2013
	1 year or less	Over 1 year to 5 years	Over 5 years	Total
MAV I and MAV II	2	–	1,189	1,191
MAV III	–	–	62	62
Commercial paper not included in the Pan-Canadian restructuring plan	13	95	–	108
Carrying value of the notes	15	95	1,251	1,361
Margin funding facility				(30)
Total	15	95	1,251	1,331

In establishing the fair value of the restructured notes of the MAV conduits and excluding ineligible assets, the Bank considered the quality of the underlying assets. The Bank determined fair value using a valuation technique that incorporates discounted cash flows. The discount rate is based 80% on the CDX.IG index tranches and 20% on a basket of securities backed by assets such as credit card receivables, Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and automobile loans. The fair valuation method also includes the effects of broker quotes and market conditions on the MAV II Class A-1, A-2, B and C notes. The adjustment related to broker quotes represented 30% in 2013 (30% in 2012) of the weighting used to determine fair value. The credit ratings and coupons were based on the terms set out in the restructured notes of the MAV conduits. Maturities are based on the anticipated cash flows of the underlying assets.

For ineligible assets, the fair value of the tracking notes is based on an analysis of the underlying assets of the notes and the market value of comparable instruments. For RMBS, fair values were based on the ABX index; for CMBS, CMBS indices, including the CMBX index, were chosen. As for derivative financial instruments, the Bank used valuation models which are commonly used by market participants with inputs that are based on factors observable in the markets such as the CDX.IG indices and the base correlation and interest rates.

In establishing the fair value of the restructured notes, in 2013 the Bank adjusted its liquidity assumption to reflect market conditions.

The Bank determines the value of the restructured notes of the MAV conduits it is holding by comparing the value obtained using the above-described methodology against a range of values. The values situated in this range were obtained from adjusting various inputs to the discount rate and broker quotes, incorporating third-party assessments and by applying various liquidity scenarios. As several assumptions may be used in determining fair value, this range reflects the level of uncertainty associated with these models.

During the year ended October 31, 2013, revenues amounting to $139 million and $12 million were recorded to reflect, respectively, the change in the fair value of restructured notes and the change in the fair value of commercial paper not included in the Pan-Canadian restructuring plan ($111 million and $34 million, respectively, during the year ended October 31, 2012). These amounts were recorded in *Trading revenues* in the Consolidated Statement of Income. The carrying value of the restructured notes, designated as *Securities at fair value through profit or loss*, was within the range of the estimated fair value as at October 31, 2013. The credit ratings of the MAV I and MAV II Class A-1 notes were maintained at "AA (low) (sf)" and the credit rating of the MAV I Class A-2 notes remained unchanged at "A (sf)". The credit rating of the MAV II Class A-2 notes was upgraded from "BBB (high) (sf)" to "A (low) (sf)", and a credit rating of "BBB (low) (sf)" was assigned to the MAV I Class B notes.

The Bank's valuation was based on its assessment of the conditions prevailing as at October 31, 2013, which may change in the future. The most significant assumptions used to determine the fair value of the restructured notes are observable discount rates, the credit ratings of the notes and the broker quotes on the MAV II Class A-1, A-2, B and C notes. Furthermore, there may be valuation uncertainty resulting from the choice of the valuation model used. The sensitivities of these assumptions on fair value as at October 31, 2013 are as follows:

- a 10-basis-point change in the discount rate would result in a $6 million decrease or increase in the fair value;
- a decrease in the credit rating by one letter grade would result in a decrease in the fair value between a range of $9 million to $16 million;
- an increase in the credit rating by one letter grade would result in an increase in the fair value between a range of $3 million to $5 million;
- a 100-basis-point change in the liquidity premium spread would result in a $13 million decrease or increase in the fair value;
- a 10% change in the weighting used to determine the discount rate would result in a $5 million decrease or increase in the fair value;
- a 10% change in the weighting attributed to the discount rate and the broker quotes on the MAV II Class A-1, A-2, B and C notes would result in a $7 million decrease or increase in the fair value; and
- a 1% change in the broker quotes on the MAV II Class A-1, A-2, B and C notes would result in a $4 million decrease or increase in the fair value.

Determining the fair value of restructured notes of the MAV conduits is complex and involves an extensive process that includes the use of quantitative modelling and relevant assumptions. Possible changes that could have a significant impact on the future value include (1) changes in the value of the underlying assets, (2) changes regarding the liquidity of the restructured notes of the MAV conduits which are not currently traded on an active market, (3) the impacts of a marked and prolonged economic slowdown in North America and certain European countries, and (4) changes in legislation.

Credit facilities to clients holding restructured notes of the MAV conduits
As at October 31, 2013, credit facilities outstanding provided to clients holding restructured notes of the MAV conduits stood at $17 million ($26 million as at October 31, 2012) and the allowances for credit losses were nil ($3 million as at October 31, 2012). As at October 31, 2013, credit facilities backed by restructured notes of the MAV conduits totalled $25 million ($100 million as at October 31, 2012) and those backed by ineligible asset tracking notes were nil ($4 million as at October 31, 2012). The face value of the restructured notes of the MAV II conduit designated as collateral totalled $29 million and the face value of the restructured notes of the MAV III conduit designated as collateral was nil ($150 million and $9 million, respectively, as at October 31, 2012).

Loans and Acceptances

At $97.3 billion, loans and acceptances accounted for 52% of total assets as at October 31, 2013, up $6.4 billion or 7%.

Residential mortgage loans outstanding totalled $36.6 billion as at October 31, 2013, rising $3.1 billion since year-end 2012, primarily due to a robust residential real estate market.

Personal loans and credit card receivables totalled $28.0 billion at year-end 2013, up $1.5 billion or 6% from $26.5 billion at year-end 2012. This substantial increase was attributable to home equity lines of credit. At $1.9 billion, credit card receivables were unchanged from year-end 2012.

At $33.3 billion as at October 31, 2013, loans and acceptances to businesses and government increased since year-end 2012, primarily loans to small- and medium-sized enterprises, which rose 5%, and corporate loans, which rose 30%. The customers' liability under acceptances item was up 9% and also contributed to the growth.

Table 9 on page 92 presents gross loans by borrower category as at October 31, 2013. Residential mortgages have grown since 2009, totalling $46.8 billion as at October 31, 2013 and representing 52.6% of total loans. The main reason for these changes was the popularity of home equity lines of credit and conventional residential mortgages. As for business loans, the construction and real estate sector and the services sector have increased.

Impaired Loans

Gross impaired loans totalled $395 million as at October 31, 2013 versus $387 million as at October 31, 2012, up 2% (Table 10, page 93). Impaired loans were 6.5% of the tangible capital adjusted for allowances, for a 1.0% decrease compared to October 31, 2012. Impaired loans net of individual and collective allowances posted a slight, $4 million increase from a year ago, mainly attributable to an increase in impaired loans in the Personal and Commercial segment due to a growth in loan volumes, partly offset by a significant decline in impaired corporate loans.

A detailed description of the Bank's credit risk management practices is provided on pages 65 to 70 of this MD&A as well as in Notes 5 and 7 to the consolidated financial statements.

Other Assets

As at October 31, 2013, other assets totalled $12.1 billion, down slightly from year-end 2012. Other assets consist of derivative financial instruments, amounts due from clients, dealers and brokers, investments in associates and joint ventures, premises and equipment, goodwill, intangible assets, and other items. The decrease in other assets essentially came from a $0.8 billion decrease in derivative financial instruments.

Deposit Liability

At $101.9 billion, deposits increased by $8.7 billion or 9% since year-end 2012. At $42.7 billion, personal deposits, as presented in Table 11 on page 93, increased $1.9 billion since October 31, 2012, accounting for 41.9% of all deposits. This increase was attributable to lower interest rates, which favoured traditional savings accounts and the CashPerformer account. A summary of total personal savings is provided below.

As at October 31, 2013, business and government deposits totalled $31.7 billion, up $5.7 billion from the same date last year, as businesses increased their liquidity. The $2.5 billion rise in unsecured senior debt was part of the funding needed to ensure sound liquidity management. Deposits from deposit-taking institutions decreased by $1.5 billion, and sources of deposits from the United States and other countries were down 28% and 49%, respectively, from October 31, 2012.

As at October 31, 2013, total personal savings totalled $157.5 billion, up 7% from $146.7 billion as at October 31, 2012. The assets of NBF's clients accounted for more than 60% of these savings, while 27% were made up of bank deposits. Overall, off-balance-sheet personal savings stood at $114.9 billion, up $9.0 billion or 8% since year-end 2012.

Total Personal Savings

As at October 31 (millions of Canadian dollars)	2013	2012	% change
Balance sheet			
Deposits	42,652	40,814	5
Off-balance-sheet			
Full-service brokerage	94,550	87,291	8
Mutual funds	16,633	15,027	11
Other	3,680	3,551	4
	114,863	105,869	8
Total	157,515	146,683	7

Other Liabilities

Other liabilities consist of the following items: acceptances, obligations related to securities sold short, obligations related to securities sold under repurchase agreements and securities loaned, derivative financial instruments, amounts due to clients, dealers and brokers, liabilities related to transferred receivables and other items. Other liabilities remained stable when compared to year-end 2012.

Subordinated Debt and Other Commitments

Since October 31, 2012, subordinated debt decreased $44 million due to a fair value hedge adjustment.

Contractual Obligations

As at October 31, 2013 (millions of Canadian dollars)	1 year or less	Over 1 year to 2 years	Over 2 years to 5 years	Over 5 years	Total
Long-term financing	2,995	3,822	6,653	369	13,839
Subordinated debt(1)	500	350	1,500	33	2,383
Lease commitments and other contracts(2)	688	453	696	550	2,387
	4,183	4,625	8,849	952	18,609

(1) At nominal value.
(2) Most of these commitments are related to operating leases for premises and to other contracts, mainly contracts for outsourced IT service.

Equity

As at October 31, 2013, the Bank's equity was $9.2 billion compared to $8.2 billion as at October 31, 2012. The Consolidated Statements of Changes in Equity (page 101 of this Annual Report) present the items of equity. The increase in equity came from net income attributable to the Bank's shareholders, net of dividends, and from a $107 million common share issuance related to stock options exercised.

As at October 31, 2013, the Bank had 163.0 million common shares issued and outstanding compared to 161.3 million a year earlier, for an increase that stems mainly from an issuance of 1.8 million shares under the stock option plan. On November 7, 2012, the Bank issued 8.0 million Series 28 preferred shares. The Bank also completed the repurchase of 8.0 million Series 15 preferred shares and 3.4 million Series 21 preferred shares on January 15 and on August 16, 2013, respectively. See Note 17 to the consolidated financial statements. An analysis of the Bank's regulatory capital is presented in the Capital Management section of this MD&A.

Shares and Stock Options

As at October 31, 2013	Number of shares	$ million
First Preferred Shares		
Series 16	8,000,000	200
Series 20	6,900,000	173
Series 24	2,425,880	61
Series 26	1,724,835	43
Series 28	8,000,000	200
	27,050,715	677
Common shares	162,991,368(1)	2,160
Stock options	7,507,878(1)	

(1) As at November 29, 2013, there were 162,931,289 common shares and 7,457,750 stock options outstanding.

Related Party Transactions

In the normal course of business, the Bank provides various banking services and enters into contractual agreements and other transactions with associates, joint ventures, directors, key officers and other related parties. These agreements and transactions are entered into under conditions similar to those offered to non-related third parties.

Loans to eligible key officers are granted under the same conditions as those granted to any other employee of the Bank. The main conditions are as follows: the employee must meet the same credit requirements as a client; mortgage loans are granted at the posted rate less 2%, limited to half of the posted rate; personal loans bear interest at the client rate divided by two; credit card advances bear interest at a prescribed fixed rate in accordance with Bank policy; and personal lines of credit bear interest at the Canadian prime rate less 3%, but never lower than Canadian prime divided by two.

For personal loans and personal lines of credit, employees may not borrow more than 50% of their annual gross base salary at the reduced rate. The Canadian prime rate is applied to the remainder.

In accordance with the *Bank Act* (Canada), the aggregate of loans granted to key officers of the Bank, excluding mortgage loans granted on their principal residence, cannot exceed twice the officer's base salary.

Furthermore, the Bank offers a deferred stock unit plan to directors who are not Bank employees. For additional information, see Notes 9 and 28 to the consolidated financial statements.

Business Combination

HSBC Securities (Canada) Inc.

On January 1, 2012, the Bank completed the acquisition of the full-service investment advisory business of HSBC Securities (Canada) Inc. as well as certain assets related to the segregated fund and to the insurance portfolio of HSBC Insurance Agency (Canada) Inc. During the measurement period ended January 1, 2013, the finalization of the working capital and purchase price adjustments did not have a significant impact on goodwill.

Investment in TMX Group Limited

On July 31, 2012, Maple Group Acquisition Corporation (Maple), now TMX Group Limited, a company whose investors comprise the Bank and 11 other leading Canadian financial institutions and pension funds, announced that all of the conditions to Maple's offer to acquire up to 80% of TMX Group Inc. (TMX) shares for $50 cash per share had been satisfied.

On August 1, 2012, Maple completed the acquisitions of Alpha Trading Systems Inc., Alpha Trading Systems Limited Partnership and The Canadian Depository for Securities Limited. The Bank recognized a gain of $25 million ($18 million after tax) on the sale of its interests in these three companies. In addition, as part of its commitment as an equity participant in Maple, the Bank, through a subsidiary, subscribed $190 million Maple securities. The Bank had also acted as co-underwriter, joint book runner and administrative agent on the acquisition financing.

On September 13, 2012, the court approved the plan of arrangement under which TMX shares not acquired by Maple at that date would be exchanged for common shares of Maple on a one-for-one basis. On September 14, 2012, Maple held all of the shares in TMX.

After these events, the Bank owned 8.8% of TMX Group Limited. For additional information, see Note 9 to the consolidated financial statements.

Disposal

On April 2, 2012, the Bank completed the sale of the operations of its subsidiary, Natcan Investment Management Inc. (Natcan), to Fiera Capital Corporation (Fiera). A before-tax gain of $246 million ($212 million after tax) on the sale, including a $25 million write-off of goodwill and intangible assets and $4 million in direct charges, was recognized in *Non-interest Income – Other* in the Consolidated Statement of Income for the year ended October 31, 2012 and reported in the Wealth Management segment.

In consideration of the sale, the Bank acquired a 35% interest in Fiera, which has been accounted for as an investment in an associate since that date. For additional information, see Note 9 to the consolidated financial statements.

Events After the Consolidated Balance Sheet Date

Acquisition of TD Waterhouse Institutional Services

On November 12, 2013, the Bank completed the acquisition, through a subsidiary, of Toronto-Dominion Bank's institutional services known as TD Waterhouse Institutional Services. The purchase price for the acquisition is $250 million, subject to a price adjustment mechanism based on asset retention over a one-year period. This acquisition marks another major step in the Bank's expansion of its wealth management platform across Canada.

The Bank has not finalized its initial accounting for the acquisition as it has yet to complete the valuation of assets acquired and liabilities assumed, including intangible assets and goodwill. The assets and liabilities of TD Waterhouse Institutional Services consist primarily of amounts due from clients, dealers and brokers and amounts due to clients, dealers and brokers, respectively.

Repurchase of Subordinated Debt

On November 15, 2013, the Bank repurchased, at their nominal value and for cancellation, $500 million in notes maturing in November 2018.

Redemption of Preferred Shares

On December 3, 2013, the Board approved the redemption of all the issued and outstanding non-cumulative 5-year rate-reset Series 24 First Preferred Shares and the redemption of all the issued and outstanding non-cumulative 5-year rate-reset Series 26 First Preferred Shares. These redemptions are subject to the approval of OSFI.

Stock Split

On December 3, 2013, the Board declared a stock dividend of one common share on each of the issued and outstanding common shares, payable on February 13, 2014. The effect will be the same as a two-for-one split of common shares. All common share numbers and per-share calculations will be adjusted retrospectively to reflect the stock dividend.

OFF-BALANCE-SHEET ARRANGEMENTS

In the normal course of business, the Bank is party to various financial arrangements that, under IFRS, are not required to be recorded on the Consolidated Balance Sheet or are recorded under amounts other than their notional or contractual values. These arrangements include, among others, transactions with special purpose entities, derivative financial instruments, the issuance of guarantees, the margin funding facility of the MAV conduits, credit instruments, and financial assets received as collateral.

Special Purpose Entities

The Bank uses special purpose entities, among other means, to diversify its funding sources and to offer services to clients, in particular to help them securitize their financial assets or provide them with investment opportunities. Under IFRS, a special purpose entity must be consolidated if the Bank controls the entity. Note 1 to the consolidated financial statements describes the accounting policy and criteria used for consolidating special purpose entities. Additional information on consolidated and non-consolidated special purpose entities is provided in Note 27 to the consolidated financial statements.

Securitization of the Bank's Financial Assets

Mortgage loans

The Bank participates in two Canada Mortgage and Housing Corporation (CMHC) securitization programs: the Mortgage-Backed Securities Program under the *National Housing Act* (Canada) (NHA) and Canada Mortgage Bond (CMB) Program. Under the first program, the Bank issues NHA securities backed by insured residential mortgage loans and, under the second, the Bank sells NHA securities to Canada Housing Trust (CHT), which finances the purchase through the issuance of mortgage bonds insured by CMHC. Moreover, these mortgage bonds feature an interest rate swap agreement under which a CMHC-certified counterparty pays CHT the interest due to investors and receives the interest on the NHA securities. As at October 31, 2013, the outstanding amount of NHA securities issued by the Bank and sold to CHT was $13.3 billion. The mortgage loans sold consist of fixed- or variable-rate residential loans that are insured against potential losses by a loan insurer. In accordance with the NHA-MBS Program, the Bank advances the funds required to cover late payments and, if necessary, obtains reimbursement from the insurer that insured the loan in default. The NHA-MBS and CMB programs do not use liquidity guarantee arrangements. The Bank uses these securitization programs mainly to diversify its funding sources. In accordance with IFRS, because the Bank retains substantially all of the risks and rewards of ownership of the mortgage loans transferred to CHT, the derecognition criteria are not met. Therefore, the insured mortgage loans securitized under the CMB program continue to be recognized in the *Loans* item on the Bank's Consolidated Balance Sheet and the liabilities for the considerations received from the transfer are recognized in *Liabilities related to transferred receivables* on the Consolidated Balance Sheet. For additional information, see Note 8 to the consolidated financial statements.

Credit card receivables

In 1998, the Bank set up the Canadian Credit Card Trust (CCCT), a securitization program for its own credit card receivables. The Bank has used this entity for capital management and funding purposes. The Bank acts as the servicer of the receivables sold, maintaining its relationships with clients. Furthermore, it administers the securitization program and ensures that all related procedures are stringently followed and that investors are paid according to the provisions of the program. As at October 31, 2013, the credit card receivables portfolio that the Bank sold to CCCT (net of the Bank Certificate held by the Bank) represented an amount outstanding of $1.4 billion. CCCT issued investors' certificates in the same amount, $1.3 billion of which is held by third parties and $0.1 billion is held by the Bank. New receivables are periodically sold to the structure on a revolving basis to replace the receivables reimbursed by clients. The different series of certificates are rated by the DBRS Limited and Standard & Poor's Corporation. From this portfolio of sold receivables, the Bank retains the excess spread, i.e., the residual net interest income after all the expenses related to this structure have been paid, and thus provides first loss protection. Furthermore, second-loss protection for issued series is provided by certificates subordinated to the senior notes, representing 6.3% (Series 2010-1, 2012-1, and 2013-1) of the total amount of the series issued. The Bank controls CCCT and thus consolidates it.

Securitization of Third-Party Financial Assets

The Bank administers multi-seller conduits that purchase financial assets from clients and finance those purchases by issuing commercial paper backed by the acquired assets. Clients use these multi-seller conduits to diversify their funding sources and reduce borrowing costs while continuing to service the financial assets and providing some amount of first-loss protection. Notes issued by the conduits and held by third parties provide additional credit loss protection. The Bank acts as a financial agent and provides administrative and transaction structuring services to these conduits. The Bank provides backstop liquidity and credit enhancement facilities under the commercial paper program. These facilities are presented and described in Note 25 to the consolidated financial statements. The Bank has concluded derivative contracts with these conduits, the fair value of which is presented on the Bank's Consolidated Balance Sheet. The Bank is not required to consolidate these conduits, as it does not control them nor is it exposed to the majority of risks and rewards of the conduits.

Derivative Financial Instruments

The Bank uses various types of derivative financial instruments to meet its clients' needs, enable it to earn revenues from its trading activities and manage its exposure to exchange, interest, and credit rate risk as well as other market risks. All derivative financial instruments, including embedded derivative financial instruments that must be bifurcated and those used as hedging items, are accounted for at fair value on the Consolidated Balance Sheet. Transactions in derivative financial instruments are expressed as notional amounts, which serve as points of reference. These amounts are not presented as assets or liabilities on the Consolidated Balance Sheet. They represent the set underlying principal of a derivative financial instrument and serve as a reference for determining the amount of cash flows to be exchanged. Notes 1 and 15 to the consolidated financial statements provide additional information on the types of derivatives used by the Bank and their accounting basis.

Guarantees

In the normal course of business, the Bank enters into various guarantee contracts. The principal types of guarantees are letters of guarantee, backstop liquidity and credit enhancement facilities, certain securities lending activities, and certain indemnification agreements. Note 25 to the consolidated financial statements provides detailed information on these guarantees.

Margin Funding Facility of the MAV Conduits

The Bank has committed to contribute $886 million to a margin funding facility related to the MAV conduits in order to finance potential collateral calls. As at October 31, 2013 and 2012, no amount had been advanced by the Bank. Note 6 to the consolidated financial statements provides additional information.

Credit Instruments

In the normal course of business, the Bank enters into various off-balance-sheet credit commitments. The credit instruments used to meet the financing needs of its clients represent the maximum amount of additional credit that the Bank could be required to extend if the commitments were fully drawn. For additional information on these off-balance-sheet credit instruments and other items, see Note 25 to the consolidated financial statements.

Financial Assets Received as Collateral

In the normal course of business, the Bank receives financial assets as collateral as a result of transactions involving securities acquired under reverse repurchase agreements, securities borrowing and lending agreements, and derivative financial instrument transactions. For additional information regarding financial assets received as collateral, see Note 25 to the consolidated financial statements.

ADDITIONAL FINANCIAL DISCLOSURE

The Financial Stability Board (FSB) is an international financial group established at the London G20 Summit in April 2009 as a successor to the Financial Stability Forum (FSF) founded in 1999 at the initiative of the G7. It brings together 26 national financial authorities (central banks, finance ministries, etc.) as well as several international organizations and groups working to develop financial stability standards. Its objective is to promote cooperation in the oversight and monitoring of financial institutions.

In April 2008, the FSF published a report at the request of the G7 Finance Ministers and Central Bank Governors, and OSFI had asked Canadian banks to apply certain recommendations set out in the report.

The recommendations seek to enhance transparency and measurement with respect to certain exposures, in particular special purpose entities, subprime and Alt-A exposures, collateralized debt obligations, residential and commercial mortgage-backed securities, and leveraged financing structures. The Bank does not market any specific mortgage financing program to subprime or Alt-A clients. Subprime loans are generally defined as loans granted to borrowers with a higher credit risk profile than prime borrowers, and the Bank does not grant this type of loan. Alt-A loans are granted to borrowers who cannot provide standard proof of income. The Bank's Alt-A loan volume was $661 million as at October 31, 2013 ($621 million as at October 31, 2012). During the year ended October 31, 2013, the Bank acquired a portfolio of residential mortgage loans with a higher credit risk profile for a total amount of $328 million.

The Bank does not have any significant direct position in residential and commercial mortgage-backed securities that are not insured by the Canadian Mortgage and Housing Corporation (CMHC). Credit derivative positions are shown in the adjacent table.

Leveraged financing structures are defined by the Bank as loans granted to large corporate and financial sponsor-backed companies that are typically non-investment grade with much higher levels of debt relative to other companies in the same industry. Leveraged finance is commonly employed to achieve a specific objective, for example, to make an acquisition, complete a buy-out or repurchase shares. Leveraged finance risk exposure takes the form of both funded and unfunded commitments. As at October 31, 2013, total commitments for this type of loan stood at $865 million ($1,044 million as at October 31, 2012). Details about other exposures are provided in the table concerning special purpose entities in Note 27 to the consolidated financial statements.

Credit Derivative Positions (notional amounts)
(millions of Canadian dollars)

As at October 31				**2013**
	Credit portfolio		**Trading**	
	Protection purchased	**Protection sold**	**Protection purchased**	**Protection sold**
Credit default swaps				
Indices, single names and other	**42**	**–**	**1,071**	**235**
Tranches on indices	**–**	**–**	**–**	**1**
Total return swaps	**–**	**–**	**–**	**9**

As at October 31				2012
	Credit portfolio		Trading	
	Protection purchased	Protection sold	Protection purchased	Protection sold
Credit default swaps				
Indices, single names and other	25	–	3,423	2,877
Tranches on indices	–	–	781	770
Total return swaps	452	–	–	26

In May 2012, the FSB formed a working group, the Enhanced Disclosure Task Force (EDTF), that was mandated to develop principles for enhancing the risk disclosures of major banks, to recommend improvements to current risk disclosures, and to identify risk disclosure best practices used by major financial institutions. On October 29, 2012, the EDTF published a report entitled *Enhancing the Risk Disclosures of Banks*, which contains 32 recommendations. As at October 31, 2013, the Bank has made every effort to ensure overall compliance with those recommendations and is continuing to enhance its risk disclosures to meet the best practices on an ongoing basis. The risk disclosures required by the EDTF are provided in this Annual Report and in the document entitled *Supplementary Financial Information* available on the Bank's website at **nbc.ca**. In addition, page 10 of this Annual Report provides a table of contents that users can use to locate information relative to the 32 recommendations.

CRITICAL ACCOUNTING ESTIMATES

A summary of the significant accounting policies used by the Bank is presented in Note 1 to the consolidated financial statements of this Annual Report. Some of these accounting policies are considered critical given their importance to the presentation of the Bank's financial position and operating results and require difficult, subjective and complex judgments and estimates because they relate to matters that are inherently uncertain. Any change in these judgments and estimates could have a significant impact on the consolidated financial statements of the Bank. The Bank's critical accounting estimates are as follows.

Impairment of Financial Assets

At the end of each reporting period, the Bank determines whether there is objective evidence of impairment of a financial asset or group of financial assets. There is objective evidence of impairment when one or more loss events occur after the initial recognition of the asset and prior to or on the balance sheet date and these events adversely affect the estimated future cash flows of the financial assets in question. Management must use judgment to determine whether events or circumstances constitute objective evidence of impairment and to estimate the timing of future cash flows.

Available-for-Sale Securities

Available-for-sale securities are assessed at the end of each reporting period to determine whether there is objective evidence of impairment, which is an exercise that requires the use of judgment and estimates. In the case of debt securities, the Bank considers all loss events, including the following: a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganization. In the case of equity securities, the Bank considers all available objective evidence of impairment, including observable data or information about events relating specifically to the securities in question. A significant or prolonged decline in the fair value below its cost is also objective evidence of impairment.

If there is objective evidence of impairment, any amount previously recognized in *Accumulated other comprehensive income* is reclassified to *Non-interest income* in the Consolidated Statement of Income. This amount is determined as the difference between the acquisition cost (net of any capital repayments and amortization) and the current fair value of the asset less any impairment loss on that investment previously recognized in the Consolidated Statement of Income.

This accounting estimate has an impact, across all business segments, on *Available-for-sale securities* on the Consolidated Balance Sheet, on *Other comprehensive income* in the Consolidated Statement of Comprehensive Income, and on *Non-interest income* in the Consolidated Statement of Income.

Allowances for Credit Losses

A loan, except credit card receivables, is considered impaired if there is objective evidence of impairment and, in management's best estimate, the timely collection of principal and interest is no longer reasonably assured, or when a payment is contractually 90 days past due, unless the loan is fully secured and collection efforts are reasonably expected to result in repayment of the debt within 180 days. For credit card receivables, they are written off when payment is 180 days in arrears. Loans that are insured or fully guaranteed by a Canadian government (federal or provincial) or by a Canadian government agency are considered impaired when they are more than 365 days in arrears.

Allowances for credit losses are management's best estimate of losses in its credit portfolio as at the balance sheet date. They relate primarily to loans but may also cover the credit risk associated with deposits with financial institutions, loan substitute securities, credit instruments such as acceptances, and off-balance-sheet items such as commitments to extend credit, letters of guarantee and letters of credit. Management reviews portfolio credit quality on an ongoing basis to ensure that the amount of the allowance for credit losses is adequate.

The allowances for credit losses on impaired loans are assessed either individually or collectively based on the portfolio's historical net loss experience. The allowance for credit losses on non-impaired loans is assessed collectively.

When assessing allowances for credit losses, management must use its judgment in establishing reasonable assumptions and subjective and critical estimates concerning the probability of default, probable losses in the event of default, the amount at risk in the event of default, the amount and dates of future cash flows, the value of the underlying collateral and realization costs. Any changes in these estimates and assumptions as well as the use of different, but equally reasonable estimates and assumptions, could have an impact on the allowances for credit losses and, consequently, on the provisions for credit losses for the year. A detailed description of the methods used to calculate the allowances for credit losses can be found in Note 1 to the consolidated financial statements. All business segments are affected by this accounting estimate.

Fair Value of Financial Instruments

When they are initially recognized, all financial assets and liabilities, including derivative financial instruments, are recorded at fair value on the Consolidated Balance Sheet. In subsequent periods, they are measured at fair value, except for items that are classified in the following categories, which are measured at amortized cost using the effective interest rate method: financial assets held to maturity, loans and receivables, and financial liabilities at amortized cost. The fair value of a financial instrument is the amount of consideration for which the financial instrument would be exchanged in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Financial instruments recorded at fair value on the Consolidated Balance Sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

– Level 1: Valuation based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities. These instruments consist primarily of equity securities and derivative financial instruments traded in active markets and certain highly liquid debt securities actively traded in over-the-counter markets;
– Level 2: Valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market inputs by correlation or other means. These instruments consist primarily of derivative financial instruments that are traded in over-the-counter markets, certain investment grade debt securities, certain equity securities whose value is not directly observable in an active market and certain liabilities related to transferred receivables; and
– Level 3: Valuation techniques with significant unobservable market inputs. These instruments consist primarily of investments in restructured notes of the MAV conduits, certain investments in asset-backed securities, structured deposit notes and private equity securities.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration received or paid. In certain circumstances, the initial fair value may be based on other observable current market transactions for the same instrument, without modification or repackaging, or based on a valuation technique whose variables include only observable market inputs. When the Bank uses a valuation technique based on observable market inputs to determine the initial fair value, or if the risks associated with the derivative contract are fully offset by other contracts entered into with third parties, the difference between the transaction price and the initially determined fair value is recognized in the Consolidated Statement of Income. In other cases, the difference between the fair value of the consideration received or paid and the amount determined using the valuation technique is deferred on the Consolidated Balance Sheet. The amount of the deferred gain or loss is recognized over the term of the financial instrument. The unamortized balance is immediately recognized in net income when (i) observable market inputs can be obtained and support the fair value of the transaction, (ii) the risks associated with the initial contract are substantially offset by other contracts entered into with third parties, (iii) the gain or loss is realized through a cash receipt or payment, or (iv) the transaction matures or is cancelled before maturity.

When financial instruments are to be subsequently remeasured, quoted market prices in an active market provide the best indication of fair value, and when such prices are available, the Bank uses them to measure the financial instruments. A financial instrument is considered to be quoted in an active market when quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency and those prices reflect actual market transactions on an arm's length basis. The fair value of a financial asset traded in an active market generally reflects the bid price and, that of a financial liability traded in an active market, the ask price. If the market for a financial instrument is not active, the Bank establishes fair value using a valuation technique that primarily makes use of observable market inputs. Such valuation techniques include using available information concerning recent market transactions, reference to the current fair value of a comparable financial instrument, discounted cash flow analysis, option pricing models, and all other valuation techniques commonly used by market participants where it has been demonstrated that the technique provides reliable estimates.

In cases where fair value is established using valuation models, the Bank makes assumptions about the amount, the timing of estimated future cash flows and the discount rates used. These assumptions are based primarily on observable market inputs such as interest rate yield curves, foreign exchange rates, credit curves as well as price and rate volatility factors. When one or more significant inputs are not observable in the markets, fair value is established primarily on the basis of internal estimates and data that consider the valuation policies in effect at the Bank, the economic environment, the specific characteristics of the financial asset or liability and other relevant factors. In certain specific cases, the Bank makes adjustments to the fair value to account for system limitations or measurement uncertainty in determining fair value. The Bank applies judgment when considering factors that could be used by market participants but that are not included in the valuation model. These factors include, but are not limited to, the unobservable nature of inputs used in the valuation model, assumptions about risk such as market risk, credit risk, or risk related to the valuation model, and future administrative expenses. The Bank may also take market liquidity risk into account in determining the fair value of financial instruments when it believes that such instruments could be disposed of for a consideration below the fair value otherwise determined due to a lack of market liquidity or an insufficient volume of transactions in a given market.

The estimated fair value reflects market conditions on a given date and, consequently, may not be indicative of future fair value. Additional information on the determination of fair value is presented in Notes 3, 4 and 6 to the consolidated financial statements.

Establishing fair value is an accounting estimate and has an impact on *Securities at fair value through profit or loss*, *Available-for-sale securities*, *Obligations related to securities sold short*, *Derivative financial instruments*, and financial instruments designated at fair value through profit or loss on the Consolidated Balance Sheet. This estimate also has an impact on *Interest income* and *Non-interest income* in the Consolidated Statement of Income of the Financial Markets segment and of the *Other* heading. Furthermore, this estimate also has an impact on *Other comprehensive income* in the Consolidated Statement of Comprehensive Income.

Impairment of Non-Financial Assets

Premises and equipment and intangible assets with finite useful lives are tested for impairment when events or changes in circumstances indicate that their carrying value may not be recoverable. At the end of each reporting period, the Bank determines whether there is an indication that premises and equipment or intangible assets with finite useful lives may be impaired. Goodwill and intangible assets that are not yet available for use or that have indefinite useful lives are tested for impairment annually or more frequently if there is an indication that the asset might be impaired.

An asset is tested for impairment by comparing its carrying amount with its recoverable amount. The recoverable amount must be estimated for the individual asset. Where it is not possible to estimate the recoverable amount of an individual asset, the recoverable amount of the cash-generating unit (CGU) to which the asset belongs will be determined. Goodwill is always tested for impairment at the level of a CGU or a group of CGUs. A CGU is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Bank uses judgment to identify CGUs.

An asset's recoverable amount is the higher of fair value less costs to sell and the value in use of the asset or CGU. Value in use is the present value of expected future cash flows from the asset or CGU. The recoverable amount of the CGU is determined using valuation models that consider various factors such as projected future cash flows, discount rates and growth rates. The use of different estimates and assumptions in applying the impairment tests could have a significant impact on income. If the recoverable amount of an asset or a CGU is less than its carrying amount, the carrying amount is reduced to its recoverable amount and an impairment loss is recognized in *Non-interest expenses* in the Consolidated Statement of Income.

Management exercises judgment when determining whether there is objective evidence that premises and equipment or intangible assets with finite useful lives may be impaired. It also uses judgment in determining to which CGU or group of CGUs an asset or goodwill is to be allocated. Moreover, for impairment assessment purposes, management must make estimates and assumptions regarding the recoverable amount of non-financial assets, CGUs or a group of CGUs. For additional information on the estimates and assumptions used to calculate the recoverable amount of an asset or CGU, see Note 11 to the consolidated financial statements.

Any changes to these estimates and assumptions may have an impact on the recoverable amount of a non-financial asset and, consequently, on impairment testing results. These accounting estimates have an impact on *Premises and equipment*, *Intangible assets* and *Goodwill* reported on the Consolidated Balance Sheet. The aggregate impairment loss, if any, is recognized as a non-interest expense for the corresponding segment and presented in the *Other* item.

Employee Benefits

Calculations of the expense recognized in the Consolidated Statement of Income, of the actuarial gains and losses on the Consolidated Statement of Comprehensive Income, and of the accrued benefit obligation are based on actuarial valuations and management's assumptions. The key assumptions used to calculate these amounts include the discount rates, the expected long-term rate of return on plan assets, the rate of compensation increase, mortality rates, the rate of employee turnover and health care cost trend rate. The assumption regarding the discount rate is determined using an interest rate curve that represents the yield for high-quality corporate bonds with terms nearing those of the Bank's pension plan obligations.

The use of different assumptions could have a significant impact on the accrued benefit asset (liability) presented in *Other assets (Other liabilities)* on the Consolidated Balance Sheet, on the pension plan and other benefit plan expenses presented in *Compensation and employee benefits* in the Consolidated Statement of Income, as well as on actuarial gains and losses presented in *Other comprehensive income*. All business segments are affected by this accounting estimate. For additional information, including the significant assumptions used to determine the Bank's pension plan and other benefit plan expenses and the sensitivity analysis for key plan assumptions, see Note 22 to the consolidated financial statements.

Income Taxes

The Bank formulates assumptions to estimate income taxes as well as deferred tax assets and liabilities. This process includes estimating the actual amount of income taxes payable and evaluating tax loss carryforwards and temporary differences as a result of differences between the values of the items reported for accounting and for income tax purposes. Deferred tax assets and liabilities, presented in *Other assets* and *Other liabilities* on the Consolidated Balance Sheet, are calculated according to the tax rates to be applied in future periods. Previously recorded deferred tax assets and liabilities must be adjusted when the expected date of the future event is revised based on current information. The Bank periodically evaluates deferred tax assets to assess recoverability. In the Bank's opinion, based on current information, it is likely that all deferred tax assets will be realized prior to their expiration.

This accounting estimate affects *Income taxes* in the Consolidated Statement of Income for all business segments. For additional information on income taxes, see Notes 1 and 23 to the consolidated financial statements.

Litigation

In the normal course of business, the Bank and its subsidiaries are involved in various claims relating, among other matters, to loan portfolios, investment portfolios and supplier agreements, including court proceedings, investigations or claims of a regulatory nature, class actions or other legal remedies of varied natures. Several of the court proceedings are related to lending activities, which occur, in particular, when the Bank takes steps to recover its claims.

More specifically, the Bank is involved as a defendant in class actions instituted by consumers who contest, inter alia, certain transaction fees or who wish to avail themselves of certain legislative provisions relating to consumer protection. Notably, the Bank is a party to *Marcotte v. Bank of Montreal, et al.*, a class action that seeks the reimbursement of foreign currency transaction fees paid by credit cardholders. The hearing at the Supreme Court of Canada is scheduled for February 2014. The decision may impact other class actions to which the Bank is a party. All of these proceedings involve several complex issues and their resolution could thus extend over several years. These class actions are defended vigorously by the Bank, which has serious grounds of contestation.

It is impossible to determine the outcome of the claims instituted or which may be instituted against the Bank and its subsidiaries. The Bank estimates, based on the information at its disposal, that, while the amount of contingent liabilities pertaining to these claims, taken individually or in the aggregate, could have a material impact on the Bank's consolidated operating income for a particular period, it would not have a material adverse impact on the Bank's consolidated financial position.

Provisions are liabilities of uncertain timing and amount. A provision is recognized when the Bank has a present obligation (legal or constructive) arising from a past event, when it is probable that an outflow of economic resources will be required to settle the obligation and when the amount of the obligation can be reliably estimated. Provisions are based on the Bank's best estimates of the economic resources required to settle the present obligation, given all relevant risks and uncertainties, and, when it is significant, the effect of the time value of money.

The recognition of a litigation provision requires the Bank's management to assess the probability of loss and estimate any potential monetary impact. The Bank examines each litigation provision individually by considering the development of each case, its past experience in similar transactions and the opinion of its legal counsel. Each new piece of information can alter the Bank's assessment as to the probability and estimated amount of the loss and the extent to which it adjusts the recorded provision. Moreover, the actual settlement cost of these litigations can be significantly higher or lower than the amounts recognized.

Special Purpose Entities

In the normal course of business, the Bank enters into arrangements and transactions with special purpose entities, which are entities that are created to accomplish a narrow and well-defined objective. A special purpose entity is consolidated when the Bank concludes, following an evaluation of the substance of the relationship and the risks and rewards of the entity, that it controls that entity. Management must exercise judgment in determining whether the Bank should consolidate the entity. Additional information is provided in the Off-Balance-Sheet Arrangements section of this Annual Report (pages 45 and 46) and in Note 27 to the consolidated financial statements.

FUTURE ACCOUNTING POLICY CHANGES

The IASB has issued revisions and amendments to a number of standards, some of which may have an impact on the Bank. A summary of these standards and the effective dates applicable to the Bank are presented below. According to a notice issued by OSFI, the Bank may not early adopt these standards nor the amendments.

Effective Date – November 1, 2013

IFRS 7 – *Financial Instruments – Disclosures*

The amendments to IFRS 7 require disclosure about legally enforceable rights of set-off for financial instruments under master netting agreements or similar arrangements. Retrospective adoption of the disclosure amendments of this standard will have no impact on the Bank's financial position.

IFRS 10 – *Consolidated Financial Statements*

IFRS 10 replaces the consolidation guidance provided in IAS 27, *Consolidated and Separate Financial Statements* and SIC-12, *Consolidation – Special Purpose Entities* by introducing a single consolidation model based on control for all interests held in other entities. According to IFRS 10, control is based on the concept of power, exposure to variable returns and the ability to use the power to affect those returns.

For the Bank, IFRS 10 will come into effect on November 1, 2013 and will be applied retrospectively. Based on its most recent assessment, the Bank believes that adoption of this standard will have no significant impact on its consolidated financial statements, except that it will no longer consolidate NBC Capital Trust (for additional information, see Note 18). The main impact of the deconsolidation will be a reclassification on the Consolidated Balance Sheets as at October 31, 2013 and as at November 1, 2012. In particular, a $225 million amount currently reported in *Non-Controlling Interests* will be reclassified to *Deposits*. The Bank's earnings per share will not be affected.

IFRS 11 – *Joint Arrangements*

IFRS 11, *Joint Arrangements* replaces IAS 31, *Interests in Joint Ventures* and SIC-13, *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. Under IFRS 11, a joint arrangement must be classified as either a joint operation or a joint venture, depending on an assessment of the rights and obligations of the parties to the arrangement. IFRS 11 requires interests in joint ventures to be recognized using the equity method. Retrospective adoption of this standard is not expected to have a significant impact on the Bank's consolidated financial statements.

IFRS 12 – *Disclosure of Interests in Other Entities*

IFRS 12 applies to entities that hold interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. It requires additional disclosure that enables financial statement users to assess the nature of, and risks associated with, an entity's interests in other entities and the effects of those interests on the entity's financial position, financial performance and cash flows. Retrospective adoption of the disclosure amendments of this standard will have no impact on the Bank's financial position.

IFRS 13 – *Fair Value Measurement*

IFRS 13 defines fair value, sets out in a single standard a framework for measuring fair value and requires disclosures about fair value measurements. Prospective adoption of this standard is not expected to have a significant impact on the Bank's consolidated financial statements.

IAS 19 – *Employee Benefits*

In June 2011, the IASB issued an amended version of IAS 19, introducing significant changes to the recognition of employee benefits, primarily defined benefit pension plans. The main changes to the revised standard are as follows:

- The expected return on plan assets is no longer used in calculating the pension plan expense. The discount rate used to measure the accrued benefit obligation must also be used to measure the return on plan assets.
- Past-service costs are recognized when a plan is amended, with no deferral over the vesting period.
- The disclosure requirements call for additional disclosure about the characteristics of defined benefit plans and the risks to which entities are exposed by participating in those plans.
- The revised standard requires that all actuarial gains and losses be immediately recognized in *Other comprehensive income*. The recognition of actuarial gains and losses can no longer be deferred. This last amendment has no impact on the Bank since it already recognizes actuarial gains and losses in *Other comprehensive income*.

For the Bank, the amendments made to IAS 19 will come into effect on November 1, 2013 and will be applied retrospectively. The Bank believes that adopting the IAS 19 amendments will have no impact on the Consolidated Balance Sheet as at November 1, 2012. The expected and estimated impacts of the revised standard on the Bank's Consolidated Balance Sheet as at October 31, 2013 will be as follows: a $15 million increase in *Other assets*, a $6 million decrease in *Other liabilities* and a $21 million increase in *Retained earnings*. For the year ended October 31, 2013, the expected and estimated impacts on income will be a $30 million decrease in *Net income* and a $51 million increase in *Other comprehensive income*, net of income taxes.

Effective Date – November 1, 2014

IAS 32 – *Financial Instruments: Presentation*

IAS 32 was amended to clarify the requirements for offsetting financial assets and financial liabilities in order to reduce inconsistencies in current practice.

Effective Date – Not yet specified

IFRS 9 – *Financial Instruments*

The purpose of IFRS 9 is to replace the current standard on financial instruments and constitutes a three-phase project: (1) Classification and measurement of financial assets and financial liabilities; (2) Impairment; and (3) Hedge accounting. In July 2013, the IASB decided to temporarily defer the mandatory effective date of IFRS 9 and to not specify that date until the requirements for financial instrument classification and measurement and financial asset impairment are finalized. The Bank is monitoring the progress of the IASB's work.

CAPITAL MANAGEMENT

Capital Management Framework

Capital management has the dual role of ensuring a competitive return to the Bank's shareholders while maintaining a solid capital foundation to cover risks inherent to the Bank's activity, supporting its business segments and protecting its clients. The Bank's capital management policy sets out the principles and practices the Bank incorporates into its capital management strategy and the basic criteria it adopts to ensure that it has sufficient capital at all times and that it is prudently managing such capital in view of its future capital requirements. Stress tests are performed to ensure that the Bank has sufficient capital even in crisis situations. A capital plan sets operational targets, taking into account expected levels for risk-weighted assets, determined under the regulatory approach. Moreover, the capital plan presents the different strategies that are available to the Bank in order to maintain a cost effective capital structure. Those strategies may include the issuance and repurchase of shares or subordinated debt securities, the reallocation of either assets or capital, and the review of the dividend payout target or employee variable compensation.

Internal Capital Adequacy Assessment Process (ICAAP)

Internal capital (or, equivalently, economic capital) is a measure that determines the capital that the Bank requires in order to pursue its business operations and accommodate unexpected losses arising from extremely adverse economic and operational conditions. The Bank has implemented a rigorous internal capital adequacy assessment process that consists of:

- conducting an overall risk assessment;
- measuring significant risks and the capital requirements on the Bank's financial budget for the next fiscal year and current and prospective risk profiles;
- integrating stress tests across the organization and executing sensitivity analyses to determine the capital buffer above minimum regulatory levels (for additional information on enterprise-wide stress testing, refer to the Risk Management section of this MD&A);
- aggregating capital and monitoring the reasonableness of internal capital compared with regulatory capital;
- comparing projected internal capital with regulatory capital levels, internal operating targets, and competing banks; and
- attesting to the adequacy of the levels of capital at the Bank.

Assessing capital adequacy is an integral part of capital planning and strategy. The Capital Management team is, conjointly with its partners from Risk Management, Treasury and Finance, responsible for maintaining integrated controls and control processes so that an overall assessment of capital adequacy may be performed. The Bank's internal capital adequacy assessment process demonstrates that it has a solid financial structure and sufficient capital to meet management's assessment of capital requirements both under normal market conditions and under a range of severe but plausible stress testing scenarios. This process is a key tool in establishing the Bank's capital strategy and is subject to quarterly reviews and periodic amendments.

Risk-adjusted return on capital (RAROC) and shareholder value added (SVA), which are obtained from the assessment of required economic capital, are calculated quarterly for each of the Bank's business segments. The results are then used to guide management in allocating capital among the different business segments.

Structure and Governance

The Board oversees the structure and development of the Bank's capital management policy and ensures that the Bank maintains sufficient capital in accordance with regulatory requirements and in consideration of market conditions. The Board delegates certain responsibilities to the Risk Management Committee (RMC), which in turn recommends capital management policies and oversees their application. Accordingly, the Board, on the recommendation of the RMC:

- reviews and approves the capital management policy;
- reviews and approves the Bank's risk tolerance, including the main capital and risk targets and the corresponding limits;
- reviews and approves the capital plan and strategy on an annual basis, including the Bank's internal capital adequacy assessment process;
- reviews and approves the implementation of significant measures respecting capital, including contingency measures;
- reviews significant capital disclosures, including Basel capital adequacy ratios; and
- ensures appropriateness of the regulatory capital adequacy assessment.

The Office of the President is responsible for defining the Bank's strategy and plays a key role in guiding measures and decisions regarding capital. The Asset/Liability Management Committee oversees capital management, which consists of reviewing the capital plan and strategy and implementing significant measures respecting capital, including contingency measures, and making recommendations with respect to these measures.

Basel II Accord

The standards for calculating and disclosing capital in accordance with the Basel II Accord took effect in Canada on November 1, 2007. The rules seek to achieve greater uniformity in terms of capital requirements in the international banking sector while providing for enhanced sensitivity of capital to risks. They also require an explicit capital charge to cover operational risk and require more detailed reporting of risk management.

The Basel II Accord proposes a range of approaches of varying complexity, the choice of which determines, to a greater or lesser extent, the sensitivity of capital to risks. A less complex approach, such as the Standardized Approach, uses regulatory weightings, while a more complex approach uses the Bank's internal estimates of risk components to establish risk-weighted assets and calculate regulatory capital.

The Bank has been in compliance with the Basel II regulatory framework since November 1, 2007. On November 1, 2009, the Bank received OSFI authorization to use the Basel II Advanced Internal Rating-Based (AIRB) Approach to calculate credit risk capital for consolidated regulatory reporting purposes. The Bank uses the Standardized Approach for operational risk. For market risk, it primarily uses an approach based on internal models but uses the Standardized Approach to assess interest-rate-specific risk. On November 1, 2011, OSFI implemented changes to the regulatory framework for market risk, requiring banks to include an additional charge in their risk-weighted assets for the Stressed Value-at-Risk (SVaR) and an incremental risk capital charge for the trading book. In 2009, to comply with certain disclosure requirements, information was added to the MD&A and to the *Supplementary Financial Information* report available on the Bank's website at **nbc.ca**. Information concerning other disclosure requirements is presented in notes 5 and 19 to the consolidated financial statements.

Basel III: Strengthening the Resilience of the Banking Sector

In December 2012, OSFI released the final version of the *Capital Adequacy Requirements (CAR) Guideline*, which came into effect in January 2013, bringing a set of new rules that does not replace but rather builds on the previous Basel II framework. The new guideline reflects the changes to capital requirements adopted by the Basel Committee on Banking Supervision (BCBS), which are commonly referred to as Basel III. These changes, along with global liquidity standards, seek to strengthen the resiliency of the banking sector and financial system. The main changes are as follows:

- More stringent capital requirements: The new framework not only imposes higher minimum capital requirements but also an add-on of both a 2.5% capital conservation buffer (at the end of the transition period) and, according to national circumstances, a varying "countercyclical buffer" of between 0% and 2.5% of risk-weighted assets in common equity Tier 1 (CET1) or other fully loss-absorbing capital.
- Two new ratios: The Common Equity Tier 1 (CET1) ratio measures the portion of common equity, which is the type of capital with the highest quality, in regard to the risk-weighted assets. This ratio has been disclosed since the first quarter of 2013. The leverage ratio is a measure independent of risk that relates the amount of Tier 1 capital to the sum of the on- and off-balance-sheet assets. Disclosure of the leverage ratio will be required beginning 2015, but the details are still uncertain and may change as the new ratio is currently subject to an observation period. Full implementation is planned for the first quarter of 2018. The new leverage ratio will eventually replace the assets-to-capital multiple (ACM) currently enforced for regulated financial institutions in Canada.
- Deductions: The amount of deductions has increased, and most of them, if not all, must be deducted from common equity.
- New risk-weighted assets (RWA) charges: The counterparty credit risk charges have increased.

In addition to those measures, OSFI now requires that regulatory capital instruments other than common equity have a non-viability contingent capital (NVCC) clause to ensure that investors bear losses before taxpayers should the government determine that it is in the public interest to rescue a non-viable financial institution. Instruments issued before January 1, 2013 that would be Basel III compliant if it were not for the absence of the NVCC clause will be grandfathered and phased out over a period of 10 years. The Bank expects to phase out all of its non-NVCC instruments without resorting to any regulatory event redemption.

The new Basel III regulatory framework sets out transitional arrangements from 2013 to 2019. OSFI has introduced two methodologies for determining capital. The "all-in" methodology includes all of the regulatory adjustments that will be required by 2019 while retaining the phase-out rules for non-qualifying capital instruments. The "transitional" methodology, which is in line with the BCBS guidelines, in addition to applying the phase-out rules for non-qualifying capital instruments, also applies a more flexible and steady phasing in of the required regulatory adjustments. The Bank will disclose its capital ratios calculated according to both methodologies for each quarter until the start of 2019. Nevertheless, OSFI has been requiring Canadian banks to meet the 2019 minimum "all-in" requirements since the first quarter of 2013 for the CET1 ratio and will implement the requirement for Tier 1 capital and total capital ratios beginning the first quarter of 2014. Furthermore, in order to ensure an implementation similar to that of other countries, OSFI has decided to phase in the Credit Valuation Adjustment (CVA) charge over a period of five years beginning in 2014. In the first year, only 57%, 65% and 77% of total CVA will be included in the calculation of, respectively, the CET1, Tier 1 and total capital ratios and these percentages will gradually increase each year until they reach 100% by 2019. The Bank estimates that the CVA charge will have a 20-basis-point impact on its CET1 ratio in 2014.

As such, since the first quarter of 2013, the Bank must now maintain a CET1 capital ratio of at least 7.0%, i.e. 4.5% for common equity and 2.5% for a capital conservation buffer. In March 2013, OSFI designated Canada's six largest banks, a group that includes National Bank, as Domestic Systemically Important Banks (D-SIBs). For these banks, a 1% surcharge will apply to their capital ratios as of January 1, 2016. Consequently, as of that date, the Bank and all other major Canadian banks will have to maintain a CET1 capital ratio of at least 8.0%, a Tier 1 capital ratio of at least 9.5% and a total capital ratio of at least 11.5%, all ratios determined using the "all-in" methodology.

In addition to regulatory capital ratios, OSFI requires Canadian banks to meet a financial leverage test. Leverage or the assets-to-capital multiple is calculated by dividing the Bank's total assets, including certain off-balance-sheet items, by its total regulatory capital in accordance with the transitional requirements for Basel III.

New disclosure requirements pursuant to Pillar 3 of the Basel II framework came into force in the third quarter of 2013. Canadian financial institutions must use a disclosure template for their "all-in" regulatory capital and must present a reconciliation of all regulatory capital elements back to the balance sheet. These two requirements are presented in the *Supplementary Financial Information* report, published quarterly and available on the Bank's website at **nbc.ca**. Furthermore, a complete list of capital instruments and their main features is now available on the Bank's website under *Investor Relations › Capital and Debt Information › Main Features of Regulatory Capital Instruments*.

Capital Management in 2013

Capital

The Bank ensures that capital levels at all times exceed the minimum capital requirements established by OSFI's "all-in" ratios. Basel rules apply at the consolidated level of the Bank. Investments in non-consolidated entities for regulatory purposes are deducted from regulatory capital, and the assets of those entities are excluded from risk-weighted assets (RWA).

The definition adopted by the BCBS distinguishes between three types of capital. Common Equity Tier 1 capital consists of common shareholders' equity less goodwill, intangible assets and other capital deductions. The Additional Tier 1 instruments comprise eligible non-cumulative preferred shares, the eligible amount of innovative instruments and non-controlling interests. The sum of Common Equity Tier 1 and Additional Tier 1 capital form what is known as Tier 1 capital. Tier 2 capital consists of the eligible portion of subordinated debt and the eligible collective allowance for credit risk on non-impaired loans. Total regulatory capital is the sum of Tier 1 and Tier 2 capital.

Owing to its strong capital position combined with its internally generated capital, the Bank is in a good position to face these new requirements over the transition period that began January 1, 2013. In light of the Bank's D-SIB status, management decided that the Bank would aim to reach a Common Equity Tier 1 ratio higher than 8.75% by the end of fiscal 2014 if there are no significant changes in market conditions or in regulatory requirements or if the Bank does not make any acquisitions until then. The following table provides a comparison of the transitional ratios established by the BCBS and those required by OSFI's "all-in" methodology. All ratios include the capital conservation buffer and the D-SIB surcharge, when applicable.

Requirements – Regulatory Capital Ratios

	2013	2014	2015	2016	2017	2018	2019	2020	2021
BCBS transitional ratios									
Capital conservation buffer				0.625 %	1.25 %	1.875 %	2.5 %	2.5 %	2.5 %
CET1 ratio	**3.5 %**	4.0 %	4.5 %	5.125 %	5.75 %	6.375 %	7.0 %	7.0 %	7.0 %
Tier 1 ratio	**4.5 %**	5.5 %	6.0 %	6.625 %	7.25 %	7.875 %	8.5 %	8.5 %	8.5 %
Total capital ratio	**8.0 %**	8.0 %	8.0 %	8.625 %	9.25 %	9.875 %	10.5 %	10.5 %	10.5 %
Phase-in and phase-out elements:									
Phase-in of regulatory capital adjustments		20 %	40 %	60 %	80 %	100 %	100 %	100 %	100 %
Phase-out of non-qualifying capital instruments	**90 %**	80 %	70 %	60 %	50 %	40 %	30 %	20 %	10 %
OSFI's "all-in" ratios									
Capital conservation buffer	**2.5 %**	2.5 %	2.5 %	2.5 %	2.5 %	2.5 %	2.5 %	2.5 %	2.5 %
D-SIB surcharge				1.0 %	1.0 %	1.0 %	1.0 %	1.0 %	1.0 %
CET1 ratio	**7.0 %**	7.0 %	7.0 %	8.0 %	8.0 %	8.0 %	8.0 %	8.0 %	8.0 %
Tier 1 ratio		8.5 %	8.5 %	9.5 %	9.5 %	9.5 %	9.5 %	9.5 %	9.5 %
Total capital ratio		10.5 %	10.5 %	11.5 %	11.5 %	11.5 %	11.5 %	11.5 %	11.5 %
Phase-out elements:									
Phase-out of non-qualifying capital instruments	**90 %**	80 %	70 %	60 %	50 %	40 %	30 %	20 %	10 %

In 2012, according to OSFI's capital adequacy guidelines, the Bank chose to phase in the impact of adopting IFRS on its regulatory capital on a straight-line basis over a five-quarter period beginning the first quarter of 2012 until the first quarter of fiscal 2013.

Management Activities

On June 20, 2013, the Bank began a normal course issuer bid to repurchase for cancellation up to 2% of its common shares outstanding over the 12-month period ending no later than June 19, 2014. During fiscal 2013, the Bank did not repurchase any common shares.

On October 30, 2012, the Bank announced the issuance of 7,000,000 non-cumulative 5-year rate-reset Series 28 First Preferred Shares at a price equal to $25.00 per share for gross proceeds of $175 million. The Bank had also granted the underwriters an option to purchase up to an additional 1,000,000 Series 28 preferred shares. The option was exercised and 8,000,000 shares were issued for total gross proceeds of $200 million. The Bank completed the issuance on November 7, 2012.

On January 15, 2013, the Bank repurchased all of the issued and outstanding non-cumulative fixed-rate Series 15 First Preferred Shares. Pursuant to the share conditions, the redemption price was $25.00 per share plus the periodic dividend declared and unpaid. The Bank repurchased 8,000,000 Series 15 preferred shares for a total amount of $200 million.

On August 16, 2013, the Bank repurchased all of the issued and outstanding non-cumulative 5-year rate-reset Series 21 First Preferred Shares. Pursuant to the share conditions, the redemption price was $25.00 per share plus the periodic dividend declared and unpaid. The Bank repurchased 3,410,861 Series 21 preferred shares for a total amount of $85 million.

On September 20, 2013, the Bank announced the repurchase for cancellation of all $500 million of its Series 6 Medium Term Notes (subordinated debt securities) maturing November 15, 2018. These notes were redeemed at their nominal value on November 15, 2013, subsequent to the closing of the fiscal year.

Movement in Regulatory Capital[1]

Year ended October 31 (millions of Canadian dollars)	2013
Common Equity Tier 1 Capital (CET1)	
Balance at beginning[2]	4,565
Issuance of common shares (including Stock Option Plan)	106
Repurchase of common shares	–
Contributed surplus	–
Dividends on preferred and common shares	(592)
Net income attributable to the Bank's shareholders	1,479
Other items related to retained earnings	56
Removal of own credit spread net of income taxes	2
Removal of reserves arising from property revaluation	(26)
IFRS-conversion adjustment	(162)
Movements in accumulated other comprehensive income	
Translation adjustments	6
Available-for-sale securities	8
Other	(1)
Change in goodwill and intangible assets (net of related tax liability)	(123)
Other, including regulatory adjustments and transitional arrangements	
Change in defined benefit pension plan asset (net of related tax liability)	(5)
Change in amount exceeding 15% threshold	
Deferred tax assets	20
Significant investment in common shares of financial institutions	30
Change in other regulatory adjustments[3]	(13)
Balance at end	5,350
Additional Tier 1 Capital	
Balance at beginning[2]	1,737
New Tier 1 eligible capital issuances	–
Redeemed capital	(285)
Change in non-qualifying Additional Tier 1 subject to phase-out[4]	200
Other, including regulatory adjustments and transitional arrangements	–
Balance at end	1,652
Tier 1 Capital	7,002
Tier 2 Capital	
Balance at beginning[2]	2,450
New Tier 2 eligible capital issuances	–
Change in non-qualifying Tier 2 subject to phase-out	(238)
Change in eligible collective allowances	(28)
Other, including regulatory adjustments and transitional arrangements	–
Balance at end	2,184
Total Regulatory Capital	9,186

(1) The 2013 figures are presented on an "all-in" basis under Basel III.
(2) Figures are presented on a pro forma basis.
(3) Represents the change in investments in the Bank's own CET1 and significant investments in the capital of unconsolidated entities above the 10% threshold.
(4) Includes an issuance of $200 million preferred shares in the first quarter of 2013, deemed to be non-qualifying as per OSFI's Basel III rules and subject to phase out.

Risk-Weighted Assets

As required under Basel II, risk-weighted assets (RWA) are calculated for each credit risk, market risk, and operational risk. The Bank uses the AIRB Approach for credit risk to determine minimum regulatory capital requirements for a majority of its portfolio. Certain portfolios considered to be non-material are risk-weighted according to the Basel II Standardized Approach for credit risk. For operational risk, the Bank uses the Standardized Approach. Market risk-weighted assets are primarily determined using the Internal Model-Based Approach. Trading positions in foreign exchange, interest rate, equity, commodity and credit trading have capital requirements calculated using VaR. Also, the Bank uses the standardized model approaches to assess market risk capital for interest-rate-specific risk.

For externally-rated securitization exposures, the Bank uses the Rating-Based Approach (RBA). The approach assigns risk weights to exposures using external ratings. The Bank uses ratings assigned by one or more of Moody's Investors Service, Standard & Poor's, Fitch Ratings and DBRS. The RBA also takes into account additional factors, including the time horizon of the rating (long-term or short-term), the amount of detail available on the underlying asset pool and the seniority of the position. Under the RBA, exposures are multiplied by risk weights prescribed by OSFI in order to calculate the risk-weighted assets.

During the year, Basel III RWA decreased by $0.9 billion, totalling $61.3 billion as at October 31, 2013 compared to a pro forma Basel III RWA of $62.2 billion one year earlier. The decrease was mainly due to the postponing of the CVA charge to 2014 (the CVA charge had been included in the calculation of the pro forma RWA as at October 31, 2012), partly offset by organic growth. The Bank's risk-weighted assets are presented in the following table.

Capital Adequacy Under Basel III(1)

As at October 31
(millions of Canadian dollars)

	2013			2012
	Exposure at default(2)	Risk-weighted assets(3)	Capital requirement(4)	Risk-weighted assets
Credit risk				
AIRB Approach				
Sovereign	19,432	418	33	
Financial institutions	2,907	599	48	
Corporate	42,998	19,159	1,533	
Retail				
Residential mortgages	37,988	4,494	360	
Qualifying revolving retail	4,574	1,440	115	
Other retail	9,547	4,704	376	
Standardized Approach				
Sovereign	202	–	–	
Financial institutions	325	144	12	
Corporate	3,259	3,015	241	
Retail				
Residential mortgages	426	71	6	
Qualifying revolving retail	–	–	–	
Other retail	2,429	921	74	
	124,087	34,965	2,798	
Other assets	21,340	4,337	347	
Counterparty credit risk				
AIRB Approach				
Sovereign	15,200	10	1	
Financial institutions	48,874	2,425	194	
Corporate	243	16	1	
Trading portfolio	7,268	2,251	180	
Standardized Approach				
Sovereign	–	–	–	
Financial institutions	–	–	–	
Corporate	2,222	213	17	
Trading portfolio	806	273	22	
	74,613	5,188	415	
Banking book equities				
Simple weighted method				
Exchange-traded	226	226	18	
Non-exchange-traded	211	211	17	
	437	437	35	
Securitization positions – AIRB Approach	4,307	2,269	182	
Regulatory scaling factor		2,255	180	
Total – Credit risk	224,784	49,451	3,957	51,246
Market risk				
Internal model				
VaR		775	62	
Stressed VaR		1,109	89	
Standardized Approach				
Interest-rate-specific risk		1,498	120	
		3,382	271	2,887
Operational risk – Standardized Approach		8,418	673	8,057
Total	224,784	61,251	4,901	62,190

(1) Figures are presented on "all-in" basis. Risk-weighted assets for 2012 are presented on a pro forma basis.
(2) Exposure at default is the expected gross exposure upon the default of an obligor.
(3) Risk-weighted assets under the Standardized Approach reflect the impact of credit risk.
(4) The capital requirement is equal to 8% of risk-weighted assets.

RWA by Key Risk Drivers

During fiscal 2013, the Bank, with OSFI approval, applied AIRB models to certain exposures that had previously been considered under the Standardized Approach. Those exposures include certain retail mortgages that the Bank has acquired in recent years and business-related exposures, in particular construction-industry loans and mortgage loans on small- and medium-sized buildings. All of these changes have been included in the "Model updates" item and reduced credit RWA by $431 million.

Risk-Weighted Assets Movement by Key Drivers[1]

For the quarter ended October 31 (millions of Canadian dollars)	2013		
	Non-counterparty credit risk	Counterparty credit risk	Total
Credit risk – Risk-weighted assets at beginning	44,156	5,101	49,257
Book size	(221)	633	412
Book quality	716	(485)	231
Model updates	(431)	(105)	(536)
Methodology and policy	–	–	–
Acquisitions and disposals	–	–	–
Foreign exchange movements	43	44	87
Credit risk – Risk-weighted assets at end	44,263	5,188	49,451
Market risk – Risk-weighted assets at beginning			3,252
Movement in risk levels[2]			130
Model updates			–
Methodology and policy			–
Acquisitions and disposals			–
Market risk – Risk-weighted assets at end			3,382
Operational risk – Risk-weighted assets at beginning			8,386
Movement in risk levels			32
Acquisitions and disposals			–
Operational risk – Risk-weighted assets at end			8,418
Risk-weighted assets at end			61,251

(1) Figures are presented on "all-in" basis.
(2) Includes foreign exchange movement as it is not considered material.

The "Model updates" item is used to reflect implementations of new models, changes in model scope, and any other change applied to address model malfunctions. The "Methodology and policy" item presents the impact of changes in calculation methods resulting from changes in regulatory policies. The "Book size" item reflects organic changes in exposure size and composition (including new loans and maturing loans). RWA movements attributable to book size include increases or decreases in exposures, measured by exposure at default, assuming a stable risk profile.

The "Book quality" item is the Bank's best estimate of changes in book quality related to experience, such as underlying customer behaviour or demographics, including changes resulting from model recalibrations or realignments.

Regulatory Capital Ratios

For fiscal 2013, Canadian financial institutions must comply with OSFI's "all-in" ratios, namely, the CET1 capital ratio of 7.0% (including the 2.5% conservation buffer). Compliance with the Tier 1 and total capital ratios will be required as of 2014; the Bank is currently compliant with all of these ratios. Capital ratios are calculated by dividing the previously-described capital by risk-weighted assets. Credit, market and operational risks are factored into the risk-weighted assets calculation for regulatory purposes.

The CET1 capital ratio under Basel III, determined using the "all-in" methodology, was 8.7% as at October 31, 2013 versus a pro forma ratio under Basel III of 7.3% as at October 31, 2012. The higher CET1 capital ratio was essentially due to net income, net of dividends, to a delay in applying the new CVA charge, which had been included in the pro forma ratio the previous year, and to the common share issuance related primarily to exercised stock options. The Tier 1 capital ratio and the total capital ratio determined using the "all-in" methodology stood at 11.4% and 15.0%, respectively, as at October 31, 2013, compared to pro forma ratios of 10.1% and 14.1% last year. The increase was mainly due to the above-discussed factors.

The assets-to-capital multiple was 18.4 as at October 31, 2013 versus 18.3 as at October 31, 2012.

Regulatory Capital and Capital Ratios Under Basel III[1]

As at October 31 (millions of Canadian dollars)	2013	2012
Common Equity Tier 1 Capital (CET1)	5,350	4,565
Tier 1 capital	7,002	6,302
Total capital	9,186	8,752
Risk-weighted assets	61,251	62,190
Capital ratios		
Common Equity Tier 1 (CET1)	8.7 %	7.3 %
Tier 1	11.4 %	10.1 %
Total	15.0 %	14.1 %

(1) 2013 figures are calculated using the "all-in" methodology and the 2012 figures are presented on a pro forma basis.

Dividends

The Bank's strategy for common share dividends is to aim for a dividend payout ratio of between 40% and 50% of net income, taking into account such factors as financial position, cash needs, regulatory requirements and any other factor deemed relevant by the Board.

For fiscal 2013, the Bank declared $552 million in dividends to common shareholders, which represents 40% of net income attributable to common shareholders excluding specified items (2012: 39%). The declared dividends are within the target payout range. Given the current economic conditions, the Bank has taken a prudent approach to managing regulatory capital. Nevertheless, it remains confident in its ability to increase earnings going forward.

RISK MANAGEMENT

The Bank views risk as an integral part of its development and the diversification of its activities and advocates a risk management approach consistent with its business expansion strategy. The purpose of sound risk management is to provide reasonable assurance that incurred risks do not exceed acceptable thresholds and that risk-taking contributes to the creation of shareholder value. For the Bank, this means striking a healthy balance between return and risk.

The Bank is affected by risk in two ways. First, it exposes itself voluntarily to certain categories of risk, especially credit and market risk, in order to generate revenue. Second, it must assume risks that are inherent to its activities to which it does not choose to expose itself and that do not generate revenue, i.e., mainly operational risk. These risks may result in losses that could adversely affect expected earnings.

Top and Emerging Risks

Top and emerging risks represent risks that could have a material adverse effect on the Bank's financial results, reputation or long-term business model and strategy. The processes aim at identifying and assessing these risks as early as possible to be able to carry out the appropriate mitigating strategies. The Bank's top and emerging risks are as follows.

General Business and Economic Conditions

Although the Bank operates primarily in Canada, it also has business operations in the United States and other countries. The economic and business conditions in these countries can therefore affect the Bank's revenues. Such conditions include short- and long-term interest rates, inflation, fluctuations in debt securities markets and financial markets, exchange rates, the crisis affecting certain European countries, the fiscal situation in the United States, the tightening of liquidity in various financial markets, the strength of the economy, and the level of the Bank's business activity. All of these factors affect the business and economic conditions in a given geographic region and, consequently, affect the Bank's level of business activity and resulting earnings in that region.

Currency rate movements in the United States and other countries in which the Bank does business can impact the Bank's financial position and future earnings.

The monetary policies of the Bank of Canada and the U.S. Federal Reserve as well as other interventionist measures in capital markets by public organizations have repercussions on the Bank's revenues. Changes in the monetary stance and the general level of interest rates can impact the Bank's profitability.

Conscious of the potential adverse effects of a deterioration in the global, U.S. or Canadian economy on the Bank's risk profile and profitability, the Bank is closely monitoring the situation and actively managing its operations to achieve its strategic objectives, mitigate risks and seize opportunities. See the Major Economic Trends section of this MD&A for additional information on the economy.

Elevated Level of Canadian Household Debt and Housing Market Imbalances

The elevated levels of household debt and property prices are still sources of risk for the Canadian economy. Some market segments continue to show signs of overbuilding, and a normalization of interest rates could lead to adverse economic conditions and a correction in the housing market. Therefore, the Bank continues to monitor the evolution of the market and to remain vigilant in line with its risk appetite. The credit quality of the portfolio remains solid, showing a low level of provisions for credit losses and a good business mix.

Low Interest Rate Environment

As a consequence of exceptional monetary measures taken by central banks combined with mild economic growth and low inflation, longer-term interest rates continue to be historically low in major advanced economies. This environment could lead market participants to deploy excessive risk-taking strategies in search for additional yield. Therefore, the Bank remains vigilant and continues to rely on its strong risk management framework to identify, assess and mitigate risk so that it remains within the risk appetite limits.

Regulatory Reforms

The banking industry is facing increasing regulation changes with an unprecedented scope and intensity following the financial crisis. Achieving compliance with some of these reforms may require significant effort and could affect the way the Bank operates in its primary market and abroad. The Bank is proactively monitoring and responding to regulatory developments while seeking to mitigate any negative effects on the Bank's activities and profitability.

Technology Risks

Technology has become a major part of the banking industry's operations with the ever increasing use of mobile, wireless and web-enabled devices. As a consequence, risks related to cybersecurity and cybercrimes are rising. This could result, for example, in system disruptions, corrupted data or theft of sensitive information, which might lead to negative impacts such as financial loss or reputational damage. The Bank is closely monitoring its control environment and continues to enhance processes and practices used to ensure its continuous effectiveness and protection.

Third parties provide the essential components of the Bank's commercial infrastructure, such as Internet connections and access to network and other communications services. The Bank is also party to outsourcing agreements for IT support and for cash management and processing. Interruptions in these services can adversely affect the Bank's ability to provide products and services to its clients and conduct its business. To mitigate this risk, the Bank has a robust outsourcing risk management framework that includes business continuity plans that are tested periodically to ensure their effectiveness in times of crisis.

Risk Management Framework

Risk must be rigorously managed. That means it is identified, measured and controlled to ensure that the Bank's operations yield an adequate return for the level of risk assumed. Managing risk requires a solid understanding of every type of risk found across the Bank. In addition to providing assurance that risk levels do not exceed acceptable thresholds, effective risk management can be used to control the volatility of the Bank's results.

Despite the exercise of stringent risk management and the mitigation measures in place, risk cannot be suppressed entirely, and the residual risks may occasionally cause significant losses. In the normal course of business, the Bank is primarily exposed to the risks listed below.

Strategic risk	Credit risk	Market risk	Liquidity risk	Operational risk	Regulatory risk	Reputation risk	Environmental risk

To achieve its risk management objectives, the Bank has a risk management framework that combines the following elements:

- risk management culture;
- governance structure;
- risk appetite framework;
- risk management policies;
- validation of risk models;
- risk reports to ensure regular monitoring of the overall risk profile and support risk awareness across the Bank;
- a review of risk decisions by independent professionals;
- capital allocation to the business units;
- independent oversight by the Compliance Service; and
- independent assessment by Internal Audit.

Risk Management Culture

The Bank's management continually promotes a risk management culture through internal communications that foster a balanced model where business development initiatives are coupled with a constant focus on sound risk management.

Furthermore, to ensure the effectiveness of the risk management framework in place, the Bank has clearly defined roles and responsibilities by reinforcing the concept of the three lines of defence. The Governance Structure section presented on the next pages sets out this concept and the roles and responsibilities of all levels of the organization.

First Line of Defence Business Lines	**Second Line of Defence** Risk Management and Oversight Functions	**Third Line of Defence** Internal Audit
Manage, identify, assess and mitigate risks in day-to-day activities Ensure activities are in alignment with the Bank's risk appetite and risk management policies	Establish the enterprise-wide risk management framework and policies Provide independent oversight of risk management practices and challenge the first line of defence Monitor and report risk levels	Provide assurance to management and the Board on the overall effectiveness of the risk management policies, processes and practices

The following guiding principles are applied to support a strong risk culture:

- Risk is Everyone's Business: Business lines, risk management and oversight functions as well as internal audit play an important role in ensuring an effective and robust risk management framework is in place.
- Client-Centric: Knowing its clients is key to strong risk management and excellent client service.
- Enterprise-Wide: An integrated view of risk is the basis of sound risk management and decision-making by management.
- Human Capital: The Bank's employees are engaged, experienced and have high expertise. Their curiosity supports continuous development and their rigour promotes a sound risk culture across the organization.
- Judgment: While supported by advanced models and systems, good risk management relies heavily on the application of common sense and judgment.

The Bank's risk management culture has a direct impact on its risk appetite.

Risk Appetite and Reporting

Risk taking is intrinsic to a financial institution's business. Business unit strategies have always—implicitly or explicitly—incorporated decisions regarding the amount of risk they are willing to assume. Risk appetite represents how much risk an organization is willing to assume consistent with its strategy. The Bank cultivates a risk management culture that is aligned with its risk appetite, doing so by setting risk tolerance thresholds that determine its risk-taking capacity.

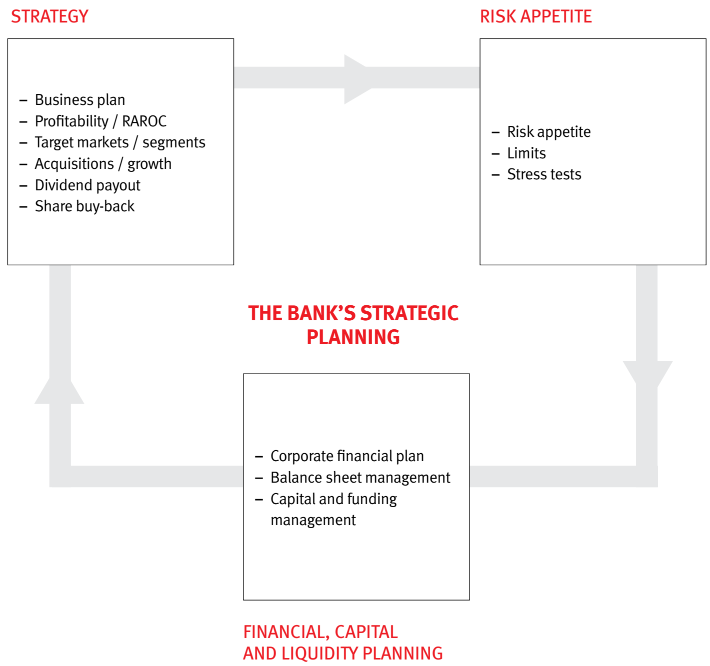
The Bank's risk appetite framework consists of principles, statements, metrics as well as targets and is reinforced by policies and limits. It is defined both quantitatively and qualitatively and requires:

- a target risk rating of at least A or equivalent;
- a risk-reward balance;
- a stable risk profile;
- a strategic level of concentration aligned with approved targets;
- a strong capital position;
- a strong liquidity position; and
- a low tolerance to operational, compliance and reputation risks.

The Bank's management and business units are involved in the process for setting the risk appetite and are responsible for adequately monitoring the chosen key risk indicators. These needs are assessed by means of the enterprise strategic planning process. The chart opposite shows that this process is continuous and iterative. The risk indicators are reported on a regular basis to ensure an effective alignment of the Bank's risk profile to its risk appetite; otherwise, appropriate actions could be taken, as needed.

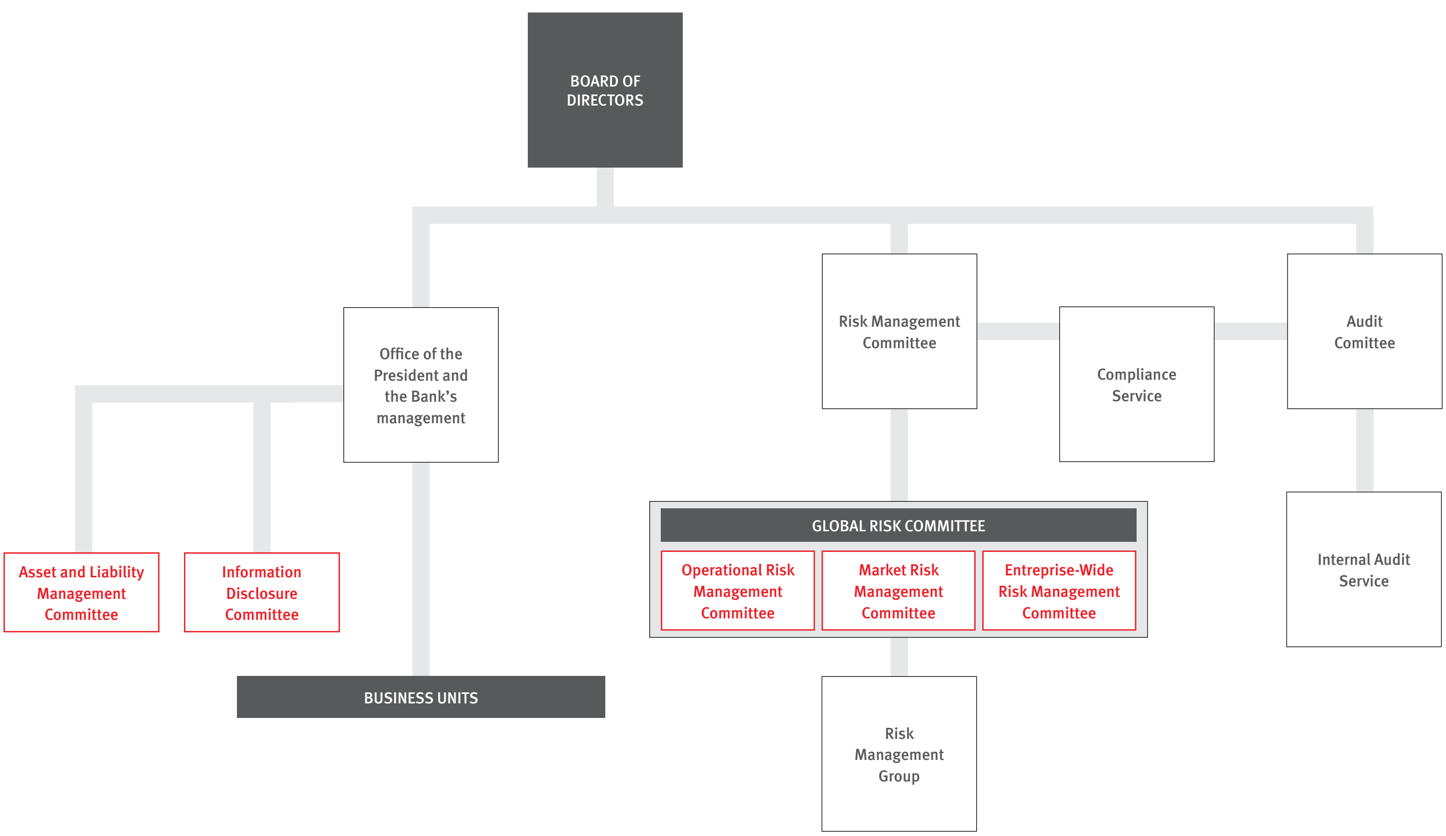
Enterprise-Wide Stress Testing

As part of a more extensive process aimed at ensuring that the Bank maintains adequate levels of capital, commensurate with its business strategy and risk appetite, an enterprise-wide stress testing program is in place at the Bank. Stress testing can be defined as a risk management method that assesses the potential effects—on the Bank's financial position, capital and liquidity—of a series of specified changes in risk factors, corresponding to exceptional but plausible events. The program supports management's decision-making process by identifying potential vulnerabilities for the Bank as a whole that are considered in setting limits as well as in longer term business planning. The scenarios and stress test results are reviewed by a stress testing oversight group and the Global Risk Committee and are approved by the Board.



Governance Structure

The following diagram shows the prevailing governance relationships for risk management. As the second line of defence, the Risk Management Group establishes the risk management rules, policies and guidelines to which the business units must adhere and also ensures compliance therewith.



The governance structure at the Bank sets out the roles and responsibilities of all levels of the organization.

The Board of Directors (Board)
The Board examines and approves the Bank's overall risk philosophy and risk appetite, acknowledges and understands the main risks faced by the Bank, and makes sure appropriate systems are in place to effectively manage and control these risks. It performs its mandate in this regard both directly and through its committees, including the Audit Committee and the Risk Management Committee.

The Audit Committee
The Audit Committee oversees the work of the internal auditor and the independent auditor, the financial reporting and analysis process, the Bank's internal controls, and the application of the policy for reporting irregularities relating to accounting, internal accounting controls and auditing matters.

The Risk Management Committee (RMC)
The Risk Management Committee reviews the risk appetite framework, the main risk management policies as well as risk tolerance limits and recommends their approval by the Board. It ensures that appropriate resources, processes and procedures are in place to properly and effectively manage risk on an ongoing basis. Finally, it monitors the risk profile and risk trends of the Bank's activities and ensures alignment with the risk appetite.

The Office of the President
Composed of the President and Chief Executive Officer and the officers responsible for the Bank's main functions and business units, the Office of the President ensures that risk management is effective and aligned with the Bank's pursuit of its objectives and strategies.

The Asset and Liability Management Committee
The Asset and Liability Management Committee provides strategic direction for management of enterprise-wide non-trading interest rate risk and monitors the liquidity and funding position, balance sheet structure and size as well as the capital position in order to achieve an optimal balance between risk and reward.

The Bank's Management
The Bank's management promotes the risk management culture Bank-wide and manages the primary risks to which it is exposed.

The Global Risk Committee (GRC)
The Global Risk Committee defines the parameters of the policies that determine risk tolerance and the overall risk strategy, for the Bank and its subsidiaries as a whole, and sets limits as well as tolerance and intervention thresholds enabling the Bank to properly manage the main risks to which it is exposed. The Committee approves and monitors all large credit facilities. It also recommends for Board approval the risk philosophy, the Bank's risk appetite and risk profile management. The Market Risk Management Committee, the Senior Complex Valuation Committee, the Operational Risk Management Committee, the Committee on Banks, the Capital Models Oversight Committee, the Enterprise-Wide Risk Management Committee, and the Product and Activity Review Committee all report to the Global Risk Committee.

The Information Disclosure Committee
The Information Disclosure Committee ensures that financial reporting disclosure controls and procedures are implemented and are operating effectively.

The Risk Management Group
This group provides an independent oversight of risk management practices and standards. It promotes a strong risk management culture throughout the Bank and proposes risk management policies and implements tools and models for identifying, measuring and monitoring risks. In addition to instituting and applying various independent risk review and approval procedures, this group also proposes risk limits that reflect the risk tolerance thresholds established by the RMC and informs management and the Board of significant risks.

The Business Units
As a first line of defence, the business units manage risks related to their operations within established limits and in accordance with risk management policies by identifying, analyzing and understanding the risks to which they are exposed and implementing risk mitigation mechanisms. The management of these units must ensure that employees are adhering to current policies and limits.

Lines of Defence
The risk management governance framework is founded on the three lines of defence concept, with the goal of promoting accountability among stakeholders in risk management. The first line of defence corresponds to the business units undertaking the risk generating activities. In this role, the business units have the primary responsibility to effectively manage their risks in compliance with policies and within the risk appetite limits. The second line of defence is primarily represented by the Risk Management Group, Compliance and other corporate units. Executives and personnel of these groups are responsible for ensuring that there exists an appropriate risk management framework, risk appetite and compliance with policies. Within this context, they ensure an independent and effective oversight of business unit activities, strategies and risk exposures. The third line of defence corresponds to the Internal Audit function, which provides assurance on the effectiveness of governance, risk management and internal controls, including the manner in which the first and second lines of defence achieve both risk management and control objectives. The frequency of Internal Audit's periodic review is determined by the level of risk.

Risk Management Policies

Risk management policies and the related standards and procedures are the essential elements of the risk management framework. They define and describe the main activity-related risks, specify the requirements that the business units must meet in assessing and managing risk, stipulate the authorization process for risk-taking and set the risk limits to be adhered to. These policies cover all the main risks in the Bank and are reviewed on a regular basis to ensure that they are still relevant given changes in the markets and the business plans of the Bank's business units. Other policies, standards and procedures complement the main policies and cover more specific aspects of management, such as business continuity, the launch of new products, initiatives or activities, or financial instrument measurement. These policies, standards and procedures apply across the Bank and its subsidiaries.

Risk Models Governance and Vetting Framework

Exposure to important risks such as credit and market risks is assessed in most cases through the use of models. The two key components of the Bank's model vetting governance framework are the Model Risk Management Policy and the model vetting group reporting to the Vice-President of Enterprise-Wide Risk Management. The policy sets the rules and standards applicable to both the model development and the model vetting groups. The scope of models covered is wide, from the basic market risk pricing models and automated credit decision-making models to the business risk capital model, including models used for regulatory capital and stressed capital purposes.

Models are playing a progressively more important role in decision making due to a better understanding of the extent to which they can enhance risk management. The Bank makes increasing use of models to guide enterprise-wide risk management, financial markets strategy, economic and regulatory capital allocation, global credit risk management, wealth management and profitability measures. Models have in fact become a standard in risk management. This stresses the growing importance of model risk for banks, hence the implementation of a rigorous policy and sound model vetting processes to ensure models can be used appropriately and efficiently to manage risks.

Among the key features of the Bank's policy is the general principle that all models that are deemed important for the Bank or that are used for regulatory capital purposes require independent vetting. To that effect, all models used by the Bank are classified in terms of their risk level (low, medium or high). Based on that assessment, the Bank applies strict guidelines with respect to model review requirements and the minimum frequency of such reviews. The Bank believes that the best defence against model risk is the implementation of a robust development and validation framework.

Independent Oversight by the Compliance Service

The Compliance Service is responsible for implementing a Bank-wide regulatory risk management framework by relying on an organizational structure that includes functional links to the main business segments.

Compliance is an independent function within the Bank. Its vice-president has direct access to the Chair of the RMC, the Chair of the Audit Committee and to the President and Chief Executive Officer. The Compliance team can communicate directly with officers and directors of the Bank and its subsidiaries, obtain unrestricted access to files, reports, records and data, and require employees of the Bank and of its subsidiaries to provide the information deemed necessary for effective oversight.

Business unit managers must oversee the implementation of mechanisms for daily control of regulatory risks arising from the operations under their responsibility. Compliance exercises independent oversight to assist managers in managing these risks effectively and to obtain reasonable assurance that the Bank is compliant with regulatory requirements.

The control framework covers the following:

- identification, evaluation, communication, maintenance and updating of regulatory requirements;
- information gathering and monitoring of regulatory changes;
- identification of the business units affected by these requirements;
- documentation of compliance and regulatory requirement controls applicable to daily operations, including monitoring procedures, remedial action plans and periodic reports produced by the business units;
- continuous training for all employees;
- information exchange between the business segments, business units and Compliance;
- independent oversight of the application of policies and procedures in effect;
- quarterly reporting to the RMC on the main results of compliance oversight; and
- annual certification process.

Independent Assessment by Internal Audit

Internal Audit is an independent, objective function within the Bank. It provides assurance as to the Bank's level of proficiency over its activities, advises on how to improve those activities and contributes to the creation of added value. It helps the Bank accomplish its objectives by applying a systematic, methodical approach for assessing and improving the effectiveness of risk management, control and governance processes. Internal Audit is mandated to provide the Board, through the Audit Committee, and the Office of the President with an evaluation in that respect.

The Senior Vice-President of Internal Audit reports to the Chair of the Audit Committee and may, at any time, call an unscheduled Audit Committee meeting. The independence of the Vice-President is also ensured through a direct line of communication with the President and Chief Executive Officer.

As Internal Audit is not mandated to institute internal control mechanisms but rather evaluate their effectiveness, it has no direct responsibility or authority over the activities it reviews. Whenever recommendations are issued, Internal Audit is mandated to independently evaluate the appropriateness of the measures taken by the managers to resolve the issues.

Internal Audit has unrestricted access to all business segments, corporate units and subsidiaries of the Bank.

Regulatory Context

The Bank operates in a highly regulated environment in which profound regulatory reforms have taken place over the past few years. The pace and volume of such reform has resulted in the Bank adapting its governance and risk management frameworks to more effectively manage the implementation, compliance and ongoing oversight of regulatory changes in order to minimize regulatory risk. See the Regulatory Risk Management section for additional information.

Strategic Risk Management

Strategic risk is the risk of a loss arising from inappropriate strategic orientations, improper execution or ineffective response to economic or financial changes. The corporate strategic plan is developed by the Office of the President, in alignment with the Bank's overall risk appetite, and approved by the Board. Once approved, the initiatives of the strategic plan are monitored regularly to ensure that they are progressing according to plan. If not, strategies could be reviewed or adjusted if deemed appropriate. Additionally, significant acquisitions are analyzed through the due diligence process which ensures that they are in line with the corporate strategic plan and the Bank's risk appetite.

Credit Risk Management

Credit risk is the risk of a financial loss if an obligor does not fully honour its contractual commitments to the Bank. Obligors may be borrowers, issuers, counterparties or guarantors. Credit risk is the most significant risk facing the Bank in the normal course of business. The Bank is exposed to credit risk not only through its direct lending activities and transactions but also through commitments to extend credit, letters of guarantee, letters of credit, over-the-counter derivatives trading, available-for-sale debt securities, securities purchased under reverse repurchase agreements, deposits with financial institutions, brokerage activities and transactions carrying a settlement risk for the Bank such as irrevocable fund transfers to third parties via electronic payment systems.

A policy framework centralizes the governance of activities that generate credit risk for the Bank and is supplemented by a series of subordinate internal or sectoral policies and guidelines on specific management issues such as credit limits, collateral requirements and risk quantification or that provide more thorough guidance for given business. For example, the institutional activities of the Bank and its subsidiaries on financial markets and international commercial transactions are governed by segment-specific directives that set out standards adapted to the specific environment of these activities. This also applies to retail brokerage subsidiaries. In isolated cases, a business unit or subsidiary may have its own credit policy, and that policy must always fall within the spirit of the Bank's policy framework and be reviewed and approved by the management of the Risk Management Group. The Risk Management Group defines the scope of the universe of subsidiaries carrying significant credit risks and the magnitude of the risks incurred.

Credit risk is controlled through a rigorous process that comprises the following elements:

– credit application;
– risk and rating assessment;
– assessment of capital at risk;
– credit decision and approval process;
– risk mitigation;
– account monitoring and recovery; and
– identification of impaired loans and provisioning for credit losses.

Credit Risk Assessment of Loans

Before a sound and prudent credit decision can be taken, the credit risk represented by the borrower or counterparty must be accurately assessed. This is the first step in processing credit applications. Each application is analyzed and assigned one of 19 grades on a scale of 1 to 10 using a credit rating system developed by the Bank for all portfolios exposed to credit risk. As each grade corresponds to a borrower's, counterparty's or third party's probability of default, the credit risk can be determined for the Bank. The credit risk assessment method varies according to portfolio type.

The main parameters used to measure the credit risk of loans outstanding and undrawn amounts are as follows:

– probability of default (PD), which is the probability that the obligor will default within one year;
– loss given default (LGD), which represents the magnitude of the expected loss from the obligor's default, expressed as a percentage of exposure at default (EAD); and
– EAD, which is the estimated amount potentially drawn at the time of the obligor's default.

The methodology as well as the data and the downturn periods used to estimate the LGD are as follows:

IRB Approach		Data	Downturn period	Methodology for calculating LGD
Sovereign		Moody's observed default price of bonds, from 1983 to 2010 S&P rating history from 1975 to 2011	No specific period	Based on implied market LGD using observed bond price decreases following the issuer's default
Financial institutions		PECDC (Pan-European Credit Data Consortium) loss and recovery database from 1998 to 2011	1998, 2001, 2008 and 2009	Econometric model for predicting LGD based on different issue- and issuer-related risk drivers
Corporate		NBC internal historical data from 2000 to 2011	2000-2003 and 2008-2009	Work out LGD based on the Bank's historical recoveries and losses
Retail	Residential mortgage	NBC internal historical data from 1996 to 2010	1996-1998	Work out LGD based on the Bank's historical recoveries and losses
	Qualifying revolving retail	NBC internal historical data from 1997 to 2009	October 2008–December 2009	
	Other retail	NBC internal historical data from 2000 to 2009	October 2008–December 2009	

Personal Credit Portfolios

This category comprises credit portfolios composed of residential mortgage loans, consumer loans and loans to certain small businesses. The credit risk of these portfolios is measured using credit scoring models. The obligor's default risk rating for personal credit is determined using these models. The assessment also takes product risk into account, for example, lines of credit versus term loans. Personal credit risk assessments are based on a group of borrowers with similar credit histories and behaviour profiles.

The credit scoring models are used to grant credit to new clients. These models use proven statistical methods that measure applicants' characteristics and history based on internal and external historical information to estimate the applicant's future credit behaviour and assign a default risk rating. The underlying data include client information such as current and past employment, historical loan data in the Bank's management systems and information from external sources such as credit rating agencies.

The Bank also uses behaviour scoring models to manage and monitor current commitments. The risk assessment is based on statistical analyses of the past behaviour of obligors with which the Bank has a long-term relationship in an effort to predict their future behaviour. The underlying information includes the obligor's cash flows and borrowing trends. Information on characteristics that determine behaviour in these models also comes from both internal sources on current commitments and external sources.

A risk analysis based on loan grouping in pools of homogeneous obligor profiles is used for overall management of personal credit portfolios. This personal credit assessment approach, which has proven particularly effective for estimating loan defaults and losses, takes a number of factors into account, namely:

- behaviour scoring;
- loan product characteristics;
- collateral provided;
- the length of time on the Bank's balance sheet; and
- loan status (active, delinquent or defaulted).

This mechanism provides adequate risk measurement inasmuch as it effectively differentiates risk levels by pool. Therefore, the results are periodically reviewed and, if necessary, adjustments are made to the models. Obligor migrations between pools are among the factors considered in the credit risk assessment.

Loan pools are also established based on probability of default, loss given default and exposure at default, which are measured based on the characteristics of the obligor and the transaction itself. Loss given default is estimated based on transaction-specific factors including loan product characteristics, loan-to-value ratio and types of collateral. In accordance with the Bank's default risk-rating and facility risk-rating policies, the review and renewal policy, and the risk quantification policy, the default risk ratings must be reviewed annually.

Business and Government Credit Portfolios

This category comprises business (other than some small businesses that are classified in personal credit portfolios), government and financial institution credit portfolios.

These credit portfolios are assigned a risk rating based on a detailed individual analysis of the financial and non-financial aspects of the borrower, including the borrower's financial strength, sector of economic activity, competitive ability, access to capital and management quality. The Bank has risk-rating tools and models enabling it to specifically assess the risk represented by an obligor in relation to its industry and peers. The models used are adapted to the obligor's broad sector of activity. Models are in place for seven sectors: business/commercial, large business, banks-brokerage, sovereigns, energy, real estate and agriculture.

This risk assessment method assigns a default risk rating to an obligor that reflects its credit quality. For each credit risk rating corresponds a probability of default (see the following table). This credit quality classification enables the Bank to adequately differentiate its respective assessments of an obligor's ability to meet its contractual obligations. This kind of assessment must be done independently of external circumstances, particularly adverse economic or financial conditions likely to put stress on the Bank. Default risk ratings are assigned according to an assessment of the obligors' commercial and financial risks, based on a solvency review. Various risk quantification models, described below, are used to perform this assessment.

The business and government default risk-rating scale used by the Bank is similar to the systems used by major external rating agencies. The complete rating scale comprised of 19 grades is presented in the *Supplementary Financial Information* report, which is available on the Bank's website at **nbc.ca**. The following table presents a grouping of the grades by major risk category and compares them with the ratings of two major rating agencies.

Internal Default Risk Ratings – Business and Government

Ratings	Standard & Poor's	Moody's	Description[1]
1 – 2.5	AAA to A-	Aaa to A3	Excellent
3 – 4	BBB+ to BBB-	Baa1 to Baa3	Good
4.5 – 6	BB+ to B+	Ba1 to B1	Satisfactory
6.5 – 7.5	B to CCC+	B2 to Caa1	Special mention
8 – 8.5	CCC to CCC-	Caa2 and Caa3	Substandard
9 – 10	CC, C and D	Ca, C and D	Default

(1) Additional information is provided in the tables in Note 5 to the consolidated financial statements.

The Bank also uses individual assessment models by industry to assign a risk-rating to the credit facility based on the collateral and guarantees the obligor is able to provide and, in some cases, based on other factors.

The Bank consequently has a bi-dimensional risk-rating system that, using internal and external historical data, establishes a default risk rating for each obligor, and models that assign a risk rating to the credit facility that is independent of the risk rating assigned to the obligor.

The Bank's default, and in some cases, facility risk-rating systems and the associated risk parameters are used to estimate expected and unexpected losses and risk-based pricing as well as to establish counterparty credit concentration limits, assess economic capital and generally manage credit portfolios.

Validation

The Risk Management Group monitors the effectiveness of the risk-rating systems and associated parameters, which are also reviewed regularly in accordance with the Bank's policies.

Backtesting is done at regular intervals to validate the effectiveness of the models used to measure probability of default, loss given default and exposure at default. For probability of default in particular, this backtesting takes the form of sequentially applied statistical tests designed to assess the following criteria:

- the model's discriminatory power;
- overrides;
- model calibrating; and
- the stability of the model's output.

The credit risk quantification models are developed and tested by a team of specialists and their performance is monitored by the applicable business units and related credit risk management services. New models are validated by a unit that is independent of both the specialists that developed the model and the business units concerned, and approved through an escalation process established by the Model Risk Management Policy. Furthermore, new models or changes to existing models that markedly impact regulatory capital must be reported to the Board once a year.

The risk-rating systems, methods and models are also subject to periodic independent validation, as often as required by the inherent risk of the activity. Models that have a significant impact on regulatory capital must be reviewed regularly, thereby further raising the certainty that these quantification mechanisms are working as expected. The key aspects to be validated are factors allowing accurate risk classification by level, adequate quantification of exposure, use of assessment techniques that include external factors such as economic conditions and credit status and, lastly, compliance with internal policies and regulatory provisions.

The Bank's credit risk assessment and rating systems are overseen by the RMC and the GRC and are an integral part of a comprehensive Bank-wide credit risk oversight framework. Along with the above-mentioned elements, policies, definitions of responsibilities, resource allocation and existing processes are documented and periodically reviewed.

Assessment of Capital at Risk

The assessment of the Bank's capital at risk, or economic capital, is based on the credit risk assessments of various borrowers. These two activities are therefore interlinked. The different models used to assess the credit risk of a given portfolio type also enable the Bank to determine the default correlation among borrowers. This information is a critical component in the evaluation of potential losses for all portfolios carrying a credit risk. Potential losses, whether expected or not, are based on past loss experience, portfolio monitoring, market data and statistical modeling. Expected and unexpected losses are factors in the assessment of capital at risk for each business segment. The main risk factors are as follows:

- probability of default;
- balance outstanding at the time of default;
- expected loss in the event of default;
- correlation between transactions;
- term of credit commitments; and
- impact of economic and sector-based cycles on asset quality.

Stress Testing and Crisis Scenarios

The Bank carries out stress tests to evaluate its sensitivity to crisis situations in certain sectors of activity and key portfolios (e.g., agriculture, construction, manufacturing, etc.). Moreover, a global stress test methodology covers most business and government credit portfolios as well as personal credit portfolios to provide the Bank with an overview of the situation. By simulating very specific extreme scenarios, these tests enable the Bank to measure the level of regulatory capital necessary to absorb potential losses and determine the impact on its solvency.

Mortgage Loan Underwriting

To mitigate the impact of an economic slowdown and ensure the long-term quality of its portfolio, the Bank uses sound risk management when granting residential mortgages to confirm: (i) the borrower's intention to meet its financial obligations (ii) the borrower's ability to repay its debts and (iii) the quality of the collateral. In addition, the Bank takes a prudent approach to client qualification by using, for example, a higher interest rate for terms less than five years to mitigate the risk of short- or medium-term rate increases.

Nonetheless, the risk of economic slowdown could adversely affect the profitability of the mortgage portfolio. In stress test analyses, the Bank considers a variety of scenarios to measure the impact of adverse market conditions. In such circumstances, our analyses show significantly higher loan losses, which would decrease profitability and reduce the Bank's capital ratios.

To counteract the negative impact of an economic slowdown, the Bank has acted preventively by defining a contingency plan to guide its response in such an event.

Credit Granting and Approval Process

Credit-granting decisions are based first and foremost on the results of the risk assessment. Aside from a client's solvency, credit-granting decisions are also influenced by factors such as available collateral, transaction compliance with policies, standards and procedures, and the Bank's overall risk-adjusted return objective. Each credit-granting decision is made by authorities within the risk management teams and management who are independent of the business units and are at a reporting level commensurate with the size of the proposed credit transaction and the associated risk.

Decision-making authority is determined in compliance with the delegation of authority set out in the Credit Risk Management Policy. A person in a senior position in the organization approves credit facilities that are substantial or carry a higher risk for the Bank. The Bank's Global Risk Committee approves and monitors all substantial credit facilities. Credit applications that exceed management's latitudes are submitted to the Board for approval. The credit-granting process demands a high level of accountability from managers, who must proactively manage the credit portfolio.

Risk Mitigation

The Bank also controls credit risk using various risk mitigation techniques. In addition to the standard practice of requiring collateral to guarantee repayment of the credit it grants, the Bank also uses protection mechanisms such as credit derivative financial instruments, syndication and loan assignments as well as an orderly reduction in the amount of credit granted.

The most common method used to mitigate credit risk is to obtain quality collateral from borrowers. Obtaining collateral cannot replace a rigorous assessment of a borrower's ability to meet its obligations, but, beyond a certain risk threshold, it is an essential complement. Collateral is not required in all cases; it depends upon the level of risk presented by the borrower and the type of loan granted. However, if the level of risk to the Bank is considered high, collateral will likely be required. The legal validity of any collateral obtained and the Bank's ability to correctly and regularly measure the collateral's value are critical for this mechanism to play its proper role in risk mitigation. The Bank has established specific requirements in its internal policies with respect to the appropriate legal documentation and assessment for the kinds of collateral that business units may require in guarantee of loans granted. The categories of eligible collateral and the lending value of these assets have also been defined by the Bank. For the most part, they include the following asset categories, as well as guarantees (whether secured by collateral or unsecured) and government and bank guarantees:

- accounts receivable;
- inventory;
- machinery and equipment and rolling stock;
- residential and commercial real estate, office buildings and industrial facilities; and
- cash and marketable securities.

<u>Portfolio Diversification and Management</u>

The Bank is exposed to credit risk not only through outstanding loans and undrawn amounts of commitments to a particular borrower but also through the sectoral distribution of loans outstanding, undrawn amounts, and the exposure of its various credit portfolios to geographical, concentration and settlement risks.

The Bank's approach to controlling these diverse risks begins with optimizing diversification of its exposures. Measures designed to maintain a healthy degree of diversification of credit risk in its portfolios are set out in the Bank's internal policies and procedures. These instructions are mainly reflected in the application of various exposure limits: credit approval limits and country limits by hierarchal level; limits on counterparty credit concentration; and credit concentration limits by industry, country, region and type of financial instrument. Compliance with these limits is monitored through periodic reports submitted by Risk Management officers to the Board.

The criteria established for portfolio diversification and the specific limits set for economic, industrial or geographical sectors are based on findings of sector-based studies and analyses conducted by economists and the Risk Management Group and are approved by the Global Risk Committee. Continuous analyses are performed in order to anticipate problems with a sector or borrower before they materialize as defaulted payments.

In accordance with the Bank's corporate strategy and its risk appetite, the credit portfolio is well diversified:

- region: more than two-thirds of the loans are based in Quebec, around 20% in Ontario and the rest in other provinces and abroad;
- industry: no single sector of the wholesale portfolio accounts for more than 20%; and
- retail portfolio: insured mortgages remain the largest asset class in the portfolio followed by HELOC and uninsured mortgages. Furthermore, the largest share of the residential mortgage portfolio is in Quebec with relatively small exposures in Toronto and Vancouver.

<u>Other Risk Mitigation Methods</u>

Credit risk mitigation measures for transactions in derivative financial instruments, which are regularly used by the Bank, are described in detail in the Counterparty Risk section.

Credit derivative financial instruments and financial guarantee contracts

The Bank also reduces credit risk by using the protection provided by credit derivative financial instruments such as credit default swaps. When the Bank acquires credit protection, it pays a premium on the swap to the counterparty in exchange for the counterparty's commitment to pay if the underlying entity defaults or another event involving the counterparty and covered by the legal agreement occurs. Since, like borrowers, providers of credit protection must receive a default risk rating, the Bank's internal policies set out all the criteria under which a counterparty may be judged eligible to mitigate the Bank's credit risk. The Bank may also reduce its credit risk by entering into financial guarantee contracts whereby a guarantor indemnifies the Bank for a loss resulting from a debtor failing to make a payment when due in accordance with the contractual terms of a debt instrument.

Loan syndication

The Bank has developed specific instructions on the appropriate objectives, responsibilities and documentation requirements for loan syndication.

Account Monitoring and Recovery

Credit granted and borrowers are monitored on an ongoing basis and in a manner commensurate with the related risk. Loan portfolio managers use an array of methods to conduct a particularly rigorous follow-up on problem loans. When loans continue to deteriorate and there is an increase in risk to the point where monitoring has to be increased, a group specialized in managing problem accounts steps in to maximize collection of the disbursed amounts and tailor strategies to these accounts.

In these cases, loan portfolio managers prepare and submit, to the credit department, a detailed monitoring report each month to track the status of at-risk obligors and the corrective measures undertaken. The management of each credit department concerned performs follow-ups on the reports, and each quarter a credit monitoring committee meets to review the action plans and monitoring reports of obligors that have loans disbursed and undrawn amounts of $2 million or more. The authority to approve allowances for credit losses is attributed using limits delegated on the basis of hierarchical level under the Credit Risk Management Policy.

Detailed information on the recognition of impaired loans and allowances for credit losses are presented in Note 1 to the audited consolidated financial statements.

Forbearance and Restructuring

Situations where a business or retail obligor begins showing clear signs of potential insolvency are managed on a case by case basis. The Impaired Loans Policy sets standards to apply when potential insolvency problems arise to guide decision-making with respect to loan restructuring and determine the situations where distressed restructuring applies. A distressed restructuring occurs when the Bank grants special concession to an obligor for economic or legal reasons related to the obligor's financial difficulties.

The Loan Work Out Policy sets standards to manage commercial and corporate obligors that represent higher-than-normal risk of default. It outlines the roles and responsibilities of the loan portfolio managers when managing high-risk accounts, the Work Out units and other participants in the management process.

Finally, the Lending Limits Policy establishes authorization limits for distressed restructuring situations and also sets guidelines for business continuity on repossession and realization or release of collateral for consideration.

Counterparty Risk

Counterparty risk is a credit risk that the Bank incurs on various types of transactions involving financial instruments. The most significant risks are those it faces when it trades derivative financial instruments with counterparties on the over-the-counter market or when it purchases securities under reverse repurchase agreements or sells securities under repurchase agreements. Securities lending transactions and securities brokerage activities are also sources of counterparty risk. Note 15 to the consolidated financial statements provides a complete description of the credit risk for derivative financial instruments by type of product traded. The Risk Management Group has developed models by broad category of financial instruments so that it can use an advanced methodology to calculate economic capital and establish internal limits for the Financial Markets segment.

Counterparty obligations related to the trading of contracts on derivative financial instruments are frequently subject to credit risk mitigation measures. The mitigation techniques are somewhat different from those used for loans and advances and depend on the nature of the instrument or the type of contract traded. The first of these, and the most widely used, is the signing of International Swaps & Derivatives Association, Inc. (ISDA) master agreements with the appropriate counterparties. These agreements make it possible to apply full netting of the gross amounts of the market price assessments, when one of the contracting parties defaults on the agreement, for each of the transactions covered by the agreement and in force at the time of default. The amount of the final settlement is therefore the net balance of gains and losses on each transaction, which reduces exposure when a counterparty defaults. The Bank's policies require signing an ISDA agreement with most derivative and foreign exchange forward contracts trading counterparties.

Another mechanism for reducing credit risk complements the ISDA master agreement in many cases and provides the Bank and its counterparty (or either of the parties, if need be) with the right to request collateral from the counterparty when the net balance of gains and losses on each transaction exceeds a threshold defined in the agreement. These agreements, also known as Credit Support Annexes (CSAs), are common between financial institutions active in international financial markets since they limit credit risk while providing traders with additional flexibility to continue trading with the counterparty. The Bank often uses this type of legal documentation in transactions with financial institutions and governments. For business transactions, the Bank prefers to use internal mechanisms set out in the credit agreements. The Bank's internal policies set the conditions governing the implementation of such mitigation methods.

Requiring collateral as part of a securities lending transaction or reverse repurchase agreement is not solely the result of an internal credit decision. In fact, it is a mandatory market practice imposed by self-regulating organizations in the financial services sector such as the Investment Industry Regulatory Organization of Canada (IIROC).

The Bank also has policies and guidelines governing its own collateral pledged to counterparties, given the potential impact of such asset transfers on its liquidity. In accordance with its collateral pledging policy, the Bank conducts simulations of potential counterparty collateral claims under CSAs in effect, in the event of a Bank downgrade or other unlikely occurrences. The simulations are based on various Bank downgrading scenarios or market value fluctuations of transactions covered by CSAs.

The Bank has identified circumstances in which it is likely to be exposed to wrong-way risk, which is generally associated with exposure to counterparty risk and increases as the counterparty's probability of default increases (unfavourable positive correlation). A common wrong-way risk arises from the trading of derivatives contracts with counterparties where the underlying assets may include equity securities issued by those counterparties.

Settlement Risk

Settlement risk potentially arises from transactions that feature reciprocal delivery of cash or securities between the Bank and a counterparty. Foreign exchange contracts are an example of transactions that can generate significant levels of settlement risk. However, the implementation of multilateral settlement systems that allow settlement netting among participating institutions (e.g., CLS Settlement) has contributed greatly to reducing the risks associated with the settlement of foreign exchange transactions among banks. The Bank also uses financial intermediaries to have access to established clearing houses in order to minimize settlement risk for certain financial derivative transactions. In some cases, the Bank may have direct access to established clearing houses for settling financial transactions such as repurchase agreements. In addition, certain derivative financial instruments traded over the counter are settled directly or indirectly by central counterparties. For additional information, see the table that presents notional amounts in Note 15 to the consolidated financial statements.

There are several other types of transactions that may generate settlement risk, in particular the use of electronic fund transfer services. This risk refers to the possibility that the Bank may make a payment or settlement on a transaction without receiving the amount owed from the counterparty, and with no opportunity to recover the funds delivered (irrevocable settlement).

The ultimate means for completely eliminating such a risk is for the Bank to complete no payments or settlements before receiving the funds due from the counterparty. Such an approach cannot, however, be used systematically. For several electronic payment services, the Bank is able to implement mechanisms that allow it to make its transfers revocable or to debit the counterparty in the amount of the settlements before it makes its own transfer. On the other hand, the nature of transactions in financial instruments makes it impossible for such practices to be widely used. For example, on foreign exchange transactions involving a currency other than the U.S. dollar, time zone differentials impose strict payment schedules on the parties. The Bank cannot unduly postpone a settlement without facing significant penalties, due to the large size of amounts involved.

The most effective way for the Bank to control settlement risks, both for financial market transactions and irrevocable transfers, is to impose internal risk limits based on the counterparty's ability to pay.

Market Risk Management

Market risk is the risk of financial loss resulting from adverse movements in underlying market factors.

Market risk at the Bank arises from its participation in market-making, trading, investment and asset/liability management activities. Trading-market risk includes market-making and trading activities that involve taking positions mainly in interest rate, equity and foreign exchange instruments, commodities or derivative products. Non-trading market risk arises from non-trading exposure in asset and liability management portfolios, as well as securities held in investment funding and liquidity portfolios.

Market risk represents the risk of a negative impact from adverse changes in the main factors and their implied volatility:

- interest rate risk: relates to changes in the term structure of interest rates of financial instruments such as bonds, money market instruments and derivatives;
- foreign exchange risk: relates to changes in foreign exchange rates of financial instruments such as investments in foreign subsidiaries, foreign currency denominated loans and securities, future cash flows in foreign currencies and derivatives;
- equity risk: relates to changes in overall equity prices (general equity risk) or in individual characteristics that are specific to an entity (equity specific risk) for financial instruments such as common stock, and derivatives such as options;
- commodity price risk: relates to changes in commodity prices of financial instruments in exchange trading or over-the-counter trading involving either physical trading or derivatives trading of commodities;
- traded credit risk: relates to changes in creditworthiness of issuers as a whole (general traded credit risk) or in characteristics of a specific issuer (traded credit issuer-specific risk) relating mainly to the Bank's portfolios of debt securities and credit derivatives, whose value could be adversely affected by changes in credit spreads, by credit migration or by defaults;
- implied correlation risk: relates to changes in implied correlations between two or more risk factors mainly included in complex derivatives;
- market liquidity risk: relates to a significant decrease or, at worst, a halt in the level of expected market activity for a specific market or for a variety of instruments, thereby making the instruments concerned less liquid or illiquid. This exposes the Bank to losses due to the inability to execute its transactions at the prevailing prices, which may not represent the true price at which the entire position can be unwound. Almost all traded instruments are exposed to this type of risk depending mainly on frequency and volume of transactions; and
- portfolio diversification and hedging risk: relates to changes in realized correlations between two or more risk factors. Adverse changes in realized correlations can reduce the portfolio diversification benefit in the sense that several of the positions could have higher correlation than expected, giving rise to simultaneous losses. In addition, adverse changes in realized correlation can make hedging strategies less effective if the underlying position and the hedge position have weaker correlation than expected.

The trading portfolios include positions in financial instruments and commodities held either with trading intent or to hedge other elements of the trading book. Positions held with trading intent are those held for short-term resale and/or with intent of taking advantage of actual or expected short-term price movements or to lock in arbitrage profits. These portfolios target one of the following objectives: market making, trading, proprietary trading, liquidating positions for clients or selling financial products to clients.

Non-trading portfolios include all financial instruments held to maturity or until conditions are more advantageous to invest in other investments, or for strict liquidity management purposes, as well as structural portfolios that aim at managing the Bank's structural interest rate and foreign exchange risks.

The following table presents financial assets and liabilities subject to market risk, distinguishing between trading positions whose main risk measures are VaR and SVaR and non-trading positions that use other risk measures.

				As at October 31, 2013
		Market risk measures		
	Balance sheet	Trading [1]	Non-Trading [2]	Main non-trading risk measures
Assets subject to Market Risk				
Securities				
At fair value through profit or loss	44,000	40,790	3,210	Interest rate[3] and other[4]
Available-for-sale	9,744	–	9,744	Interest rate[3] and equity[5]
Securities purchased under reverse repurchase agreements and securities borrowed	21,449	–	21,449	Interest rate[3][6]
Loans	88,384	1,588	86,796	Interest rate[3]
Derivative financial instruments	5,904	5,252	652	Interest rate[7]
Accrued benefit asset	108	–	108	Other[8]
	169,589	47,630	121,959	
Liabilities subject to Market Risk				
Deposits	101,886	2,055	99,831	Interest rate[3]
Obligations related to securities sold short	18,909	18,909	–	
Obligations related to securities sold under repurchase agreements and securities loaned	19,746	–	19,746	Interest rate[3][6]
Derivative financial instruments	4,858	4,559	299	Interest rate[7]
Liabilities related to transferred receivables	15,323	2,028	13,295	Interest rate[3]
Accrued benefit liability	208	–	208	Other[8]
Other liabilities	109	109	–	
	161,039	27,660	133,379	

(1) Trading positions whose main risk measures are VaR and SVaR. For additional information, see the Market Risk Management section in Note 5 to the consolidated financial statements.
(2) Non-trading positions that use other risk measures.
(3) For additional information, see the Market Risk Management section in Note 5 to the consolidated financial statements.
(4) See the Master Asset Vehicles section in Note 6 to the consolidated financial statements.
(5) The fair value of equity securities classified as available-for-sale is disclosed in Note 3 to the consolidated financial statements.
(6) These instruments are recorded at amortized cost and subject to credit risk for capital management purposes. For transactions with maturities of more than 1 day, the interest rate risk is included in the VaR and SVaR measures when they relate to trading activities.
(7) See Notes 15 and 16 to the consolidated financial statements.
(8) See Note 22 to the consolidated financial statements.

Assessing Market Risk

An integrated internal control framework is used to manage market risk, which is overseen by the Market Risk Management Committee. The Bank is continually adapting its market risk management and oversight framework.

A comprehensive policy governs global market risk management across the Bank's units and subsidiaries that are exposed to this type of risk. The policy describes the main mechanisms for identifying and measuring the types of market risk to which the Bank is exposed, most of which are described above. It also defines the link between the Bank's market risk appetite approved by the Board and the framework implemented for setting market risk limits across the Bank's business units that are allowed to undertake market risk. The purpose of the market risk limits is to set out tolerance thresholds for these business units or portfolios to comply with the Bank's market risk appetite targets. These are cascaded down to business units using a hierarchy of different types of limits (e.g., VaR, stop loss) allocated by portfolio, trading unit, unit manager and officer, as well as an appropriate breach escalation process.

The Bank also uses economic capital for market risk as an indicator for risk appetite and limits setting. This indicator measures the amount of capital that is required to absorb unexpected losses due to market risk events over a one year horizon and with a determined confidence level. For additional information related to economic capital, see the Overview section of this MD&A.

Separate policies govern the pricing and valuation adjustments on financial instruments valued at fair value.

The Risk Management Group uses a variety of risk measures to estimate the size of potential losses under both moderate and more severe scenarios, and using both short-term and long-term time horizons. For short-term horizons, the Bank's risk measures include Value-at-Risk (VaR), Stressed VaR (SVaR), and sensitivity metrics. For long-term horizons or sudden significant market moves, including those due to a lack of market liquidity, the risk measures include stress testing across an extensive range of scenarios. VaR is a statistical measure of risk that is used to quantify market risks across products, per types of risks and aggregate risk on a portfolio basis. VaR is defined as the maximum loss at a specific confidence level over a certain horizon under normal market conditions. The VaR method has the advantage of providing a uniform measurement of financial instrument-related market risks based on a single statistical confidence level and time horizon. The Bank uses an historical price distribution to compute the probable loss levels at the 99% level of confidence, using a two-year daily time series of risk factor changes. VaR is the maximum daily loss the Bank could incur, in 99 cases out of 100, in a given portfolio. In other words, the loss could exceed that amount in only one out of 100 cases.

The trading VaR is measured by assuming a holding period of one day for ongoing market risk management and a 10-day horizon for regulatory capital purposes. This assumption is used to combine the VaR of various portfolios and provides an estimate of the daily market risk incurred by the Bank. VaR is calculated on a daily basis both for major classes of financial instruments (including derivative financial instruments) and all trading portfolios of the Financial Markets segment and Corporate Treasury of the Bank.

Outstanding VaR exposure is monitored daily in relation to established limits for each type of market risk, portfolio and business unit. The RMC reviews VaR results on a quarterly basis, including breaches of the limits set out in the policy, if any.

VaR methodology techniques are well suited to measure risks under normal market conditions. VaR metrics are most appropriate as risk measure for trading positions in liquid financial markets. However, there are limitations in measuring risks with this method when extreme and sudden market risk events occur, since they are likely to underestimate the Bank's market risk. VaR methodology limitations include the following:

- past changes in market risk factors may not always produce accurate predictions of the distribution and correlations of future market movements;
- a VaR with a daily time horizon does not fully capture the market risk of positions that cannot be liquidated or hedged within one day;
- the market risk factor historical database used for VaR calculation may not reflect potential losses that could occur under unusual market conditions (e.g., periods of extreme illiquidity) relative to the historical period used for VaR estimates; and
- the use of a 99% VaR confidence level does not reflect the extent of potential losses beyond that percentile.

Given the limitations to VaR, for the Bank it represents only one component in its risk management oversight, which also incorporates, among others, stress testing, sensitivity analysis, concentration and liquidity limits and analysis.

The Bank also conducts backtesting of the VaR model. It consists of comparing the actual and theoretical profit and losses to the statistical VaR measure. The theoretical profit and losses are obtained using daily price movements but under the assumption that there is no intraday change in the composition of the portfolios. Backtesting is essential to verify the capacity of the VaR model to adequately forecast the maximum risk of market losses and thus validate, retroactively, the quality and accuracy of the statistical results obtained using the model. If the backtesting results present material discrepancies, the VaR model could be revised in accordance with the Bank's model risk management framework.

Stress Tests and Sensitivity Analyses

Stress testing is a risk management technique that consists in estimating potential losses under abnormal market conditions and risk factor movements. Stress testing enhances transparency by exploring a range of potential low-probability events. Comprehensive stress testing scenarios include the following:

- changes in all relevant market rates;
- potential political shifts;
- market illiquidity; and
- the interplay between market and credit risk.

These stress tests and sensitivity analyses simulate the results that the portfolios would generate if the extreme scenarios in question were to occur. The Bank's stress testing framework applied to all positions generating market risk currently comprises the following range of different stress test scenarios:

- interest rate: sharp parallel increases/decreases in interest rates; non-parallel movements (flattening and steepening) and increases/decreases in credit spreads;
- equity: sharp stock market crash coupled with a significant increase in volatility; increase in stock prices associated with a lesser volatility; increase in volatility of term structure coupled with a decrease in stock prices;
- commodity: significant increases/decreases in commodity prices coupled with increases/decreases in volatility; short-term and long-term increases/decreases in commodity prices; and
- foreign exchange: depreciation/appreciation of the U.S. dollar and of other currencies relative to the Canadian dollar.

The results of these stress tests and sensitivity analyses are subject to maximum potential loss limits for the Bank, which are approved by the Board.

In addition to the one-day trading VaR, the Bank calculates a trading SVaR, which is a statistical measure of risk that replicates the VaR calculation method (1 day holding period for risk management purposes and 10-day horizon for regulatory capital purposes) but uses, instead of the variable two-year history of market risk data input, 12-month historical data corresponding to a continuous period of significant financial stress that is relevant in terms of the Bank's portfolios.

Trading Activities

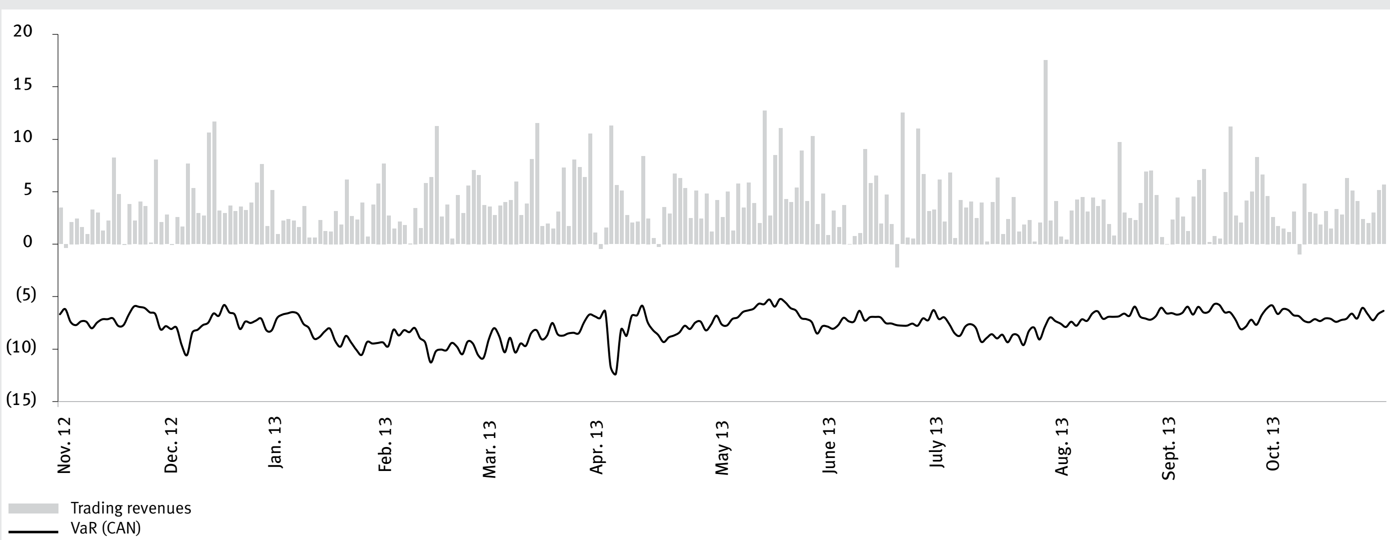
The revenues generated by trading activities are compared with VaR as a backtesting assessment of the appropriateness of this risk measure as well as the financial performance of trading activities relative to risk undertaken.

The table showing the VaR distribution of trading portfolios by risk category, as well as correlation effect, is presented in Note 5 to the consolidated financial statements in the Market Risk Management section. As shown in the table, the trading VaR is usually lower than the VaR of the individual portfolios, which shows correlation effect. Average trading VaR was $7.3 million in 2013, rising $1.6 million from 2012. This increase was mainly due to higher interest rates and equity VaR. Average trading SVaR was $10.0 million in 2013 compared to $9.1 million in 2012. This increase was primarily driven by a higher equity SVaR. Both trading VaR and SVaR peaked in the second quarter of 2013 and subsequently decreased towards the end of fiscal 2013.

The following table shows daily trading revenues and VaR. Daily trading revenues were positive almost 97% of the days in the year ended October 31, 2013. Net daily trading losses in excess of $1 million were recorded on one day. None of these losses exceeded the VaR limit.

Daily Trading Revenues

(millions of Canadian dollars)



For additional information on the VaR distribution of trading portfolios by risk category, as well as correlation effect, see the Market Risk Management section in Note 5 to the audited consolidated financial statements.

Structural Interest Rate Risk

As part of its banking activities, such as mortgage lending and issuing term deposits, the Bank is exposed to structural interest rate risk. Interest rate movements cause changes in interest income and interest expense and, although these changes move in the same direction, their relative magnitude will have a favourable or unfavourable impact on annual net interest income and the economic value (present value of estimated cash flows) of equity. The extent of that impact depends on several factors, including the following:

- a mismatch between the maturities and interest rate adjustment dates of assets and liabilities;
- risk related to the level, form and slope of the interest rate curve based on maturity, and changes in these characteristics;
- risk related to option privileges for products recorded on the balance sheet, whether implicit (mortgage prepayments, deposit redemption) or explicit (capped-rate mortgages); and
- basis risk resulting from an imperfect correlation between different rate curves.

Active management of this risk can significantly enhance the Bank's profitability and add shareholder value. By proactively covering balance sheet risk, the Bank can change the risk profile and capitalize on expected interest rate movements. The Bank's goal is to proactively and effectively manage exposure and optimize the impact of interest rate fluctuations based on expected rate movements. This proactive management approach is based on defining a benchmark index for risk exposure and enough strategic latitude to deviate from that index in response to financial market conditions and the dynamics of the asset/liability management portfolio.

Structural interest rate risk is managed by the Chief Financial Officer and Executive Vice-President, Finance and Treasury and the Senior Vice-President, Corporate Treasury, who oversee asset/liability management within the Bank. Using an internal transfer pricing mechanism, the asset/liability portfolio under management is allocated to a centralized unit within Corporate Treasury. A senior committee, the Asset/Liability Management Committee, and two subordinate management committees are responsible for supervision and general oversight of this risk and the underlying internal transfer pricing mechanism.

Interest rate risk management is managed under a specific, Board-approved policy, the revision and application of which are overseen by the various above-mentioned committees. The policy sets risk limits based on the impact of interest rate fluctuations on various parameters, mainly annual net interest income (maximum loss) and economic value. In addition, the duration of equity must be kept within certain limits.

Simulations are performed on a regular basis to assess the impact of various scenarios on annual net interest income and on the economic value of equity and to guide the management of structural interest rate risk.

The Interest Rate Sensitivity – Non-Trading Activities (Before Tax) table presented in Note 5 to the audited consolidated financial statements in the Market Risk Management section provides the potential before-tax impact of an immediate and sustained 100-basis-point increase or decrease in interest rates on net interest income and on the economic value of equity of the Bank's non-trading portfolios, assuming no further hedging is undertaken.

Structural Foreign Exchange Risk

The Bank's structural foreign exchange risk arises from investments in foreign operations denominated in currencies other than the Canadian dollar. This risk is measured by assessing the impact of currency fluctuations. The Bank uses financial instruments (derivative and non-derivative) to hedge structural foreign exchange risk. In a hedge of a net investment in a foreign operation, the financial instruments used will offset foreign exchange gains and losses on the investments. Management of this risk is governed by a specific policy submitted to the Board.

Available-for-Sale Securities Portfolios

The Bank has created available-for-sale securities portfolios in liquid or illiquid securities for strategic, long-term investment and liquidity purposes. These investments carry not only market risk, but also credit risk, liquidity risk, concentration risk and reputation risk as well as risk of non-compliance with laws and regulations in effect.

The Investment Guidelines set out the guiding principles and general management standards that must be followed by all those who manage portfolios of available-for-sale securities included in the portfolios of the Bank and its subsidiaries. Under these guidelines, business units that are active in managing this type of portfolio must adopt internal investment policies that set, among other things, targets and limits for the allocation of assets in the portfolios concerned and internal approval mechanisms. The primary objective is to reduce concentration risk by industry, issuer, country, type of financial instrument and credit quality.

Overall limits in value and in proportion to the Bank's equity are set on the outstanding amount of liquid preferred shares, liquid equity securities excluding preferred shares, and instruments classified as illiquid securities in the available-for-sale securities portfolios. The overall exposure to common shares with respect to an individual issuer and the total outstanding amount invested in hedge funds and private equity funds, for investment banking services, are also subject to these limits. Restrictions are also set on investments defined as special. Lastly, the Bank has a specific strategic investment policy, approved by the Board, which defines strategic investments as purchases of business assets or acquisitions of deemed material equity stake in an entity for purposes of acquiring control or creating a long-term relationship.

Available-for-Sale Securities – Debt Securities

In keeping with the Bank's regulatory capital requirement commitments for credit risk management, the Bank adopted the Advanced Internal Rating-Based Approach ("Advanced IRB") for credit risk effective November 1, 2009 and has applied this approach in assessing regulatory capital adequacy since the first quarter of 2010. Under the Basel II Accord, the Bank met OSFI's Advanced IRB Approach requirements and demonstrated that its presentation of capital is accurate and of high quality.

Available-for-Sale Securities – Equity Securities

For assets in the form of equity securities, which comprise common shares, perpetual or convertible preferred shares, mezzanine debt with warrants and mutual funds, the Bank adopted, on November 1, 2009, a method related to the Advanced Approach for Capital Adequacy Requirements, namely the simple risk-weight method under the "market-based" approach, as the term is used in the Basel II Accord. This approach requires proactive management of the capital allocated to portfolios with equity securities since, beyond a certain threshold, the cost of regulatory capital becomes prohibitive. The prescribed risk factors are 24% for listed equity securities and 32% for unlisted equity securities.

The Investment Guidelines require that the Bank's investments in equity securities in available-for-sale securities portfolios that exceed a certain materiality threshold be approved by a higher authority. In this way, the Bank ensures that any investment decision whereby it acquires a significant interest in the equity of a company is known and approved by management. These investments also significantly impact the Bank's capital requirements. Consequently, the Capital Management Group closely monitors these portfolios on a consolidated basis to determine if they are profitable in terms of regulatory capital cost and to ensure compliance with the materiality clauses and internal overall limits the Bank has set for these investments.

Liquidity Risk Management

Liquidity risk is the risk that the Bank will be unable to honour daily cash and collateral pledging commitments without resorting to costly and untimely measures. Liquidity risk arises when sources of funds become insufficient to meet scheduled payments under the Bank's commitments. Liquidity risk stems from mismatched cash flows related to assets and liabilities as well as the characteristics of certain products, such as credit commitments and non-fixed term deposits.

The Bank's primary objective as a financial institution is to manage liquidity such that it supports the Bank's business strategy and to enable it to honour its commitments when they come due, even in extreme conditions. This is done primarily by implementing a policy framework approved by the Board, which establishes a risk tolerance threshold, monitoring structures controlled by the various committees, risk indicators, reporting procedures, delegation of responsibilities and segregation of duties. The Bank also prepares and implements an annual funding plan that incorporates the expected growth of assets and liabilities.

In 2010, the Basel Committee on Banking Supervision (BCBS) issued new Basel III rules aimed at promoting financial stability while encouraging sustainable economic growth. This document entitled "*Basel III: International framework for liquidity risk measurement, standards and monitoring*" proposes global regulatory standards on bank liquidity risk. The proposed guidelines introduce two key liquidity ratios: the liquidity coverage ratio (LCR), which is intended to oversee banks through severe short-term stress, and the net stable funding ratio (NSFR), whose objective is to ensure banks have the long-term funding needed to fund less liquid assets. The ratios are scheduled for formal implementation in 2015 (LCR) and 2018 (NSFR), respectively. The LCR rules were finalized in January 2013. The Bank also fills out a *Quantitative Impact Study* (QIS) quarterly report which is sent to the Bank for International Settlements (BIS). The results of this QIS allow the BIS to oversee the evolution of the Basel III rules implementation. The Bank is already monitoring both ratios and reporting the LCR to the national regulator, OSFI, for observation purposes.

In February 2012, OSFI issued an update of its guideline on liquidity management to financial institutions. The revised guideline was developed based on the BCBS's *Principles for Sound Liquidity Risk Management and Supervision*.

Roles and Responsibilities

Corporate Treasury manages liquidity and funding needs Bank-wide. Its activities comprise:

- managing day-to-day cash flow, collateral and short-term funding;
- planning and issuing long-term funding and determining liquidity cost transfer pricing;
- developing and implementing the liquidity management framework, funding policy, annual funding plan and liquidity contingency plan;
- developing and implementing the Basel III liquidity project based on the principles, rules and metrics set by the BIS;
- monitoring, measuring and reporting on the Bank's exposure to liquidity risk, both overall and by currency; and
- establishing and maintaining an adequate risk assessment process and effective controls.

Governance

The Bank's liquidity, funding and pledging policy requires review and approval by the RMC, based on recommendations from the GRC. In this capacity, Board representatives not only approve the supervision of day-to-day management and risk governance, but also backup plans in anticipation of emergency situations and liquidity crisis. If a limit has to be revised, Corporate Treasury and Risk Management together submit the proposed revision to the GRC. If the latter approves the request, it is presented to the Board for approval.

Liquidity risk supervision at the Bank is mainly assigned to the Liquidity and Funding Committee, composed of Corporate Treasury and Risk Management Group representatives. In accordance with their roles and responsibilities under their respective mandates, the members of this committee are also asked for input in developing risk management and control mechanisms and implementing policies.

Through the Liquidity and Funding Committee, Corporate Treasury regularly monitors changes in liquidity, funding and pledging indicators and compliance with regulatory and Board approved limits. If control reports indicate non-compliance with the limits and, generally, deterioration of liquidity indicators, Corporate Treasury takes remedial action. According to the escalation process, problematic situations are reported to senior management of Finance and Treasury and of Risk Management as well as to the RMC. An executive report on liquidity risk management and Bank funding, which describes the Bank's liquidity position and informs the Board of non-compliance with the limits and other rules observed during the reference period as well as remedial action taken, is submitted quarterly to the RMC.

Although the day-to-day management of risks associated with liquidity, funding and pledging activities and the monitoring of compliance with the resulting policy is assumed by Corporate Treasury, the Risk Management Group is responsible for ensuring that an appropriate risk management framework is in place and that risk appetite and policy are adhered to. This provides an independent oversight and effective challenge for the liquidity, funding and pledging decisions, strategy and exposure, i.e. the second line of defence.

Liquidity Management

The Bank performs liquidity management, funding and pledging operations not only from its head office and regional offices in Canada, but also through certain foreign centres. Although the volume of such operations abroad represents a sizable portion of global liquidity management, the Bank's liquidity management is centralized. By organizing liquidity, funding and pledging activities within Corporate Treasury, the Bank can better coordinate enterprise-wide funding and risk monitoring activities. All internal funding transactions between Bank entities are controlled by Corporate Treasury, which sets the limits together with the Risk Management Group.

This centralized structure streamlines the allocation and control of liquidity, funding and pledging limits, since most (in particular the liquidity ratios) apply on a consolidated basis. Nonetheless, the liquidity, funding and pledging policy contains special provisions for the financial centres that are most active in terms of institutional funding and sets limits and monitoring thresholds for secured and unsecured short-term funding, both in absolute value and materiality.

The Bank's funds transfer pricing system prices liquidity by allocating the cost or income to the various business segments. Liquidity costs are allocated to liquidity-intensive activities, mainly long-term loans, and commitments to extend credit and less liquid securities as well as strategic investments. The liquidity compensation is credited to the suppliers of funds, primarily funding in the form of stable deposits from the Bank's distribution network.

Short-term day-to-day funding decisions are based on a daily cumulative net cash position, which is controlled using liquidity ratio limits. Among these ratios and metrics, the Bank pays particular attention to the funds obtained on the wholesale market and to cumulative cash flows over various time horizons.

Moreover, the Bank's collateral pledging activities are monitored on a daily basis in relation to the different limits set by the Bank and are subject to monthly stress tests using a series of simulations. In particular, the Bank uses various scenarios to estimate the potential amounts of additional collateral that would be required in the event of a downgrade to the Bank's credit rating.

The Bank also regularly monitors unencumbered securities outstanding in proportion to unsecured institutional market funding due in less than one year. The Bank must hold unencumbered liquid assets equal to at least the total amount of unsecured institutional market funds maturing within one year, taking into account the potential downward market volatility of the assets by applying prudent "haircuts" to the value of these securities.

Liquidity risk can be assessed in many different ways using different liquidity indicators. One of the key monitoring tools of liquidity risk is the Bank's survival period based on contractual maturity and behavioural assumptions applied to balance sheet items as well as off-balance-sheet commitments.

Stress Testing and Crisis Scenarios

Survival period measures, using various simulations, the number of months it would take to completely utilize the Bank's liquid assets if the Bank were to lose deposits prematurely or if funds from wholesale markets were not renewed at maturity. It is measured monthly using three scenarios. These scenarios were developed to assess sensitivity to a Bank-specific or systemic crisis. Deposit loss simulations are carried out based on their degree of stability, while the value of certain assets is encumbered by an amount reflecting their readiness for liquidation in a crisis. These stress test scenarios are reviewed and submitted to the Board once a year for approval.

The Bank considers, among its simulations, a severe liquidity crisis scenario, where the Bank experiences difficulties in a turbulent financial market. This scenario combines a significant limitation in the access to its funding channels and a significant decrease of its assets' marketability.

The stress test results provide the Bank with its potential liquidity requirements under each scenario and, given the liquidity risk tolerance level adopted, allow the Bank to avoid unwanted risk. Each scenario has its own set of underlying assumptions that cover a wide range of aspects, including haircuts, encumbrance on liquid assets, loss of deposits, collateral usage and assets pledged. It also includes an estimate of the funding needs of contingent liabilities. Contingent liquidity risk refers to the possibility that the Bank needs significant amount of funding due to events such as an unexpected increase in draw-downs on committed lines, withdrawal of deposits, increase in collateral requirements or other triggers embedded in legal documentation.

The following assumptions underlie the scenarios:

- no renewal at maturity for most of the Bank's unsecured wholesale funding;
- non-renewal for a portion of the retail and commercial deposits;
- run-offs on demand deposits;
- partial renewal of loans;
- no inflows from demand loans;
- drawdowns on committed lines;
- additional collateral required for the Bank in the event of a credit rating downgrade; and
- limited access to the foreign exchange market.

The results of these stress tests are reviewed on a monthly basis by designated committees. The Board reviews the results each quarter and approves the stress-testing simulations annually.

Lastly, the Bank maintains an up-to-date, comprehensive financial contingency and crisis recovery plan that describes the measures to be taken in the event of a critical liquidity situation. This plan is reviewed and approved annually by the Board as part of business continuity and recovery planning. See the Regulatory Risk Management section for additional information.

Liquidity Risk Tolerance

The Bank monitors and manages its risk tolerance through liquidity limits, ratios and stress scenarios. The Bank's liquidity risk tolerance is articulated around three axes:

- ensure the Bank has a sufficient amount of unencumbered liquid assets to cover its financial requirements;
- ensure the Bank keeps a liquidity buffer above the minimum regulatory requirement; and
- ensure the Bank maintains diversified funding products.

Liquid Assets

To protect depositors and creditors from unexpected crisis situations, the Bank holds a portfolio of unencumbered liquid assets that can be readily liquidated to meet financial obligations. This portfolio consists of highly liquid securities, most of which are issued or guaranteed by governments, and of cash loans maturing in less than 30 days. The majority of unencumbered liquid assets are held in Canadian or U.S. dollars. Moreover, all assets that can be quickly monetized are considered liquid assets. The Bank does not consider any central bank's emergency liquidity facilities in its liquidity buffer. For additional information, see the following table on encumbered and unencumbered assets.

Summary of Encumbered and Unencumbered Assets

As at October 31 (millions of Canadian dollars)							2013		2012
	Bank-owned assets[1]	Assets received[2]	Total assets	Encumbered assets[3]		Unencumbered assets		Unencumbered assets	
				Pledged as collateral	Other[4]	Available as collateral	Other[5]	Available as collateral	Other[5]
Liquid Assets									
Cash and deposits with financial institutions									
Cash and deposits with central banks	1,769	–	1,769	–	–	1,769	–	1,269	–
Deposits with financial institutions	1,779	–	1,779	–	–	1,779	–	767	–
Precious metals	48	–	48	(48)	–	–	–	–	–
Securities[6]									
Issued or guaranteed by Canada and provinces	41,547	17,924	59,471	(45,491)	–	13,980	–	12,729	–
Issued or guaranteed by foreign governments	3,104	368	3,472	(2,192)	–	1,280	–	603	–
Other	30,542	18,396	48,938	(28,315)	(804)	18,458	1,361	16,331	1,335
Loans									
Securities backed by insured residential mortgage loans	1,380	–	1,380	(760)	–	620	–	–	–
	80,169	36,688	116,857	(76,806)	(804)	37,886	1,361	31,699	1,335
Illiquid Assets									
Residential mortgage loans	35,186	–	35,186	(18,805)	–	16,381	–	16,197	–
Credit card receivables	1,925	–	1,925	(1,461)	–	464	–	322	–
Other loans	49,893	–	49,893	–	–	49,893	–	47,935	–
Other assets	21,031	–	21,031	–	–	–	21,031	–	21,555
	108,035	–	108,035	(20,266)	–	66,738	21,031	64,454	21,555
	188,204	36,688	224,892	(97,072)	(804)	104,624	22,392	96,153	22,890

As at October 31	Average[7]	2013	2012
Unencumbered assets available as collateral by entity			
National Bank (parent)	93,226	90,886	88,457
Domestic subsidiaries	10,865	10,059	4,220
Foreign subsidiaries and branches	4,447	3,679	3,476
	108,538	104,624	96,153

As at October 31	2013	2012
Unencumbered assets available as collateral by currency		
Canadian dollar	87,072	79,932
U.S. dollar	17,037	15,878
Other currencies	515	343
	104,624	96,153

(1) Bank-owned assets include assets for which there are no legal or geographic restrictions.
(2) Securities received as collateral with respect to securities financing and derivative transactions.
(3) In the normal course of its financing activities, the Bank pledges assets as collateral in accordance with standard terms. Encumbered assets include assets used to cover short sales, obligations related to securities sold under repurchase agreements and securities loaned, guarantees related to security-backed loans and borrowings, and collateral related to derivative financial instrument transactions and asset-backed securities.
(4) The other encumbered assets are assets for which there are restrictions and therefore cannot be used for collateral or financing purposes.
(5) The other unencumbered assets are assets for which there are no restrictions but that are unavailable because they are not readily acceptable at central banks.
(6) Include securities purchased under reverse repurchase agreements and securities borrowed.
(7) The average is based on the sum of the end of period balances for the months of August, September and October divided by three.

Regulatory Environment

The regulatory environment has evolved significantly since the financial crisis. The Bank is working closely with international and national regulators to implement regulatory liquidity standards.

As previously described, the BCBS released a document in 2010 that essentially focused on the proposed implementation of the two regulatory ratios: the LCR and the NSFR. While the implementation phase for the LCR is well advanced in view of the January 2015 planned deadline, extensive consultation between the BIS and the financial industry to finalize the rules on the NSFR is still ongoing.

Moreover, in April 2013, the BCBS issued a paper on intraday liquidity *"Monitoring tools for intraday liquidity management."* The intent of this document is to provide guidance for banks on their management of intraday liquidity risk and ability to meet payment and settlement obligations on a timely basis. The implementation schedule proposed ranges from January 2015 to January 2017 at the latest.

The Net Cumulative Cash Flow (NCCF) metric is defined as a survival period. The assumptions of this stress scenario are prescribed by OSFI and aim to represent a combined systemic and bank-specific crisis. The minimum survival period required is 20 weeks. However, each bank must survive at least 16 weeks per significant currency. The Bank considers two significant currencies to that effect: the Canadian dollar and the U.S. dollar.

Intraday Liquidity

The Bank manages its intraday liquidity in such a way that the amount of available liquidity exceeds its maximum intraday liquidity requirements. During the past year, intraday liquidity has gained exposure within the organization; accordingly, a monitoring process was implemented.

Funding Risk

Funding risk is defined as the risk to the Bank's ongoing ability to raise sufficient funds to finance actual or proposed business activities on an unsecured or secured basis at an acceptable price. The Bank maintains a good balance of its funding through appropriate diversification of its unsecured funding vehicles, securitization programs and secured funding. The Bank also diversifies its funding by currency, geography and maturity. The funding management priority is to achieve the optimal balance between the deposit liabilities of the Bank's retail network, secured funding and unsecured funding. This brings optimal stability to the funding and reduces vulnerability to unpredictable events.

The Bank's retail network deposit liabilities are its primary and most stable source of funding. Stable funds are used to fund bank activities, whereas funds from the wholesale markets are used to fund financial market activities. In order to maintain the ideal funding profile, the Bank seeks to limit short-term wholesale funding and is careful to diversify its funding sources. The Bank seeks to diversify its funding sources by geographic location, currency, instrument, maturity and depositor. In addition, the Bank is actively involved in securitization programs (residential mortgages and credit card receivables) that diversify its access to long-term funding.

Funding and liquidity levels remained sound and robust over the year and the Bank does not foresee any event, commitment or demand that might have a significant impact on its liquidity risk position. For additional information, see the table entitled Residual Contractual Maturities of Balance Sheet Items and Off-Balance-Sheet Commitments in Note 5 to the audited consolidated financial statements.

Funding Strategy

The key objectives of the funding strategy are to:

– support the organic growth of the Bank through prudent liquidity and funding management to withstand severe stresses;
– fund core banking activities with stable deposits and securitizations; and
– limit short-term wholesale funding.

To do so, the Bank actively monitors and controls liquidity risk exposures and funding needs within and across legal entities, business segments and currencies. The process involves evaluating the liquidity position of individual business segments in addition to that of the Bank as a whole as well as the liquidity risk from raising unsecured and secured funding in foreign currencies. The funding strategy is executed through the funding plan.

Credit Ratings

The credit ratings assigned by ratings agencies represent their assessment of the Bank's credit quality based on qualitative and quantitative information provided to them. Credit ratings may be revised at any time based on macro-economic factors or the current or projected financial condition of the Bank. Credit ratings are one of the main factors that influence the Bank's ability to access capital markets at a reasonable cost. A downgrade in credit rating could adversely affect the cost, size and term of future issuances. The following table presents the credit ratings of four agencies as at October, 31, 2013.

	Moody's	S&P	DBRS	Fitch
National Bank				
Short-term senior debt	P-1	A-1	R-1 (mid)	F1
Canadian commercial paper		A-1 (mid)		
Long-term senior debt	Aa3	A	AA(low)	A+
Subordinated debt	Baa1	BBB+	A (high)	A
Preferred shares	Baa3	P-2	Pfd-2	BBB-
Rating outlook	Stable	Stable	Stable	Stable

Funding Structure

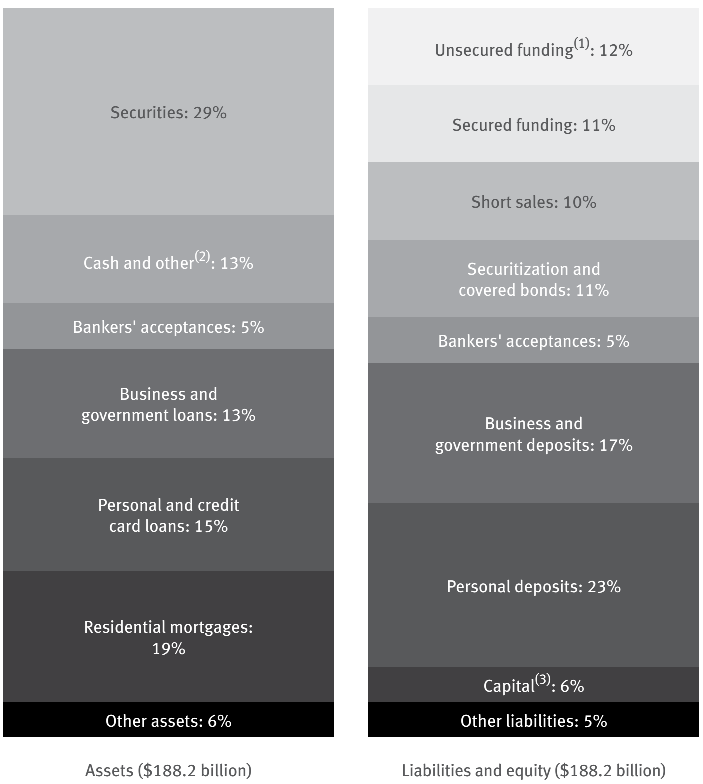
To ensure sound liquidity risk management, the Bank has implemented a robust funding structure. This structure enables the optimization of the Bank's overall liquidity position by minimizing potential stresses in order to meet the financial obligations.

The funding structure concerns both the sources and uses of funds so as to ensure that the core banking activities are funded with stable deposits and securitization. Wholesale funding is used to fund liquid assets.

The Bank's funding framework consists of:

- maintaining an active access to wholesale funding markets and ensuring diversification by depositor, funding vehicle type, geographic location, currency, and tenor of funding in the secured and unsecured markets;
- monitoring and controlling liquidity risk exposure and funding needs across all the Bank's entities, business segments and currencies using a well-developed fund transfer pricing system that includes a liquidity premium;
- funding teams in Montreal, New York and London offices;
- infrastructure investment to ensure quality and timeliness in data transmission; and
- regulatory framework integrated in day-to-day liquidity management and the long-term funding plan.

The chart below shows the Bank's funding structure as at October 31, 2013.



(1) This category comprises term debt funding products, marketable or non-marketable.
(2) Securities purchased under reverse repurchase agreements and securities borrowed.
(3) This category comprises subordinated debt.

The Bank's balance sheet is well diversified and is aligned with the funding strategy. The core banking activities are funded entirely through personal and commercial deposits and through securitization programs. Wholesale funding is invested in cash and securities.

Diversified Funding Sources

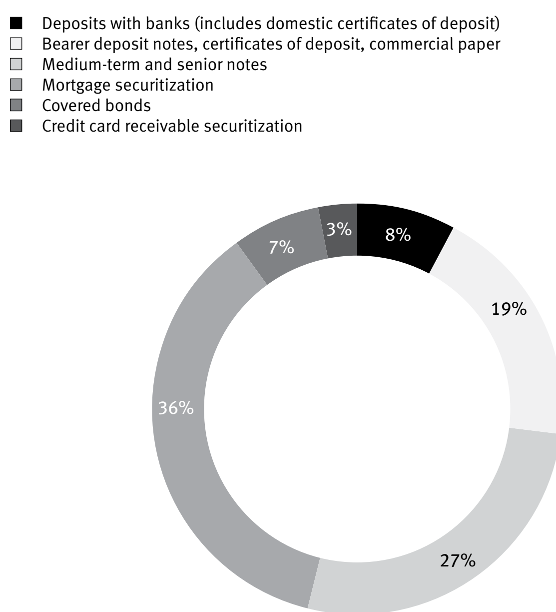
The purpose of diversification by source, geographic location, currency, instrument, maturity and depositor is to mitigate liquidity and funding risk by ensuring that the Bank has in place alternative sources of funds that strengthen its capacity to withstand a variety of severe yet plausible institution-specific and market-wide shocks. To meet this objective, the Bank:

- takes funding diversification into account in the business planning process;
- maintains a variety of funding programs to access different markets;
- sets Board approved limits on funding concentration;
- maintains strong relationships with fund providers;
- is active in various funding markets of all tenors; and
- identifies and monitors the main factors that affect the ability to raise funds.

The Bank is active in the following funding programs:

- Canadian dollar Senior Unsecured Debt;
- U.S. dollar Senior Unsecured Debt;
- Medium Term Note program;
- Canadian Medium Term Note Shelf;
- U.S. dollar Commercial Paper program;
- U.S. dollar Certificates of Deposit;
- Euro Medium Term Note program;
- Canada Mortgage and Housing Corporation securitization programs;
- Canadian Credit Card Trust; and
- U.S. dollar Covered Bond program.

The Bank's detailed breakdown of wholesale funding is as follows:



Collateral

As part of a comprehensive liquidity management framework, the Bank regularly reviews its contracts that stipulate that additional collateral could be required in the event of a downgrade of the Bank's credit rating. The Bank's liquidity position management already incorporates additional collateral requirements in the event of a one-notch to three-notch downgrade. The table below presents the additional collateral requirements in the event of a one-, two- or three-notch credit rating downgrade.

Additional Collateral Requirements

(millions of Canadian dollars)	As at October 31, 2013		
	One-notch downgrade	Two-notch downgrade	Three-notch downgrade
Derivatives(1)	77	138	201

(1) Contractual requirements related to agreements known as Credit Support Annexes.

Operational Risk Management

Operational risk is the risk of loss resulting from an inadequacy or a failure ascribable to people, processes, technology or external events. Operational risks are present in every activity of the Bank. Theft, fraud, unauthorized transactions, system errors, human error, amendments to or misinterpretation of acts and regulations, litigation or disputes with clients or property damage are just a few examples of events likely to cause financial loss, harm the Bank's reputation or result in regulatory penalties or sanctions.

In decisions related to authorizing credit or other transactions with clients and third parties, the Bank may use information provided by them, in particular their financial statements and other financial information. The Bank may also refer to statements made by clients and third parties regarding the accuracy and completeness of this information and the public accountants' reports on their financial statements. Should these financial statements be misleading or not present fairly, in all material respects, their financial position or operating results, such an event would constitute an operational risk and could adversely affect the Bank's results.

The Bank's ability to maintain or increase market share depends, in part, on how it adapts products and services in response to changes in industry standards. There is increasing pressure on financial institutions to provide products and services at lower prices, which could reduce the Bank's net interest income and revenues from fee-based products and services. In addition, new technologies that may be implemented or existing technologies that may be modified to be better adapted to the Bank's products and services could involve substantial expenditure without any guarantee as to the successful deployment of the new products or services or as to the development of a client base for them.

Although operational risk cannot be eliminated entirely, it can be managed in a thorough, transparent manner to keep it at an acceptable level. The Bank's operational risk management framework has been designed around the three-lines-of-defence concept and promotes accountable operational risk management, particularly important since operational risk management is decentralized to the Bank's units. The roles and responsibilities of the parties who make up the three lines of defence are described below.

Operational Risk Management Framework

By identifying, assessing and monitoring operational risk, business and corporate units are able to:

- recognize and understand the inherent and residual risks to which their activities and operations are exposed;
- identify measures for keeping such risks at an acceptable level; and
- manage the risks proactively and continuously.

The main tools developed to support the framework are described below.

Collection and Analysis of Data on External Operational Losses Incurred by the Bank

The Operational and Reputation Risk Unit applies a process, across the Bank and its subsidiaries, for collecting and compiling data on internal operational losses. This data is indexed in a centralized database and includes the amount of each loss, the type of risk involved, a description of the event that caused the loss, and the date of the loss, making it possible to better understand the fundamental causes of this type of loss and develop mitigation strategies.

Collection and Analysis of Data on Operational Events Observed in the Financial Industry

The Bank collects and analyzes information reported in the media on significant operational events experienced by other financial institutions in order to assess the effectiveness of its own operational risk management practices and reinforce them, if necessary.

Operational Risk Self-Assessment

The operational risk self-assessment program gives each business unit and corporate unit the means to proactively identify new or major operational risks to which they are exposed, evaluate the effectiveness of mitigating controls, and develop action plans to maintain such risks at acceptable levels.

Key Risk Indicators

The business units and corporate units define key indicators associated with their main operational risks. The key indicators are used to monitor operational risk profiles and are related to critical thresholds that, once reached, result in action by management. Using key risk indicators, the business units and corporate units can track risks and proactively detect any adverse change in risk exposure.

Specialized Risk Assessment Programs

Certain specialized groups have implemented programs with their own risk-specific policies and procedures as well as oversight mechanisms to ensure they are adhered to. Such specialized programs exist for managing:

- financial reporting risk;
- technological and information security risks;
- business continuity;
- outsourcing risk;
- fraud risk; and
- information confidentiality.

Operational Risk Reports and Disclosures

The Operational and Reputation Risk Unit regularly reports to the Operational Risk Management Committee, to the GRC, and to the RMC on the status of operational risk across the Bank, on the measures taken with respect to the risks, and on the material exposures to losses and emerging risks in order to ensure management accountability and attention is maintained over current and emerging issues. This reporting enhances the transparency and proactive management of major operational risk factors.

Insurance Program

In order to protect itself against any material losses related to its exposure to unforeseeable operational risks, the Bank also has adequate insurance, the nature and amount of which meet its coverage requirements.

Regulatory Risk Management

Regulatory risk is the risk related to the consequences of failing to meet compliance obligations, i.e., when the Bank, one of its subsidiaries or one of its employees fails to comply with regulatory requirements in effect where the Bank carries on its operations, which could result in investigations or claims of a regulatory nature and lead to penalties, sanctions and heavy financial losses.

The Bank operates in a highly regulated industry. The diversity of its activities and its geographical reach in Canada and abroad add to this complexity, since its operations are overseen by various regulatory bodies and self-regulatory organizations.

Changes in the regulatory or legal framework are a significant potential risk factor for the Bank. Various laws, regulations and other guidelines have been introduced by governments and regulatory bodies to protect the interests of the general public as well as the Bank's clients, employees and shareholders. Changes to these laws, regulations and other guidelines, including those that affect how they are interpreted and applied, could have an impact on the Bank. In particular, they could limit its product and service offering or enhance its competitors' ability to rival the Bank's offering with their own. Also, in spite of the precautions the Bank takes to prevent such an eventuality, failure to comply with laws, regulations and other guidelines could give rise to penalties and fines likely to have an adverse impact on its financial results and reputation.

Some of the key areas of Canadian regulatory banking reform, which have emanated principally from the BCBS, are described hereafter.

Regulatory Capital and Liquidity Reforms

In order to promote a more resilient banking sector and strengthen global capital standards, tighter global rules for bank regulatory capital and liquidity were introduced by the BCBS through Basel III and implemented domestically. In Canada, the capital rules changes were implemented in January 2013 and liquidity rules will begin phasing in during 2015. For more details, refer to the Capital Management and Liquidity Risk Management sections in this MD&A.

Domestic Systemically Important Bank Designation

In the context of the Canadian federal regulator's assessment of systemic risk, the Bank (along with the other five largest Canadian banks) was designated in March 2013 as a Domestic Systemically Important Bank or "D-SIB". All Canadian D-SIBs will be subject to hold additional capital (i.e., a 1% common equity surcharge) by January 2016.

D-SIBs will also be subject to more intensive regulatory supervision and enhanced market disclosures consistent with their international peers and the recommendations of the FSB's Enhanced Disclosure Task Force (EDTF). On October 29, 2012, the EDTF published a report entitled *Enhancing the Risk Disclosures of Banks*, which contains 32 recommendations. As at October 31, 2013, the Bank has made every effort to ensure overall compliance with those recommendations and is continuing to enhance its risk disclosures to meet the best practices on an ongoing basis. There are no banks currently designated as Global Systemically Important Banks ("G-SIBs") in Canada.

Recovery and Resolution Planning

As part of the regulatory efforts to manage systemic risks, D-SIBs are also required to have in place sufficient recovery and resolution plans. A recovery plan is essentially a road map that guides the recovery of a Bank in the event of severe financial stress; conversely, a resolution plan guides its orderly wind-down in the event of failure when recovery is no longer an option. The Bank began its recovery and resolution planning in 2010 and updates its plans periodically for submission to its domestic regulatory authorities. Additionally, it will be filing a recovery and resolution plan with U.S. regulators with respect to its U.S. entities and operations.

Risk Data Aggregation and Reporting

In order to strengthen risk data aggregation and risk reporting practices, the Basel Committee issued new principles for effective risk data aggregation and reporting in January 2013. Designated D-SIBs are required to implement these new standards by January 1, 2016.

Over-The-Counter (OTC) Derivatives Reforms

OTC derivatives market reforms have introduced significant changes to capital regimes, regulatory frameworks and market infrastructures. The biggest changes relate to the requirement to clear OTC derivatives through central counterparties and the higher capital requirements for transactions for non-qualifying central counterparties. The reforms also cover financial requirements and business conduct.

Sound Management of Regulatory Risk

The Bank ensures sound regulatory risk management by using a proactive approach and emphasizing the integration of regulatory requirements in its day-to-day operations, as well as ongoing communication to remind its employees of the importance of complying with laws and regulations.

Regulatory risk management ensures that events stemming from regulatory non-compliance that could have an impact on the activities and reputation of the Bank and its subsidiaries are proactively identified and understood and that mitigating strategies are implemented. It also allows the Bank to obtain reasonable assurance that it is in compliance with legislation, regulations, principles, standards, directives, guidelines, decisions, recommendations, codes of practice and voluntary commitments relevant to its operations.

The implementation of a regulatory risk management framework across the Bank is entrusted to the Compliance Service, which is mandated to:

- make sure that policies and procedures that ensure compliance with the regulations in effect in all territories where the Bank and its subsidiaries operate, including regulations related to money laundering and terrorist financing activities, are in place and operational;
- develop compliance training and information programs for employees of the Bank and its subsidiaries;
- exercise independent oversight of compliance by the Bank and its subsidiaries with policies and procedures; and
- refer relevant matters with respect to compliance and money laundering and terrorist financing to the Bank's Board.

The Bank has high regulatory risk management standards in order to earn the trust of its clients, its shareholders, the market and the general public.

Reputation Risk Management

Reputation risk is the risk that the Bank's operations or practices will be judged negatively by the public, whether that judgment is with or without basis, thereby adversely affecting the perception, image or trademarks of the Bank, potentially resulting in costly litigation or loss of income. Reputation risk generally arises from a deficiency in managing another risk. The Bank's reputation may, for example, be adversely affected by non-compliance with laws and regulations or by process failures. All risks must therefore be managed effectively in order to protect the Bank's reputation.

The Bank seeks to ensure that its employees are constantly aware of the potential repercussions of their actions on the Bank's reputation and image. In addition to the previously discussed operational risk management initiatives, a variety of mechanisms are in place to support sound reputation risk management, including codes of professional conduct applicable to all employees, policies regarding ethics and corporate governance and appropriate training programs.

The Bank also has a policy, approved by the Board, that covers reputation risk stemming from complex structured financing transactions and other transactions that may give rise to reputation issues. The policy sets the reputation risk management rules and practices applicable to these transactions. The policy is complemented by the special provisions of the new products and activities policy, which determines the approvals required by the various committees that assess risk whenever new products or activities are introduced within the business units. These provisions are intended, among other things, to provide oversight for the management of reputation risk, which may be material for such products or activities. The new products and activities policy requires that any new product or activity for which the reputation risk is determined to be high be submitted to the Global Risk Committee for approval.

The activities of the Compliance Service, Legal Affairs Department, Corporate Secretary's Office, Public Relations Department and Investor Relations Department complete the reputation risk management framework.

Environmental Risk Management

Environmental risk is the risk of a loss or of damage to the Bank's reputation, arising from environmental concerns related to the Bank or its clients. Environmental risk is often associated with credit risk and operational risk.

Environmental risk means any impact of environmental problems that leads to a loss of financial or operational value or affects the Bank's reputation. This risk arises from commercial and operating activities. For example, environmental issues related to the purchase or sale of contaminated properties by clients of the Bank or the deployment of large-scale projects could expose the Bank to credit and reputation risk. The Bank would also be forced to deal with operational risk and the risk related to the legal environment when environmental issues arise in its branches or administrative offices.

In this context, the Risk Management Group develops requirements that are prescribed in its internal policies in order to reveal, assess, control and monitor environmental risk. For their part, the business segments and corporate units must integrate requirements and controls related to the management of environmental risk in their activities. The Risk Management Group monitors its application and regularly reviews the standards.

OTHER RISK FACTORS

In addition to the risks described in the Risk Management section, other factors may have an impact on the Bank's future results.

International Risks

Through the operations of certain units and subsidiaries in Canada and abroad (in particular, Credigy Ltd.), the Bank is exposed to the risks related to its presence in international markets or foreign jurisdictions. Although these risks do not affect a significant proportion of the Bank's portfolios, their impact must not be overlooked, especially those that are of a legal or regulatory nature. Such risk can be particularly high when the exposure is in a territory where the enforceability of agreements signed by the Bank is uncertain or in countries and regions facing political or socio-economic disturbances. Generally speaking, there are many ways in which the Bank may be exposed to the risks posed by other countries, not the least of which being foreign laws and regulations. In all such situations, it is important to consider what is referred to as "country risk," which affects not only the activities that the Bank carries out abroad, but also the business that it conducts with non-resident clients as well as the services it provides to clients doing business abroad, such as electronic funds transfers and international products.

As part of its program to combat money laundering and terrorist financing (MLTFA), the Bank audits country risk, which in particular involves classifying countries into three MLTFA-risk levels and applying, in accordance with the Bank's various policies, restrictions of varying severity depending on the classification of a particular country.

The Bank is exposed to financial risks outside Canada and the United States primarily through its interbank transactions on international financial markets or through international trade finance activities. This geographic exposure, which represents a moderate proportion of the Bank's total risk, is mainly concentrated in Europe and is subject to quarterly reporting in the *Supplementary Financial Information* report. To control country risk, the Bank sets credit concentration limits by country and reviews and submits them to the Board for approval upon renewal of the Credit Risk Management Policy. These limits, which are based on a percentage of the Bank's regulatory capital, are proportionate to the level of risk represented by each country, particularly emerging countries. The risk is rated using a classification mechanism similar to the one used for credit default risk. In addition to the country limits per se, authorization caps and limits are established, as a % of capital, for the world's high-risk regions, i.e., essentially all regions except for North America, Western European countries and the developed countries of Asia.

Level of Competition

The extent of competition in the markets where the Bank operates has an impact on its performance. Retaining clients hinges on several factors, including the price of products and services, quality of service, and changes to the products and services offered.

Acquisitions

The Bank's ability to successfully complete an acquisition is often conditional on regulatory approval, and the Bank cannot be certain when or under what conditions, if any, approval will be granted. Acquisitions may affect future results depending on any difficulties the Bank experiences in integrating the acquired company. If the Bank or its subsidiary encounters difficulty in integrating the acquired business, maintaining the appropriate level of governance over the acquired business, or retaining key officers within the acquired business, these factors could prevent the Bank from realizing expected revenue growth, cost savings, market share gains and other projected benefits from the acquisition.

Ability to Attract and Retain Key Officers

The Bank's future performance depends largely on its ability to attract and retain key officers. There is intense competition for the best people in the financial services industry, and there is no assurance that the Bank, or any entity it acquires, will be able to continue to attract and retain key officers.

Accounting Policies, Methods and Estimates Used by the Bank

The accounting policies and methods used by the Bank determine how the Bank reports its financial position and operating results and may require management to make estimates or rely on assumptions about matters that are inherently uncertain. Any changes to these estimates and assumptions may have a significant impact on the Bank's operating results and financial position.

Other Factors

Lastly, other factors that could affect the Bank's future results include amendments to tax legislation, unexpected changes in consumer spending and saving habits, technological advances, the timely development and launch of new products and services, the ability to successfully align its organizational structure, resources and processes, the ability to activate a business continuity plan within a reasonable time, the potential impact of international conflicts or natural catastrophes on the Bank's activities, and the Bank's ability to foresee and effectively manage the risks associated with these factors through rigorous risk management.

ADDITIONAL FINANCIAL INFORMATION

TABLE 1 – QUARTERLY RESULTS

(millions of Canadian dollars, except per share amounts)					2013
	Total	Q4	Q3	Q2	Q1
Statement of income data					
Net interest income	2,449	595	632	623	599
Non-interest income	2,714	659	656	763	636
Total revenues	5,163	1,254	1,288	1,386	1,235
Provisions for credit losses	181	48	48	53	32
Non-interest expenses	3,165	808	789	815	753
Income taxes	263	61	32	84	86
Net income	1,554	337	419	434	364
Non-controlling interests	75	19	18	18	20
Net income attributable to the Bank's shareholders	1,479	318	401	416	344
Earnings per common share					
Basic	$ 8.87	$ 1.91	$ 2.41	$ 2.50	$ 2.05
Diluted	8.80	1.89	2.39	2.49	2.03
Dividends (per share)					
Common	$ 3.40	$ 0.87	$ 0.87	$ 0.83	$ 0.83
Preferred					
Series 15	0.2444	–	–	–	0.2444
Series 16	1.2125	0.3031	0.3031	0.3032	0.3031
Series 20	1.5000	0.3750	0.3750	0.3750	0.3750
Series 21	1.0078	–	0.3360	0.3359	0.3359
Series 24	1.6500	0.4125	0.4125	0.4125	0.4125
Series 26	1.6500	0.4125	0.4125	0.4125	0.4125
Series 28	0.9728	0.2375	0.2375	0.2375	0.2603
Return on common shareholders' equity	20.6%	16.6%	21.9%	24.3%	20.0%
Total assets		188,204	187,179	184,783	183,796
Long-term financial liabilities(1)		2,426	2,426	2,456	2,452
Net impaired loans		183	172	146	165
Number of common shares outstanding *(thousands)*					
Average – Basic	162,234	162,687	162,386	162,278	161,585
Average – Diluted	163,524	164,297	163,588	163,538	163,045
End of period		162,991	162,604	162,541	162,469
Per common share					
Book value		$ 45.81	$ 45.07	$ 43.00	$ 41.38
Stock trading range					
High	90.48	90.48	79.35	79.52	80.04
Low	72.35	77.72	72.66	72.35	75.06
Number of employees		19,691	19,817	19,779	19,858
Number of branches in Canada		453	453	452	452

(1) Subordinated debt.

				2012					2011
Total	Q4	Q3	Q2	Q1	Total	Q4	Q3	Q2	Q1
2,338	593	579	574	592	2,330	586	569	560	615
2,975	757	642	925	651	2,336	583	588	618	547
5,313	1,350	1,221	1,499	1,243	4,666	1,169	1,157	1,178	1,162
180	46	40	49	45	184	50	29	50	55
3,173	869	752	793	759	2,911	764	742	710	695
326	84	50	104	88	275	63	50	91	71
1,634	351	379	553	351	1,296	292	336	327	341
73	18	19	17	19	72	18	18	17	19
1,561	333	360	536	332	1,224	274	318	310	322
$ 9.40	$ 1.99	$ 2.16	$ 3.25	$ 2.00	$ 7.00	$ 1.63	$ 1.90	$ 1.59	$ 1.88
9.32	1.97	2.14	3.22	1.99	6.92	1.62	1.87	1.57	1.86
$ 3.08	$ 0.79	$ 0.79	$ 0.75	$ 0.75	$ 2.74	$ 0.71	$ 0.71	$ 0.66	$ 0.66
1.4625	0.3656	0.3656	0.3657	0.3656	1.4625	0.3656	0.3656	0.3657	0.3656
1.2125	0.3031	0.3031	0.3032	0.3031	1.2125	0.3031	0.3031	0.3032	0.3031
1.5000	0.3750	0.3750	0.3750	0.3750	1.5000	0.3750	0.3750	0.3750	0.3750
1.3438	0.3360	0.3360	0.3359	0.3359	1.3438	0.3360	0.3360	0.3359	0.3359
1.6500	0.4125	0.4125	0.4125	0.4125	1.6500	0.4125	0.4125	0.4125	0.4125
1.6500	0.4125	0.4125	0.4125	0.4125	1.6500	0.4125	0.4125	0.4125	0.4125
24.5%	19.8%	21.7%	35.0%	21.9%	20.2%	18.3%	21.4%	18.7%	22.2%
	177,903	179,816	176,456	175,245		166,854	163,599	165,231	162,754
	2,470	2,479	2,461	1,496		2,000	1,989	1,974	1,985
	179	158	130	159		175	162	173	194
161,387	161,763	161,829	161,343	160,611	162,425	161,112	162,164	163,414	163,044
162,873	163,190	163,231	163,117	162,151	164,255	162,771	164,365	165,520	164,811
	161,308	161,959	161,911	160,920		160,474	162,298	162,740	163,593
	$ 40.04	$ 39.60	$ 39.14	$ 36.87		$ 35.65	$ 35.19	$ 34.96	$ 34.75
81.27	77.51	77.39	81.27	77.94	81.44	73.51	81.44	80.56	71.49
63.27	73.89	71.05	75.05	63.27	64.86	66.65	74.05	69.99	64.86
	19,920	20,183	19,785	19,990		19,431	19,217	18,492	18,407
	451	449	449	447		448	442	441	441

TABLE 2 – OVERVIEW OF RESULTS

Year ended October 31 (taxable equivalent basis)(1) (millions of Canadian dollars)	2013	2012	2011	2010(2)	2009(2)
Net interest income	**2,658**	2,510	2,506	2,139	2,109
Non-interest income	**2,714**	2,975	2,336	2,351	2,172
Total revenues	**5,372**	5,485	4,842	4,490	4,281
Non-interest expenses	**3,165**	3,173	2,911	2,822	2,662
Contribution	**2,207**	2,312	1,931	1,668	1,619
Provisions for credit losses	**181**	180	184	144	305
Income before income taxes	**2,026**	2,132	1,747	1,524	1,314
Income taxes	**472**	498	451	427	400
Income before non-controlling interests				1,097	914
Non-controlling interests				63	60
Net income	**1,554**	1,634	1,296	1,034	854
Non-controlling interests	**75**	73	72		
Net income attributable to the Bank's shareholders	**1,479**	1,561	1,224		
Average assets	**193,505**	181,344	165,942	140,360	140,978

(1) See the Financial Reporting Method section on page 12.
(2) These figures are presented in accordance with previous Canadian GAAP.

TABLE 3 – CHANGES IN NET INTEREST INCOME

Year ended October 31 (taxable equivalent basis)(1) (millions of Canadian dollars)	2013	2012	2011	2010(2)(3)	2009(2)(3)
Personal and Commercial					
Net interest income	**1,614**	1,581	1,520	1,515	1,413
Average assets	**76,696**	70,524	62,205	61,076	56,070
Average interest-bearing assets	**70,718**	65,426	58,161	58,106	53,684
Net interest margin	**2.28%**	2.42%	2.61%	2.61%	2.63%
Wealth Management					
Net interest income	**272**	255	229	108	127
Average assets	**8,159**	7,980	7,861	940	873
Financial Markets					
Net interest income	**785**	584	579	773	794
Average assets	**87,063**	76,084	72,613	65,469	97,805
Other					
Net interest income	**(13)**	90	178	(257)	(225)
Average assets	**21,587**	26,756	23,263	12,875	(13,770)
Total					
Net interest income	**2,658**	2,510	2,506	2,139	2,109
Average assets	**193,505**	181,344	165,942	140,360	140,978

(1) See the Financial Reporting Method section on page 12.
(2) These figures are presented in accordance with previous Canadian GAAP.
(3) Figures for 2010 and 2009 were not restated to reflect the fact that the distribution of banking products through independent networks has been transferred from the Personal and Commercial segment to the Wealth Management segment and that banking activities with energy sector companies have been transferred from the Financial Markets segment to the Personal and Commercial segment. Figures for 2009 have not been restated to reflect the fact that Treasury activities have been transferred from the Financial Markets segment to the *Other* heading.

TABLE 4 – NON-INTEREST INCOME

Year ended October 31 (taxable equivalent basis)(1) (millions of Canadian dollars)	2013	2012	2011	2010(2)	2009(2)
Underwriting and advisory fees	**301**	318	308	268	267
Securities brokerage commissions	**335**	343	327	301	282
Mutual fund revenues	**219**	200	192	172	138
Trust service revenues	**314**	280	234	203	189
Credit fees	**165**	166	169	168	140
Revenues from acceptances, letters of credit and guarantee	**226**	203	166	146	119
Card revenues	**121**	113	116	44	38
Deposit and payment service charges	**235**	229	228	228	230
Trading revenues (losses)	**186**	233	(25)	(93)	21
Gains (losses) on available-for-sale securities, net	**82**	123	105	112	(97)
Insurance revenues, net	**118**	111	111	121	117
Securitization revenues	**–**	–	–	282	346
Foreign exchange revenues, other than trading	**90**	94	105	109	110
Share in the net income of associates and joint ventures	**26**	29	2	17	80
Other	**296**	533	298	273	192
	2,714	2,975	2,336	2,351	2,172
Domestic	**2,433**	2,675	2,101	2,099	2,088
International					
United States	**227**	223	185	160	5
Other	**54**	77	50	92	79
Non-interest income as a % of total revenues on a taxable equivalent basis(1)	**50.5%**	54.2%	48.2%	52.4%	50.7%
Non-interest income as a % of total revenues on a taxable equivalent basis and excluding specified items(1)	**49.1%**	50.7%	48.1%	52.2%	53.6%

(1) See the Financial Reporting Method section on page 12.
(2) These figures are presented in accordance with previous Canadian GAAP.

TABLE 5 – TRADING ACTIVITY REVENUES(1)

Year ended October 31 (taxable equivalent basis)(2) (millions of Canadian dollars)	2013	2012	2011	2010(3)(4)	2009(3)(4)
Financial markets					
Equities	**288**	246	234	243	205
Fixed-income securities	**237**	212	130	177	388
Commodities and foreign exchange	**88**	73	92	85	91
	613	531	456	505	684
Other segments	**212**	158	(31)	28	9
Total	**825**	689	425	533	693

(1) Including net interest income and non-interest income.
(2) See the Financial Reporting Method section on page 12.
(3) These figures are presented in accordance with previous Canadian GAAP.
(4) Figures for 2010 and 2009 were not restated to reflect the fact that banking activities with energy sector companies have been transferred from the Financial Markets segment to the Personal and Commercial segment. Figures for 2009 have not been restated to reflect the fact that Treasury activities have been transferred from the Financial Markets segment to the *Other* heading.

TABLE 6 – PROVISIONS FOR CREDIT LOSSES

Year ended October 31 (millions of Canadian dollars)	2013	2012	2011	2010[1][2]	2009[1][2]
Provisions for credit losses on impaired loans					
Personal	**148**	135	139	95	95
Commercial	**44**	36	63	42	53
Wealth Management	**3**	3	2	–	–
Corporate	**(14)**	3	(5)	2	27
Real estate	**–**	3	–	5	–
Other	**–**	–	–	–	4
Total	**181**	180	199	144	179
Collective allowance on non-impaired loans[3]	**–**	–	(15)	–	126
Total provisions for credit losses	**181**	180	184	144	305
Average loans and acceptances	**92,398**	84,009	73,575	59,014	56,236
Provisions for credit losses on impaired loans as a % of average loans and acceptances	**0.20%**	0.21%	0.27%	0.24%	0.32%
Provisions for credit losses on impaired and non-impaired loans as a % of average loans and acceptances	**0.20%**	0.21%	0.25%	0.24%	0.54%
Allowances for credit losses					
Balance at beginning	**577**	608	638	642	471
IFRS-conversion adjustment			58		
Provisions for credit losses	**181**	180	199	144	305
Write-offs	**(112)**	(154)	(193)	(134)	(103)
Write-offs on credit cards	**(78)**	(78)	(91)	(103)	(105)
Recoveries[4]	**10**	21	12	89	74
Reversal[5]	**–**	–	(15)	–	–
Balance at end	**578**	577	608	638	642
Composition of allowances:					
Portion related to securities	**–**	–	–	2	2
Individual and collective allowances on impaired loans	**212**	208	232	207	184
Collective allowance on non-impaired loans[6]	**366**	369	376	429	456

(1) Figures for 2010 and 2009 have not been restated to reflect the fact that the distribution of banking products through independent networks has been transferred from the Personal and Commercial segment to the Wealth Management segment and that banking activities with energy sector companies have been transferred from the Financial Markets segment to the Personal and Commercial segment.
(2) These figures are presented in accordance with previous Canadian GAAP.
(3) Provisions taken (reversed) for credit facilities granted to clients holding restructured notes of the MAV conduits.
(4) Including exchange rate fluctuations and the $2 million portion applicable to securities in 2011.
(5) During the year ended October 31, 2011, a $15 million reversal of allowances for credit losses taken for loans and credit facilities secured by restructured notes of the MAV conduits had been recorded to the provisions for credit losses.
(6) The collective allowance on non-impaired loans was established taking into account the Bank's overall credit portfolio (except for the following amounts created for loans and credit facilities secured by restructured notes of the MAV conduits; 2013: nil; 2012: $3 million; 2011: $10 million; 2010: $121 million; 2009: $148 million).

TABLE 7 – NON-INTEREST EXPENSES

Year ended October 31 (millions of Canadian dollars)	2013	2012	2011	2010[1]	2009[1]
Compensation and employee benefits[2]	**1,858**	1,953	1,729	1,607	1,538
Occupancy	**194**	162	151	138	153
Technology	**319**	303	323	328	356
Amortization – Premises and equipment	**43**	43	39	40	38
Amortization – Technology	**139**	111	82	79	71
Communications	**68**	70	74	71	76
Professional fees	**221**	195	185	162	143
Restructuring charges[3]	**–**	–	–	22	–
Advertising and external relations	**71**	64	58	55	53
Stationery	**22**	22	25	25	24
Travel	**17**	19	19	17	15
Security and theft	**26**	30	22	17	18
Capital and payroll taxes	**46**	57	63	60	50
Other	**141**	144	141	201	127
Total	**3,165**	3,173	2,911	2,822	2,662
Domestic	**2,965**	2,953	2,683	2,609	2,477
International					
United States	**183**	167	167	150	122
Other	**17**	53	61	63	63
Non-interest expenses as a % of total revenues on a taxable equivalent basis[4]	**58.9%**	57.8%	60.1%	62.9%	62.2%
Non-interest expenses as a % of total revenues on a taxable equivalent basis and excluding specified items[4]	**58.6%**	59.3%	58.8%	60.5%	59.7%

(1) These figures are presented in accordance with previous Canadian GAAP.
(2) Compensation and employee benefits for 2013 included an amount of $12 million for severance pay (2012: $80 million; 2011: $27 million).
(3) The restructuring charges for 2010 had included $21 million in compensation and employee benefits and $1 million in professional fees.
(4) See the Financial Reporting Method section on page 12.

TABLE 8 – CHANGE IN AVERAGE VOLUMES

Year ended October 31
(taxable equivalent basis)(1)
(millions of Canadian dollars)

	2013		2012		2011		2010(2)		2009(2)	
	Average volume $	Rate %	Average volume $	Rate %	Average volume $	Rate %	Average volume $	Rate %	Average volume $	Rate %
Assets										
Deposits with financial institutions	7,051	0.27	7,025	0.24	6,211	0.24	3,362	0.06	2,069	0.58
Securities	58,090	2.33	59,520	2.09	61,277	1.98	57,072	2.05	53,888	2.24
Securities purchased under reverse repurchase agreements and securities borrowed	21,271	0.79	15,929	0.69	11,241	1.45	–	–	–	–
Residential mortgage loans	35,590	3.13	31,846	3.33	27,265	3.88	15,898	3.73	15,314	4.23
Personal loans and credit card receivables	26,917	4.21	25,236	4.32	22,585	4.43	19,315	3.41	16,726	3.63
Business and government loans	21,126	3.60	19,394	3.72	17,318	3.91	26,712	2.38	29,523	2.50
Net impaired loans	(161)	(0.77)	(186)	(0.96)	(226)	(0.79)	(212)	(0.76)	(116)	(1.29)
Interest-bearing assets	169,884	2.68	158,764	2.67	145,671	2.84	122,147	2.51	117,404	2.74
Other assets	23,621		22,580		20,271		18,213		23,574	
Total assets	193,505	2.35	181,344	2.34	165,942	2.49	140,360	2.18	140,978	2.28
Liabilities and equity										
Personal deposits	40,156	1.45	37,835	1.54	35,491	1.45	30,674	1.44	31,679	1.71
Deposit-taking institutions	7,237	0.32	7,801	0.24	8,501	0.24	7,466	0.28	8,380	0.71
Other deposits	54,410	1.10	50,528	0.94	45,893	0.88	42,190	0.83	37,820	1.31
	101,803	1.18	96,164	1.12	89,885	1.05	80,330	1.01	77,879	1.41
Subordinated debt	2,381	4.30	1,927	4.54	1,886	4.88	1,895	5.32	2,030	5.01
Obligations other than deposits	45,385	1.06	43,431	1.23	37,751	1.55	34,589	0.74	31,857	0.80
Interest-bearing liabilities	149,569	1.27	141,522	1.21	129,522	1.26	116,814	0.81	111,766	1.00
Other liabilities	34,796		31,859		28,878		16,739		23,092	
Equity	9,140		7,963		7,542		6,807		6,120	
Liabilities and equity	193,505	0.98	181,344	0.96	165,942	0.98	140,360	0.67	140,978	0.79
Gross margin		1.37		1.38		1.51		1.51		1.49

(1) See the Financial Reporting Method section on page 12.
(2) These figures are presented in accordance with previous Canadian GAAP. Securities purchased under reverse repurchase agreements and securities borrowed are presented in Securities.

TABLE 9 – DISTRIBUTION OF GROSS LOANS BY BORROWER CATEGORY UNDER THE BASEL II ASSET CLASSES(1)

As at October 31
(millions of Canadian dollars)

	2013		2012		2011		2010(2)		2009(2)(3)	
	$	%	$	%	$	%	$	%	$	%
Residential mortgage	46,836	52.6	43,226	51.9	37,639	50.9	23,609	40.8	14,961	28.1
Qualifying revolving retail	3,962	4.5	3,918	4.7	3,917	5.3	2,556	4.4	–	–
Other retail	10,896	12.3	11,472	13.8	11,226	15.2	10,207	17.6	18,313	34.4
Agriculture and fishing	2,513	2.8	2,314	2.8	2,115	2.8	2,017	3.5	1,911	3.5
Financial institutions and insurance	1,296	1.5	987	1.2	580	0.8	3,557	6.2	3,022	5.7
Manufacturing	2,535	2.9	2,363	2.8	2,435	3.3	2,097	3.6	2,153	4.0
Construction and real estate	5,992	6.7	3,539	4.3	3,015	4.1	2,738	4.7	2,717	5.1
Transportation and communications	1,805	2.0	1,861	2.2	1,683	2.3	1,437	2.5	1,165	2.2
Mines, quarries and energy	1,708	1.9	1,988	2.4	1,349	1.8	728	1.3	1,109	2.1
Wholesale and retail	3,494	3.9	3,823	4.6	3,240	4.4	2,549	4.4	2,119	4.0
Services	5,099	5.7	4,490	5.4	3,725	5.0	3,567	6.2	3,253	6.1
Other	2,826	3.2	3,268	3.9	3,048	4.1	2,762	4.8	2,554	4.8
	88,962	100.0	83,249	100.0	73,972	100.0	57,824	100.0	53,277	100.0

(1) For additional information, see Note 7 to the consolidated financial statements on page 149.
(2) These figures are presented in accordance with previous Canadian GAAP.
(3) Qualifying revolving retail are included in Other retail.

TABLE 10 – IMPAIRED LOANS

As at October 31 (millions of Canadian dollars)	2013	2012	2011	2010[1][2]	2009[1][2]
Net impaired loans – by segment					
Personal[3]	**70**	56	57	47	56
Commercial	**90**	63	81	79	90
Wealth Management	**2**	2	–	–	–
Corporate	**–**	40	16	15	72
Real estate	**21**	18	21	21	5
Other	**–**	–	–	–	–
Total net impaired loans[4]	**183**	179	175	162	223
Gross impaired loans	**395**	387	407	369	407
Individual and collective allowances on impaired loans	**212**	208	232	207	184
Net impaired loans	**183**	179	175	162	223
Provisioning rate	**53.7%**	53.7%	57.0%	56.1%	45.2%
As a % of average loans and acceptances	**0.2%**	0.2%	0.2%	0.4%	0.4%
As a % of common shareholders' equity	**2.5%**	2.5%	2.7%	2.6%	4.1%

(1) Figures for 2010 and 2009 have not been restated to reflect the fact that the distribution of banking products through independent networks has been transferred from the Personal and Commercial segment to the Wealth Management segment and that banking activities with energy sector companies have been transferred from the Financial Markets segment to the Personal and Commercial segment.
(2) These figures are presented in accordance with previous Canadian GAAP.
(3) Including $37 million in net consumer loans in 2013 (2012: $30 million; 2011: $26 million; 2010: $23 million; 2009: $32 million).
(4) Whenever a payment is contractually 90 days past due, unless the loan is fully secured and collection efforts are reasonably expected to result in repayment of the debt within 180 days. For credit card receivables, they are written off when payment is 180 days in arrears. Loans guaranteed by a Canadian government agency are considered impaired when they are more than 365 days in arrears.

TABLE 11 – DEPOSITS

As at October 31 (millions of Canadian dollars)	2013		2012		2011		2010[1]		2009[1]	
	$	**%**	$	%	$	%	$	%	$	%
Personal	**42,652**	**41.9**	40,814	43.8	37,432	43.8	36,549	44.7	38,241	50.9
Business and government	**31,684**	**31.0**	25,997	27.9	23,911	27.9	23,227	28.4	19,460	25.9
Deposit-taking institutions	**1,072**	**1.1**	2,547	2.7	1,781	2.1	2,326	2.8	1,211	1.6
Unsecured senior debt	**23,336**	**22.9**	20,876	22.4	20,046	23.4	19,683	24.1	16,258	21.6
Covered bonds	**3,142**	**3.1**	3,015	3.2	2,392	2.8	–	–	–	–
Total	**101,886**	**100.0**	93,249	100.0	85,562	100.0	81,785	100.0	75,170	100.0
Domestic	**94,422**	**92.7**	82,593	88.6	74,865	87.5	71,872	87.9	65,461	87.1
International										
United States	**6,893**	**6.8**	9,545	10.2	10,144	11.9	8,204	10.0	7,114	9.5
Other	**571**	**0.5**	1,111	1.2	553	0.6	1,709	2.1	2,595	3.4
Total	**101,886**	**100.0**	93,249	100.0	85,562	100.0	81,785	100.0	75,170	100.0
Personal deposits as a % of total assets		**22.7**		24.7		24.2		26.7		30.3

(1) These figures are presented in accordance with previous Canadian GAAP.

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

DECLARATION OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of National Bank of Canada (the Bank) have been prepared in accordance with section 308(4) of the *Bank Act* (Canada), which states that, except as otherwise specified by the Office of the Superintendent of Financial Institutions (OSFI), the financial statements are to be prepared in accordance with the International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB) and set out in the CPA Canada Handbook. None of the OSFI accounting requirements are exceptions to IFRS.

Management maintains the accounting and internal controls necessary to discharging its responsibility, which is to provide reasonable assurance that the financial accounts are accurate and complete and that the Bank's assets are adequately safeguarded. Controls that are currently in place include quality standards on staff hiring and training; the implementation of organizational structures with clear divisions of responsibility and accountability for performance; the Code of Professional Conduct; and the communication of operating policies and procedures.

As Chief Executive Officer and as Chief Financial Officer, we have overseen the evaluation of the design and operation of the Bank's internal controls over financial reporting in accordance with *Regulation 52-109 respecting Certification of Disclosures in Issuers' Annual and Interim Filings* released by the Canadian Securities Administrators. Based on the evaluation work performed, we have concluded that the internal controls over financial reporting were effective as at October 31, 2013 and that they provide reasonable assurance that the financial information is reliable and that the Bank's consolidated financial statements have been prepared in accordance with IFRS.

The Board of Directors (the Board) is responsible for reviewing and approving the financial information contained in the Annual Report. Acting through the Audit Committee, the Board also oversees the presentation of the consolidated financial statements and ensures that accounting and control systems are maintained. Composed of directors who are neither officers nor employees of the Bank, the Audit Committee is responsible, through Internal Audit, for performing an independent and objective review of the Bank's internal control effectiveness, i.e., governance processes, risk management processes and control measures. Furthermore, the Audit Committee reviews the consolidated financial statements and recommends their approval to the Board.

The control systems are supported by the presence of the Compliance Service, which exercises independent oversight in order to assist managers in effectively managing regulatory risk and to obtain reasonable assurance that the Bank is compliant with regulatory requirements.

The Senior Vice-President of Internal Audit and the Vice-President of the Compliance Service have direct access to the Chair of the Audit Committee and to the President and Chief Executive Officer.

In accordance with the *Bank Act* (Canada), OSFI regularly examines the operations of the Bank to ensure that it is in a sound financial condition and that depositors are protected.

The independent auditor, Deloitte s.e.n.c.r.l., whose report follows, was appointed by the shareholders on the recommendation of the Board. The auditor had full and unrestricted access to the Audit Committee to discuss audit and financial reporting matters.

Louis Vachon
President and Chief Executive Officer

Ghislain Parent
Chief Financial Officer and Executive Vice-President
Finance and Treasury

Montreal, Canada, December 3, 2013

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of National Bank of Canada

We have audited the accompanying consolidated financial statements of National Bank of Canada (the Bank), which comprise the consolidated balance sheets as at October 31, 2013 and 2012, the consolidated statements of income, the consolidated statements of comprehensive income, the consolidated statements of changes in equity and the consolidated statements of cash flows for the years ended October 31, 2013 and 2012, as well as a summary of significant accounting policies and other explanatory information.

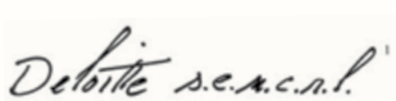
Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

The auditor's responsibility
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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Bank as at October 31, 2013 and 2012, and its financial performance and its cash flows for the years ended October 31, 2013 and 2012 in accordance with the International Financial Reporting Standards as issued by the International Accounting Standards Board.



Deloitte s.e.n.c.r.l. [1]

Montreal, Canada, December 3, 2013

[1] CPA auditor, CA, public accountancy permit No. A104644

CONSOLIDATED BALANCE SHEETS

(millions of Canadian dollars)

As at October 31		2013	2012
ASSETS			
Cash and deposits with financial institutions		**3,596**	3,249
Securities	Note 6		
At fair value through profit or loss		**44,000**	44,524
Available-for-sale		**9,744**	10,374
		53,744	54,898
Securities purchased under reverse repurchase agreements and securities borrowed		**21,449**	15,529
Loans	Note 7		
Residential mortgage		**36,573**	33,538
Personal and credit card		**27,989**	26,529
Business and government		**24,400**	23,182
		88,962	83,249
Customers' liability under acceptances		**8,954**	8,250
Allowances for credit losses		**(578)**	(577)
		97,338	90,922
Other			
Derivative financial instruments	Note 15	**5,904**	6,696
Due from clients, dealers and brokers		**1,101**	1,661
Investments in associates and joint ventures	Note 9	**684**	625
Premises and equipment	Note 10	**404**	440
Goodwill	Note 11	**1,064**	1,063
Intangible assets	Note 11	**898**	778
Other assets	Note 12	**2,022**	2,042
		12,077	13,305
		188,204	177,903
LIABILITIES AND EQUITY			
Deposits	Notes 4 and 5		
Personal		**42,652**	40,814
Business and government		**56,878**	49,314
Deposit-taking institutions		**2,356**	3,121
		101,886	93,249
Other			
Acceptances		**8,954**	8,250
Obligations related to securities sold short		**18,909**	18,124
Obligations related to securities sold under repurchase agreements and securities loaned		**19,746**	19,539
Derivative financial instruments	Note 15	**4,858**	5,600
Due to clients, dealers and brokers		**2,442**	1,959
Liabilities related to transferred receivables	Notes 4 and 8	**15,323**	15,398
Other liabilities	Note 13	**4,499**	5,074
		74,731	73,944
Subordinated debt	Note 14	**2,426**	2,470
EQUITY			
Equity attributable to the Bank's shareholders	Notes 17 and 21		
Preferred shares		**677**	762
Common shares		**2,160**	2,054
Contributed surplus		**58**	58
Retained earnings		**5,034**	4,091
Accumulated other comprehensive income		**214**	255
		8,143	7,220
Non-controlling interests	Note 18	**1,018**	1,020
		9,161	8,240
		188,204	177,903

The accompanying notes are an integral part of these audited consolidated financial statements.

Louis Vachon
President and Chief Executive Officer

Jean Houde
Director

CONSOLIDATED STATEMENTS OF INCOME

(millions of Canadian dollars)

Year ended October 31		2013	2012
Interest income			
Loans		**3,247**	3,037
Securities at fair value through profit or loss		**942**	926
Available-for-sale securities		**201**	147
Deposits with financial institutions		**20**	17
		4,410	4,127
Interest expense			
Deposits		**1,003**	805
Liabilities related to transferred receivables		**408**	427
Subordinated debt		**102**	87
Other		**448**	470
		1,961	1,789
Net interest income		**2,449**	2,338
Non-interest income			
Underwriting and advisory fees		**301**	318
Securities brokerage commissions		**335**	343
Mutual fund revenues		**219**	200
Trust service revenues		**314**	280
Credit fees		**391**	369
Card revenues		**121**	113
Deposit and payment service charges		**235**	229
Trading revenues (losses)	Note 20	**186**	233
Gains (losses) on available-for-sale securities, net		**82**	123
Insurance revenues, net		**118**	111
Foreign exchange revenues, other than trading		**90**	94
Share in the net income of associates and joint ventures		**26**	29
Other		**296**	533
		2,714	2,975
Total revenues		**5,163**	5,313
Provisions for credit losses	Note 7	**181**	180
		4,982	5,133
Non-interest expenses			
Compensation and employee benefits		**1,858**	1,953
Occupancy		**237**	205
Technology		**458**	414
Communications		**68**	70
Professional fees		**221**	195
Other		**323**	336
		3,165	3,173
Income before income taxes		**1,817**	1,960
Income taxes	Note 23	**263**	326
Net income		**1,554**	1,634
Net income attributable to			
Preferred shareholders	Note 17	**40**	43
Common shareholders	Note 17	**1,439**	1,518
Bank shareholders		**1,479**	1,561
Non-controlling interests	Note 18	**75**	73
		1,554	1,634
Earnings per share *(dollars)*	Note 24		
Basic		**8.87**	9.40
Diluted		**8.80**	9.32
Dividends per common share *(dollars)*	Note 17	**3.40**	3.08

The accompanying notes are an integral part of these audited consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(millions of Canadian dollars)

Year ended October 31	2013	2012
Net income	1,554	1,634
Other comprehensive income, net of income taxes		
Items that may be subsequently reclassified to net income		
Net foreign currency translation adjustments		
Net unrealized foreign currency translation gains (losses) on investments in foreign operations	51	(20)
Impact of hedging net foreign currency translation gains (losses)	(45)	5
	6	(15)
Net change in available-for-sale securities		
Net unrealized gains (losses) on available-for-sale securities	49	63
Net (gains) losses on available-for-sale securities reclassified to net income	(41)	(79)
	8	(16)
Net change in cash flow hedges		
Net gains (losses) on derivative financial instruments designated as cash flow hedges	(26)	(2)
Net (gains) losses on designated derivative financial instruments reclassified to net income	(28)	(54)
	(54)	(56)
Item that will not be subsequently reclassified to net income		
Actuarial gains and losses on employee benefit plans	53	(233)
Share in the other comprehensive income of associates and joint ventures	(1)	1
Total other comprehensive income, net of income taxes	12	(319)
Comprehensive income	1,566	1,315
Comprehensive income attributable to		
Bank shareholders	1,491	1,246
Non-controlling interests	75	69
	1,566	1,315

INCOME TAXES – OTHER COMPREHENSIVE INCOME

The following table presents the income tax expense or recovery for each component of other comprehensive income:

Year ended October 31	2013	2012
Net foreign currency translation adjustments		
Net unrealized foreign currency translation gains (losses) on investments in foreign operations	2	(1)
Impact of hedging net foreign currency translation gains (losses)	(11)	6
	(9)	5
Net change in available-for-sale securities		
Net unrealized gains (losses) on available-for-sale securities	20	26
Net (gains) losses on available-for-sale securities reclassified to net income	(17)	(34)
	3	(8)
Net change in cash flow hedges		
Net gains (losses) on derivative financial instruments designated as cash flow hedges	(10)	(1)
Net (gains) losses on designated derivative financial instruments reclassified to net income	(10)	(20)
	(20)	(21)
Actuarial gains and losses on employee benefit plans	21	(86)
	(5)	(110)

The accompanying notes are an integral part of these audited consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(millions of Canadian dollars)

Year ended October 31		2013	2012
Preferred shares at beginning	Note 17	**762**	762
Issuance of Series 28 preferred shares		**200**	–
Repurchase of Series 15 and 21 preferred shares for cancellation		**(285)**	–
Preferred shares at end		**677**	762
Common shares at beginning	Note 17	**2,054**	1,970
Issuances of common shares			
Stock Option Plan		**107**	93
Acquisition of Wellington West Holdings Inc.		**–**	2
Other		**(1)**	2
Repurchase of common shares for cancellation		**–**	(13)
Common shares at end		**2,160**	2,054
Contributed surplus at beginning	Note 21	**58**	46
Stock option expense		**16**	15
Stock options exercised		**(13)**	(10)
Other		**(3)**	7
Contributed surplus at end		**58**	58
Retained earnings at beginning		**4,091**	3,366
Net income attributable to the Bank's shareholders		**1,479**	1,561
Dividends	Note 17		
Preferred shares		**(40)**	(43)
Common shares		**(552)**	(498)
Premium paid on common shares repurchased for cancellation	Note 17	**–**	(62)
Share issuance expense and other		**(4)**	–
Actuarial gains and losses on employee benefit plans		**53**	(233)
Other		**7**	–
Retained earnings at end		**5,034**	4,091
Accumulated other comprehensive income at beginning		**255**	337
Net foreign currency translation adjustments		**6**	(15)
Net change in unrealized gains (losses) on available-for-sale securities		**8**	(16)
Net change in gains (losses) on cash flow hedges		**(54)**	(52)
Share in the other comprehensive income of associates and joint ventures		**(1)**	1
Accumulated other comprehensive income at end		**214**	255
Equity attributable to the Bank's shareholders		**8,143**	7,220
Non-controlling interests at beginning		**1,020**	1,024
Net income attributable to non-controlling interests		**75**	73
Other comprehensive income attributable to non-controlling interests		**–**	(4)
Distributions to non-controlling interests		**(77)**	(73)
Non-controlling interests at end		**1,018**	1,020
Equity		**9,161**	8,240

ACCUMULATED OTHER COMPREHENSIVE INCOME

As at October 31	2013	2012
Accumulated other comprehensive income		
Net foreign currency translation adjustments	**(6)**	(12)
Net unrealized gains (losses) on available-for-sale securities	**172**	164
Net gains (losses) on instruments designated as cash flow hedges	**47**	101
Share in the other comprehensive income of associates and joint ventures	**1**	2
	214	255

The accompanying notes are an integral part of these audited consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(millions of Canadian dollars)

Year ended October 31		2013	2012
Cash flows from operating activities			
Net income		1,554	1,634
Adjustments for:			
Provisions for credit losses		181	180
Amortization of premises and equipment and intangible assets		150	143
Impairment losses on intangible assets	Note 11	39	18
Gain on the sale of Natcan Investment Management Inc.'s operations	Note 26	–	(271)
Write-off of goodwill and intangible assets	Notes 11 and 26	–	31
Deferred taxes		23	33
Translation adjustment on foreign currency subordinated debt		1	–
Losses (gains) on sales of available-for-sale securities, net		(111)	(159)
Impairment of available-for-sale securities		29	36
Stock option expense		16	15
Change in operating assets and liabilities:			
Securities at fair value through profit or loss		524	2,926
Securities purchased under reverse repurchase agreements and securities borrowed		(5,920)	(3,022)
Loans		(5,893)	(9,488)
Investments in associates and joint ventures		(59)	(255)
Deposits		8,637	7,687
Obligations related to securities sold short		785	(22)
Obligations related to securities sold under repurchase agreements and securities loaned		207	(729)
Derivative financial instruments, net		124	(264)
Due from and to clients, dealers and brokers, net		1,043	726
Liabilities related to transferred receivables		(75)	2,553
Interest and dividends receivable and interest payable		97	56
Current tax assets and liabilities		(183)	100
Other items		(479)	16
		690	1,944
Cash flows from financing activities			
Issuances of preferred shares		200	–
Repurchase of preferred shares for cancellation		(285)	–
Issuances of common shares		93	85
Repurchase of common shares for cancellation		–	(75)
Issuance of subordinated debt		–	1,000
Repurchase of subordinated debt		–	(501)
Share issuance expenses		(4)	–
Dividends paid on shares		(581)	(528)
Change in other items		(113)	(155)
		(690)	(174)
Cash flows from investing activities			
Acquisition of the advisory business of HSBC Securities (Canada) Inc.	Note 26	–	109
Sale of Natcan Investment Management Inc.'s operations	Note 26	–	86
Purchases of available-for-sale securities		(5,876)	(7,468)
Sales of available-for-sale securities		6,519	6,269
Net change in premises and equipment		(146)	(176)
Net change in intangible assets		(127)	(191)
		370	(1,371)
Impact of currency rate movements on cash and cash equivalents		(23)	(1)
Increase in cash and cash equivalents		347	398
Cash and cash equivalents at beginning		3,249	2,851
Cash and cash equivalents at end(1)		3,596	3,249
Supplementary information about cash flows from operating activities			
Interest paid		1,929	1,741
Interest and dividends received		4,346	4,120
Income taxes paid		339	150

The accompanying notes are an integral part of these audited consolidated financial statements.

(1) This item is the equivalent of Consolidated Balance Sheet item *Cash and deposits with financial institutions*. The Bank is required to maintain balances with central banks and other regulatory authorities. The total balances were $456 million as at October 31, 2013 ($228 million as at October 31, 2012). In addition, $7 million was held in escrow as at October 31, 2013 ($11 million as at October 31, 2012).

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

(millions of Canadian dollars)

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

National Bank of Canada (the Bank) is a financial institution incorporated and domiciled in Canada and whose shares are listed on the Toronto Stock Exchange. Its head office is located at 600 De La Gauchetière Street West in Montreal, Quebec, Canada. The Bank is a chartered bank under Schedule 1 of the *Bank Act* (Canada) and is regulated by the Office of the Superintendent of Financial Institutions Canada (OSFI).

The Bank provides integrated financial services to consumers, small- and medium-sized enterprises, and large corporations and operates three business segments, namely, the Personal and Commercial segment, the Wealth Management segment, and the Financial Markets segment. Its full line of services include banking and investing solutions for individuals and businesses, securities brokerage, insurance and wealth management.

On December 3, 2013, the Board of Directors authorized the publication of the Bank's audited annual consolidated financial statements (the consolidated financial statements) for the year ended October 31, 2013.

Basis of Presentation

The consolidated financial statements of the Bank have been prepared in accordance with section 308(4) of the *Bank Act* (Canada), which states that, except as otherwise specified by OSFI, the financial statements are to be prepared in accordance with the International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB) and set out in the CPA Canada Handbook. None of the OSFI accounting requirements are exceptions to IFRS.

Unless otherwise indicated, all amounts are expressed in Canadian dollars.

Comparative Figures

The Bank modified the classification of certain *Deposits* items on the Consolidated Balance Sheet and of certain *Non-interest income* items in the Consolidated Statement of Income to better reflect the nature of reported amounts and revenues. As at October 31, 2012, an amount of $3.1 billion from *Deposits – Personal* was reclassified to *Deposits – Business and government*, and for the year ended October 31, 2012, $203 million in *Revenues from acceptances, letters of credit and guarantee* was reported in the *Credit fees* item.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Summary of Significant Accounting Policies

Judgments, Estimates and Assumptions

In preparing consolidated financial statements in accordance with IFRS, management must exercise judgment and make estimates and assumptions that affect the reporting date carrying amounts of assets and liabilities, net income and related information. Furthermore, certain accounting policies require complex judgments and estimates because they apply to matters that are inherently uncertain, in particular the accounting policies applicable to allowances for credit losses, the fair value determination of financial instruments, the impairment of available-for-sale securities, the impairment of non-financial assets, pension plans and other post-retirement benefits, income taxes, provisions and consolidation of special purpose entities. As such, actual results could differ from these estimates, in which case the impact is recognized in the consolidated financial statements of future fiscal periods. The accounting policies in this note provide greater detail about our use of estimates and assumptions and reliance on judgment.

Basis of Consolidation

Subsidiaries

The consolidated financial statements include all of the assets, liabilities, operating results and cash flows of the Bank and of all the subsidiaries and special purpose entities controlled by the Bank, after elimination of intercompany transactions and balances.

Entities qualify as subsidiaries when the Bank has the power to govern their financial and operating policies so as to obtain benefits from their activities, generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable and the holding of instruments convertible into voting shares are taken into account when determining whether the Bank controls an entity.

Special purpose entities (SPEs) are entities created to accomplish a narrow and well-defined objective. An SPE is consolidated when the Bank concludes, following an evaluation of the substance of the relationship and the risks and rewards of the entity, that it controls that entity. Indicators of control include, among other factors, an assessment as to whether:

- the activities of the SPE are being conducted on behalf of the Bank according to its specific business needs so that it obtains benefits from the SPE's operations;
- the Bank has decision-making powers to obtain the majority of the benefits of the activities of the SPE;
- the Bank has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or
- the Bank retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain the benefits from its activities.

The assessment of control is performed at the inception of the relationship with the entity and is based on existing arrangements. The Bank reassesses its control over an entity whenever there is a change in its relationship with the entity.

Non-controlling interests

Non-controlling interests in subsidiaries represent the equity interests of third parties in the Bank's subsidiaries and are presented in total *Equity*, separately from the *Equity attributable to the Bank's shareholders*. The non-controlling interests' proportionate share in the net income and other comprehensive income of the Bank's subsidiaries are presented in total net income and total comprehensive income, respectively.

With respect to units issued to third parties by mutual funds and certain other funds that are consolidated, they are presented at fair value in *Other liabilities* on the Consolidated Balance Sheet if certain conditions are met and the units meet the definition of a liability.

Lastly, changes in ownership interests in subsidiaries that do not result in a loss of control are recognized as equity transactions. The difference between the adjustment in the carrying value of the non-controlling interest and the fair value of the consideration paid or received is recognized directly in equity attributable to the Bank's shareholders.

Investments in associates and joint ventures

The Bank exercises significant influence over a company when it has the power to participate in the financial and operating policy decisions of the investee. The Bank exercises joint control over a company when it shares control over economic activities in accordance with a contractual arrangement and when the strategic financial and operating decisions of the company require the unanimous consent of the parties sharing control.

Investments in associates, i.e., entities over which the Bank exercises significant influence, and investments in joint ventures, i.e., those over which it exercises joint control, are accounted for using the equity method, whereby the investment is initially recorded at cost and the Bank's share in the net income and in the other comprehensive income following the acquisition are recognized in *Non-interest income* in the Consolidated Statement of Income and in *Other comprehensive income* in the Consolidated Statement of Comprehensive Income, respectively. The carrying value of the investment is adjusted by an equivalent amount on the Consolidated Balance Sheet.

Foreign Currencies

The consolidated financial statements are presented in Canadian dollars, which is the Bank's functional and presentation currency. Each entity in the group determines its own functional currency, and items included in the financial statements of each entity are measured using that currency.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency using the rates in effect on the date of the Consolidated Balance Sheet. Translation gains and losses are recognized in *Non-interest income* in the Consolidated Statement of Income. Revenues and expenses denominated in foreign currencies are translated at the average exchange rates for the period. Non-monetary assets and liabilities are translated into the functional currency at historical rates. Non-monetary items denominated in foreign currencies measured at fair value are translated using the exchange rates in effect on the date fair value is determined, and the translation gains or losses are recognized in the Consolidated Statement of Income. Translation gains or losses on non-monetary items classified as available for sale are recognized in *Other comprehensive income*. Upon disposal or due to impairment of a non-monetary item classified as available for sale, the deferred translation gains or losses are reclassified, in whole or in part, from *Accumulated other comprehensive income* to *Non-interest income* of the Consolidated Statement of Income.

In the consolidated financial statements, the assets and liabilities of all foreign operations are translated into the Bank's functional currency using the rates in effect on the Consolidated Balance Sheet date, whereas the revenues and expenses of such foreign operations are translated into the Bank's functional currency at the average exchange rates for the period. Any goodwill resulting from the acquisition of a foreign operation, which does not have the same functional currency as the parent company, and any fair value adjustments to the carrying amounts of assets and liabilities resulting from the acquisition, are treated as assets and liabilities of the foreign operation and translated using the rates in effect on the Consolidated Balance Sheet date. Gains and losses on translating the financial statements of foreign operations, along with related hedge and tax effects, are presented in *Other comprehensive income*. Upon disposal of a foreign operation, the deferred cumulative amount recognized in *Accumulated other comprehensive income* relating to that particular operation is reclassified to *Non-interest income* of the Consolidated Statement of Income.

Classification and Measurement of Financial Instruments

In accordance with the accounting framework for financial instruments, all financial assets and liabilities must be classified based on their characteristics, management's intention, or choice of category in certain circumstances. When initially recognized, all financial assets are classified as measured at fair value through profit or loss, held to maturity, available for sale, or loans and receivables, while financial liabilities are classified as measured at fair value through profit or loss or as financial liabilities at amortized cost. Debt securities that are not quoted in an active market can be classified as loans and receivables, and impairment is determined using the same model as for loans. Loans and receivables that the Bank intends to sell immediately or in the near term must be classified as at fair value through profit or loss, whereas loans and receivables for which the Bank may not recover substantially all of its initial investment, for reasons other than credit deterioration, must be classified as available for sale.

When they are initially recognized, all financial assets and liabilities, including derivative financial instruments, are recorded at fair value on the Consolidated Balance Sheet. In subsequent periods, they are measured at fair value, except for items that are classified in the following categories, which are measured at amortized cost using the effective interest rate method: financial assets held to maturity, loans and receivables, and financial liabilities at amortized cost.

Under the fair value option, a financial asset or liability may be irrevocably designated at fair value through profit or loss when it is initially recognized. Financial instruments thus designated are accounted for under the fair value option, and any change in fair value is recorded in *Non-interest income* in the Consolidated Statement of Income. Interest income and expenses resulting from these financial instruments are recorded in *Net interest income* in the Consolidated Statement of Income. The Bank may use the option in the following cases:

– If, consistent with a documented risk management strategy, using this option allows the Bank to eliminate or significantly reduce the measurement or recognition disparity of measuring financial assets or liabilities on a different basis, and if the fair values are reliable; or
– If a group of financial assets and financial liabilities to which an instrument belongs is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information is provided on that basis to senior management. Consequently, the Bank may use the fair value option if it has implemented a documented risk management strategy to manage the group of financial instruments together on the fair value basis, if it can demonstrate that significant financial risks are eliminated or significantly reduced, and if the fair values are reliable; or
– For hybrid financial instruments with one or more embedded derivatives that would significantly modify the cash flows of the financial instruments and that would otherwise be bifurcated and accounted for separately.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Establishing Fair Value

The fair value of a financial instrument is the amount of consideration for which the financial instrument would be exchanged in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration received or paid. It is not always possible to obtain the fair value of over-the-counter (OTC) transactions or transactions executed on illiquid or inactive markets. If the market for a financial instrument is not active, the Bank establishes fair value using a valuation technique that primarily makes use of observable market inputs. Such valuation techniques include using available information following recent market transactions, reference to the current fair value of a comparable financial instrument, discounted cash flow analysis, option pricing models, and all other valuation techniques commonly used by market participants where it has been demonstrated that the technique provides reliable estimates.

In cases where fair value is established using valuation models, the Bank makes assumptions about the amount, the timing of estimated future cash flows and the discount rates used. These assumptions are based primarily on observable market inputs such as interest rate yield curves, foreign exchange rates, credit curves as well as price and rate volatility factors. When one or more significant inputs are not observable in the markets, fair value is established primarily on the basis of internal estimates and data that consider the valuation policies in effect at the Bank, the economic environment, the specific characteristics of the financial asset or liability and other relevant factors.

Reclassification of Financial Instruments

A financial asset, other than a derivative financial instrument or a financial asset that, upon initial recognition, was designated as measured at fair value through profit or loss, may be reclassified out of the fair value through profit or loss category in rare circumstances if the financial asset is no longer held for the purpose of selling it in the near term. The financial asset must be reclassified at its fair value on the date of reclassification, and this fair value becomes its new amortized cost, as applicable. No gain or loss previously recognized in the Consolidated Statement of Income may be reversed.

Cash and Deposits With Financial Institutions

Cash and deposits with financial institutions consist of cash and cash equivalents, amounts pledged as collateral as well as amounts placed in escrow. Cash comprises cash, bank notes and coin. Cash equivalents consist of deposits with the Bank of Canada, deposits with financial institutions, including net receivables related to cheques and other items in the clearing process, as well as the net amount of cheques and other items in transit.

Securities at Fair Value Through Profit or Loss

Securities at fair value through profit or loss are generally purchased for sale in the near term or are part of portfolios of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. The Bank accounts for transactions in securities at fair value through profit or loss on the settlement date on the Consolidated Balance Sheet. Changes in fair value between the trade date and the settlement date are included in *Non-interest income* in the Consolidated Statement of Income.

Securities at fair value through profit or loss are recognized at fair value, and the transaction fees are recognized directly in the Consolidated Statement of Income. Realized and unrealized gains and losses on such securities are recorded in *Non-interest income* in the Consolidated Statement of Income. Dividend and interest income are recorded in *Interest income* in the Consolidated Statement of Income.

Available-for-Sale Securities

Securities that are neither classified as at fair value through profit or loss nor as held to maturity nor in the loans and receivables category are classified as available-for-sale securities. The Bank accounts for available-for-sale securities transactions on the trade date, and the related transaction costs are capitalized.

Available-for-sale securities are recognized at fair value. Unrealized gains and losses are recognized, net of income taxes, provided they are not hedged by derivative financial instruments in a fair value hedging relationship, in *Other comprehensive income*. When the securities are sold, the realized gains or losses, determined on an average cost basis, are reclassified to *Non-interest income* in the Consolidated Statement of Income on the transaction date.

The amortization of premiums and discounts, calculated using the effective interest rate method, as well as dividend and interest income, are recognized in *Interest income* in the Consolidated Statement of Income.

Held-to-Maturity Securities
Securities classified as held to maturity are financial assets with fixed or determinable payments and fixed maturities that the Bank intends and is able to hold to the specified maturity. These securities are recognized at amortized cost using the effective interest rate method less impairment losses.

Securities Purchased Under Reverse Repurchase Agreements, Obligations Related to Securities Sold Under Repurchase Agreements and Securities Borrowed and Loaned
Securities sold under repurchase agreements remain on the Consolidated Balance Sheet, whereas securities purchased under reverse repurchase agreements are not recognized. Reverse repurchase agreements and repurchase agreements are treated as collateralized lending and borrowing transactions, which the Bank recognizes on the settlement date at amortized cost using the effective interest rate method.

The Bank also borrows and lends securities. Securities loaned remain on the Consolidated Balance Sheet while securities borrowed are not recognized. As part of these transactions, the Bank pledges or receives collateral in the form of cash or securities. Collateral pledged in the form of securities remain on the Consolidated Balance Sheet. Collateral received in the form of securities are not recognized on the Consolidated Balance Sheet. Collateral pledged or received in the form of cash is recognized in financial assets or liabilities on the Consolidated Balance Sheet.

When the collateral is pledged or received in the form of cash, the interest income and expense are recorded in *Net interest income* in the Consolidated Statement of Income.

Loans
Loans, including transaction costs directly attributable to the granting of the loans, other than loans classified or designated as measured at fair value through profit or loss, are presented on the Consolidated Balance Sheet at amortized cost using the effective interest rate method. Loans classified or designated as measured at fair value through profit or loss are recognized at fair value.

Impairment of Financial Assets
At the end of each reporting period, the Bank determines whether there is objective evidence of impairment of a financial asset or group of financial assets. There is objective evidence of impairment when one or more loss events occur after the initial recognition of the asset and prior to or on the balance sheet date and these events adversely affect the estimated future cash flows of the financial assets in question. Management must use judgment to determine whether events or circumstances constitute objective evidence of impairment and to estimate the timing of future cash flows.

<u>Available-for-sale securities</u>
Available-for-sale securities are assessed at the end of each reporting period to determine whether there is objective evidence of impairment. For debt securities, the Bank considers all loss events, particularly: a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganization. In the case of equity securities, the Bank considers all available objective evidence of impairment, including observable data or information about events relating specifically to the securities in question. A significant or prolonged decline in the fair value below its cost is also objective evidence of impairment.

If there is objective evidence of impairment, any amount previously recognized in *Accumulated other comprehensive income* is reclassified to *Non-interest income* in the Consolidated Statement of Income. This amount is determined as the difference between the acquisition cost (net of any capital repayments and amortization) and the current fair value of the asset less any impairment loss on that investment previously recognized in the Consolidated Statement of Income.

Once an impairment loss has been recognized for an available-for-sale security, the subsequent accounting treatment depends on whether the instrument is a debt or equity security:

- for an available-for-sale debt security, a subsequent decline in fair value will be accounted for in *Non-interest income* in the Consolidated Statement of Income when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the debt security. Impairment losses recognized in income relating to an available-for-sale debt security must be reversed in income when, in a subsequent period, the fair value of the security increases and the increase can be objectively associated with an event occurring after the loss was recognized; and
- for an available-for-sale equity security, subsequent decreases in fair value are accounted for in the Consolidated Statement of Income. Impairment losses recognized are not reversed through the Consolidated Statement of Income. All subsequent increases in fair value will be accounted for in *Other comprehensive income* in the Consolidated Statement of Comprehensive Income.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Impaired loans
A loan, except credit card receivables, is considered impaired if there is objective evidence of impairment and, in management's best estimate, the timely collection of principal and interest is no longer reasonably assured, or when a payment is contractually 90 days past due, unless the loan is fully secured and collection efforts are reasonably expected to result in repayment of the debt within 180 days. For credit card receivables, they are written off when payment is 180 days in arrears. Loans that are insured or fully guaranteed by a Canadian government (federal or provincial) or by a Canadian government agency are considered impaired when they are more than 365 days in arrears.

When a counterparty to a loan fails to make the payment when contractually due, that loan is considered past due but not impaired.

When a loan is deemed impaired, interest recognition ceases and the carrying amount of the loan is reduced to its estimated realizable amount by writing off all or part of the loan or by taking an allowance for credit losses. The impairment loss is calculated by comparing the present value of expected future cash flows, discounted at the initial effective interest rate of the loan, to its current carrying amount including accrued interest. The losses are recorded in *Provisions for credit losses* in the Consolidated Statement of Income.

A loan is returned to performing status when the timely collection of future interest and principal is reasonably assured and when all principal and interest payments in arrears have been collected.

A loan and its related allowance for credit losses is normally written off in whole or in part when the Bank considers the probability of recovery to be non-existent and when all guarantees and other remedies available to the Bank have been exhausted or if the borrower is bankrupt, winding up and balances owing are not likely to be recovered.

Allowances for credit losses
Allowances for credit losses are management's best estimate of losses in its credit portfolio as at the balance sheet date. These allowances are primarily related to loans but may also cover the credit risk associated with deposits with financial institutions, loan substitute securities, credit instruments such as acceptances, and off-balance-sheet items such as commitments to extend credit, letters of guarantee and letters of credit.

Changes in allowances for credit losses attributable to the passage of time are recorded in *Interest income* in the Consolidated Statement of Income, whereas changes attributable to a revision of expected payments are recorded in *Provisions for credit losses* in the Consolidated Statement of Income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the allowances were recognized, the previously recognized impairment loss is reversed directly in *Provisions for credit losses* in the Consolidated Statement of Income.

The allowances for credit losses on impaired loans are calculated on a loan-by-loan basis and assessed either individually or collectively based on the portfolio's historical net loss experience. The allowance for credit losses on non-impaired loans is assessed collectively.

Individual allowances on impaired loans
An individual allowance on impaired loans is recognized following a detailed analysis of a borrower's file. This type of allowance relates primarily to business and government loan portfolios. These portfolios include loans to businesses (other than certain small businesses that are classified in the personal credit portfolios) as well as loans to governments and financial institutions. As for personal loan portfolios, the Bank recognizes individual allowances for residential mortgages and certain other loans. The credit risk for these loans is assessed individually and on an ongoing basis.

Collective allowances on impaired loans
Most personal loan portfolios—other than residential mortgages—which include consumer loans and loans to certain small businesses, are portfolios of loans made up of many homogeneous balances that are managed together, for which a collective allowance is established on a loan-by-loan basis in accordance with historical net loss experience.

Collective allowance on non-impaired loans
The collective allowance on non-impaired loans includes two components for credit risk: the allocated collective allowance and the unallocated collective allowance. The collective allowance reflects management's best estimate of probable losses in the portion of the credit portfolio that has not yet been specifically identified as impaired.

The allocated collective allowance for the business and government loan portfolio is based on the application of expected default and loss factors, determined by statistical loss migration analysis, delineated by loan type, to which is added an amount that takes into account the discovery period and migration risk. For personal loans, the allocated collective allowance is calculated based on specific parameters by product and no discovery period is calculated. Losses are determined by the application of loss ratios established through statistical analysis of loss migration over an economic cycle.

The unallocated collective allowance reflects management's assessment of probable losses in the portfolio that have not been captured by the allocated collective allowance. This assessment takes into account general economic and business conditions, recent credit loss data, and credit quality and concentration trends when the collective allowance is determined at the Consolidated Balance Sheet date. This allowance also reflects model and estimation risks. The unallocated collective allowance does not represent future losses or serve as a substitute for the allocated collective allowance.

Derecognition of Financial Assets and Securitization

A financial asset is considered for derecognition when the Bank has transferred contractual rights to receive the cash flows or assumed an obligation to transfer these cash flows to a third party. The Bank derecognizes a financial asset when it considers that substantially all of the risks and rewards of the asset have been transferred or when the contractual rights to the cash flows of the financial asset expire. When the Bank considers that it has retained substantially all of the risks and rewards of the transferred asset, it continues to recognize the financial asset and if applicable recognizes a financial liability on the Consolidated Balance Sheet. If, due to a derivative financial instrument, the transfer of a financial asset does not result in derecognition, the derivative financial instrument is not recognized on the Consolidated Balance Sheet.

When the Bank has neither transferred nor retained substantially all the risks and rewards related to a financial asset, it derecognizes the financial asset it no longer controls. Any rights and obligations retained following the asset transfer are recognized separately as an asset or liability. If the Bank retains control of the financial asset, it continues to recognize the asset to the extent of its continuing involvement in that asset, i.e., to the extent to which it is exposed to changes in the value of the transferred asset.

In order to diversify its funding sources, the Bank participates primarily in two Canada Mortgage and Housing Corporation (CMHC) securitization programs: the Mortgage-Backed Securities Program under the *National Housing Act* (Canada) (NHA) and Canada Mortgage Bond (CMB) program. Under the first program, the Bank issues NHA securities backed by insured residential mortgages and, under the second, the Bank sells NHA securities to Canada Housing Trust (CHT). As part of these transactions, the Bank retains substantially all of the risks and rewards related to ownership of the mortgage loans sold. Therefore, the insured mortgage loans securitized under the CMB program continue to be recognized in the *Loans* item on the Bank's Consolidated Balance Sheet and the liabilities for the considerations received from the transfer are recognized in *Liabilities related to transferred receivables* on the Consolidated Balance Sheet. Moreover, insured mortgage loans securitized and retained by the Bank continue to be recognized in *Loans* on the Consolidated Balance Sheet.

Derecognition of Financial Liabilities

A financial liability is derecognized when the obligation is discharged, cancelled or expires. The difference between the carrying value of the financial liability transferred and the consideration paid is recognized in the Consolidated Statement of Income.

Acceptances and Customers' Liability Under Acceptances

The potential liability of the Bank under acceptances is recorded as a liability on the Consolidated Balance Sheet. The Bank's potential recourse vis à vis clients is recorded as an equivalent offsetting asset. Fees are recorded in *Non-interest income* in the Consolidated Statement of Income.

Obligations Related to Securities Sold Short

This financial liability represents the Bank's obligation to deliver the securities it sold but did not own at the time of sale. Obligations related to securities sold short are recorded at fair value and presented as liabilities on the Consolidated Balance Sheet. Realized and unrealized gains and losses are recognized in *Non-interest income* in the Consolidated Statement of Income.

Derivative Financial Instruments

In the normal course of business, the Bank uses derivative financial instruments to meet the needs of its clients, enable it to generate income from its trading activities, and manage its exposure to interest rate risk, foreign exchange risk, credit risk and other market risks.

All derivative financial instruments are recorded at fair value on the Consolidated Balance Sheet. Derivative financial instruments with a positive fair value are included in assets, and derivative financial instruments with a negative fair value are included in liabilities on the Consolidated Balance Sheet. In accordance with the policy for offsetting financial assets and financial liabilities, the net fair value of certain derivative financial assets and liabilities are reported on the Consolidated Balance Sheet, as appropriate.

<u>Embedded derivative financial instruments</u>

An embedded derivative financial instrument is a component of a financial instrument or another contract, the characteristics of which are similar to those of a derivative product. Taken together, the financial instrument or contract is considered to be a hybrid instrument comprising a host contract and an embedded derivative financial instrument.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Embedded derivatives are bifurcated and accounted for separately if, and only if, the following three conditions are met: the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, the embedded derivative is a separate instrument that meets the definition of a derivative financial instrument, and the hybrid contract is not recorded at fair value.

An embedded derivative financial instrument is classified with the host contract on the Consolidated Balance Sheet and measured at its fair value. Realized and unrealized gains and losses are recognized in *Non-interest income* in the Consolidated Statement of Income.

Held-for-trading derivative financial instruments
Derivative financial instruments are recognized at fair value, and the realized and unrealized gains and losses (including interest income and expense) are recorded in *Non-interest income* in the Consolidated Statement of Income. Interest income and expense related to derivative financial instruments that are managed with financial instruments designated at fair value through profit and loss are recorded in *Net interest income* in the Consolidated Statement of Income.

Derivative financial instruments designated as hedging instruments
Policy
The purpose of a hedging transaction is to modify the Bank's exposure to one or more risks by creating an offset between changes in the fair value of, or the cash flows attributable to, the hedged item and the hedging instrument. Hedge accounting ensures that offsetting gains, losses, revenues and expenses are recognized in the Consolidated Statement of Income in the same period or periods.

Documenting and assessing effectiveness
The Bank designates and formally documents each hedging relationship, at its inception, by detailing the risk management objective and the hedging strategy. The documentation identifies the specific asset, liability or cash flows being hedged, the related hedging instrument, the nature of the specific risk exposure or exposures being hedged, the intended term of the hedging relationship and the method for assessing the effectiveness or ineffectiveness of the hedging relationship. At the inception of the hedging relationship, and for every financial reporting period for which the hedge has been designated, the Bank ensures that the hedging relationship is highly effective and consistent with its originally documented risk management objective and strategy. When a hedging relationship meets the hedge accounting requirements, it is designated as either a fair value hedge, a cash flow hedge or a foreign exchange hedge of a net investment in a foreign operation.

Fair value hedge
In a fair value hedge, the Bank mainly uses interest rate swaps to hedge changes in the fair value of a hedged item. The carrying amount of the hedged item is adjusted based on the effective portion of the gains or losses attributable to the hedged risk, which are recognized in the Consolidated Statement of Income, and on the change in the fair value of the hedging instrument. The resulting ineffective portion is included in *Non-interest income* in the Consolidated Statement of Income.

The Bank prospectively discontinues hedge accounting if the hedging instrument is sold or expires or if the hedging relationship no longer qualifies for hedge accounting or if the Bank revokes the designation. When the designation is revoked, the hedged item is no longer adjusted to reflect changes in fair value, and the amounts previously recorded as cumulative adjustments with respect to the effective portion of gains and losses attributable to the hedged risk are amortized using the effective interest rate method and recognized in the Consolidated Statement of Income over the remaining useful life of the hedged item. If the hedged item is sold or terminated before maturity, the cumulative adjustments to the effective portion of gains and losses attributable to the hedged risk are immediately recorded in the Consolidated Statement of Income.

Cash flow hedge
In a cash flow hedge, the Bank mainly uses interest rate swaps and total return swaps to hedge variable cash flows attributable to the hedged risk related to a financial asset or liability (or to a group of financial assets or liabilities). The effective portion of changes in fair value of the hedging instrument is recognized in *Accumulated other comprehensive income* and the ineffective portion in *Non-interest income* in the Consolidated Statement of Income.

The amounts previously recorded in *Accumulated other comprehensive income* are reclassified to the Consolidated Statement of Income of the period or periods during which the cash flows of the hedged item affect the Consolidated Statement of Income. If the hedging instrument is sold or expires or if the hedging relationship no longer qualifies for hedge accounting or if the Bank cancels that designation, then the amounts previously recognized in *Accumulated other comprehensive income* are reclassified to the Consolidated Statement of Income in the period or periods during which the cash flows of the hedged item affect the Consolidated Statement of Income.

Hedge of a net investment in a foreign operation
Derivative and non-derivative financial instruments are used to hedge foreign exchange risk related to investments made in foreign operations whose functional currency is not the Canadian dollar. The effective portion of the gains and losses on the hedging instrument is recognized in *Other comprehensive income* and the ineffective portion in *Non-interest income* in the Consolidated Statement of Income. Upon the total or partial sale of a net investment in a foreign operation, amounts reported in *Accumulated other comprehensive income* are reclassified, in whole or in part, to *Non-interest income* in the Consolidated Statement of Income.

Offsetting of Financial Assets and Liabilities

Financial assets and liabilities are offset and the net amount is presented on the Consolidated Balance Sheet when the Bank has a legally enforceable right to set off the recognized amounts and intends to settle on a net basis or to realize the asset and settle the liability simultaneously.

Premises and Equipment

Premises and equipment, except for land, are recognized at cost less accumulated amortization and accumulated impairment losses. Land is recorded at cost net of any impairment losses.

Premises and equipment and the significant components of a building that have different useful lives or that provide economic benefits at a different pace are systematically amortized over their useful lives. Amortization methods and useful lives are reviewed on an annual basis. The amortization expense is recorded in *Non-interest expenses* in the Consolidated Statement of Income.

	Methods	Useful life
Significant components of a building		
Exterior design	Straight-line	20 years
Interior design, roofing and electromechanical system	Straight-line	30 years
Structure	Straight-line	75 years
Other buildings	5% declining balance	
Equipment and furniture	Straight-line	8 years
Computer equipment	Straight-line	3-4 years
Leasehold improvements	Straight-line	(1)
Computer equipment leased under a finance lease	Straight-line	(1)

(1) Amortization period is the lesser of the useful life or the lease term plus the first renewal option.

Goodwill

The Bank uses the acquisition method to account for business combinations. The consideration transferred in a business combination is measured at the acquisition-date fair value and the transaction costs related to the acquisition are expensed as incurred. When the Bank acquires control of a business, all of the identifiable assets and liabilities of the acquiree, including intangible assets, are recorded at fair value. The interests previously held in the acquiree are also measured at fair value. Goodwill represents the excess of the purchase consideration and all previously held interests over the fair value of identifiable net assets of the acquiree. If the fair value of identifiable net assets exceeds the purchase consideration and all previously held interests, the difference is immediately recognized as a gain on a bargain purchase.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Bank's ownership interest and can be initially measured at either fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The measurement basis is selected on a case-by-case basis. Following the acquisition, non-controlling interests consist of the value assigned to those interests at initial recognition plus the non-controlling interests' share of changes in equity since the date of the combination.

Intangible Assets

Intangible assets with finite useful lives

Software, internally-designed technological developments and certain other intangible assets are recognized at cost net of accumulated amortization and accumulated impairment losses. These intangible assets are systematically amortized on a straight-line basis over their useful lives, which vary between four and ten years. The amortization expense is recorded in *Non-interest expenses* in the Consolidated Statement of Income.

Intangible assets with indefinite useful lives

The Bank's intangible assets with indefinite useful lives come from the acquisition of subsidiaries or groups of assets and consist of management contracts and trademarks. They are recognized at the acquisition-date fair value. At the end of each financial reporting period, the Bank reviews the useful lives to determine whether events and circumstances continue to support an indefinite useful life assessment.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Impairment of Non-Financial Assets

Premises and equipment and intangible assets with finite useful lives are tested for impairment when events or changes in circumstances indicate that their carrying value may not be recoverable. At the end of each reporting period, the Bank determines whether there is an indication that premises and equipment or intangible assets with finite useful lives may be impaired. Goodwill and intangible assets that are not yet available for use or that have indefinite useful lives are tested for impairment annually or more frequently if there is an indication that the asset might be impaired.

An asset is tested for impairment by comparing its carrying amount with its recoverable amount. The recoverable amount must be estimated for the individual asset. Where it is not possible to estimate the recoverable amount of an individual asset, the recoverable amount of the cash-generating unit (CGU) to which the asset belongs will be determined. A CGU is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Bank uses judgment to identify CGUs.

An asset's recoverable amount is the higher of fair value less costs to sell and the value in use of the asset or CGU. Value in use is the present value of expected future cash flows from the asset or CGU. The recoverable amount of the CGU is determined using valuation models that consider various factors such as projected future cash flows, discount rates and growth rates. The use of different estimates and assumptions in applying the impairment tests could have a significant impact on income.

Corporate assets, such as the head office building and computer equipment, do not generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Therefore, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset. However, if there is an indication that a corporate asset may be impaired, the recoverable amount is determined for the CGU or group of CGUs to which the corporate asset belongs, and is compared with the carrying amount of this CGU or group of CGUs.

Goodwill is always tested for impairment at the level of a CGU or groups of CGUs. For impairment testing purposes, from the acquisition date, goodwill resulting from a business combination must be allocated to the CGU or group of CGUs expected to benefit from the synergies of the business combination. Each CGU or group of CGUs to which goodwill is allocated must represent the lowest level for which the goodwill is monitored internally at the Bank and must not be larger than an operating segment. The allocation of goodwill to a CGU or group of CGUs involves management's judgment. If an impairment loss is to be recognized, the Bank does so by first reducing the carrying amount of goodwill allocated to the CGU or group of CGUs and then reducing the carrying amounts of the other assets of the CGU or group of CGUs in proportion to the carrying amount of each asset in the CGU or group of CGUs.

If the recoverable amount of an asset or a CGU is less than its carrying amount, the carrying amount is reduced to its recoverable amount and an impairment loss is recognized in *Non-interest expenses* in the Consolidated Statement of Income. An impairment loss recognized in prior periods for an asset other than goodwill must be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment was recognized. If this is the case, the carrying amount of the asset is increased, as the impairment loss was reversed, but shall not exceed the carrying amount that would have been determined, net of amortization, had no impairment loss been recognized for this asset in previous years.

Provisions

Provisions are liabilities of uncertain timing and amount. A provision is recognized when the Bank has a present obligation (legal or constructive) arising from a past event, when it is probable that an outflow of economic resources will be required to settle the obligation and when the amount of the obligation can be reliably estimated. Provisions are based on the Bank's best estimates of the economic resources required to settle the present obligation, given all relevant risks and uncertainties, and, when it is significant, the effect of the time value of money. The provisions are reviewed at the end of each financial reporting period and changes in the estimates are reflected in the Consolidated Statement of Income of the revaluation period. Provisions are presented in *Other liabilities* on the Consolidated Balance Sheet.

Revenue Recognition

Interest income and expense

Interest income and expense are recognized in the Consolidated Statement of Income for financial instruments measured at amortized cost using the effective interest rate method. The effective interest rate is the rate that discounts estimated future cash inflows and outflows through the expected life of the financial instrument (or, when appropriate, a shorter period) to the net carrying amount of the instrument. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but without considering future credit losses and also includes all fees paid or received related to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Commission revenues

Loan origination fees, including commitment, restructuring and renegotiation fees, are considered an integral part of the yield earned on the loan. They are deferred and amortized using the effective interest rate method, and the amortization is recognized in *Interest income* over the term of the loan. Direct costs for originating a loan are netted against the loan origination fees. If it is likely that a commitment will result in a loan, commitment fees receive the same accounting treatment, i.e., they are deferred and amortized using the effective interest rate method and the amortization is recognized in *Interest income* over the term of the loan. Otherwise, they are recorded in *Non-interest income* over the term of the commitment.

Loan syndication fees are recorded in *Non-interest income* unless the yield on the loan retained by the Bank is less than that of other comparable lenders involved in the financing. In such cases, an appropriate portion of the fees is deferred and amortized using the effective interest rate method, and the amortization is recognized in *Interest income* over the term of the loan. Certain mortgage loan prepayment fees are recognized as *Credit fees* in the Consolidated Statement of Income when earned.

Dividend income

Dividends from an equity instrument are recognized in the Consolidated Statement of Income when the Bank's right to receive payment is established.

Insurance revenues

Insurance contracts, including reinsurance contracts, are arrangements under which one party accepts significant insurance risk by agreeing to compensate the policyholder if a specified uncertain future event were to occur. Gross premiums, net of premiums transferred under reinsurance contracts, are recognized when they become due. Royalties received from reinsurers are recognized when earned. Claims are recognized when received and an amount is estimated as they are being processed. All of these amounts are recognized in *Non-interest income* in the Consolidated Statement of Income.

Upon recognition of a premium, a reinsurance asset and insurance liability are recognized, respectively, in *Other assets* and in *Other liabilities* on the Consolidated Balance Sheet. Subsequent changes in the carrying value of the reinsurance asset and insurance liability are recognized in *Non-interest income* in the Consolidated Statement of Income.

Revenues from trust services and mutual funds

Revenues from trust services and mutual funds are recognized in the Consolidated Statement of Income as they are earned.

Income Taxes

Income taxes include current taxes and deferred taxes and are recorded in net income except for income taxes generated by items recognized in *Other comprehensive income* or directly in equity.

Current tax is the amount of income tax payable on the taxable income for a period. It is calculated using the enacted or substantively enacted tax rates prevailing on the reporting date, and any adjustments recognized in the period for current tax of prior periods. Current tax assets and liabilities are offset and the net balance is presented on the Consolidated Balance Sheet when the Bank has a legally enforceable right to set off the recognized amounts and intends to settle on a net basis or to simultaneously realize the asset and settle the liability.

Deferred tax is established based on temporary differences between the carrying values and the tax bases of assets and liabilities, in accordance with enacted or substantively enacted income tax laws and rates that will apply on the date the differences will reverse. Deferred tax is not recognized for temporary differences related to:

– the initial accounting of goodwill;
– the initial accounting of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting income nor taxable income;
– investments in subsidiaries, associates and joint ventures when it is probable that the temporary difference will not reverse in the foreseeable future and that the Bank controls the timing of the reversal of the temporary difference; and
– investments in subsidiaries, associates and joint ventures when it is probable that the temporary difference will not reverse in the foreseeable future and that there will not be taxable income to which the temporary difference can be recognized.

Deferred tax assets represent the tax benefits related to deductions the Bank may claim to reduce its taxable income in future years. The carrying amount of deferred tax assets is revised at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow the benefit of the deferred tax asset.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Deferred tax assets and liabilities are offset and the net balance is presented on the Consolidated Balance Sheet when the Bank has a legally enforceable right to set off the current tax assets and liabilities, and if the deferred tax assets and liabilities relate to taxes levied by the same taxation authority on the same taxable entity, or on different taxable entities that intend to settle current tax assets and liabilities based on their net amount.

The Bank makes assumptions to estimate income taxes as well as deferred tax assets and liabilities. This process includes estimating the actual amount of current taxes and evaluating tax loss carry forwards and temporary differences arising from differences between the values of the items reported for accounting and for income tax purposes. Deferred tax assets and liabilities presented on the Consolidated Balance Sheet are calculated according to the tax rates to be applied in future periods. Previously recorded deferred tax assets and liabilities must be adjusted when the date of the future event is revised based on current information. In the Bank's opinion, based on the information at its disposal, it is probable that all deferred tax assets will be realized prior to their expiration.

Moreover, the Bank is subject to the jurisdiction of various tax authorities. In the normal course of its business, the Bank is involved in a number of transactions for which the tax impacts are uncertain. As a result, the Bank accounts for provisions for uncertain tax positions that adequately represent the tax risk stemming from tax matters under discussion or being audited by tax authorities or from other matters involving uncertainty. The amounts of these provisions reflect the best possible estimates of the amounts that may have to be paid based on qualitative assessments of all relevant factors. The provisions are estimated at the end of each reporting period. However, it is possible that an adjustment to the provision needs to be recognized at a future date following an audit by the tax authorities. When the final assessment differs from the initially provisioned amounts, the difference will impact the income taxes of the period in which the assessment was made.

Financial Guarantee Contracts
A financial guarantee contract is a contract or indemnification agreement that could require the Bank to make specified payments (in cash, financial instruments, other assets, Bank shares, or provisions of services) to reimburse the beneficiary in the event of a loss resulting from a debtor defaulting on the original or amended terms of a debt instrument.

A liability is recorded to reflect the fair value of the obligation assumed at the inception of a guarantee. After initial recognition, the Bank must measure financial guarantee contracts at the higher of the estimated amount needed to settle the financial obligation under the guarantee or the amount initially recognized less, where applicable, the accumulated amortization that corresponds to revenue earned during the period.

Employee Benefits
The Bank offers defined benefit pension plans that cover substantially all salaried employees. These defined benefit plans are funded plans. The Bank also offers its employees certain post-retirement and post-employment benefits, compensated leave and termination benefits (non-pension employee benefits) that are generally not funded. These benefits include health care, life insurance and dental benefits. Employees eligible for post-retirement benefits are those who retire at certain retirement ages and who meet certain conditions related to years of plan participation. Employees eligible for post-employment benefits are those on long-term disability or maternity leave.

An actuarial valuation is performed periodically to determine the present value of plan obligations. The actuarial valuation of the accrued benefit obligations and of the accrued post-retirement benefit obligations is based on the projected benefit method prorated on services using management's assessment of the most likely assumptions regarding future salary levels, increases in health care and other costs, employee retirement age, mortality rates and other actuarial factors. The accrued benefit obligation is measured by using market rates as at the measurement date. The assumption regarding the discount rate is determined using an interest rate curve that represents the yield for high-quality corporate bonds with terms nearing those of the Bank's pension plan obligations. The expected return on plan assets is based on the fair value of the plan assets as at October 31 of each year.

Assets and liabilities related to pension plans and other plans are recognized and presented respectively in *Other assets* or *Other liabilities* on the Consolidated Balance Sheet and represent the present value of the accrued benefit obligation less the fair value of plan assets.

The expense for the defined benefit pension plans and other benefit plans is composed of the following items: the current period accrued benefit cost, the notional interest on the accrued benefit obligation, the expected return on plan assets based on fair value, and the amortization of past service costs if any. Past service costs arising from amendments to the plans are amortized on a straight-line basis over the average vesting period. Vested past service costs are immediately recognized in income.

Actuarial gains or losses arise from the difference between the actual and expected return on plan assets for a period, from experience adjustments on liabilities or from changes in the actuarial assumptions used to determine the accrued benefit obligation. Actuarial gains and losses are recognized in *Other comprehensive income* and will not be reclassified subsequently to net income; they are recognized in *Retained earnings*.

Share-Based Payments

The Bank has several share-based compensation plans: the Stock Option Plan, the Stock Appreciation Rights (SAR) Plan, the Deferred Stock Unit (DSU) Plan, the Restricted Stock Unit (RSU) Plan, the Performance Stock Unit (PSU) Plan, the Deferred Compensation Plan (DCP) of National Bank Financial and the Employee Share Ownership Plan.

Compensation expense is recognized over the service period required for employees to become fully entitled to the award. This period is generally the same as the vesting period, except where the required service period begins before the award date. Compensation expense related to awards granted to employees eligible to retire on the award date is immediately recognized on the award date. Compensation expense related to awards granted to employees who will become eligible to retire during the vesting period is recognized over the period from the award date to the date the employee becomes eligible to retire. For all of these plans, as of the first year of recognition, the expense includes cancellation and forfeiture estimates. These estimates are subsequently revised as necessary. The Bank uses derivative financial instruments to hedge the risks associated with some of these plans. The compensation expense for these plans, net of related hedges, is recognized in the Consolidated Statement of Income.

Under the Stock Option Plan, the Bank uses the fair value method to account for stock options awarded. The options vest at 25% per year, and each tranche is treated as though it was a separate award. The fair value of each of the tranches is measured on the award date using the Black-Scholes model and recognized as an increase to *Compensation and employee benefits* and *Contributed surplus*. When the options are exercised, the *Contributed surplus* amount is credited to *Equity – Common shares* on the Consolidated Balance Sheet. The proceeds received from the employees when these options are exercised are also credited to *Equity – Common shares* on the Consolidated Balance Sheet.

SARs are recorded at fair value when awarded and their fair value is remeasured at the end of each reporting period until they are exercised. The cost is recognized in *Compensation and employee benefits* in the Consolidated Statement of Income and in *Other liabilities* on the Consolidated Balance Sheet. The obligation that results from the change in fair value at each period is recognized in net income gradually over the vesting period, and periodically thereafter, until the SARs are exercised. When a SAR is exercised, the Bank makes a cash payment equal to the increase in the stock price since the date of the award.

The obligation that results from the award of a DSU, RSU, PSU and DCP unit is recognized in net income, and the corresponding amount is included in *Other liabilities* on the Consolidated Balance Sheet. For the DSU, RSU and DCP plans, the change in the obligation attributable to variations in the share price and dividends paid on common shares for these plans is recognized in *Compensation and employee benefits* in the Consolidated Statement of Income for the period in which the variations occur. On the redemption date, the Bank makes a cash payment equal to the value of the common shares on that date. For the PSU Plan, the change in the obligation attributable to changes in the stock price, adjusted upward or downward depending on the relative result of the performance criteria, and the change in the obligation attributable to dividends paid on the shares awarded under the plan, are recognized in *Compensation and employee benefits* in the Consolidated Statement of Income for the period in which the changes occur. On the redemption date, the Bank makes a cash payment equal to the value of the common shares on that date, adjusted upward or downward according to the performance criteria. This is based on the total shareholder return (TSR) achieved by the Bank compared to that of the S&P/TSX Banks Sub-index.

The Bank's contributions to the employee share ownership plan are expensed as incurred.

NOTE 2 – FUTURE ACCOUNTING POLICY CHANGES

The IASB has issued revisions and amendments to a number of standards, some of which may have an impact on the Bank. A summary of these standards and the effective dates applicable to the Bank are presented below. According to a notice issued by OSFI, the Bank may not early adopt these standards nor the amendments.

Effective Date – November 1, 2013

IFRS 7 – *Financial Instruments – Disclosures*
The amendments to IFRS 7 require disclosure about legally enforceable rights of set-off for financial instruments under master netting agreements or similar arrangements. Retrospective adoption of the disclosure amendments of this standard will have no impact on the Bank's financial position.

IFRS 10 – *Consolidated Financial Statements*
IFRS 10 replaces the consolidation guidance provided in IAS 27, *Consolidated and Separate Financial Statements* and SIC-12, *Consolidation – Special Purpose Entities* by introducing a single consolidation model based on control for all interests held in other entities. According to IFRS 10, control is based on the concept of power, exposure to variable returns and the ability to use the power to affect those returns.

For the Bank, IFRS 10 will come into effect on November 1, 2013 and will be applied retrospectively. Based on its most recent assessment, the Bank believes that adoption of this standard will have no significant impact on its consolidated financial statements, except that it will no longer consolidate NBC Capital Trust (for additional information, see Note 18). The main impact of the deconsolidation will be a reclassification on the Consolidated Balance Sheets as at October 31, 2013 and as at November 1, 2012. In particular, a $225 million amount currently reported in *Non-Controlling Interests* will be reclassified to *Deposits*. The Bank's earnings per share will not be affected.

IFRS 11 – *Joint Arrangements*
IFRS 11, *Joint Arrangements* replaces IAS 31, *Interests in Joint Ventures* and SIC-13, *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. Under IFRS 11, a joint arrangement must be classified as either a joint operation or a joint venture, depending on an assessment of the rights and obligations of the parties to the arrangement. IFRS 11 requires interests in joint ventures to be recognized using the equity method. Retrospective adoption of this standard is not expected to have a significant impact on the Bank's consolidated financial statements.

IFRS 12 – *Disclosure of Interests in Other Entities*
IFRS 12 applies to entities that hold interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. It requires additional disclosure that enables financial statement users to assess the nature of, and risks associated with, an entity's interests in other entities and the effects of those interests on the entity's financial position, financial performance and cash flows. Retrospective adoption of the disclosure amendments of this standard will have no impact on the Bank's financial position.

IFRS 13 – *Fair Value Measurement*
IFRS 13 defines fair value, sets out in a single standard a framework for measuring fair value and requires disclosures about fair value measurements. Prospective adoption of this standard is not expected to have a significant impact on the Bank's consolidated financial statements.

IAS 19 – *Employee Benefits*
In June 2011, the IASB issued an amended version of IAS 19, introducing significant changes to the recognition of employee benefits, primarily defined benefit pension plans. The main changes to the revised standard are as follows:

- The expected return on plan assets is no longer used in calculating the pension plan expense. The discount rate used to measure the accrued benefit obligation must also be used to measure the return on plan assets.
- Past-service costs are recognized when a plan is amended, with no deferral over the vesting period.
- The disclosure requirements call for additional disclosure about the characteristics of defined benefit plans and the risks to which entities are exposed by participating in those plans.
- The revised standard requires that all actuarial gains and losses be immediately recognized in *Other comprehensive income*. The recognition of actuarial gains and losses can no longer be deferred. This last amendment has no impact on the Bank since it already recognizes actuarial gains and losses in *Other comprehensive income*.

For the Bank, the amendments made to IAS 19 will come into effect on November 1, 2013 and will be applied retrospectively. The Bank believes that adopting the IAS 19 amendments will have no impact on the Consolidated Balance Sheet as at November 1, 2012. The expected and estimated impacts of the revised standard on the Bank's Consolidated Balance Sheet as at October 31, 2013 will be as follows: a $15 million increase in *Other asset*s, a $6 million decrease in *Other liabilities* and a $21 million increase in *Retained earnings*. For the year ended October 31, 2013, the expected and estimated impacts on income will be a $30 million decrease in *Net income* and a $51 million increase in *Other comprehensive income*, net of income taxes.

Effective Date – November 1, 2014

IAS 32 – *Financial Instruments: Presentation*
IAS 32 was amended to clarify the requirements for offsetting financial assets and financial liabilities in order to reduce inconsistencies in current practice.

Effective Date – Not yet specified

IFRS 9 – *Financial Instruments*
The purpose of IFRS 9 is to replace the current standard on financial instruments and constitutes a three-phase project: (1) Classification and measurement of financial assets and financial liabilities; (2) Impairment; and (3) Hedge accounting. In July 2013, the IASB decided to temporarily defer the mandatory effective date of IFRS 9 and to not specify that date until the requirements for financial instrument classification and measurement and financial asset impairment are finalized. The Bank is monitoring the progress of the IASB's work.

(millions of Canadian dollars)

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value and Carrying Value of Financial Instruments by Category

Financial assets and financial liabilities are recognized on the Consolidated Balance Sheet at fair value or at amortized cost in accordance with the categories set out in the accounting framework for financial instruments. The Bank did not classify any financial assets as held to maturity.

							As at October 31, 2013
	Carrying value and fair value			Carrying value	Fair value		
	Financial instruments classified as at fair value through profit or loss	Financial instruments designated at fair value through profit or loss	Available-for-sale	Loans and receivables and financial liabilities at amortized cost	Loans and receivables and financial liabilities at amortized cost	Total carrying value	Total fair value
FINANCIAL ASSETS							
Cash and deposits with financial institutions	–	–	–	3,596	3,596	3,596	3,596
Securities	40,778	3,222	9,744	–	–	53,744	53,744
Securities purchased under reverse repurchase agreements and securities borrowed	–	–	–	21,449	21,449	21,449	21,449
Loans and acceptances	1,526	62	–	95,750	96,323	97,338	97,911
Other							
Derivative financial instruments	5,904	–	–	–	–	5,904	5,904
Due from clients, dealers and brokers	–	–	–	1,101	1,101	1,101	1,101
Other assets	–	–	–	891	891	891	891
FINANCIAL LIABILITIES							
Deposits	–	1,846	–	100,040(1)	100,398	101,886	102,244
Other							
Acceptances	–	–	–	8,954	8,954	8,954	8,954
Obligations related to securities sold short	18,909	–	–	–	–	18,909	18,909
Obligations related to securities sold under repurchase agreements and securities loaned	–	–	–	19,746	19,746	19,746	19,746
Derivative financial instruments	4,858	–	–	–	–	4,858	4,858
Due to clients, dealers and brokers	–	–	–	2,442	2,442	2,442	2,442
Liabilities related to transferred receivables	–	6,819	–	8,504	8,593	15,323	15,412
Other liabilities	109	–	–	2,341	2,341	2,450	2,450
Subordinated debt	–	–	–	2,426	2,450	2,426	2,450

(1) Including embedded derivative financial instruments.

(millions of Canadian dollars)

As at October 31, 2012

	Carrying value and fair value			Carrying value	Fair value		
	Financial instruments classified as at fair value through profit or loss	Financial instruments designated at fair value through profit or loss	Available-for-sale	Loans and receivables and financial liabilities at amortized cost	Loans and receivables and financial liabilities at amortized cost	Total carrying value	Total fair value
FINANCIAL ASSETS							
Cash and deposits with financial institutions	–	–	–	3,249	3,249	3,249	3,249
Securities	39,072	5,452	10,374	–	–	54,898	54,898
Securities purchased under reverse repurchase agreements and securities borrowed	–	54	–	15,475	15,475	15,529	15,529
Loans and acceptances	1,017	39	–	89,866[1]	90,483	90,922	91,539
Other							
Derivative financial instruments	6,696	–	–	–	–	6,696	6,696
Due from clients, dealers and brokers	–	–	–	1,661	1,661	1,661	1,661
Other assets	–	–	–	490	490	490	490
FINANCIAL LIABILITIES							
Deposits	–	1,039	–	92,210[1]	93,064	93,249	94,103
Other							
Acceptances	–	–	–	8,250	8,250	8,250	8,250
Obligations related to securities sold short	18,124	–	–	–	–	18,124	18,124
Obligations related to securities sold under repurchase agreements and securities loaned	–	–	–	19,539	19,539	19,539	19,539
Derivative financial instruments	5,600	–	–	–	–	5,600	5,600
Due to clients, dealers and brokers	–	–	–	1,959	1,959	1,959	1,959
Liabilities related to transferred receivables	–	8,960	–	6,438	6,492	15,398	15,452
Other liabilities	110	–	–	2,451	2,451	2,561	2,561
Subordinated debt	–	–	–	2,470	2,479	2,470	2,479

(1) Including embedded derivative financial instruments.

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Establishing Fair Value

The Bank has policies governing the process for determining fair value. These policies are documented and periodically reviewed by the Risk Management Group. All valuation models are validated, and controls have been implemented to ensure that they are applied.

Judgment is required when applying a large number of acceptable valuation techniques and estimates to calculate fair value. The estimated fair value reflects market conditions on a given date and, consequently, may not be indicative of future fair value.

When a financial instrument is initially recognized, its fair value is the amount of consideration that would be paid for the financial instrument in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration received or paid. In certain circumstances, the initial fair value may be based on other observable current market transactions for the same instrument, without modification or repackaging, or based on a valuation technique whose variables include only observable market inputs. When the Bank uses a valuation technique based on observable market inputs to determine the initial fair value, or if the risks associated with the derivative contract are fully offset by other contracts entered into with third parties, the difference between the transaction price and the initially determined fair value is recognized in the Consolidated Statement of Income. In other cases, the difference between the fair value of the consideration received or paid and the amount determined using the valuation technique is deferred on the Consolidated Balance Sheet. The amount of the deferred gain or loss is recognized over the term of the financial instrument. The unamortized balance is immediately recognized in net income when (i) observable market inputs can be obtained and support the fair value of the transaction, (ii) the risks associated with the initial contract are substantially offset by other contracts entered into with third parties, (iii) the gain or loss is realized through a cash receipt or payment, or (iv) the transaction matures or is cancelled before maturity. As at October 31, 2013 and 2012, the deferred amounts were negligible.

When financial instruments are to be subsequently remeasured, quoted market prices in an active market provide the best indication of fair value, and when such prices are available, the Bank uses them to measure the financial instruments. A financial instrument is considered to be quoted in an active market when quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency and those prices reflect actual market transactions on an arm's length basis. The fair value of a financial asset traded in an active market generally reflects the bid price and, that of a financial liability traded in an active market, the ask price. If the market for a financial instrument is not active, the Bank establishes fair value using a valuation technique that primarily makes use of observable market inputs. Such valuation techniques include using available information concerning recent market transactions, reference to the current fair value of a comparable financial instrument, discounted cash flow analysis, option pricing models, and all other valuation techniques commonly used by market participants where it has been demonstrated that the technique provides reliable estimates.

In cases where fair value is established using valuation models, the Bank makes assumptions about the amount, the timing of estimated future cash flows and the discount rates used. These assumptions are based primarily on observable market inputs such as interest rate yield curves, foreign exchange rates, credit curves as well as price and rate volatility factors. When one or more significant inputs are not observable in the markets, fair value is established primarily on the basis of internal estimates and data that consider the valuation policies in effect at the Bank, the economic environment, the specific characteristics of the financial asset or liability and other relevant factors. In certain specific cases, the Bank makes adjustments to the fair value to account for system limitations or measurement uncertainty in determining fair value. The Bank applies judgment when considering factors that could be used by market participants but that are not included in the valuation model. These factors include, but are not limited to, the unobservable nature of inputs used in the valuation model, assumptions about risk such as market risk, credit risk, or risk related to the valuation model, and future administrative expenses. The Bank may also take market liquidity risk into account in determining the fair value of financial instruments when it believes that such instruments could be disposed of for a consideration below the fair value otherwise determined due to a lack of market liquidity or an insufficient volume of transactions in a given market.

<u>Valuation methods and assumptions</u>

Financial instruments whose fair value is equal to their carrying value

The carrying value of certain financial assets and liabilities is a reasonable approximation of fair value. The Bank considers that the carrying value of cash; deposits with financial institutions; securities purchased under reverse repurchase agreements and securities borrowed; securities sold under repurchase agreements and securities loaned; customers' liability under acceptances and acceptances; amounts due from and to clients, dealers and brokers; and certain items of other assets and other liabilities corresponds to their fair value.

Securities and obligations related to securities sold short
These financial instruments are presented at fair value on the Consolidated Balance Sheet. Their fair values are based on quoted prices in an active market or, where quoted market prices in an active market are not readily available, quoted market prices of securities that are substantially the same. If such prices are not available, fair value is determined by valuation techniques that incorporate assumptions based primarily on observable market inputs such as current market prices and the contractual prices of the underlying instruments, the time value of money, interest rate yield curves and currency rates.

When one or more significant inputs are not observable in the markets, fair value is established primarily on the basis of estimates and internally obtained data that consider the valuation policies in effect at the Bank, economic conditions, the specific characteristics of the financial asset or liability and other relevant factors.

Information about the fair value determination of the restructured notes of the MAV conduits, designated at fair value through profit and loss, is provided in Note 6.

Derivative financial instruments
The fair value of derivative financial instruments is based on quoted prices in an active market, where available. Otherwise, fair value is determined using valuation models that incorporate assumptions based primarily on inputs observed in external markets such as current market prices and the contractual prices of the underlying instruments, the time value of money, interest rate yield curves, credit curves, currency rates as well as price and rate volatility factors. When one or more significant inputs are not observable in the markets, fair value is established primarily on the basis of internal estimates and data that consider the valuation policies in effect at the Bank, economic conditions, the specific characteristics of the financial asset or liability and other relevant factors. In establishing the fair value of derivative financial instruments, the Bank incorporates credit risk, taking into consideration the financial capacity of the counterparties to the contracts, the measurement of the current or future market value of the transactions as well as credit risk mitigation measures such as master netting arrangements and collateral agreements. The Bank also incorporates its own credit risk.

Loans
The fair value of loans is determined as at the balance sheet date by discounting expected future contractual cash flows, adjusted for prepayment options using market interest rates currently offered for similar new financial instruments.

Deposits
The fair value of deposits is determined primarily as at the balance sheet date by discounting expected future contractual cash flows and using market interest rates currently offered for financial instruments with similar terms. For certain deposits, fair value is established using market prices for similar instruments. As for structured deposit notes, fair value is established using valuation models that maximize the use of observable inputs when available, such as benchmark indices.

Liabilities related to transferred receivables
These liabilities arise from two types of transactions: (1) the sale to Canada Housing Trust (CHT) of securities backed by insured residential mortgages and other securities under the Canada Mortgage Bond (CMB) program, and (2) the sale of insured residential mortgages to a mutual fund administered by the Bank. These transactions do not qualify for derecognition and are recorded as guaranteed borrowings, which results in the recording of liabilities on the Bank's Consolidated Balance Sheet. As part of the sale to CHT, the fair value of the liability at the balance sheet date is established using valuation techniques based on observable market inputs such as Canada Mortgage Bond prices. As for the sales to the mutual fund, the fair value of the liability is determined by discounting expected future contractual cash flows, adjusted for prepayment options, using market interest rates currently offered for similar new financial instruments.

Subordinated debt
The fair value of subordinated debt is based on quoted market prices in an active market. If such prices are not available, fair value is determined by discounting future contractual cash flows using market interest rates currently offered for similar financial instruments and that have the same term to maturity.

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Hierarchy of Fair Value Measurements

Financial instruments recorded at fair value on the Consolidated Balance Sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1: Valuation based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities. These instruments consist primarily of equity securities and derivative financial instruments traded in active markets and certain highly liquid debt securities actively traded in over-the-counter markets;
- Level 2: Valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market inputs by correlation or other means. These instruments consist primarily of derivative financial instruments that are traded in over-the-counter markets, certain investment grade debt securities, certain equity securities whose value is not directly observable in an active market and certain liabilities related to transferred receivables; and
- Level 3: Valuation techniques with significant unobservable market inputs. These instruments consist primarily of investments in restructured notes of the MAV conduits, certain investments in asset-backed securities, structured deposit notes and private equity securities.

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. The following tables present the financial instruments recorded at fair value on the Consolidated Balance Sheet on a recurring basis, classified using the fair value hierarchy described above. During fiscal years 2013 and 2012, there were no significant transfers of financial instruments between Levels 1 and 2.

The categories of financial instruments whose fair values are classified in Level 3 consist mainly of the following products:

- financial instruments measured at fair value through profit or loss: investments in the restructured notes of the MAV conduits (for additional information, see Note 6), certain investments in asset-backed debt securities, investments in hedge funds for which there are certain restrictions on unit or security redemptions, as well as certain derivative financial instruments whose fair value is established using internal valuation models that are based on significant unobservable market inputs;
- available-for-sale securities: investments in the restructured notes of the MAV conduits and private equity securities; and
- structured deposit notes classified in business and government deposits and whose fair value is established using internal valuation models that are based on significant unobservable market inputs.

The Bank performs sensitivity analyses for fair value measurements of financial instruments classified in Level 3, substituting the unobservable inputs with one or more reasonably plausible alternative assumptions. For the sensitivity analysis of investments in restructured notes of the MAV conduits, see Note 6. For private equity securities classified in *Available-for-sale securities*, the Bank varies significant unobservable market inputs, such as net asset value or projected future cash flows, and establishes a reasonable fair value range that could result in a $17 million increase or decrease in recorded fair value as at October 31, 2013 (an $18 million increase or decrease as at October 31, 2012). For other financial instruments classified in Level 3, sensitivity analyses result in a negligible change in fair value.

(millions of Canadian dollars)

The following tables present the financial instruments recorded at fair value on the Consolidated Balance Sheet.

				As at October 31, 2013
	Level 1	Level 2	Level 3	Total financial assets/ liabilities at fair value
Financial assets				
Securities				
At fair value through profit or loss				
Securities issued or guaranteed by:				
Canada	5,476	5,080	–	10,556
Provinces	–	10,654	–	10,654
Municipalities and school boards	–	367	–	367
U.S. Treasury and other U.S. agencies	689	–	–	689
Other debt securities	–	2,784	1,305	4,089
Equity securities	15,929	1,670	46	17,645
	22,094	20,555	1,351	44,000
Available-for-sale				
Securities issued or guaranteed by:				
Canada	143	5,517	–	5,660
Provinces	–	2,617	–	2,617
Municipalities and school boards	–	302	–	302
U.S. Treasury and other U.S. agencies	390	–	–	390
Other debt securities	–	253	77	330
Equity securities	209	65	171	445
	742	8,754	248	9,744
Securities purchased under reverse repurchase agreements and securities borrowed	–	–	–	–
Loans	–	1,588	–	1,588
Other				
Derivative financial instruments	239	5,609	56	5,904
	23,075	36,506	1,655	61,236
Financial liabilities				
Deposits				
Business and government	–	1,978	73	2,051
Other				
Obligations related to securities sold short	11,415	7,494	–	18,909
Derivative financial instruments	330	4,454	74	4,858
Liabilities related to transferred receivables	–	6,819	–	6,819
Other liabilities	–	109	–	109
	11,745	20,854	147	32,746

(millions of Canadian dollars)

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

			As at October 31, 2012	
	Level 1	Level 2	Level 3	Total financial assets/ liabilities at fair value
Financial assets				
Securities				
At fair value through profit or loss				
Securities issued or guaranteed by:				
Canada	7,343	7,417	–	14,760
Provinces	–	10,442	–	10,442
Municipalities and school boards	–	412	–	412
U.S. Treasury and other U.S. agencies	899	–	–	899
Other debt securities	–	2,226	1,276	3,502
Equity securities	13,482	977	50	14,509
	21,724	21,474	1,326	44,524
Available-for-sale				
Securities issued or guaranteed by:				
Canada	709	4,966	–	5,675
Provinces	–	2,908	–	2,908
Municipalities and school boards	–	294	–	294
U.S. Treasury and other U.S. agencies	341	–	–	341
Other debt securities	–	631	72	703
Equity securities	64	191	198	453
	1,114	8,990	270	10,374
Securities purchased under reverse repurchase agreements and securities borrowed	–	54	–	54
Loans	–	1,056	(3)	1,053
Other				
Derivative financial instruments	407	6,242	47	6,696
	23,245	37,816	1,640	62,701
Financial liabilities				
Deposits				
Business and government	–	1,090	73	1,163
Other				
Obligations related to securities sold short	10,300	7,824	–	18,124
Derivative financial instruments	171	5,346	83	5,600
Liabilities related to transferred receivables	–	8,960	–	8,960
Other liabilities	–	110	–	110
	10,471	23,330	156	33,957

(millions of Canadian dollars)

Changes in the Fair Value of Financial Instruments Classified in Level 3

The Bank classifies financial instruments in Level 3 when the valuation technique is based on at least one significant input that is not observable in the markets or due to a lack of liquidity in certain markets. The valuation technique may also be based, in part, on observable market inputs. The gains and losses presented hereafter may therefore comprise changes in fair value based on observable and unobservable inputs.

The Bank may hedge the fair value of financial instruments classified in the various existing levels through inverse hedge positions. Gains and losses for financial instruments classified in Level 3 presented in the following tables do not reflect the inverse gains and losses on financial instruments used for economic hedging purposes that may have been classified in Level 1 or 2 by the Bank. In addition, the Bank may hedge the fair value of financial instruments classified in Level 3 using other financial instruments classified in Level 3. The effect of these hedges is not included in the net amount presented in the following tables.

Year ended October 31					2013
	Securities at fair value through profit or loss	Available-for-sale securities	Loans	Derivative financial instruments[1]	Business and government deposits
Fair value as at October 31, 2012	1,326	270	(3)	(36)	(73)
Total realized and unrealized gains (losses) included in *Net income*[2]	181	8	–	6	(3)
Total realized and unrealized gains (losses) included in *Other comprehensive income*	–	13	–	–	–
Purchases	32	15	–	–	–
Sales	(39)	(43)	–	–	–
Issuances	–	–	–	2	(68)
Settlements and other	(149)	(15)	3	1	(1)
Financial instruments transferred to or from Level 3[3]	–	–	–	9	72
Fair value as at October 31, 2013	1,351	248	–	(18)	(73)
Change in unrealized gains and losses included in net income with respect to financial assets and financial liabilities held as at October 31, 2013[4]	181	–	–	6	(3)

Year ended October 31					2012
	Securities at fair value through profit or loss	Available-for-sale securities	Loans	Derivative financial instruments[1]	Business and government deposits
Fair value as at October 31, 2011	1,237	363	(10)	12	(13)
Total realized and unrealized gains (losses) included in *Net income*[5]	142	54	–	(15)	(15)
Total realized and unrealized gains (losses) included in *Other comprehensive income*	–	(58)	–	–	–
Purchases	19	4	–	–	–
Sales	(59)	(61)	–	–	–
Issuances	–	–	–	(26)	(58)
Settlements and other	(12)	(33)	7	–	–
Financial instruments transferred to or from Level 3[3]	(1)	1	–	(7)	13
Fair value as at October 31, 2012	1,326	270	(3)	(36)	(73)
Change in unrealized gains and losses included in net income with respect to financial assets and financial liabilities held as at October 31, 2012[6]	142	2	–	(15)	(15)

(1) Derivative financial instruments include assets and liabilities presented on a net basis.
(2) The total amount of net gains included in *Non-interest income* was $192 million.
(3) During the years ended October 31, 2013 and 2012, certain financial instruments were transferred to or from Level 3 due to changes in the availability of observable market inputs resulting from changing market conditions.
(4) Total unrealized gains included in *Non-interest income* was $184 million.
(5) The total amount of net gains included in *Non-interest income* was $166 million.
(6) Total unrealized gains included in *Non-interest income* was $114 million.

(millions of Canadian dollars)

NOTE 4 – FINANCIAL INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

The Bank chose to designate certain financial instruments at fair value through profit or loss according to criteria presented in Note 1. In accordance with its risk management strategy, which allows the Bank to eliminate or significantly reduce the measurement or recognition disparity resulting from measuring financial assets and liabilities on different bases, the Bank designated certain debt securities, certain securities purchased under reverse repurchase agreements, and certain liabilities related to transferred receivables as at fair value through profit or loss. The fair value of liabilities related to transferred receivables does not include credit risk, as the holders of these liabilities are not exposed to the Bank's credit risk.

The Bank also designated certain hybrid financial instruments with one or more embedded derivatives, such as restructured notes of the MAV conduits, certain deposits, and certain loans as at fair value through profit or loss. There is no exposure to credit risk on the loans to the extent that they are fully collateralized.

Information about the financial assets and financial liabilities designated at fair value through profit or loss is provided in the following tables:

Year ended October 31			**2013**
	Carrying value as at October 31, 2013	**Change in the total fair value (including the change in the fair value attributable to credit risk)**	**Change in fair value since the initial recognition of the instrument**
Financial assets designated at fair value through profit or loss			
Securities	**3,222**	**136**	**343**
Loans	**62**	**2**	**2**
	3,284	**138**	**345**
Financial liabilities designated at fair value through profit or loss			
Deposits(1)	**1,846**	**(99)**	**(137)**
Liabilities related to transferred receivables	**6,819**	**110**	**(190)**
	8,665	**11**	**(327)**

Year ended October 31			2012
	Carrying value as at October 31, 2012	Change in the total fair value (including the change in the fair value attributable to credit risk)	Change in fair value since the initial recognition of the instrument
Financial assets designated at fair value through profit or loss			
Securities	5,452	156	299
Securities purchased under reverse repurchase agreements	54	–	–
Loans	39	3	3
	5,545	159	302
Financial liabilities designated at fair value through profit or loss			
Deposits(1)	1,039	(25)	(58)
Liabilities related to transferred receivables	8,960	76	(376)
	9,999	51	(434)

(1) For the year ended October 31, 2013, the change in the fair value of deposits designated at fair value through profit or loss attributable to credit risk resulted in a $2 million gain ($7 million loss for the year ended October 31, 2012).

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS

The Bank views risk as an integral part of its development and the diversification of its activities and advocates a risk management approach consistent with its business expansion strategy. The purpose of sound risk management is to provide reasonable assurance that incurred risks do not exceed acceptable thresholds and that risk-taking contributes to the creation of shareholder value. For the Bank, this means striking a healthy balance between return and risk.

Risk Management Framework

To achieve its risk management objectives, the Bank has a risk management framework that comprises the elements presented hereafter.

Risk Management Culture
The Bank's management continually promotes a risk management culture through internal communications that foster a balanced model where business development initiatives are coupled with a constant focus on sound risk management.

Governance Structure
The governance structure at the Bank sets out the roles and responsibilities of all levels of the organization.

The Board of Directors (Board)
The Board examines and approves the Bank's overall risk philosophy and risk appetite, acknowledges and understands the main risks faced by the Bank, and makes sure appropriate systems are in place to effectively manage and control these risks. It performs its mandate in this regard both directly and through its committees, including the Audit Committee and the Risk Management Committee.

The Audit Committee
The Audit Committee oversees the work of the internal auditor and the independent auditor, the financial reporting and analysis process, the Bank's internal controls, and the application of the policy for reporting irregularities relating to accounting, internal accounting controls and auditing matters.

The Risk Management Committee (RMC)
The Risk Management Committee reviews the risk appetite framework, the main risk management policies as well as risk tolerance limits and recommends their approval by the Board. It ensures that appropriate resources, processes and procedures are in place to properly and effectively manage risk on an ongoing basis. Finally, it monitors the risk profile and risk trends of the Bank's activities and ensures alignment with the risk appetite.

The Office of the President
Composed of the President and Chief Executive Officer and the officers responsible for the Bank's main functions and business units, the Office of the President ensures that risk management is effective and aligned with the Bank's pursuit of its objectives and strategies.

The Asset and Liability Management Committee
The Asset and Liability Management Committee provides strategic direction for management of enterprise-wide non-trading interest rate risk and monitors the liquidity and funding position, balance sheet structure and size as well as the capital position in order to achieve an optimal balance between risk and reward.

The Bank's Management
The Bank's Management promotes the risk management culture Bank-wide and manages the primary risks to which it is exposed.

The Global Risk Committee (GRC)
The Global Risk Committee defines the parameters of the policies that determine risk tolerance and the overall risk strategy, for the Bank and its subsidiaries as a whole, and sets limits as well as tolerance and intervention thresholds enabling the Bank to properly manage the main risks to which it is exposed. The Committee approves and monitors all large credit facilities. It also recommends for Board approval the risk philosophy, the Bank's risk appetite and risk profile management. The Market Risk Management Committee, the Senior Complex Valuation Committee, the Operational Risk Management Committee, the Committee on Banks, the Capital Models Oversight Committee, the Enterprise-Wide Risk Management Committee, and the Product and Activity Review Committee all report to the Global Risk Committee.

The Information Disclosure Committee
The Information Disclosure Committee ensures that financial reporting disclosure controls and procedures are implemented and are operating effectively.

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

The Risk Management Group
This group provides an independent oversight of risk management practices and standards. It promotes a strong risk management culture throughout the Bank and proposes risk management policies and implements tools and models for identifying, measuring and monitoring risks. In addition to instituting and applying various independent risk review and approval procedures, this group also proposes risk limits that reflect the risk tolerance thresholds established by the RMC and informs management and the Board of significant risks.

The Business Units
As a first line of defence, the business units manage risks related to their operations within established limits and in accordance with risk management policies by identifying, analyzing and understanding the risks to which they are exposed and implementing risk mitigation mechanisms. The management of these units must ensure that employees are adhering to current policies and to the limits set out therein.

Lines of Defence
The risk management governance framework is founded on the three lines of defence concept, with the goal of promoting accountability among stakeholders in risk management. The first line of defence corresponds to the business lines undertaking the risk generating activities. In this role, the business lines have the primary responsibility to effectively manage their risks in compliance with policies and within the risk appetite limits. The second line of defence is primarily represented by the Risk Management Group, Compliance and other corporate units. Executives and personnel of these groups are responsible for ensuring that there exists an appropriate risk management framework, risk appetite and compliance with policies. Within this context, they ensure an independent and effective oversight of business unit activities, strategy and risk exposures. The third line of defence corresponds to the Internal Audit function, which provides assurance on the effectiveness of governance, risk management and internal controls, including the manner in which the first and second lines of defence achieve both risk management and control objectives. The frequency of Internal Audit's periodic review is determined by the level of risk.

Risk Management Policies
Risk management policies and the related standards and procedures are the essential elements of the risk management framework. They define and describe the main activity-related risks, specify the requirements that the business units must meet in assessing and managing risk, stipulate the authorization process for risk taking and set the risk limits to be adhered to. These policies cover all the main risks in the Bank and are reviewed on a regular basis to ensure that they are still relevant given changes in the markets and the business plans of the Bank's business units. Other policies, standards and procedures complement the main policies and cover more specific aspects of management, such as business continuity, the launch of new products, initiatives or activities, or financial instrument measurement. These policies, standards and procedures apply across the Bank and its subsidiaries.

The Bank's risk management policies and accompanying guidelines and procedures are presented in the Management's Discussion and Analysis.

Credit Risk Management

Credit risk is the risk of a financial loss if an obligor does not fully honour its contractual commitments to the Bank. Obligors may be borrowers, issuers, counterparties or guarantors. Credit risk is the most significant risk facing the Bank in the normal course of business. The Bank is exposed to credit risk not only through its direct lending activities and transactions but also through commitments to extend credit, letters of guarantee, letters of credit, over-the-counter derivatives trading, available-for-sale debt securities, securities purchased under reverse repurchase agreements, deposits with financial institutions, brokerage activities and transactions carrying a settlement risk for the Bank such as irrevocable fund transfers to third parties via electronic payment systems.

A policy framework centralizes the governance of activities that generate credit risk for the Bank and is supplemented by a series of subordinate internal or sectoral policies and guidelines on specific management issues such as credit limits, collateral requirements and risk quantification or that provide more thorough guidance for given business segments.

Credit Risk Assessment of Loans
Before a sound and prudent credit decision can be taken, the credit risk represented by the borrower or counterparty must be accurately assessed. This is the first step in processing credit applications. Each application is analyzed and assigned one of 19 grades on a scale of 1 to 10 using a credit rating system developed by the Bank for all portfolios exposed to credit risk. As each grade corresponds to a borrower's, counterparty's or third party's probability of default, the credit risk can be determined for the Bank. The credit risk assessment method varies according to portfolio type.

The main parameters used to measure the credit risk of loans outstanding and undrawn amounts are as follows:

– probability of default (PD), which is the probability that the obligor will default within one year;
– loss given default (LGD), which represents the magnitude of the expected loss from the obligor's default, expressed as a percentage of exposure at default (EAD); and
– EAD, which is the estimated amount potentially drawn at the time of the obligor's default.

Personal Credit Portfolios
This category comprises credit portfolios composed of residential mortgage loans, consumer loans and loans to certain small businesses. The credit risk of these portfolios is measured using credit scoring models. The obligor's default risk rating for personal credit is determined using these models. The assessment also takes product risk into account, for example, lines of credit versus term loans. Personal credit risk assessments are based on a group of borrowers with similar credit histories and behaviour profiles.

A risk analysis based on loan grouping in pools of homogeneous obligor profiles is used for overall management of personal credit portfolios. This personal credit assessment approach, which has proven particularly effective for estimating loan defaults and losses, takes a number of factors into account, namely:

– behaviour scoring;
– loan product characteristics;
– collateral provided;
– the length of time on the Bank's balance sheet; and
– loan status (active, delinquent or defaulted).

Loan pools are also established based on probability of default, loss given default and exposure at default, which are measured based on the characteristics of the obligor and the transaction itself. Loss given default is estimated based on transaction-specific factors including loan product characteristics, loan-to-value ratio and types of collateral. In accordance with the Bank's default risk-rating and facility risk-rating policies, the review and renewal policy, and the risk quantification policy, the default risk ratings must be reviewed annually.

Business and Government Credit Portfolios
This category comprises business (other than some small businesses that are classified in personal credit portfolios), government and financial institution credit portfolios.

These credit portfolios are assigned a risk rating based on a detailed individual analysis of the financial and non-financial aspects of the borrower, including the borrower's financial strength, sector of economic activity, competitive ability, access to capital and management quality. The Bank has risk-rating tools and models enabling it to specifically assess the risk represented by an obligor in relation to its industry and peers. The models used are adapted to the obligor's broad sector of activity. Models are in place for seven sectors: business/commercial, large business, banks-brokerage, sovereigns, energy, real estate and agriculture.

This risk assessment method assigns a default risk rating to an obligor that reflects its credit quality. For each credit risk rating corresponds a probability of default (see the following table). This credit quality classification enables the Bank to adequately differentiate its respective assessments of an obligor's ability to meet its contractual obligations. This kind of assessment must be done independently of external circumstances, particularly adverse economic or financial conditions likely to put stress on the Bank. Default risk ratings are assigned according to an assessment of the obligors' commercial and financial risks, based on a solvency review.

The business and government default risk-rating scale used by the Bank is similar to the systems used by major external rating agencies. The following table presents a grouping of the grades by major risk category and compares them with the ratings of two major rating agencies.

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Internal Default Risk Ratings – Business and Government

Ratings	Standard & Poor's	Moody's	Description[1]
1 – 2.5	AAA to A-	Aaa to A3	Excellent
3 – 4	BBB+ to BBB-	Baa1 to Baa3	Good
4.5 – 6	BB+ to B+	Ba1 to B1	Satisfactory
6.5 – 7.5	B to CCC +	B2 to Caa1	Special mention
8 – 8.5	CCC and CCC-	Caa2 and Caa3	Substandard
9 – 10	CC, C and D	Ca, C and D	Default

(1) Additional information is provided in the tables on page 133.

The Bank also uses individual assessment models by industry to assign a risk rating to the credit facility based on the collateral and guarantees the obligor is able to provide and, in some cases, based on other factors.

The Bank consequently has a bi-dimensional risk-rating system that, using internal and external historical data, establishes a default risk rating for each obligor, and models that assign a risk-rating to the credit facility that is independent of the risk rating assigned to the obligor.

Credit Granting and Approval Process
Credit-granting decisions are based first and foremost on the results of the risk assessment. Aside from a client's solvency, credit-granting decisions are also influenced by factors such as available collateral, transaction compliance with policies, standards and procedures, and the Bank's overall risk-adjusted return objective. Each credit-granting decision is made by authorities within the risk management teams and management who are independent of the business units and are at a reporting level commensurate with the size of the proposed credit transaction and the associated risk.

Decision-making authority is determined in compliance with the delegation of authority set out in the Credit Risk Management Policy. A person in a senior position in the organization approves credit facilities that are substantial or carry a higher risk for the Bank. The Bank's Global Risk Committee approves and monitors all substantial credit facilities. Credit applications that exceed management's latitudes are submitted to the Board for approval. The credit-granting process demands a high level of accountability from managers, who must proactively manage the credit portfolio.

Risk Mitigation
The Bank also controls credit risk using various risk mitigation techniques. In addition to the standard practice of requiring collateral to guarantee repayment of the credit it grants, the Bank also uses protection mechanisms such as credit derivative financial instruments, syndication and loan assignments as well as an orderly reduction in the amount of credit granted.

The most common method used to mitigate credit risk is to obtain quality collateral from borrowers. Obtaining collateral cannot replace a rigorous assessment of a borrower's ability to meet its obligations, but, beyond a certain risk threshold, it is an essential complement. Collateral is not required in all cases; it depends upon the level of risk presented by the borrower and the type of loan granted. However, if the level of risk to the Bank is considered high, collateral will likely be required. The legal validity of any collateral obtained and the Bank's ability to correctly and regularly measure the collateral's value are critical for this mechanism to play its proper role in risk mitigation. The Bank has established specific requirements in its internal policies with respect to the appropriate legal documentation and assessment for the kinds of collateral that business units may require in guarantee of loans granted. The categories of eligible collateral and the lending value of these assets have also been defined by the Bank. For the most part, they include the following asset categories as well as guarantees (whether secured by collateral or unsecured) and government and bank guarantees:

- accounts receivable;
- inventory;
- machinery and equipment and rolling stock;
- residential and commercial real estate, office buildings, and industrial facilities; and
- cash and marketable securities.

Counterparty obligations related to the trading of contracts on derivative financial instruments are frequently subject to credit risk mitigation measures. The mitigation techniques are somewhat different from those used for loans and advances and depend on the nature of the instrument or the type of contract traded. The first of these, and the most widely used, is the signing of International Swaps & Derivatives Association, Inc. (ISDA) master agreements with the appropriate counterparties. These agreements make it possible to apply full netting of the gross amounts of the market price assessments, when one of the contracting parties defaults on the agreement, for each of the transactions covered by the agreement and in force at the time of default. The amount of the final settlement is therefore the net balance of gains and losses on each transaction, which reduces exposure when a counterparty defaults. The Bank's policies require signing an ISDA agreement with most derivative and foreign exchange forward contracts trading counterparties.

Another mechanism for reducing credit risk complements the ISDA master agreement in many cases and provides the Bank and its counterparty (or either of the parties, if need be) with the right to request collateral from the counterparty when the net balance of gains and losses on each transaction exceeds a threshold defined in the agreement. These agreements, also known as Credit Support Annexes (CSAs), are common between financial institutions active in international financial markets since they limit credit risk while providing traders with additional flexibility to continue trading with the counterparty. The Bank often uses this type of legal documentation in transactions with financial institutions and governments. For business transactions, the Bank prefers to use internal mechanisms set out in the credit agreements. The Bank's internal policies set the conditions governing the implementation of such mitigation methods.

Finally, the implementation of multilateral settlement systems that allow settlement netting among participating institutions (e.g., CLS Settlement) has contributed greatly to reducing the risks associated with the settlement of foreign exchange transactions among banks. The Bank also uses financial intermediaries to have access to established clearing houses in order to minimize settlement risk for certain financial derivative transactions. In some cases, the Bank may have direct access to established clearing houses for settling financial transactions such as repurchase agreements. In addition, certain derivative financial instruments traded over the counter are settled directly or indirectly by central counterparties.

Portfolio Diversification and Management

The Bank is exposed to credit risk not only through outstanding loans and undrawn amounts of commitments to a particular borrower but also through the sectoral distribution of loans outstanding, undrawn amounts, and the exposure of its various credit portfolios to geographical, concentration and settlement risks.

The Bank's approach to controlling these diverse risks begins with optimizing diversification of its exposures. Measures designed to maintain a healthy degree of diversification of credit risk in its portfolios are set out in the Bank's internal policies and procedures. These instructions are mainly reflected in the application of various exposure limits: credit approval limits and country limits by hierarchal level; limits on counterparty credit concentration; and credit concentration limits by industry, country, region and type of financial instrument. Compliance with these limits is monitored through periodic reports submitted by Risk Management officers to the Board.

The criteria established for portfolio diversification and the specific limits set for economic, industrial or geographical sectors are based on findings of sector-based studies and analyses conducted by economists and the Risk Management Group and are approved by the Global Risk Committee. Continuous analyses are performed in order to anticipate problems with a sector or borrower before they materialize as defaulted payments.

Other Risk Mitigation Methods

Credit derivative financial instruments and financial guarantee contracts

The Bank also reduces credit risk by using the protection provided by credit derivative financial instruments such as credit default swaps. When the Bank acquires credit protection, it pays a premium on the swap to the counterparty in exchange for the counterparty's commitment to pay if the underlying entity defaults or another event involving the counterparty and covered by the legal agreement occurs. Since, like borrowers, providers of credit protection must receive a default risk rating, the Bank's internal policies set out all the criteria under which a counterparty may be judged eligible to mitigate the Bank's credit risk. The Bank may also reduce its credit risk by entering into financial guarantee contracts whereby a guarantor indemnifies the Bank for a loss resulting from a debtor failing to make a payment when due in accordance with the contractual terms of a debt instrument.

Loan syndication

The Bank has developed specific instructions on the appropriate objectives, responsibilities and documentation requirements for loan syndication.

Account Monitoring and Recovery

Credit granted and borrowers are monitored on an ongoing basis and in a manner commensurate with the related risk. Loan portfolio managers use an array of methods to conduct a particularly rigorous follow-up on problem loans. When loans continue to deteriorate and there is an increase in risk to the point where monitoring has to be increased, a group specialized in managing problem accounts steps in to maximize collection of the disbursed amounts and tailor strategies to these accounts.

In these cases, loan portfolio managers prepare and submit, to the credit department, a detailed monitoring report each month to track the status of at-risk obligors and the corrective measures undertaken. The management of each credit department concerned performs follow-ups on the reports, and each quarter a credit monitoring committee meets to review the action plans and monitoring reports of obligors that have loans disbursed and undrawn amounts of $2 million or more. The authority to approve allowances for credit losses is attributed using limits delegated on the basis of hierarchical level under the Credit Risk Management Policy.

Detailed information on the recognition of impaired loans and allowances for credit losses are presented in Note 1.

(millions of Canadian dollars)

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Maximum Credit Risk Exposure Under the Basel II Asset Categories

The amounts shown in the following tables represent the Bank's maximum exposure to credit risk as at the financial reporting date without taking into account any collateral held or any other credit enhancements. These amounts do not take into account allowances for credit losses nor amounts pledged as collateral. The tables also exclude equity securities.

						As at October 31, 2013
	Drawn	Undrawn commitments	Repo-style transactions(1)	OTC derivatives	Other off-balance sheet items(2)	Total
Retail						
Residential mortgages	33,533	4,881	–	–	–	38,414
Qualifying revolving retail	2,600	1,974	–	–	–	4,574
Other retail	10,805	1,155	–	–	16	11,976
	46,938	8,010	–	–	16	54,964
Non-retail						
Corporate	31,576	12,504	2,425	40	2,176	48,721
Sovereign	16,368	3,126	14,924	276	139	34,833
Financial institutions	2,352	143	48,470	405	738	52,108
	50,296	15,773	65,819	721	3,053	135,662
Trading portfolio	–	–	–	8,074	–	8,074
Securitization	1,323	–	–	–	2,984	4,307
Total – Credit risk	98,557	23,783	65,819	8,795	6,053	203,007
Standardized Approach	5,338	456	2,183	845	847	9,669
AIRB Approach	93,219	23,327	63,636	7,950	5,206	193,338
Total – Credit risk	98,557	23,783	65,819	8,795	6,053	203,007

						As at October 31, 2012
	Drawn	Undrawn commitments	Repo-style transactions(1)	OTC derivatives	Other off-balance sheet items(2)	Total
Retail						
Residential mortgages	31,235	4,469	–	–	–	35,704
Qualifying revolving retail	2,559	1,874	–	–	–	4,433
Other retail	10,883	1,096	–	–	16	11,995
	44,677	7,439	–	–	16	52,132
Non-retail						
Corporate	30,605	10,246	1,884	23	2,011	44,769
Sovereign	14,120	3,002	10,873	75	110	28,180
Financial institutions	4,114	143	39,134	663	786	44,840
	48,839	13,391	51,891	761	2,907	117,789
Trading portfolio	–	–	–	5,931	–	5,931
Securitization	1,909	–	–	–	2,959	4,868
Total – Credit risk	95,425	20,830	51,891	6,692	5,882	180,720
Standardized Approach	7,930	596	1,786	883	787	11,982
AIRB Approach	87,495	20,234	50,105	5,809	5,095	168,738
Total – Credit risk	95,425	20,830	51,891	6,692	5,882	180,720

(1) Securities purchased under reverse repurchase agreements and sold under repurchase agreements as well as securities loaned and borrowed.
(2) Letters of guarantee, documentary letters of credit and securitized assets that represent the Bank's commitment to make payments in the event that a client cannot meet its financial obligations to third parties.

(millions of Canadian dollars)

Business and Government Credit Portfolio Subject to the Advanced Internal Rating-Based Approach

The following table presents the credit quality of the business and government credit portfolio subject to the Advanced Internal Rating-Based Approach, according to the internal risk-rating categories assigned to borrowers.

					Exposure at default
As at October 31				2013	2012
	Drawn(1)	Undrawn commitments(2)	Other exposures(3)	Total	Total
Excellent	18,813	5,024	39,203	63,040	50,615
Good	12,561	7,949	15,021	35,531	36,941
Satisfactory	14,124	2,137	12,234	28,495	19,484
Special mention	1,923	196	56	2,175	2,198
Substandard	107	8	9	124	92
Default	285	3	1	289	256
Total – Credit risk	47,813	15,317	66,524	129,654	109,586

(1) Amounts drawn represent certain deposits with financial institutions, available-for-sale debt securities, gross loans, customers' liability under acceptances and other assets.
(2) Undrawn commitments represent unused portions of authorized credit facilities in the form of loans, acceptances, letters of guarantee and documentary letters of credit, excluding investment banking activities.
(3) Other exposures represent securities purchased under reverse repurchase agreements and securities borrowed as well as securities sold under repurchase agreements and securities loaned, forwards, futures, swaps and options and also include letters of guarantee, documentary letters of credit, and securitized assets that represent the Bank's commitment to make payments in the event a client cannot meet its financial obligations to third parties.

Personal Credit Portfolio Subject to the Advanced Internal Rating-Based Approach

The following table presents the credit quality of the personal credit portfolio subject to the Advanced Internal Rating-Based Approach, according to the internal risk-rating categories assigned to borrowers.

					Exposure at default
As at October 31				2013	2012
	Residential mortgages(1)	Qualifying revolving retail(2)	Other retail(3)	Total	Total
Excellent	18,008	2,073	2,421	22,502	19,863
Good	14,179	909	2,868	17,956	17,300
Satisfactory	4,578	1,022	3,426	9,026	9,833
Special mention	600	442	589	1,631	1,568
Substandard	498	101	132	731	432
Default	125	27	111	263	218
Total – Credit risk	37,988	4,574	9,547	52,109	49,214

(1) Includes home equity lines of credit.
(2) Includes lines of credit and credit card receivables.
(3) Includes consumer loans, commercial credit card receivables, certain SME loans, and other personal loans.

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Market Risk Management

Market risk is the risk of financial loss resulting from adverse changes in various risk factors and their implied volatility. The main risk factors include interest rate risk, foreign exchange risk, equity risk, commodity price risk, traded credit risk, implied correlation risk, market liquidity risk, portfolio diversification and hedging risk. Market risk at the Bank arises from its participation in market making, trading, investment and asset/liability management activities.

Assessing Market Risk

An integrated internal control framework is used to manage market risk, which is overseen by the Market Risk Management Committee. The Bank is continually adapting its market risk management and oversight framework.

A comprehensive policy governs global market risk management across the Bank's units and subsidiaries that are exposed to this type of risk. The policy describes the main mechanisms for identifying and measuring the types of market risk to which the Bank is exposed. It also defines the link between the Bank's market risk appetite approved by the Board and the framework implemented for setting market risk limits across the Bank's business units that are allowed to undertake market risk. The purpose of the market risk limits is to set out tolerance thresholds for these business units or portfolios to comply with the Bank's market risk appetite targets. These are cascaded down to business units using a hierarchy of different types of limits (e.g., VaR, stop loss) allocated by portfolio, trading unit, unit manager and officer, as well as an appropriate breach escalation process.

The Risk Management Group uses a variety of risk measures to estimate the size of potential losses under both moderate and more severe scenarios, and using both short-term and long-term time horizons. For short-term horizons, the Bank's risk measures include Value-at-Risk (VaR), Stressed VaR (SVaR), and sensitivity metrics. For long-term horizons or sudden significant market moves, including those due to a lack of market liquidity, the risk measures include stress testing across an extensive range of scenarios. VaR is a statistical measure of risk that is used to quantify market risks across products, per types of risks and aggregate risk on a portfolio basis. VaR is defined as the maximum loss at a specific confidence level over a certain horizon under normal market conditions. The VaR method has the advantage of providing a uniform measurement of financial instrument-related market risks based on a single statistical confidence level and time horizon. The Bank uses an historical price distribution to compute the probable loss levels at the 99% level of confidence, using a two-year daily time series of risk factor changes. VaR is the maximum daily loss the Bank could incur, in 99 cases out of 100, in a given portfolio. In other words, the loss could exceed that amount in only one out of 100 cases.

The trading VaR is measured by assuming a holding period of one day for ongoing market risk management. This assumption is used to combine the VaR of various portfolios and provides an estimate of the daily market risk incurred by the Bank. VaR is calculated on a daily basis both for major classes of financial instruments (including derivative financial instruments) and all trading portfolios of the Financial Markets segment and Corporate Treasury of the Bank. Outstanding VaR exposure is monitored daily in relation to established limits for each type of market risk, portfolio and business unit. The RMC reviews VaR results on a quarterly basis, including breaches of the limits set out in the policy, if any.

The Bank also conducts backtesting of the VaR model. It consists in comparing the actual and theoretical profit and losses to the statistical VaR measure. The theoretical profit and losses are obtained using daily price movements but under the assumption that there is no intraday change in the composition of the portfolios. Backtesting is essential to verify the capacity of the VaR model to adequately forecast the maximum risk of market losses and thus validate, retroactively, the quality and accuracy of the statistical results obtained using the model. If the backtesting results present material discrepancies, the VaR model could be revised in accordance with the Bank's model risk management framework.

Stress Tests and Sensitivity Analyses

Stress testing is a risk management technique that consists in estimating potential losses under abnormal market conditions and risk factor movements. Stress testing enhances transparency by exploring a range of potential low-probability events. These stress tests and sensitivity analyses simulate the results that the portfolios would generate if the extreme scenarios in question were to occur. The results of stress tests and sensitivity analyses are subject to maximum potential loss limits for the Bank, which are approved by the Board.

In addition to the one-day trading VaR, the Bank calculates a trading SVaR, which is a statistical measure of risk that replicates the VaR calculation method but uses 12-month historical data corresponding to a continuous period of significant financial stress that is relevant in terms of the Bank's portfolios.

(millions of Canadian dollars)

Trading Activities

The first table below shows the VaR distribution of trading portfolios by risk category as well as the correlation effect. The second table shows the stressed VaR distribution, i.e., the VaR of the Bank's current portfolios obtained following the calibration of risk factors over a 12-month stress period.

Trading VaR by Risk Category(1)

Year ended October 31				2013				2012
	Low	High	Average	Period end	Low	High	Average	Period end
Interest rate	(4.6)	(12.3)	(6.6)	(5.7)	(4.0)	(9.3)	(5.7)	(5.4)
Foreign exchange	(0.2)	(1.6)	(0.7)	(0.4)	(0.2)	(2.4)	(1.1)	(0.5)
Equity	(2.4)	(8.6)	(4.4)	(3.4)	(1.9)	(7.3)	(3.5)	(4.5)
Commodity	(0.5)	(1.9)	(1.1)	(1.1)	(0.6)	(2.3)	(1.0)	(0.8)
Correlation effect(2)	n.m.	n.m.	5.5	4.2	n.m.	n.m.	5.6	5.3
	(5.0)	(11.4)	(7.3)	(6.4)	(3.9)	(11.4)	(5.7)	(5.9)

n.m. Computation of a correlation effect for the high and low is not meaningful as highs and lows may occur on different days and may be attributable to different types of risk.
(1) Amounts are presented on a pre-tax basis and represent one-day VaR using a 99% confidence level.
(2) The correlation effect is the result of the diversification of types of risk.

Trading Stressed VaR by Risk Category(1)

Year ended October 31				2013				2012
	Low	High	Average	Period end	Low	High	Average	Period end
Interest rate	(5.9)	(13.9)	(10.1)	(11.4)	(5.9)	(15.3)	(10.2)	(9.5)
Foreign exchange	(0.3)	(3.6)	(1.2)	(0.7)	(0.3)	(4.2)	(1.4)	(0.8)
Equity	(3.3)	(12.2)	(6.5)	(5.7)	(2.0)	(11.4)	(5.2)	(6.3)
Commodity	(0.5)	(3.4)	(1.7)	(1.2)	(1.1)	(6.6)	(2.4)	(1.5)
Correlation effect(2)	n.m.	n.m.	9.5	8.5	n.m.	n.m.	10.1	9.8
	(6.7)	(14.7)	(10.0)	(10.5)	(5.0)	(18.9)	(9.1)	(8.3)

n.m. Computation of a correlation effect for the high and low is not meaningful as highs and lows may occur on different days and may be attributable to different types of risk.
(1) Amounts are presented on a pre-tax basis and represent one-day SVaR using a 99% confidence level.
(2) The correlation effect is the result of the diversification of types of risk.

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Available-for-Sale Securities Portfolios
The Bank has created available-for-sale securities portfolios in liquid or illiquid securities for strategic, long-term investment and liquidity purposes. These investments carry not only market risk, but also credit risk, liquidity risk, concentration risk and reputation risk as well as risk of non-compliance with laws and regulations in effect.

The Investment Guidelines set out the guiding principles and general management standards that must be followed by all those who manage portfolios of available-for-sale securities included in the portfolios of the Bank and its subsidiaries. Under these guidelines, business units that are active in managing this type of portfolio must adopt internal investment policies that set, among other things, targets and limits for the allocation of assets in the portfolios concerned and internal approval mechanisms. The primary objective is to reduce concentration risk by industry, issuer, country, type of financial instrument and credit quality.

Overall limits in value and in proportion to the Bank's equity are set on the outstanding amount of liquid preferred shares, liquid equity securities excluding preferred shares, and instruments classified as illiquid securities in the available-for-sale securities portfolios. The overall exposure to common shares with respect to an individual issuer and the total outstanding amount invested in hedge funds and private equity funds, for investment banking services, are also subject to these limits. Restrictions are also set on investments defined as special. Lastly, the Bank has a specific strategic investment policy, approved by the Board, which defines strategic investments as purchases of business assets or acquisitions of deemed material equity stake in an entity for purposes of acquiring control or creating a long-term relationship.

Structural Interest Rate Risk
As part of its banking activities, such as mortgage lending and issuing term deposits, the Bank is exposed to structural interest rate risk. Interest rate movements cause changes in interest income and interest expense and, although these changes move in the same direction, their relative magnitude will have a favourable or unfavourable impact on annual net interest income and the economic value (present value of estimated cash flows) of equity. The extent of that impact depends on several factors, including the following:

- a mismatch between the maturities and interest rate adjustment dates of assets and liabilities;
- risk related to the level, form and slope of the interest rate curve based on maturity, and changes in these characteristics;
- risk related to option privileges for products recorded on the balance sheet, whether implicit (mortgage prepayments, deposit redemption) or explicit (capped-rate mortgages); and
- basis risk resulting from an imperfect correlation between different rate curves.

Active management of this risk can significantly enhance the Bank's profitability and add shareholder value. By proactively covering balance sheet risk, the Bank can change the risk profile and capitalize on expected interest rate movements. The Bank's goal is to proactively and effectively manage exposure and optimize the impact of interest rate fluctuations based on expected rate movements. This proactive management approach is based on defining a benchmark index for risk exposure and enough strategic latitude to deviate from that index in response to financial market conditions and the dynamics of the asset/liability management portfolio.

Interest rate risk management is managed under a specific, Board-approved policy, the revision and application of which are overseen by various committees. The policy sets risk limits based on the impact of interest rate fluctuations on various parameters, mainly annual net interest income (maximum loss) and economic value. In addition, the duration of equity must be kept within certain limits.

Simulations are performed on a regular basis to assess the impact of various scenarios on annual net interest income and on the economic value of equity and to guide the management of structural interest rate risk.

(millions of Canadian dollars)

The following table presents the potential before-tax impact of an immediate and sustained 100-basis-point increase or decrease in interest rates on net interest income for the next 12 months and on the economic value of equity of the Bank's non-trading portfolios, assuming no further hedging is undertaken.

Interest Rate Sensitivity – Non-Trading Activities (Before Tax)

			As at October 31, 2013			
	Impact on equity			Impact on net interest income		
	Canadian dollars	U.S. dollars	Total	Canadian dollars	U.S. dollars	Total
100-basis-point increase in the interest rate	(148)	15	(133)	(13)	17	4
100-basis-point decrease in the interest rate	122	(17)	105	2	(19)	(17)

			As at October 31, 2012			
	Impact on equity			Impact on net interest income		
	Canadian dollars	U.S. dollars	Total	Canadian dollars	U.S. dollars	Total
100-basis-point increase in the interest rate	(124)	3	(121)	4	7	11
100-basis-point decrease in the interest rate	95	(3)	92	(13)	(7)	(20)

Structural Foreign Exchange Risk

The Bank's structural foreign exchange risk arises from investments in foreign operations denominated in currencies other than the Canadian dollar. This risk is measured by assessing the impact of currency fluctuations. The Bank uses financial instruments (derivative and non-derivative) to hedge structural foreign exchange risk. In a hedge of a net investment in a foreign operation, the financial instruments used will offset foreign exchange gains and losses on the investments. Management of this risk is governed by a specific policy submitted to the Board.

Liquidity Risk Management

Liquidity risk is the risk that the Bank will be unable to honour daily cash and collateral pledging commitments without resorting to costly and untimely measures. Liquidity risk arises when sources of funds become insufficient to meet scheduled payments under the Bank's commitments. Liquidity risk stems from mismatched cash flows related to assets and liabilities as well as the characteristics of certain products, such as credit commitments and non-fixed term deposits.

The Bank's primary objective as a financial institution is to manage liquidity such that it supports the Bank's business strategy and to enable it to honour its commitments when they come due, even in extreme conditions. This is done primarily by implementing a policy framework approved by the Board, which establishes a risk tolerance threshold, monitoring structures controlled by the various committees, risk indicators, reporting procedures, delegation of responsibilities and segregation of duties. The Bank also prepares and implements an annual funding plan that incorporates the expected growth of assets and liabilities.

Corporate Treasury manages liquidity and funding needs Bank-wide. The Bank's liquidity, funding and pledging policy requires review and approval by the RMC, based on recommendations from the GRC. In this capacity, Board representatives not only approve the supervision of day-to-day management and risk governance, but also backup plans in anticipation of emergency situations and liquidity crisis. Liquidity risk supervision at the Bank is mainly assigned to the Liquidity and Funding Committee, composed of Corporate Treasury and Risk Management Group representatives, which reviews and assesses the Bank's liquidity position. Through the Liquidity and Funding Committee, Corporate Treasury regularly monitors changes in liquidity, funding and pledging, indicators and compliance with regulatory and Board-approved limits. Although the day-to-day management of risks associated with liquidity, funding and pledging activities and the related monitoring of compliance with the policy is assumed by Corporate Treasury, the Risk Management Group is responsible for ensuring that an appropriate management framework is in place and that risk appetite and policy are adhered to.

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Liquidity Management
The Bank performs liquidity management, funding and pledging operations not only from its head office and regional offices in Canada, but also through certain foreign centres. Although the volume of such operations abroad represents a sizable portion of global liquidity management, the Bank's liquidity management is centralized. By organizing liquidity, funding and pledging activities within Corporate Treasury, the Bank can better coordinate enterprise-wide funding and risk monitoring activities.

Short-term day-to-day funding decisions are based on a daily cumulative net cash position, which is controlled using liquidity ratio limits. Among these ratios and metrics, the Bank pays particular attention to the funds obtained on the wholesale market and to cumulative cash flows over various time horizons.

Moreover, the Bank's collateral pledging activities are monitored on a daily basis in relation to the different limits set by the Bank and are subject to monthly stress tests using a series of simulations. In particular, the Bank uses various scenarios to estimate the potential amounts of additional collateral that would be required in the event of a downgrade to the Bank's credit rating.

The Bank also regularly monitors unencumbered securities outstanding in proportion to unsecured institutional market funding due in less than one year. The Bank must hold unencumbered liquid assets equal to at least the total amount of unsecured wholesale market funds maturing within one year, taking into account the potential downward market volatility of the assets by applying conservative "haircuts" to the value of these securities.

Liquidity risk can be assessed in many different ways using different liquidity indicators. One of the key monitoring tools of liquidity risk is the Bank's survival period based on contractual maturity and behavioural assumptions applied to balance sheet items as well as off-balance-sheet commitments.

Stress Testing and Crisis Scenarios
Survival period measures, using various simulations, the number of months it would take to completely utilize the Bank's liquid assets if the Bank were to lose deposits prematurely or if funds from wholesale markets were not renewed at maturity. It is measured monthly using three scenarios. These scenarios were developed to assess sensitivity to a Bank-specific or systemic crisis. Deposit loss simulations are carried out based on their degree of stability, while the value of certain assets is encumbered by an amount reflecting their readiness for liquidation in a crisis. These stress test scenarios are reviewed and submitted to the Board once a year for approval.

The Bank monitors and manages its risk tolerance through liquidity limits, ratios and stress scenarios. The Bank's liquidity risk tolerance is articulated around three axes:

- ensure the Bank has a sufficient amount of unencumbered liquid assets to cover its financial requirements;
- ensure the Bank keeps a liquidity buffer above the minimum regulatory requirement; and
- ensure the Bank maintains diversified funding products.

To protect depositors and creditors from unexpected crisis situations, the Bank holds a portfolio of unencumbered liquid assets that can be readily liquidated to meet financial obligations. This portfolio consists of highly liquid securities, most of which are issued or guaranteed by governments, and of cash loans maturing in less than 30 days. The majority of unencumbered liquid assets are held in Canadian or U.S. dollars. Moreover, all assets that can be quickly monetized are considered liquid assets. The Bank does not consider any central bank's emergency liquidity facilities in its liquidity buffer.

Funding Risk

Funding risk is defined as the risk to the Bank's ongoing ability to raise sufficient funds to finance actual or proposed business activities on an unsecured or secured basis at an acceptable price. The Bank maintains a good balance of its funding through appropriate diversification of its unsecured funding vehicles, securitization programs and secured funding. The Bank also diversifies its funding by currency, geography and maturity. The funding management priority is to achieve the optimal balance between the deposit liabilities of the Bank's retail network, secured funding and unsecured funding. This brings optimal stability to the funding and reduces vulnerability to unpredictable events.

The Bank's retail network deposit liabilities are its primary and most stable source of funding. Stable funds are used to fund bank activities, whereas funds from the wholesale markets are used to fund financial market activities. In order to maintain the ideal funding profile, the Bank seeks to limit short-term wholesale funding and is careful to diversify its funding sources. The Bank seeks to diversify its funding sources by geographic location, currency, instrument, maturity and depositor. In addition, the Bank is actively involved in securitization programs (residential mortgages and credit card receivables) that diversify its access to long-term funding.

The key objectives of the funding strategy are to:

- support the organic growth of the Bank through prudent liquidity and funding management to withstand severe stresses;
- fund core banking activities with stable deposits and securitizations; and
- limit short-term wholesale funding.

To do so, the Bank actively monitors and controls liquidity risk exposures and funding needs within and across legal entities, business segments and currencies. The process involves evaluating the liquidity position of individual business segments in addition to that of the Bank as a whole as well as the liquidity risk from raising unsecured and secured funding in foreign currencies. The funding strategy is executed through the funding plan.

(millions of Canadian dollars)

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Residual Contractual Maturities of Balance Sheet Items and Off-Balance-Sheet Commitments

The following tables present balance sheet items and off-balance-sheet commitments by residual contractual maturity as at October 31, 2013 and 2012. The information gathered from this maturity analysis is a component of liquidity and funding management. However, this maturity profile does not represent how the Bank manages its interest rate risk nor its liquidity risk and funding needs. The Bank considers factors other than contractual maturity in the assessment of liquid assets or in determining expected future cash flows.

In the normal course of business, the Bank enters into various off-balance-sheet commitments. The credit instruments used to meet the funding needs of its clients represent the maximum amount of additional credit the Bank could be obligated to extend if the commitments were fully drawn.

The Bank also has future minimum commitments under leases for premises as well for other contracts, mainly contracts for outsourced IT services. Most of the lease commitments are related to operating leases.

Assets

									As at October 31, 2013	
	1 month or less	Over 1 month to 3 months	Over 3 months to 6 months	Over 6 months to 9 months	Over 9 months to 12 months	Over 1 year to 2 years	Over 2 years to 5 years	Over 5 years	No specified maturity	Total
Cash and deposits with financial institutions	1,177	203	–	–	–	–	–	–	2,216	3,596
Securities										
At fair value through profit or loss	286	1,151	770	10	2,234	4,233	7,335	10,374	17,607	44,000
Available-for-sale	365	36	64	103	60	607	4,917	3,193	399	9,744
	651	1,187	834	113	2,294	4,840	12,252	13,567	18,006	53,744
Securities purchased under reverse repurchase agreements and securities borrowed	7,142	5,039	3,814	1,330	347	–	–	–	3,777	21,449
Loans and acceptances(1)										
Residential mortgage	871	968	1,289	2,271	1,732	7,503	20,976	698	265	36,573
Personal and credit card	254	322	500	624	513	1,652	5,619	1,447	17,058	27,989
Business and government	4,050	1,492	1,063	1,421	908	1,463	3,427	901	9,675	24,400
Customers' liability under acceptances	8,104	843	7	–	–	–	–	–	–	8,954
Allowances for credit losses	–	–	–	–	–	–	–	–	(578)	(578)
	13,279	3,625	2,859	4,316	3,153	10,618	30,022	3,046	26,420	97,338
Other										
Derivative financial instruments	321	338	156	148	151	705	1,580	2,505	–	5,904
Due from clients, dealers and brokers(1)									1,101	1,101
Investments in associates and joint ventures									684	684
Premises and equipment									404	404
Goodwill									1,064	1,064
Intangible assets									898	898
Other assets	144	63	219	115	113	64	127	77	1,100	2,022
	465	401	375	263	264	769	1,707	2,582	5,251	12,077
	22,714	10,455	7,882	6,022	6,058	16,227	43,981	19,195	55,670	188,204

(1) Amounts collectible on demand are considered to have no specified maturity.

(millions of Canadian dollars)

Liabilities, Equity and Off-Balance-Sheet Commitments

									As at October 31, 2013	
	1 month or less	Over 1 month to 3 months	Over 3 months to 6 months	Over 6 months to 9 months	Over 9 months to 12 months	Over 1 year to 2 years	Over 2 years to 5 years	Over 5 years	No specified maturity	Total
Deposits[1][2]										
Personal	801	970	1,808	2,043	1,479	4,457	8,272	355	22,467	42,652
Business and government	840	189	247	143	153	308	450	80	29,274	31,684
Deposit-taking institutions	141	314	–	–	–	–	–	–	617	1,072
Unsecured senior debt	3,349	1,835	1,895	617	1,506	8,891	4,725	518	–	23,336
Covered bonds	–	1,043	–	–	–	–	2,099	–	–	3,142
	5,131	4,351	3,950	2,803	3,138	13,656	15,546	953	52,358	101,886
Other										
Acceptances	8,104	843	7	–	–	–	–	–	–	8,954
Obligations related to securities sold short[3]	258	210	413	–	818	1,183	4,199	8,260	3,568	18,909
Obligations related to securities sold under repurchase agreements and securities loaned	8,968	3,349	5,366	773	–	–	–	–	1,290	19,746
Derivative financial instruments	245	580	345	140	160	590	1,380	1,418	–	4,858
Due to clients, dealers and brokers[1]									2,442	2,442
Liabilities related to transferred receivables[4]	14	490	362	402	283	1,108	7,274	5,390	–	15,323
Securitization – Credit card[5]	–	–	–	–	–	1,280	–	–	–	1,280
Other liabilities – Other items[1][5]	152	63	155	1	588	97	120	173	1,870	3,219
	17,741	5,535	6,648	1,316	1,849	4,258	12,973	15,241	9,170	74,731
Subordinated debt	543	–	–	–	–	350	1,500	33	–	2,426
Equity									9,161	9,161
	23,415	9,886	10,598	4,119	4,987	18,264	30,019	16,227	70,689	188,204
Commitments										
Letters of guarantee and documentary letters of credit	8	404	43	254	265	1,150	1,054	65	–	3,243
Credit card receivables[6]									6,332	6,332
Backstop liquidity and credit enhancement facilities	–	15	2,050	15	–	2,098	–	886	–	5,064
Commitments to extend credit[7]	813	507	1,175	1,740	1,613	7,423	6,507	294	18,172	38,244
Lease commitments and other contracts	62	120	174	169	163	453	696	550	–	2,387
Other guarantee	–	–	–	–	–	–	–	–	29	29

(1) Amounts payable upon demand or notice are considered to have no specified maturity.
(2) The *Deposits* item is presented in greater detail than it is on the Consolidated Balance Sheet.
(3) Amounts have been disclosed according to the remaining contractual maturity of the underlying security.
(4) These amounts mainly include liabilities related to the securitization of mortgage loans.
(5) The *Other liabilities* item is presented in greater detail than it is on the Consolidated Balance Sheet.
(6) These amounts are unconditionally revocable at the Bank's discretion at any time.
(7) These amounts include $15.9 billion that is unconditionally revocable at the Bank's discretion at any time.

(millions of Canadian dollars)

NOTE 5 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Assets

As at October 31, 2012

	1 month or less	Over 1 month to 3 months	Over 3 months to 6 months	Over 6 months to 9 months	Over 9 months to 12 months	Over 1 year to 2 years	Over 2 years to 5 years	Over 5 years	No specified maturity	Total
Cash and deposits with financial institutions	1,156	11	1	–	–	–	–	–	2,081	3,249
Securities										
At fair value through profit or loss	203	1,542	1,702	1,447	1,095	3,676	9,176	11,189	14,494	44,524
Available-for-sale	281	622	37	7	276	147	5,024	3,527	453	10,374
	484	2,164	1,739	1,454	1,371	3,823	14,200	14,716	14,947	54,898
Securities purchased under reverse repurchase agreements and securities borrowed	4,390	6,569	1,839	46	–	943	–	–	1,742	15,529
Loans and acceptances(1)										
Residential mortgage	773	823	1,228	1,916	1,609	4,896	21,402	602	289	33,538
Personal and credit card	226	271	513	586	516	872	4,770	1,330	17,445	26,529
Business and government	5,335	1,153	1,024	1,085	819	1,186	3,057	755	8,768	23,182
Customers' liability under acceptances	7,354	895	1	–	–	–	–	–	–	8,250
Allowances for credit losses									(577)	(577)
	13,688	3,142	2,766	3,587	2,944	6,954	29,229	2,687	25,925	90,922
Other										
Derivative financial instruments	210	424	266	211	246	543	2,089	2,707	–	6,696
Due from clients, dealers and brokers(1)									1,661	1,661
Investments in associates and joint ventures									625	625
Premises and equipment									440	440
Goodwill									1,063	1,063
Intangible assets									778	778
Other assets	307	40	222	86	306	25	192	127	737	2,042
	517	464	488	297	552	568	2,281	2,834	5,304	13,305
	20,235	12,350	6,833	5,384	4,867	12,288	45,710	20,237	49,999	177,903

(1) Amounts collectible on demand are considered to have no specified maturity.

(millions of Canadian dollars)

Liabilities, Equity and Off-Balance-Sheet Commitments

As at October 31, 2012

	1 month or less	Over 1 month to 3 months	Over 3 months to 6 months	Over 6 months to 9 months	Over 9 months to 12 months	Over 1 year to 2 years	Over 2 years to 5 years	Over 5 years	No specified maturity	Total
Deposits(1)(2)										
Personal	989	1,108	2,097	1,701	1,626	4,702	7,496	692	20,403	40,814
Business and government	95	74	–	59	35	290	380	159	24,905	25,997
Deposit-taking institutions	391	443	–	–	–	–	244	203	1,266	2,547
Unsecured senior debt	3,994	3,001	2,427	998	2,028	561	7,662	205	–	20,876
Covered bonds	–	–	–	–	–	999	2,016	–	–	3,015
	5,469	4,626	4,524	2,758	3,689	6,552	17,798	1,259	46,574	93,249
Other										
Acceptances	7,354	895	1	–	–	–	–	–	–	8,250
Obligations related to securities sold short(3)	–	–	1	–	14,304	171	642	877	2,129	18,124
Obligations related to securities sold under repurchase agreements and securities loaned	10,247	4,063	2,872	1,490	–	–	–	–	867	19,539
Derivative financial instruments	179	483	198	199	163	684	1,683	2,011	–	5,600
Due to clients, dealers and brokers(1)									1,959	1,959
Liabilities related to transferred receivables(4)	–	1,414	–	1,162	456	1,579	5,956	4,831	–	15,398
Securitization – Credit card(5)	–	–	400	–	–	–	880	–	–	1,280
Other liabilities – Other items(1)(5)	243	76	142	–	856	105	131	40	2,201	3,794
	18,023	6,931	3,614	2,851	15,779	2,539	9,292	7,759	7,156	73,944
Subordinated debt	88	–	–	–	–	500	1,850	32	–	2,470
Equity									8,240	8,240
	23,580	11,557	8,138	5,609	19,468	9,591	28,940	9,050	61,970	177,903
Commitments										
Letters of guarantee and documentary letters of credit	1	405	49	658	269	1,208	303	273	–	3,166
Credit card receivables(6)									5,523	5,523
Backstop liquidity and credit enhancement facilities	–	–	800	30	2,049	–	–	910	–	3,789
Commitments to extend credit	46	716	674	1,937	2,069	6,382	5,896	403	16,245	34,368
Lease commitments and other contracts	35	72	107	107	107	343	631	528	–	1,930
Other guarantee	–	–	–	–	–	–	–	–	31	31

(1) Amounts payable upon demand or notice are considered to have no specified maturity.
(2) The *Deposits* item is presented in greater detail than it is on the Consolidated Balance Sheet.
(3) Amounts have been disclosed according to the remaining contractual maturity of the underlying security.
(4) These amounts mainly include liabilities related to the securitization of mortgage loans.
(5) The *Other liabilities* item is presented in greater detail than it is on the Consolidated Balance Sheet.
(6) These amounts are unconditionally revocable at the Bank's discretion at any time.

(millions of Canadian dollars)

NOTE 6 – SECURITIES

Residual Contractual Maturities of Securities

As at October 31					2013	2012
	1 year or less	Over 1 year to 5 years	Over 5 years	No specified maturity	Total	Total
Securities at fair value throught profit or loss						
Securities issued or guaranteed by:						
Canada	577	5,342	4,637	–	10,556	14,760
Provinces	2,738	4,085	3,831	–	10,654	10,442
Municipalities and school boards	99	178	90	–	367	412
U.S. Treasury and other U.S. agencies	213	176	300	–	689	899
Other debt securities	793	1,782	1,514	–	4,089	3,502
Equity securities	31	5	2	17,607	17,645	14,509
	4,451	11,568	10,374	17,607	44,000	44,524
Available-for-sale securities						
Securities issued or guaranteed by:						
Canada	172	4,706	782	–	5,660	5,675
Provinces	–	638	1,979	–	2,617	2,908
Municipalities and school boards	–	44	258	–	302	294
U.S. Treasury and other U.S. agencies	390	–	–	–	390	341
Other debt securities	20	136	174	–	330	703
Equity securities	46	–	–	399	445	453
	628	5,524	3,193	399	9,744	10,374

(millions of Canadian dollars)

Gross Unrealized Gains (Losses) on Available-for-Sale Securities

				As at October 31, 2013
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
Securities issued or guaranteed by:				
Canada	5,646	30	(16)	5,660
Provinces	2,480	159	(22)	2,617
Municipalities and school boards	286	17	(1)	302
U.S. Treasury and other U.S. agencies	387	3	–	390
Other debt securities	292	40	(2)	330
Equity securities	391	58	(4)	445
	9,482	307	(45)	9,744

				As at October 31, 2012
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
Securities issued or guaranteed by:				
Canada	5,619	56	–	5,675
Provinces	2,658	250	–	2,908
Municipalities and school boards	270	24	–	294
U.S. Treasury and other U.S. agencies	341	–	–	341
Other debt securities	670	35	(2)	703
Equity securities	401	63	(11)	453
	9,959	428	(13)	10,374

Impairment Losses Recognized

At the end of each financial reporting period, the Bank determines whether there is objective evidence of impairment for each available-for-sale security. During the year ended October 31, 2013, an amount of $29 million ($36 million for the year ended October 31, 2012) for impairment charges was recognized in *Gains (losses) on available-for-sale securities*, *net* in the Consolidated Statement of Income. In addition, during the years ended October 31, 2013 and 2012, no amounts were reversed in the Consolidated Statement of Income to recognize subsequent increases in the fair value of previously impaired debt securities.

Gross Unrealized Losses

As at October 31, 2013 and 2012, the Bank concluded that the gross unrealized losses on available-for-sale securities were mainly due to market price fluctuations and to changes in foreign exchange rates and that there is no objective evidence of impairment requiring an impairment loss to be recognized in the Consolidated Statement of Income.

(millions of Canadian dollars)

NOTE 6 – SECURITIES (cont.)

Master Asset Vehicles

As at October 31, 2013, the face value of the restructured notes of the master asset vehicle (MAV) conduits and of the other restructured notes held by the Bank was $1,727 million ($1,933 million as at October 31, 2012), of which $1,506 million was designated as *Securities at fair value through profit or loss* under the fair value option, and an amount of $221 million was classified in *Available-for-sale securities* ($1,647 million designated as *Securities at fair value through profit or loss* and $286 million classified in *Available-for-sale securities* as at October 31, 2012). The change in the face value of the restructured notes of the MAV conduits during the year ended October 31, 2013 was mainly due to capital repayments and disposals.

The following table provides a breakdown of the face value of the restructured notes of the MAV conduits held by the Bank:

As at October 31	2013	2012
MAV I		
Class A-1	478	597
Class A-2	553	552
Class B	94	94
Class C	39	39
IA tracking notes for ineligible assets	12	20
Total MAV I	1,176	1,302
MAV II		
Class A-1	101	100
Class A-2	80	82
Class B	14	15
Class C	6	6
IA tracking notes for ineligible assets	16	21
Total MAV II	217	224
MAV III		
TA tracking notes for traditional assets	9	15
IA tracking notes for ineligible assets	186	243
Total MAV III	195	258
Commercial paper not included in the Pan-Canadian restructuring plan	139	149
Total	1,727	1,933

The Bank has committed to contribute $886 million ($910 million as at October 31, 2012) to a margin funding facility related to the MAV conduits in order to finance potential collateral calls. As at October 31, 2013 and 2012, no amount had been advanced by the Bank.

(millions of Canadian dollars)

Establishing Fair Value

The carrying value of the restructured notes of the MAV conduits and of the other restructured notes held by the Bank in an investment portfolio as at October 31, 2013, designated as *Securities at fair value through profit or loss*, was $1,293 million, and $68 million was classified in *Available-for-sale securities* ($1,269 million designated as *Securities at fair value through profit or loss* and $69 million classified in *Available-for-sale securities* as at October 31, 2012). The notes held in an investment portfolio with one or more embedded derivatives were designated as *Securities at fair value through profit or loss* under the fair value option, and the other notes were classified in *Available-for-sale securities*.

The following table provides a breakdown of the carrying value of the restructured notes held by the Bank and their residual contractual maturities.

As at October 31				2013	2012
	1 year or less	Over 1 year to 5 years	Over 5 years	Total	Total
MAV I and MAV II	2	–	1,189	1,191	1,196
MAV III	–	–	62	62	62
Commercial paper not included in the Pan-Canadian restructuring plan	13	95	–	108	80
Carrying value of the notes	15	95	1,251	1,361	1,338
Margin funding facility				(30)	(38)
Total	15	95	1,251	1,331	1,300

In establishing the fair value of the restructured notes of the MAV conduits and excluding ineligible assets, the Bank considered the quality of the underlying assets. The Bank determined fair value using a valuation technique that incorporates discounted cash flows. The discount rate is based 80% on the CDX.IG index tranches and 20% on a basket of securities backed by assets such as credit card receivables, Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and automobile loans. The fair valuation method also includes the effects of broker quotes and market conditions on the MAV II Class A-1, A-2, B and C notes. The adjustment related to broker quotes represented 30% in 2013 (30% in 2012) of the weighting used to determine fair value. The credit ratings and coupons were based on the terms set out in the restructured notes of the MAV conduits. Maturities are based on the anticipated cash flows of the underlying assets.

For ineligible assets, the fair value of the tracking notes is based on an analysis of the underlying assets of the notes and the market value of comparable instruments. For RMBS, fair values were based on the ABX index; for CMBS, CMBS indices, including the CMBX index, were chosen. As for derivative financial instruments, the Bank used valuation models which are commonly used by market participants with inputs that are based on factors observable in the markets such as the CDX.IG indices and the base correlation and interest rates.

In establishing the fair value of the restructured notes in 2013, the Bank adjusted its liquidity assumption to reflect market conditions.

The Bank determines the value of the restructured notes of the MAV conduits it is holding by comparing the value obtained using the above-described methodology against a range of values. The values situated in this range were obtained from adjusting various inputs to the discount rate and broker quotes, incorporating third-party assessments and by applying various liquidity scenarios. As several assumptions may be used in determining fair value, this range reflects the level of uncertainty associated with these models.

During the year ended October 31, 2013, revenues amounting to $139 million and $12 million were recorded to reflect, respectively, the change in the fair value of restructured notes and the change in the fair value of commercial paper not included in the Pan-Canadian restructuring plan ($111 million and $34 million, respectively, during the year ended October 31, 2012). These amounts were recorded in *Trading revenues* in the Consolidated Statement of Income. The carrying value of the restructured notes, designated as *Securities at fair value through profit or loss*, was within the range of the estimated fair value as at October 31, 2013. The credit ratings of the MAV I and MAV II Class A-1 notes were maintained at "AA (low) (sf)" and the credit rating of the MAV I Class A-2 notes remained unchanged at "A (sf)". The credit rating of the MAV II Class A-2 notes was upgraded from "BBB (high) (sf)" to "A (low) (sf)", and a credit rating of "BBB (low) (sf)" was assigned to the MAV I Class B notes.

NOTE 6 – SECURITIES (cont.)

The Bank's valuation was based on its assessment of the conditions prevailing as at October 31, 2013, which may change in the future. The most significant assumptions used to determine the fair value of the restructured notes are observable discount rates, the credit ratings of the notes and the broker quotes on the MAV II Class A-1, A-2, B and C notes. Furthermore, there may be valuation uncertainty resulting from the choice of the valuation model used. The sensitivities of these assumptions on fair value as at October 31, 2013 are as follows:

- a 10-basis-point change in the discount rate would result in a $6 million decrease or increase in the fair value;
- a decrease in the credit rating by one letter grade would result in a decrease in the fair value between a range of $9 million to $16 million;
- an increase in the credit rating by one letter grade would result in an increase in the fair value between a range of $3 million to $5 million;
- a 100-basis-point change in the liquidity premium spread would result in a $13 million decrease or increase in the fair value;
- a 10% change in the weighting used to determine the discount rate would result in a $5 million decrease or increase in the fair value;
- a 10% change in the weighting attributed to the discount rate and the broker quotes on the MAV II Class A-1, A-2, B and C notes would result in a $7 million decrease or increase in the fair value; and
- a 1% change in the broker quotes on the MAV II Class A-1, A-2, B and C notes would result in a $4 million decrease or increase in the fair value.

Determining the fair value of restructured notes of the MAV conduits is complex and involves an extensive process that includes the use of quantitative modelling and relevant assumptions. Possible changes that could have a significant impact on the future value include (1) changes in the value of the underlying assets, (2) changes regarding the liquidity of the restructured notes of the MAV conduits which are not currently traded on an active market, (3) the impacts of a marked and prolonged economic slowdown in North America and certain European countries, and (4) changes in legislation.

Credit Facilities to Clients Holding Restructured Notes of the MAV Conduits

As at October 31, 2013, credit facilities outstanding provided to clients holding restructured notes of the MAV conduits stood at $17 million ($26 million as at October 31, 2012) and the allowances for credit losses were nil ($3 million as at October 31, 2012). As at October 31, 2013, credit facilities backed by restructured notes of the MAV conduits totalled $25 million ($100 million as at October 31, 2012) and those backed by ineligible asset tracking notes were nil ($4 million as at October 31, 2012). The face value of the restructured notes of the MAV II conduit designated as collateral totalled $29 million and the face value of the restructured notes of the MAV III conduit designated as collateral was nil ($150 million and $9 million, respectively, as at October 31, 2012).

(millions of Canadian dollars)

NOTE 7 – LOANS

Credit Quality of Loans

				As at October 31, 2013
	Residential mortgage	Personal and credit card	Business and government[1]	Total
Neither past due[2] nor impaired	36,213	27,674	24,022	87,909
Past due[2] but not impaired	314	245	99	658
Impaired	46	70	279	395
Gross loans	36,573	27,989	24,400	88,962
Less: Allowances on impaired loans				
Individual allowances	7	13	170	190
Collective allowances	–	20	2	22
Allowances on impaired loans	7	33	172	212
	36,566	27,956	24,228	88,750
Less: Collective allowance on non-impaired loans[3]				366
Loans, net of allowances				88,384

				As at October 31, 2012
	Residential mortgage	Personal and credit card	Business and government[1]	Total
Neither past due[2] nor impaired	33,214	26,248	22,720	82,182
Past due[2] but not impaired	285	226	169	680
Impaired	39	55	293	387
Gross loans	33,538	26,529	23,182	83,249
Less: Allowances on impaired loans				
Individual allowances	7	7	173	187
Collective allowances	–	18	3	21
Allowances on impaired loans	7	25	176	208
	33,531	26,504	23,006	83,041
Less: Collective allowance on non-impaired loans[3]				369
Loans, net of allowances				82,672

(1) Business credit portfolios are closely monitored and a monthly watchlist of problem commitments is produced. The watchlist is analyzed by the loan portfolio managers concerned, who must then submit a report to Credit Risk Management.
(2) A loan is past due when the counterparty has not made a payment the day of the contractual expiry date.
(3) The collective allowance on non-impaired loans for credit risk was established taking into account the Bank's overall credit portfolio.

(millions of Canadian dollars)

NOTE 7 – LOANS (cont.)

Loans Past Due But Not Impaired

As at October 31			2013			2012
	Residential mortgage	**Personal and credit card**	**Business and government**(1)	Residential mortgage	Personal and credit card	Business and government(1)
Past due but not impaired						
1 month late	**168**	**89**	**24**	166	82	70
2 months late	**52**	**50**	**14**	45	34	40
3 months late and more(2)	**94**	**106**	**61**	74	110	59
	314	**245**	**99**	285	226	169

(1) As at October 31, 2013, the fair value of financial collateral held against loans that were past due but not impaired was $7 million ($27 million as at October 31, 2012).
(2) Comprises fully secured loans for which, in the opinion of management, there is reasonable assurance that principal and interest will ultimately be collected. Credit card receivables are included in this category because they are written off only when payment is 180 days in arrears.

Impaired Loans

				As at October 31, 2013
	Gross	**Individual allowances**	**Collective allowances**	**Net**
Loans				
Residential mortgage	**46**	**7**	**–**	**39**
Personal and credit card	**70**	**13**	**20**	**37**
Business and government	**279**	**170**	**2**	**107**
	395	**190**	**22**	**183**

				As at October 31, 2012
	Gross	Individual allowances	Collective allowances	Net
Loans				
Residential mortgage	39	7	–	32
Personal and credit card	55	7	18	30
Business and government	293	173	3	117
	387	187	21	179

(millions of Canadian dollars)

Allowances for Credit Losses

Year ended October 31									2013
	Residential mortgage		Personal and credit card		Business and government		Total		Total
	Individual allowances	Collective allowances	Individual allowances	Collective allowances	Individual allowances	Collective allowances	Individual allowances	Collective allowances	
Allowances on impaired loans									
Balance at beginning	7	–	7	18	173	3	187	21	208
Provisions for credit losses	5	–	111	33	30	2	146	35	181
Write-offs	(5)	–	(28)	(36)	(36)	(4)	(69)	(40)	(109)
Write-offs on credit cards	–	–	(78)	–	–	–	(78)	–	(78)
Recoveries	–	–	1	5	3	1	4	6	10
Balance at end	7	–	13	20	170	2	190	22	212
Collective allowance on non-impaired loans(1)									
Balance at beginning									369
Write-offs									(3)
Balance at end									366
Total allowances									578

Year ended October 31									2012
	Residential mortgage		Personal and credit card		Business and government		Total		Total
	Individual allowances	Collective allowances	Individual allowances	Collective allowances	Individual allowances	Collective allowances	Individual allowances	Collective allowances	
Allowances on impaired loans									
Balance at beginning	5	–	8	15	202	2	215	17	232
Provisions for credit losses	5	–	104	31	35	5	144	36	180
Write-offs	(3)	–	(30)	(30)	(79)	(5)	(112)	(35)	(147)
Write-offs on credit cards	–	–	(78)	–	–	–	(78)	–	(78)
Recoveries	–	–	3	2	15	1	18	3	21
Balance at end	7	–	7	18	173	3	187	21	208
Collective allowance on non-impaired loans(2)									
Balance at beginning									376
Write-offs									(7)
Balance at end									369
Total allowances									577

(1) The collective allowance on non-impaired loans was established taking into account the Bank's overall credit portfolio, except for an amount of $3 million as at October 31, 2012 for loans and credit facilities secured by restructured notes of the MAV conduits.
(2) The collective allowance on non-impaired loans was established taking into account the Bank's overall credit portfolio, except for an amount of $10 million as at October 31, 2011 and $3 million as at October 31, 2012 for loans and credit facilities secured by restructured notes of the MAV conduits.

(millions of Canadian dollars)

NOTE 7 – LOANS (cont.)

Distribution of Gross and Impaired Loans by Borrower Category Under the Basel II Asset Classes

					2013
			As at October 31		Year ended October 31
	Gross loans	Impaired loans	Allowances for impaired loans	Provisions for credit losses	Write-offs
Residential mortgage[1]	46,836	53	8	5	5
Qualifying revolving retail[2]	3,962	16	9	78	78
Other retail[3]	10,896	71	32	66	64
Total – Retail	61,694	140	49	149	147
Agriculture and fishing	2,513	22	11	2	2
Mines, quarries and energy	1,708	21	21	24	2
Construction and real estate[4]	5,992	33	6	3	2
Manufacturing	2,535	95	64	4	5
Wholesale and retail	3,494	15	13	(1)	4
Transportation	778	–	–	1	1
Communications	1,027	6	5	–	–
Financial institutions and insurance	1,296	1	–	–	–
Services	4,876	47	30	(5)	17
Governments	223	–	–	–	–
Other	2,826	15	13	4	7
Total – Non-retail	27,268	255	163	32	40
	88,962	395	212	181	187

					2012
			As at October 31		Year ended October 31
	Gross loans	Impaired loans	Allowances for impaired loans	Provisions for credit losses	Write-offs
Residential mortgage[1]	43,226	41	6	5	4
Qualifying revolving retail[2]	3,918	13	7	78	78
Other retail[3]	11,472	62	27	57	60
Total – Retail	58,616	116	40	140	142
Agriculture and fishing	2,314	19	11	1	7
Mines, quarries and energy	1,988	6	3	1	3
Construction and real estate[4]	3,539	33	10	(2)	4
Manufacturing	2,363	75	68	2	14
Wholesale and retail	3,823	15	12	7	23
Transportation	711	1	–	–	–
Communications	1,150	83	43	6	–
Financial institutions and insurance	987	1	–	–	–
Services	4,185	28	11	23	26
Governments	305	–	–	–	–
Other	3,268	10	10	2	6
Total – Non-retail	24,633	271	168	40	83
	83,249	387	208	180	225

(1) Includes home equity lines of credit.
(2) Includes lines of credit and credit card receivables.
(3) Includes consumer loans, credit card receivables, SME loans, and other personal loans.
(4) Includes non-residential mortgages.

(millions of Canadian dollars)

NOTE 8 – FINANCIAL ASSETS TRANSFERRED BUT NOT DERECOGNIZED

In the normal course of its business, the Bank enters into transactions in which it transfers financial assets such as securities or loans directly to third parties, including special purpose entities (SPEs). In some of those transactions, the Bank retains substantially all of the risks and rewards related to those financial assets. The risks include credit risk, interest rate risk, foreign exchange risk, prepayment risk and other price risks, whereas the rewards include income streams associated with the financial assets. As such, those financial assets are not derecognized and the transactions are treated as collateralized or secured borrowings. The nature of those transactions is described below.

Securities Sold Under Repurchase Agreements and Securities Loaned
In sale of securities under repurchase agreements and lending of securities under securities lending agreements, the Bank transfers financial assets to third parties in accordance with the standard terms for such transactions. These third parties may have an unlimited right to resell or repledge the financial assets received. If cash collateral is received, the Bank records the cash along with an obligation to return the cash, which are included in *Obligations related to securities sold under repurchase agreements and securities loaned* on the Consolidated Balance Sheet. Where securities are received as collateral, the Bank does not record the collateral on the Consolidated Balance Sheet.

Financial Assets Transferred to SPEs
Under the Canada Mortgage Bond (CMB) program, the Bank sells securities backed by insured residential mortgages and other securities to Canada Housing Trust (CHT), which finances the purchase through the issuance of insured mortgage bonds. Third-party CMB investors have legal recourse only to the transferred assets. The Bank also sells insured and non-insured residential mortgages to a mutual fund administered by the Bank. The cash received for these transferred assets is treated as a secured borrowing and a corresponding liability is recorded in *Liabilities related to transferred receivables* on the Consolidated Balance Sheet.

The following table provides additional information about the nature of the transferred financial assets that do not qualify for derecognition and the associated liabilities.

As at October 31	2013	2012
Carrying value of financial assets transferred but not derecognized		
Securities(1)	33,677	29,870
Residential mortgages	14,280	13,551
	47,957	43,421
Carrying value of associated liabilities(2)	28,543	28,377
Fair value of financial assets transferred but not derecognized		
Securities(1)	33,677	29,870
Residential mortgages	14,464	13,694
	48,141	43,564
Fair value of associated liabilities(2)	28,632	28,431

(1) The amount related to the securities loaned represents the maximum amount of the Bank's securities that can be lent. For obligations related to securities sold under repurchase agreements, the amount includes the Bank's own financial assets as well as those of third parties.
(2) Associated liabilities include obligations related to securities sold under repurchase agreements before offsetting impact of $1,029 million ($343 million as at October 31, 2012) and liabilities related to transferred receivables. Liabilities related to securities loaned are not included, as the Bank can lend its own financial assets and those of third parties. The carrying value and fair value of liabilities related to securities loaned were $7,555 million as at October 31, 2013 ($6,903 million as at October 31, 2012).

The following table specifies the nature of the transactions related to financial assets transferred but not derecognized.

As at October 31	2013	2012
Carrying value of financial assets transferred but not derecognized		
Securities backed by insured residential mortgage loans and other securities sold to CHT	14,903	14,604
Securities sold under repurchase agreements	13,297	12,815
Securities loaned	19,674	15,780
Residential mortgages transferred to a mutual fund	83	222
	47,957	43,421

(millions of Canadian dollars)

NOTE 9 – ASSOCIATES AND JOINT VENTURES

Major Investments in Associates and Joint Ventures

As at October 31			2013	2012
Name	Business segment	Ownership percentage	Carrying value	Carrying value
Listed associates[(1)]				
TMX Group Limited[(2)]	Other	8.8%	**231**	228
Fiera Capital Corporation[(3)]	Wealth Management	35.0%	**207**	165
Non-listed associates				
Maple Financial Group Inc.	Financial Markets	21.4%	**161**	149
Other non-listed associates			**27**	30
Joint ventures				
National Bank General Insurance Inc. and Innovassur, assurances générales inc.	Personal and Commercial	50.0%	**28**	38
Innocap Investment Management Inc.	Financial Markets	50.0%	**8**	7
Other joint ventures	Financial Markets		**22**	8
			684	625

(1) The fair value of investments in associates based on quoted market prices in an active market totalled $551 million as at October 31, 2013 ($397 million as at October 31, 2012).
(2) The Bank exercises significant influence over TMX Group Limited mainly because of its equity interest, debt financing, and presence on TMX Group's board of directors.
(3) For additional information, see Note 26.

The following tables present aggregate summarized financial information for the Bank's associates and joint ventures.

Summarized Balance Sheet Information

As at October 31	2013[(1)]	2012[(1)]
Associates		
Assets	**30,798**	23,499
Liabilities	**26,875**	19,658
Joint ventures		
Assets	**126**	124
Liabilities	**72**	74

(1) Certain amounts were prepared using the unaudited financial statements as at September 30, 2013 and 2012.

Summarized Statement of Income Information

Year ended October 31	2013[(1)]	2012[(1)]
Associates		
Total revenues	**969**	357
Net income	**98**	18
Joint ventures		
Total revenues	**58**	59
Net income	**11**	7

(1) Certain amounts were prepared using the unaudited financial statements as at September 30, 2013 and 2012.

The associates and joint ventures had no contingent liabilities as at October 31, 2013 and 2012.

(millions of Canadian dollars)

NOTE 10 – PREMISES AND EQUIPMENT

				Cost				Accumulated amortization	Carrying value
	As at October 31, 2012	Acquisitions	Disposals	As at October 31, 2013	As at October 31, 2012	Amortization	Disposals	As at October 31, 2013	As at October 31, 2013
Land	15	–	(1)	14					14
Buildings	263	5	(13)	255	143	7	(4)	146	109
Computer equipment	119	18	(10)	127	71	22	(11)	82	45
Equipment and furniture	340	9	(10)	339	291	10	(7)	294	45
Computer equipment under a finance lease	85	–	–	85	43	12	–	55	30
Leasehold improvements	554	23	(4)	573	388	27	(3)	412	161
	1,376	55	(38)	1,393	936	78	(25)	989	404

				Cost				Accumulated amortization	Carrying value
	As at October 31, 2011	Acquisitions	Disposals	As at October 31, 2012	As at October 31, 2011	Amortization	Disposals	As at October 31, 2012	As at October 31, 2012
Land	15	–	–	15					15
Buildings	252	15	(4)	263	139	8	(4)	143	120
Computer equipment	91	31	(3)	119	54	18	(1)	71	48
Equipment and furniture	333	16	(9)	340	289	10	(8)	291	49
Computer equipment under a finance lease	85	–	–	85	31	12	–	43	42
Leasehold improvements	522	37	(5)	554	367	26	(5)	388	166
	1,298	99	(21)	1,376	880	74	(18)	936	440

Buildings Rented Under Operating Leases

The Bank is a lessor under operating lease agreements for certain buildings. The following table breaks down the future minimum payments receivable under these leases:

As at October 31	2013
1 year or less	13
Over 1 year to 5 years	43
Over 5 years	23
	79

(millions of Canadian dollars)

NOTE 11 – GOODWILL AND INTANGIBLE ASSETS

Goodwill

The following table presents the change in the carrying amount of goodwill by cash-generating unit (CGU) and business segment for the years ended October 31, 2013 and 2012.

		Wealth Management(1)					
	Personal and Commercial (1)(2)	Third-Party Solutions(2)	Securities Brokerage(2)	Managed Solutions(2)	Total	Financial Markets (1)(2)	Total
Balance as at October 31, 2011	51	53	322	287	662	270	983
CGU transfer(3)	–	(3)	14	–	11	(11)	–
Acquisition of the full-service advisory business of HSBC Investment Securities (Canada) Inc.(3)	–	–	104	–	104	–	104
Disposal of the operations of Natcan Investment Management Inc. (Note 26)	–	–	–	(18)	(18)	–	(18)
Disposal of a subsidary of Wellington West Holdings Inc.	–	–	(6)	–	(6)	–	(6)
Balance as at October 31, 2012	51	50	434	269	753	259	1,063
Other(4)						1	1
Balance as at October 31, 2013	**51**	**50**	**434**	**269**	**753**	**260**	**1,064**

(1) Constitutes a business segment of the Bank.
(2) Constitutes a CGU.
(3) As a result of changes to the structure of the Wealth Management segment, $2 million in goodwill was transferred between Securities Brokerage and Third-Party Solutions. An amount of $11 million in goodwill was also transferred between the Financial Markets segment and Securities Brokerage upon finalization of the purchase price allocation of Wellington West Holdings Inc. In addition, the acquisition of the full-service investment advisory business of HSBC Securities (Canada) Inc. resulted in $5 million in goodwill being transferred between Third-Party Solutions and Securities Brokerage.
(4) The impact of translating goodwill denominated in foreign currencies.

Goodwill Impairment Testing and Significant Assumptions

For impairment testing purposes, from the acquisition date, goodwill resulting from a business combination must be allocated to a CGU or a group of CGUs expected to benefit from the synergies of the business combination. Goodwill is tested for impairment annually or more frequently if events or circumstances indicate that the recoverable value of the CGU or group of CGUs has fallen below its carrying amount.

The recoverable value of a CGU or CGU group is calculated based on discounted pre-tax cash flows. Future pre-tax cash flows are estimated based on the reference period used for the most recent financial forecasts approved by management. Cash flows beyond that period are extrapolated using a long-term growth rate.

The discount rate used for each CGU or group of CGUs is calculated using the cost of debt financing and cost related to the Bank's equity. This rate corresponds to the Bank's weighted average cost of capital. The long-term growth rate used in calculating discounted cash flow estimates is based on the forecasted growth rate plus a risk premium. The rate is constant over the entire five-year period for which the cash flows were determined. Growth rates are determined, among other factors, based on past growth rates, economic trends, inflation, competition and the impact of the Bank's strategic initiatives. As at October 31, 2013, for each CGU or CGU group, the discount rate used was 13.5% (13.5% as at October 31, 2012) and the long-term growth rate ranged between 2.4% and 4.0%, depending on the CGU (range between 2.4% and 4.0% as at October 31, 2012).

Goodwill was tested for impairment during the years ended October 31, 2013 and 2012, and no impairment loss was recognized.

(millions of Canadian dollars)

Intangible Assets

	Cost					Accumulated amortization				Carrying value
	As at October 31, 2012	Acquisitions	Disposals	Impairment losses	As at October 31, 2013	As at October 31, 2012	Amortization	Impairment losses	As at October 31, 2013	As at October 31, 2013
Finite useful lives										
Software	170	31	–	(2)	199	132	16	–	148	51
Internally designed technology developments(1)(2)	871	200	–	(39)	1,032	332	50	(2)	380	652
Other	48	–	–	–	48	19	6	–	25	23
	1,089	231	–	(41)	1,279	483	72	(2)	553	726
Indefinite useful lives										
Management contracts	161	–	–	–	161					161
Trademarks	11	–	–	–	11					11
	172	–	–	–	172					172
	1,261	231	–	(41)	1,451	483	72	(2)	553	898

	Cost					Accumulated amortization				Carrying value
	As at October 31, 2011	Acquisitions	Dispositions	Impairment losses	As at October 31, 2012	As at October 31, 2011	Amortization	Impairment losses	As at October 31, 2012	As at October 31, 2012
Finite useful lives										
Software	154	16	–	–	170	120	12	–	132	38
Internally designed technology developments(2)	669	247	–	(45)	871	310	49	(27)	332	539
Other	46	3	(1)	–	48	11	8	–	19	29
	869	266	(1)	(45)	1,089	441	69	(27)	483	606
Indefinite useful lives										
Management contracts	168	–	(7)	–	161					161
Trademarks	11	–	–	–	11					11
	179	–	(7)	–	172					172
	1,048	266	(8)	(45)	1,261	441	69	(27)	483	778

(1) The remaining amortization period for significant internally-designed technology developments is six years.
(2) The Bank wrote off certain technology developments due to obsolescence and decided to discontinue them or replace them. The recoverable amount of those technology developments was estimated to be nil. During the year ended October 31, 2013, a $39 million impairment loss ($18 million for the year ended October 31, 2012) was recognized and charged to the *Other* heading.

(millions of Canadian dollars)

NOTE 12 – OTHER ASSETS

As at October 31	2013	2012
Receivables, prepaid expenses and other items	612	894
Interest and dividends receivable	425	490
Purchased receivables	466	206
Accrued benefit asset (Note 22)	108	47
Deferred tax assets (Note 23)	297	349
Current tax assets (Note 23)	88	31
Reinsurance assets	26	25
	2,022	2,042

NOTE 13 – OTHER LIABILITIES

As at October 31	2013	2012
Accounts payable and accrued expenses	1,236	1,603
Subsidiaries' debts to third parties	1,457	1,466
Interest and dividends payable	781	739
Accrued benefit liability (Note 22)	208	327
Deferred tax liabilities (Note 23)	119	127
Current tax liabilities (Note 23)	70	196
Insurance liabilities	73	81
Other items(1)	555	535
	4,499	5,074

(1) As at October 31, 2013, other items include a $26 million ($64 million as at October 31, 2012) provision for severance pay related to the optimization of certain organizational structures.

(millions of Canadian dollars)

NOTE 14 – SUBORDINATED DEBT

The subordinated debt represents direct unsecured obligations, in the form of notes and debentures, to the Bank's debt holders. The rights of the holders of the Bank's notes and debentures are subordinate to the claims of depositors and certain other creditors. Approval from OSFI is required before the Bank can redeem its subordinated notes and debentures in whole or in part.

During the year ended October 31, 2012, the Bank issued a total of $1 billion in notes maturing in April 2022 as part of its Canadian Medium Term Note Program.

During the year ended October 31, 2012, the Bank repurchased for cancellation a total of $500 million in notes maturing in November 2016 and a total of US$1 million in subordinated debentures maturing in February 2087.

As at October 31				**2013**	2012
Maturity date		**Interest rate**	**Characteristics**		
November	2018	5.55% (1)	Redeemable(2)	**500**	500
December	2019	4.926% (3)	Redeemable(4)	**350**	350
November	2020	4.70% (5)	Redeemable(6)	**500**	500
April	2022	3.261% (7)	Redeemable(8)	**1,000**	1,000
February	2087	Variable (9)	Redeemable at the Bank's option since February 28, 1993	**33**	32
				2,383	2,382
Fair value adjustment(10)				**48**	94
Unamortized issuance costs(11)				**(5)**	(6)
Total				**2,426**	2,470

(1) Bearing interest at a rate of 5.55% until November 15, 2013, and thereafter at an annual rate equal to the 90-day bankers' acceptance rate plus 2.64%.
(2) The Bank may, at its option, redeem all or any portion of the notes at the following price: (i) if the notes are redeemed before November 15, 2013, the interest reset date, at the price based on the Government of Canada yield (defined as the yield, compounded semi-annually, that non-callable Government of Canada Bonds would offer if they were issued at their nominal value on the redemption date, in Canadian dollars, in Canada and for which the term to maturity would equal the term to the interest reset date) plus 55 basis points, or (ii) if the notes are redeemed on or after November 15, 2013, at their nominal value.
(3) Bearing interest at a rate of 4.926% until December 22, 2014, and thereafter at an annual rate equal to the 90-day bankers' acceptance rate plus 1%.
(4) The Bank may, at its option, redeem all or any portion of the notes at the following price: (i) if the notes are redeemed before December 22, 2014, the interest reset date, at the price based on the Government of Canada yield (as defined in point 2 above) plus 17 basis points or the nominal value, whichever of the two amounts is higher; (ii) if the notes are redeemed on or after December 22, 2014, at their nominal value.
(5) Bearing interest at a rate of 4.70% until November 2, 2015, and thereafter at an annual rate equal to the 90-day bankers' acceptance rate plus 1%.
(6) The Bank may, at its option, redeem all or any portion of the notes at the following price: (i) if the notes are redeemed before November 2, 2015, the interest reset date, at the price based on the Government of Canada yield (as defined in point 2 above) plus 16 basis points or the nominal value, whichever of the two amounts is higher; (ii) if the notes are redeemed on or after November 2, 2015, at their nominal value.
(7) Bearing interest at a rate of 3.261% until April 11, 2017 and thereafter at a floating rate equal to the rate on three-month CDOR plus 1.38%.
(8) The Bank may, at its option, redeem all or any portion of the notes at nominal value plus unpaid accrued interest.
(9) Debentures denominated in foreign currency totalling US$32 million as at October 31, 2013 (2012: US$33 million) bearing interest at an annual rate of 1/8% above LIBOR.
(10) The fair value adjustment is the adjustment made to the carrying value of the subordinated debt covered by a fair value hedge.
(11) The unamortized costs related to the issuance of the subordinated debt represent the initial cost, net of accumulated amortization calculated using the effective interest rate method.

On November 15, 2013, the Bank repurchased at their nominal value for cancellation, $500 million in notes maturing in November 2018.

NOTE 15 – DERIVATIVE FINANCIAL INSTRUMENTS

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

The main types of derivative financial instruments used are presented below.

Forwards and Futures

Forwards and futures are contractual obligations to buy or deliver a specified amount of currency, interest rates, commodities or financial instruments on a specified future date at a specified price. Forwards are tailor-made agreements transacted in the over-the-counter market. Futures are traded on organized exchanges and are subject to cash margining calculated daily by clearing houses.

Swaps

Swaps are over-the-counter contracts in which two parties agree to exchange cash flows. The Bank uses the following types of swap contracts:

- cross-currency swaps are transactions in which counterparties exchange fixed-rate interest payments and principal payments in different currencies;
- interest rate swaps are transactions in which counterparties exchange fixed and floating rate interest payments, based on the notional principal value in the same currency;
- commodity swaps are transactions in which counterparties exchange fixed and floating rate payments, based on the notional principal value of a single product;
- equity swaps are transactions in which counterparties agree to exchange the return on one equity or group of equities for a payment based on a benchmark interest rate; and
- credit default swaps are transactions in which one of the parties agrees to pay interest expenses to the other party so that the latter can make a payment if a credit event occurs.

Options

Options are agreements between two parties in which the writer of the option conveys to the buyer the right, but not the obligation, to buy or sell, at or by a predetermined date, at any time prior to a predetermined expiry date, a specific amount of currency, commodities or financial instruments at a price agreed to when the option is sold. The writer receives a premium for selling this instrument.

(millions of Canadian dollars)

Notional Amounts

Notional amounts are not presented in assets or liabilities on the Consolidated Balance Sheet. They represent the set underlying principal of a derivative financial instrument and serve as a point of reference in applying an exchange rate, interest rate, stock market price or other variable in order to determine the amount of cash flows to be exchanged.

As at October 31								2013	2012
	Term to maturity								
	3 months or less	Over 3 months to 12 months	Over 1 year to 5 years	Over 5 years	Total contracts	Contracts held for trading purposes	Contracts designated as hedges		Total contracts
INTEREST RATE CONTRACTS									
OTC contracts									
Guaranteed interest rate contracts									
Not settled by central counterparties	869	11,765	4,300	–	16,934	16,934	–		57,898
Settled by central counterparties	–	–	364	–	364	364	–		–
Swaps									
Not settled by central counterparties	24,552	34,003	110,065	40,390	209,010	185,423	23,587		286,016
Settled by central counterparties	3,839	33,968	37,655	10,478	85,940	85,304	636		11,575
Options purchased	–	1,854	262	716	2,832	2,688	144		4,109
Options written	–	529	865	1,165	2,559	2,193	366		5,381
	29,260	82,119	153,511	52,749	317,639	292,906	24,733		364,979
Exchange-traded contracts									
Futures									
Long positions	214	1,546	2,075	–	3,835	3,835	–		2,407
Short positions	7,121	1,841	5,517	–	14,479	14,479	–		15,655
Options purchased	1,150	1,000	–	–	2,150	2,150	–		14,630
Options written	1,011	250	–	–	1,261	1,261	–		5,078
	9,496	4,637	7,592	–	21,725	21,725	–		37,770
FOREIGN EXCHANGE CONTRACTS									
OTC contracts									
Forwards	6,648	3,713	1,723	93	12,177	12,129	48		10,367
Swaps	32,651	12,569	18,420	9,220	72,860	72,718	142		67,332
Options purchased	1,182	1,400	338	105	3,025	3,025	–		5,871
Options written	1,336	1,402	353	53	3,144	3,144	–		4,838
	41,817	19,084	20,834	9,471	91,206	91,016	190		88,408
Exchange-traded contracts									
Futures									
Long positions	54	–	–	–	54	54	–		193
Short positions	127	3	–	–	130	130	–		41
Options purchased	9	–	–	–	9	9	–		64
Options written	14	–	–	–	14	14	–		71
	204	3	–	–	207	207	–		369
EQUITY, COMMODITY AND CREDIT DERIVATIVE CONTRACTS(1)									
OTC contracts									
Forwards	33	28	83	2	146	146	–		510
Swaps									
Not settled by central counterparties	5,114	10,067	7,728	895	23,804	23,751	53		26,780
Settled by central counterparties	170	8	81	21	280	280	–		203
Options purchased	475	227	1,137	10	1,849	1,849	–		3,297
Options written	381	288	1,018	62	1,749	1,749	–		2,517
	6,173	10,618	10,047	990	27,828	27,775	53		33,307
Exchange-traded contracts									
Futures									
Long positions	1,110	165	161	80	1,516	1,516	–		1,386
Short positions	4,343	2,414	995	4	7,756	7,756	–		5,748
Options purchased	994	466	180	–	1,640	1,640	–		4,329
Options written	451	613	351	3	1,418	1,418	–		596
	6,898	3,658	1,687	87	12,330	12,330	–		12,059
	93,848	120,119	193,671	63,297	470,935	445,959	24,976		536,892

(1) Includes precious metal contracts.

(millions of Canadian dollars)

NOTE 15 – DERIVATIVE FINANCIAL INSTRUMENTS (cont.)

Credit Risk

Credit risk on derivative financial instruments is the risk of financial loss that the Bank will have to assume if a counterparty fails to honour its contractual obligations. Credit risk related to derivative financial instruments is subject to the same credit approval, credit limit and monitoring standards as those applied to the Bank's other credit transactions. Consequently, the Bank evaluates the creditworthiness of counterparties and monitors the size of the portfolios as well as the diversification and maturity profiles of these financial instruments.

The Bank limits the credit risk of over-the-counter contracts by dealing with creditworthy counterparties and entering into contracts that provide for the exchange of collateral between parties where the fair value of the outstanding transactions exceeds an agreed threshold. The Bank also negotiates master netting agreements that provide for the simultaneous close-out and settling of all transactions with a given counterparty in the event of default. However, overall exposure to credit risk, reduced through master netting agreements, may change substantially after the balance sheet date because it is affected by all transactions subject to a contract as well as by changes in the market rates of the underlying instruments.

In the case of exchange-traded contracts, exposure to credit risk is limited because these transactions are standardized contracts executed on established exchanges, each of which is associated with a well-capitalized clearing house that assumes the obligations of both counterparties and guarantees their performance obligations. All exchange-traded contracts are subject to initial margins and daily settlement.

Terms Used

Replacement cost

The replacement cost represents the Bank's maximum credit risk associated with derivative financial instruments as at the Consolidated Balance Sheet date. This amount is the positive fair value of all over-the-counter derivative financial instruments, before all master netting agreements and collateral held.

Credit risk equivalent

The credit risk equivalent amount is the total replacement cost plus an amount representing the potential future credit risk exposure, as outlined in the guidelines issued by OSFI.

Risk-weighted amount

The risk-weighted amount is determined by applying the Basel II rules to the credit risk equivalent.

Credit Risk Exposure of the Derivative Financial Instrument Portfolio

As at October 31			2013			2012
	Replacement cost[1]	Credit risk equivalent	Risk-weighted amount	Replacement cost[1]	Credit risk equivalent	Risk-weighted amount
Interest rate contracts	3,105	4,664	1,336	4,272	5,628	1,823
Foreign exchange contracts	1,011	3,372	989	913	2,763	358
Equity, commodity and credit derivative contracts	1,549	3,765	2,076	1,104	3,572	1,072
	5,665	11,801	4,401	6,289	11,963	3,253
Impact of master netting agreements	(2,826)	(5,484)	(1,728)	(3,831)	(6,395)	(1,225)
	2,839	6,317	2,673	2,458	5,568	2,028

(1) As at October 31, 2013, the total positive fair value of the exchange-traded contracts, which amounted to $0.2 billion, was excluded ($0.4 billion as at October 31, 2012).

Credit Risk Exposure of the Derivative Financial Instrument Portfolio by Counterparty

As at October 31		2013		2012
	Replacement cost	Credit risk equivalent	Replacement cost	Credit risk equivalent
OECD[1] governments	262	590	162	378
Banks of OECD member countries	601	2,108	881	2,565
Other	1,976	3,619	1,415	2,625
	2,839	6,317	2,458	5,568

(1) Organization for Economic Co-operation and Development.

(millions of Canadian dollars)

Fair Value of Derivative Financial Instruments

As at October 31			2013			2012
	Positive	Negative	Net	Positive	Negative	Net
CONTRACTS HELD FOR TRADING PURPOSES						
Interest rate contracts						
Forwards	22	12	10	13	10	3
Swaps	2,613	2,240	373	3,575	3,163	412
Options	9	17	(8)	2	15	(13)
	2,644	2,269	375	3,590	3,188	402
Foreign exchange contracts						
Forwards	116	77	39	69	91	(22)
Swaps	850	592	258	796	675	121
Options	45	58	(13)	54	55	(1)
	1,011	727	284	919	821	98
Equity, commodity and credit derivative contracts						
Forwards	200	284	(84)	341	131	210
Swaps	1,329	1,024	305	860	942	(82)
Options	246	333	(87)	297	282	15
	1,775	1,641	134	1,498	1,355	143
Total – Contracts held for trading purposes	5,430	4,637	793	6,007	5,364	643
CONTRACTS DESIGNATED AS HEDGES						
Interest rate contracts						
Forwards	–	–	–	–	–	–
Swaps	469	210	259	685	235	450
Options	2	11	(9)	2	–	2
	471	221	250	687	235	452
Foreign exchange contracts						
Forwards	–	–	–	–	–	–
Swaps	2	–	2	–	1	(1)
Options	–	–	–	–	–	–
	2	–	2	–	1	(1)
Equity, commodity and credit derivative contracts						
Forwards	–	–	–	–	–	–
Swaps	1	–	1	2	–	2
Options	–	–	–	–	–	–
	1	–	1	2	–	2
Total – Contracts designated as hedges	474	221	253	689	236	453
Designated as fair value hedges	390	188	202	559	207	352
Designated as cash flow hedges	82	33	49	130	28	102
Designated as a hedge of a net investment in a foreign operation	2	–	2	–	1	(1)
Total fair value	5,904	4,858	1,046	6,696	5,600	1,096
Impact of master netting agreements	(2,826)	(2,826)	–	(3,831)	(3,831)	–
	3,078	2,032	1,046	2,865	1,769	1,096

(millions of Canadian dollars)

NOTE 16 – HEDGING ACTIVITIES

Hedges of Net Investments in Foreign Operations

The Bank's structural foreign exchange risk arises from investments in foreign operations denominated in currencies other than the Canadian dollar. This risk is measured by assessing the impact of foreign currency fluctuations. The Bank uses financial instruments (derivative or non-derivative) to hedge structural foreign exchange risk. In a hedge of a net investment in a foreign operation, the financial instruments used offset foreign exchange gains and losses on the investments. When non-derivative financial instruments are designated as foreign exchange risk hedges, only the changes in fair value that are attributable to foreign exchange risk are taken into account in assessing and calculating the effectiveness of the hedge.

For the years ended October 31, 2013 and 2012, a negligible amount representing the ineffective portion was recognized in *Non-interest income* in the Consolidated Statement of Income.

Fair Value Hedges

Fair value hedge transactions consist in using interest rate swaps to hedge changes in the fair value of a financial asset or financial liability caused by interest rate fluctuations. The change in fair value of the derivative financial instruments used as hedging instruments offsets the change in fair value of the hedged item. The Bank applies this strategy mainly to portfolios of available-for-sale securities, fixed-rate deposits, liabilities related to transferred receivables and subordinated debt.

Results of the Fair Value Hedges

Year ended October 31	2013	2012
Gains (losses) on hedging instruments	(106)	(4)
Gains (losses) on hedged items attributable to the hedged risk	107	7
Ineffectiveness of fair value hedging relationships	2	–

Cash Flow Hedges

Cash flow hedge transactions consist in using interest rate swaps to hedge the risk of changes in future cash flows caused by floating-rate assets or liabilities. The Bank applies this strategy mainly to loan, personal credit line and variable-rate deposit portfolios. The Bank also uses total return swaps to hedge the risk of changes in future cash flows related to the Restricted Stock Unit (RSU) Plan. Some of these swaps are designated as part of a cash flow hedge against a portion of the unrecognized obligation of the RSU Plan. In a cash flow hedge, the derivative financial instruments used as hedging instruments reduce the variability of future cash flows related to the hedged item.

Results of the Cash Flow Hedges

Year ended October 31	2013	2012
Unrealized gains (losses) included in *Other comprehensive income* as the effective portion of the hedging instrument	(36)	(3)
Losses (gains) reclassified to *Net interest income* in the Consolidated Statement of Income	(38)	(74)
Ineffectiveness of cash flow hedging relationships	(2)	–

(millions of Canadian dollars)

The following table shows the periods during which the Bank expects the hedged cash flows to occur and have an impact on net income:

	As at October 31, 2013			
	1 year or less	Over 1 year to 2 years	Over 2 years to 5 years	Over 5 years
Expected cash flows from hedged assets	60	49	66	22
Expected cash flows from hedged liabilities	75	63	111	–
Net exposure	(15)	(14)	(45)	22

	As at October 31, 2012			
	1 year or less	Over 1 year to 2 years	Over 2 years to 5 years	Over 5 years
Expected cash flows from hedged assets	71	60	116	52
Expected cash flows from hedged liabilities	15	13	22	–
Net exposure	56	47	94	52

Derivative and Non-Derivative Financial Instruments Designated as Hedging Instruments

As at October 31	2013			2012		
	Fair value hedge	Cash flow hedge	Net investment hedge	Fair value hedge	Cash flow hedge	Net investment hedge
Assets						
Derivative financial instruments	390	82	2	559	130	–
Liabilities						
Derivative financial instruments	188	33	–	207	28	1
Carrying value of non-derivative financial instruments	–	–	1,192	–	–	1,810
Notional amounts of designated derivative financial instruments	20,830	3,956	190	20,265	2,778	177

NOTE 17 – SHARE CAPITAL

Authorized

Common Shares

An unlimited number of shares without par value.

First Preferred Shares

An unlimited number of shares, without par value, issuable for a maximum aggregate consideration of $5 billion.

Characteristics of first preferred shares issued and outstanding (amounts in dollars)

Series 16

Redeemable in cash at the Bank's option, subject to prior approval of OSFI, since May 15, 2010, in whole or in part, at a price equal to $26.00 per share if redeemed before May 15, 2011, at a price equal to $25.75 per share if redeemed during the 12-month period preceding May 15, 2012, at a price equal to $25.50 per share if redeemed during the 12-month period preceding May 15, 2013, at a price equal to $25.25 per share if redeemed during the 12-month period preceding May 15, 2014, and at a price equal to $25.00 per share if redeemed on or after May 15, 2014, plus, in all cases, all declared and unpaid dividends at the date fixed for redemption. These shares carry a non-cumulative quarterly dividend of $0.303125.

Series 20

Redeemable in cash at the Bank's option, subject to prior approval of OSFI, since May 15, 2013, in whole or in part, at a price equal to $26.00 per share if redeemed before May 15, 2014, at a price equal to $25.75 per share if redeemed during the 12-month period preceding May 15, 2015, at a price equal to $25.50 per share if redeemed during the 12-month period preceding May 15, 2016, at a price equal to $25.25 per share if redeemed during the 12-month period preceding May 15, 2017, and at a price equal to $25.00 per share if redeemed on or after May 15, 2017, plus, in all cases, all declared and unpaid dividends at the date fixed for redemption. These shares carry a non-cumulative quarterly dividend of $0.375.

Series 24

Redeemable in cash at the Bank's option, subject to prior approval of OSFI, on or after February 15, 2014 and February 15 every five years thereafter, in whole or in part, at a price equal to $25.00 per share, plus all declared and unpaid dividends at the date fixed for redemption. Convertible into floating-rate non-cumulative Series 25 First Preferred Shares of the Bank, subject to certain conditions, on February 15, 2014 and on February 15 every five years thereafter. These shares carry a non-cumulative quarterly dividend of $0.4125 for the initial period ending February 15, 2014. Thereafter, these shares carry a non-cumulative quarterly fixed dividend in an amount per share determined by multiplying the interest rate, equal to the sum of the Government of Canada yield on the calculation date of the applicable fixed rate plus 4.63%, by $25.00.

Series 26

Redeemable in cash at the Bank's option, subject to prior approval of OSFI, on or after February 15, 2014 and February 15 every five years thereafter, in whole or in part, at a price equal to $25.00 per share, plus all declared and unpaid dividends at the date fixed for redemption. Convertible into floating-rate non-cumulative Series 27 First Preferred Shares of the Bank, subject to certain conditions, on February 15, 2014 and on February 15 every five years thereafter. These shares carry a non-cumulative quarterly dividend of $0.4125 for the initial period ending February 15, 2014. Thereafter, these shares carry a non-cumulative quarterly fixed dividend in an amount per share determined by multiplying the interest rate, equal to the sum of the Government of Canada yield on the calculation date of the applicable fixed rate plus 4.79%, by $25.00.

Series 28

Redeemable in cash at the Bank's option, subject to prior approval of OSFI, on or after November 15, 2017 and November 15 every five years thereafter, in whole or in part, at a price equal to $25.00 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption. Convertible into floating-rate non-cumulative Series 29 First Preferred Shares of the Bank, subject to certain conditions, on November 15, 2017 and on November 15 every five years thereafter. These shares carry a non-cumulative quarterly dividend of $0.2375 for the initial period ending November 15, 2017. Thereafter, these shares carry a non-cumulative quarterly fixed dividend in an amount per share determined by multiplying the interest rate, equal to the sum of the Government of Canada yield on the calculation date of the applicable fixed rate plus 2.43%, by $25.00.

Characteristics of first preferred shares, authorized but unissued (amounts in dollars)

Series 17

Each NBC CapS – Series 1 is exchangeable at any time, upon prior notice, for 40 Series 17 First Preferred Shares, which pay semi-annual non-cumulative cash dividends and are redeemable at the Bank's option, subject to the prior approval of OSFI, since June 30, 2011, but are not redeemable at the option of the holders.

Series 18

Each NBC CapS – Series 1 can be exchanged automatically, without the consent of the holders, for 40 Series 18 First Preferred Shares, upon the occurrence of any one of the following events: (i) proceedings are commenced for the winding-up of the Bank; (ii) OSFI takes control of the Bank; (iii) the Bank has a Tier 1 capital ratio of less than 5% or a total capital ratio of less than 8%; or (iv) OSFI has directed the Bank to increase its capital or to provide additional liquidity and the Bank elects such automatic exchange or the Bank fails to comply with such direction to the satisfaction of OSFI. Series 18 First Preferred Shares pay semi-annual non-cumulative cash dividends and are redeemable at the option of the Bank, subject to the prior approval of OSFI, since June 30, 2011, but are not redeemable at the option of the holders.

Series 19

Each NBC CapS II – Series 1 can be exchanged automatically, without the consent of the holders, for 40 Series 19 First Preferred Shares of the Bank upon the occurrence of one of the following events: (i) proceedings are commenced for the winding-up of the Bank; (ii) OSFI takes control of the Bank; (iii) the Bank posts a Tier 1 capital ratio of less than 5% or a total capital ratio of less than 8%; or (iv) OSFI has directed the Bank to increase its capital or to provide additional liquidity and the Bank elects to cause such automatic exchange or the Bank does not comply with such direction to the satisfaction of OSFI. Series 19 First Preferred Shares pay semi-annual non-cumulative cash dividends and are redeemable at the Bank's option, subject to the prior approval of OSFI, since June 30, 2013, but are not redeemable at the option of the holders.

Series 23

Each NBC CapS II – Series 2 can be exchanged automatically, without the consent of the holders, for 40 Series 23 First Preferred Shares of the Bank upon the occurrence of one of the following events: (i) proceedings are commenced for the winding-up of the Bank; (ii) OSFI takes control of the Bank; (iii) the Bank posts a Tier 1 capital ratio of less than 5% or a total capital ratio of less than 8%; or (iv) OSFI has directed the Bank to increase its capital or to provide additional liquidity and the Bank elects to cause such automatic exchange or the Bank does not comply with such direction to the satisfaction of OSFI. Series 23 First Preferred Shares pay semi-annual non-cumulative cash dividends and are redeemable at the Bank's option, subject to the prior approval of OSFI, since July 31, 2013, but are not redeemable at the option of the holders.

Series 25

Redeemable in cash at the Bank's option, subject to prior approval of OSFI, on or after February 15, 2019 and February 15 every five years thereafter, in whole or in part, at a price equal to $25.00 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption or at $25.50 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption on any other date on or after February 15, 2014. Series 25 First Preferred Shares pay quarterly floating-rate non-cumulative dividends on or after February 15, 2014.

Series 27

Redeemable in cash at the Bank's option, subject to prior approval of OSFI, on or after February 15, 2019 and February 15 every five years thereafter, in whole or in part, at a price equal to $25.00 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption or at $25.50 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption on any other date on or after February 15, 2014. Series 27 First Preferred Shares pay quarterly floating-rate non-cumulative dividends on or after February 15, 2014.

Series 29

Redeemable in cash at the Bank's option, subject to prior approval of OSFI, on or after November 15, 2022 and November 15 every five years thereafter, in whole or in part, at a price equal to $25.00 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption or at $25.50 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption on any other date on or after November 15, 2017. Series 29 First Preferred Shares pay quarterly floating-rate non-cumulative dividends on or after November 15, 2017.

Second Preferred Shares

15 million shares without par value, issuable for a total maximum consideration of $300 million. As at October 31, 2013, no shares had been issued or traded.

(millions of Canadian dollars)

NOTE 17 – SHARE CAPITAL (cont.)

Shares Outstanding and Dividends Declared

				2013
	As at October 31		Year ended October 31	
	Shares		Dividends	
	Number of shares	$	$	Per share
First Preferred Shares				
Series 15	–	–	2	0.2444
Series 16	8,000,000	200	10	1.2125
Series 20	6,900,000	173	10	1.5000
Series 21	–	–	3	1.0078
Series 24	2,425,880	61	4	1.6500
Series 26	1,724,835	43	3	1.6500
Series 28	8,000,000	200	8	0.9728
Preferred shares and dividends	27,050,715	677	40	
Common shares at beginning	161,308,273	2,054		
Issued pursuant to:				
Stock Option Plan	1,764,764	107		
Impact of shares purchased or sold for trading	(68,844)	(1)		
Other	(12,825)	–		
Common shares at end and dividends	162,991,368	2,160	552	3.4000
Total dividends			592	

				2012
	As at October 31		Year ended October 31	
	Shares		Dividends	
	Number of shares	$	$	Per share
First Preferred Shares				
Series 15	8,000,000	200	12	1.4625
Series 16	8,000,000	200	10	1.2125
Series 20	6,900,000	173	10	1.5000
Series 21	3,410,861	85	4	1.3438
Series 24	2,425,880	61	4	1.6500
Series 26	1,724,835	43	3	1.6500
Preferred shares and dividends	30,461,576	762	43	
Common shares at beginning	160,474,334	1,970		
Issued pursuant to:				
Stock Option Plan	1,706,081	93		
Acquisition of Wellington West Holdings Inc.	28,399	2		
Impact of shares purchased or sold for trading	97,165	2		
Repurchase of common shares for cancellation	(1,000,000)	(13)		
Other	2,294	–		
Common shares at end and dividends	161,308,273	2,054	498	3.0800
Total dividends			541	

Issuances of Preferred Shares

On October 30, 2012, the Bank announced the issuance of 7,000,000 non-cumulative 5-year rate-reset Series 28 First Preferred Shares at a price equal to $25.00 per share for gross proceeds of $175 million. The Bank had also granted the underwriters an option to purchase up to an additional 1,000,000 Series 28 preferred shares. The option was exercised and 8,000,000 shares were issued for total gross proceeds of $200 million. The Bank completed the issuance on November 7, 2012.

Repurchases of Preferred Shares

On August 16, 2013, the Bank completed the repurchase of all the issued and outstanding non-cumulative 5-year rate-reset Series 21 First Preferred Shares. Pursuant to the share conditions, the redemption price was $25.00 per share plus the periodic dividend declared and unpaid. The Bank repurchased 3,410,861 Series 21 preferred shares for a total amount of $85 million, which reduced *Preferred share capital* by $85 million.

On January 15, 2013, the Bank completed the repurchase of all the issued and outstanding non-cumulative fixed-rate Series 15 First Preferred Shares. Pursuant to the share conditions, the redemption price was $25.00 per share plus the periodic dividend declared and unpaid. The Bank repurchased 8,000,000 Series 15 preferred shares for a total amount of $200 million, which reduced *Preferred share capital* by $200 million.

Repurchase of Common Shares

On June 20, 2013, the Bank began a normal course issuer bid to repurchase for cancellation up to 3,248,114 common shares over the 12-month period ending no later than June 19, 2014. The shares will be repurchased on the open market at market prices through the Toronto Stock Exchange. Premiums paid above the average book value of the common shares will be charged to *Retained earnings*. During the year ended October 31, 2013, the Bank did not repurchase any shares.

Reserved Common Shares

As at October 31, 2013, 7,753,784 common shares were reserved under the Dividend Reinvestment and Share Purchase Plan, and 13,065,437 common shares were reserved under the Stock Option Plan.

Common Shares Held in Escrow

As part of the acquisition of Wellington West Holdings Inc. (Wellington West) completed on July 15, 2011, the Bank had issued 2,149,108 common shares for $169 million. During the valuation period ended July 15, 2012, the calculation of working capital adjustments resulted in an issuance of 28,399 additional Bank common shares for an amount of $2 million. All of these common shares were placed in escrow in the name of the vendors and will be released contingent on certain non-compete criteria being met.

In July 2013, the Bank released a payment of 457,620 common shares (375,670 common shares in July 2012). In October 2012, as part of the sale of one of Wellington West's subsidiaries, Wellington West Financial Services Inc., the Bank also released 12,083 common shares on an accelerated basis. As at October 31, 2013, the balance of the common shares held in escrow was 1,332,134 (1,789,754 as at October 31, 2012). The Bank expects that the conditions will be met and that the remaining shares held in escrow will be released over the next two fiscal years.

Restriction on the Payment of Dividends

The Bank is prohibited from declaring dividends on its common or preferred shares if there are reasonable grounds for believing that the Bank would, by so doing, be in contravention of the regulations of the *Bank Act* (Canada) or OSFI's capital adequacy and liquidity guidelines. In addition, the ability to pay common share dividends is restricted by the terms of the outstanding preferred shares pursuant to which the Bank may not pay dividends on its common shares without the approval of the holders of the outstanding preferred shares, unless all preferred share dividends have been declared and paid or set aside for payment. Moreover, if NBC Capital Trust or NBC Asset Trust failed to pay any required distribution on the trust units in full, the Bank could not declare dividends on any of its preferred or common shares. For additional information, see Note 18.

Dividend Reinvestment Plan

The Bank has a dividend reinvestment plan for common and preferred shareholders. Participation in the plan is optional. Under the terms and conditions of the plan, participants acquire shares through the reinvestment of cash dividends paid on the shares they hold or through optional cash payments. The common shares are issued for an amount equal to the average of the closing prices of shares traded on the Toronto Stock Exchange during the five business days immediately preceding a dividend payment date.

(millions of Canadian dollars)

NOTE 18 – NON-CONTROLLING INTERESTS

As at October 31	2013	2012
Trust units issued by NBC Capital Trust (NBC CapS – Series 1)(1)	229	229
Trust units issued by NBC Asset Trust (NBC CapS II)		
Series 1(2)	409	409
Series 2(3)	359	359
Other	21	23
Total	1,018	1,020

(1) Includes $4 million in accrued interest ($4 million as at October 31, 2012).
(2) Includes $9 million in accrued interest ($9 million as at October 31, 2012).
(3) Includes $9 million in accrued interest ($9 million as at October 31, 2012).

Trust Units Issued by NBC Capital Trust
Through special purpose entity NBC Capital Trust (the Trust), an open-end trust established under the laws of the Province of Ontario, the Bank issued transferable non-voting trust units called "Trust Capital Securities – Series 1," or "NBC CapS – Series 1." These securities are not redeemable at the option of the holder. The gross proceeds of $225 million from the offering were used by the Trust to acquire a deposit note from the Bank.

The main terms and characteristics of the NBC CapS – Series 1 trust units are presented below:

	Number	Issuance Date	Annual yield	Distribution date	Semi-annual distribution per NBC CapS – Series 1(1)	Date of conversion at the option of the holder(2)
Series 1	225,000	June 15, 2006	5.329 %	June 30, December 31	$ 26.645(3)	Anytime

(1) For each unit with a face value of $1,000.
(2) Holders of NBC CapS – Series 1 may exchange, subject to prior notice, each NBC CapS – Series 1 for 40 Series 17 First Preferred Shares of the Bank. This exchange right will be effected through the conversion by the Trust of the corresponding amount of the deposit note of the Bank. The NBC CapS – Series 1 exchanged for the Bank's Series 17 First Preferred Shares will be cancelled by the Trust.
(3) For each distribution date after June 30, 2016, the distribution will be paid at the rate corresponding to one-half of the sum of 180-day bankers' acceptance rate in effect plus 1.50%.

Distribution
No cash distributions will be payable by the Trust on NBC CapS – Series 1 if the Bank fails to declare regular dividends on its preferred shares or, if no preferred shares are then outstanding, on its outstanding common shares. In this case, the net distributable funds of the Trust will be paid to the Bank in its capacity as holder of the Special Trust Securities, representing the residual interest in the Trust. Should the Trust fail to pay the semi-annual distributions in full on the NBC CapS – Series 1, the Bank will not declare dividends on any of its preferred shares and common shares for a specified period of time.

Automatic exchange
Each NBC CapS – Series 1 will be exchanged automatically, without the consent of the holders, for 40 Series 18 First Preferred Shares of the Bank, upon the occurrence of certain predetermined events. For additional information, see Note 17. On an automatic exchange, the Bank will hold all outstanding trust capital securities of the Trust.

Redemption at the option of the Trust
Since June 30, 2011, and on any subsequent distribution date, the Trust may, subject to prior written notice and OSFI approval, redeem, at its option, the NBC CapS – Series 1, in whole or in part, without the consent of the holders. Should a predetermined regulatory or tax event occur, the Trust may, under the same terms and conditions, redeem all the NBC CapS at any time.

Purchase for cancellation
Since June 30, 2011, the Trust may, at the direction of the Bank and with OSFI approval, purchase any outstanding NBC CapS – Series 1 at any time, in whole or in part, in the open market or by tender or private contract at any price. The NBC CapS – Series 1 purchased by the Trust, if any, will be cancelled and will not be reissued.

Regulatory capital
The NBC CapS – Series 1 qualify as innovative capital instruments and are eligible as additional Tier 1 capital, but because these instruments do not satisfy the non-viability contingent capital requirements, they are to be phased out at a rate of 10% per year between 2013 and 2022.

(millions of Canadian dollars)

Trust Units Issued by NBC Asset Trust

The Bank issued non-voting transferable trust units called “Trust Capital Securities”, or “NBC CapS II”, through its special purpose entity NBC Asset Trust (the Trust), a closed-end trust established under the laws of Ontario. These securities are not redeemable or exchangeable for Bank preferred shares at the option of the holder. The gross proceeds from the investments are used by the Trust to finance the acquisition of mortgage loans from the Bank.

The main terms and characteristics of the NBC CapS II trust units are presented below:

	Number	Issuance date	Annual yield	Distribution date	Semi-annual distribution by NBC Caps II(1)
Series 1	400,000	January 22, 2008	7.235 %	June 30, December 31	$ 36.175(2)
Series 2	350,000	June 30, 2008	7.447 %	June 30, December 31	$ 37.235(3)

(1) For each unit with a face value of $1,000.
(2) For each distribution date after June 30, 2018, the distribution will be paid at the rate equal to one-half of the sum of 180-day bankers’ acceptance rate in effect plus 3.79%.
(3) For each distribution date after June 30, 2020, the distribution will be paid at the rate corresponding to one-half of the sum of 180-day bankers’ acceptance rate in effect plus 4.09%.

Distribution

No cash distributions will be payable by the Trust on NBC CapS II if the Bank fails to declare regular dividends on its preferred shares or, if no preferred shares are then outstanding, on its outstanding common shares. In this case, the net distributable funds of the Trust will be paid to the Bank as the sole holder of the special trust securities, representing the residual interest in the Trust. Should the Trust fail to pay the semi-annual distributions in full on the NBC CapS II, the Bank will withhold from declaring dividends on any of its preferred and common shares during a determined period.

Automatic exchange

Each NBC CapS II – Series 1 can be exchanged automatically, without the consent of the holders, for 40 Series 19 First Preferred Shares of the Bank, and each NBC CapS – Series 2 can be exchanged automatically, without the consent of the holders, for 40 Series 23 First Preferred Shares of the Bank, upon the occurrence of certain predetermined events. For additional information, see Note 17. On an automatic exchange, the Bank will hold all outstanding trust capital securities of the Trust.

Redemption at the option of the Trust

Since June 30, 2013 for Series 1, and since July 31, 2013 for Series 2, and on any subsequent distribution date, the Trust may, subject to prior written notice and OSFI approval, redeem, at its option, the NBC CapS II, in whole but not in part, without the consent of the holders.

Purchase for cancellation

Since January 22, 2013 for Series 1 and since June 30, 2013 for Series 2, the Trust may, with OSFI approval, purchase NBC CapS II in whole or in part on the open market or by tender or private contract at any price. The NBC CapS II purchased by the Trust, if any will be cancelled and will not be reissued.

Regulatory capital

The NBC CapS II qualify as innovative capital instruments and are eligible as additional Tier 1 capital, but because these instruments do not satisfy the non-viability contingent capital requirements, they are to be phased out at a rate of 10% per year between 2013 and 2022.

NOTE 19 – CAPITAL DISCLOSURE

Capital Management Objectives, Policies and Procedures

Capital management has the dual role of ensuring a competitive return to the Bank's shareholders while maintaining a solid capital foundation to cover risks inherent to the Bank's activity, supporting its business segments and protecting its clients.

Each year, the Board, on the recommendation of the RMC, approves a detailed capital management policy and the Bank's capital plan. The capital policy sets out the principles and practices the Bank incorporates into its capital management strategy and the basic criteria it adopts to ensure that the Bank has sufficient capital at all times and that it is prudently managing such capital in view of its future capital requirements. Stress tests are performed to ensure that the Bank has sufficient capital even in crisis situations. A capital plan sets operational targets, taking into account expected levels for risk-weighted assets, determined under the regulatory approach. Moreover, the capital plan presents the different strategies that are available to the Bank in order to maintain a cost effective capital structure. Those strategies may include the issuance and repurchase of shares or subordinated debt securities, the reallocation of either assets or capital, and the review of the dividend policy or employee variable compensation.

Capital Management

The capital ratio is the ratio expressed as a percentage of regulatory capital to risk-weighted assets. Risk-weighted assets are calculated in accordance with the rules established by OSFI for on- and off-balance-sheet risks. Credit, market and operational risks are factored into the risk-weighted assets calculation for regulatory purposes. The definition adopted by the Basel Committee on Banking Supervision (BCBS) distinguishes between three types of capital. Common Equity Tier 1 capital consists of common shareholders' equity less goodwill, intangible assets and other capital deductions. The Additional Tier 1 instruments comprise eligible non-cumulative preferred shares, the eligible amount of innovative instruments and non-controlling interests. The sum of Common Equity Tier 1 and Additional Tier 1 capital form what is known as Tier 1 capital. Tier 2 capital consists of the eligible portion of subordinated debt and the eligible collective allowance for credit risk on non-impaired loans. Total regulatory capital is the sum of Tier 1 and Tier 2 capital.

The Bank has been in compliance with the Basel II regulatory framework since November 1, 2007. On November 1, 2009, the Bank received OSFI's authorization to use the Basel II Advanced Internal Rating-Based (AIRB) Approach to calculate credit risk capital for consolidated regulatory reporting purposes. The Bank uses the Standardized Approach for operational risk. For market risk, it primarily uses an approach based on internal models but uses the Standardized Approach for certain exposures. On November 1, 2011, OSFI implemented changes to the regulatory framework for market risk, requiring banks to include an additional charge in their risk-weighted assets for the Stressed VaR and an incremental risk capital charge for the trading book.

Changes to capital requirements were adopted by the BCBS in 2012 and the new Basel III regulatory framework set out transitional arrangements from 2013 to 2019. However, OSFI has been requiring Canadian banks to meet the 2019 minimum "all-in" requirements since the first quarter of 2013 for the Common Equity Tier 1 (CET1) ratio and will implement the requirement for Tier 1 capital and total capital ratios beginning the first quarter of 2014. The "all-in" methodology includes all of the regulatory adjustments that will be required by 2019 while retaining the phase-out rules for non-qualifying capital instruments. As such, since the first quarter of 2013, the Bank must now maintain a CET1 capital ratio of at least 7.0%, i.e., 4.5% for common equity and 2.5% for a capital conservation buffer, and in 2014 the Bank will also be required to maintain a Tier 1 capital ratio and a total capital ratio of at least, respectively, 8.5% and 10.5%, both already including the 2.5% capital conservation buffer.

In March 2013, OSFI designated Canada's six largest banks, a group that includes National Bank, as Domestic Systemically Important Banks (D-SIBs). For these banks, a 1% surcharge will apply to all their capital ratios as of January 1, 2016, increasing the minimum CET1, the Tier 1 and the total capital ratios to 8.0%, 9.5% and 11.5%, respectively (including the 2.5% capital conservation buffer).

In addition to regulatory capital ratios, OSFI requires Canadian banks to meet a financial leverage test. Leverage of the assets-to-capital multiple is calculated by dividing the Bank's total assets, including certain off-balance-sheet items, by its total regulatory capital, in accordance with the transitional requirements for Basel III.

In both 2013 and 2012, the Bank was in compliance with all of OSFI's regulatory capital requirements.

(millions of Canadian dollars)

Regulatory Capital According to Basel III

As at October 31, 2013	"All-in" basis
Common Equity Tier 1 Capital before adjustments	
Directly issued qualifying common share capital plus related contributed surplus	2,218
Retained earnings	5,034
Accumulated other comprehensive income and other reserves	214
Common share capital issued by subsidiaries and held by third parties	–
	7,466
Regulatory adjustments to Common Equity Tier 1 Capital	
Regulatory adjustment in respect of own-use property	26
Goodwill	1,064
Intangible assets other than mortgage-servicing rights	816
Accumulated other comprehensive income related to cash flow hedges	47
Expected losses in excess of allowances	7
Gains (losses) due to changes in own credit risk on liabilities at fair value	21
Defined benefit pension plan asset (net of related tax liability)	40
Investments in own shares	11
Amount exceeding the 15% threshold	
of which: significant investments in the common shares of financial institutions	47
of which: deferred tax assets arising from temporary differences	37
	2,116
Common Equity Tier 1 Capital (CET1)	5,350
Additional Tier 1 Capital	
Directly issued capital instruments subject to phase out from Additional Tier 1	1,652
Regulatory adjustments to Additional Tier 1 Capital	–
	1,652
Tier 1 Capital	7,002
Tier 2 Capital	
Directly issued capital instruments subject to phase out from Tier 2	2,144
Collective allowances	40
	2,184
Regulatory adjustments to Tier 2 Capital	–
Tier 2 Capital	2,184
Total Regulatory Capital	9,186

NOTE 20 – TRADING ACTIVITY REVENUES

Trading activity revenues consist of the net interest income from trading activities and trading revenues recognized in *Non–interest income* in the Consolidated Statement of Income.

Net interest income comprises interest and dividends related to financial assets and liabilities associated with trading activities, net of interest expenses and interest income related to the financing of these financial assets and liabilities.

Non-interest income consists of the realized and unrealized gains and losses on securities measured at fair value through profit or loss, income from held-for-trading derivative financial instruments, and the change in fair value of financial instruments designated at fair value through profit or loss.

Year ended October 31	2013	2012
Net interest income	430	284
Non-interest income	186	233
Total	616	517

(millions of Canadian dollars)

NOTE 21 – SHARE-BASED PAYMENTS

The information below on compensation expense excludes the impact of hedging.

Stock Option Plan

The Bank's Stock Option Plan is for officers and other designated persons of the Bank and its subsidiaries. Under this plan, options are awarded annually and provide participants with the right to purchase common shares at an exercise price equal to the closing price of the Bank's common share on the Toronto Stock Exchange on the day preceding the award. The options vest evenly over a four-year period and expire 10 years from the award date or, in certain circumstances set out in the plan, within specified time limits. The Stock Option Plan contains provisions for retiring employees that allow a participant's rights to continue vesting in accordance with the terms of the grant agreement. The maximum number of common shares that may be issued under the Stock Option Plan was 13,065,437 as at October 31, 2013 (14,830,201 as at October 31, 2012). The maximum number of common shares reserved for a participant may not exceed 5% of the total number of Bank shares issued and outstanding.

As at October 31	2013		2012	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock Option Plan				
Outstanding at beginning	7,794,218	$58.66	7,903,735	$54.58
Awarded	1,612,696	$76.72	1,761,548	$68.17
Exercised	(1,764,764)	$52.96	(1,706,081)	$49.55
Cancelled(1)	(134,272)	$68.59	(164,984)	$58.35
Outstanding at end	7,507,878	$63.72	7,794,218	$58.66
Exercisable at end	3,566,163	$55.92	3,615,009	$54.39

(1) No options expired during the years ended October 31, 2013 and 2012.

Exercise price	Options outstanding	Options exercisable	Expiry date
$41.00	70,550	70,550	December 2013
$48.20	108,550	108,550	December 2014
$61.44	192,900	192,900	December 2015
$65.90	430,371	430,371	December 2016
$53.85	605,249	605,249	December 2017
$34.87	689,699	689,699	December 2018
$58.49	1,003,514	608,982	December 2019
$68.67	1,250,232	531,946	December 2020
$68.17	1,573,321	327,916	December 2021
$76.72	1,583,492	–	December 2022
Total	7,507,878	3,566,163	

During the year ended October 31, 2013, the Bank awarded 1,612,696 stock options (1,761,548 during the year ended October 31, 2012) with an average fair value of $9.79 per option ($8.89 for the year ended October 31, 2012).

The average fair value of options awarded was estimated on the award date using the Black-Scholes model as well as the following assumptions:

As at October 31	2013	2012
Risk-free interest rate	1.78%	1.53%
Expected life of options	7 years	6 years
Expected volatility	22.85%	24.29%
Expected dividend yield	4.3%	4.4%

(millions of Canadian dollars)

The expected life of the options is based on historical data and is not necessarily representative of how options will be exercised in the future. Expected volatility is extrapolated from the implied volatility of the Bank's share price and observable market inputs, which are not necessarily representative of actual results. The return on dividends represents the annualized dividend divided by the Bank's share price at the award date. The risk-free interest rate is based on the Canadian dollar swap curve at the award date. The exercise price is equal to the Bank's share price at the award date. No other market parameter has been included in the fair value measurement of the options.

The compensation expense recorded for this plan for the year ended October 31, 2013 was $16 million ($15 million for the year ended October 31, 2012).

Stock Appreciation Rights (SAR) Plan

The SAR Plan is for officers and other designated persons of the Bank and its subsidiaries. Under this plan, participants receive, upon exercising the right, a cash amount equal to the difference between the closing price of the Bank's common share on the Toronto Stock Exchange on the day preceding the exercise date and the closing price on the day preceding the award date. SARs vest evenly over a four-year period and expire 10 years after the award date or, in certain circumstances set out in the plan, within specified time limits. The SAR Plan contains provisions for retiring employees that allow a participant's rights to continue vesting in accordance with the stated terms of the grant agreement. The compensation expense recognized for the year ended October 31, 2013 with respect to this plan was $2 million ($1 million for the year ended October 31, 2012).

As at October 31	**2013**		2012	
	Number of SARs	**Weighted average exercise price**	Number of SARs	Weighted average exercise price
SAR Plan				
Outstanding at beginning	**180,026**	**$57.22**	175,770	$55.47
Awarded	**23,748**	**$76.72**	17,580	$68.17
Exercised	**(25,727)**	**$55.81**	(10,127)	$48.78
Cancelled[(1)]	**–**	**–**	(3,197)	$48.64
Outstanding at end	**178,047**	**$60.02**	180,026	$57.22
Exercisable at end	**110,883**	**$54.09**	98,942	$54.50

(1) No SARs expired during the years ended October 31, 2013 and 2012.

Exercise price	SARs outstanding	SARs exercisable	Expiry date
$48.20	2,850	2,850	December 2014
$61.44	2,300	2,300	December 2015
$65.90	16,872	16,872	December 2016
$53.85	14,738	14,738	December 2017
$34.87	31,688	31,688	December 2018
$58.49	30,499	19,964	December 2019
$68.67	37,772	18,076	December 2020
$68.17	17,580	4,395	December 2021
$76.72	23,748	–	December 2022
Total	178,047	110,883	

Deferred Stock Unit (DSU) Plans

The DSU Plans are for officers and other designated persons of the Bank and its subsidiaries as well as directors. These plans allow the Bank to tie a portion of the value of the compensation of participants to the future value of the Bank's common shares. A DSU is a right that has a value equal to the closing price of a common share of the Bank on the Toronto Stock Exchange on the day preceding the award. DSUs generally vest evenly over four years. Additional DSUs are credited to the account of participants equal in amount to the dividends paid on common shares of the Bank and vest evenly over the same period as the reference DSUs. DSUs may only be cashed when participants retire or leave the Bank, or for directors, when their term ends. The DSU Plan contains provisions for retiring employees that allow the participant's units to continue vesting in accordance with the stated terms of the grant agreement.

During the year ended October 31, 2013, the Bank awarded 45,361 DSUs at a weighted average price of $76.72 (49,308 DSUs at a weighted average price of $68.17 for the year ended October 31, 2012). A total of 369,385 DSUs were outstanding as at October 31, 2013 (362,961 DSUs as at October 31, 2012). A compensation expense of $11 million was recognized for the year ended October 31, 2013 with respect to these plans ($8 million for the year ended October 31, 2012).

NOTE 21 – SHARE-BASED PAYMENTS (cont.)

Restricted Stock Unit (RSU) Plan

The RSU Plan is for certain officers and other designated persons of the Bank and its subsidiaries. The objective of this plan is to ensure that the compensation of certain officers is competitive and to foster retention. An RSU is a right that has a value equal to the closing price of a common share of the Bank on the Toronto Stock Exchange on the day preceding the award. RSUs generally vest evenly over three years, although some RSUs vest on the last day of the 35th month following the date of the award, the date on which all RSUs expire. Additional RSUs are credited to the account of participants equal in amount to the dividends declared on the common shares of the Bank and vest evenly over the same period as the reference RSUs. The RSU Plan contains provisions for retiring employees that allow the participant's units to continue vesting in accordance with the stated terms of the grant agreement.

During the year ended October 31, 2013, the Bank awarded 1,041,290 RSUs at a weighted average price of $76.72 (1,119,173 RSUs at a weighted average price of $68.17 for the year ended October 31, 2012). As at October 31, 2013, a total of 2,495,174 RSUs were outstanding (2,594,150 RSUs as at October 31, 2012). A compensation expense of $129 million was recognized for the year ended October 31, 2013 with respect to this plan ($78 million for the year ended October 31, 2012).

Performance Stock Unit (PSU) Plan

The PSU Plan is for certain members of senior management of the Bank. The objective of this plan is to tie a portion of the value of the compensation of these members of senior management to the future value of the Bank's common shares. A PSU is a right that has a value equal to the closing price of a common share of the Bank on the Toronto Stock Exchange on the day preceding the award, adjusted upward or downward according to performance criteria, which is based on the total shareholder return (TSR) achieved by the Bank compared to that of the S&P/TSX Banks Sub-index. PSUs vest on the last day of the 35th month following the date of the award, the date on which all PSUs expire. Additional PSUs are credited to the account of participants in an amount equal to the dividends declared on the common shares of the Bank and vest evenly over the same period as the reference PSUs. The PSU Plan contains provisions for retiring employees that allow the participant's units to continue vesting in accordance with the stated terms of the award agreement.

During the year ended October 31, 2013, the Bank awarded 118,868 PSUs at a weighted average price of $76.72 (118,087 PSUs at a weighted average price of $68.17 for the year ended October 31, 2012). As at October 31, 2013, a total of 307,369 PSUs were outstanding (263,746 PSUs as at October 31, 2012). A compensation expense of $11 million was recognized for the year ended October 31, 2013 with respect to this plan ($9 million for the year ended October 31, 2012).

Deferred Compensation Plan of National Bank Financial (NBF)

This plan is exclusively for key employees of Individual Investor Services of NBF. The purpose of this plan is to foster the retention of key employees and promote the growth in income and the continuous improvement in profitability at Individual Investor Services. Under this plan, participants can defer a portion of their annual compensation and NBF may pay a contribution to key employees when certain financial objectives are met. Amounts awarded by NBF and the compensation deferred by participants are invested in, among others, Bank share units. These share units represent a right, the value of which corresponds to the closing price of the Bank's common share on the Toronto Stock Exchange on the award date. Additional units are paid to the participant's account equal in amount to the dividends declared on the common shares of the Bank. Share units representing the amounts awarded by NBF vest evenly over four years. When a participant retires, or in certain cases when the participant's employment is terminated, the participant receives a cash amount representing the value of the vested share units.

During the year ended October 31, 2013, NBF awarded 32,935 stock units at a weighted average price of $76.87 (133,787 stock units at a weighted average price of $71.26 for the year ended October 31, 2012). As at October 31, 2013, 580,688 units were outstanding (569,575 units as at October 31, 2012). During the year ended October 31, 2013, a $12 million compensation expense was recognized for this plan ($8 million for the year ended October 31, 2012).

Employee Share Ownership Plan

Under the Bank's Employee Share Ownership Plan, employees who meet the eligibility criteria can contribute up to 8% of their annual gross salary by way of payroll deductions. The Bank matches 25% of the employee contribution, to a maximum of $1,500 per annum. Bank contributions vest to the employee after one year of uninterrupted participation in the plan. Subsequent contributions vest immediately. The Bank's contributions, amounting to $9 million for the year ended October 31, 2013 ($8 million for the year ended October 31, 2012), were charged to *Compensation and employee benefits* when paid. As at October 31, 2013, a total of 2,947,330 common shares were held for this plan (2,975,711 common shares as at October 31, 2012).

Plan shares are purchased on the open market and are considered to be outstanding for earnings per share calculations. Dividends paid on the Bank's common shares held for the Employee Share Ownership Plan are used to purchase other common shares on the open market.

Total liabilities arising from the Bank's share-based compensation plans amounted to $353 million as at October 31, 2013 ($294 million as at October 31, 2012). The intrinsic value of liabilities that had vested as at October 31, 2013 was $170 million ($139 million as at October 31, 2012).

(millions of Canadian dollars)

NOTE 22 – EMPLOYEE BENEFITS

The Bank offers defined benefit pension plans that cover substantially all salaried employees. These defined benefit plans are funded plans. The Bank also offers its employees certain post-retirement benefits and post-employment benefits, compensated leave and termination benefits (non-pension employee benefits) that are generally not funded. The Bank's employee pension plans provide for the payment of benefits that are based on the length of service and final average earnings of the employees covered by the plans. The date used to measure plan assets is October 31 of each year.

Following a review of its employee benefit programs, the Bank decided to maintain a defined benefit pension plan with new provisions and to implement a new group insurance plan for retirees. Amendments to these plans will take effect on January 1, 2014 with the impact on the expense being recognized as of November 1, 2012. A negative past service cost is thus recognized and amortized over a period of 4 to 7 years (until retirement eligibility).

Accrued Benefit Obligation, Plan Assets and Funded Status

As at October 31	2013	2012	2013	2012
		Pension plans		Other plans
Accrued benefit obligation				
Balance at beginning	**2,696**	2,234	**197**	178
Current service cost	**68**	42	**7**	6
Interest cost	**120**	129	**11**	10
Employee contributions	**37**	31	**–**	–
Benefits paid	**(125)**	(111)	**(7)**	(8)
Actuarial losses (gains)	**51**	371	**(1)**	11
Past service cost	**(27)**	–	**(8)**	–
Balance at end	**2,820**	2,696	**199**	197
Plan assets				
Fair value at beginning	**2,613**	2,373	**–**	–
Expected return on plan assets	**185**	167	**–**	–
Actuarial gains (losses)	**124**	63	**–**	–
Bank contributions[1]	**114**	90	**–**	–
Employee contributions	**37**	31	**–**	–
Benefits paid	**(125)**	(111)	**–**	–
Fair value at end	**2,948**	2,613	**–**	–
Funded status	**128**	(83)	**(199)**	(197)
Unamortized past service cost	**(23)**	–	**(6)**	–
Accrued benefit asset (liability) at end	**105**	(83)	**(205)**	(197)

(1) The Bank expects to pay an employer contribution of $130 million to the defined benefit pension plans for fiscal 2014.

Experience Adjustments[1]

As at October 31	2013	2012	2011	2013	2012	2011
Experience adjustment on plan obligation	**64**	–	(11)	**(2)**	(1)	(14)
Experience adjustment on plan assets	**124**	63	(64)			

(1) Experience adjustments consist of all the actuarial gains and losses that do not result from changes made to actuarial assumptions from one year to another.

(millions of Canadian dollars)

NOTE 22 – EMPLOYEE BENEFITS (cont.)

Accrued Benefit Asset (Liability)

As at October 31	2013	2012	2013	2012
		Pension plans		Other plans
Accrued benefit asset included in *Other assets*	108	47	–	–
Accrued benefit liability included in *Other liabilities*	(3)	(130)	(205)	(197)
Net amount	105	(83)	(205)	(197)

Pension Plan Assets

As at October 31	2013	2012	2013	2012
		% of the fair value of the asset categories		Expected rate of return of the asset categories
Asset category				
Bonds	40	42	3.25	3.75
Equities	53	49	7.95	7.75
Other	7	9		

The expected rates of return on the asset categories are related to the asset mix. Generally speaking, the expected rates of return on the plan asset categories are calculated by weighting the expected returns of each asset category by their respective weighting in the target asset allocation in the investment policy. To determine the expected rate of return on pension plan assets, an additional value must be used for the leverage effect and periodic rebalancing of the asset categories.

Pension plan assets include investment securities issued by the Bank. As at October 31, 2013, these investments totalled $176 million ($168 million as at October 31, 2012).

In fiscal 2013, the Bank and its related parties received close to $6 million ($4 million during 2012) in management fees for related management, administration and custodial services for pension plans.

Expense Components of the Pension Plans and Other Plans

Year ended October 31	2013	2012	2013	2012
		Pension plans		Other plans
Current service cost	68	42	7	6
Interest cost	120	129	11	10
Expected return on plan assets	(185)	(167)	–	–
Amortization of past service cost	(4)	–	(2)	–
Pension plan expense (recovery)	(1)	4		
Other plan expense			16	16

Actuarial Gains and Losses Recognized in *Other Comprehensive Income*[1]

Year ended October 31	2013	2012	2013	2012
		Pension plans		Other plans
Cumulative actuarial gains (losses) at beginning – Retained earnings	(383)	(75)	(25)	(14)
Actuarial gains (losses) for the year – Other comprehensive income	73	(308)	1	(11)
Cumulative actuarial gains (losses) at end – Retained earnings	(310)	(383)	(24)	(25)

(1) The amounts are presented on a pre-tax basis.

(millions of Canadian dollars)

Significant Actuarial Assumptions (Weighted Average)

The assumption regarding the discount rate is determined based on an interest rate curve that represents the yield for corporate AA bonds. Short-term maturities are obtained using a curve based on actual data from corporate AA bonds. Long-term maturities are obtained using a curve based on extrapolated data, which is obtained by adding a yield spread, based on maturity, to the long-term provincial bond yields. The spread is established based on the differences observed between the yields for corporate AA bonds and provincial AA bonds in three maturity ranges of the yield curve.

For measurement purposes, a 5.75% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2013 (6.0% in 2012). The rate was assumed to decrease gradually to reach 3.0% in 2032 and remain steady thereafter.

As at October 31	2013	2012	2013	2012
		Pension plans		**Other plans**
	%	%	%	%
Accrued benefit obligations				
Discount rate	**4.75**	4.50	**4.75**	4.50
Rate of compensation increase	**3.00**	3.00	**3.00**	3.00
Health care cost trend rate			**5.75**	6.00

Year ended October 31	2013	2012	2013	2012
		Pension plans		**Other plans**
	%	%	%	%
Pension plan expense				
Discount rate	**4.50**	5.75	**4.50**	5.75
Rate of compensation increase	**3.00**	3.00	**3.00**	3.00
Expected long-term rate of return on plan assets	**7.25**	7.25		
Health care cost trend rate			**5.75**	6.00

Sensitivity of Key Assumptions for 2013

	Pension plans		Other plans	
	Change in obligation	Change in expense	Change in obligation	Change in expense
Impact of a 0.25% increase in the discount rate	(103)	(4)		
Impact of a 0.25% decrease in the discount rate	106	5		
Impact of a 0.25% increase in the rate of compensation increase	22	3		
Impact of a 0.25% decrease in the rate of compensation increase	(22)	(3)		
Impact of a 1.00% increase in the expected health care cost trend rate			11	1
Impact of a 1.00% decrease in the expected health care cost trend rate			(9)	–

The sensitivity analysis presented in the above table must be used with caution given that the changes are hypothetical and the changes in each significant assumption may not be linear.

Benefits Payment Projection

Year ended October 31	Pension plans	Other plans
2014	114	10
2015	117	11
2016	122	11
2017	122	12
2018	123	12
2019 and thereafter	688	75

(millions of Canadian dollars)

NOTE 23 – INCOME TAXES

The Bank's income tax expense reported in the consolidated financial statements is as follows:

Year ended October 31	**2013**	2012
Consolidated Statement of Income		
Current taxes		
Current year	**270**	329
Prior period adjustments	**(30)**	(36)
	240	293
Deferred taxes		
Origination and reversal of temporary differences	**43**	33
Prior period adjustments	**(20)**	–
	23	33
	263	326
Consolidated Statement of Changes in Equity		
Share issuance expense and other	**–**	(1)
Consolidated Statement of Comprehensive Income		
Actuarial gains and losses on employee benefit plans	**21**	(86)
Other	**(26)**	(24)
	(5)	(110)
Income taxes	**258**	215

The income tax expense breaks down as follows:

Year ended October 31	**2013**	2012
Current taxes	**214**	268
Deferred taxes	**44**	(53)
	258	215

The temporary differences and tax loss carryforwards resulting in deferred tax assets and liabilities are as follows:

	Consolidated Balance Sheet		Consolidated Statement of Income		Consolidated Statement of Comprehensive Income	
	As at October 31		Year ended October 31		Year ended October 31	
	2013	2012	**2013**	2012	**2013**	2012
Deferred tax assets						
Allowances for credit losses and other liabilities	**271**	251	**20**	33	**–**	–
Accrued benefit liability – Pension plans	**–**	30	**(30)**	(19)	**–**	49
Accrued benefit liability – Other plans	**54**	53	**1**	3	**–**	3
Deferred revenue	**32**	31	**1**	2	**–**	–
Tax loss carryforwards	**4**	6	**(2)**	(8)	**–**	–
Other	**64**	66	**(6)**	(37)	**4**	–
	425	437	**(16)**	(26)	**4**	52
Deferred tax liabilities						
Premises and equipment	**(99)**	(102)	**3**	19	**–**	–
Accrued benefit asset – Pension plans	**(19)**	–	**2**	–	**(21)**	34
Investments in associates	**(73)**	(66)	**(7)**	(29)	**–**	–
Other	**(56)**	(47)	**(5)**	3	**(4)**	–
	(247)	(215)	**(7)**	(7)	**(25)**	34
Net deferred tax assets (liabilities)	**178**	222	**(23)**	(33)	**(21)**	86

Net deferred tax assets are included in *Other assets* and net deferred tax liabilities are included in *Other liabilities*.

As at October 31	**2013**	2012
Deferred tax assets	**297**	349
Deferred tax liabilities	**(119)**	(127)
	178	222

As at October 31, 2013, the total amount of temporary differences, unused tax losses and unused tax credits for which no deferred tax asset has been recognized was $91 million ($139 million as at October 31, 2012).

As at October 31, 2013, the total amount of temporary differences related to investments in subsidiaries, associates, joint ventures and investments in branches for which no deferred tax liability has been recognized was $463 million ($457 million as at October 31, 2012).

The following table provides a reconciliation of the Bank's income tax rate:

Year ended October 31		**2013**		2012
	$	**%**	$	%
Income before income taxes	**1,817**	**100.0**	1,960	100.0
Income taxes at Canadian statutory income tax rate	**487**	**26.8**	529	27.0
Reduction in income tax rate due to:				
Tax-exempt income from securities, mainly dividends from Canadian corporations	**(150)**	**(8.3)**	(126)	(6.4)
Non-taxable portion of the gain realized on the sale of the operations of subsidiary Natcan Investment Management Inc.	**–**	**–**	(16)	(0.8)
Tax rates of subsidiaries, foreign entities and associates	**(6)**	**(0.4)**	(42)	(2.2)
Tax benefit from loss carrybacks to prior periods	**(10)**	**(0.6)**	–	–
Reversal of provisions for income tax contingencies, net	**(37)**	**(2.0)**	(29)	(1.5)
Other items	**(21)**	**(1.1)**	10	0.5
	(224)	**(12.4)**	(203)	(10.4)
Income taxes reported in the Consolidated Statement of Income and effective income tax rate	**263**	**14.4**	326	16.6

NOTE 24 – EARNINGS PER SHARE

Diluted earnings per share is calculated by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding after taking into account the dilution effect of stock options using the treasury stock method and any gain (loss) on repurchases of preferred shares.

Year ended October 31	**2013**	2012
Basic earnings per share		
Net income attributable to the Bank's shareholders	**1,479**	1,561
Dividends on preferred shares	**40**	43
Net income attributable to common shareholders	**1,439**	1,518
Weighted average basic number of common shares outstanding *(thousands)*	**162,234**	161,387
Basic earnings per share *(dollars)*	**8.87**	9.40
Diluted earnings per share		
Net income attributable to common shareholders	**1,439**	1,518
Average basic number of common shares outstanding *(thousands)*	**162,234**	161,387
Adjustment to average number of common shares *(thousands)*		
Stock options	**1,290**	1,486
Weighted average diluted number of common shares outstanding *(thousands)*	**163,524**	162,873
Diluted earnings per share *(dollars)*	**8.80**	9.32

For the years ended October 31, 2013 and 2012, as the exercise price of the options was less than the average price of the Bank's common shares, no option was excluded from the diluted earnings per share calculation.

(millions of Canadian dollars)

NOTE 25 – GUARANTEES, COMMITMENTS AND CONTINGENT LIABILITIES

Guarantees

The maximum potential amount of future payments represents the maximum risk of loss if there were a total default by the guaranteed parties, without consideration of recoveries under recourse provisions, insurance policies or from collateral held or pledged. The maximum potential amount of future payments for significant guarantees issued by the Bank and in effect as at October 31 is presented in the following table:

	2013	2012
Letters of guarantee	3,174	3,093
Backstop liquidity, credit enhancement facilities and other	5,064	3,789
Securities lending	509	311
Other guarantee	29	31

Letters of Guarantee

In the normal course of business, the Bank issues letters of guarantee. These letters of guarantee represent irrevocable commitments that the Bank will make payments in the event that a client cannot meet its financial obligations to third parties. The Bank's policy for requiring collateral security with respect to letters of guarantee is similar to that for loans. Generally, the term of these letters of guarantee is less than two years. The collective allowance on non-impaired loans covers all credit risks, including those relating to letters of guarantee. As at October 31, 2013 and 2012, no amount has been recorded on the Consolidated Balance Sheet with respect to these letters of guarantee.

Backstop Liquidity and Credit Enhancement Facilities

<u>Facilities to multi-seller conduits</u>

The Bank administers multi-seller conduits that purchase financial assets from clients and finance those purchases by issuing asset-backed commercial paper. The Bank provides backstop liquidity facilities to these multi-seller conduits. As at October 31, 2013, the notional amount of the global-style backstop liquidity facilities totalled $2.1 billion ($2.1 billion as at October 31, 2012), representing the total amount of the commercial paper outstanding.

These backstop liquidity facilities can be drawn if the conduits are unable to access the commercial paper market, without there necessarily being a general market disruption. These facilities have terms of less than one year and can be periodically renewed. The terms and conditions of these backstop liquidity facilities do not require the Bank to advance money to the conduits if the conduits are insolvent or involved in bankruptcy proceedings or to fund non-performing assets beyond the amount of the available credit enhancements. The backstop liquidity facilities provided by the Bank have not been drawn to date.

Since May 2009, the Bank has provided credit enhancement facilities to these multi-seller conduits. These facilities have terms of less than one year and are automatically renewable unless the Bank sends a non-renewal notice. As at October 31, 2013, the committed notional value for these facilities was $30 million ($30 million as at October 31, 2012). To date, the credit enhancement facilities provided by the Bank have not been drawn.

The maximum risk of loss for the Bank cannot exceed the total amount of commercial paper outstanding. As at October 31, 2013, the Bank held $6 million ($12 million as at October 31, 2012) of this commercial paper and, consequently, the maximum potential amount of future payments was $2.1 billion ($2.0 billion as at October 31, 2012).

<u>CDCC overnight liquidity facility</u>

Canadian Derivatives Clearing Corporation (CDCC) acts as a central clearing counterparty for multiple financial instrument transactions in Canada. Certain fixed-income clearing members of CDCC have provided an equally shared committed and uncommitted global overnight liquidity facility for the purpose of supporting CDCC in its clearing activities of securities purchased under reverse repurchase agreements or sold under repurchase agreements. The objective of this facility is to maintain sufficient liquidity in the event of a clearing member's default. As a fixed-income clearing member providing support to CDCC, the Bank provides a liquidity facility. As at October 31, 2013, the notional amount of the CDCC overnight committed and uncommitted liquidity facility amounted to $200 million and $1.9 billion, respectively ($200 million and $600 million as at October 31, 2012). As at October 31, 2013 and 2012, no amounts had been drawn.

(millions of Canadian dollars)

Securities Lending

Under securities lending agreements the Bank has entered into with certain clients who have entrusted it with the safekeeping of their securities, the Bank lends the securities to third parties and indemnifies its clients in the event of loss. In order to protect itself against any contingent loss, the Bank obtains, as security from the borrower, a cash amount or extremely liquid marketable securities with a fair value greater than that of the securities loaned. No amount has been recognized on the Consolidated Balance Sheet with respect to potential indemnities resulting from these securities lending agreements.

Other Guarantee

Pursuant to a mutual guarantee agreement required by a regulatory authority, a subsidiary of the Bank has agreed to guarantee all commitments, debts and liabilities of an associate to the maximum of its regulatory capital. This guarantee expires no later than the date the investment in the associate is sold, or sooner if deemed appropriate by the regulatory authority. As at October 31, 2013 and 2012, this guarantee remains undrawn and no amount has been recognized on the Consolidated Balance Sheet with respect to this agreement.

Other Indemnification Agreements

In the normal course of business, including securitization transactions and discontinuances of businesses and operations, the Bank enters into numerous contractual agreements under which it undertakes to compensate the counterparty for costs incurred as a result of litigation, changes in laws and regulations (including tax legislation), claims with respect to past performance, incorrect representations or the non-performance of certain restrictive covenants. The Bank also undertakes to indemnify any person acting as a director or officer or performing a similar function within the Bank or one of its subsidiaries or another entity, at the request of the Bank, for all expenses incurred by that person in proceedings or investigations to which he or she is party in that capacity. Moreover, as a member of a securities transfer network and pursuant to the membership agreement and the regulations governing the operation of the network, the Bank granted a movable hypothec to the network that can be used in the event another member fails to meet its contractual obligations. The durations of the indemnification agreements vary according to circumstance; as at October 31, 2013 and 2012, given the nature of the agreements, the Bank is unable to make a reasonable estimate of the maximum potential liability it could be required to pay to counterparties. No amount has been recorded on the Consolidated Balance Sheet with respect to these agreements.

Master Asset Vehicles

Margin funding facilities

The Bank has committed to contribute $886 million ($910 million as at October 31, 2012) to a margin funding facility related to the MAV conduits in order to finance potential collateral calls. As at October 31, 2013 and 2012, no amount had been advanced by the Bank. Note 6 to the consolidated financial statements provides additional information on this topic.

Credit facilities to clients holding restructured notes of the master asset vehicle (MAV) conduits

In 2008, the Bank had offered improved credit facilities to commercial and corporate clients holding restructured notes of the MAV conduits for their liquidity needs. These credit facilities covered up to 75% of the face value of the notes. The credit agreements also provided for an option in favour of the borrower allowing the borrower to assign to the Bank, on or after the maturity date of the credit facility, the restructured notes in payment of the principal of the credit facility. These credit facilities were available for a period of two to three years and could be extended by the Bank if borrowers maintained a normal banking relationship with the Bank during the period of the credit facility. As at October 31, 2013, credit facilities outstanding provided to clients holding restructured notes of the MAV conduits stood at $17 million ($26 million as at October 31, 2012) and the allowances for credit losses were nil ($3 million as at October 31, 2012). As at October 31, 2013, credit facilities backed by restructured notes of the MAV conduits and those backed by ineligible asset tracking notes totalled $25 million and nil, respectively ($100 million and $4 million, respectively, as at October 31, 2012). For additional information, see Note 6.

Commitments

Credit Instruments

In the normal course of business, the Bank enters into various off-balance-sheet commitments. The credit instruments used to meet the financing needs of its clients represent the maximum amount of additional credit the Bank could be obligated to extend if the commitments were fully drawn.

As at October 31	**2013**	2012
Letters of guarantee(1)	**3,174**	3,093
Documentary letters of credit(2)	**69**	73
Credit card receivables(3)	**6,332**	5,523
Commitments to extend credit(3)	**38,244**	34,368

(1) See *Letters of guarantee* on page 182.
(2) Documentary letters of credit are documents issued by the Bank and used in international trade to enable a third party to draw drafts on the Bank up to an amount established under specific terms and conditions; these instruments are collateralized by the delivery of the goods to which they are related.
(3) Credit card receivables and commitments to extend credit represent the undrawn portions of credit authorizations granted in the form of loans, acceptances, letters of guarantee and documentary letters of credit. The Bank is required at all times to make the undrawn portion of the credit authorization available, subject to certain conditions.

(millions of Canadian dollars)

NOTE 25 – GUARANTEES, COMMITMENTS AND CONTINGENT LIABILITIES (cont.)

Financial Assets Received as Collateral

As at October 31, 2013, the fair value of financial assets received as collateral that the Bank was authorized to sell or repledge totalled $24 billion ($20 billion as at October 31, 2012). These financial assets received as collateral were obtained as a result of transactions involving securities purchased under reverse repurchase agreements, securities borrowing and lending agreements, and derivative financial instrument transactions. These transactions are concluded in accordance with standard terms and conditions for such transactions.

Other Commitments

The Bank acts as an investor in investment banking activities where it enters into agreements to finance external private equity funds and investments in equity and debt securities at market value at the time the agreements are signed. In connection with these activities, the Bank has commitments to invest up to $106 million as at October 31, 2013 ($85 million as at October 31, 2012).

Pledged Assets

In the normal course of business, the Bank pledges securities and other assets as collateral for various liabilities it incurs. A breakdown of assets pledged as collateral is provided in the following table. These transactions are concluded in accordance with standard terms and conditions for such transactions.

As at October 31	2013	2012
Assets pledged to:		
Bank of Canada	25	25
Direct clearing organizations(1)	17,292	16,956
Assets pledged in relation to:		
Derivative financial instrument transactions	1,388	626
Borrowing, securities lending and securities sold under reverse repurchase agreements	45,863	35,206
Securitization transactions	16,784	16,492
Covered bonds(2)	3,482	3,233
Other	115	110
Total	84,949	72,648

(1) Includes assets pledged as collateral for Large Value Transfer System (LVTS) activities, even if these assets are generally returned back to the Bank at the end of the daily settlement cycle.
(2) During the year ended October 31, 2013, the Bank did not issue any covered bonds (US$0.6 billion as at October 31, 2012). A special purpose entity was created to guarantee the payments of principal and interest due to the bondholders. During fiscal 2012, the Bank sold insured residential mortgages to this special purpose entity and granted it a loan to facilitate the acquisition of these assets. The Bank controls this special purpose entity and thus consolidates it. The Bank has limited access to the assets owned by this special purpose entity according to the terms of the agreements related to this transaction. The assets owned by this entity totalled $3.9 billion as at October 31, 2013 ($4.0 billion as at October 31, 2012), of which $3.5 billion ($3.8 billion as at October 31, 2012) is presented in the *Residential mortgage* item on the Consolidated Balance Sheet. The covered bonds, totalling $3.1 billion as at October 31, 2013 ($3.0 billion as at October 31, 2012), are presented in the *Deposits – Business and government* item on the Consolidated Balance Sheet. The assets pledged as collateral for this transaction amounted to $3.5 billion as at October 31, 2013 ($3.2 billion as at October 31, 2012).

Contingent Liabilities

Litigation

In the normal course of business, the Bank and its subsidiaries are involved in various claims relating, among other matters, to loan portfolios, investment portfolios and supplier agreements, including court proceedings, investigations or claims of a regulatory nature, class actions or other legal remedies of varied natures. Several of the court proceedings are related to lending activities, which generally occur, in particular, when the Bank takes steps to recover its claims.

More specifically, the Bank is involved as a defendant in class actions instituted by consumers who contest, inter alia, certain transaction fees or who wish to avail themselves of certain legislative provisions relating to consumer protection. Notably, the Bank is a party to *Marcotte v. Bank of Montreal, et al.*, a class action that seeks the reimbursement of foreign currency transaction fees paid by credit cardholders. The hearing at the Supreme Court of Canada is scheduled for February 2014. The decision may impact other class actions to which the Bank is a party. All of these involve several complex issues and their resolution could thus extend over several years. These class actions are defended vigorously by the Bank, which has serious grounds of contestation.

It is impossible to determine the outcome of the claims instituted or which may be instituted against the Bank and its subsidiaries. The Bank estimates, based on the information at its disposal, that while the amount of contingent liabilities pertaining to these claims, taken individually or in the aggregate, could have a material impact on the Bank's consolidated operating income for a particular period, it would not have a material adverse impact on the Bank's consolidated financial position.

NOTE 26 – ACQUISITIONS AND DISPOSAL

Business Combination

HSBC Securities (Canada) Inc.
On January 1, 2012, the Bank completed the acquisition of the full-service investment advisory business of HSBC Securities (Canada) Inc. as well as certain assets related to the segregated fund and to the insurance portfolio of HSBC Insurance Agency (Canada) Inc. During the measurement period ended January 1, 2013, the finalization of the working capital and purchase price adjustments did not have a significant impact on goodwill.

Investment in TMX Group Limited

On July 31, 2012, Maple Group Acquisition Corporation (Maple), now TMX Group Limited, a company whose investors comprise the Bank and 11 other leading Canadian financial institutions and pension funds, announced that all of the conditions to Maple's offer to acquire up to 80% of TMX Group Inc. (TMX) shares for $50 cash per share had been satisfied.

On August 1, 2012, Maple completed the acquisitions of Alpha Trading Systems Inc., Alpha Trading Systems Limited Partnership and The Canadian Depository for Securities Limited. The Bank recognized a gain of $25 million ($18 million after tax) on the sale of its interests in these three companies. In addition, as part of its commitments as an equity participant in Maple, the Bank, through a subsidiary, subscribed $190 million Maple securities. The Bank had also acted as co-underwriter, joint book runner and administrative agent on the acquisition financing.

On September 13, 2012, the court approved the plan of arrangement under which TMX shares not acquired by Maple at that date would be exchanged for common shares of Maple on a one-for-one basis. On September 14, 2012, Maple held all of the shares in TMX.

After these events, the Bank owned 8.8% of TMX Group Limited. For additional information, see Note 9.

Disposal

On April 2, 2012, the Bank completed the sale of the operations of its subsidiary, Natcan Investment Management Inc. (Natcan), to Fiera Capital Corporation (Fiera). A before-tax gain of $246 million ($212 million after tax) on the sale, including a $25 million write-off of goodwill and intangible assets and $4 million in direct charges, was recognized in *Non-interest income – Other* in the Consolidated Statement of Income for the year ended October 31, 2012 and reported in the Wealth Management segment.

In consideration of the sale, the Bank acquired a 35% interest in Fiera, which has been accounted for as an investment in an associate since that date. For additional information, see Note 9.

NOTE 27 – SPECIAL PURPOSE ENTITIES

Special purpose entities (SPEs) are entities that are created to accomplish a specific and well-defined objective. SPEs are assessed for consolidation in accordance with the accounting policy set out in Note 1. The Bank's maximum exposure to loss resulting from economic interests consists primarily of the investments in these entities, the fair value of the derivative contracts entered into with them, and the backstop liquidity and credit enhancement facilities granted to certain SPEs.

Non-Consolidated Special Purpose Entities

Multi-seller conduits

The Bank administers multi-seller conduits that purchase financial assets from clients and finance those purchases by issuing asset-backed commercial paper. Clients use these multi-seller conduits to diversify their funding sources and reduce borrowing costs, while continuing to manage their assets and provide some amount of first-loss protection. Notes issued by the conduits and held by third parties provide additional credit loss protection. The Bank acts as a financial agent and provides these conduits with administrative and transaction structuring services as well as backstop liquidity and credit enhancement facilities under the commercial paper program. These facilities are presented and described in Note 25. The Bank has concluded derivative contracts with these conduits, the fair value of which is presented on the Bank's Consolidated Balance Sheet. The Bank is not required to consolidate these conduits, as it does not control the conduits nor is it exposed to the majority of risks and rewards of the conduits.

Master asset vehicles (MAV)

The Bank holds economic interests in MAVs in the form of restructured notes and the margin funding facility provided. The Bank is not required to consolidate these MAVs as it does not control them and is not exposed to the majority of the risks and rewards inherent to these assets.

Private capital funds and investments

As part of its investment banking operations, the Bank invests in several limited liability partnerships and other incorporated entities. These investment companies in turn invest in operating companies with a view to reselling these investments at a profit over the medium or long term. The Bank does not intervene in the operations of these entities; its only role is that of an investor. The Bank is not required to consolidate these entities as it does not control them.

Consolidated Special Purpose Entities

Securitization entity for the Bank's credit card receivables

The Bank established the Canadian Credit Card Trust (CCCT) to securitize its credit card receivables. The Bank has used this entity for capital management and funding purposes. The Bank acts as an administrative agent and holds certificates issued by CCCT. From this portfolio of sold receivables, the Bank retains the excess spread, i.e., the residual interest income after all the expenses related to this structure have been paid: it thus provides first loss protection. The Bank controls this special purpose entity and thus consolidates it.

National Bank hedge fund managed accounts (Innocap Platform)

Innocap Investment Management Inc. (Innocap), a company under joint control, offers hedge fund account programs for fund sponsors seeking a platform that gives them a high degree of transparency and leading-edge tools to manage liquidity and control assets and risk. The Bank can hold economic interests in certain hedge funds of the platform and consolidates those it controls and in which it is exposed to the majority of the risks and rewards inherent to the funds.

Covered bonds

The Bank issued covered bonds and created an entity to guarantee the payment of principal and interest due to bondholders. The Bank has sold insured residential mortgages to this entity and granted it a loan to facilitate the acquisition of these assets. The Bank controls this special purpose entity and thus consolidates it.

Mutual funds and private investments

The Bank invests in mutual funds and private investment funds and consolidates those over which it has control and in which it is exposed to the majority of the risks and rewards inherent to the funds.

The Bank enters into derivative contracts with third parties to provide them with the desired exposure to certain mutual funds. The Bank economically hedges the risks related to these derivatives by investing in those mutual funds. The Bank consolidates those over which it has control and in which it is exposed to the majority of the risks and rewards inherent to the mutual funds.

(millions of Canadian dollars)

NBC Capital Trust

The Bank created NBC Capital Trust for its financing and capital management needs. The securities issued by this trust qualify as innovative capital instruments and are eligible as additional Tier 1 capital, but because these instruments do not satisfy the non-viability contingent capital requirements, they are to be phased out at a rate of 10% per year between 2013 and 2022. The gross proceeds from the securities issued by this trust were used to acquire a deposit note from the Bank. The Bank also holds all of the trust's equity and has committed to lend it the liquidity it needs in the normal course of business. The Bank acts as the trust's administrative agent and manages its day-to-day operations. The Bank controls this trust and thus consolidates it. Note 18 provides a description of the trust units issued by NBC Capital Trust.

NBC Asset Trust

The Bank created NBC Asset Trust for its financing and capital management needs. The securities issued by this trust qualify as innovative capital instruments and are eligible as additional Tier 1 capital, but because these instruments do not satisfy the non-viability contingent capital requirements, they are to be phased out at a rate of 10% per year between 2013 and 2022. The issuance proceeds were used to acquire the Bank's residential mortgage loans. The Bank continues to administer these loans and is committed to repurchase from NBC Asset Trust the capital balance and unpaid accrued interest on any loan that is 90 days past due. The Bank also holds the special voting securities of the trust. After the distribution has been paid to the holders of the trust capital securities, the Bank, as the sole holder of the special trust securities, is entitled to receive the balance of net residual funds. The Bank acts as the trust's administrative agent, controls this trust and thus consolidates it. Note 18 provides a description of the trust units issued by NBC Asset Trust.

The following table presents the Bank's exposure to consolidated and non-consolidated SPEs.

As at October 31		2013		2012
	Investments and other assets	**Total assets**	Investments and other assets	Total assets
Non-consolidated special purpose entities				
Multi-seller asset-backed commercial paper conduits administered by the Bank(1)	**6**	**2,110**	12	2,067
National Bank hedge fund managed accounts (Innocap platform)(2)	**32**	**290**	105	513
Restructured notes of the MAV conduits(3)	**1,361**	**–**	1,338	–
Private capital funds and investments(4)	**1,304**	**7,183**	186	2,562
	2,703	**9,583**	1,641	5,142
Consolidated special purpose entities				
Securitization entity for the Bank's credit card receivables(5)(6)	**328**	**1,621**	321	1,615
National Bank hedge fund managed accounts (Innocap platform)(2)(6)	**508**	**617**	529	624
Mutual funds(6)(7)	**411**	**411**	587	602
Covered bonds(8)	**3,506**	**3,939**	3,856	3,978
Building(9)	**78**	**71**	85	78
Private investments(10)	**–**	**2**	10	21
NBC Capital Trust(11)	**4**	**246**	4	248
NBC Asset Trust(12)	**938**	**1,710**	750	1,528
	5,773	**8,617**	6,142	8,694
	8,476	**18,200**	7,783	13,836

(1) The main underlying assets, located in Canada, are residential mortgages, automobile loans, automobile inventory financings, and other receivables. As at October 31, 2013, the notional committed amount of the global-style liquidity facilities totalled $2,104 million ($2,061 million as at October 31, 2012), representing the total amount of commercial paper outstanding. The Bank also provides series-wide credit enhancement facilities for a notional committed amount of $30 million ($30 million as at October 31, 2012). The maximum exposure to loss cannot exceed the amount of commercial paper outstanding. As at October 31, 2013, the Bank held $6 million in commercial paper ($12 million as at October 31, 2012) and, consequently, the maximum potential amount of future payments as at October 31, 2013 was limited to $2,098 million ($2,049 million as at October 31, 2012), which represents the undrawn liquidity and credit enhancement facilities.
(2) The underlying assets are various financial instruments (trading portfolio). The total assets of the Innocap platform are presented on a net asset basis.
(3) See the Master Asset Vehicles section in Note 6. The total amount outstanding of restructured notes of the MAV conduits was $25 billion as at October 31, 2013 ($27 billion as at October 31, 2012). The undrawn margin funding facilities amounted to $886 million as at October 31, 2013 ($910 million as at October 31, 2012).
(4) The underlying assets are private investments. The amount of total assets of the special purpose entities corresponds to the amount for the most recent available period.
(5) The underlying assets are credit card receivables.
(6) The Bank's exposure is presented net of third-party holdings.
(7) The underlying assets are various financial instruments and are presented on a net asset basis. Certain mutual funds are in a trading portfolio.
(8) The underlying assets are insured residential mortgage loans. The average maturity of the underlying assets is two years. See Note 25.
(9) The underlying asset is a building located in Canada.
(10) The underlying assets are private investments.
(11) The underlying asset is a deposit note from the Bank. See Note 18.
(12) See Note 18. The underlying assets are insured and uninsured residential mortgage loans of the Bank. As at October 31, 2013, insured loans amounted to $277 million ($377 million as at October 31, 2012). The average maturity of the underlying assets is two years.

(millions of Canadian dollars)

NOTE 28 – RELATED PARTY DISCLOSURES

In the normal course of business, the Bank provides various banking services to related parties and enters into contractual agreements and other operations with related parties. The Bank considers the following to be related parties:

– its key officers and directors and members of their immediate family, including spouses and children under 18 living in the same household;
– entities over which its key officers and directors and their immediate family have control and/or significant influence through their significant voting power;
– the Bank's associates and joint ventures; and
– the Bank's pension plans (for additional information, see Note 22).

According to the established definition, the Bank's key officers are those persons having authority and responsibility for planning, directing and controlling the Bank's activities, directly or indirectly.

Transactions With Related Parties

As at October 31	2013	2012	2013	2012
		Key officers and directors[1]		Related entities
Assets				
Loans and mortgage loans[2]	**33**	17	**327**[3]	384[3]
Other	**–**	–	**58**	58
Liabilities				
Deposits	**51**	60	**605**[4]	338[4]
Other	**–**	–	**34**	21

(1) As at October 31, 2013, key officers, directors and their immediate family members were holding $30 million in the Bank's common and preferred shares ($29 million as at October 31, 2012).
(2) The Bank did not record any allowance or provisions for credit losses in 2013 and 2012.
(3) As at October 31, 2013, loans and mortgage loans consisted of (i) $116 million in loans to the Bank's associates and joint ventures ($206 million as at October 31, 2012) and (ii) $211 million in loans to entities whose key officers, directors and immediate family members exercise control or significant influence through significant voting power ($178 million as at October 31, 2012).
(4) As at October 31, 2013, deposits consisted of (i) $251 million in deposits from the Bank's associates and joint ventures ($89 million as at October 31, 2012), (ii) $178 million in deposits from entities whose key officers, directors and their immediate family members exercise control or significant influence through significant voting power ($81 million as at October 31, 2012), and (iii) $176 million in deposits from the Bank's pension plan ($168 million as at October 31, 2012).

The agreements and other transactions with related entities as well as with directors and key officers are entered into under conditions similar to those offered to non-related third parties. These agreements did not have a significant impact on the Bank's results. Loans to eligible key officers are granted under the same conditions as those granted to any other employee of the Bank. The main conditions are as follows: the employee must meet the same credit requirements as a client; mortgage loans are granted at the posted rate less 2% limited to half of the posted rate; personal loans bear interest at the client rate divided by two; credit card advances bear interest at a prescribed fixed rate in accordance with Bank policy; and personal lines of credit bear interest at the Canadian prime rate less 3%, but never lower than Canadian prime divided by two. For personal loans and personal lines of credit, employees may not borrow more than 50% of their annual gross base salary at the reduced rate. The Canadian prime rate is applied to the remainder. In accordance with the *Bank Act* (Canada), the aggregate of loans granted to key officers of the Bank, excluding mortgage loans granted on their principal residence, cannot exceed twice the officer's base salary. Moreover, the Bank offers a deferred stock unit plan to directors who are not Bank employees. For additional information, see Notes 9 and 21.

(millions of Canadian dollars)

Compensation of Key Officers and Directors

As at October 31	2013	2012
Compensation and other short-term and long-term benefits	21	23
Share-based payments	13	11

Other
The Bank analyzes all contracts and commitments that it has signed with related parties. These transactions were executed at the market conditions prevailing at the time of the transactions.

Principal Subsidiaries of the Bank

Name	Principal office address	Voting and participating shares	
		2013	2012
National Bank Acquisition Holding Inc.	Montreal, Canada	100%	100%
National Bank Life Insurance Company	Montreal, Canada	100%	100%
National Bank Insurance Firm Inc.	Montreal, Canada	100%	100%
1261095 Ontario Limited	Toronto, Canada	100%	100%
National Bank Group Inc.	Montreal, Canada	100%	100%
National Bank Financial & Co. Inc.	Montreal, Canada	100%	100%
National Bank Financial Inc.	Montreal, Canada	100%	100%
Natcan Insurance Company Limited	Bridgetown, Barbados	100%	100%
Natcan Trust Company	Montreal, Canada	100%	100%
FMI Acquisition Inc.	Montreal, Canada	100%	100%
NBC Commodities (2010) Inc.	Montreal, Canada	100%	100%
NBC Financial Markets Asia Limited	Hong Kong, China	100%	
8062072 Canada Inc.	Montreal, Canada	100%	100%
National Bank Trust Inc.	Montreal, Canada	100%	100%
CABN Investments Inc.	Montreal, Canada	100%	100%
Natcan Acquisition Holdings Inc.(1)	Montreal, Canada		100%
National Bank Securities Inc.	Montreal, Canada	100%	100%
9130-1564 Quebec Inc.	Montreal, Canada	100%	100%
Natcan Investment Management Inc.	Montreal, Canada	100%	100%
National Bank Direct Brokerage Inc.	Montreal, Canada	100%	100%
3562719 Canada Inc.	Montreal, Canada	100%	100%
National Bank Realty Inc.	Montreal, Canada	100%	100%
3673430 Canada Inc.	Montreal, Canada	100%	
Assurances générales Banque Nationale (Gestion) inc.	Montreal, Canada	90%	90%
National Bank General Insurance Inc.	Montreal, Canada	90%	90%
Natcan Global Holdings Ltd.	Sliema, Malta	100%	100%
Innocap Global Investment Management Ltd.	Sliema, Malta	100%	100%
NBC Global Finance Limited	Dublin, Ireland	100%	
NatBC Holding Corporation	Hollywood, United States	100%	100%
Natbank, National Association	Hollywood, United States	100%	100%
NBC Trade Finance Limited	Hong Kong, China	100%	100%
NBC Alternative Investments Inc.	Montreal, Canada	100%	100%
NBC Financial Services Inc.	Montreal, Canada	100%	100%
NBC Asset Trust(2)	Montreal, Canada		
NBC Capital Trust(2)	Montreal, Canada		
Canadian Credit Card Trust(2)	Toronto, Canada		
NBC Covered Bond GP Inc.(2)	Montreal, Canada		

(1) Liquidated company during the year ended October 31, 2013.
(2) For additional information on these special purpose entities, see Note 27.

(millions of Canadian dollars)

NOTE 29 – INTEREST RATE SENSITIVITY

The Bank offers a range of financial products whose cash flows are sensitive to interest rate fluctuations. Interest rate risk arises from on- and off-balance sheet cash flow mismatches. The degree of exposure is based on the magnitude and direction of interest rate movements and on the extent of the mismatch of the maturities. Analyzing interest rate sensitivity gaps is one of the techniques used by the Bank to manage interest rate risk.

The following table illustrates the sensitivity of the Bank's Consolidated Balance Sheet to interest rate fluctuations as at October 31.

As at October 31							2013	2012
	Floating rate	3 months or less	Over 3 months to 12 months	Over 1 year to 5 years	Over 5 years	Non-interest sensitive	Total	Total
Assets								
Cash and deposits with financial institutions	690	623	–	–	–	2,283	3,596	3,249
Effective yield		0.2%	–%	–%	–%			
Securities	2	3,398	3,088	15,239	13,962	18,055	53,744	54,898
Effective yield		1.3%	0.9%	1.2%	3.5%			
Loans and acceptances(1)	38,988	28,034	12,930	27,365	1,246	10,224	118,787	106,451
Effective yield		2.3%	3.7%	3.6%	2.9%			
Other	5,376	–	–	–	–	6,701	12,077	13,305
	45,056	32,055	16,018	42,604	15,208	37,263	188,204	177,903
Liabilities and equity								
Deposits	39,518	15,056	7,944	25,090	1,009	13,269	101,886	93,249
Effective yield		0.8%	1.7%	2.2%	2.1%			
Obligations related to securities sold short and related to securities sold under repurchase agreements and securities loaned	–	12,390	4,456	5,387	8,257	8,165	38,655	37,663
Effective yield		2.3%	0.6%	1.4%	3.1%			
Subordinated debt	–	543	–	1,850	33	–	2,426	2,470
Effective yield		5.6%	–%	3.9%	0.6%			
Acceptances and other liabilities	7,927	9,449	1,025	6,593	5,115	5,967	36,076	36,281
Equity	–	373	104	200	–	8,484	9,161	8,240
	47,445	37,811	13,529	39,120	14,414	35,885	188,204	177,903
On-balance-sheet gap	(2,389)	(5,756)	2,489	3,484	794	1,378	–	–
Derivative financial instruments	–	(10,332)	(3,933)	9,866	4,399	–	–	–
	(2,389)	(16,088)	(1,444)	13,350	5,193	1,378	–	–
Position in Canadian dollars								
On-balance-sheet total	(438)	(2,324)	2,741	8,099	8	(8,189)	(103)	2,423
Derivative financial instruments	–	(12,194)	(52)	8,517	3,754	–	25	(2,794)
	(438)	(14,518)	2,689	16,616	3,762	(8,189)	(78)	(371)
Position in foreign currency								
On-balance-sheet total	(1,951)	(3,432)	(252)	(4,615)	786	9,567	103	(2,423)
Derivative financial instruments	–	1,862	(3,881)	1,349	645	–	(25)	2,794
	(1,951)	(1,570)	(4,133)	(3,266)	1,431	9,567	78	371
	(2,389)	(16,088)	(1,444)	13,350	5,193	1,378	–	–

(1) Includes securities purchased under reverse repurchase agreements and securities borrowed.

The effective yield represents the weighted average effective yield based on the earlier of contractual repricing and maturity dates.

(millions of Canadian dollars)

NOTE 30 – SEGMENT DISCLOSURES

The Bank carries out its activities in three business segments, which are defined below. For presentation purposes, other operating activities are grouped in the *Other* heading. Each reportable segment is distinguished by services offered, type of clientele and marketing strategy.

Personal and Commercial
The Personal and Commercial segment encompasses the banking, financing, and investing services offered to individuals and businesses as well as insurance operations.

Wealth Management
The Wealth Management segment comprises investment solutions, trust services, banking services, lending services and other wealth management solutions offered through internal and third-party distribution networks.

Financial Markets
The Financial Markets segment encompasses banking services, investment banking services and financial solutions for institutional clients. The segment is also active in proprietary trading and investment activities.

Other
This heading encompasses treasury activities, including the Bank's liquidity management and funding operations, certain non-recurring items and the unallocated portion of corporate services.

The Bank's segment reporting is consistent with that adopted for the fiscal year beginning November 1, 2012, with the following changes having been made to better reflect how management monitors performance. The distribution of banking products through independent networks has been reclassified from the Personal and Commercial segment to the Wealth Management segment. Banking activities with energy sector companies have been transferred from the Financial Markets segment to the Personal and Commercial segment. These changes had no impact on the Bank's consolidated results.

The segment disclosures have been prepared in accordance with the accounting policies described in Note 1, except for the net interest income and income taxes (recovery) of the operating segments, which are presented on a taxable equivalent basis. Taxable equivalent basis is a calculation method that consists in grossing up certain tax-exempt income by the amount of income tax that would have otherwise been payable. The effect of these adjustments is reversed under the *Other* heading. Head office expenses are allocated to each operating segment presented in the segmented results. The Bank assesses performance based on the net income attributable to the Bank's shareholders. Intersegment revenues are recognized at the exchange amount. Segment assets correspond to average assets used in segment operations.

Results by Business Segment

Year ended October 31	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
		Personal and Commercial		Wealth Management		Financial Markets		Other		Total
Net interest income[1]	1,614	1,581	272	255	785	584	(222)	(82)	2,449	2,338
Non-interest income	985	950	865	1,068	594	719	270	238	2,714	2,975
Total revenues	2,599	2,531	1,137	1,323	1,379	1,303	48	156	5,163	5,313
Non-interest expenses	1,435	1,434	846	881	657	707	227	151	3,165	3,173
Contribution	1,164	1,097	291	442	722	596	(179)	5	1,998	2,140
Provisions for credit losses	192	174	3	3	(14)	3	–	–	181	180
Income before income taxes (recovery)	972	923	288	439	736	593	(179)	5	1,817	1,960
Income taxes (recovery)[1]	259	248	76	86	195	160	(267)	(168)	263	326
Net income	713	675	212	353	541	433	88	173	1,554	1,634
Non-controlling interests	–	–	–	1	8	3	67	69	75	73
Net income attributable to the Bank's shareholders	713	675	212	352	533	430	21	104	1,479	1,561
Average assets	76,696	70,524	8,159	7,980	87,063	76,084	21,587	26,756	193,505	181,344

(1) For the business segments as a whole, *Net interest income* was grossed up by $209 million ($172 million in 2012). An equivalent amount was added to *Income taxes (recovery)*. The effect of these adjustments is reversed under the *Other* heading.

(millions of Canadian dollars)

NOTE 30 – SEGMENT DISCLOSURES (cont.)

Results by Geographic Segment

Year ended October 31	2013	2012	2013	2012	2013	2012	2013	2012
		Canada		United States		Other		Total
Net interest income	2,464	2,377	(3)	(17)	(12)	(22)	2,449	2,338
Non-interest income	2,433	2,675	227	223	54	77	2,714	2,975
Total revenues	4,897	5,052	224	206	42	55	5,163	5,313
Non-interest expenses	2,965	2,953	183	167	17	53	3,165	3,173
Contribution	1,932	2,099	41	39	25	2	1,998	2,140
Provisions for credit losses	181	179	–	1	–	–	181	180
Income before income taxes (recovery)	1,751	1,920	41	38	25	2	1,817	1,960
Income taxes (recovery)	242	309	20	17	1	–	263	326
Net income	1,509	1,611	21	21	24	2	1,554	1,634
Non-controlling interests	67	69	8	4	–	–	75	73
Net income attributable to the Bank's shareholders	1,442	1,542	13	17	24	2	1,479	1,561
Average assets	182,315	170,538	10,454	9,233	736	1,573	193,505	181,344

NOTE 31 – EVENTS AFTER THE CONSOLIDATED BALANCE SHEET DATE

Acquisition of TD Waterhouse Institutional Services

On November 12, 2013, the Bank completed the acquisition, through a subsidiary, of Toronto-Dominion Bank's institutional services known as TD Waterhouse Institutional Services. The purchase price for the acquisition is $250 million, subject to a price adjustment mechanism based on asset retention over a one-year period. This acquisition marks another major step in the Bank's expansion of its wealth management platform across Canada.

The Bank has not finalized its initial accounting for the acquisition as it has yet to complete the valuation of assets acquired and liabilities assumed, including intangible assets and goodwill. The assets and liabilities of TD Waterhouse Institutional Services consist primarily of amounts due from clients, dealers and brokers and amounts due to clients, dealers and brokers, respectively.

Repurchase of Subordinated Debt

On November 15, 2013, the Bank repurchased at their nominal value, for cancellation, a total of $500 million in notes maturing in November 2018.

Redemption of Preferred Shares

On December 3, 2013, the Board approved the redemption of all the issued and outstanding non-cumulative 5-year rate-reset Series 24 First Preferred Shares and the redemption of all the issued and outstanding non-cumulative 5-year rate-reset Series 26 First Preferred Shares. These redemptions are subject to the approval of OSFI.

Stock Split

On December 3, 2013, the Board declared a stock dividend of one common share on each of the issued and outstanding common shares, payable on February 13, 2014. The effect will be the same as a two-for-one split of common shares. All common share numbers and per-share calculations will be adjusted retrospectively to reflect the stock dividend.

SUPPLEMENTARY INFORMATION

STATISTICAL REVIEW[1]

As at October 31	**2013**	2012	2011	2010	2009	2008	2007	2006	2005	2004
Consolidated Balance Sheet data										
(millions of Canadian dollars)										
Cash and deposits with financial institutions	**3,596**	3,249	2,851	2,274	2,228	3,660	3,328	10,879	10,314	5,777
Securities	**53,744**	54,898	56,592	54,268	50,233	46,185	39,270	38,678	33,052	28,007
Securities purchased under reverse repurchase agreements and securities borrowed	**21,449**	15,529	12,507	10,878	7,637	7,868	5,966	7,592	7,023	4,496
Loans and acceptances	**97,338**	90,922	80,758	63,134	58,370	56,015	52,045	50,670	47,311	44,574
Other assets	**12,077**	13,305	14,146	14,748	13,670	15,604	12,476	8,982	10,270	5,643
Total assets	**188,204**	177,903	166,854	145,302	132,138	129,332	113,085	116,801	107,970	88,497
Deposits	**101,886**	93,249	85,562	81,785	75,170	76,022	70,798	71,917	62,219	53,432
Other liabilities	**74,731**	73,944	71,787							
Other liabilities and non-controlling interests				54,276	48,474	45,546	36,045	38,647	40,052	29,453
Subordinated debt	**2,426**	2,470	2,000	2,033	2,017	2,255	1,605	1,449	1,102	1,408
Share capital										
Preferred	**677**	762	762	1,089	1,089	774	400	400	400	375
Common	**2,160**	2,054	1,970	1,804	1,729	1,656	1,575	1,566	1,565	1,545
Contributed surplus	**58**	58	46	66	48	31	32	21	13	7
Retained earnings	**5,034**	4,091	3,366	4,081	3,515	3,110	2,793	2,893	2,645	2,287
Accumulated other comprehensive income (loss)	**214**	255	337	168	96	(62)	(163)	(92)	(26)	(10)
Non-controlling interests	**1,018**	1,020	1,024							
Total liabilities and equity	**188,204**	177,903	166,854	145,302	132,138	129,332	113,085	116,801	107,970	88,497
Average assets	**193,505**	181,344	165,942	140,360	140,978	128,319	125,964	106,192	90,794	78,553
Average capital funds[2]	**10,429**	9,346	9,056	7,779	7,198	6,416	5,840	5,568	5,268	5,238
Consolidated Statement of Income data										
(millions of Canadian dollars)										
Net interest income	**2,449**	2,338	2,330	1,933	1,961	1,772	1,116	1,284	1,441	1,363
Non-interest income	**2,714**	2,975	2,336	2,351	2,172	2,062	2,301	2,511	2,226	2,155
Total revenues	**5,163**	5,313	4,666	4,284	4,133	3,834	3,417	3,795	3,667	3,518
Provisions for credit losses	**181**	180	184	144	305	144	103	77	33	86
Non-interest expenses	**3,165**	3,173	2,911	2,822	2,662	2,695	2,626	2,538	2,463	2,361
Income taxes	**263**	326	275	221	252	167	79	277	291	318
Non-controlling interests				63	60	52	68	32	25	28
Net income	**1,554**	1,634	1,296	1,034	854	776	541	871	855	725
Non-controlling interests	**75**	73	72							
Net income attributable to the Bank's shareholders	**1,479**	1,561	1,224							

(1) Figures for 2010 and years prior are presented in accordance with previous Canadian GAAP.
(2) Average capital funds include common shareholders' equity, redeemable preferred shares and subordinated debt.
(3) In 2013, the capital ratios under Basel III are calculated using the "all-in" methodology and the October 31, 2012 and 2011 ratios are presented on a pro forma basis.
(4) In 2008, the Bank adopted the rules of the Basel II Accord and, since November 1, 2009, it has been applying the Advanced Internal Rating-Based Approach for credit risk, whereas prior to that date, it had been using the Standardized Approach under Basel I for 2007 and years prior.
(5) Taking into account the issuance of $500 million in subordinated debt on November 2, 2006.
(6) Taking into account the issuance of $500 million in subordinated debt on November 2, 2005.
(7) In full-time equivalent.

As at October 31	**2013**	2012	2011	2010	2009	2008	2007	2006	2005	2004
Number of common shares *(thousands)*	**162,991**	161,308	160,474	162,772	161,201	159,447	157,806	161,512	165,335	167,430
Number of common shareholders on record	**22,737**	23,180	23,588	23,598	23,970	24,354	24,780	25,531	26,235	26,961
Basic earnings per share	**$ 8.87**	$ 9.40	$ 7.00	$ 5.99	$ 4.96	$ 4.69	$ 3.25	$ 5.22	$ 4.98	$ 4.10
Diluted earnings per share	**$ 8.80**	$ 9.32	$ 6.92	$ 5.94	$ 4.94	$ 4.67	$ 3.22	$ 5.13	$ 4.90	$ 4.05
Dividend per share	**$ 3.40**	$ 3.08	$ 2.74	$ 2.48	$ 2.48	$ 2.48	$ 2.28	$ 1.96	$ 1.72	$ 1.42
Stock trading range										
High	**$ 90.48**	$ 81.27	$ 81.44	$ 67.87	$ 62.08	$ 54.63	$ 66.59	$ 65.60	$ 61.47	$ 48.78
Low	**$ 72.35**	$ 63.27	$ 64.86	$ 54.45	$ 25.62	$ 42.25	$ 50.50	$ 56.14	$ 46.39	$ 40.17
Close	**$ 90.48**	$ 77.18	$ 71.14	$ 67.13	$ 56.39	$ 45.21	$ 54.65	$ 61.25	$ 59.14	$ 48.78
Book value	**$ 45.81**	$ 40.04	$ 35.65	$ 37.59	$ 33.43	$ 29.70	$ 26.85	$ 27.17	$ 25.39	$ 22.87
Dividends on preferred shares										
Series 13	**–**	–	–	–	–	–	–	–	$ 1.2000	$ 1.6000
Series 15	**$ 0.2444**	$ 1.4625	$ 1.4625	$ 1.4625	$ 1.4625	$ 1.4625	$ 1.4625	$ 1.4625	$ 1.4625	$ 1.4625
Series 16	**$ 1.2125**	$ 1.2125	$ 1.2125	$ 1.2125	$ 1.2125	$ 1.2125	$ 1.2125	$ 1.2125	$ 0.8089	–
Series 20	**$ 1.5000**	$ 1.5000	$ 1.5000	$ 1.5000	$ 1.5000	$ 0.8692	–	–	–	–
Series 21	**$ 1.0078**	$ 1.3438	$ 1.3438	$ 1.3438	$ 1.3438	$ 0.5596	–	–	–	–
Series 24	**$ 1.6500**	$ 1.6500	$ 1.6500	$ 1.6500	$ 1.3765	–	–	–	–	–
Series 26	**$ 1.6500**	$ 1.6500	$ 1.6500	$ 1.6500	$ 1.3042	–	–	–	–	–
Series 28	**$ 0.9728**	–	–	–	–	–	–	–	–	–
Financial ratios										
Return on common shareholders' equity	**20.6%**	24.5%	20.2%	17.0%	15.6%	16.4%	11.5%	20.1%	20.7%	18.8%
Return on average assets	**0.80%**	0.90%	0.78%	0.74%	0.61%	0.60%	0.43%	0.82%	0.94%	0.92%
Return on average capital funds	**14.9%**	17.5%	14.3%	13.3%	11.9%	12.1%	9.3%	15.6%	16.2%	13.8%
Capital ratios										
Common Equity Tier 1[3]	**8.7%**	7.3%	7.6%							
Tier 1[4]	**11.4%**	10.1%	10.8%	14.0%	10.7%	9.4%	9.0%	9.9%	9.6%	9.6%
Total[4]	**15.0%**	14.1%	14.3%	17.5%	14.3%	13.2%	12.4%	14.0%[5]	12.8%[6]	13.0%
Other information										
Net impaired loans *(millions of dollars)*	**$ 183**	$ 179	$ 175	$ 162	$ 223	$ 169	$ 129	$ 116	$ 117	$ 160
Number of employees[7]	**16,675**	16,636	16,217	15,298	14,851	14,420	14,484	14,381	14,372	14,122
Branches in Canada	**453**	451	448	442	445	446	447	451	457	462
Banking machines	**937**	923	893	869	866	858	836	801	788	770

INFORMATION FOR SHAREHOLDERS

DESCRIPTION OF SHARE CAPITAL

The authorized share capital of the Bank consists of an unlimited number of common shares, without par value, an unlimited number of first preferred shares, without par value, issuable for a maximum aggregate consideration of $5 billion; and 15 million second preferred shares, without par value, issuable for a maximum aggregate consideration of $300 million. As at October 31, 2013, the Bank had a total of 162,991,368 common shares and 27,050,715 first preferred shares issued and outstanding.

STOCK EXCHANGE LISTINGS

The Bank's common shares and Series 16, 20, 24, 26 and 28 First Preferred Shares are listed on the Toronto Stock Exchange.

Issue or class	Ticker symbol	Newspaper abbreviation
Common shares	NA	Nat Bk or Natl Bk
First Preferred Shares		
Series 16	NA.PR.L	Nat Bk s16 or Natl Bk s16
Series 20	NA.PR.M	Nat Bk s20 or Natl Bk s20
Series 24	NA.PR.O	Nat Bk s24 or Natl Bk s24
Series 26	NA.PR.P	Nat Bk s26 or Natl Bk s26
Series 28	NA.PR.Q	Nat Bk s28 or Natl Bk s28

NUMBER OF REGISTERED SHAREHOLDERS

As at October 31, 2013, there were 22,737 common shareholders recorded in the Bank's common share register.

DIVIDENDS

Dividend Dates in 2014

(subject to approval by the Board of Directors of the Bank)

Ex-dividend date	Record date	Payment date
Common shares		
December 23, 2013	December 27, 2013	February 1, 2014
March 25, 2014	March 27, 2014	May 1, 2014
June 24, 2014	June 26, 2014	August 1, 2014
September 23, 2014	September 25, 2014	November 1, 2014
Preferred shares, Series 16, 20, 24, 26 and 28[(1)]		
January 8, 2014	January 10, 2014	February 15, 2014
April 9, 2014	April 11, 2014	May 15, 2014
July 9, 2014	July 11, 2014	August 15, 2014
October 8, 2014	October 10, 2014	November 15, 2014

(1) On December 3, 2013, the Board approved the redemption of all the issued and outstanding non-cumulative 5-year rate-reset Series 24 First Preferred Shares and the redemption of all the issued and outstanding non-cumulative 5-year rate-reset Series 26 First Preferred Shares. These redemptions are subject to the approval of OSFI.

Dividends Declared on Common Shares During 2013

Ex-dividend date	Record date	Payment date	Dividend per share ($)
December 21, 2012	December 27, 2012	February 1, 2013	0.83
March 26, 2013	March 28, 2013	May 1, 2013	0.83
June 18, 2013	June 20, 2013	August 1, 2013	0.87
September 24, 2013	September 26, 2013	November 1, 2013	0.87

Dividends Declared on Preferred Shares During 2013

			Dividend per share ($)						
Ex-dividend date	Record date	Payment date	Series 15	Series 16	Series 20	Series 21	Series 24	Series 26	Series 28
Jan.9, 13	Jan. 11, 13	Feb. 15, 13	0.24442	0.303125	0.375	0.3359	0.4125	0.4125	0.2603
Apr. 10, 13	Apr. 12, 13	May 15, 13	–	0.303125	0.375	0.3359	0.4125	0.4125	0.2375
Jul. 3, 13	Jul. 5, 13	Aug. 15, 13	–	0.303125	0.375	0.3360	0.4125	0.4125	0.2375
Oct. 9, 13	Oct. 11, 13	Nov. 15, 13	–	0.303125	0.375	–	0.4125	0.4125	0.2375

Dividends paid are "eligible dividends" in accordance with the *Income Tax Act* (Canada).

DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN

National Bank has a Dividend Reinvestment and Share Purchase Plan for Canadian holders of its common and preferred shares under which they can acquire common shares of the Bank without paying commissions or administration fees. Canadian participants acquire common shares through the reinvestment of cash dividends paid on the shares they hold or through optional cash payments of at least $500 per payment, up to a maximum of $5,000 per quarter.

For additional information, shareholders may contact National Bank's registrar and transfer agent, Computershare Trust Company of Canada, at 1-888-838-1407. To participate in the plan, National Bank's beneficial or non-registered common shareholders must contact their financial institution or broker.

Direct Deposit

Shareholders may elect to have their dividend payments deposited directly via electronic funds transfer to their bank account at any financial institution that is a member of the Canadian Payments Association. To do so, they must send a written request to the Transfer Agent, Computershare Trust Company of Canada.

Head Office
National Bank of Canada
National Bank Tower
600 De La Gauchetière Street West, 4th Floor
Montreal, Quebec H3B 4L2 Canada

Telephone: 514-394-5000
Website: nbc.ca

Annual Meeting
The Annual Meeting of Holders of Common Shares of the Bank will be held on Thursday, April 10, 2014, at the Fairmont Palliser Hotel in Calgary, Alberta, Canada.

Public Accountability Statement
The 2013 Social Responsibility Report will be available in March 2014 on the Bank's website at nbc.ca.

Communication with Shareholders
For information about stock transfers, address changes, dividends, lost certificates, tax forms and estate transfers, shareholders of record may contact the Transfer Agent at the following address:

Computershare Trust Company of Canada
Share Ownership Management
1500 University Street, 7th Floor
Montreal, Quebec H3A 3S8 Canada

Telephone: 1-888-838-1407
Fax: 1-888-453-0330
E-mail: *service@computershare.com*
Website: computershare.com

Shareholders whose shares are held by a market intermediary are asked to contact the market intermediary concerned.

Other shareholder inquiries can be addressed to:
Investor Relations
National Bank of Canada
National Bank Tower
600 De La Gauchetière Street West, 7th Floor
Montreal, Quebec H3B 4L2 Canada

Telephone: 1-866-517-5455
Fax: 514-394-6196
E-mail: investorrelations@nbc.ca
Website: nbc.ca/investorrelations

Caution Regarding Forward-Looking Statements
From time to time, National Bank of Canada makes written and oral forward-looking statements included in this Annual Report, in other filings with Canadian regulators, in reports to shareholders, in press releases and in other communications. All such statements are made pursuant to the Canadian and American securities legislation and the provisions of the United States *Private Securities Litigation Reform Act of 1995*.

Additional information about these statements can be found on page 11 of this Annual Report.

Trademarks

Pour obtenir une version française du Rapport annuel, veuillez vous adresser à :
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