

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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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 (Canada) (OSFI), the financial statements are to be prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). IFRS represent Canadian generally accepted accounting principles (GAAP). None of the OSFI accounting requirements are exceptions to IFRS.

Management maintains the accounting and internal control systems needed to discharge 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, 2017 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 compliance risk and to obtain reasonable assurance that the Bank is compliant with regulatory requirements.

The Senior Vice-President of Internal Audit has direct access to the Chair of the Audit Committee and to the President and Chief Executive Officer. In addition, the Senior Vice-President and Chief Compliance Officer has a direct functional link to the Chair of the Risk Management Committee and direct access to the President and Chief Executive Officer.

In accordance with the *Bank Act* (Canada), OSFI is mandated to protect the rights and interests of the depositors. Accordingly, OSFI examines and enquires into the business and affairs of the Bank, as deemed necessary, to ensure that the provisions of the *Bank Act* (Canada) are being satisfied and that the Bank is in sound financial condition.

The independent auditor, Deloitte LLP, whose report follows, was appointed by the shareholders on the recommendation of the Board. The auditor has 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, November 30, 2017

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, 2017 and 2016, 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, 2017 and 2016, and 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, 2017 and 2016 and its financial performance and its cash flows for the years ended October 31, 2017 and 2016 in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board.

Deloitte LLP¹

Montreal, Canada, November 30, 2017

¹ CPA auditor, CA, public accountancy permit No. A121501

CONSOLIDATED BALANCE SHEETS

As at October 31		2017	2016
Assets			
Cash and deposits with financial institutions		8,802	8,183
Securities	Notes 4 and 6		
At fair value through profit or loss		47,536	45,964
Available-for-sale		8,552	14,608
Held-to-maturity		9,255	3,969
		65,343	64,541
Securities purchased under reverse repurchase agreements and securities borrowed		20,789	13,948
Loans	Note 7		
Residential mortgage		50,518	48,868
Personal and credit card		36,963	33,964
Business and government		41,690	37,686
		129,171	120,518
Customers' liability under acceptances		5,991	6,441
Allowances for credit losses		(719)	(781)
		134,443	126,178
Other			
Derivative financial instruments	Note 17	8,423	10,416
Purchased receivables		2,014	1,858
Investments in associates and joint ventures	Note 9	631	645
Premises and equipment	Note 10	558	1,338
Goodwill	Note 11	1,409	1,412
Intangible assets	Note 11	1,239	1,140
Other assets	Note 12	2,176	2,547
		16,450	19,356
		245,827	232,206
Liabilities and equity			
Deposits	Notes 4 and 13	156,671	142,066
Other			
Acceptances		5,991	6,441
Obligations related to securities sold short		15,363	14,207
Obligations related to securities sold under repurchase agreements and securities loaned		21,767	22,636
Derivative financial instruments	Note 17	6,612	7,725
Liabilities related to transferred receivables	Notes 4 and 8	20,098	20,131
Other liabilities	Note 14	5,758	5,886
		75,589	77,026
Subordinated debt	Note 16	9	1,012
Equity			
Equity attributable to the Bank's shareholders	Notes 19 and 23		
Preferred shares		2,050	1,650
Common shares		2,768	2,645
Contributed surplus		58	73
Retained earnings		7,706	6,706
Accumulated other comprehensive income		168	218
		12,750	11,292
Non-controlling interests	Note 20	808	810
		13,558	12,102
		245,827	232,206

The accompanying notes are an integral part of these audited consolidated financial statements.

Louis Vachon
President and Chief Executive Officer

Karen Kinsley
Director

CONSOLIDATED STATEMENTS OF INCOME

Year ended October 31		2017	2016
Interest income			
Loans		4,511	3,872
Securities at fair value through profit or loss		598	620
Available-for-sale securities		227	330
Held-to-maturity securities		130	24
Deposits with financial institutions		114	65
		5,580	4,911
Interest expense			
Deposits		1,780	1,435
Liabilities related to transferred receivables		403	404
Subordinated debt		16	33
Other		149	47
		2,348	1,919
Net interest income		3,232	2,992
Non-interest income			
Underwriting and advisory fees		349	376
Securities brokerage commissions		216	235
Mutual fund revenues		412	364
Trust service revenues		518	453
Credit fees		361	346
Card revenues		132	119
Deposit and payment service charges		279	258
Trading revenues (losses)	Note 22	374	150
Gains (losses) on available-for-sale securities, net		140	70
Insurance revenues, net		117	114
Foreign exchange revenues, other than trading		81	81
Share in the net income of associates and joint ventures	Note 9	35	15
Other	Note 9	363	267
		3,377	2,848
Total revenues		6,609	5,840
Provisions for credit losses	Note 7	244	484
		6,365	5,356
Non-interest expenses			
Compensation and employee benefits		2,358	2,161
Occupancy		236	233
Technology		568	587
Communications		61	67
Professional fees		254	276
Restructuring charge	Note 15	–	131
Other		380	420
		3,857	3,875
Income before income taxes		2,508	1,481
Income taxes	Note 25	484	225
Net income		2,024	1,256
Net income attributable to			
Preferred shareholders		85	64
Common shareholders		1,855	1,117
Bank shareholders		1,940	1,181
Non-controlling interests		84	75
		2,024	1,256
Earnings per share (dollars)	Note 26		
Basic		5.44	3.31
Diluted		5.38	3.29
Dividends per common share (dollars)	Note 19	2.28	2.18

The accompanying notes are an integral part of these audited consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Year ended October 31	2017	2016
Net income	2,024	1,256
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	(64)	62
Net foreign currency translation (gains) losses on investments in foreign operations reclassified to net income	–	(12)
Impact of hedging net foreign currency translation gains (losses)	25	(33)
Impact of hedging net foreign currency translation (gains) losses reclassified to net income	–	5
	(39)	22
Net change in available-for-sale securities		
Net unrealized gains (losses) on available-for-sale securities	119	113
Net (gains) losses on available-for-sale securities reclassified to net income	(131)	(74)
	(12)	39
Net change in cash flow hedges		
Net gains (losses) on derivative financial instruments designated as cash flow hedges	33	34
Net (gains) losses on designated derivative financial instruments reclassified to net income	(26)	(18)
	7	16
Share in the other comprehensive income of associates and joint ventures	(10)	1
Items that will not be subsequently reclassified to net income		
Remeasurements of pension plans and other post-employment benefit plans	97	(257)
Net fair value change attributable to credit risk on financial liabilities designated at fair value through profit or loss	(21)	(66)
	76	(323)
Total other comprehensive income (loss), net of income taxes	22	(245)
Comprehensive income	2,046	1,011
Comprehensive income attributable to		
Bank shareholders	1,966	931
Non-controlling interests	80	80
	2,046	1,011

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	2017	2016
Net foreign currency translation adjustments		
Net unrealized foreign currency translation gains (losses) on investments in foreign operations	(2)	(1)
Net foreign currency translation (gains) losses on investments in foreign operations reclassified to net income	–	(2)
Impact of hedging net foreign currency translation gains (losses)	1	(9)
Impact of hedging net foreign currency translation (gains) losses reclassified to net income	–	2
	(1)	(10)
Net change in available-for-sale securities		
Net unrealized gains (losses) on available-for-sale securities	46	42
Net (gains) losses on available-for-sale securities reclassified to net income	(48)	(27)
	(2)	15
Net change in cash flow hedges		
Net gains (losses) on derivative financial instruments designated as cash flow hedges	12	13
Net (gains) losses on designated derivative financial instruments reclassified to net income	(9)	(7)
	3	6
Share in the other comprehensive income of associates and joint ventures	(3)	–
Remeasurements of pension plans and other post-employment benefit plans	36	(94)
Net fair value change attributable to credit risk on financial liabilities designated at fair value through profit or loss	(8)	(24)
	25	(107)

The accompanying notes are an integral part of these audited consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Year ended October 31		2017	2016
Preferred shares at beginning	Note 19	1,650	1,023
Issuances of Series 34, 36 and 38 preferred shares		400	800
Redemption of Series 20 preferred shares for cancellation		–	(173)
Preferred shares at end		2,050	1,650
Common shares at beginning	Note 19	2,645	2,614
Issuances of common shares			
Stock Option Plan		179	43
Repurchases of common shares for cancellation		(16)	–
Impact of shares purchased or sold for trading		(37)	(12)
Other		(3)	–
Common shares at end		2,768	2,645
Contributed surplus at beginning		73	67
Stock option expense	Note 23	11	12
Stock options exercised		(26)	(6)
Contributed surplus at end		58	73
Retained earnings at beginning		6,706	6,705
Net income attributable to the Bank's shareholders		1,940	1,181
Dividends	Note 19		
Preferred shares		(85)	(61)
Common shares		(778)	(736)
Premium paid on preferred shares redeemed for cancellation	Note 19	–	(3)
Premium paid on common shares repurchased for cancellation	Note 19	(99)	–
Share issuance expenses, net of income taxes		(8)	(11)
Remeasurements of pension plans and other post-employment benefit plans		97	(257)
Net fair value change attributable to the credit risk on financial liabilities designated at fair value through profit or loss		(21)	(66)
Impact of a financial liability resulting from put options written to non-controlling interests		(34)	(46)
Other		(12)	–
Retained earnings at end		7,706	6,706
Accumulated other comprehensive income at beginning		218	145
Net foreign currency translation adjustments		(39)	22
Net change in unrealized gains (losses) on available-for-sale securities		(12)	39
Net change in gains (losses) on cash flow hedges		11	11
Share in the other comprehensive income of associates and joint ventures		(10)	1
Accumulated other comprehensive income at end		168	218
Equity attributable to the Bank's shareholders		12,750	11,292
Non-controlling interests at beginning	Note 20	810	801
Net income attributable to non-controlling interests		84	75
Other comprehensive income attributable to non-controlling interests		(4)	5
Distributions to non-controlling interests		(82)	(71)
Non-controlling interests at end		808	810
Equity		13,558	12,102

ACCUMULATED OTHER COMPREHENSIVE INCOME

As at October 31		2017	2016
Accumulated other comprehensive income			
Net foreign currency translation adjustments		(13)	26
Net unrealized gains (losses) on available-for-sale securities		39	51
Net gains (losses) on instruments designated as cash flow hedges		146	135
Share in the other comprehensive income of associates and joint ventures		(4)	6
		168	218

The accompanying notes are an integral part of these audited consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended October 31	2017	2016
Cash flows from operating activities		
Net income	2,024	1,256
Adjustments for		
Provisions for credit losses	244	484
Amortization of premises and equipment and intangible assets	351	417
Impairment losses on intangible assets	–	45
Write-off of an equity interest in an associate	–	164
Gain on the revaluation of the previously held equity interest in Advanced Bank of Asia Limited	–	(41)
Gain on the disposal of an equity interest in a joint venture	(17)	–
Deferred taxes	(13)	(136)
Losses (gains) on sales of available-for-sale securities, net	(140)	(79)
Impairment losses on available-for-sale securities	–	9
Share in the net income of associates and joint ventures	(35)	(15)
Stock option expense	11	12
Change in operating assets and liabilities		
Securities at fair value through profit or loss	(1,572)	(3,967)
Securities purchased under reverse repurchase agreements and securities borrowed	(6,841)	3,754
Loans, net of securitization	(8,982)	(13,278)
Deposits	14,605	10,639
Obligations related to securities sold short	1,156	(3,126)
Obligations related to securities sold under repurchase agreements and securities loaned	(869)	8,857
Derivative financial instruments, net	880	395
Purchased receivables	(156)	(420)
Interest and dividends receivable and interest payable	19	6
Current tax assets and liabilities	(73)	245
Other items	929	217
	1,521	5,438
Cash flows from financing activities		
Issuances of preferred shares	400	800
Redemption of preferred shares for cancellation	–	(176)
Issuances of common shares, net of the impact of shares purchased for trading	116	25
Repurchases of common shares for cancellation	(115)	–
Redemption of subordinated debt	(1,000)	(500)
Share issuance expenses	(8)	(11)
Dividends paid	(846)	(600)
Distributions to non-controlling interests	(82)	(71)
	(1,535)	(533)
Cash flows from investing activities		
Acquisition of Advanced Bank of Asia Limited	–	(119)
Net change in investments in associates and joint ventures	35	–
Purchases of available-for-sale securities	(4,277)	(6,284)
Maturities of available-for-sale securities	516	786
Sales of available-for-sale securities	9,523	5,355
Purchases of held-to-maturity securities	(5,269)	(3,962)
Net change in tangible assets leased under operating leases	674	372
Net change in premises and equipment	(94)	(140)
Net change in intangible assets	(268)	(268)
	840	(4,260)
Impact of currency rate movements on cash and cash equivalents	(207)	(29)
Increase in cash and cash equivalents	619	616
Cash and cash equivalents at beginning	8,183	7,567
Cash and cash equivalents at end⁽¹⁾	8,802	8,183
Supplementary information about cash flows from operating activities		
Interest paid	2,315	1,898
Interest and dividends received	5,565	4,860
Income taxes paid	612	235

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*. It includes an amount of \$2.0 billion as at October 31, 2017 (\$2.0 billion as at October 31, 2016) for which there are restrictions. In addition, a negligible amount was held in escrow as at October 31, 2017 (\$3 million as at October 31, 2016).

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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 four business segments, namely, the Personal and Commercial segment, the Wealth Management segment, the Financial Markets segment, and the U.S. Specialty Finance and International (USSF&I) segment. Its full line of services includes banking and investing solutions for individuals and businesses, securities brokerage, insurance and wealth management.

On November 30, 2017, the Board of Directors (the Board) authorized the publication of the Bank's audited annual consolidated financial statements (the consolidated financial statements) for the year ended October 31, 2017.

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). IFRS represent Canadian generally accepted accounting principles (GAAP). None of the OSFI accounting requirements are exceptions to IFRS.

On November 1, 2016, the Bank reclassified certain Personal and Commercial segment revenues in the Consolidated Statement of Income to better reflect the nature of the income reported. As a result, for the year ended October 31, 2016, an amount of \$36 million reported in *Non-interest income – Credit fees* was reclassified to *Interest income – Loans*.

Also on November 1, 2016, the Bank changed the presentation of certain items on the Consolidated Balance Sheet, and certain amounts were revised from those previously reported. The *Due from clients, dealers and brokers* item as at October 31, 2016 is now presented in *Other assets* on the Consolidated Balance Sheet. All deposits have been grouped into a single *Deposits* item. To better reflect the nature of certain liabilities on the Consolidated Balance Sheet, an amount of \$2.2 billion reported in the *Due to clients, dealers and brokers* item was reclassified to the *Deposits* item as at October 31, 2016. The *Due to clients, dealers and brokers* item is now presented in *Other liabilities* on the Consolidated Balance Sheet.

Unless otherwise indicated, all amounts are expressed in Canadian dollars, which is the Bank's functional and presentation currency.

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 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-employment benefits, income taxes, provisions, and the consolidation of structured entities. Descriptions of these judgments and estimates are provided in each of the related notes to the consolidated financial statements. 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 described in this note provide greater detail about the 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 its subsidiaries, after elimination of intercompany transactions and balances. The subsidiaries are entities, including structured entities, controlled by the Bank. A structured entity is an entity created to accomplish a narrow and well-defined objective and is designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when voting rights relate solely to administrative tasks and the relevant activities are directed by means of contractual arrangements.

Management must exercise judgment in determining whether the Bank must consolidate an entity. The Bank controls an entity only if the following three conditions are met:

- it has decision-making authority regarding the entity's relevant activities;
- it has exposure or rights to variable returns from its involvement with the entity; and
- it has the ability to use its power to affect the amount of the returns.

When determining decision-making authority, many factors are taken into account, including the existence and effect of actual and potential voting rights held by the Bank that can be exercised as well as the holding of instruments that are convertible into voting shares. In addition, the Bank must determine whether, as an investor with decision-making rights, it acts as a principal or agent.

Based on these principles, an assessment of control is performed at the inception of a relationship between any entity and the Bank. When performing this assessment, the Bank considers all facts and circumstances, and it must reassess whether it still controls an investee if facts and circumstances indicate that there are changes to one or more of the three conditions of control.

The Bank consolidates the entities it controls from the date on which control is obtained and ceases to consolidate them from the date control ceases. The Bank uses the acquisition method to account for the acquisition of a subsidiary from a third party on the date control is obtained.

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 *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. 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 an entity when it has the power to participate in the financial and operating policy decisions of the investee. The Bank has joint control over an entity when there's a contractually agreed sharing of control of an entity that exists only when decisions about the relevant activities 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., entities over which the Bank has rights to the net assets and exercises joint control, are accounted for using the equity method. Under the equity method, the investment is initially recorded at cost and, following acquisition, the Bank's shares in the net income and in the other comprehensive income are recognized, respectively, in *Non-interest income* in the Consolidated Statement of Income and in *Other comprehensive income* in the Consolidated Statement of Comprehensive Income. The carrying value of the investment is adjusted by an equivalent amount on the Consolidated Balance Sheet and reduced by distributions received.

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 the items reported 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 that 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 at fair value through profit or loss, held to maturity, available for sale, or loans and receivables, while financial liabilities are classified as at fair value through profit or loss or as financial liabilities at amortized cost. Certain debt securities that are not quoted in an active market may 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 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 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 assets thus designated are recognized at fair value, and any change in fair value is recorded in *Non-interest income* in the Consolidated Statement of Income. Financial liabilities thus designated are recognized at fair value, and any changes in fair value attributable to changes in the Bank's own credit risk are recognized in *Other comprehensive income* unless these changes offset the amounts recognized in *Net income*. Fair value changes not attributable to the Bank's own credit risk are recognized in *Non-interest income* in the Consolidated Statement of Income. The amounts recognized in *Other comprehensive income* will not be subsequently reclassified to *Net income*. Interest income and expenses arising from these financial instruments designated at fair value through profit or loss are recorded in the *Net interest income* item of the Consolidated Statement of Income. The Bank may use this 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 mismatch of measuring financial assets or liabilities on a different basis, and if the fair values are reliable.
- 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 a 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.
- 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.)

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.

Establishing Fair Value

The fair value of a financial instrument is the price that would be received to sell a financial asset or paid to transfer a financial liability in an orderly transaction in the principal market at the measurement date under current market conditions (i.e., an exit price).

Unadjusted quoted prices in active markets, based on bid prices for financial assets and offered prices for financial liabilities, provide the best evidence of fair value. A financial instrument is considered quoted in an active market when prices in exchange, dealer, broker or principal-to-principal markets are accessible at the measurement date. An active market is one where transactions occur with sufficient frequency and volume to provide quoted prices on an ongoing basis.

When there is no quoted price in an active market, the Bank uses another valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in pricing a transaction. Judgment is required when applying a large number of acceptable valuation techniques and estimates to determine fair value. The estimated fair value reflects market conditions on the valuation date and, consequently, may not be indicative of future fair value.

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. If there is a difference between the fair value at initial recognition and the transaction price, and the fair value is determined using a valuation technique based on observable market inputs or, in the case of a derivative, if the risks are fully offset by other contracts entered into with third parties, this difference is recognized in the Consolidated Statement of Income. In other cases, the difference between the fair value at initial recognition and the transaction price 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.

In certain cases, measurement adjustments are recognized to address factors that market participants would use at the measurement date to determine fair value but that are not included in the measurement technique due to system limitations or uncertainty surrounding the measure. 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 administration costs. The Bank may also consider market liquidity risk when determining the fair value of financial instruments when it believes these 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.

As permitted when certain criteria are met, the Bank has elected to determine fair value based on net exposure to credit risk or market risk for certain portfolios of financial instruments, mainly derivatives.

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 and bank notes. 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 securities transactions 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 transaction fees are recognized directly in the Consolidated Statement of Income. Interest income as well as realized and unrealized gains and losses on such securities are recorded in *Non-interest income* in the Consolidated Statement of Income. Dividend income is 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 impairment losses and 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

Held-to-maturity securities are financial assets with fixed or determinable payments and a fixed maturity that the Bank intends and is able to hold until maturity. The Bank accounts for held-to-maturity securities transactions on the trade date, and the related transaction costs are capitalized. These securities are initially recognized at fair value. In subsequent periods, they are recognized at amortized cost using the effective interest rate method, less any impairment loss measured using the same impairment model used for loans. Interest income and the amortization of premiums and discounts on these securities are recognized in *Net interest income* in the Consolidated Statement of Income.

Securities Purchased Under Reverse Repurchase Agreements, Obligations Related to Securities Sold Under Repurchase Agreements and Securities Borrowed and Loaned

The Bank recognizes these transactions at amortized cost using the effective interest rate method. 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.

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 remains on the Consolidated Balance Sheet. Collateral received in the form of securities is 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 exercise judgment to determine whether certain 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 reviewed for objective evidence of impairment at the end of each reporting period. The Bank considers all available objective evidence of impairment, including observable data about loss events such as: a significant financial difficulty of the issuer, a breach of contract such as a default, and situations involving bankruptcy or other financial reorganization. In addition to these loss events, objective evidence of impairment for an equity security also includes information about significant changes with an adverse effect that have taken place in the technological, market, economic, or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity security may not be recovered. For equity securities, a significant or prolonged decline in fair value below cost is also considered objective evidence of impairment.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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 the Consolidated Statement of 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.
- 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.

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 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 are 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 or winding up and balances owing are not likely to be recovered.

Situations where a retail, commercial or government borrower begin showing clear signs of potential insolvency are managed on a case-by-case basis and require the use of judgment. In these situations, the Bank may grant a concession to the borrower regarding the original terms and conditions of the loan, for example by reducing the rate, granting a forgiveness of principal or extending the term despite the Bank's credit policies. Once the terms of the loan have been renegotiated and agreed upon with the borrower, the loan is considered a restructured loan. As of the restructuring date, the current carrying amount of the loan, including accrued interest, is reduced to the present value of expected cash flows under the modified terms, discounted at the original effective interest rate of the loan. The reduction in the carrying value is recorded in *Provisions for credit losses* in the Consolidated Statement of Income.

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. 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.

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.

Allowances on Impaired Loans

Impairment allowances are recorded for all individually identified impaired loans to reduce their carrying amount to the estimated realizable amount. For each impaired loan, the Bank records an individual allowance, when the credit loss assessment is based on a detailed analysis of the borrower's file, or a collective allowance, when the credit loss assessment is based on the portfolio's historical net loss experience.

For all individually significant impaired loans, namely business and government loans, and for certain impaired loans that are not individually significant, namely residential mortgages, the Bank records an individual allowance since the credit loss assessment is based on a detailed analysis of the borrower's file. For all other impaired loans that are not individually significant but have been individually identified as impaired, the Bank records for each such loan a collective allowance based on historical net loss experience.

Allowances on Non-Impaired Loans

When the credit risk of a portfolio of loans that have similar credit risk characteristics increases significantly, such as a group of loans of a specific industry, but the loans have yet to be individually identified as impaired, a sectoral allowance is established collectively for the entire loan portfolio. The sectoral allowance is determined using an approach similar to the collective allowance measurement on non-impaired loans, i.e., an approach based on expected default and loss factors determined by statistical analysis of historical loss data by loan type, and on an analysis of the industry-specific market factors such as market liquidity, credit spreads, and risk factor levels.

All loans that have not been individually identified as impaired, and that are not covered by a sectoral allowance, are grouped according to their credit risk characteristics for the purpose of calculating a 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 allocated collective allowance for the business and government loan portfolio is based on expected default and loss factors determined by statistical analysis of historical loss data, 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 historical loss data.

The unallocated collective allowance reflects management's assessment of probable portfolio losses 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.

The sectoral allowance and collective allowance on non-impaired loans are collectively established and reflect the impairment losses that the Bank has incurred as a result of events that have occurred but where the individual loss has not been identified.

Purchased Receivables

On the acquisition date, purchased receivables are measured at fair value, which incorporates incurred and expected credit losses estimated on the acquisition date and the interest rate differential between the receivable's contractual interest rate and the current market rates for the remaining term. As a result, no allowances for credit losses are recorded on the Consolidated Balance Sheet on the acquisition date. Discounts related to incurred credit losses are not amortized.

Purchased performing receivables are subsequently accounted for at amortized cost based on their contractual cash flows, and any discount or premium is considered an adjustment to the loan yield and is amortized over the expected life of the receivable using the effective interest rate method and recorded in the Consolidated Statement of Income.

When receivables are acquired with objective evidence of incurred credit loss, where the timely collection of contractual principal and interest is not reasonably assured, these receivables are subsequently accounted for at amortized cost based on the present value of expected future cash flows discounted at the initial effective interest rate. At the end of each reporting period, the Bank re-evaluates the expected future cash flows and adjusts the carrying amount of the receivables to reflect the revised expected future cash flows discounted at the initial effective interest rate. This adjustment is immediately recorded in the Consolidated Statement of Income.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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 if 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 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 customer commitment 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, to generate trading activity revenues, and to 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.

Embedded Derivative Financial Instruments

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.

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.

Embedded derivatives that must be bifurcated and separately accounted for are recorded at fair value on the Consolidated Balance Sheet. Realized and unrealized gains and losses are recognized in *Non-interest income* in the Consolidated Statement of Income. In general, all embedded derivatives are presented on a combined basis with the host contract. However, certain embedded derivatives that are bifurcated from the host contract are presented in *Derivative financial instruments* on the Consolidated Balance Sheet.

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.

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, as well as the change in the fair value of the hedging instrument. The resulting ineffective portion is recognized 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 *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.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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	
Computer equipment	Straight-line	3-4 years
Other equipment and furniture	Straight-line	1-8 years
Leasehold improvements	Straight-line	(1)

(1) The average amortization period is 15 years, determined using 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 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 a trademark. They are recognized at the acquisition-date fair value. The management contracts are for the management of open-ended funds. At the end of each reporting period, the Bank reviews the useful lives to determine whether events and circumstances continue to support an indefinite useful life assessment. Intangible assets are deemed to have an indefinite useful life following an examination of all relevant factors, in particular: a) the contracts do not have contractual maturities; b) the stability of the business segment to which the intangible assets belong; c) the Bank's capacity to control the future economic benefits of the intangible assets; and d) the continued economic benefits generated by the intangible assets.

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 generates 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.

Leases

A lease is an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for a payment or series of payments. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of the leased asset to the lessee. Title may or may not eventually be transferred. An operating lease is a lease other than a finance lease. The Bank primarily enters into operating leases.

When the Bank is the lessee under an operating lease, the rental expense is recognized on a straight-line basis over the lease term in *Non-interest expenses* in the Consolidated Statement of Income. When the Bank is the lessor, the lease assets remain on the Consolidated Balance Sheet and are reported in premises and equipment, and the rental income is recognized net of related expenses in *Non-interest income* in the Consolidated Statement of Income.

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 reporting period. Provisions are presented in *Other liabilities* on the Consolidated Balance Sheet.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Revenue Recognition

The Bank's revenues are recognized in the Consolidated Statement of Income as they are earned.

Interest Income and Expense

Interest income and expense, except for the interest income on securities classified as at fair value through profit or loss, are recognized in *Net interest income* and calculated 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 in *Interest income* 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 on a net basis 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 on a net basis in *Non-interest income* in the Consolidated Statement of Income.

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 in either *Other assets* or *Other liabilities* 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 following:

- 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;
- 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 are tax benefits in the form of deductions the Bank may claim to reduce its taxable income in future years. At the end of each reporting period, the carrying amount of deferred tax assets is revised 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 to be utilized.

Deferred tax assets and liabilities are offset and the net balance is presented in either *Other assets* or *Other liabilities* 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 carryforwards 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.

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.

To reflect the fair value of the obligation assumed at the inception of a financial guarantee, a liability is recorded in *Other liabilities* on the Consolidated Balance Sheet. 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. This revenue is recognized in *Credit fees* in the Consolidated Statement of Income.

Employee Benefits – Pension Plans and Other Post-Employment Benefits

The Bank offers defined benefit pension plans and other post-employment benefit plans to eligible employees. The other post-employment benefit plans include post-retirement medical, dental and life insurance coverage. While pension plans are funded, the other plans are not.

Plan expenses and obligations are actuarially determined based on the projected benefit method prorated on service. The calculations use management's best estimates of various actuarial assumptions such as discount rates, rates of compensation increase, health care cost trend rates, mortality rates and retirement age.

The net asset or net liability of pension plans and other post-employment benefit plans are calculated separately for each plan as the difference between the present value of the future benefits earned by employees in respect of current- and prior-period service and the fair value of plan assets. The net asset or net liability is included in either the *Other assets* or *Other liabilities* item of the Consolidated Balance Sheet.

The expense related to pension plans and other post-employment benefit plans consists of the following items: current service cost, net interest on the net plan asset or liability, administration costs and past service cost, if any, recognized when a plan is amended. This expense is recognized in *Compensation and employee benefits* in the Consolidated Statement of Income. The net amount of interest income and expense is determined by applying a discount rate to the net plan asset or liability amount.

Remeasurements resulting from pension plans and other post-employment benefit plans represent actuarial gains and losses related to the defined benefit obligation and the actual return on plan assets, excluding net interest determined by applying a discount rate to the net asset or liability of the plans. Remeasurements are immediately recognized in *Other comprehensive income* and will not be subsequently reclassified to net income; these cumulative gains and losses are reclassified to *Retained earnings*.

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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 this fair value is recognized in *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 adjusted sub-index.

The Bank's contributions to the employee share ownership plan are expensed as incurred.

NOTE 2 – FUTURE ACCOUNTING POLICY CHANGES

The IASB issues revisions and amendments to a number of standards, some of which have already had an impact on the Bank and others that could have an impact in the future. The Bank is currently assessing the impact that adoption of the following standards will have on its consolidated financial statements. A summary of these amendments and the effective dates applicable to the Bank are presented below.

Effective Date – Early Adoption on November 1, 2017

IFRS 9 – *Financial Instruments*

In July 2014, the IASB issued a complete and final version of IFRS 9, which replaces the guidance in IAS 39 – *Financial Instruments: Recognition and Measurement*. IFRS 9 sets out requirements for the classification and measurement of financial assets and financial liabilities, for the impairment of financial assets, and for general hedge accounting. Macro hedge accounting has been decoupled from IFRS 9 and will be considered and issued as a separate standard. As a result of IFRS 9, consequential amendments have been made to IFRS 7 – *Financial Instruments: Disclosures*, requiring additional qualitative and quantitative disclosures that must be adopted at the same time as IFRS 9. In December 2015, the Basel Committee on Banking Supervision issued *Guidance on Credit Risk and Accounting for Expected Credit Losses*. In June 2016, OSFI issued the final guideline on IFRS 9 *Financial Instruments and Disclosures*, setting out its expectations regarding IFRS 9 application.

For the Bank, the IFRS 9 effective date is November 1, 2018 with early adoption permitted. However, on January 9, 2015, OSFI issued a final version of *Early Adoption of IFRS 9 Financial Instruments for Domestic Systemically Important Banks* and stated therein that it expects Domestic Systemically Important Banks (D-SIBs), a group that includes the Bank, to adopt IFRS 9 as of November 1, 2017. The Bank will therefore adopt IFRS 9 as of November 1, 2017. Its first financial statements presented in accordance with IFRS 9 will be its unaudited interim condensed consolidated financial statements for the quarter ending January 31, 2018. In general, IFRS 9 is to be applied retrospectively. As permitted by IFRS 9, the Bank will not restate the comparative period financial statements. The retrospective impact of applying IFRS 9 will be accounted for through adjustments to the opening balances of *Retained earnings*, *Accumulated other comprehensive income* and *Non-controlling interests* as at November 1, 2017.

Classification and Measurement

IFRS 9 provides a single model for financial asset classification and measurement that is based on both the business model for managing financial assets and the contractual cash flow characteristics of the financial assets. These factors determine whether the financial assets are measured at amortized cost, fair value through other comprehensive income, or fair value through profit or loss.

IFRS 9 requires that all debt instrument financial assets, including loans, that do not meet a “solely payment of principal and interest” (SPPI) condition, including those that contain embedded derivatives, be classified as at fair value through profit or loss. For those that meet the SPPI condition, classification at initial recognition will be determined based on the business model under which these assets are managed. Upon transition, the business model test will be based on the facts and circumstances as at November 1, 2017. Debt instruments that are being managed on a “held for trading” or fair value basis will be classified as at fair value through profit or loss. Debt instruments that are managed on a “hold to collect and for sale” basis will be classified as at fair value through other comprehensive income. Finally, debt instruments that are managed on a “hold to collect” basis will be classified as at amortized cost. In addition, IFRS 9 also includes an option to irrevocably designate, at initial recognition, a debt instrument as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch and if OSFI requirements are also met. This designation is also available for existing financial assets and liabilities at the date of IFRS 9 adoption.

Under IFRS 9, all equity instrument financial assets must be classified as at fair value through profit or loss. However, the Bank may, at initial recognition of a non-trading equity instrument, irrevocably elect to designate the instrument as at fair value through other comprehensive income with no subsequent reclassification of gains and losses to net income. Dividends will continue to be recognized in net income. This designation is also available for existing non-trading equity instruments at the date of IFRS 9 adoption. Derivative financial instruments will continue to be measured at fair value through profit or loss.

The classification and measurement of financial liabilities remain essentially unchanged under IFRS 9, except for financial liabilities designated as measured at fair value through profit or loss under the fair value option. Once the fair value election is made, changes in fair value attributable to changes in an entity’s own credit risk must be recognized in *Other comprehensive income* rather than in net income. On February 1, 2016, the Bank early adopted, on a prospective basis, the own credit risk provisions of IFRS 9.

NOTE 2 – FUTURE ACCOUNTING POLICY CHANGES (cont.)

Impairment

Overall Comparison of the New Impairment Model and the Current Model

IFRS 9 introduces a new, single impairment model for financial assets that requires the recognition of expected credit losses (ECL) rather than incurred losses as applied under the current standard. Currently, impairment losses are recognized if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after initial recognition of the asset and that loss event has a detrimental impact on the estimated future cash flows of the asset that can be reliably estimated. If there is no objective evidence of impairment for an individual financial asset, that financial asset is included in a group of assets with similar credit risk characteristics and collectively assessed for impairment losses incurred but not yet identified. Under IFRS 9, ECLs will be recognized in profit or loss before a loss event has occurred, which could result in earlier recognition of credit losses compared to the current model.

Under the current standard, incurred losses are measured by incorporating reasonable and supportable information about past events and current conditions. Under IFRS 9, the ECL model, which is forward-looking, in addition requires that forecasts of future events and economic conditions be used when determining significant increases in credit risk and when measuring expected losses. Forward-looking macroeconomic factors such as unemployment rates, housing price indices, interest rates, and gross domestic product will be incorporated into the risk parameters. Estimating forward-looking information will require significant judgment and must be consistent with the forward-looking information used by the Bank for other purposes, such as forecasting and budgeting.

Scope

The impairment model applies to all financial assets not measured at fair value through profit or loss. The ECL model also applies to loan commitments and financial guarantees that are not measured at fair value through profit or loss.

Measurement of Expected Credit Losses

ECLs are measured as the probability-weighted present value of expected cash shortfalls over the remaining expected life of the financial instrument. The measurement of ECLs will be based primarily on the product of the instrument's probability of default (PD), loss given default (LGD), and exposure at default (EAD). IFRS 9 requires the estimate of expected credit losses to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. The Bank will incorporate three forward-looking macroeconomic scenarios in its ECL calculation process: a base scenario, an upside scenario, and a downside scenario. Probability-weights will be attributed to each scenario. The scenarios and probability weights will be reassessed quarterly and subject to management review.

The ECL model contains a three-stage approach that is based on the change in the credit quality of assets since initial recognition. If, at the reporting date, the credit risk of non-impaired financial instruments has not increased significantly since initial recognition, these financial instruments are classified in Stage 1, and a loss allowance that is measured, at each reporting date, at an amount equal to 12-month expected credit losses is recorded. When there is a significant increase in credit risk since initial recognition, these non-impaired financial instruments are migrated to Stage 2, and a loss allowance that is measured, at each reporting date, at an amount equal to lifetime expected credit losses is recorded. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a significant increase in credit risk since initial recognition, the ECL model requires reverting to recognition of 12-month expected credit losses. When one or more events that have a detrimental impact on the estimated future cash flows of a financial asset have occurred, the financial asset is considered credit-impaired and is migrated to Stage 3, and an allowance equal to lifetime expected losses continues to be recorded or the financial asset is written off.

Interest income is calculated on the gross carrying amount of the financial assets in Stages 1 and 2 and on the net carrying amount of the financial assets in Stage 3.

Assessment of Significant Increase in Credit Risk

To assess whether the credit risk of a financial instrument has increased significantly, the PD occurring over its expected life as at the reporting date is compared with the PD occurring over its expected life on the date of initial recognition, and reasonable and supportable information indicative of significant increases in credit risk since initial recognition is considered. The Bank has included relative and absolute thresholds in the definition of significant increase in credit risk and a backstop of 30 days past due. All financial instruments that are 30 days past due are migrated to Stage 2 even if other metrics do not indicate that a significant increase in credit risk has occurred.

Definition of Default

IFRS 9 does not define default but requires the definition to be consistent with the definition used for internal credit risk management purposes. However, IFRS 9 contains a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due. Under IFRS 9, the Bank will consider a financial asset, other than a credit card receivable, as credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of a financial asset have occurred or when contractual payments are 90 days past due. The backstop for credit card receivables will be 180 days past due. The Bank's write-off policy under IAS 39 is not expected to be materially different under IFRS 9.

Comparison of Regulatory Expected Credit Loss Model and IFRS 9 Expected Credit Loss Model

The IFRS 9 ECL calculation has leveraged, where appropriate, the expected credit loss model parameters used by the Bank for regulatory purposes, namely: PD, LGD and EAD. Adjustments to these parameters were made to comply with IFRS 9 requirements. After the adoption of IFRS 9, an ECL model will be used for both regulatory and accounting purposes. However, there are key differences, which are summarized below.

	Regulatory Capital	IFRS 9
PD	Through-the-cycle 12-month PD calibrated on a long run average PD throughout a full economic cycle. The default backstop is generally 90 days past due.	Point-in-time 12-month or lifetime PD based on past experience, current conditions and relevant forward-looking information. The default backstop is generally 90 days past due.
LGD	Downturn LGD based on losses that would be expected in an economic downturn and subject to certain regulatory floors. All collection costs are included.	Expected LGD based on past experience, current conditions and relevant forward-looking information. The value of collateral and other credit risk mitigants are incorporated as appropriate and undue conservatism and floors are excluded.
EAD	Based on the drawn balance plus expected utilization of any undrawn portion prior to default, and cannot be lower than the current balance.	Represents the expected balance at default across the lifetime horizon on forward-looking expectations.
Other		ECLs are discounted from the default date to the reporting date.

Regulatory Capital

On March 29, 2017, the Basel Committee on Banking Supervision (BCBS) released details on the interim regulatory treatment for accounting provisions as well as standards for transitional arrangements. Given the coming into effect of IFRS 9, the BCBS will retain the current Basel Accord regulatory treatment for provisions during a transition period. Jurisdictions may adopt transitional measures to phase in any potential significant negative impacts on regulatory capital arising from the new expected credit loss impairment model under IFRS 9. On August 21, 2017, OSFI released for comment a new, revised version of the *Capital Adequacy Requirements (CAR) Guideline* to be implemented in the first quarter of 2018. Consistent with the BCBS position, the proposed CAR Guideline retains the current regulatory treatment of accounting provisions. As for transitional measures to phase-in any potential negative impacts on regulatory capital, on November 29, 2017, OSFI has announced that no mitigation measures will be allowed for banks whose capital position could be significantly affected by IFRS 9 adoption.

Hedge Accounting

IFRS 9 introduces a new general hedge accounting model that better aligns hedge accounting with risk management activities. However, the current hedge accounting requirements under IAS 39 may continue to be applied until the IASB finalizes its macro hedge accounting project. As permitted, the Bank elected not to adopt the IFRS 9 hedge accounting requirements and instead will continue applying the IAS 39 hedge accounting requirements. The Bank will, however, comply with the revised hedge accounting disclosures required by the consequential amendments made to IFRS 7.

NOTE 2 – FUTURE ACCOUNTING POLICY CHANGES (cont.)

Transition Impact

As at October 31, 2017, the Bank's best estimate of the impact of transitioning to IFRS 9 is a decrease of approximately \$165 million, net of income taxes, in equity as at November 1, 2017, and a decrease of approximately 16 basis points in the Common Equity Tier 1 (CET1) capital ratio. The estimate of the impact for the Bank relates primarily to the classification and measurement requirements, in particular the election to irrevocably designate certain financial assets and financial liabilities at fair value through profit or loss under the fair value option, as permitted by the IFRS 9 transitional provisions.

The estimate of the impact of applying the new impairment model for financial assets is not significant. The Bank continues to refine and validate the new impairment models leading up to the disclosure of its 2018 first quarter results.

Effective Date – November 1, 2018

IFRS 15 – Revenue From Contracts With Customers

In May 2014, the IASB issued a new standard, IFRS 15, which replaces the current revenue recognition standards and interpretations. IFRS 15 provides a single comprehensive model to use when accounting for revenue arising from contracts with customers. The new model applies to all contracts with customers except those that are within the scope of other IFRS standards such as leases, insurance contracts and financial instruments. As a result, the majority of the Bank's revenue, including net interest income, will not be impacted.

At its meeting on July 22, 2015, the IASB unanimously confirmed its proposal to defer the effective date of IFRS 15 to fiscal years beginning on or after January 1, 2018, which will be November 1, 2018 for the Bank. In April 2016, the IASB issued amendments to IFRS 15, clarifying some requirements and providing additional transitional relief at the date of initial application.

On transition, IFRS 15 permits to either restate prior periods or to apply the standard on a modified retrospective basis. The Bank plans to use the modified retrospective basis, recognizing the cumulative effect of initially applying the standard as an adjustment to the opening balance of *Retained earnings* as at November 1, 2018, without restating comparative periods.

While the impact assessment is not complete, the Bank does not currently expect the adoption of IFRS 15 to have a significant impact on the consolidated financial statements. The Bank is continuing to review its revenue contracts that fall within the scope of IFRS 15 and to assess the impact of the new standard on its consolidated financial statements, including the additional disclosure requirements.

Effective Date – November 1, 2019

IFRS 16 – Leases

In January 2016, the IASB issued a new standard, IFRS 16 – *Leases*. The new standard requires lessees to recognize most leases on the balance sheet using a single model, thereby eliminating the distinction between operating and finance leases. Lessor accounting, however, remains similar to current accounting practice, and the distinction between operating and finance leases is retained. Early application is permitted if IFRS 15 – *Revenue From Contracts With Customers* is also applied.

IFRIC Interpretation 23 – Uncertainty Over Income Tax Treatments

In June 2017, the IASB issued IFRIC Interpretation 23, which addresses how to reflect tax treatment uncertainty in accounting for income taxes.

Effective Date – November 1, 2021

IFRS 17 – Insurance Contracts

In May 2017, the IASB issued IFRS 17 – *Insurance Contracts*, a new standard that replaces IFRS 4, the current insurance contract accounting standard. IFRS 17 introduces a new accounting framework that will improve the comparability and quality of financial information.

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.

	As at October 31, 2017						
	Carrying value and fair value			Carrying value	Fair value	Total carrying value	Total 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 financial instruments measured at fair value	Financial instruments at amortized cost	Financial instruments at amortized cost		
Financial assets							
Cash and deposits with financial institutions	–	–	–	8,802	8,802	8,802	8,802
Securities	46,780	756	8,552	9,255	9,229	65,343	65,317
Securities purchased under reverse repurchase agreements and securities borrowed	–	657	–	20,132	20,132	20,789	20,789
Loans and acceptances, net of allowances	5,523	115	–	128,805	128,944	134,443	134,582
Other							
Derivative financial instruments	8,423	–	–	–	–	8,423	8,423
Purchased receivables	–	–	–	2,014	2,014	2,014	2,014
Other assets	–	–	–	994	994	994	994
Financial liabilities							
Deposits	–	5,501	–	151,170 ⁽¹⁾	151,571	156,671	157,072
Other							
Acceptances	–	–	–	5,991	5,991	5,991	5,991
Obligations related to securities sold short	15,363	–	–	–	–	15,363	15,363
Obligations related to securities sold under repurchase agreements and securities loaned	–	534	–	21,233	21,233	21,767	21,767
Derivative financial instruments	6,612	–	–	–	–	6,612	6,612
Liabilities related to transferred receivables	–	6,209	–	13,889	13,940	20,098	20,149
Other liabilities	15	–	–	2,902	2,904	2,917	2,919
Subordinated debt	–	–	–	9	6	9	6

(1) Includes embedded derivative financial instruments.

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

							As at October 31, 2016	
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 financial instruments measured at fair value	Financial instruments at amortized cost	Financial instruments at amortized cost	Total carrying value	Total fair value	
Financial assets								
Cash and deposits with financial institutions	–	–	–	8,183	8,183	8,183	8,183	
Securities	44,499	1,465	14,608	3,969	3,993	64,541	64,565	
Securities purchased under reverse repurchase agreements and securities borrowed	–	158	–	13,790	13,790	13,948	13,948	
Loans and acceptances, net of allowances	6,290	164	–	119,724	120,641	126,178	127,095	
Other								
Derivative financial instruments	10,416	–	–	–	–	10,416	10,416	
Purchased receivables	–	–	–	1,858	1,858	1,858	1,858	
Other assets ⁽¹⁾	–	–	–	1,317	1,317	1,317	1,317	
Financial liabilities								
Deposits⁽²⁾	–	4,655		137,411 ⁽³⁾	138,267	142,066	142,922	
Other								
Acceptances	–	–		6,441	6,441	6,441	6,441	
Obligations related to securities sold short	14,207	–		–	–	14,207	14,207	
Obligations related to securities sold under repurchase agreements and securities loaned	–	–		22,636	22,636	22,636	22,636	
Derivative financial instruments	7,725	–		–	–	7,725	7,725	
Liabilities related to transferred receivables	–	6,206		13,925	13,974	20,131	20,180	
Other liabilities ⁽²⁾	43	–		3,158	3,173	3,201	3,216	
Subordinated debt	–	–		1,012	1,013	1,012	1,013	

- (1) The *Due from clients, dealers and brokers* amount of \$843 million presented separately on the Consolidated Balance Sheet as at October 31, 2016 is now reported in *Other assets*.
 (2) An amount of \$2,699 million reported in *Due to clients, dealers and brokers* on the Consolidated Balance Sheet as at October 31, 2016 is now reported in *Deposits* (\$2,159 million) and in *Other liabilities* (\$540 million).
 (3) Includes embedded derivative financial instruments.

Establishing Fair Value

The fair value of a financial instrument is the price that would be received to sell a financial asset or paid to transfer a financial liability in an orderly transaction in the principal market at the measurement date under current market conditions (i.e., an exit price).

Unadjusted quoted prices in active markets provide the best evidence of fair value. When there is no quoted price in an active market, the Bank applies other valuation techniques that maximize the use of relevant observable inputs and that minimize the use of unobservable inputs. Such valuation techniques include the following: using information available from recent market transactions, referring to the current fair value of a comparable financial instrument, applying discounted cash flow analysis, applying option pricing models, or relying on any other valuation technique that is commonly used by market participants and has proven to yield reliable estimates. Judgment is required when applying many of the valuation techniques. The Bank's valuation was based on its assessment of the conditions prevailing as at October 31, 2017 and may change in the future. Furthermore, there may be valuation uncertainty resulting from the choice of valuation model used.

Valuation Governance

Fair value is established in accordance with a rigorous control framework. The Bank has policies and procedures that govern 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.

The fair value of existing or new products is determined and validated by functions independent of the risk-taking team. Complex fair value matters are reviewed by valuation committees made up of experts from various specialized functions.

For financial instruments classified in Level 3 of the fair value hierarchy, the Bank has documented the classification policies to determine the hierarchy, and there are controls in place to ensure that fair value is measured appropriately, reliably and consistently. Valuation methods and the underlying assumptions are reviewed on a regular basis.

Valuation Methods and Assumptions

Financial Instruments Whose Fair Value Equals Carrying Value

The carrying value of the following financial instruments is a reasonable approximation of fair value:

- cash and deposits with financial institutions;
- securities purchased under reverse repurchase agreements and securities borrowed;
- obligations related to securities sold under repurchase agreements and securities loaned;
- customers' liability under acceptances;
- acceptances;
- purchased receivables;
- certain items of other assets and other liabilities.

Securities and Obligations Related to Securities Sold Short

These financial instruments are recognized at fair value on the Consolidated Balance Sheet. Their fair value is based on quoted prices in active markets, i.e., bid prices for financial assets and offered prices for financial liabilities. If there are no quoted prices in an active market, fair value is estimated based on prices for securities that, in substance, are identical. If such prices are not available, fair value is determined using valuation techniques that incorporate assumptions based primarily on observable market inputs such as current market prices, the contractual prices of the underlying instruments, the time value of money, credit risk, 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 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.

Securities Issued or Guaranteed by Governments

Securities issued or guaranteed include government debt securities of the governments of Canada (federal, provincial and municipal) as well as debt securities of the U.S. government (U.S. Treasury), of other U.S. agencies and of other foreign governments. The fair value of these securities is based on unadjusted quoted prices in active markets. For those classified in Level 2, quoted prices for identical or similar instruments in active markets are used to determine fair value. In the absence of an observable market, valuation techniques such as the discounted cash flow method could be used, incorporating assumptions on benchmark yields (CDOR, LIBOR and other) and the risk spreads of similar securities.

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Equity Securities and Other Debt Securities

The fair value of equity securities is determined primarily by using quoted prices in active markets. For equity securities and other debt securities classified in Level 2, a valuation technique based on quoted prices of identical and similar instruments in an active market is used to determine fair value. In the absence of observable inputs, valuation techniques such as the discounted cash flow method could be used, incorporating assumptions on benchmark yields (CDOR, LIBOR and other) and the risk spreads of similar securities. For those classified in Level 3, fair value can be determined based on the net asset value, which represents the estimated value of a security based on valuations received from investment or fund managers or the general partners of the limited partnerships. Fair value can also be determined using internal valuation techniques adjusted for risk factors related to the financial instruments and for economic conditions.

Restructured Notes of the Master Asset Vehicle (MAV) Conduits

In establishing the fair value of the restructured notes of the MAV conduits classified as Level 2, the Bank considered the quality of the underlying assets. The Bank determined fair value using a valuation technique that incorporates discounted cash flows. For the restructured notes of the MAV I and MAV II conduits, 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.

In establishing the fair value of the restructured notes, the Bank adjusts, as required, its liquidity assumption to reflect market conditions. The Bank determines the fair 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 by adjusting various liquidity scenarios.

Other Restructured Notes of MAV I and MAV II Conduits

The fair value of these financial instruments, which are classified in Level 3, is determined based on the net asset value, which represents the estimated value of a security based on valuations received from the administrator of the conduits.

Derivative Financial Instruments

Derivative financial instruments are recorded at fair value on the Consolidated Balance Sheet. For exchange-traded derivative financial instruments, fair value is based on the quoted price in an active market, i.e., bid prices for financial assets or offered prices for financial liabilities.

For over-the-counter (OTC) derivative financial instruments, fair value is determined using well established 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, credit curves, currency rates as well as price and rate volatility factors. In establishing the fair value of OTC derivative financial instruments, the Bank also incorporates the following factors:

Credit Valuation Adjustment (CVA)

The CVA is a valuation adjustment applied to derivative financial instruments to reflect the credit risk of the counterparty. For each counterparty, the CVA is based on the expected positive exposure and probabilities of default through time. The exposures are determined by incorporating relevant factors such as current and potential future market values, master netting arrangements, collateral agreements and expected recovery rates. The default probabilities are inferred using credit default swap (CDS) spreads. When unavailable, relevant proxies are used. While the general methodology currently assumes independence between expected positive exposures and probabilities of default, adjustments are applied to certain types of transactions where there is a direct link between the exposure at default and the default probabilities.

Debit Valuation Adjustment (DVA)

The DVA reflects the Bank's own credit risk in the valuation of derivative financial instruments. The DVA is based on the expected negative exposure and probabilities of default of the Bank over time. The exposures are determined by incorporating relevant factors such as current and potential future market values, master netting arrangements, collateral agreements and expected recovery rates. The market implied spreads of the Bank are used in the calculation of the DVA.

Funding Valuation Adjustment (FVA)

The FVA is a valuation adjustment applied to derivative financial instruments to reflect the market implied cost or benefits of funding collateral for uncollateralized or partly collateralized transactions. The expected exposures are determined using methodologies consistent with the CVA and DVA framework. The funding level used to determine the FVA is based on the average funding level of relevant market participants.

When the valuation techniques incorporate one or more significant inputs that are not observable in the markets, the fair value of OTC derivative financial instruments 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 financial liability and other relevant factors.

Loans

The fair value of fixed-rate mortgage loans is determined by discounting expected future contractual cash flows, adjusted for several factors, including prepayment options, current market interest rates for similar loans, and other relevant variables where applicable. The fair value of variable-rate mortgage loans is deemed to equal carrying value.

The fair value of other fixed-rate loans is determined by discounting expected future contractual cash flows using current market interest rates charged for similar new loans. The fair value of variable-rate loans is deemed to equal carrying value.

Deposits

The fair value of fixed-term deposits is determined primarily by discounting expected future contractual cash flows and considering several factors such as redemption options and market interest rates currently offered for financial instruments with similar conditions. For certain term funding instruments, fair value is determined using market prices for similar instruments. The fair value of demand deposits and notice deposits is deemed to equal carrying value.

The fair value of structured deposit notes is established using valuation models that maximize the use of observable inputs when available, such as benchmark indices, and also incorporates the DVA, which reflects the Bank's own credit risk. In calculating DVA, the market implied spreads of the Bank are used to infer its probabilities of default. Lastly, when fair value is determined using option pricing models, the valuation techniques are similar to those described for derivative financial instruments.

Liabilities Related to Transferred Receivables

These liabilities arise from sale transactions to Canada Housing Trust (CHT) of securities backed by insured residential mortgages and other securities under the Canada Mortgage Bond (CMB) program. These transactions do not qualify for derecognition. They are recorded as guaranteed borrowings, which results in the recording of liabilities on the Consolidated Balance Sheet. The fair value of these liabilities is established using valuation techniques based on observable market inputs such as Canada Mortgage Bond prices.

Other Liabilities and Subordinated Debt

The fair value of these financial liabilities is based on quoted market prices in an active market. If there is no active market, fair value is determined by discounting contractual cash flows using the current market interest rates offered for similar financial instruments that have the same term to maturity.

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Hierarchy of Fair Value Measurements

IFRS establishes a fair value hierarchy that classifies the inputs used in financial instrument fair value measurement techniques according to three levels. This fair value hierarchy requires observable market inputs to be used whenever such inputs exist. According to the hierarchy, the highest level of inputs are unadjusted quoted prices in active markets for identical instruments and the lowest level of inputs are unobservable inputs. If inputs from different levels of the hierarchy are used, the financial instrument is classified in the same level as the lowest level input that is significant to the fair value measurement. The fair value hierarchy has the following levels.

- Level 1: Inputs corresponding to unadjusted quoted prices in active markets for identical assets and liabilities and accessible to the Bank at the measurement date. These instruments consist primarily of equity securities, 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, other than the quoted prices included in Level 1 inputs, that are directly or indirectly observable in the market for the asset or liability. These inputs 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 certain loans, certain deposits, derivative financial instruments traded in over-the-counter markets, certain debt securities, certain equity securities whose value is not directly observable in an active market, liabilities related to transferred receivables and certain other liabilities.
- Level 3: Valuation techniques based on one or more significant inputs that are not observable in the market for the asset or liability. 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. The valuation technique may also be partly based on observable market inputs.

Financial instruments whose fair values are classified in Level 3 consist of the following:

- financial instruments measured at fair value through profit or loss: 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: certain restructured notes as well as equity and debt securities of private companies.
- certain deposits (structured deposit notes) whose fair value is established using internal valuation models that are based on significant unobservable market inputs.

Transfers Between the Fair Value Hierarchy Levels

Transfers of financial instruments between Levels 1 and 2 and transfers to (or from) Level 3 are deemed to have taken place at the beginning of the quarter in which the transfer occurred. Significant transfers can occur between the fair value hierarchy levels due to new information on inputs used to determine fair value and the observable nature of those inputs.

During fiscal 2017, \$358 million in securities classified as at fair value through profit or loss and \$17 million in obligations related to securities sold short were transferred from Level 2 to Level 1 resulting from changing market conditions (\$214 million in securities classified as at fair value through profit or loss and \$71 million in obligations related to securities sold short in fiscal 2016). In addition, during fiscal 2017, \$103 million in securities classified as at fair value through profit or loss and \$53 million in obligations related to securities sold short were transferred from Level 1 to Level 2 (for fiscal 2016, \$56 million in securities classified as at fair value through profit or loss and no obligations related to securities sold short).

During fiscal years 2017 and 2016, financial instruments were transferred to (or from) Level 3 due to changes in the availability of observable market inputs resulting from changing market conditions.

Financial Instruments Recorded at Fair Value on the Consolidated Balance Sheet

The following tables show financial instruments recorded at fair value on the Consolidated Balance Sheet according to the fair value hierarchy.

	As at October 31, 2017			Total financial assets/liabilities at fair value
	Level 1	Level 2	Level 3	
Financial assets				
Securities				
At fair value through profit or loss				
Securities issued or guaranteed by				
Canadian government	2,506	6,156	–	8,662
Canadian provincial and municipal governments	–	7,770	–	7,770
U.S. Treasury, other U.S. agencies and other foreign governments	1,916	212	–	2,128
Other debt securities	–	2,599	–	2,599
Equity securities	25,751	610	16	26,377
	30,173	17,347	16	47,536
Available-for-sale				
Securities issued or guaranteed by				
Canadian government	66	4,215	–	4,281
Canadian provincial and municipal governments	–	2,584	–	2,584
U.S. Treasury, other U.S. agencies and other foreign governments	519	2	–	521
Other debt securities	–	494	–	494
Equity securities	109	237	326	672
	694	7,532	326	8,552
Securities purchased under reverse repurchase agreements and securities borrowed	–	657	–	657
Loans and acceptances, net of allowances	–	5,638	–	5,638
Other				
Derivative financial instruments	68	8,284	71	8,423
	30,935	39,458	413	70,806
Financial liabilities				
Deposits	–	5,708	1	5,709
Other				
Obligations related to securities sold short	10,515	4,848	–	15,363
Obligations related to securities sold under repurchase agreements	–	534	–	534
Derivative financial instruments	118	6,443	51	6,612
Liabilities related to transferred receivables	–	6,209	–	6,209
Other liabilities	–	15	–	15
	10,633	23,757	52	34,442

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

	As at October 31, 2016			Total financial assets/liabilities at fair value
	Level 1	Level 2	Level 3	
Financial assets				
Securities				
At fair value through profit or loss				
Securities issued or guaranteed by				
Canadian government	2,284	4,904	–	7,188
Canadian provincial and municipal governments	–	10,547	–	10,547
U.S. Treasury, other U.S. agencies and other foreign governments	3,968	206	–	4,174
Other debt securities	–	2,934	–	2,934
Equity securities	20,410	693	18	21,121
	26,662	19,284	18	45,964
Available-for-sale				
Securities issued or guaranteed by				
Canadian government	241	6,040	–	6,281
Canadian provincial and municipal governments	–	4,996	–	4,996
U.S. Treasury, other U.S. agencies and other foreign governments	1,614	95	–	1,709
Other debt securities	–	948	30	978
Equity securities	201	168	275	644
	2,056	12,247	305	14,608
Securities purchased under reverse repurchase agreements and securities borrowed	–	158	–	158
Loans and acceptances, net of allowances	–	6,454	–	6,454
Other				
Derivative financial instruments	87	10,196	133	10,416
	28,805	48,339	456	77,600
Financial liabilities				
Deposits	–	4,788	7	4,795
Other				
Obligations related to securities sold short	8,732	5,475	–	14,207
Derivative financial instruments	117	7,490	118	7,725
Liabilities related to transferred receivables	–	6,206	–	6,206
Other liabilities	–	43	–	43
	8,849	24,002	125	32,976

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. The valuation technique may also be based, in part, on observable market inputs. The following table shows the significant unobservable inputs used for the fair value measurements of financial instruments classified in Level 3 of the hierarchy.

As at October 31, 2017					
	Fair value	Primary valuation techniques	Significant unobservable inputs	Range of input values	
				Low	High
Financial assets					
Securities					
Equity securities and other debt securities	342	Net asset value Market comparable Discounted cash flows	Net asset value EV/EBITDA ⁽¹⁾ multiple Credit spread	100 % 11 x 455 Bps ⁽²⁾	100 % 14 x 705 Bps ⁽²⁾
Other					
Derivative financial instruments					
Interest rate contracts	1	Discounted cash flows	Discount rate	2.20 %	2.20 %
Equity contracts	70	Option pricing model	Long-term volatility Market correlation	7 % (42) %	23 % (42) %
	413				
Financial liabilities					
Deposits					
Structured deposit notes	1	Option pricing model	Long-term volatility Market correlation	8 % (37) %	39 % 83 %
Other					
Derivative financial instruments					
Interest rate contracts	1	Discounted cash flows	Discount rate	2.20 %	2.20 %
Equity contracts	50	Option pricing model	Long-term volatility Market correlation	8 % (42) %	41 % 83 %
	52				

As at October 31, 2016					
	Fair value	Primary valuation techniques	Significant unobservable inputs	Range of input values	
				Low	High
Financial assets					
Securities					
Other restructured notes of the MAV I and MAV II conduits	6	Net asset value	Net asset value	100 %	100 %
Equity securities and other debt securities	317	Net asset value Market comparable Price-based model	Net asset value EV/EBITDA ⁽¹⁾ multiple Price equivalent	100 % 11 x 71 %	100 % 14 x 121 %
Other					
Derivative financial instruments					
Interest rate contracts	2	Discounted cash flows	Discount rate	2.20 %	2.20 %
Equity contracts	131	Option pricing model	Long-term volatility Market correlation	10 % (56) %	25 % (56) %
	456				
Financial liabilities					
Deposits					
Structured deposit notes	7	Option pricing model	Long-term volatility Market correlation	10 % (33) %	55 % 87 %
Other					
Derivative financial instruments					
Equity contracts	118	Option pricing model	Long-term volatility Market correlation	10 % (56) %	54 % 87 %
	125				

- (1) EV/EBITDA means Enterprise Value/Earnings Before Interest, Taxes, Depreciation and Amortization.
 (2) Bps or basis point is a unit of measure equal to 0.01%.

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Significant Unobservable Inputs Used for Fair Value Measurements of Financial Instruments Classified in Level 3

Net Asset Value

Net asset value is the estimated value of a security based on valuations received from the investment or fund managers, the administrators of the conduits or the general partners of the limited partnerships. The net asset value of a fund is the total fair value of assets less liabilities.

EV/EBITDA (Enterprise Value/Earnings Before Interest, Taxes, Depreciation and Amortization) Multiple and Price Equivalent

Private equity valuation inputs include earnings multiples, which are determined based on comparable companies, and a higher multiple will translate into a higher fair value. Price equivalent is a percentage of the market price based on the liquidity of the security.

Discount Rate

When discounted cash flow methods are used, the discount rate is the input used to bring future cash flows to their present value. A higher discount rate will translate into a lower fair value.

Long-Term Volatility

Volatility is a measure of the expected future variability of market prices. Volatility is generally observable in the market through options prices. However, the long-term volatility of options with a longer maturity might not be observable. An increase (decrease) in long-term volatility is generally associated with an increase (decrease) in long-term correlation. Higher long-term volatility may increase or decrease an instrument's fair value depending on its terms.

Market Correlation

Correlation is a measure of the inter-relationship between two different variables. A positive correlation means that the variables tend to move in the same direction; a negative correlation means that the variables tend to move in opposite directions. Correlation is used to measure financial instruments whose future returns depend on several variables. Changes in correlation will either increase or decrease a financial instrument's fair value depending on the terms of its contractual payout.

Sensitivity Analysis of Financial Instruments Classified in Level 3

The Bank performs sensitivity analyses for the fair value measurements of financial instruments classified in Level 3, substituting unobservable inputs with one or more reasonably possible alternative assumptions.

For equity securities and other debt securities, the Bank varies significant unobservable inputs such as net asset values, EV/EBITDA multiples, or price equivalents and establishes a reasonable fair value range that could result in a \$40 million increase or decrease in the fair value recorded as at October 31, 2017 (a \$40 million increase or decrease as at October 31, 2016).

For derivative financial instruments and embedded derivatives related to structured deposit notes, the Bank varies long-term volatility and market correlation inputs and establishes a reasonable fair value range. As at October 31, 2017, for derivative financial instruments, the net fair value could result in a \$3 million increase or decrease (\$7 million increase or decrease as at October 31, 2016), whereas for structured deposit notes, the fair value could result in a \$1 million increase or decrease (\$1 million increase or decrease as at October 31, 2016).

Change in the Fair Value of Financial Instruments Classified in Level 3

The Bank may hedge the fair value of financial instruments classified in the various levels through offsetting 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. The gains and losses presented hereafter may comprise changes in fair value based on observable and unobservable inputs.

	Year ended October 31, 2017			
	Securities at fair value through profit or loss	Available-for-sale securities	Derivative financial instruments ⁽¹⁾	Deposits
Fair value as at October 31, 2016	18	305	15	(7)
Total realized and unrealized gains (losses) included in <i>Net income</i> ⁽²⁾	2	24	(9)	–
Total realized and unrealized gains (losses) included in <i>Other comprehensive income</i>	–	(28)	–	–
Purchases	4	85	–	–
Sales	(10)	(57)	–	–
Issuances	–	–	–	(10)
Settlements and other	–	(3)	18	1
Financial instruments transferred into Level 3	2	–	–	(1)
Financial instruments transferred out of Level 3	–	–	(4)	16
Fair value as at October 31, 2017	16	326	20	(1)
Change in unrealized gains and losses included in <i>Net income</i> with respect to financial assets and financial liabilities held as at October 31, 2017 ⁽³⁾	1	–	(9)	–

	Year ended October 31, 2016			
	Securities at fair value through profit or loss	Available-for-sale securities	Derivative financial instruments ⁽¹⁾	Deposits
Fair value as at October 31, 2015	21	261	(38)	(20)
Total realized and unrealized gains (losses) included in <i>Net income</i> ⁽⁴⁾	(1)	8	(31)	9
Total realized and unrealized gains (losses) included in <i>Other comprehensive income</i>	–	14	–	–
Purchases	18	42	–	–
Sales	(26)	(13)	–	–
Issuances	–	–	–	(13)
Settlements and other	–	(8)	20	3
Financial instruments transferred into Level 3	6	1	67	(32)
Financial instruments transferred out of Level 3	–	–	(3)	46
Fair value as at October 31, 2016	18	305	15	(7)
Change in unrealized gains and losses included in <i>Net income</i> with respect to financial assets and financial liabilities held as at October 31, 2016 ⁽⁵⁾	(1)	–	(31)	9

(1) The derivative financial instruments include assets and liabilities presented on a net basis.

(2) Total net gains included in *Non-interest income* was \$17 million.

(3) Total unrealized losses included in *Non-interest income* was \$8 million.

(4) Total net losses included in *Non-interest income* was \$15 million.

(5) Total unrealized losses included in *Non-interest income* was \$23 million.

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Financial Instruments Not Recorded at Fair Value on the Consolidated Balance Sheet

The following tables show the financial instruments that have not been recorded at fair value on the Consolidated Balance Sheet according to the fair value hierarchy, except for those whose carrying value is a reasonable approximation of fair value.

	As at October 31, 2017			
	Level 1	Level 2	Level 3	Total
Financial assets				
Held-to-maturity securities				
Securities issued or guaranteed by				
Canadian government	–	5,368	–	5,368
Canadian provincial and municipal governments	–	2,086	–	2,086
U.S. Treasury, other U.S. agencies and other foreign governments	–	20	–	20
Other debt securities	–	1,755	–	1,755
	–	9,229	–	9,229
Loans, net of allowances	–	50,665	72,288	122,953
Financial liabilities				
Deposits	–	151,571	–	151,571
Other				
Liabilities related to transferred receivables	–	13,940	–	13,940
Other liabilities	–	947	–	947
Subordinated debt	–	6	–	6
	–	166,464	–	166,464

	As at October 31, 2016			
	Level 1	Level 2	Level 3	Total
Financial assets				
Held-to-maturity securities				
Securities issued or guaranteed by				
Canadian government	–	2,652	–	2,652
Canadian provincial and municipal governments	–	548	–	548
Other debt securities	–	793	–	793
	–	3,993	–	3,993
Loans, net of allowances	–	44,895	69,305	114,200
Financial liabilities				
Deposits	–	136,108	–	136,108
Other				
Liabilities related to transferred receivables	–	13,974	–	13,974
Other liabilities	–	1,359	–	1,359
Subordinated debt	–	1,013	–	1,013
	–	152,454	–	152,454

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 the criteria presented in Note 1. Consistent with its risk management strategy and as permitted by the fair value option, when the designation eliminates or significantly reduces the measurement or recognition mismatch resulting from measuring financial assets and liabilities on different bases, the Bank designated at fair value through profit or loss certain securities, certain securities purchased under reverse repurchase agreements, certain obligations related to securities sold under repurchase agreements, and certain liabilities related to transferred receivables. 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 deposits that include embedded derivative financial instruments and certain loans 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.

To determine a change in fair value arising from a change in the credit risk of deposits designated at fair value through profit or loss, the Bank calculates, at the beginning of the period, the present value of the instrument's contractual cash flows using the following rates: first, using an observed discount rate for similar securities that reflects the Bank's credit spread and, then, using a rate that excludes the Bank's credit spread. The difference obtained between the two values is then compared to the difference obtained using the same rates at the end of the period.

Information about the financial assets and financial liabilities designated at fair value through profit or loss is provided in the following tables.

	Carrying value as at October 31, 2017	Change in the total fair value (including the change in the fair value attributable to credit risk) for the year ended October 31, 2017	Change in fair value since the initial recognition of the instrument
Financial assets designated at fair value through profit or loss			
Securities	756	(4)	16
Securities purchased under reverse repurchase agreements	657	–	–
Loans	115	(11)	(32)
	1,528	(15)	(16)
Financial liabilities designated at fair value through profit or loss			
Deposits ⁽¹⁾⁽²⁾	5,501	(113)	34
Securities sold under repurchase agreements	534	–	–
Liabilities related to transferred receivables	6,209	158	(52)
	12,244	45	(18)

	Carrying value as at October 31, 2016	Change in the total fair value (including the change in the fair value attributable to credit risk) for the year ended October 31, 2016	Change in fair value since the initial recognition of the instrument
Financial assets designated at fair value through profit or loss			
Securities	1,465	10	326
Securities purchased under reverse repurchase agreements	158	–	–
Loans	164	(14)	(27)
	1,787	(4)	299
Financial liabilities designated at fair value through profit or loss			
Deposits ⁽¹⁾⁽²⁾	4,655	(132)	(81)
Liabilities related to transferred receivables	6,206	41	(207)
	10,861	(91)	(288)

- (1) For the year ended October 31, 2017, the change in the fair value of deposits designated at fair value through profit or loss attributable to credit risk, and recorded in *Other comprehensive income*, resulted in a \$29 million loss (for the year ended October 31, 2016, a net loss of \$75 million consisting of a \$90 million loss recognized in *Other comprehensive income* upon early prospective adoption of the credit risk provisions set out in IFRS 9 – *Financial Instruments* on February 1, 2016 and a \$15 million gain recognized in *Net income*).
- (2) The amount at maturity that the Bank will be contractually required to pay to the holders of these deposits varies and will differ from the reporting date fair value.

NOTE 5 – OFFSETTING FINANCIAL ASSETS AND FINANCIAL 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.

Generally, over-the-counter financial derivatives subject to master netting arrangements of the International Swaps & Derivatives Association, Inc. or other similar agreements do not meet the netting criteria on the Consolidated Balance Sheet because the right of set-off is legally enforceable only in the event of default, insolvency or bankruptcy.

Generally, securities purchased under reverse repurchase agreements and securities borrowed as well as obligations related to securities sold under repurchase agreements and securities loaned, subject to master agreements, do not meet the netting criteria since they confer a right of set-off that is enforceable only in the event of default, insolvency or bankruptcy.

However, the above-mentioned transactions may be subject to contractual netting agreements concluded with clearing houses. If the netting criteria are met, these transactions are netted on the Consolidated Balance Sheet. In addition, as part of these transactions, the Bank may give or receive cash or other financial instruments used as collateral.

The following tables present information on financial assets and financial liabilities that are netted on the Consolidated Balance Sheet because they meet the netting criteria and on those that are not netted and are subject to an enforceable master netting arrangement or similar agreement.

As at October 31, 2017						
	Gross amounts recognized	Amounts set off on the Consolidated Balance Sheet	Net amounts reported on the Consolidated Balance Sheet	Associated amounts not set off on the Consolidated Balance Sheet		Net amounts
				Financial instruments ⁽¹⁾	Financial assets received/pledged as collateral ⁽²⁾	
Financial assets						
Securities purchased under reverse repurchase agreements and securities borrowed	24,939	4,150	20,789	3,304	17,403	82
Derivative financial instruments	9,848	1,425	8,423	3,931	2,688	1,804
	34,787	5,575	29,212	7,235	20,091	1,886
Financial liabilities						
Obligations related to securities sold under repurchase agreements and securities loaned	25,917	4,150	21,767	3,304	18,385	78
Derivative financial instruments	8,037	1,425	6,612	3,931	1,187	1,494
	33,954	5,575	28,379	7,235	19,572	1,572

As at October 31, 2016						
	Gross amounts recognized	Amounts set off on the Consolidated Balance Sheet	Net amounts reported on the Consolidated Balance Sheet	Associated amounts not set off on the Consolidated Balance Sheet		Net amounts
				Financial instruments ⁽¹⁾	Financial assets received/pledged as collateral ⁽²⁾	
Financial assets						
Securities purchased under reverse repurchase agreements and securities borrowed	25,115	11,167	13,948	1,843	12,035	70
Derivative financial instruments	12,521	2,105	10,416	4,743	3,390	2,283
	37,636	13,272	24,364	6,586	15,425	2,353
Financial liabilities						
Obligations related to securities sold under repurchase agreements and securities loaned	33,803	11,167	22,636	1,843	20,633	160
Derivative financial instruments	9,830	2,105	7,725	4,743	1,740	1,242
	43,633	13,272	30,361	6,586	22,373	1,402

- (1) Carrying amount of financial instruments that are subject to a master netting agreement or similar agreement but that do not satisfy offsetting criteria.
 (2) Excluding non-financial instruments collateral.

NOTE 6 – SECURITIES

Residual Contractual Maturities of Securities

As at October 31					2017	2016
	1 year or less	Over 1 year to 5 years	Over 5 years	No specified maturity	Total	Total
Securities at fair value through profit or loss						
Securities issued or guaranteed by						
Canadian government	1,976	5,528	1,158	–	8,662	7,188
Canadian provincial and municipal governments	412	4,734	2,624	–	7,770	10,547
U.S. Treasury, other U.S. agencies and other foreign governments	1,856	205	67	–	2,128	4,174
Other debt securities	862	1,084	653	–	2,599	2,934
Equity securities	6	28	–	26,343	26,377	21,121
	5,112	11,579	4,502	26,343	47,536	45,964
Available-for-sale securities						
Securities issued or guaranteed by						
Canadian government	56	3,569	656	–	4,281	6,281
Canadian provincial and municipal governments	2	353	2,229	–	2,584	4,996
U.S. Treasury, other U.S. agencies and other foreign governments	1	116	404	–	521	1,709
Other debt securities	11	275	203	5	494	978
Equity securities	75	79	4	514	672	644
	145	4,392	3,496	519	8,552	14,608
Held-to-maturity securities						
Securities issued or guaranteed by						
Canadian government	60	5,331	–	–	5,391	2,606
Canadian provincial and municipal governments	30	1,161	901	–	2,092	544
U.S. Treasury, other U.S. agencies and other foreign governments	–	20	–	–	20	–
Other debt securities	538	1,057	157	–	1,752	819
	628	7,569	1,058	–	9,255	3,969

NOTE 6 – SECURITIES (cont.)

Gross Gains (Losses) on Available-for-Sale Securities

	As at October 31, 2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
Securities issued or guaranteed by				
Canadian government	4,308	6	(33)	4,281
Canadian provincial and municipal governments	2,502	87	(5)	2,584
U.S. Treasury, other U.S. agencies and other foreign governments	536	–	(15)	521
Other debt securities	487	9	(2)	494
Equity securities	633	64	(25)	672
	8,466	166	(80)	8,552

	As at October 31, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
Securities issued or guaranteed by				
Canadian government	6,201	83	(3)	6,281
Canadian provincial and municipal governments	4,704	312	(20)	4,996
U.S. Treasury, other U.S. agencies and other foreign governments	1,702	11	(4)	1,709
Other debt securities	951	29	(2)	978
Equity securities	588	94	(38)	644
	14,146	529	(67)	14,608

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, 2017, a negligible amount (\$9 million for the year ended October 31, 2016) 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, 2017 and 2016, 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, 2017 and 2016, 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 charge to be recognized in the Consolidated Statement of Income.

Held-to-Maturity Securities

At the end of each financial reporting period, the Bank determines whether there is objective evidence of impairment for each held-to-maturity security. As at October 31, 2017 and 2016, there was no objective evidence of impairment on held-to-maturity securities.

Master Asset Vehicles (MAV)

As at October 31, 2017, the carrying value of the restructured notes of the MAV conduits and of the other restructured notes held by the Bank was nil (\$619 million as at October 31, 2016). The change in the carrying value of the restructured notes of the MAV conduits during the year ended October 31, 2017 was mainly attributable to capital repayments.

NOTE 7 – LOANS

Credit Quality

	As at October 31, 2017			
	Residential mortgage	Personal and credit card	Business and government ⁽¹⁾⁽²⁾	Total
Neither past due ⁽³⁾ nor impaired	50,232	36,498	47,369	134,099
Past due ⁽³⁾ but not impaired	220	385	78	683
Impaired	66	80	234	380
Gross loans	50,518	36,963	47,681	135,162
Less: Allowances on impaired loans				
Individual allowances	13	22	119	154
Collective allowances	–	18	2	20
Allowances on impaired loans	13	40	121	174
	50,505	36,923	47,560	134,988
Less:				
Sectoral allowance on non-impaired loans – Oil and gas ⁽⁴⁾				139
Collective allowance on non-impaired loans ⁽⁵⁾				406
				545
Loans and acceptances, net of allowances				134,443

	As at October 31, 2016			
	Residential mortgage	Personal and credit card	Business and government ⁽¹⁾⁽²⁾	Total
Neither past due ⁽³⁾ nor impaired	48,552	33,591	43,673	125,816
Past due ⁽³⁾ but not impaired	245	294	112	651
Impaired	71	79	342	492
Gross loans	48,868	33,964	44,127	126,959
Less: Allowances on impaired loans				
Individual allowances	13	20	156	189
Collective allowances	–	19	3	22
Allowances on impaired loans	13	39	159	211
	48,855	33,925	43,968	126,748
Less:				
Sectoral allowance on non-impaired loans – Oil and gas ⁽⁴⁾				204
Collective allowance on non-impaired loans ⁽⁵⁾				366
				570
Loans and acceptances, net of allowances				126,178

- (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) Includes customers' liability under acceptances.
- (3) A loan is past due when the counterparty has not made a payment by the contractual due date.
- (4) The sectoral allowance on non-impaired loans was established collectively for the portfolio of loans to producers and service companies in the oil and gas sector.
- (5) The collective allowance for credit risk on non-impaired loans was established taking into account the Bank's overall credit portfolio, except for loans covered by the sectoral allowance.

NOTE 7 – LOANS (cont.)

Loans Past Due But Not Impaired⁽¹⁾

As at October 31	2017			2016		
	Residential mortgage	Personal and credit card	Business and government	Residential mortgage	Personal and credit card	Business and government
Past due but not impaired						
31 to 60 days	111	110	30	115	112	51
61 to 90 days	40	50	15	48	36	9
90 days and greater	69	225	33	82	146	52
	220	385	78	245	294	112

(1) Loans less than 31 days past due are not presented as they are not considered past due from an administrative standpoint.

Impaired Loans

	As at October 31, 2017			
	Gross	Individual allowances	Collective allowances	Net
Loans				
Residential mortgage	66	13	–	53
Personal and credit card	80	22	18	40
Business and government ⁽¹⁾	234	119	2	113
	380	154	20	206

	As at October 31, 2016			
	Gross	Individual allowances	Collective allowances	Net
Loans				
Residential mortgage	71	13	–	58
Personal and credit card	79	20	19	40
Business and government ⁽¹⁾	342	156	3	183
	492	189	22	281

(1) Includes customers' liability under acceptances.

Allowances for Credit Losses

	Year ended October 31, 2017						Balance at end
	Balance at beginning	Provisions for credit losses	Write-offs	Write-offs on credit cards	Recoveries and other ⁽¹⁾	Transfers ⁽²⁾	
Allowances on impaired loans							
Residential mortgage							
Individual allowances	13	13	(14)	–	1	–	13
Collective allowances	–	–	–	–	–	–	–
Personal and credit card							
Individual allowances	20	163	(80)	(82)	1	–	22
Collective allowances	19	27	(37)	–	9	–	18
Business and government ⁽³⁾							
Individual allowances	156	39	(104)	–	3	25	119
Collective allowances	3	2	(3)	–	–	–	2
Individual allowances	189	215	(198)	(82)	5	25	154
Collective allowances	22	29	(40)	–	9	–	20
	211	244	(238)	(82)	14	25	174
Sectoral allowance on non-impaired loans – Oil and gas⁽⁴⁾	204	(40)	–	–	–	(25)	139
Collective allowance on non-impaired loans⁽⁵⁾	366	40	–	–	–	–	406
	570	–	–	–	–	(25)	545
	781	244	(238)	(82)	14	–	719

	Year ended October 31, 2016						Balance at end
	Balance at beginning	Provisions for credit losses	Write-offs	Write-offs on credit cards	Recoveries and other ⁽¹⁾	Transfers ⁽²⁾	
Allowances on impaired loans							
Residential mortgage							
Individual allowances	10	12	(11)	–	2	–	13
Collective allowances	–	–	–	–	–	–	–
Personal and credit card							
Individual allowances	18	123	(41)	(81)	1	–	20
Collective allowances	22	28	(39)	–	8	–	19
Business and government ⁽³⁾							
Individual allowances	151	67	(107)	–	(1)	46	156
Collective allowances	2	4	(3)	–	–	–	3
Individual allowances	179	202	(159)	(81)	2	46	189
Collective allowances	24	32	(42)	–	8	–	22
	203	234	(201)	(81)	10	46	211
Sectoral allowance on non-impaired loans – Oil and gas⁽⁴⁾	–	250	–	–	–	(46)	204
Collective allowance on non-impaired loans⁽⁵⁾	366	–	–	–	–	–	366
	366	250	–	–	–	(46)	570
	569	484	(201)	(81)	10	–	781

(1) Includes foreign exchange movements.

(2) When a loan covered by the *Sectoral allowance on non-impaired loans – Oil and gas* becomes impaired, the sectoral allowance related to that loan is transferred to the individual allowances on impaired loans.

(3) Includes customers' liability under acceptances.

(4) The sectoral allowance on non-impaired loans was established collectively for the portfolio of loans to producers and service companies in the oil and gas sector.

(5) The collective allowance for credit risk on non-impaired loans was established taking into account the Bank's overall credit portfolio, except for loans covered by the sectoral allowance.

NOTE 7 – LOANS (cont.)

Distribution of Gross and Impaired Loans by Borrower Category Under the Basel Asset Classes

	2017				
	As at October 31			Year ended October 31	
	Gross loans ⁽¹⁾	Impaired loans ⁽²⁾	Allowances on impaired loans ⁽¹⁾	Provisions for credit losses	Write-offs
Retail					
Residential mortgage ⁽²⁾⁽³⁾	66,398	68	13	13	14
Qualifying revolving retail ⁽⁴⁾	4,217	17	10	104	109
Other retail ⁽⁵⁾	12,150	53	29	86	90
	82,765	138	52	203	213
Non-retail					
Agriculture	4,923	7	3	(1)	3
Oil and gas	2,129	93	34	(40)	56
Mining	470	–	–	–	–
Construction and real estate ⁽⁶⁾	11,891	41	20	16	4
Manufacturing	4,341	16	14	–	12
Wholesale and retail	5,497	44	22	10	8
Transportation	2,593	3	2	–	6
Telecommunications, media and technology	1,662	13	8	3	2
Financial institutions	4,932	–	–	–	–
Services	6,178	18	12	7	4
Governments and other related services	6,548	5	5	5	12
Other ⁽³⁾	1,233	2	2	41	–
	52,397	242	122	41	107
	135,162	380	174	244	320

	2016				
	As at October 31			Year ended October 31	
	Gross loans ⁽¹⁾	Impaired loans ⁽²⁾	Allowances on impaired loans ⁽¹⁾	Provisions for credit losses	Write-offs
Retail					
Residential mortgage ⁽²⁾	58,265	76	13	11	11
Qualifying revolving retail ⁽⁴⁾	4,178	18	10	105	108
Other retail ⁽⁵⁾	10,316	49	28	45	53
	72,759	143	51	161	172
Non-retail					
Agriculture	4,599	16	6	–	3
Oil and gas	2,102	178	66	284	66
Mining	582	–	–	–	–
Construction and real estate ⁽⁶⁾	10,729	19	9	5	2
Manufacturing	3,597	25	21	8	6
Wholesale and retail	4,932	34	17	12	23
Transportation	3,013	6	4	3	5
Telecommunications, media and technology	1,578	23	9	4	–
Financial institutions	3,872	–	–	–	–
Services	6,021	22	8	4	4
Governments and other related services	5,638	18	12	–	–
Other	7,537	8	8	3	1
	54,200	349	160	323	110
	126,959	492	211	484	282

- (1) Includes customers' liability under acceptances.
 (2) Includes residential mortgages on one-to-four-unit dwellings (Basel definition) and home equity lines of credit.
 (3) Since November 1, 2016, the loans acquired by the Financial Markets segment for securitization purposes, and reported in the *Other* category, are now being reported in the *Residential mortgage* category. Figures as at October 31, 2016 were not adjusted to reflect those modifications.
 (4) Includes lines of credit and credit card receivables.
 (5) Includes consumer loans and other retail loans but excludes SME loans.
 (6) Includes non-residential mortgages.

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, in particular structured entities. According to the terms of 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

When securities are sold under repurchase agreements and securities loaned 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 is 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 Structured Entities

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 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	2017	2016
Carrying value of financial assets transferred but not derecognized		
Securities ⁽¹⁾	42,014	39,989
Residential mortgages	19,080	19,093
	61,094	59,082
Carrying value of associated liabilities⁽²⁾	33,330	34,992
Fair value of financial assets transferred but not derecognized		
Securities ⁽¹⁾	42,014	39,989
Residential mortgages	19,169	19,403
	61,183	59,392
Fair value of associated liabilities⁽²⁾	33,356	35,041

(1) The amount related to the securities loaned is the maximum amount of Bank securities that can be lent. For the 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 the offsetting impact of \$1,621 million as at October 31, 2017 (\$3,521 million as at October 31, 2016) 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 \$10,156 million as at October 31, 2017 (\$11,296 million as at October 31, 2016).

The following table specifies the nature of the transactions related to financial assets transferred but not derecognized.

As at October 31	2017	2016
Carrying value of financial assets transferred but not derecognized		
Securities backed by insured residential mortgages and other securities sold to CHT	20,012	20,030
Securities sold under repurchase agreements	13,544	14,615
Securities loaned	27,538	24,437
	61,094	59,082

NOTE 9 – INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

As at October 31			2017	2016
	Business segment	Ownership percentage	Carrying value	Carrying value
Listed associates⁽¹⁾				
	TMX Group Limited ⁽²⁾	8.6 %	241	231
	Fiera Capital Corporation	Wealth Management 20.6 %	152	154
			393	385
Unlisted associates				
	Maple Financial Group Inc. ⁽³⁾	Financial Markets 24.9 %	–	–
	Other		229	230
			229	230
Unlisted joint ventures				
			9	30
			631	645

(1) The fair value of investments in associates based on quoted prices in an active market was \$581 million as at October 31, 2017 (\$497 million as at October 31, 2016).

(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) During fiscal 2016, the Bank had written off the carrying value of its equity interest in Maple Financial Group Inc. in an amount of \$164 million. For additional information, see the text below.

As at October 31, 2017 and 2016, there were no significant restrictions limiting the ability of associates and joint ventures to transfer funds to the Bank in the form of dividends or to repay any loans or advances. Furthermore, the Bank has not made any specific commitment or contracted any contingent liability with respect to associates or joint ventures.

TMX Group Limited

TMX Group Limited is a Canadian corporation that directly or indirectly controls a number of entities that operate stock exchanges and clearing houses and provide clearing and settlement services. During the year ended October 31, 2017, TMX Group Limited paid \$9 million in dividends to the Bank (\$8 million for the year ended October 31, 2016).

Fiera Capital Corporation

Fiera Capital Corporation is an independent Canadian investment management firm. During the year ended October 31, 2017, Fiera Capital Corporation paid \$12 million in dividends to the Bank (\$10 million for the year ended October 31, 2016).

Maple Financial Group Inc.

The Bank has a 24.9% equity interest in Maple Financial Group Inc. (Maple), a privately owned Canadian company that operated through direct and indirect wholly owned subsidiaries in Canada, Germany, the United Kingdom and the United States. In August 2016, Maple filed for bankruptcy under applicable Canadian laws, and a receiver was appointed to administer the company. Similar proceedings were initiated for each of Maple's other material subsidiaries in their home jurisdictions.

Maple Bank GmbH, an indirect wholly owned subsidiary of Maple, has been the subject of an investigation into alleged tax irregularities by German prosecutors since September 2015 and, to the Bank's knowledge, that investigation is ongoing. The Bank understands that the investigation is focusing on selected trading activities by Maple Bank GmbH and some of its current and former employees during taxation years 2006 to 2010, although the Bank has been advised that the investigation may also extend to subsequent taxation years. The German authorities have alleged that these trading activities violated German tax laws. Neither the Bank nor its employees were involved in these trading activities and, to the Bank's knowledge, are not the subject of this investigation.

On February 6, 2016, the German Federal Financial Supervisory Authority, BaFin, placed a moratorium on the business activities of Maple Bank GmbH, preventing it from carrying out its normal business activities. In light of the situation, the Bank wrote off the carrying value of its equity interest in Maple in an amount of \$164 million (\$145 million net of income taxes) during the first quarter of 2016. The \$164 million write-off of the equity interest in this associate was recognized in the *Non-interest income – Other* item of the Consolidated Statement of Income for the year ended October 31, 2016 and was reported in the Financial Markets segment.

The Bank has advised the German authorities that if it is determined that portions of dividends received from Maple could be reasonably attributable to tax fraud by Maple Bank GmbH, arrangements will be made to repay those amounts to the relevant authority. If any repayments are required, they are not expected to be material to the Bank's financial position.

The following table provides summarized financial information on the Bank's listed associates.

As at October 31	2017 ⁽¹⁾			2016 ⁽¹⁾
	TMX Group Limited	Fiera Capital Corporation	Total	Total
Balance sheet				
Current assets	14,743	164	14,907	18,934
Non-current assets	4,469	941	5,410	5,452
Current liabilities	14,641	84	14,725	18,986
Non-current liabilities	1,549	482	2,031	1,975
Income statement				
Total revenues	732	438	1,170	1,027
Net income	218	15	233	(10)
Other comprehensive income (loss)	(2)	(12)	(14)	1
Comprehensive income (loss)	216	3	219	(9)

(1) The balance sheet amounts are the balances reported in the unaudited financial statements as at September 30, 2017 and 2016, which are the most recent available, and the income statement amounts are based on the cumulative balances for the 12-month periods ended September 30, 2017 and 2016.

The table below provides summarized financial information related to the Bank's share of associates and joint ventures that are not individually significant.

Year ended October 31	2017 ⁽¹⁾			2016 ⁽¹⁾
	Unlisted associates	Unlisted joint ventures	Total	Total
Net income	11	1	12	11
Other comprehensive income	(10)	-	(10)	-
Comprehensive income	1	1	2	11

(1) The amounts are based on the cumulative balances for the 12-month periods ended September 30, 2017 and 2016.

NOTE 10 – PREMISES AND EQUIPMENT

	Land	Buildings	Computer equipment	Equipment and furniture	Leasehold improvements	Total
Cost						
As at October 31, 2015	14	252	244	1,633	281	2,424
Acquisitions	–	4	115	24	37	180
Disposals	–	(1)	(21)	(566)	(6)	(594)
Fully amortized assets		(2)	(114)	(4)	(16)	(136)
As at October 31, 2016	14	253	224	1,087	296	1,874
Acquisitions	3	7	38	16	32	96
Disposals	–	(4)	–	(818)	(6)	(828)
Fully amortized assets		(1)	(27)	(7)	(30)	(65)
As at October 31, 2017	17	255	235	278	292	1,077
Accumulated amortization						
As at October 31, 2015		151	158	164	134	607
Amortization for the year		5	42	203	23	273
Disposals		(1)	(13)	(191)	(3)	(208)
Fully amortized assets		(2)	(114)	(4)	(16)	(136)
As at October 31, 2016		153	73	172	138	536
Amortization for the year		5	46	106	25	182
Disposals		(3)	–	(125)	(6)	(134)
Fully amortized assets		(1)	(27)	(7)	(30)	(65)
As at October 31, 2017		154	92	146	127	519
Carrying value as at October 31, 2016	14	100	151	915	158	1,338
Carrying value as at October 31, 2017	17	101	143	132	165	558

Assets Leased Under Operating Leases

The Bank is a lessor under operating lease agreements for certain buildings. Through one of its subsidiaries, the Bank is also a lessor for equipment leased under operating leases. Upon expiry of a lease, the Bank disposes of the equipment. These leases have terms varying from one year to five years and do not contain any bargain purchase options or contingent rent.

The following table breaks down the future minimum payments receivable under these operating leases.

	As at October 31, 2017
1 year or less	84
Over 1 year to 5 years	42
Over 5 years	8
	134

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 by business segment for the years ended October 31, 2017 and 2016.

	Personal and Commercial ⁽¹⁾	Wealth Management			Financial Markets ⁽¹⁾	USSF&I			Total	
		Third-Party Solutions ⁽¹⁾	Securities Brokerage ⁽¹⁾	Managed Solutions ⁽¹⁾		Total	Credigy Ltd. ⁽²⁾	Advanced Bank of Asia Limited ⁽¹⁾		Total
Balance as at October 31, 2015	51	256	434	269	959	234	33	–	33	1,277
Acquisition of Advanced Bank of Asia Limited (Note 33)	–	–	–	–	–	–	–	129	129	129
Impact of foreign currency translation	–	–	–	–	–	1	–	5	5	6
Balance as at October 31, 2016	51	256	434	269	959	235	33	134	167	1,412
Acquisition of Groupe Financier Abi-Témi inc. ⁽²⁾	3	–	–	–	–	–	–	–	–	3
Impact of foreign currency translation	–	–	–	–	–	–	(1)	(5)	(6)	(6)
Balance as at October 31, 2017	54	256	434	269	959	235	32	129	161	1,409

(1) Constitutes a CGU.

(2) During the year ended October 31, 2017, the Bank, through one of its wholly owned subsidiaries, acquired Groupe Financier Abi-Témi inc. located in Rouyn-Noranda, Canada.

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 may have fallen below its carrying amount.

Goodwill was tested for impairment during the years ended October 31, 2017 and 2016, and no impairment loss was recognized.

The recoverable value of a CGU or group of CGUs is based on the value in use that is calculated based on discounted pre-tax cash flows. Future pre-tax cash flows are estimated based on a five-year period, which is 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 the cost related to the Bank's equity. This rate corresponds to the Bank's weighted average cost of capital and reflects the risk specific to the CGU. 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, 2017, for each CGU or CGU group, the discount rate used was 13.2% (12.3% as at October 31, 2016) and the long-term growth rate was between 2.0% and 5.0% depending on the CGU as at October 31, 2017 and 2016.

Estimating a CGU's value in use requires significant judgment regarding the inputs used in applying the discounted cash flow method. The Bank conducts sensitivity analyses by varying the after-tax discount rate and the terminal growth rates upward by 1%; such sensitivity analyses would not increase a CGU's carrying value above its value in use.

NOTE 11 – GOODWILL AND INTANGIBLE ASSETS (cont.)

Intangible Assets

	Indefinite useful life			Finite useful life			Total
	Management contracts ⁽¹⁾	Trademark	Total	Internally-generated software ⁽²⁾	Other software	Other intangible assets	
Cost							
As at October 31, 2015	161	11	172	913	107	107	1,299
Acquisitions	–	–	–	234	36	–	270
Impairment losses ⁽³⁾	–	–	–	(69)	–	(1)	(70)
Fully amortized intangible assets				(40)	(17)	–	(57)
As at October 31, 2016	161	11	172	1,038	126	106	1,442
Acquisitions	–	–	–	245	21	2	268
Fully amortized intangible assets				(16)	(32)	–	(48)
As at October 31, 2017	161	11	172	1,267	115	108	1,662
Accumulated amortization							
As at October 31, 2015				133	58	49	240
Amortization for the year				108	27	9	144
Impairment losses ⁽³⁾				(25)	–	–	(25)
Fully amortized intangible assets				(40)	(17)	–	(57)
As at October 31, 2016				176	68	58	302
Amortization for the year				135	25	9	169
Fully amortized intangible assets				(16)	(32)	–	(48)
As at October 31, 2017				295	61	67	423
Carrying value as at October 31, 2016	161	11	172	862	58	48	968
Carrying value as at October 31, 2017	161	11	172	972	54	41	1,067

(1) For annual impairment testing purposes, management contracts are allocated to the Managed Solutions CGU.

(2) The remaining amortization period for significant internally-generated software is five years.

(3) The Bank wrote off certain internally generated software applications due to obsolescence and decided to discontinue them. The recoverable amount of those applications was estimated to be nil. During the year ended October 31, 2016, \$44 million in impairment losses had been recognized and charged to the *Other* heading of segment disclosures.

NOTE 12 – OTHER ASSETS

As at October 31	2017	2016
Receivables, prepaid expenses and other items	690	668
Interest and dividends receivable	489	474
Due from clients, dealers and brokers ⁽¹⁾	505	843
Defined benefit asset (Note 24)	56	48
Deferred tax assets (Note 25)	374	402
Current tax assets	31	80
Reinsurance assets	31	32
	2,176	2,547

(1) The *Due from clients, dealers and brokers* amount of \$843 million presented separately on the Consolidated Balance Sheet as at October 31, 2016 is now reported in *Other assets*.

NOTE 13 – DEPOSITS

As at October 31			2017	2016 ⁽¹⁾
	On demand or after notice ⁽²⁾	Fixed term ⁽³⁾	Total	Total
Personal	28,516	25,203	53,719	52,521
Business and government	46,938	50,633	97,571	83,905
Deposit-taking institutions	2,447	2,934	5,381	5,640
	77,901	78,770	156,671	142,066

(1) Certain amounts have been revised from those previously reported, particularly an amount of \$2,159 million classified in *Due to clients, dealers and brokers* on the Consolidated Balance Sheet as at October 31, 2016 that is now reported in *Deposits*.

(2) Demand deposits are deposits for which the Bank does not have the right to require notice of withdrawal and consist essentially of deposits in chequing accounts. Notice deposits are deposits for which the Bank may legally require notice of withdrawal and consist mainly of deposits in savings accounts.

(3) Fixed-term deposits are deposits that can be withdrawn by the holder on a specified date and include term deposits, guaranteed investment certificates, savings accounts and plans, covered bonds and similar instruments.

The *Deposits – Business and government* item includes, among other items, the covered bonds, as described below.

Covered Bonds

NBC Covered Bond Guarantor (Legislative) Limited Partnership

In December 2013, the Bank established the covered bond legislative program under which covered bonds are issued. It therefore created NBC Covered Bond Guarantor (Legislative) Limited Partnership (the Guarantor) to guarantee payment of the principal and interest owed to the bondholders. The Bank sold uninsured residential mortgages to the Guarantor and granted it loans to facilitate the acquisition of these assets. During the year ended October 31, 2017, the Bank issued covered bonds under this program in an amount of 150 million pounds sterling (covered bonds in amounts of 750 million euros and 100 million pounds sterling issued during the year ended October 31, 2016). The covered bonds totalled \$7.0 billion as at October 31, 2017 (\$6.7 billion as at October 31, 2016). See Note 28 for additional information.

The Bank has limited access to the assets owned by this structured entity according to the terms of the agreements that apply to this transaction. The assets owned by this entity totalled \$15.9 billion as at October 31, 2017 (\$14.2 billion as at October 31, 2016), of which \$15.6 billion (\$13.9 billion as at October 31, 2016) is presented in *Residential mortgage* loans on the Bank's Consolidated Balance Sheet.

NOTE 14 – OTHER LIABILITIES

As at October 31	2017	2016
Accounts payable and accrued expenses	1,797	1,510
Subsidiaries' debts to third parties	1,075	1,447
Interest and dividends payable	883	832
Due to clients, dealers and brokers ⁽¹⁾	647	540
Defined benefit liability (Note 24)	252	314
Deferred tax liabilities (Note 25)	35	57
Current tax liabilities	93	215
Insurance liabilities	60	71
Other items ⁽²⁾⁽³⁾	916	900
	5,758	5,886

(1) An amount of \$540 million reported in the *Due to clients, dealers and brokers* item on the Consolidated Balance Sheet as at October 31, 2016 is now reported in *Other liabilities*.

(2) As at October 31, 2017, *Other items* included a \$46 million restructuring provision (\$152 million as at October 31, 2016). See Note 15 for additional information.

(3) As at October 31, 2017, *Other items* included a \$12 million litigation provision (\$18 million as at October 31, 2016).

NOTE 15 – RESTRUCTURING

During fiscal years 2016 and 2015, the Board approved certain restructuring initiatives to accelerate its transformation plan, satisfy the changing needs of its clients and enhance operational efficiency. This transformation will allow the Bank to maintain the pace of its client-centric shift, pursue the transition to digital banking, maintain a compelling workplace and focus on operational excellence.

During fiscal 2016, the Bank recorded a charge of \$131 million in the *Restructuring charge* item of the Consolidated Statement of Income, consisting of severance pay and onerous contracts. This restructuring charge was reported in the *Other* heading of the segment disclosures.

The table below presents the changes in the restructuring provision on the Consolidated Balance Sheet.

	Severance pay	Other	Total
As at October 31, 2015	51	16	67
Restructuring charge	129	2	131
Payments during the year	(34)	(12)	(46)
As at October 31, 2016	146	6	152
Payments during the year	(104)	(2)	(106)
As at October 31, 2017	42	4	46

NOTE 16 – 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 Bank's note and debenture holders 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.

On April 11, 2017, the Bank redeemed \$1.0 billion of medium-term notes maturing on April 11, 2022 at a price equal to their nominal value plus accrued interest.

As at October 31				2017	2016
Maturity date	Interest rate	Characteristics			
April 2022	3.261%	Redeemable	–		1,000
February 2087	Variable ⁽¹⁾	Redeemable at the Bank's option since February 28, 1993	9		9
Fair value hedge adjustment				–	5
Unamortized issuance costs ⁽²⁾				–	(2)
Total				9	1,012

(1) Debentures denominated in foreign currency totalling US\$7 million as at October 31, 2017 (2016: US\$7 million) and bearing interest at a rate of 1/8% above six-month LIBOR.

(2) 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.

NOTE 17 – 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 rate, commodity or financial instrument 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 commodity.
- 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.
- Credit default swaps are transactions in which one of the parties agrees to pay returns 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 grants the buyer the right, but not the obligation, to buy or sell, either at a specified date or dates or at any time prior to a predetermined expiry date, a specific amount of currency, commodity or financial instrument at an agreed-upon price upon the sale of the option. The writer receives a premium for the sale of this instrument.

NOTE 17 – DERIVATIVE FINANCIAL INSTRUMENTS (cont.)

Notional Amounts

Notional amounts are not presented in assets or liabilities on the Consolidated Balance Sheet. They represent the reference amount of the contract to which a rate or price is applied to determine the amount of cash flows to be exchanged.

As at October 31	Term to maturity					2017		2016
	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								
Forward rate agreements								
Not settled by central counterparties	691	104	–	–	795	795	–	2,249
Settled by central counterparties	–	819	129	–	948	948	–	8,015
Swaps								
Not settled by central counterparties	6,064	9,143	68,050	41,694	124,951	119,531	5,420	132,364
Settled by central counterparties	111,227	82,338	116,566	48,890	359,021	327,496	31,525	289,597
Options purchased	10	1,082	1,084	630	2,806	2,647	159	4,862
Options written	23	628	567	606	1,824	1,546	278	2,874
	118,015	94,114	186,396	91,820	490,345	452,963	37,382	439,961
Exchange-traded contracts								
Futures								
Long positions	19,817	15,887	7,369	–	43,073	43,073	–	32,275
Short positions	13,793	26,881	5,257	–	45,931	45,931	–	50,275
Options purchased	11,708	–	6,392	–	18,100	18,100	–	19,248
Options written	65	–	2,516	–	2,581	2,581	–	20,119
	45,383	42,768	21,534	–	109,685	109,685	–	121,917
Foreign exchange contracts								
OTC contracts								
Forwards	16,043	6,570	7,365	1,635	31,613	31,613	–	45,221
Swaps	65,571	26,867	57,930	29,493	179,861	168,479	11,382	175,742
Options purchased	4,798	4,138	747	–	9,683	9,683	–	7,822
Options written	4,815	3,526	619	–	8,960	8,960	–	7,005
	91,227	41,101	66,661	31,128	230,117	218,735	11,382	235,790
Exchange-traded contracts								
Futures								
Long positions	45	–	–	–	45	45	–	41
Short positions	424	–	–	–	424	424	–	756
Options purchased	–	–	–	–	–	–	–	10
Options written	–	–	–	–	–	–	–	4
	469	–	–	–	469	469	–	811
Equity, commodity and credit derivative contracts⁽¹⁾								
OTC contracts								
Forwards	4	56	1,895	287	2,242	2,242	–	3,209
Swaps								
Not settled by central counterparties	6,622	9,520	8,507	457	25,106	24,989	117	20,194
Settled by central counterparties	143	238	7,291	1,210	8,882	8,882	–	1,969
Options purchased	602	90	1,287	230	2,209	2,209	–	2,160
Options written	206	316	846	208	1,576	1,576	–	2,562
	7,577	10,220	19,826	2,392	40,015	39,898	117	30,094
Exchange-traded contracts								
Futures								
Long positions	4,588	192	261	70	5,111	5,111	–	3,574
Short positions	7,976	1,747	1,081	43	10,847	10,847	–	9,798
Options purchased	1,505	357	131	–	1,993	1,993	–	2,311
Options written	746	943	1,032	109	2,830	2,830	–	2,929
	14,815	3,239	2,505	222	20,781	20,781	–	18,612
	277,486	191,442	296,922	125,562	891,412	842,531	48,881	847,185

(1) Includes precious metal contracts.

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, insolvency or bankruptcy. 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.

The Bank also uses financial intermediaries to have access to established clearing houses in order to minimize the settlement risk for certain financial derivative transactions. In some cases, the Bank has direct access to clearing houses for settling derivative financial instruments. In addition, certain derivative financial instruments traded over the counter are settled directly or indirectly by central counterparties.

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

Replacement cost is 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 OSFI's *Capital Adequacy Requirements Guideline*.

Risk-Weighted Amount

The risk-weighted amount is determined by applying the OSFI guidance to the credit risk equivalent.

Credit Risk Exposure of the Derivative Financial Instrument Portfolio

As at October 31	2017			2016		
	Replacement cost ⁽¹⁾	Credit risk equivalent	Risk-weighted amount	Replacement cost ⁽¹⁾	Credit risk equivalent	Risk-weighted amount
Interest rate contracts	2,214	8,598	821	3,812	9,213	909
Foreign exchange contracts	4,465	11,373	1,901	4,295	10,784	1,715
Equity, commodity and credit derivative contracts	1,677	4,816	305	2,222	4,702	487
	8,356	24,787	3,027	10,329	24,699	3,111
Impact of master netting agreements	(3,931)	(10,445)	(756)	(4,743)	(11,721)	(629)
	4,425	14,342	2,271	5,586	12,978	2,482

(1) As at October 31, 2017, the total positive fair value of exchange-traded contracts, which amounted to \$67 million (\$87 million as at October 31, 2016), was excluded.

Credit Risk Exposure of the Derivative Financial Instrument Portfolio by Counterparty

As at October 31	2017		2016	
	Replacement cost	Credit risk equivalent	Replacement cost	Credit risk equivalent
OECD ⁽¹⁾ governments	956	1,761	1,084	1,859
Banks of OECD member countries	969	3,809	1,025	3,809
Other	2,500	8,772	3,477	7,310
	4,425	14,342	5,586	12,978

(1) Organization for Economic Co-operation and Development.

NOTE 17 – DERIVATIVE FINANCIAL INSTRUMENTS (cont.)

Fair Value of Derivative Financial Instruments

As at October 31	2017			2016		
	Positive	Negative	Net	Positive	Negative	Net
Contracts held for trading purposes						
Interest rate contracts						
Forwards	5	1	4	7	3	4
Swaps	1,713	1,362	351	2,843	2,147	696
Options	36	7	29	43	10	33
	1,754	1,370	384	2,893	2,160	733
Foreign exchange contracts						
Forwards	573	423	150	1,140	873	267
Swaps	3,531	2,498	1,033	2,987	2,782	205
Options	141	146	(5)	160	138	22
	4,245	3,067	1,178	4,287	3,793	494
Equity, commodity and credit derivative contracts						
Forwards	773	159	614	1,407	152	1,255
Swaps	626	1,163	(537)	490	521	(31)
Options	336	416	(80)	410	407	3
	1,735	1,738	(3)	2,307	1,080	1,227
Total – Contracts held for trading purposes	7,734	6,175	1,559	9,487	7,033	2,454
Contracts designated as hedges						
Interest rate contracts						
Forwards	–	–	–	–	–	–
Swaps	468	342	126	917	679	238
Options	1	6	(5)	2	12	(10)
	469	348	121	919	691	228
Foreign exchange contracts						
Forwards	–	–	–	–	1	(1)
Swaps	220	89	131	8	–	8
Options	–	–	–	–	–	–
	220	89	131	8	1	7
Equity, commodity and credit derivative contracts						
Forwards	–	–	–	–	–	–
Swaps	–	–	–	2	–	2
Options	–	–	–	–	–	–
	–	–	–	2	–	2
Total – Contracts designated as hedges	689	437	252	929	692	237
Designated as fair value hedges	246	217	29	580	436	144
Designated as cash flow hedges	442	220	222	341	255	86
Designated as a hedge of a net investment in a foreign operation	1	–	1	8	1	7
Total fair value	8,423	6,612	1,811	10,416	7,725	2,691
Impact of master netting agreements	(3,931)	(3,931)	–	(4,743)	(4,743)	–
	4,492	2,681	1,811	5,673	2,982	2,691

NOTE 18 – HEDGING ACTIVITIES

Derivative and Non-Derivative Financial Instruments Designated as Hedging Instruments

As at October 31	2017			2016		
	Fair value hedge	Cash flow hedge	Net investment hedge	Fair value hedge	Cash flow hedge	Net investment hedge
Assets						
Derivative financial instruments	246	442	1	580	341	8
Liabilities						
Derivative financial instruments	217	220	–	436	255	1
Carrying value of non-derivative financial instruments	–	–	841	–	–	1,024
Notional amounts of designated derivative financial instruments	18,878	29,955	48	18,965	24,714	492

Fair Value Hedges

Fair value hedge transactions consist of using interest rate swaps to hedge changes in the fair value of a financial asset or financial liability caused by interest rate fluctuations. Changes in the fair value of the derivative financial instruments used as hedging instruments offset changes in the 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	2017	2016
Gains (losses) on hedging instruments	(150)	(13)
Gains (losses) on hedged items attributable to the hedged risk	147	12
Ineffectiveness of fair value hedging relationships	4	–

Cash Flow Hedges

Cash flow hedge transactions consist of 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, acceptance and 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	2017	2016
Unrealized gains (losses) included in <i>Other comprehensive income</i> as the effective portion of the hedging instrument	45	47
Losses (gains) reclassified to <i>Net interest income</i> in the Consolidated Statement of Income	(35)	(25)
Ineffectiveness of cash flow hedging relationships	1	(1)

NOTE 18 – HEDGING ACTIVITIES (cont.)

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, 2017			
	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	41	41	127	51
Expected cash flows from hedged liabilities	147	119	208	80
Net exposure	(106)	(78)	(81)	(29)

	As at October 31, 2016			
	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	24	27	74	52
Expected cash flows from hedged liabilities	55	54	120	36
Net exposure	(31)	(27)	(46)	16

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. The Bank measures this risk by assessing the impact of foreign currency fluctuations and hedges it using financial instruments (derivative or non-derivative). 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, 2017 and 2016, a negligible amount representing the ineffective portion was recognized in *Non-interest income* in the Consolidated Statement of Income.

NOTE 19 – 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.

First Preferred Shares

As at October 31, 2017					
	Redemption and conversion date in effect as of ⁽¹⁾⁽²⁾	Redemption price per share (\$) ⁽¹⁾	Convertible into preferred shares ⁽²⁾	Dividend per share (\$) ⁽³⁾	Reset premium
First preferred shares issued and outstanding					
Series 28	November 15, 2017 ⁽⁴⁾⁽⁵⁾	25.00	Series 29	0.23750 ⁽⁶⁾	2.43 %
Series 30 ⁽⁷⁾	May 15, 2019 ⁽⁴⁾⁽⁵⁾	25.00	Series 31	0.25625 ⁽⁶⁾	2.40 %
Series 32 ⁽⁷⁾	February 15, 2020 ⁽⁴⁾⁽⁵⁾	25.00	Series 33	0.24375 ⁽⁶⁾	2.25 %
Series 34 ⁽⁷⁾	May 15, 2021 ⁽⁴⁾⁽⁵⁾	25.00	Series 35	0.35000 ⁽⁶⁾	4.90 %
Series 36 ⁽⁷⁾	August 15, 2021 ⁽⁴⁾⁽⁵⁾	25.00	Series 37	0.33750 ⁽⁶⁾	4.66 %
Series 38 ⁽⁷⁾	November 15, 2022 ⁽⁴⁾⁽⁵⁾	25.00	Series 39	0.27813 ⁽⁶⁾	3.43 %
First preferred shares authorized but not issued					
Series 19 ⁽⁸⁾	June 30, 2013	25.00	n.a.	0.68750	n.a.
Series 23 ⁽⁸⁾	July 31, 2013	25.00	n.a.	0.75000	n.a.
Series 29	November 15, 2017 ⁽⁴⁾	25.50 ⁽⁹⁾	n.a.	Floating rate ⁽¹⁰⁾	2.43 %
Series 31 ⁽⁷⁾	May 15, 2019 ⁽⁴⁾	25.50 ⁽⁹⁾	n.a.	Floating rate ⁽¹⁰⁾	2.40 %
Series 33 ⁽⁷⁾	February 15, 2020 ⁽⁴⁾	25.50 ⁽⁹⁾	n.a.	Floating rate ⁽¹⁰⁾	2.25 %
Series 35 ⁽⁷⁾	May 15, 2021 ⁽⁴⁾	25.50 ⁽⁹⁾	n.a.	Floating rate ⁽¹⁰⁾	4.90 %
Series 37 ⁽⁷⁾	August 15, 2021 ⁽⁴⁾	25.50 ⁽⁹⁾	n.a.	Floating rate ⁽¹⁰⁾	4.66 %
Series 39 ⁽⁷⁾	November 15, 2022 ⁽⁴⁾	25.50 ⁽⁹⁾	n.a.	Floating rate ⁽¹⁰⁾	3.43 %

n.a. Not applicable

- (1) Redeemable in cash at the Bank's option, in whole or in part, subject to the provisions of the *Bank Act* (Canada) and to OSFI approval. Redemption prices are increased by all the declared and unpaid dividends on the preferred shares to the date fixed for redemption.
- (2) Convertible at the option of the holders of first preferred shares, subject to certain conditions.
- (3) The dividends are non-cumulative and payable quarterly, except for Series 19 and 23, for which the dividends are payable semi-annually.
- (4) Redeemable as of the date fixed for redemption and on the same date every five years thereafter.
- (5) Convertible as of the date fixed for conversion and on the same date every five years thereafter, subject to certain conditions.
- (6) The dividend amount is set for the initial period ending on the date fixed for redemption. Thereafter, these shares carry a non-cumulative quarterly fixed dividend in an amount per share determined by multiplying the rate of interest equal to the sum of the 5-year Government of Canada bond yield on the applicable fixed-rate calculation date by \$25.00, plus the reset premium.
- (7) Upon the occurrence of a trigger event as defined by OSFI, each outstanding preferred share will be automatically and immediately converted, on a full and permanent basis, without the consent of the holder, into a number of common shares of the Bank determined pursuant to an automatic conversion formula. This conversion will be calculated by dividing the value of the preferred shares, i.e., \$25.00 per share, plus all declared and unpaid dividends as at the date of the trigger event, by the value of the common shares. The value of the common shares will be the greater of a \$5.00 floor price or the current market price of the common shares. Current market price means the volume weighted average trading price of common shares for the ten consecutive trading days ending on the trading day preceding the date of the trigger event. If the common shares are not listed on an exchange when this price is being established, the price will be the fair value reasonably determined by the Bank's Board.
- (8) For additional information, see Note 20.
- (9) As of the date fixed for redemption, the redemption price will be \$25.50 per share. Thereafter, on the same date every five years, the redemption price will be \$25.00 per share.
- (10) The dividend period begins as of the date fixed for redemption. The amount of the floating quarterly non-cumulative dividend is determined by multiplying the rate of interest equal to the sum of the 90-day Government of Canada treasury bill yield on the floating rate calculation date by \$25.00, plus the reset premium.

Second Preferred Shares

15 million shares without par value, issuable for a total maximum consideration of \$300 million. As at October 31, 2017, no shares had been issued or traded.

NOTE 19 – SHARE CAPITAL (cont.)

Shares Outstanding

As at October 31	2017		2016	
	Number of shares	Shares \$	Number of shares	Shares \$
First Preferred Shares				
Series 28	8,000,000	200	8,000,000	200
Series 30	14,000,000	350	14,000,000	350
Series 32	12,000,000	300	12,000,000	300
Series 34	16,000,000	400	16,000,000	400
Series 36	16,000,000	400	16,000,000	400
Series 38	16,000,000	400	–	–
	82,000,000	2,050	66,000,000	1,650
Common shares at beginning of the fiscal year	338,053,054	2,645	337,236,322	2,614
Issued pursuant to the Stock Option Plan	4,239,095	179	1,122,756	43
Repurchase of common shares for cancellation	(2,000,000)	(16)	–	–
Impact of shares purchased or sold for trading ⁽¹⁾	(591,843)	(37)	(306,024)	(12)
Other	(108,341)	(3)	–	–
Common shares at end of year	339,591,965	2,768	338,053,054	2,645

(1) As at October 31, 2017, 553,980 shares were held for trading, representing a total amount of \$35 million (37,863 shares sold short for trading representing \$2 million as at October 31, 2016).

Dividends Declared

Year ended October 31	2017		2016	
	Dividends \$	Dividends per share	Dividends \$	Dividends per share
First Preferred Shares				
Series 28	8	0.9500	8	0.9500
Series 30	14	1.0250	14	1.0250
Series 32	12	0.9750	12	0.9750
Series 34	22	1.4000	18	1.1373
Series 36	22	1.3500	9	0.5733
Series 38	7	0.4724	–	–
	85		61	
Common shares	778	2.2800	736	2.1800
	863		797	

Issuances of Preferred Shares

On June 13, 2017, the Bank issued 16,000,000 Non-Cumulative 5-Year Rate-Reset Series 38 First Preferred Shares at a price equal to \$25.00 per share for gross proceeds of \$400 million. Given that the Series 38 preferred shares satisfy the non-viability contingent capital requirements, they qualify for the purposes of calculating regulatory capital under Basel III.

On June 13, 2016, the Bank had issued 16,000,000 Non-Cumulative 5-Year Rate-Reset Series 36 First Preferred Shares at a price equal to \$25.00 per share for gross proceeds of \$400 million. Given that the Series 36 preferred shares satisfy the non-viability contingent capital requirements, they qualify for the purposes of calculating regulatory capital under Basel III.

On January 22, 2016, the Bank had issued 16,000,000 Non-Cumulative 5-Year Rate-Reset Series 34 First Preferred Shares at a price equal to \$25.00 per share for gross proceeds of \$400 million. Given that the Series 34 preferred shares satisfy the non-viability contingent capital requirements, they qualify for the purposes of calculating regulatory capital under Basel III.

Redemption of Preferred Shares

On August 29, 2017, the Board approved the redemption, on November 15, 2017, of all the issued and outstanding Non-Cumulative 5-Year Rate-Reset Series 28 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 redeemed 8,000,000 Series 28 preferred shares for a total amount of \$200 million on November 15, 2017.

Repurchases of Common Shares

On June 5, 2017, the Bank began a normal course issuer bid to repurchase for cancellation up to 6,000,000 common shares over the 12-month period ending no later than June 4, 2018. Any repurchase through the Toronto Stock Exchange will be done at market prices. The amounts that will be paid above the average book value of the common shares will be charged to *Retained earnings*. During the year ended October 31, 2017, the Bank repurchased 2,000,000 common shares for \$115 million, which reduced *Common share capital* by \$16 million and *Retained earnings* by \$99 million.

Reserved Common Shares

As at October 31, 2017 and 2016, 15,507,568 common shares were reserved under the Dividend Reinvestment and Share Purchase Plan. As at October 31, 2017, 25,764,866 common shares (21,003,961 as at October 31, 2016) were reserved under the Stock Option Plan.

Common Shares Held in Escrow

As part of the acquisition of Wellington West Holdings Inc. in 2011, the Bank had issued common shares held in escrow. In December 2016, 799,563 of these shares were released to shareholders. In addition, 108,341 shares were cancelled, mainly upon the settlement of certain indemnifications guaranteed by those shares. As at October 31, 2017, the number of common shares held in escrow was 28,881 (936,785 as at October 31, 2016). The Bank expects that the remaining shares in escrow will be settled by the end of calendar year 2018.

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 Asset Trust were unable to pay the full amount of distributions on the trust units, the Bank would withhold from declaring dividends on any of its preferred and common shares during a determined period. For additional information, see Notes 20 and 28.

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. Common shares subscribed by participants are purchased on their behalf in the secondary market through the Bank's transfer agent, Computershare Trust Company of Canada, at a price equal to the average purchase price of the common shares during the ten business days immediately following the dividend payment date.

NOTE 20 – NON-CONTROLLING INTERESTS

As at October 31	2017	2016
Trust units issued by NBC Asset Trust (NBC CapS II)		
Series 1 ⁽¹⁾	410	410
Series 2 ⁽²⁾	359	359
Other	39	41
	808	810

(1) Includes \$10 million in accrued interest (\$10 million as at October 31, 2016).

(2) Includes \$9 million in accrued interest (\$9 million as at October 31, 2016).

Trust Units Issued by NBC Asset Trust

Through structured entity NBC Asset Trust (the Trust), a closed-end trust established under the laws of the Province of Ontario, the Bank issued transferable non-voting trust units called “Trust Capital Securities” or “NBC CapS II.” These securities are not redeemable or exchangeable for Bank preferred shares at the option of the holder. The gross proceeds from the issuance were used by the Trust to finance the acquisition of mortgage loans from the Bank. For additional information, see Note 28.

The main terms and characteristics of the NBC CapS II trust units are presented below.

	Number	Issuance date	Annual yield	Distribution dates	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 a rate equal to one-half the sum of the 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 a rate equal to one-half the sum of the 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 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 such automatic exchange or the Bank fails to comply with such direction to the satisfaction of OSFI. On an automatic exchange, the Bank will hold all outstanding trust capital securities of the Trust.

Redemption at the Option of the Trust

On any distribution date, the Trust may, subject to prior written notice and OSFI approval, redeem, at its option, the NBC CapS II – Series 1 and Series 2, in whole but not in part, without the consent of the holders.

Purchase for Cancellation

The Trust may, with OSFI approval, purchase NBC CapS II – Series 1 and Series 2, 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 – Series 1 and Series 2 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 21 – CAPITAL DISCLOSURE

Capital Management Objectives, Policies and Procedures

Capital management has a dual role of ensuring a competitive return to the Bank's shareholders while maintaining a solid capital foundation that covers the risks inherent to the Bank's business, supports its business segments and protects its clients.

The Bank's capital management policy defines the guiding principles as well as the roles and responsibilities regarding its internal capital adequacy assessment process. This process is a key tool in establishing the Bank's capital strategy and is subject to quarterly reviews and periodic amendments.

Capital Management

Capital ratios are obtained by dividing regulatory capital by risk-weighted assets and are expressed as a percentage. 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 (CET1) 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 and the eligible amount of innovative instruments. The sum of CET1 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 certain loan loss allowances. Total regulatory capital is the sum of Tier 1 and Tier 2 capital.

The Basel III regulatory framework sets out transitional arrangements for the period of 2013 to 2019. However, OSFI is requiring Canadian banks to meet the 2019 minimum "all-in" requirements rather than the minimum ratios calculated using the transitional methodology. 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. Consequently, the Bank and all other major Canadian banks have had to maintain, on an "all-in" basis, 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 of these ratios are to include a capital conservation buffer of 2.5% and a 1% surcharge applicable to Domestic Systemically Important Banks.

OSFI has been requiring Canadian banks to meet a Basel III leverage ratio of at least 3.0%. The leverage ratio is a measure independent of risk that is calculated by dividing the amount of Tier 1 capital by total exposure. Total exposure is defined as the sum of on-balance-sheet assets (including derivative exposures and securities financing transaction exposures) and off-balance-sheet items. The assets deducted from Tier 1 capital are also deducted from total exposure.

During the years ended October 31, 2017 and 2016, the Bank was in compliance with all of OSFI's regulatory capital requirements.

NOTE 21 – CAPITAL DISCLOSURE (cont.)

Regulatory Capital and Ratios Under Basel III⁽¹⁾

As at October 31	2017	2016
Capital		
CET1	7,856	6,865
Tier 1 ⁽²⁾	10,457	9,265
Total ⁽²⁾	10,661	10,506
Risk-weighted assets		
CET1 capital	70,173	68,205
Tier 1 capital	70,327	68,430
Total capital	70,451	68,623
Total exposure	262,539	253,097
Capital ratios		
CET1	11.2 %	10.1 %
Tier 1 ⁽²⁾	14.9 %	13.5 %
Total ⁽²⁾	15.1 %	15.3 %
Leverage ratio	4.0 %	3.7 %

(1) Figures are presented on an “all-in” basis.

(2) Figures as at October 31, 2017 include the redemption of the Series 28 preferred shares on November 15, 2017.

NOTE 22 – 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 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 realized and unrealized gains and losses as well as interest income 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	2017	2016
Net interest income	392	515
Non-interest income	374	150
	766	665

NOTE 23 – SHARE-BASED PAYMENTS

The compensation expense information provided below 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 ten 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 the participant's rights to continue vesting in accordance with the stated terms of the grant agreement. The maximum number of common shares that may be issued under the Stock Option Plan was 25,764,866 as at October 31, 2017 (21,003,961 as at October 31, 2016). The 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	2017		2016	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock Option Plan				
Outstanding at beginning	17,302,322	\$ 38.05	16,652,313	\$ 37.33
Awarded	1,804,016	\$ 54.69	2,140,420	\$ 42.17
Exercised	(4,239,095)	\$ 36.31	(1,122,756)	\$ 33.06
Cancelled ⁽¹⁾	(291,349)	\$ 45.90	(367,655)	\$ 44.30
Outstanding at end	14,575,894	\$ 40.46	17,302,322	\$ 38.05
Exercisable at end	9,250,560	\$ 36.03	10,850,976	\$ 34.32

(1) Includes 10,728 expired options during the year ended October 31, 2017 (900 expired options during the year ended October 31, 2016).

Exercise price	Options outstanding	Options exercisable	Expiry date
\$26.93	546,861	546,861	December 2017
\$17.44	881,360	881,360	December 2018
\$29.25	909,483	909,483	December 2019
\$34.34	1,086,075	1,086,075	December 2020
\$34.09	1,297,570	1,297,570	December 2021
\$38.36	1,615,570	1,615,570	December 2022
\$44.96	2,051,898	1,409,054	December 2023
\$47.93	2,494,194	1,104,420	December 2024
\$42.17	1,927,107	400,167	December 2025
\$54.69	1,765,776	–	December 2026
	14,575,894	9,250,560	

During the year ended October 31, 2017, the Bank awarded 1,804,016 stock options (2,140,420 during the year ended October 31, 2016) with an average fair value of \$5.75 per option (\$3.70 for the year ended October 31, 2016).

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	2017	2016
Risk-free interest rate	1.59%	1.43%
Expected life of options	7 years	7 years
Expected volatility	20.53%	21.12%
Expected dividend yield	4.41%	5.33%

NOTE 23 – SHARE-BASED PAYMENTS (cont.)

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 expected dividend yield 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, 2017 was \$11 million (\$12 million for the year ended October 31, 2016).

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 the participant's rights to continue vesting in accordance with the stated terms of the grant agreement. A compensation expense of \$4 million was recognized for the year ended October 31, 2017 with respect to this plan (\$1 million for the year ended October 31, 2016).

As at October 31	2017		2016	
	Number of SARs	Weighted average exercise price	Number of SARs	Weighted average exercise price
SAR Plan⁽¹⁾				
Outstanding at beginning	349,856	\$ 39.59	319,920	\$ 37.42
Awarded	63,356	\$ 54.69	74,180	\$ 42.17
Exercised	(17,878)	\$ 33.34	(44,244)	\$ 28.24
Outstanding at end	395,334	\$ 42.29	349,856	\$ 39.59
Exercisable at end	225,637	\$ 37.69	185,143	\$ 35.28

(1) No SARs cancelled or expired during the years ended October 31, 2017 and 2016.

Exercise price	SARs outstanding	SARs exercisable	Expiry date
\$26.93	–	–	December 2017
\$17.44	10,780	10,780	December 2018
\$29.25	34,430	34,430	December 2019
\$34.34	29,340	29,340	December 2020
\$34.09	31,616	31,616	December 2021
\$38.36	33,020	33,020	December 2022
\$44.96	35,360	26,280	December 2023
\$47.93	83,252	41,626	December 2024
\$42.17	74,180	18,545	December 2025
\$54.69	63,356	–	December 2026
	395,334	225,637	

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 participant's account 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, 2017, the Bank awarded 74,436 DSUs at a weighted average price of \$54.69 (79,098 DSUs at a weighted average price of \$42.17 for the year ended October 31, 2016). A total of 637,989 DSUs were outstanding as at October 31, 2017 (688,035 DSUs as at October 31, 2016). A compensation expense of \$14 million was recognized for the year ended October 31, 2017 with respect to these plans (\$9 million for the year ended October 31, 2016).

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 and other designated persons is competitive and to foster retention. An RSU represents a right that has a value equal to the average closing price of the Bank's common share, as published by the Toronto Stock Exchange, over the ten trading days preceding the sixth business day in December. RSUs generally vest evenly over three years, although some RSUs vest on the sixth business day of December of the third year following the date of the award, the date on which all RSUs expire. Additional RSUs are credited to the participant's account 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 award agreement.

During the year ended October 31, 2017, the Bank awarded 2,411,016 RSUs at a weighted average price of \$51.21 (2,631,545 RSUs at a weighted average price of \$43.43 for the year ended October 31, 2016). As at October 31, 2017, a total of 5,156,316 RSUs were outstanding (5,205,269 RSUs as at October 31, 2016). A compensation expense of \$174 million was recognized for the year ended October 31, 2017 with respect to the Plan (\$122 million for the year ended October 31, 2016).

Performance Stock Unit (PSU) Plan

The PSU Plan is for officers and other designated persons of the Bank. The objective of this plan is to tie a portion of the value of the compensation of these officers and other designated persons to the future value of the Bank's common shares. A PSU represents a right that has a value equal to the average closing price of the Bank's common share, as published by the Toronto Stock Exchange, over the ten trading days preceding the sixth business day in December, adjusted upward or downward according to performance criteria, which is based on the total shareholder return (TSR) over three years achieved by the Bank compared to that of the S&P/TSX Banks adjusted sub-index. PSUs vest on the sixth business day of December of the third year following the date of the award, the date on which all PSUs expire. Additional PSUs are credited to the participant's account in an amount equal to the dividends declared on the Bank's common shares 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, 2017, the Bank awarded 345,237 PSUs at a weighted average price of \$51.21 (364,163 PSUs at a weighted average price of \$43.43 for the year ended October 31, 2016). As at October 31, 2017, a total of 881,701 PSUs were outstanding (781,846 PSUs as at October 31, 2016). A compensation expense of \$24 million was recognized for the year ended October 31, 2017 with respect to the Plan (\$15 million for the year ended October 31, 2016).

Deferred Compensation Plan of National Bank Financial (NBF)

This plan is exclusively for key employees of NBF Wealth Management. 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 Wealth Management. 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 common 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 Bank's common shares. 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, 2017, NBF awarded 132,226 share units at a weighted average price of \$55.36 (163,845 share units at a weighted average price of \$42.05 for the year ended October 31, 2016). As at October 31, 2017, 1,598,966 share units were outstanding (1,569,501 share units as at October 31, 2016). During the year ended October 31, 2017, a \$24 million compensation expense was recognized for this Plan (\$13 million for the year ended October 31, 2016).

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 up 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 \$10 million for the year ended October 31, 2017 (\$10 million for the year ended October 31, 2016), were charged to *Compensation and employee benefits* when paid. As at October 31, 2017, a total of 5,961,203 common shares were held for this plan (6,359,681 common shares as at October 31, 2016).

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.

Plan Liabilities and Intrinsic Value

Total liabilities arising from the Bank's share-based compensation plans amounted to \$511 million as at October 31, 2017 (\$391 million as at October 31, 2016). The intrinsic value of these liabilities that had vested as at October 31, 2017 was \$223 million (\$186 million as at October 31, 2016).

NOTE 24 – EMPLOYEE BENEFITS – PENSION PLANS AND OTHER POST-EMPLOYMENT BENEFITS

The Bank offers defined benefit pension plans and other post-employment benefit plans to eligible employees. The pension plans provide benefits based on years of plan participation and average earnings at retirement. The other post-employment benefit plans include post-retirement medical, dental and life insurance coverage. The pension plans are funded whereas the other plans are not funded. The fair value of plan assets and the present value of the defined benefit obligation are measured as at October 31.

The Bank's most significant pension plan is the *Employee Pension Plan of the National Bank of Canada*; it is registered with OSFI and the Canada Revenue Agency and subject to the *Pension Benefits Standards Act, 1985* and the *Income Tax Act*.

The defined benefit plans expose the Bank to specific risks such as investment performance, changes to the discount rate used to calculate the obligation, the longevity of plan members and future inflation. While management believes that the assumptions used in the actuarial valuation process are reasonable, there remains a degree of risk and uncertainty that may cause future results to differ significantly from these assumptions, which could give rise to gains or losses.

According to the Bank's governance rules, the policies and risk management related to the defined benefit plans are overseen at different levels by the pension committees, the Bank's management and the Board's Human Resources Committee. The defined benefit plans are examined on an ongoing basis in order to monitor the funding and investment policies, the plans' financial status and the Bank's funding requirements.

The Bank's funding policy for the defined benefit pension plans is to make at least the minimum annual contributions required by pension regulators.

For funded plans, the Bank determines whether an economic benefit exists in the form of potential reductions in future contributions and in the form of refunds from the plan surplus, where permitted by applicable regulations and plan provisions.

Defined Benefit Obligation, Plan Assets and Funded Status

As at October 31

	Pension plans		Other post-employment benefit plans	
	2017	2016	2017	2016
Defined benefit obligation				
Balance at beginning	3,843	3,263	199	173
Current service cost	114	71	5	4
Interest cost	142	145	7	7
Remeasurements				
Actuarial (gains) losses arising from changes in demographic assumptions	–	–	–	–
Actuarial (gains) losses arising from changes in financial assumptions	(77)	492	(3)	23
Actuarial (gains) losses arising from experience adjustments	92	2	(7)	1
Employee contributions	49	48		
Benefits paid	(179)	(178)	(10)	(9)
Balance at end	3,984	3,843	191	199
Plan assets				
Fair value at beginning	3,776	3,521		
Interest income	135	154		
Administration cost	(3)	(3)		
Remeasurements				
Return on plan assets (excluding interest income)	138	167		
Bank contributions ⁽¹⁾	63	67		
Employee contributions	49	48		
Benefits paid	(179)	(178)		
Fair value at end	3,979	3,776		
Defined benefit asset (liability) at end	(5)	(67)	(191)	(199)

(1) For fiscal 2018, the Bank expects to pay an employer contribution of \$60 million to the defined benefit pension plans.

Defined Benefit Asset (Liability)

As at October 31

	Pension plans		Other post-employment benefit plans	
	2017	2016	2017	2016
Defined benefit asset included in <i>Other assets</i>	56	48		
Defined benefit liability included in <i>Other liabilities</i>	(61)	(115)	(191)	(199)
	(5)	(67)	(191)	(199)

Cost for Pension Plans and Other Post-Employment Benefits

Year ended October 31

	Pension plans		Other post-employment benefit plans	
	2017	2016	2017	2016
Current service cost	114	71	5	4
Interest expense (income), net	7	(9)	7	7
Administration costs	3	3		
Expense recognized in <i>Net income</i>	124	65	12	11
Remeasurements⁽¹⁾				
Actuarial (gains) losses on defined benefit obligation	15	494	(10)	24
Return on plan assets ⁽²⁾	(138)	(167)		
Remeasurements recognized in <i>Other comprehensive income</i>	(123)	327	(10)	24
	1	392	2	35

(1) Changes related to the discount rate and to the return on plan assets are reviewed and updated on a quarterly basis. All other assumptions are updated annually.

(2) Excluding interest income.

Allocation of the Fair Value of Pension Plan Assets

As at October 31

	2017			2016		
	Quoted in an active market ⁽¹⁾	Not quoted in an active market	Total	Quoted in an active market ⁽¹⁾	Not quoted in an active market	Total
Asset classes						
Cash and cash equivalents	–	108	108	–	54	54
Equity securities	1,693	390	2,083	1,489	391	1,880
Debt securities						
Canadian government	244	–	244	297	–	297
Canadian provincial and municipal governments	–	1,038	1,038	–	1,052	1,052
Restructured notes of the MAV III conduits	–	39	39	–	44	44
Other issuers	–	395	395	–	376	376
Other	–	72	72	–	73	73
	1,937	2,042	3,979	1,786	1,990	3,776

(1) Unadjusted quoted prices in active markets for identical assets that the Bank can access at the measurement date.

The Bank's investment strategy for plan assets considers several factors, including the time horizon of pension plan obligations and investment risk. For each plan, an allocation range per asset class is defined using a mix of equity and debt securities to optimize the risk-return profile of plan assets and minimize asset/liability mismatching.

The pension plan assets may include investment securities issued by the Bank. As at October 31, 2017 and 2016, the pension plan assets do not include any securities issued by the Bank.

For fiscal 2017, the Bank and its related entities received \$6 million (\$6 million in fiscal 2016) in fees from the pension plans for related management, administration and custodial services.

NOTE 24 – EMPLOYEE BENEFITS – PENSION PLANS AND OTHER POST-EMPLOYMENT BENEFITS (cont.)

Allocation of the Defined Benefit Obligation by the Status of Defined Benefit Plan Participants

As at October 31

	Pension plans		Other post-employment benefit plans	
	2017	2016	2017	2016
Active employees	46 %	48 %	31 %	38 %
Retirees	50 %	48 %	69 %	62 %
Participants with deferred vested benefits	4 %	4 %		
	100 %	100 %	100 %	100 %
Weighted average duration of the defined benefit obligation (in years)	17	17	15	16

Significant Actuarial Assumptions (Weighted Average)

Discount Rate

The discount rate assumption is based on an interest rate curve that represents the yields on corporate AA bonds. Short-term maturities are obtained using a curve based on observed data from corporate AA bonds. Long-term maturities are obtained using a curve based on observed data and extrapolated data.

In order to measure the pension plan and other post-employment plan obligation, the vested benefits that the Bank expects to pay in each future period are discounted to the measurement date using the spot rate associated with each of the respective periods based on the yield curve derived using the above methodology. The sum of discounted benefit amounts represents the defined benefit obligation. An average discount rate that replicates this obligation is then computed.

To better reflect current service cost, a separate discount rate was determined to account for the timing of future benefit payments associated with the additional year of service to be earned by the plan's active participants. Since these benefits are, on average, being paid at a later date than the benefits already earned by participants as a whole (i.e., longer duration), this method results in the use of a generally higher discount rate for calculating current service cost than that used to measure obligations where the yield curve is positively sloped. The methodology used to determine this discount rate is the same as the one used to establish the discount rate for measuring the obligation.

Other Assumptions

For measurement purposes, the estimated annual growth rate for health care costs was 5.28% for 2017 (5.77% for 2016). Based on the assumption retained, this rate is expected to decrease gradually to 2.97% in 2034 and remain steady thereafter.

The mortality assumption is a determining factor when measuring the defined benefit obligation. Determining the expected benefit payout period is based on best estimate assumptions regarding mortality. Mortality tables are reviewed at least once a year, and the assumptions made are in accordance with accepted actuarial practice. New results regarding the plans are reviewed and used in calculating best estimates of future mortality.

As at October 31

	Pension plans		Other post-employment benefit plans	
	2017	2016	2017	2016
Defined benefit obligation				
Discount rate	3.65 %	3.60 %	3.65 %	3.60 %
Rate of compensation increase	3.00 %	3.00 %	3.00 %	3.00 %
Health care cost trend rate			5.28 %	5.77 %
Life expectancy (<i>in years</i>) at 65 for a participant currently at				
Age 65				
Men	21.2	21.1	21.2	21.1
Women	23.5	23.5	23.5	23.5
Age 45				
Men	22.2	22.2	22.2	22.2
Women	24.5	24.5	24.5	24.5

Year ended October 31

	Pension plans		Other post-employment benefit plans	
	2017	2016	2017	2016
Pension plan expense				
Discount rate – Current service	3.75 %	4.75 %	3.75 %	4.75 %
Discount rate – Interest expense (income), net	3.60 %	4.40 %	3.60 %	4.40 %
Rate of compensation increase	3.00 %	3.00 %	3.00 %	3.00 %
Health care cost trend rate			5.77 %	5.77 %
Life expectancy (<i>in years</i>) at 65 for a participant currently at				
Age 65				
Men	21.1	21.1	21.1	21.1
Women	23.5	23.4	23.5	23.4
Age 45				
Men	22.2	22.1	22.2	22.1
Women	24.5	24.4	24.5	24.4

NOTE 24 – EMPLOYEE BENEFITS – PENSION PLANS AND OTHER POST-EMPLOYMENT BENEFITS (cont.)

Sensitivity of Significant Assumptions for 2017

The following table shows the potential impacts of changes to key assumptions on the defined benefit obligation of the pension plans and other post-employment benefit plans as at October 31, 2017. These impacts are hypothetical and should be interpreted with caution as changes in each significant assumption may not be linear.

	Pension plans	Other post-employment benefit plans
	Change in the obligation	Change in the obligation
Impact of a 0.25% increase in the discount rate	(165)	(7)
Impact of a 0.25% decrease in the discount rate	180	8
Impact of a 0.25% increase in the rate of compensation increase	38	1
Impact of a 0.25% decrease in the rate of compensation increase	(34)	(1)
Impact of a 1.00% increase in the health care cost trend rate		9
Impact of a 1.00% decrease in the health care cost trend rate		(8)
Impact of an increase in the age of participants by one year	(96)	(2)
Impact of a decrease in the age of participants by one year	97	2

Projected Benefit Payments

Year ended October 31

	Pension plans	Other post-employment benefit plans
2018	139	10
2019	138	9
2020	139	9
2021	144	9
2022	150	9
2023 to 2027	840	43

NOTE 25 – INCOME TAXES

The Bank's income tax expense reported in the consolidated financial statements is as follows.

Year ended October 31	2017	2016
Consolidated Statement of Income		
Current taxes		
Current year	508	378
Prior period adjustments	(11)	(17)
	497	361
Deferred taxes		
Origination and reversal of temporary differences	(8)	(150)
Prior period adjustments	(5)	14
	(13)	(136)
	484	225
Consolidated Statement of Changes in Equity		
Share issuance expense and other	8	(4)
Consolidated Statement of Comprehensive Income		
Remeasurements of pension plans and other post-employment benefit plans	36	(94)
Other	(11)	(13)
	25	(107)
Income taxes	517	114

The breakdown of the income tax expense is as follows.

Year ended October 31	2017	2016
Current taxes	505	352
Deferred taxes	12	(238)
	517	114

The temporary differences and tax loss carryforwards resulting in deferred tax assets and liabilities are as follows.

	As at October 31		Year ended October 31		Year ended October 31	
	Consolidated Balance Sheet		Consolidated Statement of Income		Consolidated Statement of Comprehensive Income	
	2017	2016	2017	2016	2017	2016
Deferred tax assets						
Allowances for credit losses	151	159	(8)	54	–	–
Deferred charges	246	241	5	53	–	–
Defined benefit liability – Pension plans	69	102	–	–	(33)	88
Defined benefit liability – Other post-employment benefit plans	56	58	–	10	(2)	(2)
Deferred revenue	38	33	5	(3)	–	–
Tax loss carryforwards	24	18	6	14	–	–
Other items ⁽¹⁾⁽²⁾	61	48	(4)	(10)	8	–
	645	659	4	118	(27)	86
Deferred tax liabilities						
Premises and equipment and intangible assets	(199)	(177)	(22)	(22)	–	–
Defined benefit asset – Pension plans	(55)	(70)	16	(7)	(1)	8
Investments in associates	(25)	(43)	18	22	–	–
Other items	(27)	(24)	(3)	25	–	4
	(306)	(314)	9	18	(1)	12
Net deferred tax assets (liabilities)	339	345	13	136	(28)	98

(1) As at October 31, 2017, the Consolidated Balance Sheet amount includes \$3 million in deferred tax assets related to share issuance costs (\$4 million as at October 31, 2016) reported in *Retained earnings* on the Consolidated Statement of Changes in Equity.

(2) As at October 31, 2017, the Consolidated Balance Sheet amount includes \$6 million in deferred tax assets related to the impact of a foreign subsidiary's transition to IFRS reported in *Retained earnings*.

NOTE 25 – INCOME TAXES (cont.)

Net deferred tax assets are included in *Other assets* and net deferred tax liabilities are included in *Other liabilities*.

As at October 31	2017	2016
Deferred tax assets	374	402
Deferred tax liabilities	(35)	(57)
	339	345

According to forecasts, which are based on information available on October 31, 2017, the Bank believes that it is probable that the results of future operations will generate sufficient taxable income to utilize all the deferred tax assets before they expire.

As at October 31, 2017, the total amount of temporary differences, unused tax loss carryforwards and unused tax credits for which no deferred tax asset has been recognized was \$383 million (\$290 million as at October 31, 2016).

As at October 31, 2017, the total amount of temporary differences related to investments in subsidiaries, associates, and joint ventures for which no deferred tax liability has been recognized was \$1,057 million (\$834 million as at October 31, 2016).

The following table provides a reconciliation of the Bank's income tax rate.

Year ended October 31	2017		2016	
	\$	%	\$	%
Income before income taxes	2,508	100.0	1,481	100.0
Income taxes at Canadian statutory income tax rate	670	26.7	400	27.0
Reduction in income tax rate due to				
Tax-exempt income from securities	(178)	(7.1)	(168)	(11.3)
Non-taxable portion of capital gains	(2)	(0.1)	–	–
Tax rates of subsidiaries, foreign entities and associates	1	0.1	3	0.2
Other items	(7)	(0.3)	(10)	(0.7)
	(186)	(7.4)	(175)	(11.8)
Income taxes reported in the Consolidated Statement of Income and effective income tax rate	484	19.3	225	15.2

Notice of Assessment

In March 2017, the Canada Revenue Agency (CRA) issued a proposed reassessment to the Bank for the 2011 and 2012 taxation years. In May 2017, the CRA reassessed the Bank for the 2012 taxation year. The transactions to which the proposed reassessment and the actual reassessment relate are similar to those prospectively addressed by the synthetic equity arrangement rules introduced in the 2015 Canadian federal budget. The proposed reassessment and the actual reassessment (including estimated provincial income taxes and interest) total approximately \$173 million. The CRA may issue reassessments to the Bank in respect of similar activities for fiscal years subsequent to 2012. The Bank is confident that its tax position was appropriate and intends to vigorously defend its position. As a result, no amount has been recognized in the consolidated financial statements as at October 31, 2017.

NOTE 26 – 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 the redemption of preferred shares.

Year ended October 31	2017	2016
Basic earnings per share		
Net income attributable to the Bank's shareholders	1,940	1,181
Dividends on preferred shares	85	61
Premium paid on preferred shares redeemed for cancellation	–	3
Net income attributable to common shareholders	1,855	1,117
Weighted average basic number of common shares outstanding (<i>thousands</i>)	340,809	337,460
Basic earnings per share (<i>dollars</i>)	5.44	3.31
Diluted earnings per share		
Net income attributable to common shareholders	1,855	1,117
Weighted average basic number of common shares outstanding (<i>thousands</i>)	340,809	337,460
Adjustment to average number of common shares (<i>thousands</i>)		
Stock options ⁽¹⁾	3,962	2,435
Weighted average diluted number of common shares outstanding (<i>thousands</i>)	344,771	339,895
Diluted earnings per share (<i>dollars</i>)	5.38	3.29

- (1) For the year ended October 31, 2017, as the exercise price of the options was lower than the average price of the Bank's common shares, no option was excluded from the diluted earnings per share calculation. For the year ended October 31, 2016, the calculation of the diluted earnings per share had excluded an average number of 5,730,365 options outstanding with a weighted average exercise price of \$46.55, as the exercise price of these options was greater than the average price of the Bank's common shares.

NOTE 27 – 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 is presented in the following table.

As at October 31	2017	2016
Letters of guarantee	3,847	3,125
Backstop liquidity, credit enhancement facilities and other	5,049	5,969
Securities lending	1,293	982

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, 2017 and 2016, no amount has been recorded on the Consolidated Balance Sheet with respect to these letters of guarantee.

Backstop Liquidity and Credit Enhancement Facilities

Facilities to 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. The Bank provides backstop liquidity facilities to these multi-seller conduits. As at October 31, 2017, the notional amount of the global-style backstop liquidity facilities totalled \$2.7 billion (\$2.9 billion as at October 31, 2016), 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, even if there is no 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.

The Bank also provides 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, 2017 and 2016, the committed notional value for these facilities was \$30 million. 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, i.e., \$2.7 billion as at October 31, 2017 (\$2.9 billion as at October 31, 2016). As at October 31, 2017, the Bank held \$6 million (\$4 million as at October 31, 2016) of this commercial paper and, consequently, the maximum potential amount of future payments was \$2.7 billion (\$2.9 billion as at October 31, 2016).

CDCC Overnight Liquidity Facility

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, 2017, the notional amount of the overnight uncommitted liquidity facility amounted to \$2.3 billion (\$2.3 billion as at October 31, 2016). As at October 31, 2017 and 2016, no amount had been drawn.

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 securities lending agreements.

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, 2017 and 2016, 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 (MAV)

Margin Funding Facility

During fiscal 2017, given the repayment of the restructured notes, the Bank ceased its commitment to contribute to the margin funding facility of the MAV conduits. As at October 31, 2016, the Bank had committed to contribute \$800 million to a margin funding facility related to the MAV conduits in order to finance potential collateral calls, and no amount had been advanced.

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	2017	2016
Letters of guarantee ⁽¹⁾	3,847	3,125
Documentary letters of credit ⁽²⁾	137	136
Credit card receivables ⁽³⁾	7,688	7,187
Commitments to extend credit ⁽³⁾	52,391	47,815

(1) See the Letters of Guarantee heading on page 184.

(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.

Financial Assets Received as Collateral

As at October 31, 2017, the fair value of financial assets received as collateral that the Bank was authorized to sell or repledge was \$92.2 billion (\$71.3 billion as at October 31, 2016). These financial assets received as collateral consist of securities related to securities financing and derivative transactions as well as securities purchased under reverse repurchase agreements and securities borrowed.

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 \$77 million as at October 31, 2017 (\$37 million as at October 31, 2016).

NOTE 27 – GUARANTEES, COMMITMENTS AND CONTINGENT LIABILITIES (cont.)

Pledged Assets

In the normal course of business, the Bank pledges securities and other assets as collateral. A breakdown of encumbered 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	2017	2016
Assets pledged to		
Bank of Canada	502	–
Direct clearing organizations ⁽¹⁾	1,358	563
Assets pledged in relation to		
Derivative financial instrument transactions	1,330	2,419
Borrowing, securities lending and securities sold under reverse repurchase agreements	40,693	43,390
Securitization transactions	23,151	23,457
Covered bonds ⁽²⁾	7,668	7,296
Other	126	125
Total	74,828	77,250

(1) Includes assets pledged as collateral for Large Value Transfer System (LVTS) activities.

(2) The Bank has a covered bond program. For additional information, see Notes 13 and 28.

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. The recent developments in the main legal proceeding involving the Bank are as follows:

Watson

In 2011, a class action was filed in the Supreme Court of British Columbia against Visa Corporation Canada (Visa), MasterCard International Incorporated (MasterCard) as well as National Bank and a number of other financial institutions. The plaintiff is alleging that the credit card networks and financial institutions engaged in a price-fixing system to increase or maintain the fees paid by merchants on Visa and MasterCard transactions. In so doing, they would have been in breach of the *Competition Act*. An unspecified amount of compensatory and punitive damages is being claimed. During the year ended October 31, 2017, the Bank entered into an agreement-in-principle with the plaintiffs in order to settle this dispute in the five jurisdictions where the class action was filed. This agreement is subject to the approval of the Court in each of those jurisdictions.

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 28 – STRUCTURED ENTITIES

A structured entity is an entity created to accomplish a narrow and well-defined objective and is designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate solely to administrative tasks and the relevant activities are directed by means of contractual arrangements. Structured entities are assessed for consolidation in accordance with the accounting treatment described in Note 1. The Bank's maximum exposure to loss resulting from its interests in these structured entities consists primarily of the investments in these entities, the fair value of derivative financial instrument contracts entered into with them, and the backstop liquidity and credit enhancement facilities granted to certain structured entities.

In the normal course of business, the Bank may enter into financing transactions with third-party structured entities, including commercial loans, reverse repurchase agreements, prime brokerage margin lending, and similar collateralized lending transactions. While such transactions expose the Bank to the counterparty credit risk of the structured entities, this exposure is mitigated by the collateral related to these transactions. The Bank typically has neither power nor significant variable returns resulting from financing transactions with structured entities and does not consolidate such entities. Financing transactions with third-party-sponsored structured entities are included in the Bank's consolidated financial statements and are not included in the table accompanying this note.

Non-Consolidated Structured Entities

Multi-Seller Conduits

The Bank administers multi-seller conduits that purchase financial assets from clients and finance those purchases by issuing commercial paper backed by the assets acquired. Clients use these multi-seller conduits to diversify their funding sources and reduce borrowing costs, while continuing to manage 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 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 27. The Bank has concluded derivative financial instrument contracts with these conduits, the fair value of which is presented on the Bank's Consolidated Balance Sheet. Although the Bank has the ability to direct the relevant activities of these conduits, it cannot use its power to affect the amount of the returns it obtains, as it acts as an agent. Consequently, the Bank does not control these conduits and does not consolidate them.

Master Asset Vehicles (MAV)

The MAVs are structured entities created for the purpose of grouping the restructured notes stemming from asset-backed commercial paper held by Canadian corporate investors. The Bank held economic interests in MAVs in the form of restructured notes and the margin funding facility. The Bank did not have the ability to direct the relevant activities of the MAVs. Consequently, it did not control these MAVs and did not consolidate them. During fiscal 2017, the restructured notes were repaid and the Bank ceased its commitment to contribute to the margin funding facility of the MAV conduits.

Investment Funds

The Bank enters into derivative or other financial instrument contracts with third parties to provide them with the desired exposure to certain investment funds. The Bank economically hedges the risks related to these derivatives by investing in those investment funds. The Bank can also hold economic interests in certain investment funds as part of its investing activities. The Bank does not control the funds where its holdings are not significant as in these circumstances, the Bank either acts only as an agent or does not have any power over the relevant activities. In both cases, it does not have significant exposure to the variable returns of the funds. Therefore, the Bank does not consolidate these funds.

Private 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. Consequently, it does not control these companies and does not consolidate them.

Asset-Backed Structured Entities

The Bank invested in certain asset-backed structured entities. The underlying assets consist of residential mortgages, consumer loans, equipment loans and leases. The Bank does not have the ability to direct the relevant activities of these structured entities and has no exposure to their variable returns, other than the right to receive interest income and dividend income from its investments. Consequently, the Bank does not control these structured entities and does not consolidate them.

NOTE 28 – STRUCTURED ENTITIES (cont.)

The following table presents the carrying amounts of the assets and liabilities relating to the Bank's interests in non-consolidated structured entities, the Bank's maximum exposure to loss from these interests, as well as the total assets of these structured entities. The structured entity Canada Housing Trust is not presented. For additional information, see Note 8.

	As at October 31, 2017				
	Multi-seller conduits ⁽¹⁾	Master asset vehicles ⁽²⁾	Investment funds ⁽³⁾	Private investments ⁽⁴⁾	Asset-backed structured entities ⁽⁵⁾
Assets on the Consolidated Balance Sheet					
Securities at fair value through profit or loss	6	–	29	–	–
Available-for-sale securities	–	–	29	70	–
Held-to-maturity securities	–	–	–	–	1,306
	6	–	58	70	1,306
As at October 31, 2016	10	619	86	97	503
Liabilities on the Consolidated Balance Sheet					
Derivative financial instruments	13	–	–	–	–
	13	–	–	–	–
As at October 31, 2016	–	–	–	–	–
Maximum exposure to loss					
Securities	6	–	58	70	1,306
Liquidity, credit enhancement facilities and commitments	2,721	–	–	–	216
	2,727	–	58	70	1,522
As at October 31, 2016	2,883	1,419	86	97	503
Total assets of the structured entities					
As at October 31, 2016	2,912	–	303	2,650	813

- (1) The main underlying assets, located in Canada, are residential mortgages, automobile loans, automobile inventory financings, and other receivables. As at October 31, 2017, the notional committed amount of the global-style liquidity facilities totalled \$2.7 billion (\$2.9 billion as at October 31, 2016), 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, 2016). The maximum exposure to loss cannot exceed the amount of commercial paper outstanding. As at October 31, 2017, the Bank held \$6 million in commercial paper (\$4 million as at October 31, 2016) and, consequently, the maximum potential amount of future payments as at October 31, 2017 is limited to \$2.7 billion (\$2.9 billion as at October 31, 2016), which represents the undrawn liquidity and credit enhancement facilities.
- (2) As at October 31, 2017, the carrying value of the restructured notes of the master asset vehicle (MAV) conduits and of the other restructured notes held by the Bank was nil (\$619 million as at October 31, 2016). The change in the carrying value of the restructured notes of the MAV conduits during the year ended October 31, 2017 was mainly attributable to capital repayments. During fiscal 2017, given the repayment of the restructured notes, the Bank ceased its commitment to contribute to the margin funding facility of the MAV conduits. The undrawn margin funding facility stood at \$800 million as at October 31, 2016.
- (3) The underlying assets are various financial instruments and are presented on a net asset basis. Certain investment funds are in a trading portfolio.
- (4) The underlying assets are private investments. The amount of total assets of the structured entities corresponds to the amount for the most recent available period.
- (5) The underlying assets are residential mortgages, consumer loans, equipment loans and leases.

Consolidated Structured Entities

Securitization Entity for the Bank's Credit Card Receivables

In April 2015, the Bank set up Canadian Credit Card Trust II (CCCT II) to continue its credit card securitization program on a revolving basis and to use the entity for capital management and funding purposes.

The Bank provides first-loss protection against the losses since it retains the excess spread from the portfolio of sold receivables. The excess spread represents the residual net interest income after all the expenses related to this structure have been paid. The Bank also provides second-loss protection as it holds subordinated notes issued by CCCT II. In addition, the Bank acts as an administrative agent and servicer and as such is responsible for the daily administration and management of CCCT II's credit card receivables. The Bank therefore has the ability to direct the relevant activities of CCCT II and can exercise its power to affect the amount of returns it obtains. Consequently, the Bank controls CCCT II and consolidates it.

Investment Funds

The Bank enters into derivative or other financial instrument contracts with third parties to provide them with the desired exposure to certain investment funds. The Bank economically hedges the risks related to these derivatives by investing in those investment funds. The Bank can also hold economic interests in certain investment funds as part of its investing activities. The Bank controls the relevant activities of these funds through its involvement as an investor and its significant exposure to their variable returns. Therefore, the Bank consolidates these funds.

Covered Bonds

NBC Covered Bond Guarantor (Legislative) Limited Partnership

In December 2013, the Bank established the covered bond legislative program under which covered bonds are issued. It therefore created NBC Covered Bond Guarantor (Legislative) Limited Partnership (the Guarantor) to guarantee payment of the principal and interest owed to the bondholders. The Bank sold uninsured residential mortgages to the Guarantor and granted it loans to facilitate the acquisition of these assets. The Bank acts as manager of the partnership and has decision-making authority over its relevant activities in accordance with the contractual terms governing the covered bond legislative program. In addition, the Bank is able, in accordance with the contractual terms governing the covered bond legislative program, to affect the variable returns of the partnership, which are directly related to the return on the mortgage loan portfolio and the interest on the loans from the Bank. Consequently, the Bank controls the partnership and consolidates it.

NBC Asset Trust

The Bank created NBC Asset Trust for its funding and capital management needs. The securities issued by this trust constitute 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. For additional information, see Note 20. The issuance proceeds were used to acquire, from the Bank, 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 more than 90 days past due. The Bank also manages day-to-day operations and 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. Therefore, the Bank has the ability to direct the relevant activities of NBC Asset Trust and can use its power to affect the amount of returns it obtains. Consequently, the Bank controls this trust and consolidates it.

Third-Party Structured Entities

In 2015, the Bank, through one of its subsidiaries, acquired interests in portions of a third-party structured entity. Each portion of the structured entity is a deemed separate entity since all of the following criteria are met: 1) specified assets of the entity are the only source of payment for specified liabilities of (or specified other interests in) the entity; 2) parties other than those with the specified liabilities do not have rights or obligations related to the specified assets or to residual cash flows from those assets. The Bank controls and therefore consolidates the deemed separate entities, as it has the ability to direct their relevant activities through its kick-out rights over the servicer of their assets and because it is also exposed to the variability of their returns.

The following table presents the Bank's investments and other assets in the consolidated structured entities as well as the total assets of these entities.

As at October 31	2017		2016	
	Investments and other assets	Total assets ⁽¹⁾	Investments and other assets	Total assets ⁽¹⁾
Consolidated structured entities				
Securitization entity for the Bank's credit card receivables ⁽²⁾⁽³⁾	863	1,784	343	1,882
Investment funds ⁽⁴⁾	205	217	156	199
Covered bonds ⁽⁵⁾	15,605	15,891	13,908	14,176
Building ⁽⁶⁾	61	54	66	59
NBC Asset Trust ⁽⁷⁾	1,350	2,122	1,350	2,121
Third-party structured entities ⁽⁸⁾	74	74	867	867
	18,158	20,142	16,690	19,304

- (1) There are restrictions that stem mainly from regulatory requirements, corporate or securities laws and contractual arrangements that limit the ability of certain consolidated structured entities to transfer funds to the Bank.
- (2) The underlying assets are credit card receivables.
- (3) The Bank's investment is presented net of third-party holdings.
- (4) The underlying assets are various financial instruments and are presented on a net asset basis. Certain investment funds are in a trading portfolio.
- (5) The underlying assets are uninsured residential mortgage loans of the Bank. The average maturity of these underlying assets is three years. As at October 31, 2017, the total amount of transferred mortgage loans was \$15.6 billion (\$13.9 billion as at October 31, 2016), and the total amount of covered bonds of \$7.0 billion was recognized in *Deposits* on the Consolidated Balance Sheet (\$6.7 billion as at October 31, 2016). For additional information, see Note 13.
- (6) The underlying asset is a building located in Canada.
- (7) The underlying assets are insured and uninsured residential mortgage loans of the Bank. As at October 31, 2017, insured loans amounted to \$82 million (\$148 million as at October 31, 2016). The average maturity of the underlying assets is two years. For additional information, see Note 20.
- (8) The underlying assets consist of equipment leased under operating leases.

NOTE 29 – 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, i.e., 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.
- The Bank's pension plans (for additional information, see Note 24).

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.

Related Party Transactions

As at October 31

	Key officers and directors ⁽¹⁾		Related entities	
	2017	2016 ⁽²⁾	2017	2016
Assets				
Mortgage loans and other loans ⁽³⁾	30	34	364 ⁽⁴⁾	789 ⁽⁴⁾
Other	–	–	21	43
Liabilities				
Deposits	43	38	789 ⁽⁵⁾	628 ⁽⁵⁾
Other	–	–	23	19

(1) As at October 31, 2017, key officers, directors and their immediate family members were holding \$46 million of the Bank's common and preferred shares (\$29 million as at October 31, 2016).

(2) For the year ended October 31, 2016, certain amounts have been revised from those previously reported.

(3) The Bank did not record any allowance or provisions for credit losses in fiscal years 2017 and 2016.

(4) As at October 31, 2017, mortgage loans and other loans consisted of: (i) \$28 million in loans to the Bank's associates and joint ventures (\$190 million as at October 31, 2016), and (ii) \$336 million in loans to entities whose key officers, directors and their immediate family members exercise control or significant influence through significant voting power (\$599 million as at October 31, 2016).

(5) As at October 31, 2017, deposits consisted of: (i) \$285 million in deposits from the Bank's associates and joint ventures (\$321 million as at October 31, 2016) and (ii) \$504 million in deposits from entities whose key officers, directors and their immediate family members exercise control or significant influence through significant voting power (\$307 million as at October 31, 2016).

The contractual 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. The Bank also offers a deferred stock unit plan to directors who are not Bank employees. For additional information, see Notes 9, 23 and 28.

Compensation of Key Officers and Directors

Year ended October 31

	2017	2016
Compensation and other short-term and long-term benefits	24	19
Share-based payments	21	19

Principal Subsidiaries of the Bank⁽¹⁾

As at October 31, 2017				
Name	Business activity	Principal office address	Voting shares ⁽²⁾	Investment at cost
Canada and United States				
National Bank Acquisition Holding Inc.	Holding company	Montreal, Canada	100%	772
National Bank Group Inc.	Holding company	Montreal, Canada	100%	
National Bank Financial Inc.	Investment dealer	Montreal, Canada	100%	
NBCN Inc.	Investment dealer	Toronto, Canada	100%	
National Bank Financial Ltd.	Investment dealer	Montreal, Canada	100%	
NBF International Holdings Inc.	Holding company	Montreal, Canada	100%	
Credigy International Holdings Inc.	Holding company	Montreal, Canada	80%	
National Bank of Canada Financial Group Inc.	Holding company	New York, NY, United States	100%	
Credigy Ltd.	Holding company	Atlanta, GA, United States	80%	
National Bank of Canada Financial Inc.	Investment dealer	New York, NY, United States	100%	
National Bank Life Insurance Company	Insurance	Montreal, Canada	100%	
Natcan Trust Company	Trustee	Montreal, Canada	100%	238
National Bank Trust Inc.	Trustee	Montreal, Canada	100%	195
National Bank Realty Inc.	Real estate	Montreal, Canada	100%	13
National Bank Investments Inc.	Mutual funds dealer	Montreal, Canada	100%	585
National Bank Direct Brokerage Inc.	Investment dealer	Montreal, Canada	100%	38
NatBC Holding Corporation	Holding company	Hollywood, FL, United States	100%	31
Natbank, National Association	Banking	Hollywood, FL, United States	100%	
Other countries				
Natcan Global Holdings Ltd.	Holding company	Sliema, Malta	100%	22
NBC Global Finance Limited	Investment services	Dublin, Ireland	100%	
NBC Financial Markets Asia Limited	Investment dealer	Hong Kong, China	100%	5
Advanced Bank of Asia Limited	Commercial bank	Phnom Penh, Cambodia	90%	283
ATA IT Ltd.	Information technology	Bangkok, Thailand	100%	3

(1) Excluding consolidated structured entities. See Note 28.

(2) The Bank's percentage of voting rights in these subsidiaries.

NOTE 30 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS

The Bank is exposed to credit risk, market risk, liquidity risk and financing risk. The Bank's objectives, policies and procedures for managing risk and the risk measurement methods are presented in the Risk Management section of the MD&A for the year ended October 31, 2017. Text in grey shading and tables identified with an asterisk (*) in the Risk Management section of the MD&A are an integral part of these consolidated financial statements.

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, 2017 and 2016. 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 information technology services. Most of the lease commitments are related to operating leases.

NOTE 30 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Assets

	As at October 31, 2017									
	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	6,181	534	23	1	1	4	–	–	2,058	8,802
Securities										
At fair value through profit or loss	467	1,182	931	1,623	909	3,413	8,166	4,502	26,343	47,536
Available-for-sale	–	67	19	29	30	419	3,973	3,496	519	8,552
Held-to-maturity	25	–	–	–	603	388	7,181	1,058	–	9,255
	492	1,249	950	1,652	1,542	4,220	19,320	9,056	26,862	65,343
Securities purchased under reverse repurchase agreements and securities borrowed	8,235	2,717	1,534	129	19	3,677	770	–	3,708	20,789
Loans and acceptances⁽¹⁾										
Residential mortgage	758	1,039	1,428	2,735	2,046	7,944	33,029	1,525	14	50,518
Personal and credit card	227	343	550	873	680	2,893	9,557	2,779	19,061	36,963
Business and government	7,576	2,493	2,014	2,192	1,840	4,636	9,946	2,718	8,275	41,690
Customers' liability under acceptances	5,030	865	96	–	–	–	–	–	–	5,991
Allowances for credit losses									(719)	(719)
	13,591	4,740	4,088	5,800	4,566	15,473	52,532	7,022	26,631	134,443
Other										
Derivative financial instruments	546	861	402	255	180	903	2,070	3,177	29	8,423
Purchased receivables									2,014	2,014
Investments in associates and joint ventures									631	631
Premises and equipment									558	558
Goodwill									1,409	1,409
Intangible assets									1,239	1,239
Other assets ⁽¹⁾	381	109	71	85	36	83	79	109	1,223	2,176
	927	970	473	340	216	986	2,149	3,286	7,103	16,450
	29,426	10,210	7,068	7,922	6,344	24,360	74,771	19,364	66,362	245,827

(1) Amounts collectible on demand are considered to have no specified maturity.

Liabilities, Equity and Off-Balance-Sheet Commitments

	As at October 31, 2017									
	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	944	1,829	2,410	2,083	2,578	4,641	8,463	2,255	28,516	53,719
Business and government	10,689	5,744	6,423	2,539	2,032	7,762	10,601	4,843	46,938	97,571
Deposit-taking institutions	2,252	495	134	–	–	–	–	53	2,447	5,381
	13,885	8,068	8,967	4,622	4,610	12,403	19,064	7,151	77,901	156,671
Other										
Acceptances	5,030	865	96	–	–	–	–	–	–	5,991
Obligations related to securities sold short ⁽³⁾	1,243	472	259	118	99	578	6,147	4,553	1,894	15,363
Obligations related to securities sold under repurchase agreements and securities loaned	5,652	932	3,049	3,315	–	–	–	–	8,819	21,767
Derivative financial instruments	408	919	448	303	255	826	1,541	1,906	6	6,612
Liabilities related to transferred receivables ⁽⁴⁾	–	1,873	448	1,081	–	3,486	9,272	3,938	–	20,098
Securitization – Credit card ⁽⁵⁾	–	–	–	–	–	36	873	–	–	909
Other liabilities – Other items ⁽¹⁾⁽⁵⁾	327	85	231	55	51	75	130	163	3,732	4,849
	12,660	5,146	4,531	4,872	405	5,001	17,963	10,560	14,451	75,589
Subordinated debt	–	–	–	–	–	–	–	9	–	9
Equity									13,558	13,558
	26,545	13,214	13,498	9,494	5,015	17,404	37,027	17,720	105,910	245,827
Off-balance-sheet commitments										
Letters of guarantee and documentary letters of credit	240	848	648	906	408	892	40	2	–	3,984
Credit card receivables ⁽⁶⁾	–	–	–	–	–	–	–	–	7,688	7,688
Backstop liquidity and credit enhancement facilities ⁽⁷⁾	–	2,736	2,298	15	–	–	–	–	–	5,049
Commitments to extend credit ⁽⁸⁾	3,841	3,532	3,214	4,100	3,303	3,584	6,730	124	23,963	52,391
Lease commitments and other contracts	79	147	199	195	190	676	1,431	425	–	3,342

(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 are 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) In the event of payment on one of the backstop liquidity facilities, the Bank will receive as collateral government bonds in an amount up to \$2.3 billion.

(8) These amounts include \$39.6 billion that is unconditionally revocable at the Bank's discretion at any time.

NOTE 30 – MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Assets

	As at October 31, 2016									
	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	5,487	199	21	22	7	–	–	–	2,447	8,183
Securities										
At fair value through profit or loss	1,066	1,207	2,646	702	935	4,800	7,864	5,641	21,103	45,964
Available-for-sale	108	177	134	76	63	365	7,553	5,580	552	14,608
Held-to-maturity	–	–	–	–	472	30	3,263	204	–	3,969
	1,174	1,384	2,780	778	1,470	5,195	18,680	11,425	21,655	64,541
Securities purchased under reverse repurchase agreements and securities borrowed	4,842	2,320	2,846	1,532	10	456	–	–	1,942	13,948
Loans and acceptances⁽¹⁾										
Residential mortgage	874	1,155	1,607	2,389	1,839	7,764	32,034	1,193	13	48,868
Personal and credit card	873	413	592	724	570	2,235	8,797	2,041	17,719	33,964
Business and government Customers' liability under acceptances	6,266	2,116	1,937	2,321	1,731	4,684	8,578	2,275	7,778	37,686
Allowances for credit losses	5,633	718	90	–	–	–	–	–	–	6,441
									(781)	(781)
	13,646	4,402	4,226	5,434	4,140	14,683	49,409	5,509	24,729	126,178
Other										
Derivative financial instruments	569	730	457	293	219	838	2,628	4,682	–	10,416
Purchased receivables									1,858	1,858
Investments in associates and joint ventures									645	645
Premises and equipment									1,338	1,338
Goodwill									1,412	1,412
Intangible assets									1,140	1,140
Other assets ⁽¹⁾⁽²⁾	294	122	71	77	92	123	90	125	1,553	2,547
	863	852	528	370	311	961	2,718	4,807	7,946	19,356
	26,012	9,157	10,401	8,136	5,938	21,295	70,807	21,741	58,719	232,206

(1) Amounts collectible on demand are considered to have no specified maturity.

(2) The *Due from clients, dealers and brokers* amount of \$843 million presented separately on the Consolidated Balance Sheet as at October 31, 2016 is now reported in *Other assets*.

Liabilities, Equity and Off-Balance-Sheet Commitments

	As at October 31, 2016									
	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 ⁽³⁾	978	1,905	2,827	1,824	1,499	4,448	9,208	1,776	28,056	52,521
Business and government ⁽³⁾⁽⁴⁾	9,493	4,210	4,591	1,981	3,419	5,880	9,012	6,343	38,976	83,905
Deposit-taking institutions ⁽³⁾	3,466	222	310	31	7	–	–	61	1,543	5,640
	13,937	6,337	7,728	3,836	4,925	10,328	18,220	8,180	68,575	142,066
Other										
Acceptances	5,631	719	91	–	–	–	–	–	–	6,441
Obligations related to securities sold short ⁽⁵⁾	84	201	50	41	53	586	4,652	5,629	2,911	14,207
Obligations related to securities sold under repurchase agreements and securities loaned	11,992	1,505	3,555	4,260	–	–	–	–	1,324	22,636
Derivative financial instruments	661	693	486	303	182	740	1,608	3,052	–	7,725
Liabilities related to transferred receivables ⁽⁶⁾	–	1,341	324	1,107	548	2,465	9,795	4,551	–	20,131
Securitization – Credit card ⁽⁷⁾	424	–	–	–	–	–	873	–	–	1,297
Other liabilities – Other items ⁽³⁾⁽⁴⁾⁽⁷⁾	470	296	127	19	77	43	88	197	3,272	4,589
	19,262	4,755	4,633	5,730	860	3,834	17,016	13,429	7,507	77,026
Subordinated debt	–	–	1,003	–	–	–	–	9	–	1,012
Equity									12,102	12,102
	33,199	11,092	13,364	9,566	5,785	14,162	35,236	21,618	88,184	232,206
Off-balance-sheet commitments										
Letters of guarantee and documentary letters of credit	145	614	288	286	282	693	741	212	–	3,261
Credit card receivables ⁽⁸⁾	–	–	–	–	–	–	–	–	7,187	7,187
Backstop liquidity and credit enhancement facilities ⁽⁹⁾	–	2,056	3,898	15	–	–	–	–	–	5,969
Commitments to extend credit ⁽¹⁰⁾	1,149	1,293	1,012	1,927	1,685	8,525	10,565	550	21,109	47,815
Lease commitments and other contracts	87	169	243	236	221	718	1,526	520	–	3,720

(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) Certain amounts have been revised from those previously reported.

(4) An amount of \$2,699 million reported in *Due to clients, dealers and brokers* on the Consolidated Balance Sheet as at October 31, 2016 is now reported in *Deposits – Business and government* (\$2,159 million) and in *Other liabilities – Other items* (\$540 million).

(5) Amounts have been disclosed according to the remaining contractual maturity of the underlying security.

(6) These amounts mainly include liabilities related to the securitization of mortgage loans.

(7) The *Other liabilities* item is presented in greater detail than it is on the Consolidated Balance Sheet.

(8) These amounts are unconditionally revocable at the Bank's discretion at any time.

(9) In the event of payment on one of the backstop liquidity facilities, the Bank will receive as collateral government bonds in an amount up to \$2.3 billion.

(10) These amounts include \$21.1 billion that is unconditionally revocable at the Bank's discretion at any time.

NOTE 31 – 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 presents the sensitivity of the Bank's Consolidated Balance Sheet items to interest rate fluctuations.

As at October 31							2017	2016
	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	1,149	6,797	–	–	–	856	8,802	8,183
Effective yield		0.9 %	– %	– %	– %			
Securities	1,706	2,782	3,992	21,170	8,838	26,855	65,343	64,541
Effective yield		0.9 %	1.5 %	1.6 %	2.6 %			
Loans and acceptances, net of allowances ⁽¹⁾	54,831	36,357	16,391	41,636	2,303	3,714	155,232	140,126
Effective yield		1.7 %	2.9 %	2.8 %	7.1 %			
Other	8,620	–	–	–	–	7,830	16,450	19,356
	66,306	45,936	20,383	62,806	11,141	39,255	245,827	232,206
Liabilities and equity								
Deposits ⁽²⁾	61,201	28,773	16,659	28,313	3,374	18,351	156,671	142,066
Effective yield		1.2 %	1.5 %	1.7 %	0.5 %			
Obligations related to securities sold short and related to securities sold under repurchase agreements and securities loaned	7,562	8,279	5,870	6,719	4,504	4,196	37,130	36,843
Effective yield		1.3 %	1.5 %	1.5 %	2.4 %			
Subordinated debt	–	–	–	–	9	–	9	1,012
Effective yield		– %	– %	– %	1.5 %			
Acceptances and other liabilities ⁽²⁾	11,675	6,478	695	8,585	3,801	7,225	38,459	40,183
Equity	–	200	–	1,450	400	11,508	13,558	12,102
	80,438	43,730	23,224	45,067	12,088	41,280	245,827	232,206
On-balance-sheet gap	(14,132)	2,206	(2,841)	17,739	(947)	(2,025)	–	–
Position in Canadian dollars	(4,972)	6,415	4,034	21,618	(1,832)	(11,843)	13,420	7,505
Position in foreign currency	(9,160)	(4,209)	(6,875)	(3,879)	885	9,818	(13,420)	(7,505)
On-balance-sheet gap	(14,132)	2,206	(2,841)	17,739	(947)	(2,025)	–	–

(1) Includes securities purchased under reverse repurchase agreements and securities borrowed.

(2) Certain amounts have been revised from those previously reported, particularly an amount of \$2,159 million, representing amounts due to clients, dealers and brokers, classified in the *Other liabilities* item of this table as at October 31, 2016 that is now reported in *Deposits*.

The effective yield represents the weighted average effective yield based on the earlier of contractual repricing and maturity dates.

NOTE 32 – SEGMENT DISCLOSURES

The Bank carries out its activities in four business segments, which are defined below. For presentation purposes, other activities are grouped in the *Other* heading. Each reportable segment is distinguished by services offered, type of clientele and marketing strategy.

The presentation of segment disclosures is consistent with the presentation adopted by the Bank for the fiscal year beginning November 1, 2016. This presentation reflects the fact that the activities of subsidiary Credigy Ltd., which had previously been presented in the Financial Markets segment, and that the activities of subsidiary Advanced Bank of Asia Limited (ABA Bank) and of other international investments, which had previously been presented in the *Other* heading, are now presented in the U.S. Specialty Finance and International (USSF&I) segment. The Bank made this change to better align the monitoring of its activities with its management structure.

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 large and mid-size corporations, public sector organizations, and institutional investors. The segment is also active in proprietary trading and investment activities for the Bank.

U.S. Specialty Finance and International (USSF&I)

The USSF&I segment encompasses the specialty finance expertise provided by subsidiary Credigy Ltd.; the activities of subsidiary ABA Bank, which offers financial products and services to individuals and businesses in Cambodia; and the activities of targeted investments in certain emerging markets.

Other

This heading encompasses Treasury activities, including the Bank's asset and liability management, liquidity management and funding operations, certain non-recurring items and the unallocated portion of corporate services.

The segment disclosures have been prepared in accordance with the accounting policies described in Note 1, except for the net interest income, non-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 business segment 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.

NOTE 32 – SEGMENT DISCLOSURES (cont.)

Results by Business Segment

Year ended October 31⁽¹⁾

	Personal and Commercial		Wealth Management		Financial Markets		USSF&I		Other		Total	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Net interest income ⁽²⁾	2,071	1,955	431	372	782	938	262	71	(314)	(344)	3,232	2,992
Non-interest income ⁽²⁾	990	945	1,173	1,069	848	375	279	340	87	119	3,377	2,848
Total revenues	3,061	2,900	1,604	1,441	1,630	1,313	541	411	(227)	(225)	6,609	5,840
Non-interest expenses	1,646	1,662	1,036	999	658	615	225	207	292	392	3,857	3,875
Contribution	1,415	1,238	568	442	972	698	316	204	(519)	(617)	2,752	1,965
Provisions for credit losses ⁽³⁾	153	475	3	5	–	–	48	4	40	–	244	484
Income before income taxes (recovery)	1,262	763	565	437	972	698	268	200	(559)	(617)	2,508	1,481
Income taxes (recovery) ⁽²⁾	337	206	149	116	260	213	84	53	(346)	(363)	484	225
Net income	925	557	416	321	712	485	184	147	(213)	(254)	2,024	1,256
Non-controlling interests	–	–	–	–	–	–	29	20	55	55	84	75
Net income attributable to the Bank's shareholders	925	557	416	321	712	485	155	127	(268)	(309)	1,940	1,181
Average assets	96,261	92,234	11,652	11,006	95,004	87,504	7,519	5,319	37,915	39,850	248,351	235,913

- (1) For the year ended October 31, 2016, certain amounts have been revised from those previously reported, particularly in the Personal and Commercial segment, where an amount of \$36 million reported in *Non-interest income* was reclassified to *Net interest income*.
- (2) For the year ended October 31, 2017, *Net interest income* was grossed up by \$209 million (\$231 million in 2016), *Non-interest income* was grossed up by \$35 million (\$4 million in 2016), and an equivalent amount was recognized in *Income taxes (recovery)*. The effect of these adjustments is reversed under the *Other* heading.
- (3) During the year ended October 31, 2017, the Bank reversed, by \$40 million, the sectoral provision on non-impaired loans recorded for the oil and gas producer and service company loan portfolio presented in the Personal and Commercial segment, and the \$40 million in provisions for credit losses in the *Other* heading reflects an increase in the collective allowance for credit risk on non-impaired loans. For the year ended October 31, 2016, the *Provisions for credit losses* item had included a \$250 million sectoral provision on non-impaired loans recorded for the oil and gas producer and service company loan portfolio, reported in the Personal and Commercial segment.

Results by Geographic Segment

Year ended October 31

	Canada		United States		Other		Total	
	2017	2016	2017	2016	2017	2016	2017	2016
Net interest income ⁽¹⁾	2,748	2,839	255	110	229	43	3,232	2,992
Non-interest income ⁽¹⁾	2,992	2,430	340	337	45	81	3,377	2,848
Total revenues	5,740	5,269	595	447	274	124	6,609	5,840
Non-interest expenses	3,571	3,601	209	235	77	39	3,857	3,875
Contribution	2,169	1,668	386	212	197	85	2,752	1,965
Provisions for credit losses	196	480	44	4	4	–	244	484
Income before income taxes	1,973	1,188	342	208	193	85	2,508	1,481
Income taxes	354	162	107	56	23	7	484	225
Net income	1,619	1,026	235	152	170	78	2,024	1,256
Non-controlling interests	61	57	23	18	–	–	84	75
Net income attributable to the Bank's shareholders	1,558	969	212	134	170	78	1,940	1,181
Average assets	212,946	209,414	18,479	18,325	16,926	8,174	248,351	235,913

- (1) For the year ended October 31, 2016, certain amounts have been revised from those previously reported, particularly an amount of \$36 million reported in *Non-interest income* was reclassified to *Net interest income* to better reflect the nature of the income.

NOTE 33 – ACQUISITION

Acquisition of Advanced Bank of Asia Limited

On May 16, 2016, the Bank completed the acquisition of Advanced Bank of Asia Limited (ABA Bank), a major Cambodian financial institution that offers financial products and services to individuals and businesses. This acquisition is part of the Bank's international growth strategy and, upon completion, brought the Bank's common share equity interest in ABA Bank to 90%. The sum of the \$119 million cash purchase price, of the fair value of the previously held interest, and of the estimated value of the non-controlling interest established at the acquisition date exceeded the fair value of the net assets acquired by \$129 million. This excess amount was recorded on the Consolidated Balance Sheet as goodwill and mainly represents ABA Bank's expected business growth in Cambodia. The goodwill from this acquisition was not deductible for tax purposes. The acquired receivables, consisting mainly of personal and commercial loans, had an estimated acquisition-date fair value of \$754 million. This amount also represents the gross contractual amounts receivable that the Bank expects to fully recover.

During the year ended October 31, 2016, the Bank also recognized a \$41 million non-taxable gain on the revaluation of its previously held equity interest in ABA Bank in the *Non-interest income – Other* item of the Consolidated Statement of Income. For business segment disclosure purposes, this gain and ABA Bank's financial results have been included in the USSF&I segment. ABA Bank's results have been consolidated in the Bank's financial statements since May 17, 2016.

NOTE 34 – EVENT AFTER THE CONSOLIDATED BALANCE SHEET DATE

Redemption of Preferred Shares

On November 15, 2017, the Bank redeemed all the issued and outstanding Non-Cumulative 5-Year Rate-Reset Series 28 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 redeemed 8,000,000 Series 28 preferred shares for a total amount of \$200 million, which will reduce *Preferred share capital*.
