**Glossary**

**Acceptances**  
A bill of exchange or negotiable instrument drawn by the borrower for payment at maturity and accepted by a bank. The acceptance constitutes a guarantee of payment by the bank and can be traded in the money market. The bank earns a “stamping fee” for providing this guarantee.

**Allowance for credit losses**  
The amount deemed adequate by management to absorb identified and probable credit related losses in the portfolio of loans, acceptances, guarantees, letters of credit, deposits with other banks and derivatives. The allowance is increased by the provision for credit losses, which is charged to income and decreased by the amount of charge-offs (write-offs in Canadian GAAP), net of recoveries.

**Assets under administration (AUA)**  
Assets administered by a financial institution which are beneficially owned by clients and are therefore not reported on the consolidated balance sheet. Services provided in respect of assets under administration include the selection of investments and the provision of investment advice. Assets under management may also be administered by the financial institution.

**Basis point (bp)**  
One one-hundredth of a percentage point (.01%).

**Beta**  
The measure of a security’s volatility relative to a market index.

**Canadian GAAP**  
Canadian generally accepted accounting principles.

**Capital ratio (Canadian basis)**  
The percentage of risk-adjusted assets supported by capital using the guidelines of the Superintendent of Financial Institutions Canada based on standards issued by the Bank for International Settlements and Canadian GAAP financial information.

**Capital ratio (U.S. basis)**  
The percentage of risk-adjusted assets supported by capital using the guidelines issued to U.S. banks by the Board of Governors of the Federal Reserve System and U.S. GAAP financial information.

**Commercial clients**  
Generally, mid-market private companies with sophisticated financial needs (e.g., financing requirements between $5 million and $100 million), served by our RBC Banking segment. Large corporations with a frequent need to access capital markets and greater financing requirements are served by RBC Capital Markets.

**Commitments to extend credit**  
Credit facilities available to clients either in the form of loans, bankers’ acceptances and other on-balance sheet financing, or through off-balance sheet products such as guarantees and letters of credit.

**Cost of capital**  
Management’s estimate of its weighted average cost of equity and debt capital.

**Derivative**  
A derivative is a contract whose value is “derived” from interest rates, foreign exchange rates, or equity or commodity prices. Use of derivatives allows for the transfer, modification or reduction of current or expected risks, including interest rate, foreign exchange and other market risks. The most common types of derivatives include interest rate and cross currency swaps, foreign exchange forward contracts, foreign currency and interest rate futures, forward rate agreements, and foreign currency and interest rate options. Derivatives can be transacted either through organized exchanges or over-the-counter agreements.

**Dividend payout ratio**  
Common dividends as a percentage of net income after preferred share dividends.

**Dividend yield**  
Dividends per common share divided by the average of the high and low share prices.

**Documentary and commercial letters of credit**  
Written undertakings by a bank on behalf of its client (typically an importer), authorizing a third party (e.g., an exporter) to draw drafts on the bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

**Earnings per share, basic**  
Net income less preferred share dividends divided by the average number of shares outstanding.

**Earnings per share (EPS), diluted**  
Net income less preferred share dividends divided by the average number of shares outstanding adjusted for the dilutive effects of stock options and other convertible securities.

**Economic Capital (EC)**  
EC is an estimate of the amount of equity capital required to underpin risks. It is calculated by estimating the level of capital that is necessary to support our various businesses, given their risks, consistent with our desired solvency standard and credit ratings.

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

**Efficiency ratio**  
Non-interest expenses expressed as a percentage of gross revenue (i.e., net interest income and non-interest revenue). Used as a measure of productivity and for comparison with peers.

**Foreign exchange spot and forward contract**  
A foreign exchange forward contract, which is a type of derivative, is a commitment to buy or sell a fixed amount of foreign currency on a future specified date at a set rate of exchange. A foreign exchange spot contract is a commitment to buy or sell a fixed amount of foreign currency for delivery within two business days of the contract date.

**Forward rate agreement (FRA)**  
A contract which obliges two parties to make a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional amount.

**Futures**  
A contract which creates an obligation to buy or sell a foreign currency or a financial instrument on a future date at a specified price established on a commodity exchange.

**Goodwill/Amortization of goodwill**  
Goodwill represents the excess of the price paid for the acquisition of subsidiaries over the fair value of the net assets acquired, and up to the end of 2001, was amortized over appropriate periods of up to 20 years, except where a writedown was required to reflect permanent impairment. Effective November 1, 2001, as a result of a change in accounting standards, goodwill is no longer amortized but is tested for impairment at a reporting unit level on a periodic basis.

**Guarantees and standby letters of credit**  
Primarily represent irrevocable assurances that a bank will make payments in the event that its client cannot meet its financial obligations to third parties. Certain other guarantees, such as bid and performance bonds, represent non-financial undertakings.

**Net income less preferred share dividends divided by the average number of shares outstanding.**  
Calculated by the amount of charge-offs (write-offs in Canadian GAAP), net of recoveries.

**Non-interest expenses expressed as a percentage of gross revenue (i.e., net interest income and non-interest revenue).**  
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Hedge
A risk management technique used to insulate financial results from market, interest rate or foreign currency exchange risk (exposure) arising from normal banking operations. The elimination or reduction of such exposure is accomplished by establishing offsetting positions. For example, assets denominated in foreign currencies can be offset with liabilities in the same currencies or through the use of foreign exchange hedging instruments such as futures, options or foreign exchange contracts.

International
In the context of the annual report, the term international refers to Royal Bank of Canada’s operations and clients outside of Canada.

Mark-to-market
Valuation at market rates, as of the balance sheet date, of securities and derivatives held for trading purposes.

Net interest income
The difference between what is earned on assets such as loans and securities and what is paid on liabilities such as deposits and subordinated debentures.

Net interest margin
Net taxable equivalent interest income divided by average interest-earning assets. It is a measure of how effectively a corporation utilizes its earning assets in relation to its sources of funding.

Nonaccrual loans/Impaired loans
Loans are classified as nonaccrual (impaired in Canadian GAAP) when, in the opinion of management, there is no longer reasonable assurance of the timely collection of principal and interest. Loans, other than credit card balances and government guaranteed loans, are automatically classified as nonaccrual when a payment is 90 days past due, unless the loan is well secured and in the process of collection.

Notional amount
The contract amount used as a reference point to calculate payments for derivatives.

Off-balance sheet financial instrument
A variety of products offered to clients which fall into two broad categories: (i) credit related arrangements which generally provide clients with liquidity protection, and (ii) derivatives, which are defined on the previous page.

Operating efficiency ratio
Operating non-interest expenses as a percentage of operating revenues.

Operating non-interest expenses
Non-interest expenses excluding special items, costs of Stock Appreciation Rights and certain acquisition expenses such as retention compensation.

Operating revenues
Revenues excluding special items.

Options (foreign currency, interest rate)
A contract in which the writer grants the purchaser the right, but not the obligation, either to buy (call option) or sell (put option) at or by a set date a set amount of foreign currency or a financial instrument at a set price.

Prepaid pension costs
The cumulative excess of amounts contributed to a pension fund over the amounts recorded as pension expense.

 Provision for credit loss
The amount charged to income necessary to bring the allowance for credit losses to a level determined appropriate by management.

 Repurchase agreements (REPOS)
Involve the sale of securities for cash at a near value date and the simultaneous repurchase of the securities for value at a later date.

Return on equity (ROE)
Net income, less preferred share dividends, expressed as a percentage of average common equity.

Reverse repurchase agreements
(reverse REPOS)
Involve the purchase of securities for cash at a near value date and the simultaneous sale of the securities for value at a later date.

Risk
Financial institutions face a number of different risks that expose them to possible losses. These risks include credit risk, market risk, liquidity risk, insurance risk and operational risk.

Risk-adjusted assets
Used in the calculation of risk-based capital ratios. The face value of assets is discounted using risk-weighting factors in order to reflect a comparable risk per dollar among all types of assets. The risk inherent in off-balance sheet instruments is also recognized, first by adjusting notional values to balance sheet (or credit) equivalents, and then by applying appropriate risk-weighting factors.

Securities lending
Transactions in which a bank acts as an agent for the owner of a security, who agrees to lend the security under the terms of a pre-arranged contract to a borrower for a fee. The borrower must fully collateralize the security loan at all times. There are two types of securities lending arrangements, lending with and without credit or market risk indemnification. In securities lending without indemnification, the bank bears no risk of loss. For transactions in which the bank provides an indemnification, risk of loss occurs if the borrower defaults and the value of the collateral declines concurrently.

Securities sold short
A transaction in which the seller sells securities it does not own. The seller borrows the securities in order to deliver them to the purchaser. At a later date, the seller buys identical securities in the market to replace the borrowed securities.

Securitization
The process by which high-quality assets, mainly loans or mortgages, are pooled into standardized securities backed by these assets, which can be traded.

Special items
Items that are viewed by management as items that do not arise as part of normal day-to-day business operations or that are unusual in nature and could potentially distort the calculation of trends analyzed by management.

Special purpose entities (SPEs)
SPEs are entities that are typically organized for a single discrete purpose, have a limited life and serve to legally isolate the financial assets held by the SPE from the selling organization. SPEs are principally used to securitize financial and other assets in order to obtain access to funding, to mitigate credit risk and to manage capital.

Stock Appreciation Rights (SARs)
Rights attached to stock options, which can be exchanged for a cash amount equal to the difference between the exercise price and the closing price of common shares on the day immediately preceding the day of exercise.

Superintendent of Financial Institutions (OSFI)
The primary regulator of federally chartered financial institutions and federally administered pension plans in Canada. OSFI’s mission is to safeguard policyholders, depositors and pension plan members from undue loss.

Swaps (foreign currency, interest rate)
Contracts which oblige two parties to exchange currencies and/or the related interest flows (e.g., fixed-rate for floating-rate) on a specified notional amount for a specified period.

Taxable equivalent adjustment
An additional interest income in order to gross up the tax-exempt income earned on certain securities (primarily loan substitute securities) to an amount which, had it been taxable at the statutory rate, would result in the same after-tax net income as appears in the financial statements. The gross-up of such income to a taxable equivalent basis permits a uniform measurement and comparison of net interest income.

Trust Capital Securities (RBC TruCS)
A form of innovative Tier 1 capital which is reported as a non-controlling interest in a subsidiary on the consolidated balance sheet.

 U.S. GAAP
U.S. generally accepted accounting principles.

Value-at-risk (VAR)
A generally accepted risk-measurement concept that uses statistical models to estimate within a given level of confidence the maximum loss in market value that the bank would experience in its trading portfolios from an adverse one-day movement in market rates and prices.