

# Financial review

## > Canadian GAAP

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### Caution regarding forward-looking statements

From time to time, we make written and oral forward-looking statements within the meaning of certain securities laws, included in this Annual Report, in other filings with Canadian regulators or the United States Securities and Exchange Commission, in reports to shareholders and in other communications. These forward-looking statements include, among others, statements with respect to our objectives for 2005, our medium- and long-term goals, and our strategies to achieve those objectives and goals, as well as statements with respect to our beliefs, plans, objectives, expectations, anticipations, estimates and intentions. The words “may,” “could,” “should,” “would,” “suspect,” “outlook,” “believe,” “plan,” “anticipate,” “estimate,” “expect,” “intend,” and words and expressions of similar import are intended to identify forward-looking statements.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution readers not to place undue reliance on these statements as a number of important factors could cause our actual results to differ materially from the beliefs, plans, objectives, expectations, anticipations, estimates and intentions expressed in such forward-looking statements. These factors include, but are not limited to, the strength of the Canadian and United States economies and economies of other countries in which we conduct business; the impact of the movement of the Canadian dollar relative to other currencies, particularly the U.S. dollar; the effects of changes in monetary policy, including changes in interest rate policies of the Bank of Canada and the Board of Governors of the

Federal Reserve System in the United States; the effects of competition in the markets in which we operate; the impact of changes in the laws and regulations regulating financial services and the enforcement thereof (including banking, insurance and securities); judicial or regulatory judgments and legal proceedings; our ability to obtain accurate and complete information from or on behalf of our customers and counterparties; our ability to successfully realign our organizational structure, resources and processes; our ability to complete strategic acquisitions and to integrate our acquisitions successfully; the changes in accounting policies and methods we use to report our financial condition, including uncertainties associated with critical accounting assumptions and estimates; operational and infrastructure risks; and other factors that may affect future results including changes in trade policies, timely development and introduction of new products and services, changes in tax laws, technological changes, unexpected changes in consumer spending and saving habits, the possible impact on our businesses of international conflicts and other developments including those relating to the war on terrorism, and our anticipation of and success in managing the foregoing risks.

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

## > MANAGEMENT'S DISCUSSION AND ANALYSIS

This portion of the Annual Report provides a discussion and analysis of our financial condition and results of operations, so as to enable a reader to assess material changes in financial condition and results of operations for the 12 months ended October 31, 2004, compared to those of the 12 months ended October 31, 2003 and 2002. The consolidated financial statements prepared in accordance with Canadian generally accepted accounting principles (GAAP) are on pages 74A to 114A.

Our fiscal year-end is October 31. This management's discussion and analysis is dated December 20, 2004. All dollar amounts are in Canadian dollars, unless otherwise specified.

Additional information relating to Royal Bank of Canada, including our 2004 Annual Information Form, is available free of charge on our website at [rbc.com](http://rbc.com), on the Canadian Securities Administrators' website at [sedar.com](http://sedar.com) and on the EDGAR section of the United States Securities and Exchange Commission's website at [sec.gov](http://sec.gov).

### Business overview

Royal Bank of Canada is a diversified global financial service group and a leading provider of personal and commercial banking, investment and trust services, insurance, corporate and investment banking, online banking, and transaction-based services including custody. Royal Bank of Canada operates under the masterbrand RBC Financial Group and for the fiscal year ended October 31, 2004, had five major business segments: RBC Banking (personal and commercial banking), RBC Investments (wealth management), RBC Insurance (insurance), RBC Capital Markets (corporate and investment banking) and RBC Global Services (securities custody and transaction processing). Royal Bank of Canada serves more than 12 million personal, business and public sector clients worldwide from offices in more than 30 countries.

Effective November 1, 2004, we realigned our organizational structure, resources and processes to serve our clients better and more efficiently across all of our businesses, find new ways to generate stronger revenue growth, and streamline our organization and processes for faster decision-making, quicker implementation and better productivity. As part of the realignment, our five prior business

segments were realigned into three segments structured around client needs and geographic location: (1) a Canadian personal and business segment, which combines our Canadian banking, investments and global insurance businesses, including Canadian, U.S. and international insurance operations; (2) a U.S. and international segment, which includes banking and investments in the U.S., banking and brokerage in the Caribbean, and Global Private Banking internationally; and (3) a global capital markets segment that includes corporate banking, which serves corporate and larger commercial clients.

We are integrating all our systems and operating capabilities in a global technology and operations group. In the fourth quarter, we eliminated a number of executive and senior management positions, commenced streamlining resources and took action to close redundant premises. We expect the majority of the remaining staff and occupancy cost reductions to be completed during 2005. The more complex technology initiatives will likely yield results in 2006 and 2007.

We will begin reporting our financial results under our new structure in the first quarter of 2005. We believe that as a result of the realignment, we will record better expense control and revenue growth performance in Canada and the United States and, accordingly, have established more aggressive financial objectives in these areas for 2005.

For much of 2005, our outlook is for steady interest rates in Canada and rising interest rates in the United States. We look for economic growth in the United States to ease to around 3.7% in 2005, after an estimated 4.4% pace in 2004. In Canada we expect a slight acceleration into the 3% range, after estimated growth of 2.7% in 2004. Overall, the global economy has entered a period of slower, more sustainable growth following robust expansion, which should have a favourable impact on our loan, deposit and revenue growth and the performance of our loan portfolio. The Canadian dollar equivalent of the company's U.S. dollar-denominated revenues, expenses and net income in 2004 were lowered relative to 2003 by the weaker U.S. dollar. The continued appreciation of the Canadian dollar relative to the U.S. dollar would reduce the translated value of our U.S. dollar-denominated revenues, expenses and earnings in 2005 compared to those in 2004.

## FINANCIAL OVERVIEW

As shown in the table below, net income in 2004 decreased \$188 million or 6% from 2003. This largely reflected a \$700 million increase in non-interest expenses (including a \$406 million increase in human resources expenses and the Cooperatieve Centrale Raiffeisen-Boerenleenbank (Rabobank) settlement costs in the first quarter), business realignment charges of \$192 million, a goodwill impairment charge of \$130 million and

a \$55 million decline in the translated value of the U.S. dollar-denominated earnings due to the strengthening of the Canadian dollar relative to the U.S. dollar. These factors more than offset the benefits of a \$703 million increase in revenues, a \$375 million decline in the provision for credit losses and a lower income tax expense.

**Table 1 Financial overview**

(C\$ millions, except per share data and percentage amounts)	2004	2003	2002	2004 vs 2003 Increase (decrease)	
Total revenues	\$ 18,121	\$ 17,418	\$ 17,255	\$ 703	4%
Non-interest expense	11,109	10,409	10,420	700	7
Business realignment charges	192	—	—	192	n.m.
Goodwill impairment	130	—	—	130	n.m.
Provision for (recovery of) credit losses					
Specific	521	721	1,065	(200)	(28)
General	(175)	—	—	(175)	n.m.
Net income	2,817	3,005	2,762	(188)	(6)
Earnings per share (EPS) – diluted	4.23	4.39	3.93	(.16)	(4)
Return on equity (ROE)	15.6%	16.7%	15.8%		(110)bp
Tier 1 capital ratio (1)	8.9%	9.7%	9.3%		(80)bp
Total capital ratio (1)	12.4%	12.8%	12.7%		(40)bp

(1) Calculated using guidelines issued by the Superintendent of Financial Institutions Canada and Canadian GAAP financial information.  
n.m. not meaningful

Diluted earnings per share were \$4.23, down \$.16 or 4% from a year ago. This decline occurred despite a \$.09 increase due to a 2% reduction in average shares outstanding in 2004, which was offset by an \$.08 decrease due to the strengthening of the Canadian dollar relative to the U.S. dollar.

The Canadian dollar appreciated 9% relative to the U.S. dollar, averaging US\$.762 in 2004 compared to US\$.697 in 2003, which lowered our revenues, expenses and net income by \$550 million, \$345 million and \$55 million, respectively, compared to 2003. The movement of the Canadian dollar compared to currencies other than the U.S. dollar had a minimal impact on the change in our earnings compared to a year ago.

Our 2004 results were affected by a number of factors. Revenues were negatively influenced by low interest rates and competitive pricing

pressures, which compressed deposit and residential mortgage spreads, and by the appreciation of the Canadian dollar relative to the U.S. dollar compared to a year ago. However, we delivered solid loan and deposit growth as the result of ongoing marketing initiatives and product and service launches and benefited from stronger capital markets. On the expense side, we experienced higher human resources expenses (primarily higher benefit costs and higher variable compensation costs, driven by increases in revenues) and the Rabobank settlement costs, net of a related reduction in compensation. Further improvement in the credit environment and successful collection efforts resulted in lower impaired loans and a lower provision for credit losses.

As a result of the business realignment mentioned above, we recorded charges as follows:

Business realignment charges						
(C\$ millions)	Employee-related charges	Premises-related charges	Other charges	Total charges	Related income taxes	Total charges (after-tax)
RBC Banking	\$ 62	\$ 13	\$ —	\$ 75	\$ 26	\$ 49
RBC Investments	17	—	—	17	6	11
RBC Insurance	8	—	—	8	3	5
RBC Capital Markets	25	—	—	25	9	16
RBC Global Services	3	—	—	3	1	2
Other	51	—	13	64	22	42
<b>Total</b>	<b>\$ 166</b>	<b>\$ 13</b>	<b>\$ 13</b>	<b>\$ 192</b>	<b>\$ 67</b>	<b>\$ 125</b>

We have eliminated a number of executive and senior management positions, commenced streamlining resources and taken actions to close redundant premises. We took business realignment charges of \$192 million, including \$166 million of employee-related charges, and \$26 million of premises-related charges and other charges consisting entirely of professional service fees. The employee-related charge of \$166 million relates to approximately 1,660 position eliminations, largely in head office and support roles made redundant by the realignment of our five business segments into three and by the ongoing consolidation of our operations and technology platforms. About 40 staff of the approximately 1,660 positions (primarily executive and senior management staff) were notified by October 31, 2004, and the majority

of the remaining positions are expected to be eliminated in 2005. We are in the process of closing 38 of RBC Mortgage's 213 branches in the U.S., with an additional 9 RBC Mortgage branches and 10 of RBC Centura's 275 branches scheduled to be closed in 2005. While these actions reduced the year's earnings, we believe they position us for better performance in the future.

During the fourth quarter, coincident with completion of our annual goodwill impairment test, we announced our business realignment. The results of our goodwill impairment test, which was based on a discounted cash flow model, indicated that the goodwill attributable to RBC Mortgage is impaired by \$130 million. As a result, we recorded a \$130 million goodwill impairment charge.

Table 2 Results by geographic segment								
(C\$ millions)	2004				2003			
	Canada	United States	Other International	Total	Canada	United States	Other International	Total
Net interest income	\$ 5,183	\$ 1,116	\$ 394	\$ 6,693	\$ 5,128	\$ 1,210	\$ 258	\$ 6,596
Non-interest income	6,121	3,699	1,608	11,428	5,426	3,537	1,859	10,822
Total revenues	11,304	4,815	2,002	18,121	10,554	4,747	2,117	17,418
Provision for credit losses								
Specific	417	126	(22)	521	527	108	86	721
General	(74)	(65)	(36)	(175)	—	(2)	2	—
Insurance policyholder benefits, claims and acquisition expense	909	872	343	2,124	669	543	484	1,696
Non-interest expense	6,449	3,680	980	11,109	5,992	3,511	906	10,409
Business realignment charges	142	44	6	192	—	—	—	—
Goodwill impairment	—	130	—	130	—	—	—	—
Income taxes (1)	1,306	12	85	1,403	1,316	216	55	1,587
<b>Net income</b>	<b>\$ 2,155</b>	<b>\$ 16</b>	<b>\$ 646</b>	<b>\$ 2,817</b>	<b>\$ 2,050</b>	<b>\$ 371</b>	<b>\$ 584</b>	<b>\$ 3,005</b>

(1) Includes non-controlling interest in net income of subsidiaries.

Net income from Canadian operations was \$2,155 million, up \$105 million or 5% from 2003. This increase reflects loan and deposit growth in RBC Banking of 9% and 6%, respectively, significant revenue growth in Wealth Management Canada within RBC Investments of \$169 million or 14%, the acquisition of the Canadian operations of Provident Life and Accident Insurance Company (UnumProvident) by RBC Insurance, and a decline in the provision for credit losses, partially offset by higher non-interest expenses (largely benefit and variable compensation costs), and business realignment charges of \$142 million recorded in the fourth quarter of 2004.

Net income from U.S. operations was down \$355 million or 96% from a year ago to \$16 million, primarily as a result of the Rabobank settlement costs, the \$130 million goodwill impairment charge and lower mortgage origination volumes and margins at RBC Mortgage, lower returns in RBC Centura's investment portfolio, and the business realignment charges of \$44 million reported in the fourth quarter.

Other international net income was \$646 million in 2004, up \$62 million or 11% from 2003, mainly reflecting a recovery of credit losses of \$58 million compared to provisions for credit losses of \$88 million in 2003.

## Financial priorities

### Revenue growth and diversification

Total revenues were up \$703 million or 4%. The increase in revenues reflected higher insurance revenues (which now include UnumProvident), higher capital markets-related revenues other than trading (mutual fund revenues, securities brokerage commissions, underwriting and other advisory fees, investment management and custodial fees), and strong growth in loans and deposits. These factors more than offset a \$550 million reduction due to the strengthening of the Canadian dollar against the U.S. dollar and a \$169 million decline in total trading revenues (included in both net interest income and non-interest income). A detailed discussion follows on pages 42A to 45A.

### Cost control

Non-interest expense was up \$700 million or 7%, largely due to an increase in human resource expenses (primarily higher benefit costs, and higher variable compensation costs, driven by increases in revenues) and the Rabobank settlement costs, net of a related reduction in compensation. The appreciation of the Canadian dollar relative to the U.S. dollar reduced non-interest expense by \$345 million. A full discussion is provided on pages 46A to 47A.

### Strong credit quality

The provision for credit losses declined by \$375 million or 52% due to fewer new problem loans, the reversal of specific allowances reflecting the favourable resolution of a number of earlier problem loans and the reversal of \$175 million of the general allowance. Impaired loans declined by \$486 million or 28% this year due to successful collection efforts, resulting in a number of problem accounts being repaid, restructured or sold and a general improvement in the credit environment, resulting in fewer new problem loans. Detailed discussion and tables can be found on pages 48A to 56A.

### Balance sheet and capital management

Total assets were \$429.2 billion at October 31, 2004, up \$26.2 billion or 6% from October 31, 2003, reflecting higher loans and other assets. At October 31, 2004, using Superintendent of Financial Institutions Canada (OSFI) guidelines and Canadian GAAP financial information, our Tier 1 capital ratio was 8.9% and our Total capital ratio was 12.4%, both above our medium-term (three- to five-year) goals of 8–8.5% for Tier 1 capital and 11–12% for Total capital. More details are provided on pages 62A to 64A.

## Outlook

We are targeting growth in earnings per share of 20%+ and ROE of 18–20% in 2005 based on expectations of better revenue growth and expense control, stronger results in our U.S. operations and continued strength in the Canadian economy in 2005.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

### Application of critical accounting policies and estimates

Our significant accounting policies are contained in Note 1 to the consolidated financial statements on pages 79A to 84A. Certain of these policies as well as estimates made by management in applying such policies are recognized as critical because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that significantly different amounts could be reported under different conditions or using different assumptions. Our critical accounting policies and estimates relate to the allowance for credit losses, fair value of financial instruments, securitization and pensions. They have been reviewed and approved by our Audit Committee, in consultation with management, as part of their review and approval of our significant accounting policies and estimates.

### Allowance for credit losses

The allowance for credit losses represents management's estimate of probable losses incurred in our lending portfolio including loans, acceptances, letters of credit and unfunded commitments, as at the balance sheet date. The allowance for credit losses comprises three distinct components – specific, general allocated and general unallocated; each component is available to absorb losses incurred in the entire portfolio. The specific allowance is determined on an ongoing basis through management's identification and determination of losses related to impaired accounts. The general (allocated and unallocated) allowances are determined on a quarterly basis through management's assessment of probable losses in the remaining portfolio.

The process for determining the allowances involves quantitative and qualitative assessments using current and historical credit information. The process inherently requires the use of certain assumptions and judgments including (i) assessing the impaired status and/or risk

ratings of loans, (ii) estimating cash flows and collateral values, (iii) developing default and loss rates based on historical and industry data, (iv) adjusting loss rates and parameters based on the relevance of historical experience given changes in credit strategies, processes and policies, (v) assessing the current credit quality of the portfolio based on credit metric trends in relation to impairments, write-offs and recoveries, and portfolio composition and concentrations, and (vi) determining the current position in the economic and credit cycles. Changes in these assumptions or using other reasonable judgments can materially affect the allowance level and net income.

### Specific allowance

Specific allowances are established to absorb probable losses on impaired loans. Loan impairment is recognized when, based on management's judgment, there is no longer reasonable assurance that all interest and principal payments will be made in accordance with the contracted agreement.

For large business and government portfolios, which are continuously monitored, an account is classified as impaired based on our evaluation of the borrower's overall financial condition, its available resources and its propensity to pay amounts as they come due. Specific allowance is then established on individual accounts that are classified as impaired, using management's judgment relating to the timing of future cash flows including amounts that can be reasonably expected from the borrower, financially responsible guarantors or the realization of collateral. The amounts expected to be recovered are reduced by estimated collection costs and discounted at the effective interest rate of the obligation.

For homogeneous portfolios (consumer and small businesses), excluding credit cards, which are directly written off after 180 days in

arrears, accounts are classified as impaired based on contractual delinquency status, generally 90 days past due. The estimation of specific allowance on these accounts is based on formulas that apply product-specific net write-off ratios to the related impaired amounts. The net write-off ratios are based on historical loss experience, adjusted to reflect management's judgment relating to recent credit quality trends including delinquency, loss severity and portfolio composition.

#### *General allocated allowance*

The general allocated allowance is established to absorb expected losses on accounts in the lending portfolio that have not yet been specifically classified as impaired. This estimation is based on a number of assumptions including (i) the level of unidentified problem loans given current economic and business conditions, (ii) the timing of the realization of impairment, (iii) the committed amount that will be drawn when the account is classified as impaired, and (iv) the ultimate severity of loss. In determining the appropriate level of general allocated allowance, management first employs a number of statistical models using historical loss rates and parameters to estimate a range of probable losses over an economic cycle. Management then considers changes in the credit processes including underwriting, limit setting and the workout process in order to adjust historical experience to better reflect the current environment. In addition, current credit information including portfolio composition, credit quality trends and economic, business and industry information is assessed to determine the appropriate allowance level. The level is then compared to other relevant benchmarks to ensure the consistency and reasonableness of the assumptions and the allowance level.

For large business and government loans, the general allocated allowance level is estimated based on management's judgment of business and economic conditions, historical and expected loss experience, the impact of policy changes and other relevant factors. The range of loss is derived through the application of a number of loss parameters related to committed obligations. The key parameters used are probability of default (PD), loss given default (LGD) and usage given default (UGD). PDs are delineated by borrower type and risk rating, LGDs are largely based on transactional structure and client type, and UGDs are applied based on risk rating. These parameters are based on long-term historical loss experience (default migration, loss severity and exposure at default), supplemented by external studies and industry initiatives, and are updated on a regular basis. This approach allows us to generate a range of potential losses over an economic cycle, including an average "expected loss." One of the key judgmental factors that influences the loss estimate for this portfolio is the application of the internal risk rating framework, which relies on our quantitative and qualitative assessments of a borrower's financial condition in order to assign it an internal credit risk rating similar to those used by external rating agencies. As the large business and government loan portfolio is subject to a high level of volatility, management also considers single-name and sectoral concentration risk in assessing the adequacy of the allowance level. Any material change in the above parameters or assumptions would affect the range of expected credit losses and consequently may affect the general allocated allowance level.

For homogeneous loans, including residential mortgages, credit cards, and personal and small business loans, probable losses are estimated on a portfolio basis. Long-term historical net write-off experience is applied to current outstanding loans to determine a range of probable losses over an economic cycle. Management then considers the current portfolio credit quality trends, business and economic conditions, the impact of policy and process changes, and other supporting factors to determine the level of the general allocated allowance.

#### *General unallocated allowance*

The general unallocated allowance is based on management's assessment of the overall adequacy of the allowance. This assessment includes

- (i) an estimate of probable credit losses that have not been captured in the specific and general allocated allowances, due to limitations and imprecision inherent in the allocated allowance methodologies, and
- (ii) benchmarking against internal and external references.

Based on the procedures discussed above, management is of the opinion that the total allowance for credit losses of \$1,714 million is adequate to absorb estimated credit losses incurred in the lending portfolio as at October 31, 2004. This amount includes \$70 million related to letters of credit and unfunded commitments, which is classified in other liabilities. The year-over-year reduction of \$450 million largely reflects the overall improvement in the credit quality of the portfolio, as well as the reduction in exposure to problem sectors.

#### **Fair value of financial instruments**

In accordance with Canadian GAAP, certain financial instruments are carried on our balance sheet at their fair value. These financial instruments comprise securities held in our trading portfolio, obligations related to securities sold short and derivative financial instruments (excluding non-trading derivatives subject to hedge accounting). At October 31, 2004, approximately \$128 billion of our financial assets and \$67 billion of our financial liabilities were carried at fair value. Fair value is defined as the amount at which an instrument could be bought or sold in a current transaction between willing parties, other than in a forced or liquidation sale.

The fair value of the majority of the financial instruments in our portfolios is determined based on their quoted market price as it provides the best evidence of fair value. Note 23 on pages 107A to 109A provides disclosure of the estimated fair value of all our financial instruments at October 31, 2004.

If a quoted market price is not available, we use internal or external financial valuation models to estimate fair value. Where we believe the potential exists that the amount realized on sale will be less than the estimated fair value due to insufficient liquidity over a short period of time, a provision is made. We also maintain a provision for model risk, which may occur when the estimated value does not reflect the true value under certain stress market conditions. These provisions reflect varying levels of management judgment based on quantitative research and analysis.

The majority of our trading securities portfolio and obligations related to securities sold short comprise or relate to actively traded debt and equity securities, which are carried at fair value based on available quoted market prices. Where quoted market prices are not available for a particular security, the quoted market price of a security with similar characteristics and risk profile is used to estimate the fair value of the unquoted security.

For derivative financial instruments, we determine fair value using various methodologies, including quoted market prices, prevailing market values for similar instruments, net present value of future cash flows and other internal or external pricing models. As few over-the-counter (OTC) derivative financial instruments are actively quoted, we rely primarily on internally developed pricing models and established industry standard pricing models, such as Black-Scholes, to determine fair value. In determining the assumptions to be used in our pricing models, we look primarily to external readily observable market inputs including factors such as interest rate yield curves, currency rates and price and rate volatilities as applicable. However, certain derivative financial instruments are valued using significant unobservable market inputs such as default correlations, among others. These inputs are subject to significantly more quantitative analysis and management judgment. Unrealized gains and losses at inception are deferred and recognized over the term of the contract unless the fair value of the derivative financial instrument at inception is evidenced by quoted market prices, other current market transactions or observable market inputs. For further information on our derivative instruments, refer to Note 21 on pages 104A to 106A.

The following table summarizes our significant financial assets and liabilities by valuation methodology at October 31, 2004.

**Assets and liabilities carried at fair value by valuation methodology**

(C\$ millions, except percentage amounts)	Financial assets		Financial liabilities	
	Trading securities	Derivatives	Obligations related to securities sold short	Derivatives
<b>Fair value</b>	\$ 89,322	\$ 38,729	\$ 25,005	\$ 42,103
<b>Based on</b>				
Quoted market prices	87%	—%	93%	—%
Pricing models with significant observable market parameters	13	99	7	100
Pricing models with significant unobservable market parameters	—	1	—	—
	100%	100%	100%	100%

The use of methodologies, models and assumptions in pricing and valuing these financial assets and liabilities is subjective and requires varying degrees of judgment by management. The use of different methodologies, models and assumptions may result in significantly different fair values and financial results. To mitigate this risk, all significant financial valuation models are vetted by our risk management function, which is not involved in trading the assets and liabilities and is mandated to provide an independent perspective. Our internal financial valuation models for accounting are strictly controlled and regularly recalibrated, and require the approval of our risk management function. In addition, OSFI reviews our models selectively based on the risk profile of the business to ensure appropriateness of the models and validity of the assumptions used by management. Refer to the Risk management section on pages 57A to 61A and the Asset/Liability management section on pages 65A to 71A for further details on the sensitivity of financial instruments used in trading and non-trading activities, respectively.

As outlined in Note 1 on page 79A, changes in the fair value of trading securities and obligations related to securities sold short are recognized as trading revenues in non-interest income.

Changes in the fair value of our trading and non-trading derivatives that do not qualify for hedge accounting are recognized in non-interest income. Refer to Note 1 on pages 80A and 81A for further details.

**Securitization**

We periodically securitize residential mortgages, credit card receivables and commercial mortgage loans by selling them to special purpose entities (SPEs) or trusts that issue securities to investors. Some of the key accounting determinations in a securitization of our loans are whether the transfer of the loans meets the criteria required to be treated as a sale and, if so, the valuation of our retained interests in the securitized loans. A sale can be recognized if we receive consideration other than beneficial interests in the transferred loans, the transferred loans are legally isolated from our creditors, the transferee is able to sell or pledge the transferred loans and we do not maintain effective control over the transferred loans through an agreement to repurchase them or have a

right to cause the loans to be returned. When we securitize loans and retain an interest in the securitized loans it is a matter of judgment whether the loans have been legally isolated. We obtain legal opinions where required to establish legal isolation of the transferred loans. We often retain interests in securitized loans such as interest-only strips, servicing rights or cash reserve accounts. Where quoted market prices are not available, the valuation of retained interests in sold assets is based on our best estimate of several key assumptions such as the payment rate of the transferred loans, excess spread, expected credit losses and discount rate. The fair value of such retained interests calculated using these assumptions affects the gain or loss that is recognized from the sale of the loans. See Note 7 on pages 89A to 90A for the volume of securitization activity in our loans, the gain or loss recognized on sale and a sensitivity analysis of the key assumptions in valuing our retained interests. Another key accounting determination is whether the SPE that is used to securitize and sell our loans is required to be consolidated. We concluded that none of the SPEs used to securitize our financial assets should be consolidated.

**Pensions**

We sponsor a number of defined benefit and defined contribution plans providing pension and other benefits to eligible employees after retirement. These plans include statutory pension plans, supplemental pension plans and health, dental and life insurance plans. These pension plans provide benefits based on years of service, contributions and average earnings at retirement.

Due to the long-term nature of these plans, the calculation of benefit expenses and obligations depends on various assumptions such as discount rates, expected rates of return on assets, health care cost trend rates, projected salary increases, retirement age, mortality and termination rates. These assumptions are determined by management and are reviewed annually by the actuaries. Actual experience that differs from the assumed experience will affect the amounts of benefit obligation and expense. The weighted average assumptions used and the sensitivity of key assumptions are presented in Note 17 on pages 98A to 99A.

## LINE OF BUSINESS RESULTS

### Overview

Table 3 below shows our results by business segment in 2004. GAAP does not prescribe a method for allocating equity to business segments. For management and reporting purposes, we attribute common equity to our business segments (including the Other segment) based on methodologies designed to measure the equity capital necessary to underpin the risks of the businesses in each segment, as discussed in the Economic Capital section on page 58A. Common equity in excess of that required to support the risks in our five business segments is allocated to the Other segment. The capital attribution methodologies involve judgment by management, are revised from time to time with changes applied prospectively and affect measures such as business segment ROE. Furthermore, the attribution of common equity is a dynamic process and is affected by current business activity, volumes and environmental factors. Other companies may use different methodologies to allocate equity to their segments.

Average allocated common equity attributed to RBC Banking and RBC Capital Markets in 2004 was lower than a year ago. This is partially due to the decline in the translated value of U.S. dollar-denominated assets as a result of the appreciation of the Canadian dollar relative to the U.S. dollar. RBC Banking was also affected by the recalibration of credit risk portfolio rates for personal loan products, which reduced its allocated common equity, largely offset by attributions for the acquisitions of Sterling Capital Mortgage Company (Sterling) on September 30, 2003, and the Florida operations of Provident Financial Group, Inc. on November 21, 2003. The decrease in RBC Capital Markets also reflected lower credit risk, partially offset by an increase in equity attributed for higher market risk. Average allocated common equity attributed to RBC Insurance was higher, largely due to the acquisition of the Canadian operations of Provident Life and Accident Insurance Company (UnumProvident) on May 1, 2004, and to the first full year of the attribution for the acquisition of Business Men's Assurance Company of America (BMA) on May 1, 2003. Average allocated common equity attributed to RBC Investments had minimal change, while that attributed to RBC Global Services was unchanged.

Net income from RBC Banking fell to 46% of total net income from 52% last year, as net income declined 17%. ROE was 18.5% compared to 21.0% in 2003, reflecting the earnings decline. The financial performance of RBC Banking is discussed in detail on pages 30A–32A.

RBC Investments contributed 17% of our total net income. Net income grew 20% in 2004, while ROE increased 350 basis points to 18.5%. The factors contributing to the earnings improvement of RBC Investments are discussed in detail on pages 33A–34A.

We generated 9% of our total net income from RBC Insurance, which had net income growth of 19%. ROE remains strong at 23.8%. A detailed discussion of the financial performance of RBC Insurance is provided on pages 35A–37A.

Net income from RBC Capital Markets increased 23% from last year, accounting for 22% of our total net income in 2004. ROE rose to 17.7% from 13.0% last year. An analysis of the financial performance of RBC Capital Markets is provided on pages 38A–39A.

RBC Global Services generated 8% of total net income and recorded earnings growth of 27%, while ROE increased 760 basis points to 35.1% in 2004. The financial performance of RBC Global Services is discussed in detail on pages 40A–41A.

The Other segment recorded a net loss of \$70 million compared to net income of \$133 million in 2003. The decline in net income reflected a number of factors, which are discussed in detail on page 41A.

*Effective November 1, 2004, we realigned our five prior business segments into three segments structured around client needs and geographic locations: (1) a Canadian personal and business segment, which combines our Canadian banking, investments and global insurance businesses including Canadian, U.S. and international insurance operations; (2) a U.S. and international segment, which includes banking and investments in the U.S., banking and brokerage in the Caribbean, and Global Private Banking internationally; and (3) a global capital markets segment that includes corporate banking, which serves corporate and larger commercial clients. In addition, we are integrating all our systems and operating capabilities in a global technology and operations group. As the reorganization only became effective after the end of the 2004 fiscal year, the following management discussion and analysis is based on our previous structure. Further details on how businesses in each of the five segments will be reorganized under the new structure are presented in the Overview section for each segment on the pages that follow. We will begin reporting our financial results under the new structure in the first quarter of 2005.*

**Table 3 Results by business segment**

	2004						2003	
(C\$ millions, except per share and percentage amounts)	RBC Banking	RBC Investments	RBC Insurance	RBC Capital Markets	RBC Global Services	Other (1)	Total	Total
Net interest income	\$ 5,517	\$ 429	\$ –	\$ 679	\$ 177	\$ (109)	\$ 6,693	\$ 6,596
Non-interest income	2,040	3,322	2,870	2,077	887	232	11,428	10,822
Total revenues	7,557	3,751	2,870	2,756	1,064	123	18,121	17,418
Provision for credit losses								
Specific	550	4	–	8	(5)	(36)	521	721
General	(76)	–	–	(85)	(14)	–	(175)	–
Insurance policyholder benefits, claims and acquisition expense	–	–	2,124	–	–	–	2,124	1,696
Non-interest expense	4,840	3,014	487	2,017	738	13	11,109	10,409
Business realignment charges	75	17	8	25	3	64	192	–
Goodwill impairment	130	–	–	–	–	–	130	–
Income taxes	730	226	(5)	164	118	(1)	1,232	1,460
Non-controlling interest	16	–	–	2	–	153	171	127
Net income (loss)	\$ 1,292	\$ 490	\$ 256	\$ 625	\$ 224	\$ (70)	\$ 2,817	\$ 3,005
U.S. net (loss) income	(179)	118	(6)	87	8	(12)	16	371
Net income								
As a % of total	46%	17%	9%	22%	8%	(2)%	100%	100%
% growth over prior year	(17)%	20%	19%	23%	27%	(153)%	(6)%	9%
Return on common equity	18.5%	18.5%	23.8%	17.7%	35.1%	(2.6)%	15.6%	16.7%
Average allocated common equity (2)	\$ 7,000	\$ 2,600	\$ 1,050	\$ 3,500	\$ 650	\$ 3,000	\$ 17,800	\$ 17,550

(1) Represents other activities, which mainly comprise Corporate Treasury, Corporate Resources, and Information Technology.

(2) Calculated using methods intended to approximate the average of the daily balances for the period. Attributed to the segments as discussed above.

## RBC BANKING

### Overview

RBC Banking serves 11.5 million individual, small and medium-sized business, and mid-market commercial clients in Canada, the U.S., the Caribbean and the Bahamas. Our multiple distribution capabilities include a network of branches, business banking centres and other sales units, accredited financial planners, mobile sales representatives, automated banking machines, and telephone and Internet banking channels.

Drawing on our extensive distribution network and working together with other RBC businesses, we offer our clients tailored solutions and financial planning and advice based on life events and client preferences through a diverse range of financial products and services including deposit accounts, investments and mutual funds, credit and debit cards, business and personal loans, and residential and commercial mortgages.

*Effective November 1, 2004, most of the Canadian operations within RBC Banking became part of the new Canadian personal and business segment, and operations in the U.S. and the Caribbean and the Bahamas became part of the new U.S. and international segment. Larger commercial clients previously served by RBC Banking will be served by the new global capital markets segment.*

### Industry profile

In Canada, personal and commercial banking is a mature industry dominated by the five largest Canadian banks, although competition is fierce and niche players increasingly operate in select businesses such as credit cards, mortgages and deposits. The U.S. market is more fragmented, and regional markets are often highly competitive. Many banks across North America have expanded their focus to offer investment products and financial planning and advice to targeted clients. Critical success factors include providing a superior client experience, competitive products, strong revenue-focused sales processes, rigorous credit and operational risk management practices, and tight expense control.

### Our strengths

- Established Canadian retail banking brand
- Strong capabilities in Customer Relationship Management (CRM), client segmentation and specialized sales forces
- Comprehensive product, sales, service and national distribution capabilities in Canada compared to niche players
- Among Canadian banks, market leadership in client household penetration in personal markets in Canada, and lead market share in total personal deposits and mutual funds, residential mortgages, business deposits, and business financing in Canada
- Presence in U.S. retail banking

### 2005 outlook

Our business results are influenced by Canadian and U.S. economic conditions and the effects of interest rates on consumer and business loan demand, net interest margins, credit quality trends and exchange rates, particularly the value of the U.S. dollar relative to the Canadian dollar.

In Canada, based on our forecast of stable interest rates through much of 2005, we anticipate that deposit spreads could remain somewhat compressed. However, reasonable economic and accompanying loan growth should have positive overall revenue implications for our Canadian consumer business, which will be part of the Canadian personal and business segment in 2005.

For our U.S. businesses, which will be part of the U.S. and international segment in 2005, we anticipate that organic loan and deposit balance growth will contribute favourably to RBC Centura revenues. Higher U.S. interest rates expected in 2005 could reduce the volume of mortgage origination loan activity at RBC Mortgage.

Our focus on revenue growth and cost management initiatives across Canada and the U.S. should also yield favourable results.

### Financial performance

Net income from RBC Banking declined \$269 million or 17% from a year ago as an earnings decline in U.S. operations more than offset earnings growth in Canada. Earnings in Canada improved \$68 million or 5%, as revenue growth of \$160 million, lower income taxes and a \$76 million reversal of the general allowance were partially offset by a \$169 million increase in non-interest expense (largely attributable to higher benefit and other compensation costs) and \$47 million in business realignment charges. The \$179 million net loss in the U.S. operations reflects the goodwill impairment charge of \$130 million, as well as lower revenues from both RBC Centura and RBC Mortgage and \$28 million in business realignment charges. The strengthening of the Canadian dollar relative to the U.S. dollar had an unfavourable impact on RBC Banking's net income of \$6 million.

<b>Results</b>				
(C\$ millions, except percentage amounts)	% change		2004	2003
Net interest income	(1)%	\$	5,517	\$ 5,546
Non-interest income	(4)		2,040	2,127
Total revenues	(2)		7,557	7,673
Provision for credit losses				
Specific	(1)		550	554
General	n.m.		(76)	—
Total	(14)		474	554
Non-interest expense	4		4,840	4,650
Business realignment charges	n.m.		75	—
Goodwill impairment	n.m.		130	—
Net income before income taxes	(17)		2,038	2,469
Income taxes	(19)		730	900
Non-controlling interest	100		16	8
Net income	(17)%	\$	1,292	\$ 1,561
U.S. net (loss) income	(216)%	\$	(179)	\$ 154
Net income as a % of total group net income	(600)bp		46%	52%
ROE	(250)bp		18.5%	21.0%
Net interest margin (average assets)	(22)bp		3.20%	3.42%
Net interest margin (average earning assets)	(24)bp		3.38%	3.62%
Efficiency ratio (1)	340 bp		64.0%	60.6%
Average assets (2)	6%	\$	172,300	\$ 162,400
Average loans and acceptances (2)	7		158,500	147,900
Average deposits (2)	5		140,700	133,700
Average allocated common equity (2), (3)	(5)		7,000	7,350
<b>Credit information</b>				
Impaired loans	(17)	\$	507	\$ 609
Net write-offs	(6)		611	648
Net write-offs as a % of average loans and acceptances	(5)bp		.39%	.44%
<b>Number of employees</b>				
(full-time equivalent)	1%		37,884	37,475

(1) Efficiency ratio is defined in the Glossary on page 121.

(2) Calculated using methods intended to approximate the average of the daily balances for the period.

(3) Attributed to the segment as discussed on page 29A.

n.m. not meaningful



Total revenues declined \$116 million or 2% from last year, including the impact of the stronger Canadian dollar relative to the U.S. dollar, which reduced revenues by \$107 million. In Canada, revenues rose \$160 million or 3%, reflecting strong growth in loan and deposit balances and higher fee income, partly offset by a narrower net interest margin. Revenues in the U.S., however, were down \$261 million or 20% (down 13% in U.S. dollars), reflecting lower origination volumes and margins at RBC Mortgage and lower returns in RBC Centura's investment portfolio. These factors were partially offset by the inclusion of a full year of revenues for Sterling in 2004 compared to one month of revenues in 2003, and strong loan growth in RBC Centura.

Total non-interest expense increased \$190 million or 4% from a year ago, notwithstanding the favourable impact of the strengthening of the Canadian dollar relative to the U.S. dollar, which reduced expenses by \$94 million. Expenses in Canada grew \$169 million or 5%, mainly due to higher benefit costs (largely reflecting pension and postretirement

benefit expenses), and other compensation costs. In the U.S., expenses increased \$23 million or 2% (up 11% in U.S. dollars) reflecting a full year of expenses for Sterling in 2004 compared to one month of expenses in 2003, and a valuation allowance of \$33 million in the second quarter of 2004 relating to certain mortgage loans that are believed to have been fraudulently originated in 2001 and 2002. However, the increase was partially offset by the impact of the strengthening Canadian dollar relative to the U.S. dollar, which reduced expenses by \$93 million.

The provision for credit losses decreased \$80 million or 14% from last year principally due to the \$76 million reversal of the general allowance in 2004. Credit quality strengthened across the portfolio, with net write-offs as a per cent of average loans and acceptances declining 5 basis points to .39%.

ROE declined to 18.5% from 21.0% a year ago, due to lower earnings this year and despite a decrease in average allocated common equity attributed to the segment.

## REVIEW BY DIVISION

### RBC BANKING – CANADA

Operating under the RBC Royal Bank brand, we serve individuals, small and medium-sized businesses, and commercial clients in all provinces and territories. Roughly one third of Canadian households deal with Royal Bank of Canada, which is the leading financial institution in Canada in terms of household penetration.

We offer our clients extensive physical and alternative distribution choices, providing them with 24/7 access. We continue to strengthen our distribution channel capabilities, including reinvestment in our branch network and staff, and in our electronic banking capabilities. More and more of our clients are availing themselves of our online banking services (see chart below). We have also strengthened our telephone banking capabilities delivered through Royal Direct, with specialized business advisors focused on small business clients and client care officers dedicated to client problem resolution.

We offer a wide range of financial services and advice, as detailed on page 30A, and products and expertise in specialized areas such as foreign exchange, asset-based finance, leasing and automotive finance. We continue to strengthen our product lines, which include a full choice of credit card products such as our no fee RBC Rewards Visa Classic card introduced in 2004 and our increasingly popular RBC Royal Bank Visa Platinum Avion card. We provide merchants with credit and debit card acceptance services, point-of-sale capabilities and Internet-secure electronic transaction solutions through Moneris Solutions, Inc. (Moneris Solutions), a joint venture in which we participate equally with Bank of Montreal. We expanded our mortgage product offerings with the introduction in 2004 of RBC Homeline Plan, RBC Vacation Home Mortgages, and RBC No Down Payment Mortgages. Such product depth has contributed to strong volume growth in 2004 across nearly all product categories (see table at right), reinforcing our number one or number two product market share positions in Canada.

We also continue to strengthen our expertise in CRM and client segmentation, placing strong focus on targeted sub-segments such as high-growth manufacturers, professionals, business owners and "Snowbirds." We have a strong specialized sales force, which includes investment and retirement planners, financial planners, mortgage specialists and Knowledge-Based Industry and Agriculture focused account managers, among others. We are leveraging our diverse expertise to deliver strong capabilities in financial planning and advice.

### Financial performance

Total revenues rose \$160 million or 3%, as strong growth in loan and deposit balances and higher fee income were partly offset by a narrower

net interest margin. Residential mortgage, personal loan and credit card average balances all grew in excess of 10%, while non-interest income grew 5%, driven by stronger credit card revenues due to higher spending volumes and higher mutual fund revenues from capital market appreciation and stronger sales. Net interest margin narrowed 19 basis points as the low interest rate environment and competitive pricing contributed to spread compression on deposits and residential mortgages.

#### Selected highlights <sup>(1)</sup>

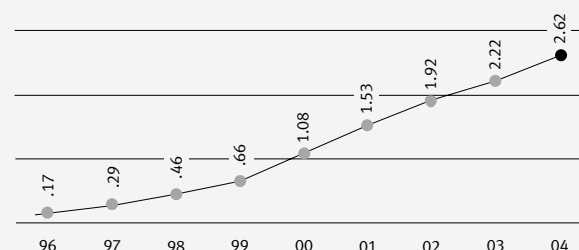
(C\$ millions, except percentage amounts)	% change	2004	2003
Total revenues	3%	\$ 6,325	\$ 6,165
Average residential mortgages <sup>(2)</sup>	11	80,300	72,600
Average personal loans	12	27,000	24,200
Average personal deposits	5	87,700	83,700
Average business loans and acceptances	2	33,900	33,300
Average business deposits	8	34,300	31,700
Average card balances	14	7,900	6,900
Card spending volumes	16	34,900	30,200
Number of:			
Employees (full-time equivalent)	1	31,244	30,865
Automated banking machines	(2)	3,999	4,062
Branches	(1)	1,098	1,104
Online banking clients	18	2,619,800	2,219,100

(1) Averages are calculated using methods intended to approximate the average of the daily balances for the period.

(2) Includes loans originated and serviced by RBC Royal Bank that have been securitized.

#### RBC Online Banking – Canada (Online banking enrollment trend)

Number of clients enrolled (millions)



## RBC BANKING – UNITED STATES

Our personal and commercial banking business in the United States is conducted through RBC Centura. Headquartered in Rocky Mount, North Carolina, RBC Centura serves individual and business clients in the Southeast United States.

In 2004, RBC Centura expanded its reach by acquiring the 13 Florida branches of Ohio-based Provident Financial Group Inc. We also opened 21 new branches in Atlanta, various locations in Florida, and other high-growth markets. We plan to further optimize our branch network by continuing to open new branches selectively in high-growth markets and also by closing 10 low-return branches in 2005. In addition, we strengthened our product capabilities, including the Home Equity Line of Credit, Homebuyer Rewards package and RBC Access USA cross-border services, and expanded our sub-segment expertise focused on health care professionals, executives, and Canadian "Snowbirds" and other cross-border clients. RBC Builder Finance, a financing division of RBC Centura serving home builders and developers, increased its new loan commitments by 39% in 2004, leveraging its 35 loan production offices serving over 90 markets across the United States.

The U.S. platform of RBC Banking also includes RBC Mortgage, a mortgage originator increasingly focused on new purchase business versus refinancings. As part of the business realignment, we are in the process of closing 38 of RBC Mortgage's 213 branches, with an additional 9 branches to be closed in 2005. In January 2005, the Chicago headquarters of RBC Mortgage will be closed and the operations transferred to its Houston office, which was the base of Sterling, acquired in September 2003.

In 2004, RBC Mortgage strengthened its loan origination processes and technology and extended its reach through new Affiliated Business Arrangements, joint ventures with home builders and realtors to provide new home mortgages directly to homebuyers.

### Financial performance

Total revenues declined \$261 million or 20% from last year. The strengthening of the Canadian dollar relative to the U.S. dollar (which reduced the translated value of revenues) accounted for \$93 million of the decline. In U.S. dollars, total revenues decreased US\$114 million or 13%, with RBC Centura and RBC Mortgage down US\$48 million or 7% and US\$66 million or 36%, respectively. Strong loan growth at RBC Centura was more than offset by lower returns in its investment portfolio due to lower yields as the portfolio was reinvested into higher-quality but lower-yielding instruments at the end of 2003. RBC Mortgage revenue was negatively affected by lower margins and an industry-wide decline in origination volumes from exceptionally high levels in 2003 when low interest rates drove a mortgage refinance boom. These declines were partially offset by the inclusion of a full year of revenues for Sterling in 2004 compared to one month of revenues in 2003.

### Selected highlights <sup>(1)</sup>

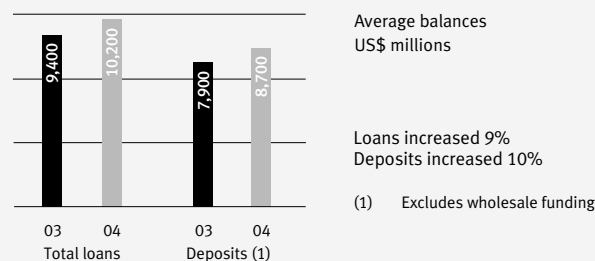
(C\$ millions, except percentage amounts)	% change	2004	2003
Total revenues	(20)%	\$ 1,024	\$ 1,285
Average residential mortgages	(10)	3,800	4,200
Average personal loans	3	3,400	3,300
Average personal deposits	—	8,000	8,000
Average business loans and acceptances	3	9,000	8,700
Average business deposits	3	6,000	5,800
Average card balances	—	100	100
Card spending volumes	—	400	400
Mortgage originations (\$ billions)	(47)	22.5	42.6
Number of:			
Employees (full-time equivalent)	—	5,430	5,444
Automated banking machines	9	304	279
Branches <sup>(2)</sup>	14	275	242
Online banking clients <sup>(3)</sup>	(33)	70,300	104,500

(1) Averages are calculated using methods intended to approximate the average of the daily balances for the period.

(2) Excludes RBC Mortgage and RBC Builder Finance sales offices.

(3) Certain inactive clients were not transferred to a new technology platform in 2004.

### RBC Centura (Loan and deposit growth)



## RBC BANKING – CARIBBEAN AND THE BAHAMAS

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

### Financial performance

Total revenues fell \$15 million or 7% from last year, due to the strengthening of the Canadian dollar relative to the U.S. dollar and certain Caribbean currencies.

### Selected highlights

(C\$ millions, except percentage amounts)	% change	2004	2003
Total revenues	(7)%	\$ 208	\$ 223
Number of:			
Employees (full-time equivalent)	4	1,210	1,166
Automated banking machines	15	69	60
Branches	—	43	43

## RBC INVESTMENTS

### Overview

RBC Investments provides wealth management services including full-service and self-directed brokerage, financial planning, investment counselling, personal trust, private banking and investment management products and services to clients in Canada, the U.S. and internationally. Products and services are delivered through the RBC Royal Bank branch network across Canada, RBC Investments offices, RBC Dain Rauscher branches in the U.S., private banking offices and other locations worldwide. Services are also delivered via the Internet and telephone.

*Effective November 1, 2004, Canadian operations within RBC Investments became part of the new Canadian personal and business segment while the U.S. and international operations became part of the new U.S. and international segment.*

### Industry profile

Wealth management remains a highly competitive business with numerous large and boutique firms serving the North American market. Volatile capital markets and the rising costs of managing the regulatory and compliance requirements of the industry continue to encourage consolidation. However, consolidation in the Canadian mutual fund industry has not significantly altered the competitive landscape as players continue to expand their distribution channels.

### Our strengths

- Relationship management capabilities resulting from experienced people and state of the art technology applications
- Ability to deliver the breadth of products and services clients need to meet their financial goals
- Multiple distribution channels for client convenience
- Close relationship to the client base and ability to draw on the diverse capabilities of RBC Financial Group
- Solutions designed for specific investment strategies and client risk tolerance

### 2005 outlook

Based on our expectation that in both Canada and the U.S., investor confidence and capital markets performance will continue to improve modestly, we expect moderate revenue growth in all of our businesses in 2005, and expense growth below that of revenue growth in light of our cost-containment efforts.

### Financial performance

Net income increased \$80 million or 20% in 2004, primarily driven by improved earnings in U.S. and Canadian brokerage and asset management businesses, as well as from Global Private Banking. These increases more than offset the effect of the strengthening of the Canadian dollar relative to the U.S. dollar in 2004, which reduced net income by \$29 million. U.S. net income was up \$31 million from a year ago, with significant growth in transaction-based and asset value based fee revenues in the full-service brokerage business and lower retention compensation costs at RBC Dain Rauscher.

Total revenues increased \$222 million or 6%, reflecting higher transaction-based and asset value based fee revenues from the U.S. and Canadian brokerages and larger asset balances in the asset management businesses. This growth more than offset the impact of the strengthening of the Canadian dollar relative to the U.S. dollar, which reduced the translated value of U.S. dollar-denominated revenues by \$188 million.

The \$102 million or 4% increase in non-interest expense largely reflected higher variable compensation costs associated with revenue growth and pension, postretirement and benefit costs. These increases were partly offset by a \$147 million reduction in the translated value of U.S. dollar-denominated expenses due to the stronger Canadian dollar, and a \$32 million decline in retention compensation costs at RBC Dain Rauscher.

ROE improved 350 basis points to 18.5%, reflecting higher earnings in 2004.

<b>Results</b>				
(C\$ millions, except percentage amounts)	% change	2004	2003	
Net interest income	2%	\$ 429	\$ 419	
Non-interest income	7	3,322	3,110	
Total revenues	6	3,751	3,529	
Provision for credit losses				
Specific	n.m.	4	(2)	
Total	n.m.	4	(2)	
Non-interest expense	4	3,014	2,912	
Business realignment charges	n.m.	17	–	
Net income before income taxes	16	716	619	
Income taxes	8	226	209	
Net income	20%	\$ 490	\$ 410	
U.S. net income	36%	\$ 118	\$ 87	
Net income as a % of total group net income	300 bp	17%	14%	
ROE	350 bp	18.5%	15.0%	
Average allocated common equity (1)	(2)%	2,600	2,650	
Number of employees (full-time equivalent)	3%	10,748	10,464	

(1) Calculated using methods intended to approximate the average of the daily balances for the period. Attributed to the segment as discussed on page 29A.

n.m. not meaningful

## REVIEW BY DIVISION – RBC INVESTMENTS

## CANADA

**Wealth Management Canada**

This group includes Dominion Securities (full-service brokerage) and Action Direct (self-directed brokerage), which serve investors requiring advisor-based comprehensive financial solutions and self-managed investors, respectively. Services are provided by over 1,320 investment advisors and 115 investment representatives, as well as via telephone and the Internet. Additionally, within this group, Private Counsel, Trust Services and Private Banking serve high net worth clients across Canada, offering a relationship management approach for clients in need of sophisticated financial solutions. There are more than 25 investment counsellors, 65 trust officers and 50 private bankers in locations across the country. Financial Planning serves more than 381,000 branch-based clients with over \$56 billion in investment and credit balances. There are approximately 1,000 relationship financial planners and more than 480 commission-based investment and retirement planners who are financial planners and also licensed mutual fund salespeople. Financial Planning and Private Banking are businesses operated jointly with RBC Banking, and RBC Investments reports the financial results from its share of these businesses within Wealth Management Canada.

**Global Asset Management**

This unit is responsible for our proprietary asset management business in Canada and the United States. In Canada, RBC Asset Management directly manages more than \$49 billion of assets in mutual and pooled funds as well as other client assets. We provide proprietary and externally managed investment management products and advisory services through RBC Royal Bank, RBC Investments' distribution businesses and external distributors to private and institutional clients in Canada and worldwide. Our family of mutual funds and other pooled products encompasses a broad range of investment solutions including money market, fixed income and balanced funds and Canadian, U.S. and global equity funds, as well as alternative investments. RBC Asset Management enjoyed industry-leading total and long-term net sales in 2004 resulting from strong relative investment performance, improved client retention by RBC Royal Bank and RBC Investments Financial Planning, and support for RBC Funds in the advisory (broker and independent financial planner) channel, which contributed to continued gains in market share. In the U.S., Voyager Asset Management achieved a record US\$25 billion in assets under management (AUM) as at October 31, 2004.

## UNITED STATES

**RBC Dain Rauscher**

Minneapolis-based RBC Dain Rauscher is ranked as the eighth-largest full-service securities firm in the U.S., based on number of financial consultants. We have over 1,750 financial consultants serving individual clients from coast to coast and a fixed income business with more than 375 investment bankers, sales representatives and traders serving institutional and retail clients nationwide. In addition, we have a clearing and execution services group that serves small to mid-sized independent broker-dealers and institutions.

## INTERNATIONAL

**Global Private Banking**

Operating under the brand name Royal Bank of Canada Global Private Banking, this division provides private banking, trust, investment management and investment advisory solutions to high net worth clients in more than 100 countries from 24 offices around the world. Focused on clients with assets of more than US\$1 million, Global Private Banking provides an integrated offering based on the foundations of strong personal relationships, expertise, advice and choice.

**Financial performance by division**

Higher transaction-based and asset value based fee revenues largely drove the \$169 million or 14% increase in revenues from the wealth management businesses in Canada, reflecting a strong Canadian registered retirement savings plan (RRSP) season in 2004 and the benefits of market appreciation. Global Asset Management revenues were higher as a result of strong sales and capital appreciation in mutual funds and managed portfolios. RBC Dain Rauscher revenues increased \$15 million or 1% despite the strengthening of the Canadian dollar relative to the U.S. dollar, as performance in both its full-service brokerage and fixed income businesses improved. Global Private Banking revenues grew \$11 million mainly due to stronger brokerage activities.

The assets under administration (AUA) of the wealth management businesses in Canada improved 8% from 2003 as a result of capital market appreciation early in 2004 as well as strong sales. RBC Dain Rauscher's AUA balance grew 5% in 2004 as a result of market appreciation, which more than offset the strengthening of the Canadian dollar relative to the U.S. dollar, which reduced the translated value of U.S. dollar-denominated assets. In U.S. dollars, RBC Dain Rauscher's AUA increased US\$14 billion or 14%. Global Private Banking's personal AUA was also affected by the stronger Canadian dollar, which lowered the translated value of U.S. dollar-denominated assets. Institutional AUA declined 33% primarily due to the loss of a large client in the second quarter of 2004.

Higher AUM balances were primarily a result of strong mutual fund sales and capital market appreciation. During the year, \$1 billion of personal AUM was transferred to AUA due to a change in client strategy.

<b>Total revenues</b>			
(C\$ millions, except percentage amounts)	% change	2004	2003
RBC Dain Rauscher	1%	\$ 1,628	\$ 1,613
Wealth Management Canada	14	1,339	1,170
Global Private Banking	3	421	410
Global Asset Management	7	363	340
Other	n.m.	–	(4)
	6%	\$ 3,751	\$ 3,529

n.m. not meaningful

<b>Assets under administration (AUA)</b>			
(C\$ millions, except percentage amounts)	% change	2004	2003
Personal			
Wealth Management Canada	8%	\$ 147,585	\$ 136,910
RBC Dain Rauscher	5	135,070	128,150
Global Private Banking	1	50,320	49,590
	6	332,975	314,650
Institutional – Global Private Banking	(33)	52,170	77,520
	(2)%	\$ 385,145	\$ 392,170

<b>Assets under management (AUM)</b>			
(C\$ millions, except percentage amounts)	% change	2004	2003
Mutual funds	9%	\$ 57,520	\$ 52,620
Institutional	3	20,220	19,690
Personal	(10)	15,240	17,010
	4%	\$ 92,980	\$ 89,320

## RBC INSURANCE

### Overview

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

*Effective November 1, 2004, our global insurance businesses, which include Canadian, U.S. and international operations, became part of the new Canadian personal and business segment.*

### Industry profile

The Canadian life insurance industry is dominated by three large Canadian companies and generates almost \$50 billion in premiums annually. The property and casualty market in Canada is more fragmented. The U.S. life insurance industry, in which our U.S. business is focused, is both competitive and fragmented and includes almost 1,200 national and regional companies. The U.S. travel insurance industry, which continues to be a growth market for RBC Insurance, is estimated to be worth more than US\$500 million in premiums and is served by a small number of companies. The international reinsurance industry continues to be dominated by several global players but also includes a number of smaller and niche companies.

Key industry trends that continue to affect the insurance sector include ongoing consolidation, further convergence of banking, insurance and investment products, increased government regulation and oversight as well as the impact of technology. In addition, consumer product preferences are shifting to reflect demographic and economic changes and are also creating new distribution opportunities.

### Our strengths

- A diverse set of products designed to meet a wide range of consumer needs
- Market leadership in a number of Canadian insurance markets, including travel and individual living benefits insurance
- Multiple distribution channels, which are supported by strong infrastructure and sales expertise
- Access, as part of RBC Financial Group, to a broad range of distribution channels, client bases and financial services as well as the benefit of a strong brand and infrastructure
- An integrated global insurance operation

### 2005 outlook

Performance in our business is influenced by our policyholder claims experience, geopolitical events, the general economic and interest rate environment, and credit risk considerations related to our investment portfolios. Our outlook is for revenue growth to continue, driven by demographic trends, reasonable economic growth in Canada and the U.S., and new products and markets with a particular focus on wealth management and living benefits solutions. We will also focus on opportunities for efficiencies from integrating insurance operations with RBC's Canadian retail businesses as well as increased opportunities in the Canadian group and living benefits markets, as a result of our acquisition in May 2004 of UnumProvident, a subsidiary of UnumProvident Corporation.

### Financial performance

Net income was up \$40 million or 19% from a year ago, reflecting higher earnings from the Canadian life and health operations (which now include UnumProvident), the home and auto business and the U.S. operations. Despite growth in the reinsurance operations, earnings from this business were relatively unchanged from last year, as a result of higher claims costs in the property reinsurance business associated with the recent hurricanes in the Southeast United States and the Caribbean.

As of August 1, 2004, the acquired business of UnumProvident, which consists predominantly of living benefits products for individuals and groups, has been integrated with the existing Canadian life and health operations.

Our 2003 results included a significant block of reinsurance business that was not renewed in 2004. This block of business contributed \$182 million to total revenues and \$183 million to policyholder benefits, claims and acquisition expenses, reducing net income by \$1 million in 2003.

<b>Results</b>				
(C\$ millions, except percentage amounts)	% change	2004	2003	
<b>Non-interest income</b>				
Net earned premiums (1)	21%	\$ 2,382	\$ 1,965	
Investment income	37	408	298	
Fee income	(14)	80	93	
Insurance premiums, investment and fee income	22	2,870	2,356	
Insurance policyholder benefits, claims and acquisition expense	25	2,124	1,696	
Non-interest expense	6	487	460	
Business realignment charges	n.m.	8	—	
Net income before income taxes	26	251	200	
Income taxes	(69)	(5)	(16)	
Net income	19%	\$ 256	\$ 216	
U.S. net (loss) income	(250)	\$ (6)	\$ 4	
Net income as a % of total group net income	200 bp	9%	7%	
ROE	(120)bp	23.8%	25.0%	
Gross premiums and deposits	16%	\$ 3,185	\$ 2,753	
Average assets (2)	39	9,300	6,700	
Average allocated common equity (2), (3)	24	1,050	850	
Number of employees (full-time equivalent)	24%	3,575	2,883	

(1) Net of reinsurance premiums.

(2) Calculated using methods intended to approximate the average of the daily balances for the period.

(3) Attributed to the segment as discussed on page 29A.

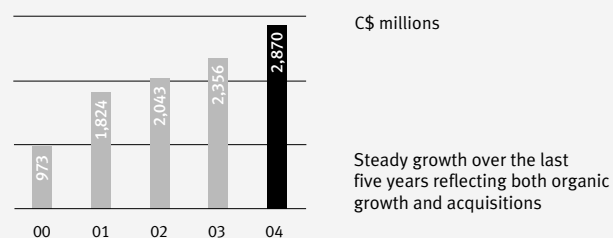
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Insurance premiums, investment and fee income was up \$514 million or 22% over a year ago, primarily reflecting growth in group, living benefit and universal life product sales in the Canadian life and health operations (principally from UnumProvident), the home and auto business and the U.S. fixed annuity business. This growth more than offset the loss of revenues of \$182 million from the non-renewed block of reinsurance business. As a result of the growth mentioned above, policyholder benefits, claims and acquisition expense increased \$428 million or 25% from a year ago, despite a reduction related to the non-renewed block of reinsurance business, which had contributed \$183 million to policyholder benefits, claims and acquisition expense in 2003.

Non-interest expense increased \$27 million or 6% from a year ago, largely reflecting an increase in the number of employees to support business growth, including that from the UnumProvident acquisition.

Despite the growth in earnings, ROE decreased to 23.8%, reflecting the higher average allocated common equity attributed to this segment primarily resulting from the acquisition of UnumProvident.

#### RBC Insurance (Insurance premiums, investment and fee income)



### REVIEW BY DIVISION – RBC INSURANCE

#### LIFE

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

In Canada, we distribute life and health insurance products through more than 17,000 independent brokers affiliated with producer groups, financial planning firms and stock brokerage firms, as well as through direct sales and a network of approximately 500 career sales representatives. In the U.S., we offer life and health insurance, annuities and related personal financial security solutions to consumers through regional and independent broker-dealers, national marketing organizations, banking and investment channels, the Internet, other direct marketing channels and a field force of over 400 full-time sales agents.

#### NON-LIFE

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

We provide Canadians with a wide range of home and auto insurance products, offering them to individual clients and employee and affinity groups through direct sales. Our travel insurance business provides a wide range of products and services, including trip cancellation, interruption and emergency assistance services, to clients in Canada and the United States. These products are distributed through a network of travel agencies, as well as over the Internet and, in Canada, through bank channels and brokers.

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

#### FEE BUSINESSES

We are involved in a number of key insurance and related activities that generate fee and other income, including travel assistance services, credit and trade reinsurance, the administration of bank creditor insurance programs, insurance software and outsourcing and administration solutions services.

Our travel and emergency assistance services include co-ordinating the delivery of emergency health, evacuation and transportation services when clients have a travel emergency, while our credit and trade

reinsurance business provides solutions to help corporations better manage financial risk. We also oversee the creditor insurance products and services for individual and business clients of RBC Financial Group. This includes life and disability insurance for mortgages, loans and Visa cards.

In the U.S., our fee businesses, through Liberty Insurance Services Corporation (LIS), include the Business Process Outsourcing and Software Solutions divisions and provide underwriting, billing, collection claims processing and web-enabled software for life, health, annuity and reinsurance administration. On November 23, 2004, we announced that IBM had agreed to acquire LIS. The transaction is expected to close by December 31, 2004, subject to the satisfaction of customary conditions including the receipt of regulatory approvals. In addition, IBM and RBC Insurance have agreed to enter into a long-term agreement for IBM to perform key business processes for RBC Insurance's U.S. operations, including contact centre management, policy administration, claims management and payment receipt and reconciliation.

#### Financial performance by division

##### Life:

Growth in insurance premiums, investment and fee income of \$638 million was driven by the Canadian life and health operations (principally from UnumProvident) and U.S. operations. The addition of the group and living benefits product segment, along with strong universal life sales in the Canadian life and health business and strong fixed annuity sales in the U.S., drove the increase from last year. Similarly, the 11% increase in the number of Canadian policies and certificates reflects growth in the Canadian life and health operations (which now includes UnumProvident), which more than offset the decline in the number of U.S. policies in force due to increased policy surrenders. Average assets increased 52%, reflecting the UnumProvident acquisition as well as growth in our U.S. fixed annuity business. The number of sales agents decreased 33%, reflecting our continued efforts to improve productivity in this distribution channel.

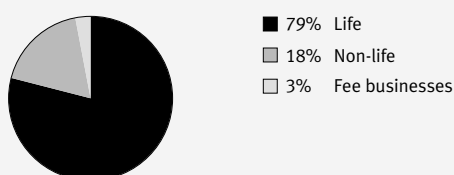
##### Non-life:

Continued growth in the number of new home and auto policies in force reflecting both sales to new customers and strong retention of existing policyholders from the home and auto business drove the \$81 million increase in insurance premiums, investment and fee income.

**Fee businesses:**

Our 2003 revenues included a significant block of reinsurance business that was not renewed in 2004. This block of business contributed \$182 million to insurance premiums, investments and fee income. The decrease in average assets also reflects the non-renewed reinsurance contract. Additionally, U.S. outsourcing revenue declined as there were fewer policies under administration and as several contracts were renewed at lower prices. As discussed on page 36A, we announced the sale of the LIS fee businesses in the U.S., subsequent to the end of fiscal 2004.

**RBC Insurance (Insurance premiums, investment and fee income by division – 2004)**

**Selected highlights**

(C\$ millions, except percentage amounts)	% change	2004	2003 (1)
<b>Life</b>			
Insurance premiums, investment and fee income	39%	\$ 2,263	\$ 1,625
Average assets (2)	52	8,200	5,400
Number of:			
Life and health policies in force and certificates in Canada (thousands)	11	4,276	3,850
Life policies in force in the U.S. (thousands)	(10)	1,976	2,185
Sales agents (U.S. and Canada)	(33)	847	1,268
<b>Non-life</b>			
Insurance premiums, investment and fee income	19%	\$ 517	\$ 436
Average assets (2)	–	900	900
Number of:			
Home and auto – personal lines policies in force (thousands)	46	193	132
Travel – coverages (thousands)	(11)	2,121	2,388
<b>Fee businesses</b>			
Insurance premiums, investment and fee income	(69)%	\$ 90	\$ 295
Average assets (2)	(50)	200	400
Number of:			
Assistance services – calls (thousands)	14	766	670
Policies under administration in the U.S. (thousands)	(9)	3,556	3,925

- (1) The Canadian operations reported 13 months of results in 2003 as a result of a change in its reporting period from September 30 to October 31 to be consistent with our fiscal year. The net impact on our financial results in 2003 due to the extra month was immaterial.
- (2) Calculated using methods intended to approximate the average of the daily balances for the period.

**RBC CAPITAL MARKETS****Overview**

RBC Capital Markets provides wholesale financial services to large corporate, government and institutional clients in North America and in specialized product and industry sectors globally. Headquartered in Toronto, RBC Capital Markets has key centres of expertise in New York and London, and offices in 28 other cities.

*Effective November 1, 2004, the new global capital markets segment includes RBC Capital Markets as well as the business serving larger commercial clients that is being transferred from RBC Banking. As part of the realignment, we are also reorganizing our business divisions within the new segment. The operations of Global Treasury Services and Global Financial Products (described on page 38A) will be merged into a new Global Markets division, which will include all of our debt market, money market, foreign exchange, derivative, alternative assets and proprietary trading businesses. Global Investment Banking will be combined with our equity sales and trading capabilities into Global Investment Banking Equity Markets. The newly formed Global Research division will combine our economics and research staff in all product areas, while Global Credit will remain relatively unchanged.*

**Industry profile**

The Canadian wholesale financial services market is mature and, as a result, many Canadian firms are seeking growth opportunities outside their domestic market, primarily in the U.S. The U.S. capital markets are dominated by several large global investment banks whose principal focus is on the top tier of companies forming the S&P 500 Index. We believe significant opportunities exist for specialized players targeting the lower end of the S&P 500 as well as companies that have the potential to move into this category. To succeed in the North American context requires the ability to provide clients with innovative, value-added

solutions that reflect a keen understanding of both the company and industry sector. We believe that, increasingly, new business opportunities will accrue to those firms with a reputation for adhering to high ethical standards.

**Our strengths**

- Top-tier market shares in virtually all lines of business in Canada
- Established reputation as a premier Canadian investment dealer as evidenced by our market share leadership
- Superior origination and distribution capability in Canada as measured by our standings in underwriting league tables
- Expertise and market knowledge in a broad array of industries
- Demonstrated capabilities in specialized markets including alternative assets, structured products and proprietary trading

**2005 outlook**

Our total revenues and earnings are dependent on the performance of both capital and credit markets and the strength of the economic environment, which drive demand for new issue and advisory services, merger and acquisition activities, and trading volumes. Our expectation is that capital markets performance will improve modestly in 2005, resulting in moderate revenue growth. We also expect to maintain our discipline with respect to credit risk, and refocus our attention on cost control.

## Financial performance

Full year net income increased \$117 million or 23% from last year due to solid performance in investment banking, higher returns from private debt and equity investments and a significantly lower provision for credit losses.

Total revenues increased \$100 million or 4%, reflecting higher returns on private debt and equity investments and higher investment banking revenues. These increases more than offset a \$118 million reduction in the translated value of U.S. dollar-denominated revenues as a result of the stronger Canadian dollar in 2004 and lower total trading revenues, primarily in the fixed income businesses. Trading revenues recorded in net interest income increased \$227 million, while trading revenues recorded in non-interest income declined \$304 million.

Non-interest expense was up \$346 million or 21% compared to last year. The increase in non-interest expense reflects a \$74 million after-tax charge relating to Rabobank settlement costs net of a related reduction in compensation, higher variable compensation, legal costs associated with ongoing Enron litigation and costs relating to the relocation of RBC Capital Markets' London office. These increases more than offset the \$65 million reduction in the translated value of U.S. dollar-denominated expenses due to the stronger Canadian dollar.

The \$272 million decline in the provision for credit losses reflects better credit conditions, higher recoveries of credit losses and an \$85 million reversal of the general allowance in 2004.

ROE improved 470 basis points to 17.7% due to higher net income as well as a \$300 million reduction in average allocated common equity attributed to this segment, as discussed on page 29A.

<b>Results</b>				
(C\$ millions, except percentage amounts)		% change	2004	2003
Net interest income	64%	\$	679	\$ 415
Non-interest income	(7)		2,077	2,241
Total revenues	4		2,756	2,656
Provision for credit losses				
Specific	(96)		8	195
General	n.m.		(85)	–
Total	(139)		(77)	195
Non-interest expense	21		2,017	1,671
Business realignment charges	n.m.		25	–
Net income before income taxes	–		791	790
Income taxes	(41)		164	278
Non-controlling interest	(50)		2	4
Net income	23%	\$	625	\$ 508
U.S. net income	(28)	\$	87	\$ 120
Net income as a % of total group net income			22%	17%
ROE	500 bp		17.7%	13.0%
Average assets (1)	470 bp		218,300	198,500
Average loans and acceptances (1)	10%		59,400	62,700
Average deposits (1)	(5)		80,700	74,000
Average allocated common equity (1), (2)	9		3,500	3,800
<b>Credit information</b>				
Impaired loans	(8)			
Net write-offs	(29)%	\$	265	\$ 373
Net write-offs as a % of average loans and acceptances	7		197	184
	4 bp		.33%	.29%
<b>Number of employees</b>				
(full-time equivalent)	6%		3,084	2,912

- (1) Calculated using methods intended to approximate the average of the daily balances for the period.  
 (2) Attributed to the segment as discussed on page 29A.  
 n.m. not meaningful

## REVIEW BY DIVISION – RBC CAPITAL MARKETS

### GLOBAL INVESTMENT BANKING

The Global Investment Banking division houses the corporate and investment banking businesses. We offer a full range of credit and corporate finance products, including debt and equity underwriting, mergers and acquisitions advice, and execution and financial sponsor/Private Equity investor coverage.

In Canada, we continue to be a full-service provider to all industries, building on the breadth and longevity of our client relationships and a long-standing reputation as a top-ranked investment bank. In the U.S., we are focused on select industries – specifically technology, telecommunication, health care, energy, consumer products, mid-sized financial institutions and real estate. We differentiate ourselves in our ability to provide superior market-based solutions for our target clients.

### GLOBAL EQUITY

Global Equity provides expertise in the research and trading of North American and select international securities. Our product offering includes leading-edge electronic trading systems as clients are increasingly demanding access to electronic execution services.

### GLOBAL FINANCIAL PRODUCTS

This division brings together the business activities involving the origination, syndication, securitization, trading and distribution of debt products globally. These products include loans, bonds and derivatives at both the investment grade and sub-investment grade levels. As well,

Global Financial Products is the centre of expertise for the proprietary trading activities of RBC Capital Markets. The combination of these businesses provides the ability to maximize internal expertise and deliver a broad array of value-added ideas and solutions to clients. Alternative Investments was formed in June 2002 with a mandate to expand our wholesale asset management capabilities, which today includes structuring hedge fund transactions. In 2004, this business was moved into the Global Financial Products division. The alternative asset business provides non-traditional investment opportunities to high net worth individuals, corporations and institutional clients. These investment options include hedge funds, and can extend to other vehicles such as Collateralized Debt Obligations.

### GLOBAL TREASURY SERVICES

Global Treasury Services combines our money markets and foreign exchange businesses and provides global clients with foreign exchange, commodities, derivatives and interest rate products, as well as prime brokerage, currency risk management and advisory services. These products and services are delivered through our extensive global sales and trading network, operating from centres that include Toronto, London, New York, Sydney, Tokyo, Singapore and our recently opened Hong Kong office. Global Treasury Services continues to lead in technological development of e-trading solutions; this year, MM Direct, our electronic deposit system, joined FX Direct, expanding our e-trading platform.



## GLOBAL CREDIT

Global Credit provides centralized management of all credit exposure associated with our loan portfolio. While wholesale lending is fundamental to the attraction and expansion of high-margin client businesses, lending must be strategic in order to maximize the returns to shareholders.

Our transaction specialists use appropriate structures to provide clients with value-added, as opposed to commoditized, credit solutions. We work closely with our distribution teams to manage the size and credit quality of our corporate lending base.

Our portfolio and transaction management specialists use sophisticated risk management and analytical tools designed to ensure that the pricing on loans is commensurate with the associated risk and reflects the value of all products and services a client has with RBC Financial Group.

### Financial performance by division

Revenues from Global Financial Products were up \$150 million or 14% reflecting higher returns from private debt and equity investments and strong revenues from structured products. Higher revenues were also achieved in the alternative assets business reflecting higher asset levels, while revenues from proprietary equity trading activities were lower than last year, largely due to the appreciation of the Canadian dollar relative to the U.S. dollar. Global Investment Banking revenues were up \$84 million or 15% due to higher levels of equity and debt underwriting in Canada and the U.S., as well as higher fund of fund distributions in 2004. Global Equity revenues decreased \$4 million from 2003 reflecting the impact of the stronger Canadian dollar on the translated value of U.S. dollar-denominated revenues, which more than offset higher revenues from equity sales in Canada, and from new equity issues globally. Global Treasury Services revenues were lower by \$29 million or 5% in 2004, despite higher revenues from derivatives and commodities products during the year, primarily due to lower results in the foreign exchange sales and trading business, which was negatively affected by the strengthening of the Canadian dollar throughout 2004. Revenues from Global Credit were down \$101 million reflecting our continued intentional reduction of the non-strategic loan portfolio.

Overall, revenues in each of the divisions were negatively affected by the appreciation of the Canadian dollar relative to the U.S. dollar, which reduced the translated value of U.S. dollar-denominated revenues by \$118 million.

The increase in average assets in Global Financial Products related to growth in the securities inventories of the global debt markets and global equity derivatives trading books and the related securities borrowing activities. The higher trading securities inventories also reflected continued growth in the hedge fund business. The growth in average

assets in Global Investment Banking was related to an increase in non-investment grade loans to clients in the United States. Global Treasury Services recorded growth in average assets primarily in the equity and securities finance businesses. The average of the derivative-related amounts relating to Global Treasury Services and Global Financial Products derivative trading activity declined moderately during the year. The year-over-year decrease in average assets for Global Credit of \$1.7 billion or 35% is a result of the intentional reduction of the non-strategic loan portfolio as well as the effect of the stronger Canadian dollar on the translated value of U.S. dollar-denominated assets.

### Total revenues

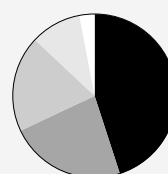
(C\$ millions, except percentage amounts)	% change	2004	2003
Global Financial Products	14%	\$ 1,240	\$ 1,090
Global Investment Banking	15	638	554
Global Treasury Services	(5)	524	553
Global Equity	(1)	295	299
Global Credit	(63)	59	160
	4%	\$ 2,756	\$ 2,656

### Average assets (1)

(C\$ millions, except percentage amounts)	% change	2004	2003
Global Financial Products	17%	\$ 121,100	\$ 103,100
Global Investment Banking	6	5,500	5,200
Global Treasury Services	4	88,100	84,700
Global Equity	(33)	400	600
Global Credit	(35)	3,200	4,900
	10%	\$ 218,300	\$ 198,500

(1) Calculated using methods intended to approximate the average of the daily balances for the period.

### RBC Capital Markets (Total revenues by division – 2004)



■ 45%	Global Financial Products
■ 23%	Global Investment Banking
■ 19%	Global Treasury Services
■ 11%	Global Equity
■ 2%	Global Credit

## RBC GLOBAL SERVICES

### Overview

RBC Global Services offers specialized transaction processing services to business, commercial, corporate and institutional clients in Canada and select international markets, principally the U.K. and Australia. Key businesses include Institutional & Investor Services, Global Financial Institutions and Treasury Management & Trade, which are described in detail on pages 40A–41A. RBC Global Services also includes RBC's 50% interest in the Moneris Solutions joint venture with Bank of Montreal for merchant card processing.

Effective November 1, 2004, the Institutional & Investor Services and Global Financial Institutions divisions of RBC Global Services became part of the new global capital markets segment. The Treasury Management & Trade division became part of the new Canadian personal and business segment.

### Industry profile

The transaction processing businesses are highly competitive and relatively mature in the Canadian market. Scale is a critical success factor and is required to support the significant investment in technology required to introduce new products and services and enhance operational efficiencies. The quality of client service and strength of client relationships are also key differentiating factors in retaining and attracting new business. Monoline specialists, with domestic and global capability, compete against traditional financial institutions. Market consolidation continued in 2004, particularly in merchant card processing and custody, which are businesses requiring global capability and scale.

### Our strengths

- We have a market share leadership position in Canada in these businesses as measured by assets under administration (AUA), transactions processed and number of client relationships
- We have strong client relationships as demonstrated by our high rate of client retention and new business generated from existing clients
- We are recognized for quality of service as evidenced in third-party client surveys, such as *Global Investor* magazine's 2004 Global Custody Survey, which ranked us as the best overall global custodian; Stewart and Associates' 2004 Survey of Bank Fees, which rated our cash management services first overall in Canada for quality of service for the fifth year in a row; and our recognition by *Global Finance* magazine as best trade finance bank in Canada for 2004
- We continue to develop and deploy new technology and client service solutions

### 2005 outlook

Our revenue across all divisions is primarily derived from fee-based services and transaction fees. Interest earned on deposit and cash balances, foreign exchange fees and fees earned on client assets are variable sources of revenue that are influenced by capital markets performance and the interest rate environment. For 2005, we anticipate that our net interest income should remain stable as interest rates are expected to stay at current levels through much of the year. We expect modestly rising capital markets in 2005 to have a favourable impact on our revenue streams particularly in the Institutional & Investor Services division.

### Financial performance

Full year net income was up \$47 million or 27%, reflecting strong earnings growth in all divisions, as revenues grew significantly more than expenses, and also reflecting a reversal of the general allowance and recoveries in the provision for credit losses totalling \$19 million.

Total revenues increased \$74 million or 7%. The increase in revenues was largely due to growth in fee-based revenues in Institutional & Investor Services as well as higher net interest income driven by deposit balance growth in Global Financial Institutions and Treasury Management & Trade, which more than offset the adverse impact of a lower interest rate environment. In addition, stronger earnings from Moneris Solutions also contributed favourably to revenue growth.

Non-interest expense was \$24 million or 3% higher in 2004, largely due to higher pension and postretirement benefit and other compensation costs, as well as increased costs incurred to support the growth in business activity.

The provision for credit losses decreased \$21 million primarily due to a reversal of the general allowance for credit losses of \$14 million in the first quarter and the sale of credit facilities in the second and fourth quarters of 2004.

ROE improved 760 basis points in 2004 to 35.1% as a result of the higher earnings.

<b>Results</b>				
(C\$ millions, except percentage amounts)		% change	2004	2003
Net interest income	7%	\$	177	\$ 166
Non-interest income	8		887	824
Total revenues	7		1,064	990
Provision for credit losses				
Specific	n.m.		(5)	2
General	n.m.		(14)	—
Total	n.m.		(19)	2
Non-interest expense	3		738	714
Business realignment charges	n.m.		3	—
Net income before income taxes	25		342	274
Income taxes	22		118	97
Net income	27%	\$	224	\$ 177
U.S. net income	—	\$	8	\$ 8
Net income as a % of total group net income	200 bp		8%	6%
ROE	760 bp		35.1%	27.5%
Average allocated common equity <sup>(1)</sup>	—		650	650
<b>Credit information</b>				
Impaired loans	n.m.	\$	—	\$ 5
Net write-offs	60%		8	5
Net write-offs as a % of average loans and acceptances	26 bp		.62%	.36%
Number of employees (full-time equivalent)	(2)%		2,504	2,550

(1) Calculated using methods intended to approximate the average of the daily balances for the period. Attributed to the segment as discussed on page 29A.

n.m. not meaningful

## REVIEW BY DIVISION

### INSTITUTIONAL & INVESTOR SERVICES

Institutional & Investor Services is Canada's largest custodian as measured by AUA, and a provider of investment administration services, including foreign exchange and securities lending, to corporate and institutional investors worldwide. We operate from 12 locations throughout the world, with a global custody network spanning 79 markets.

### GLOBAL FINANCIAL INSTITUTIONS

A comprehensive range of correspondent banking services is provided to banks globally and to broker-dealers within Canada, including cash management, payments and clearing.

## TREASURY MANAGEMENT & TRADE

Treasury Management & Trade provides cash management, payment and trade services to corporate, business and public sector markets in Canada. Our trade team provides Canadian and foreign importers and exporters with a variety of trade products, services and counsel. Our cash management group provides a full range of solutions to clients including disbursements, collections and information products. Through our web-based delivery platform, RBC Express, clients have access to an increasing number of cash management and payment services. Our payments centre processes a high volume of domestic and international payment services for clients and is the largest processor of Canadian dollar payments in Canada. Through Moneris Solutions we provide merchants with debit and credit card transaction processing services.

### Financial performance by division

#### Institutional & Investor Services:

Total revenues increased \$38 million or 9% driven by strong growth in foreign exchange and securities lending fees. The higher AUA balance in 2004 reflects the positive impact of new business and the overall strengthening of global capital markets in 2004.

#### Global Financial Institutions:

Total revenues increased by \$4 million or 4% due to growth in net interest income driven by higher deposit balances, which more than offset the adverse impact of the continued low interest rate environment.

#### Treasury Management & Trade:

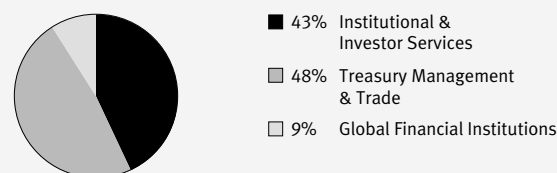
Total revenues increased \$32 million or 7% primarily due to higher earnings from Moneris Solutions, which benefited from higher transaction volumes in 2004, and to higher net interest income. The 11% growth in average deposits resulted in an increase in net interest income, which more than offset the adverse impact of the continued low interest rate environment.

### Selected highlights

(C\$ millions, except percentage amounts)	% change	2004	2003
<b>Institutional &amp; Investor Services</b>			
Total revenues	9%	\$ 455	\$ 417
Assets under administration	9	1,223,000	1,122,000
<b>Global Financial Institutions</b>			
Total revenues	4%	\$ 100	\$ 96
Average assets (1)	–	1,400	1,400
Average deposits (1)	29	2,600	2,020
<b>Treasury Management &amp; Trade</b>			
Total revenues	7%	\$ 509	\$ 477
Average deposits (1)	11	7,500	6,740
Payment volumes	7	8,188	7,634
Payment errors (per 100,000 payments)	(10)	2.6	2.9

(1) Calculated using methods intended to approximate the average of the daily balances for the period.

### RBC Global Services (Total revenues by division – 2004)



## OTHER

### Overview and financial performance

The Other segment consists mainly of the Information Technology, Corporate Treasury and Corporate Resources functional groups, which are largely designed to manage and pass through cost and revenue items in their areas of responsibility.

### Financial performance

Net loss for the Other segment was \$70 million compared to net income of \$133 million a year ago, reflecting a \$91 million decrease in revenues and an \$11 million increase in expenses. Also included in the net loss for 2004 were business realignment charges of \$64 million.

The decline in revenues included a \$26 million charge for equity losses on investments and a \$26 million writedown of an investment in AOL Canada (a similar writedown was also recorded in RBC Banking). In addition, we incurred \$68 million of consolidation adjustment charges to eliminate intercompany underwriting fees, trading gains and losses on Royal Bank of Canada securities held by subsidiaries and to partially offset a gain recorded on the sale by RBC Centura of its merchant acquiring card portfolio to Moneris Solutions in light of our 50% ownership interest in the joint venture.

The increase in non-interest expenses was largely due to costs associated with a processing disruption in the third quarter. The processing disruption, which occurred during a programming update to one

of our computer systems, affected our ability to promptly reflect some transactions in client account balances and affected most of our business segments.

### Results

(C\$ millions, except percentage amounts)	% change	2004	2003
Net interest income	n.m.	\$ (109)	\$ 50
Non-interest income	41%	232	164
Total revenues	(43)	123	214
Provision for credit losses	n.m.	(36)	(28)
Non-interest expense	n.m.	13	2
Business realignment charges	n.m.	64	–
Net income before income taxes	(66)	82	240
Income taxes and non-controlling interest	42	152	107
Net (loss) income	(153)	\$ (70)	\$ 133
U.S. net (loss)	n.m.	\$ (12)	\$ (2)
Net (loss) income as a % of total group net income	(600)bp	(2)%	4%
ROE	(820)bp	(2.6)%	5.6%
Average allocated common equity (1)	33%	3,000	2,250

(1) Attributed to the segment as discussed on page 29A.  
n.m. not meaningful

## FINANCIAL PRIORITY: REVENUE GROWTH AND DIVERSIFICATION

### Highlights

- Revenues up \$703 million or 4%
- Net interest income up \$97 million or 1%
- Net interest margin of 1.56%, down 10 basis points
- Non-interest income up \$606 million or 6%
- Non-interest income 63% of total revenues, up 1% from 2003

**Table 4 Total revenues**

(C\$ millions)	2004	2003	2002	2004 vs 2003 Increase (decrease)	
Net interest income	\$ 6,693	\$ 6,596	\$ 6,935	\$ 97	1%
Non-interest income	11,428	10,822	10,320	606	6
Total revenues	\$ 18,121	\$ 17,418	\$ 17,255	\$ 703	4%

Total revenues were up \$703 million or 4% from 2003, reflecting higher insurance revenues (which now include UnumProvident), higher capital markets-related revenues other than trading (mutual fund revenues, securities brokerage commissions, underwriting and other advisory fees, investment management and custodial fees), and strong growth in

loans and deposits which resulted in higher net interest income. These factors more than offset a \$550 million reduction due to the strengthening of the Canadian dollar and a \$169 million decline in total trading revenues (including a \$396 million decline in non-interest income, which more than offset a \$227 million increase in net interest income).

### Outlook

We are targeting revenue growth of 6–8% in fiscal 2005 based on our expectations of improved results from U.S. banking operations, the full year impact of the UnumProvident acquisition and results from our Client First initiatives. We also expect that Canadian economic growth will be moderately higher in 2005 than in 2004, capital markets performance will improve modestly and the strengthening of the Canadian dollar exchange rate relative to the U.S. dollar will reduce our year-over-year revenues less than in 2004.

### Net interest income

Net interest income was up \$97 million or 1% from 2003, reflecting a \$227 million increase in trading revenues included in net interest income primarily due to dividends earned as part of our arbitrage trading strategies, and average loan and deposit growth of 7%, which was partially offset by the impact of narrower margins.

As shown in Table 7 on page 44A, while higher asset volumes (including residential mortgage, personal, credit card, and business and government loans) added \$434 million to net interest income in 2004, changes in rates received on assets and paid on liabilities reduced net interest income by \$337 million, primarily reflecting price competition in retail banking and low interest rates, which led to margin compression.

**Table 5 Net interest income and margin**

(C\$ millions, except percentage amounts)	2004	2003	2002	2004 vs 2003 Increase (decrease)	
Average assets (1)	\$ 429,200	\$ 396,400	\$ 367,300	\$ 32,800	8%
Net interest income	6,693	6,596	6,935	97	1%
Net interest margin (2)	1.56%	1.66%	1.89%	–	(10)bp

(1) Calculated using methods intended to approximate the average of the daily balances for the period.

(2) Net interest income, as a percentage of average assets.

### Net interest margin

As shown in Table 5, the net interest margin decreased by 10 basis points in 2004 to 1.56%. This reflected spread compression on Canadian mortgages and deposits resulting from lower interest rates and competitive pricing pressures, as well as growth in capital markets-related assets that generate non-interest income.

As shown in Table 6 on page 43A, while the average rate paid on total liabilities decreased by 24 basis points, the average rate received on total assets decreased by 32 basis points, leading to the 10 basis point decrease in the net interest margin. The average rate received on loans and securities decreased 61 basis points and 16 basis points,

respectively, while volumes of loans and securities were up \$11.4 billion and \$24.3 billion, respectively, on average.

**Table 6 Net interest income on average assets and liabilities (1)**

(C\$ millions, except percentage amounts)	Average balances (2)			Interest (3)			Average rate		
	2004	2003	2002	2004	2003	2002	2004	2003	2002
<b>Assets</b>									
<b>Deposits with banks</b>									
Canada	\$ 629	\$ 428	\$ 367	\$ 22	\$ 9	\$ 7	3.52%	2.10%	1.91%
United States	1,093	2,490	2,316	18	37	64	1.69	1.49	2.76
Other International	3,897	4,401	2,464	88	67	89	2.23	1.52	3.61
	5,619	7,319	5,147	128	113	160	2.27	1.54	3.11
<b>Securities</b>									
Trading account	94,178	77,422	72,709	2,603	2,049	2,115	2.76	2.65	2.91
Investment account	43,146	35,639	28,486	837	959	1,033	1.94	2.69	3.63
Loan substitute	358	354	407	17	17	27	4.75	4.80	6.63
	137,682	113,415	101,602	3,457	3,025	3,175	2.51	2.67	3.12
<b>Assets purchased under reverse repurchase agreements</b>	39,540	42,779	37,494	531	806	651	1.34	1.88	1.74
<b>Loans (4)</b>									
Canada									
Residential mortgage	75,722	69,911	65,901	3,903	3,896	3,903	5.15	5.57	5.92
Personal	28,857	25,614	25,394	1,813	1,837	1,734	6.28	7.17	6.83
Credit card	5,656	5,197	4,354	674	615	519	11.93	11.83	11.92
Business and government	28,249	26,632	27,856	1,345	1,755	1,291	4.76	6.59	4.63
	138,484	127,354	123,505	7,735	8,103	7,447	5.59	6.36	6.03
United States	28,175	28,189	29,784	1,255	1,388	1,791	4.45	4.92	6.01
Other International	12,176	11,884	11,348	670	572	1,225	5.50	4.81	10.79
	178,835	167,427	164,637	9,660	10,063	10,463	5.40	6.01	6.36
<b>Total interest-earning assets</b>	361,676	330,940	308,880	13,776	14,007	14,449	3.81	4.23	4.68
<b>Non-interest-bearing deposits with banks</b>	2,758	1,947	1,753	—	—	—	—	—	—
<b>Customers' liability under acceptances</b>	6,047	6,838	8,515	—	—	—	—	—	—
<b>Other assets</b>	58,719	56,675	48,152	—	—	—	—	—	—
<b>Total assets</b>	\$ 429,200	\$ 396,400	\$ 367,300	\$ 13,776	\$ 14,007	\$ 14,449	3.21%	3.53%	3.93%
<b>Liabilities and shareholders' equity</b>									
<b>Deposits (5)</b>									
Canada	\$ 139,466	\$ 121,690	\$ 111,880	\$ 3,186	\$ 3,311	\$ 2,964	2.28%	2.72%	2.65%
United States	38,501	40,131	40,036	510	564	787	1.33	1.41	1.97
Other International	68,052	68,316	68,584	1,446	1,577	1,958	2.12	2.31	2.85
	246,019	230,137	220,500	5,142	5,452	5,709	2.09	2.37	2.59
<b>Obligations related to securities sold short</b>	27,013	22,898	19,912	874	839	797	3.23	3.66	4.00
<b>Obligations related to assets sold under repurchase agreements</b>	30,125	22,522	19,630	430	552	414	1.43	2.45	2.11
<b>Subordinated debentures</b>	8,000	6,455	6,804	429	376	406	5.36	5.82	5.97
<b>Other interest-bearing liabilities</b>	8,857	7,889	5,546	208	192	188	2.35	2.43	3.39
<b>Total interest-bearing liabilities</b>	320,014	289,901	272,392	7,083	7,411	7,514	2.21	2.56	2.76
<b>Non-interest-bearing deposits</b>	22,183	20,640	19,897	—	—	—	—	—	—
<b>Acceptances</b>	6,049	6,838	8,515	—	—	—	—	—	—
<b>Other liabilities</b>	62,332	60,260	47,974	—	—	—	—	—	—
<b>Total liabilities</b>	\$ 410,578	\$ 377,639	\$ 348,778	\$ 7,083	\$ 7,411	\$ 7,514	1.72%	1.96%	2.15%
<b>Shareholders' equity</b>									
Preferred	832	1,210	1,713	—	—	—	—	—	—
Common	17,790	17,551	16,809	—	—	—	—	—	—
<b>Total liabilities and shareholders' equity</b>	\$ 429,200	\$ 396,400	\$ 367,300	\$ 7,083	\$ 7,411	\$ 7,514	1.65%	1.87%	2.05%
<b>Net interest income as a % of total average assets</b>	\$ 429,200	\$ 396,400	\$ 367,300	\$ 6,693	\$ 6,596	\$ 6,935	1.56%	1.66%	1.89%
<b>Net interest income as a % of total average interest-earning assets</b>									
Canada	\$ 212,118	\$ 199,292	\$ 196,321	\$ 5,036	\$ 5,140	\$ 5,472	2.37%	2.58%	2.79%
United States	67,253	59,368	51,144	1,119	1,188	1,106	1.66	2.00	2.16
Other International	82,305	72,280	61,415	538	268	357	.65	.37	.58
<b>Total</b>	\$ 361,676	\$ 330,940	\$ 308,880	\$ 6,693	\$ 6,596	\$ 6,935	1.85%	1.99%	2.25%

(1) Geographic classification for selected assets and liabilities is based on the domicile of the booking point of the subject assets and liabilities.

(2) Calculated using methods intended to approximate the average of the daily balances for the period.

(3) Interest income includes loan fees of \$336million (2003 – \$303 million; 2002 – \$321 million).

(4) Average balances include impaired loans.

(5) Deposits include savings deposits with average balances of \$45 billion (2003 – \$38 billion; 2002 – \$39 billion), interest expense of \$.2 billion (2003 – \$.3 billion; 2002 – \$.3 billion) and average rates of .53% (2003 – .78%; 2002 – .69%). Deposits also include term deposits with average balances of \$169 billion (2003 – \$160 billion; 2002 – \$155 billion), interest expense of \$.4 billion (2003 – \$.4 billion; 2002 – \$.4 billion) and average rates of 2.34% (2003 – 2.53%; 2002 – 2.85%).

**Table 7** Change in net interest income <sup>(1)</sup>

(C\$ millions)	2004 vs 2003 Increase (decrease) due to changes in			2003 vs 2002 Increase (decrease) due to changes in			Net change
	Average volume (2)	Average rate (2)	Net change	Average volume (2)	Average rate (2)	Net change	
<b>Assets</b>							
<b>Deposits with banks</b>							
Canada	\$ 5	\$ 8	\$ 13	\$ 1	\$ 1	\$ 2	
United States	(24)	5	(19)	4	(31)	(27)	
Other International	(7)	28	21	47	(69)	(22)	
<b>Securities</b>							
Trading account	460	94	554	132	(198)	(66)	
Investment account	178	(300)	(122)	226	(300)	(74)	
Loan substitute	0	–	–	(3)	(7)	(10)	
<b>Assets purchased under reverse repurchase agreements</b>	(57)	(218)	(275)	97	58	155	
<b>Loans</b>							
Canada							
Residential mortgage	311	(304)	7	230	(237)	(7)	
Personal	218	(242)	(24)	15	88	103	
Credit card	54	5	59	100	(4)	96	
Business and government	101	(511)	(410)	(59)	523	464	
United States	(1)	(132)	(133)	(92)	(311)	(403)	
Other International	14	84	98	55	(708)	(653)	
<b>Total interest income</b>	\$ 1,252	\$ (1,483)	\$ (231)	\$ 753	\$ (1,195)	\$ (442)	
<b>Liabilities</b>							
<b>Deposits</b>							
Canada	\$ 446	\$ (571)	\$ (125)	\$ 265	\$ 82	\$ 347	
United States	(22)	(32)	(54)	2	(225)	(223)	
Other International	(6)	(125)	(131)	(8)	(373)	(381)	
<b>Obligations related to securities sold short</b>	140	(105)	35	113	(71)	42	
<b>Obligations related to assets sold under repurchase agreements</b>	152	(274)	(122)	66	72	138	
<b>Subordinated debentures</b>	85	(32)	53	(20)	(10)	(30)	
<b>Other interest-bearing liabilities</b>	23	(7)	16	66	(62)	4	
<b>Total interest expense</b>	818	(1,146)	(328)	484	(587)	(103)	
<b>Net interest income</b>	\$ 434	\$ (337)	\$ 97	\$ 269	\$ (608)	\$ (339)	

(1) Geographic classification for selected assets and liabilities is based on the domicile of the booking point of the subject assets and liabilities.

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

**Table 8** Non-interest income

(C\$ millions, except percentage amounts)	2004	2003	2002	2004 vs 2003 Increase (decrease)	
Insurance premiums, investment and fee income	\$ 2,870	\$ 2,356	\$ 2,043	\$ 514	22%
Trading revenues	1,526	1,922	1,690	(396)	(21)
Investment management and custodial fees	1,198	1,143	1,177	55	5
Securities brokerage commissions	1,166	1,031	1,187	135	13
Deposit and payment service charges	1,050	1,078	1,041	(28)	(3)
Underwriting and other advisory fees	909	813	755	96	12
Mutual fund revenues	850	673	723	177	26
Card service revenues	555	518	496	37	7
Foreign exchange revenues, other than trading	331	279	276	52	19
Credit fees	224	227	223	(3)	(1)
Securitization revenues	200	165	174	35	21
Mortgage banking revenues	59	198	222	(139)	(70)
Gain (loss) on sale of investment account securities	23	31	(111)	(8)	(26)
Other	467	388	424	79	20
<b>Total</b>	<b>\$ 11,428</b>	<b>\$ 10,822</b>	<b>\$ 10,320</b>	<b>\$ 606</b>	<b>6%</b>

### Non-interest income

As shown in Table 8 on page 44A, non-interest income was up \$606 million or 6% from 2003, for the reasons discussed below.

Insurance premiums, investment and fee income were up \$514 million or 22%, primarily reflecting growth in the Canadian life and health operations (principally from UnumProvident) and the home and auto business, which more than offset the loss of revenues from a non-renewed block of reinsurance business in 2004. Mutual fund revenues were up \$177 million or 26% reflecting growth in mutual fund assets, appreciation in the value of mutual funds and an increase in the proportion of long-term funds on which we earn higher fees. Securities brokerage commissions were up \$135 million or 13% due to strong equities markets and the resultant higher client trading volumes during the year. Underwriting and other advisory fees increased by \$96 million or 12% reflecting improvements in capital markets activity over 2003.

Investment management and custodial fees were up \$55 million or 5% largely reflecting increased fees from market appreciation of equities and higher volumes.

Trading revenues included in non-interest income were down \$396 million or 21% primarily reflecting derivative returns associated with our arbitrage trading strategies. Mortgage banking revenues (which relate to mortgages originated in the U.S. by RBC Mortgage and RBC Centura) were down \$139 million or 70% due to lower margins and origination volumes at RBC Mortgage from exceptionally high levels in 2003, when low interest rates drove a mortgage refinance boom. Non-interest income was reduced \$420 million due to the appreciation of the Canadian dollar relative to the U.S. dollar.

Non-interest income accounted for 63% of total revenues, up 1% from 2003.

<b>Table 9      Trading revenues</b>						
(C\$ millions, except percentage amounts)						
	2004	2003	2002	2004 vs 2003 Increase (decrease)		
Net interest income (1)	\$ 322	\$ 95	\$ 127	\$ 227	239%	
Non-interest income (2)	1,526	1,922	1,690	(396)	(21)	
<b>Total</b>	<b>\$ 1,848</b>	<b>\$ 2,017</b>	<b>\$ 1,817</b>	<b>\$ (169)</b>	<b>(8)%</b>	
<b>By product</b>						
Equity	\$ 533	\$ 541	\$ 657	\$ (8)	(1)%	
Fixed income and money markets (3)	1,037	1,175	896	(138)	(12)	
Foreign exchange contracts (4)	278	301	264	(23)	(8)	
<b>Total</b>	<b>\$ 1,848</b>	<b>\$ 2,017</b>	<b>\$ 1,817</b>	<b>\$ (169)</b>	<b>(8)%</b>	

1) Interest and dividends on trading securities, other cash instruments and trading-related derivatives and related funding charges or benefits.

2) Realized and unrealized gains and losses on trading securities, derivative instruments and foreign exchange trading activities.

3) Includes government securities and corporate debt instruments, swaps, interest rate options, interest rate futures and forward rate agreements.

4) Includes primarily foreign exchange spot, forward, futures and options contracts as well as commodity and precious metals.

### Trading revenues

Trading revenues presented in Table 9 include both trading revenues reported in non-interest income and trading-related net interest income as they are both considered in evaluating the overall revenues of our trading activities.

As shown in Table 9, total trading revenues were down \$169 million or 8% in 2004. Trading revenues reported in net interest income were up \$227 million or 239%, primarily due to dividends earned as part of our arbitrage trading strategies. Trading revenues reported in non-interest income were down \$396 million or 21%, primarily reflecting derivative returns also associated with our arbitrage trading strategies.

Fixed income and money market trading revenues decreased by \$138 million or 12% reflecting tighter spreads on client business due to competitive markets. Lower revenues were experienced in sales and trading of debt securities and money market instruments. Revenues in interest rate derivatives were stable while revenues in credit derivatives improved due to increased client volumes and higher returns on proprietary credit positions taken during the year.

Equity trading revenues decreased by \$8 million or 1% despite higher revenues experienced in structured hedge fund transactions. Lower revenues were experienced in proprietary equity derivative trading businesses due primarily to the stronger Canadian dollar experienced in fiscal 2004, which negatively affected U.S. dollar-denominated revenues.

Foreign exchange trading revenues, which include foreign exchange spot, forward and derivative contracts in addition to commodity and precious metals, decreased by \$23 million or 8% due primarily to the strengthening Canadian dollar, which resulted in a \$25 million reduction in U.S. dollar-denominated revenues. Canadian dollar liquidity also made for difficult trading conditions. However, partially offsetting this decline were improved results from the derivatives group, which leveraged its global platform to capitalize on trading flows and market movements.

## FINANCIAL PRIORITY: COST CONTROL

### Highlight

- Non-interest expense was up 7% from 2003

### Non-interest expense

Non-interest expense was up \$700 million or 7% from 2003. The increase was largely due to higher human resource expenses throughout 2004 (primarily higher benefit costs and higher variable compensation costs, driven by increases in revenues) and the Rabobank settlement costs net of a related reduction in compensation, which more than offset a \$345 million reduction of non-interest expense due to the appreciation of the Canadian dollar relative to the U.S. dollar in 2004.

As shown in Table 10 below, human resource costs increased by \$406 million or 6% in 2004, reflecting a \$195 million or 21% increase in benefits expense, a \$189 million or 9% increase in variable compensation expense and a \$61 million or 2% increase in salaries. The increase

in benefits costs was largely due to higher pension and postretirement benefit costs. Pension costs increased due to the amortization of prior year lower asset returns and the impact of lower discount rates. Postretirement benefit expense increased primarily due to the amortization of actuarial losses resulting from higher claims experiences and a lower discount rate used to value other postretirement benefit liabilities in 2004 (see Note 17 on page 98A). The increase in variable compensation costs resulted from stronger capital markets-related revenues in RBC Capital Markets and RBC Investments. Higher salary costs partially reflected an increase in the number of employees, largely due to acquisitions completed over the past year.

**Table 10 Non-interest expense**

(C\$ millions, except percentage amounts)	2004	2003	2002	2004 vs 2003 Increase (decrease)	
<b>Human resources</b>					
Salaries	\$ 3,343	\$ 3,282	\$ 3,224	\$ 61	2%
Variable compensation	2,273	2,084	2,095	189	9
Acquisition-related retention compensation	36	84	158	(48)	(57)
Benefits	1,120	925	783	195	21
Stock compensation (1)	82	73	55	9	12
	6,854	6,448	6,315	406	6
<b>Occupancy</b>					
Net premises rent	389	370	395	19	5
Premises repairs and maintenance (2)	218	192	177	26	14
Depreciation	93	95	103	(2)	(2)
Property taxes	84	82	84	2	2
	784	739	759	45	6
<b>Equipment</b>					
Office and computer rental and maintenance	631	598	589	33	6
Depreciation	303	303	304	—	—
	934	901	893	33	4
<b>Communications</b>					
Telecommunication	253	303	328	(50)	(17)
Marketing and public relations	238	212	211	26	12
Postage and courier	105	113	121	(8)	(7)
Stationery and printing	105	104	108	1	1
	701	732	768	(31)	(4)
<b>Professional fees</b>	493	460	416	33	7
<b>Outsourced item processing</b>	294	292	306	2	1
<b>Amortization of other intangibles</b>	69	71	72	(2)	(3)
<b>Other</b>					
Business and capital taxes	155	144	129	11	8
Travel and relocation	144	140	144	4	3
Employee training	39	39	46	—	—
Donations	42	38	41	4	11
Other	600	405	531	195	48
	980	766	891	214	28
<b>Total</b>	\$ 11,109	\$ 10,409	\$ 10,420	\$ 700	7%

(1) Includes the cost of stock options, stock appreciation rights and performance deferred shares.

(2) Premises repairs and maintenance includes energy costs.



Occupancy costs were up \$45 million or 6%, largely due to higher premises repairs and maintenance costs, partially reflecting the reversal in the fourth quarter of 2003 of a reserve previously established for vacant space that was subsequently subleased. Equipment costs were up \$33 million or 4% due to higher office and computer rental and maintenance expenses largely as a result of the UnumProvident acquisition and the relocation of RBC Capital Markets' London office.

Other non-interest expenses were up by \$214 million or 28%, mainly due to the Rabobank settlement costs and recognition of a \$33 million valuation allowance in the U.S. relating to certain mortgage loans that are believed to have been fraudulently originated in 2001 and 2002.

### Focus on cost control

Our expense growth of 7% in 2004 missed our objective of growing expenses at a lower rate than revenues (which were up only 4%). In light of this disappointing performance, we took strong action in the fourth quarter to become more efficient and cost-effective. As part of the Client First Initiative, we are streamlining our organizational structure, resources and processes for faster decision-making, quicker implementation and better productivity. We are realigning to focus more effectively on our distinct client groups in Canada, the U.S. and internationally, and are integrating all our systems and operating capabilities in a global technology and operations group. We believe the Client First Initiative will allow us to control our costs more aggressively.

The business realignment charges of the fourth quarter are discussed on page 25A in the Financial overview section.

**Table 11 Taxes**

(C\$ millions, except percentage amounts)

	2004	2003	2002
<b>Income taxes</b>	<b>\$ 1,232</b>	<b>\$ 1,460</b>	<b>\$ 1,365</b>
<b>Other taxes</b>			
Goods and services and sales taxes	225	220	224
Payroll taxes	207	212	204
Capital taxes	140	124	107
Property taxes <sup>(1)</sup>	84	82	84
Business taxes	15	20	22
Insurance premium taxes	33	26	22
	<b>704</b>	<b>684</b>	<b>663</b>
<b>Total</b>	<b>\$ 1,936</b>	<b>\$ 2,144</b>	<b>\$ 2,028</b>
<b>Effective income tax rate <sup>(2)</sup></b>	<b>29.2%</b>	<b>31.8%</b>	<b>32.2%</b>
<b>Effective total tax rate <sup>(3)</sup></b>	<b>39.3%</b>	<b>40.6%</b>	<b>41.4%</b>

(1) Includes amounts netted against non-interest income regarding investment properties.

(2) Income taxes, as a percentage of net income before income taxes.

(3) Total income and other taxes as a percentage of net income before income and other taxes.

### Income and other taxes

Our operations are subject to a variety of taxes, including taxes on income and capital assessed by Canadian federal and provincial governments and taxes on income assessed by the governments of foreign jurisdictions where we operate. Taxes are also assessed on expenditures and supplies consumed in support of our operations.

Income and other taxes shown in Table 11 above were \$1,936 million in 2004, comprising income taxes of \$1,232 million and other taxes of \$704 million. Income taxes decreased by \$228 million from 2003, largely due to lower net income before tax. Other taxes increased by \$20 million, largely due to an increase in capital taxes.

As shown above, the effective income tax rate decreased from 31.8% in 2003 to 29.2% in 2004, reflecting a reduction in the federal tax rate in Canada. In addition to the income and other taxes reported in the Consolidated statement of income, we recorded income taxes of \$330 million in 2004 (\$1,065 million in 2003) in shareholders' equity, a reduction of \$735 million, reflecting a decrease in unrealized foreign currency translation gains as shown in Note 15 on page 96A.

## FINANCIAL PRIORITY: STRONG CREDIT QUALITY

### Highlights

- Portfolio continues to be well diversified
- \$175 million drawdown of the general allowance, reflecting continued improvement in credit quality
- Gross impaired loans down 28% from 2003 to \$1,259 million
- Net impaired loans to total loans, acceptances and reverse repurchase agreements down from .46% to .34%
- Provision for credit losses down 52% to \$346 million
- Specific provision ratio of .23%, down from .33% in 2003
- Net write-offs ratio of .35%, down from .37% in 2003

### Loan portfolio

During 2004, our loan portfolio continued to perform well, reflecting strong economic conditions in Canada and the U.S. and a continuation of the low interest rate environment, which contributed to strong household and business credit quality.

As shown in the charts below, our loan portfolio remains well balanced among residential mortgage, personal, credit card, business and government loans, acceptances and reverse repurchase agreements. Compared to October 31, 2003, loans, acceptances and reverse repurchase agreements were up \$14.6 billion, reflecting good loan demand in a lower interest rate environment. Business and government loans and acceptances were up \$4.3 billion, residential mortgages were up \$5.4 billion, personal loans were up \$4.7 billion and credit card balances were up \$1.6 billion. The domestic portfolios experienced strong growth and accounted for a significant portion of the overall increase experienced during the year.

The portion of our business and government credit exposure rated investment grade was 69% in 2004, unchanged from 2003. Business and government loans and acceptances include our small business portfolio of \$10.1 billion, which is generally rated lower than our loans to larger businesses.

Table 12 on page 50A provides a detailed breakdown of loans, acceptances and reverse repurchase agreements, which we believe continue to be well diversified across sectors and geographies.

In 2004, we increased our exposure to key areas that we have targeted for growth including financial services. The increase in financial services was largely due to an increase in securities lending activity. During 2004, we continued to reduce our exposure to certain risk sensitive areas such as telecommunication, cable, electricity generation and distribution (within the energy sector) and airlines and aerospace (within the transportation and environment sector). Our aggregate exposure to these areas has declined by \$1.3 billion since 2003 to \$1.9 billion or .82% of loans, acceptances and reverse repurchase agreements.

### Impaired loans

Loans are generally classified as impaired (meaning interest is no longer being accrued) when there is no longer reasonable assurance of timely collection of the full amount of principal or interest, as more fully described in Note 1 on page 79A.

As indicated in Table 13 on page 51A, gross impaired loans decreased by \$486 million or 28% during the year to \$1,259 million. This was largely due to successful collection efforts, resulting in a number of problem accounts being repaid, restructured or sold and a general improvement in the credit environment, resulting in fewer new problem loans.

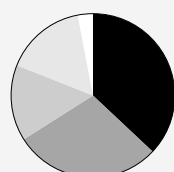
Business and government gross impaired loans fell by \$455 million to \$924 million, primarily resulting from reductions of \$232 million in Canada and \$223 million in Other International. The majority of the decline in Canada occurred in the transportation and environment, agriculture, and small business sectors, while the majority of the decline in Other International was in the energy, mining and metals, financial services and media and cable sectors. Small business gross impaired loans in Canada continue to decline as a result of enhanced underwriting, monitoring and collection processes.

In the consumer portfolio, gross impaired loans declined by \$31 million to \$335 million, with a \$49 million decline in Canada partially offset by an increase of \$15 million in the United States. New additions to gross impaired loans declined during the year, largely due to healthy household credit quality and the realization of benefits from our prior implementation of advanced risk modeling technology designed to optimize reward for risk assumed.

Net impaired loans as a percentage of related loans, acceptances and reverse repurchase agreements decreased to .34% from .46% in 2003, reflecting improvements in both the Canadian and Other international ratios and a slight deterioration in the U.S., as shown in Table 20 on page 56A.

**Breakdown of loans, acceptances and reverse repurchase agreements portfolio (2004)**

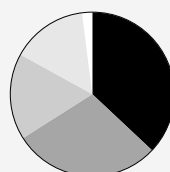
Portfolio remains ...



■ 37%	Residential mortgage
■ 29%	Business and government loans and acceptances
■ 15%	Reverse repurchase agreements
■ 16%	Personal
■ 3%	Credit card

**Breakdown of loans, acceptances and reverse repurchase agreements portfolio (2003)**

...well balanced



■ 37%	Residential mortgage
■ 29%	Business and government loans and acceptances
■ 17%	Reverse repurchase agreements
■ 15%	Personal
■ 2%	Credit card

### Provision for credit losses

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

The provision for credit losses was \$346 million in 2004, down \$375 million from 2003, as shown in Table 14 on page 52A. This reflected a \$200 million decline in the specific provision and a \$175 million reduction in the general allowance.

The specific provision on business and government loans decreased by \$179 million or 59% to \$125 million in 2004, reflecting declines of \$111 million in Canada (largely in the transportation and environment sector), and \$96 million in Other International (mostly in the energy sector), partially offset by an increase of \$28 million in the United States. The overall increase in the United States is a result of

an increase in the energy sector of \$47 million, partially offset by reductions in other sectors. In the consumer portfolio, the specific provision for credit losses decreased by \$21 million, largely related to personal loans in the United States.

In 2004, the specific provisions for credit losses were \$521 million or .23% of average loans, acceptances and reverse repurchase agreements (as shown in Table 20 on page 56A) and .28% of average loans and acceptances. This compared to \$721 million or .33% and .41%, respectively, a year ago. We believe that a ratio of specific provisions to average loans and acceptances is a more meaningful measure of loan quality than a ratio based on average loans, acceptances and reverse repurchase agreements. Based on the new ratio, we have revised our medium-term goal and objective for 2005, according to which we will measure our future performance.

### Outlook

In 2005, we expect a ratio of specific provisions for credit losses to average loans and acceptances in the range of .35–.45% compared to our 2004 performance of .28%. This reflects management's view that credit losses in our large business and government portfolios will likely revert to more normalized levels.

### Allowance for credit losses

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

The determination of the allowance for credit losses is based upon estimates derived from historical analysis, adjusted to take into account management's assessment of underlying assumptions in relation to the current environment. As a result, the allowance for credit losses will not likely equal the actual losses incurred in the future. To minimize these differences, management undertakes an assessment of the methodology utilized, and its underlying assumptions, on a regular basis.

As described in the Critical accounting policies and estimates section on page 26A, the allowance for credit losses comprises three components – specific, general allocated and general unallocated.

As shown in Table 18 on page 54A, the allowance for credit losses decreased by \$450 million or 21% from 2003 to a cyclical low of \$1,714 million. This change was largely due to a \$175 million drawdown of the general allowance, and decreases in the specific allowance, which were in line with the reduction in impaired loans over the same period. The drawdown of the general allowance followed an assessment of the credit quality of our loan portfolios and the adequacy of the related general allowance levels. The drawdown reflects positive changes in portfolio composition, improving default trends and better economic conditions. During the year, write-offs, net of recoveries, declined to \$785 million or .35% of average loans, acceptances and reverse repurchase agreements from \$812 million or .37% a year ago.

### Credit risk concentrations

Concentration risk exists if a number of clients are engaged in similar activities, are located in the same geographic region or have comparable economic characteristics such that their ability to meet contractual obligations would be similarly affected by changes in economic, political or other conditions. The strategies we use to minimize concentration risk are discussed further under Risk mitigation in the Risk management section on page 59A.

As shown in Table 15 on page 53A, the largest Canadian exposure is in Ontario, which has 40% of total loans, acceptances and reverse repurchase agreements. Internationally, the largest concentration is in the U.S., where we have 13% of our total loans, acceptances and reverse repurchase agreements.

As shown in Table 12 on page 50A, the largest sector concentrations, excluding small business, are in financial services, commercial real estate and agriculture, with 7%, 4% and 2% of loans, acceptances and reverse repurchase agreements, respectively.

Table 19 on page 55A shows contractual amounts with clients outside of Canada. Of the total international contractual amounts, \$63 billion or 15% of total assets are in the United States and \$51 billion or 12% of total assets are outside Canada and the U.S.

**Table 12 Loans, acceptances and reverse repurchase agreements by industry sector <sup>(1)</sup>**

(C\$ millions, except percentage amounts)	2004	2003	2002	2001	2000	Percentage of total	
						2004	2000
Canada							
Consumer							
Residential mortgage	\$ 80,168	\$ 73,978	\$ 67,700	\$ 64,066	\$ 61,444	35.0%	33.0%
Personal	30,415	26,445	24,550	26,086	26,275	13.3	14.1
Credit card	6,298	4,663	4,740	4,110	4,666	2.7	2.5
	116,881	105,086	96,990	94,262	92,385	51.0	49.6
Business and government loans and acceptances							
Small business (2)	10,137	9,705	9,470	9,788	11,701	4.4	6.3
Agriculture	4,400	4,526	4,427	4,758	4,931	1.9	2.6
Commercial mortgages	2,761	2,616	2,485	2,635	2,961	1.2	1.6
Consumer goods	2,215	2,394	2,280	2,447	2,874	1.0	1.5
Commercial real estate	2,418	2,086	2,327	2,325	2,594	1.1	1.4
Energy	2,160	1,702	2,919	4,293	3,754	.9	2.0
Government	1,921	1,805	1,006	1,597	1,385	.8	.7
Automotive (3)	1,724	1,630	1,376	864	673	.8	.4
Industrial products	1,521	1,503	1,642	2,174	2,470	.7	1.3
Transportation and environment (3)	1,034	1,111	1,524	2,138	1,519	.5	.8
Forest products	779	1,052	975	1,275	1,362	.3	.7
Financial services	2,027	947	2,245	3,010	2,218	.9	1.2
Media and cable (4)	772	839	996	1,510	1,120	.3	.6
Mining and metals	250	369	369	636	897	.1	.5
Telecommunication	135	169	488	677	1,008	.1	.5
Information technology	274	126	197	203	210	.1	.1
Other	4,520	3,996	6,859	8,098	7,369	2.0	4.0
	39,048	36,576	41,585	48,428	49,046	17.0	26.3
Reverse repurchase agreements	18,262	14,996	19,116	22,860	12,094	8.0	6.5
Total Canada	174,191	156,658	157,691	165,550	153,525	76.0	82.5
United States							
Consumer							
Residential mortgage	3,225	4,094	4,351	2,664	845	1.4	.5
Personal	5,849	5,015	5,269	4,621	78	2.6	—
Cards	108	107	125	128	—	—	—
	9,182	9,216	9,745	7,413	923	4.0	.5
Business and government loans and acceptances							
Consumer goods	723	824	958	1,172	435	.3	.2
Commercial real estate	5,267	5,480	4,531	3,773	44	2.3	—
Energy	843	1,200	2,680	1,613	1,582	.4	.8
Government	221	100	19	23	—	.1	—
Automotive (3)	255	329	409	408	221	.1	.1
Industrial products	360	466	974	1,513	1,107	.2	.6
Transportation and environment (3)	213	350	484	788	469	.1	.3
Forest products	89	127	223	98	181	—	.1
Financial services	5,003	3,330	3,200	2,754	4,521	2.2	2.4
Media and cable (4)	564	854	1,107	1,038	1,782	.2	1.0
Mining and metals	26	97	70	45	104	—	.1
Telecommunication	54	315	689	835	1,131	—	.6
Information technology	128	86	177	299	374	.1	.2
Other	2,817	2,773	3,348	3,089	541	1.2	.3
	16,563	16,331	18,869	17,448	12,492	7.2	6.7
Reverse repurchase agreements	4,985	5,721	4,512	5,199	2,524	2.2	1.4
Total United States	30,730	31,268	33,126	30,060	15,939	13.4	8.6
Other International							
Consumer							
Residential mortgage	777	745	789	712	695	.3	.4
Personal	584	726	769	688	734	.3	.4
Cards	50	46	49	45	—	—	—
	1,411	1,517	1,607	1,445	1,429	.6	.8
Business and government loans and acceptances							
Consumer goods	119	185	425	527	676	.1	.4
Commercial real estate	153	504	593	309	227	.1	.1
Energy	340	672	1,051	1,381	1,469	.1	.8
Government	21	30	111	105	167	—	.1
Automotive (3)	9	6	2	119	292	—	.2
Industrial products	7	91	225	603	642	—	.3
Transportation and environment (3)	1,000	1,326	1,958	783	1,018	.4	.5
Forest products	37	77	194	287	287	—	.2
Financial services	7,983	4,914	2,414	3,893	3,391	3.5	1.8
Media and cable (4)	20	95	213	342	251	—	.1
Mining and metals	333	525	1,122	1,026	797	.1	.4
Telecommunication	13	56	557	723	1,113	—	.6
Information technology	—	—	2	97	59	—	—
Other	1,251	1,185	595	589	1,179	.5	.6
	11,286	9,666	9,462	10,784	11,568	4.9	6.2
Reverse repurchase agreements	11,615	15,572	13,457	9,342	3,685	5.1	2.0
Total Other International	24,312	26,755	24,526	21,571	16,682	10.6	9.0
Total loans, acceptances and reverse repurchase agreements	229,233	214,681	215,343	217,181	186,146	100.0%	100.0%
Allowance for loan losses	(1,644)	(2,055)	(2,203)	(2,278)	(1,871)		
Total	\$ 227,589	\$ 212,626	\$ 213,140	\$ 214,903	\$ 184,275		

(1) Based on residence of borrower.

(2) Comprises the following industries in 2004: commercial real estate of \$1,821 million (2003 – \$1,777 million; 2002 – \$1,737 million), consumer goods of \$1,764 million (2003 – \$1,777 million; 2002 – \$1,583 million), industrial products of \$999 million (2003 – \$952 million; 2002 – \$887 million), transportation and environment of \$502 million (2003 – \$503 million; 2002 – \$552 million), automotive of \$463 million (2003 – \$462 million; 2002 – \$377 million), forest products of \$276 million (2003 – \$298 million; 2002 – \$278 million), energy of \$150 million (2003 – \$137 million; 2002 – \$125 million), information technology of \$124 million (2003 – \$113 million; 2002 – \$93 million), mining and metals of \$62 million (2003 – \$65 million; 2002 – \$69 million), financial services of \$86 million (2003 – \$136 million; 2002 – \$132 million), media and cable of \$85 million (2003 – \$81 million; 2002 – \$77 million), telecommunications of \$23 million (2003 – \$48 million; 2002 – \$34 million), and other of \$3,782 million (2003 – \$3,356 million; 2002 – \$3,526 million).

(3) Commencing in 2002, certain amounts were reclassified from the transportation and environment sector grouping to the automotive group.

(4) Includes cable loans of \$218 million in Canada in 2004 (2003 – \$236 million; 2002 – \$267 million; 2001 – \$330 million; 2000 – \$262 million) and \$191 million in the United States in 2004 (2003 – \$357 million; 2002 – \$522 million; 2001 – \$455 million; 2000 – \$1,162 million); and \$20 million in Other International in 2004 (2003 – \$75 million; 2002 – \$112 million; 2001 – \$170 million; 2000 – \$159 million).

**Table 13 Impaired loans by industry sector**

(C\$ millions)	2004				2003				2002		2001		2000	
	Gross		Net (1)		Gross		Net (1)		Net (1)		Net (1)		Net (1)	
<b>Canada</b>														
Consumer														
Residential mortgage	\$	96	\$	85	\$	110	\$	98	\$	87	\$	118	\$	157
Personal		178		70		213		84		112		129		51
		274		155		323		182		199		247		208
<b>Business and government</b>														
Small business (2)		142		62		169		80		104		132		141
Agriculture (2)		75		48		127		90		97		86		39
Commercial mortgages		17		14		24		18		8		5		—
Consumer goods		25		24		32		17		26		5		23
Commercial real estate		2		1		8		4		11		44		41
Energy		1		1		1		1		1		9		—
Automotive		—		—		—		—		3		5		4
Industrial products		34		22		18		5		12		26		18
Transportation and environment		9		—		118		62		108		222		120
Forest products		151		94		169		115		156		184		180
Financial services		—		—		3		3		(1)		2		7
Media and cable (3)		3		2		15		13		6		15		17
Mining and metals		6		5		—		—		—		1		(1)
Telecommunication		10		6		8		3		6		—		—
Information technology		—		—		17		13		2		7		(2)
Other		34		22		32		20		28		17		1
		509		301		741		444		567		760		588
Total Canada		783		456		1,064		626		766		1,007		796
<b>United States</b>														
Consumer														
Residential mortgage		33		31		7		6		13		22		—
Personal		11		8		22		12		17		8		—
		44		39		29		18		30		30		—
<b>Business and government</b>														
Consumer goods		11		7		16		12		7		7		—
Commercial real estate		65		51		65		53		62		49		1
Energy		141		93		114		49		29		—		—
Automotive		4		2		7		6		22		25		—
Industrial products		4		1		5		2		13		(1)		34
Transportation and environment		3		1		9		2		28		26		25
Financial services		—		—		9		6		35		23		—
Media and cable (3)		64		57		44		44		56		—		—
Telecommunication		—		—		—		—		35		122		—
Information technology		9		8		11		1		17		70		—
Other		31		(6)		52		26		21		24		9
		332		214		332		201		325		345		69
Total United States		376		253		361		219		355		375		69
<b>Other International</b>														
Consumer														
Residential mortgage		17		17		14		14		13		13		5
		17		17		14		14		13		13		5
<b>Business and government</b>														
Energy		20		15		125		47		110		—		(2)
Industrial products		—		—		2		—		—		(1)		4
Transportation and environment		—		—		9		5		11		32		—
Financial services		14		—		33		5		11		1		(2)
Media and cable (3)		—		—		27		13		—		—		—
Mining and metals		2		1		57		25		90		29		6
Other		47		30		53		34		38		27		27
		83		46		306		129		260		88		33
Total Other International		100		63		320		143		273		101		38
Total (4), (5)	\$	1,259	\$	772	\$	1,745	\$	988	\$	1,394	\$	1,483	\$	903

(1) Net of specific allowance.

(2) Includes government guaranteed portions of impaired loans of \$24 million in small business in 2004 (2003 – \$39 million; 2002 – \$64 million; 2001 – \$95 million; 2000 – \$101 million) and \$9 million in agriculture (2003 – \$9 million; 2002 – \$10 million; 2001 – \$6 million; 2000 – \$6 million).

(3) Consists entirely of cable loans.

(4) Includes foreclosed assets of \$27 million in 2004 (2003 – \$34 million; 2002 – \$32 million; 2001 – \$37 million; 2000 – \$16 million).

(5) Past due loans greater than 90 days not included in impaired loans was \$219 million in 2004 (2003 – \$222 million; 2002 – \$217 million; 2001 – \$245 million).

**Table 14 Provision for credit losses by industry sector**

(C\$ millions)	2004	2003	2002	2001	2000
<b>Canada</b>					
<b>Consumer</b>					
Residential mortgage	\$ 6	\$ 4	\$ 3	\$ 8	\$ –
Personal	212	230	266	265	301
Credit card	165	152	135	125	102
	383	386	404	398	403
<b>Business and government</b>					
Small business	75	77	110	164	105
Agriculture	6	(2)	22	20	4
Commercial mortgages	–	(3)	(5)	7	2
Consumer goods	(20)	2	19	2	7
Commercial real estate	(10)	(14)	(15)	15	(17)
Energy	–	–	4	17	(8)
Automotive	–	–	–	17	–
Industrial products	4	2	(7)	14	2
Transportation and environment	(33)	69	(19)	13	56
Forest products	3	13	4	7	(36)
Financial services	–	(4)	(27)	(9)	–
Media and cable	(1)	1	(7)	13	12
Mining and metals	–	1	(1)	–	(1)
Telecommunication	8	5	59	–	(1)
Information technology	(1)	2	3	3	8
Other	(1)	(8)	(15)	8	(10)
	30	141	125	291	123
<b>Total Canada</b>	<b>413</b>	<b>527</b>	<b>529</b>	<b>689</b>	<b>526</b>
<b>United States</b>					
<b>Consumer</b>					
Residential mortgage	1	3	7	8	–
Personal	9	24	15	5	–
Cards	3	3	4	2	–
	13	30	26	15	–
<b>Business and government</b>					
Consumer goods	1	8	4	2	–
Commercial real estate	3	5	5	66	2
Energy	63	16	107	–	–
Automotive	1	(1)	1	6	–
Industrial products	1	(1)	8	3	40
Transportation and environment	(1)	7	5	(4)	42
Financial services	–	–	11	7	–
Media and cable	8	12	–	3	–
Telecommunication	(13)	–	202	272	–
Information technology	(4)	(4)	41	7	–
Other	47	36	30	–	15
	106	78	414	362	99
<b>Total United States</b>	<b>119</b>	<b>108</b>	<b>440</b>	<b>377</b>	<b>99</b>
<b>Other International</b>					
<b>Consumer</b>					
Residential mortgage	–	1	–	(8)	–
	–	1	–	(8)	–
<b>Business and government</b>					
Consumer goods	–	–	(6)	(2)	(7)
Commercial real estate	–	–	(1)	(1)	(1)
Energy	(13)	62	34	(8)	(2)
Automotive	–	–	–	1	(8)
Industrial products	–	–	(3)	–	(6)
Transportation and environment	(1)	1	16	12	–
Financial services	–	3	10	(10)	(21)
Media and cable	4	14	–	–	–
Mining and metals	(4)	4	28	–	2
Other	3	1	18	(1)	(11)
	(11)	85	96	(9)	(54)
<b>Total Other International</b>	<b>(11)</b>	<b>86</b>	<b>96</b>	<b>(17)</b>	<b>(54)</b>
<b>Total specific provision</b>	<b>521</b>	<b>721</b>	<b>1,065</b>	<b>1,049</b>	<b>571</b>
<b>General allocated</b>	<b>(147)</b>	<b>6</b>	<b>(22)</b>	<b>205</b>	<b>73</b>
<b>General unallocated</b>	<b>(28)</b>	<b>(6)</b>	<b>22</b>	<b>(135)</b>	<b>47</b>
<b>Total general provision</b>	<b>(175)</b>	<b>–</b>	<b>–</b>	<b>70</b>	<b>120</b>
<b>Total</b>	<b>\$ 346</b>	<b>\$ 721</b>	<b>\$ 1,065</b>	<b>\$ 1,119</b>	<b>\$ 691</b>

**Table 15** Loans, acceptances and reverse repurchase agreements by geographic location <sup>(1)</sup>

(C\$ millions, except percentage amounts)						Percentage of total	
	2004	2003	2002	2001	2000	2004	2000
<b>Canada</b>							
Atlantic provinces (2)	\$ 10,385	\$ 9,856	\$ 9,741	\$ 9,518	\$ 9,690	4.5%	5.2%
Quebec	16,976	15,800	15,224	13,760	16,191	7.4	8.7
Ontario	90,485	80,541	82,438	94,821	73,124	39.5	39.3
Prairie provinces (3)	29,899	26,823	26,953	24,949	29,402	13.1	15.8
British Columbia	26,446	23,638	23,335	22,502	25,118	11.5	13.5
<b>Total Canada</b>	<b>174,191</b>	<b>156,658</b>	<b>157,691</b>	<b>165,550</b>	<b>153,525</b>	<b>76.0</b>	<b>82.5</b>
<b>United States</b>	<b>30,730</b>	<b>31,268</b>	<b>33,126</b>	<b>30,060</b>	<b>15,939</b>	<b>13.4</b>	<b>8.5</b>
<b>Other International</b>	<b>24,312</b>	<b>26,755</b>	<b>24,526</b>	<b>21,571</b>	<b>16,682</b>	<b>10.6</b>	<b>9.0</b>
<b>Total loans and acceptances and reverse repurchase agreements</b>	<b>229,233</b>	<b>214,681</b>	<b>215,343</b>	<b>217,181</b>	<b>186,146</b>	<b>100.0%</b>	<b>100.0%</b>
Allowance for loan losses	(1,644)	(2,055)	(2,203)	(2,278)	(1,871)		
<b>Total</b>	<b>\$ 227,589</b>	<b>\$ 212,626</b>	<b>\$ 213,140</b>	<b>\$ 214,903</b>	<b>\$ 184,275</b>		

(1) Based on residence of borrower.

(2) Comprises Newfoundland and Labrador, Prince Edward Island, Nova Scotia and New Brunswick.

(3) Comprises Manitoba, Saskatchewan and Alberta.

**Table 16** Impaired loans by geographic location

(C\$ millions, except percentage amounts)	2004		2003		2002	2001	2000	Percentage of total	
								2004	2000
	Gross	Net (3)	Gross	Net (3)	Net (3)	Net (3)	Net (3)		
Canada									
Atlantic provinces (1)	\$ 60	\$ 35	\$ 81	\$ 44	\$ 55	\$ 67	\$ 65	4.5%	7.2%
Quebec	131	96	155	85	60	204	121	12.4	13.4
Ontario	254	122	348	199	261	330	287	15.8	31.8
Prairie provinces (2)	93	53	140	79	98	71	57	6.9	6.3
British Columbia	245	150	340	219	292	335	266	19.4	29.5
Total Canada	783	456	1,064	626	766	1,007	796	59.0	88.2
United States	376	253	361	219	355	375	69	32.8	7.6
Other International	100	63	320	143	273	101	38	8.2	4.2
Total	\$ 1,259	\$ 772	\$ 1,745	\$ 988	\$ 1,394	\$ 1,483	\$ 903	100.0%	100.0%

(1) Comprises Newfoundland and Labrador, Prince Edward Island, Nova Scotia and New Brunswick.

(2) Comprises Manitoba, Saskatchewan and Alberta.

(3) Net of specific allowance.

**Table 17** Provision for credit losses by geographic location

(C\$ millions, except percentage amounts)						Percentage of total	
	2004	2003	2002	2001	2000	2004	2000
<b>Canada</b>							
Atlantic provinces (1)	\$ 34	\$ 46	\$ 59	\$ 63	\$ 58	9.8%	8.4%
Quebec	(1)	77	(5)	43	22	(.3)	3.2
Ontario	318	309	330	398	342	91.9	49.5
Prairie provinces (2)	31	55	86	81	64	9.0	9.3
British Columbia	31	40	59	104	40	9.0	5.7
<b>Total Canada</b>	<b>413</b>	<b>527</b>	<b>529</b>	<b>689</b>	<b>526</b>	<b>119.4</b>	<b>76.1</b>
<b>United States</b>	<b>119</b>	<b>108</b>	<b>440</b>	<b>377</b>	<b>99</b>	<b>34.4</b>	<b>14.3</b>
<b>Other International</b>	<b>(11)</b>	<b>86</b>	<b>96</b>	<b>(17)</b>	<b>(54)</b>	<b>(3.2)</b>	<b>(7.8)</b>
<b>Total specific provision</b>	<b>521</b>	<b>721</b>	<b>1,065</b>	<b>1,049</b>	<b>571</b>	<b>150.6</b>	<b>82.6</b>
<b>General allocated provision</b>	<b>(147)</b>	<b>6</b>	<b>(22)</b>	<b>205</b>	<b>73</b>	<b>(42.5)</b>	<b>10.6</b>
<b>Total allocated provision</b>	<b>374</b>	<b>727</b>	<b>1,043</b>	<b>1,254</b>	<b>644</b>	<b>108.1</b>	<b>93.2</b>
<b>Total general unallocated provision</b>	<b>(28)</b>	<b>(6)</b>	<b>22</b>	<b>(135)</b>	<b>47</b>	<b>(8.1)</b>	<b>6.8</b>
<b>Total</b>	<b>\$ 346</b>	<b>\$ 721</b>	<b>\$ 1,065</b>	<b>\$ 1,119</b>	<b>\$ 691</b>	<b>100.0%</b>	<b>100.0%</b>

(1) Comprises Newfoundland and Labrador, Prince Edward Island, Nova Scotia and New Brunswick.

(2) Comprises Manitoba, Saskatchewan and Alberta.

**Table 18 Allowance for credit losses**

(C\$ millions)	2004	2003	2002	2001	2000
<b>Allowance at beginning of year</b>	\$ 2,164	\$ 2,314	\$ 2,392	\$ 1,975	\$ 1,900
<b>Provision for credit losses</b>	346	721	1,065	1,119	691
<b>Write-offs</b>					
Canada					
Residential mortgage	(7)	(6)	(11)	(15)	(11)
Personal	(306)	(345)	(381)	(394)	(372)
Credit card	(204)	(188)	(172)	(169)	(150)
Business and government	(193)	(224)	(330)	(296)	(225)
	(710)	(763)	(894)	(874)	(758)
United States					
Residential mortgage	–	(4)	(1)	(9)	–
Personal	(19)	(28)	(17)	(7)	–
Credit card	(3)	(4)	(6)	(2)	–
Business and government	(129)	(131)	(467)	(215)	(41)
	(151)	(167)	(491)	(233)	(41)
Other International					
Business and government	(140)	(52)	(39)	(18)	(40)
LDC exposures	–	–	(33)	–	–
	(140)	(52)	(72)	(18)	(40)
	(1,001)	(982)	(1,457)	(1,125)	(839)
<b>Recoveries</b>					
Canada					
Personal	65	66	68	66	44
Credit card	38	36	37	44	48
Business and government	80	53	72	58	48
	183	155	177	168	140
United States					
Personal	3	2	2	1	–
Credit card	1	1	1	–	–
Business and government	24	10	7	5	–
	28	13	10	6	–
Other International					
Business and government	5	2	11	11	22
	5	2	11	11	22
	216	170	198	185	162
<b>Net write-offs</b>	(785)	(812)	(1,259)	(940)	(677)
Adjustments	(11)	(59)	116	238	61
<b>Allowance at end of year</b>	\$ 1,714	\$ 2,164	\$ 2,314	\$ 2,392	\$ 1,975
<b>Allocation of allowance (1)</b>					
Canada					
Residential mortgage	\$ 23	\$ 33	\$ 35	\$ 45	\$ 46
Personal	384	395	429	447	403
Credit card	188	147	147	147	88
Business and government	502	682	711	791	664
	1,097	1,257	1,322	1,430	1,201
United States					
Residential mortgage	3	3	6	4	3
Personal	55	42	36	33	–
Credit card	3	4	5	5	–
Business and government	234	319	409	434	184
	295	368	456	476	187
Other International					
Residential mortgage	1	1	–	–	8
Business and government	44	191	174	147	138
	45	192	174	147	146
Allocated allowance for loan losses	1,437	1,817	1,952	2,053	1,534
Unallocated allowance for loan losses	207	238	251	225	337
<b>Total allowance for loan losses</b>	1,644	2,055	2,203	2,278	1,871
Allowance for off-balance sheet and other items (2)	70	109	109	109	98
Allowance for tax-exempt securities	–	–	2	5	6
<b>Total allowance for credit losses</b>	\$ 1,714	\$ 2,164	\$ 2,314	\$ 2,392	\$ 1,975

- (1) The allowance for loan losses includes an amount for the allocated general allowance, which has been allocated to loan categories. These amounts total \$950 million (2003 – \$1,060 million; 2002 – \$1,060 million; 2001 – \$1,076 million; 2000 – \$765 million) and have been allocated as follows: for Canada – residential mortgage \$12 million (2003 – \$21 million; 2002 – \$20 million; 2001 – \$21 million; 2000 – \$18 million), personal \$276 million (2003 – \$266 million; 2002 – \$266 million; 2001 – \$266 million; 2000 – \$207 million), credit card \$188 million (2003 – \$147 million; 2002 – \$147 million; 2001 – \$147 million; 2000 – \$88 million), business and government \$295 million (2003 – \$385 million; 2002 – \$386 million; 2001 – \$385 million; 2000 – \$321 million), and for United States – residential mortgage \$2 million (2003 – \$2 million; 2002 – \$3 million; 2001 – \$2 million; 2000 – \$2 million), personal \$53 million (2003 – \$33 million; 2002 – \$22 million; 2001 – \$26 million; 2000 – nil), credit card \$3 million (2003 – \$4 million; 2002 – \$5 million; 2001 – \$5 million; 2000 – nil), and business and government \$114 million (2003 – \$187 million; 2002 – \$196 million; 2001 – \$192 million; 2000 – \$110 million), and for Other International – business and government \$7 million (2003 – \$15 million; 2002 – \$15 million; 2001 – \$32 million; 2000 – \$19 million).
- (2) Commencing in 2000, the allowance for off-balance sheet and other items was separated and reported under other liabilities. Previously, the amount was included in the allowance for loan losses.



**Table 19 Foreign outstandings** <sup>(1)</sup>

	2004		2003		2002	
(C\$ millions, except percentage amounts)		% of total assets		% of total assets		% of total assets
United States – Banks	\$ 5,355		\$ 7,204		\$ 5,838	
– Government	6,917		7,970		3,257	
– Other	50,774		57,086		62,210	
	63,046	14.7%	72,260	17.9%	71,305	18.9%
Western Europe – Banks	25,673		24,371		21,419	
– Government	2,717		2,792		1,286	
– Other	12,969		12,119		9,152	
	41,359	9.6	39,282	9.8	31,857	8.5
Central/Eastern Europe, Middle East and Africa	138	–	198	.1	247	.1
Latin America	585	.1	865	.2	1,607	.4
Caribbean	2,912	.7	2,692	.7	3,045	.8
Asia	2,712	.6	5,791	1.4	3,645	1.0
Australia and New Zealand	2,897	.7	2,425	.6	2,842	.8
Allowance for loan losses <sup>(2)</sup>	(446)	(.1)	(678)	(.2)	(760)	(.2)
<b>Total</b>	<b>\$ 113,203</b>	<b>26.4%</b>	<b>\$ 122,835</b>	<b>30.5%</b>	<b>\$ 113,788</b>	<b>30.2%</b>

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

(2) Includes the international component of the specific, general allocated and general unallocated allowance.

**Table 20 Risk profile**

(C\$ millions, except percentage amounts)	2004	2003	2002	2001	2000
<b>Percentage of loans to total loans (1)</b>					
Canada (2)					
Residential mortgage	35%	35%	32%	30%	33%
Personal	13	13	12	12	15
Credit card	3	2	2	2	2
Business and government	24	22	26	30	32
	75	72	72	74	82
United States	14	15	16	15	9
Other International	11	13	12	11	9
Total	100%	100%	100%	100%	100%
<b>Gross impaired loans</b>					
Beginning of year	\$ 1,745	\$ 2,288	\$ 2,465	\$ 1,678	\$ 1,704
Net additions	515	439	1,280	1,912	813
Write-offs and adjustments	(1,001)	(982)	(1,457)	(1,125)	(839)
End of year	\$ 1,259	\$ 1,745	\$ 2,288	\$ 2,465	\$ 1,678
Net impaired loans as a % of related loans, acceptances and reverse repurchase agreements					
Canada (2)					
Residential mortgage	.11%	.13%	.13%	.18%	.26%
Personal	.23	.32	.46	.50	.20
Business and government	.54	.90	.98	1.15	.97
	.26	.41	.49	.63	.52
United States	.80	.68	1.03	1.14	.43
Other International	.25	.52	1.07	.43	.22
Total	.34%	.46%	.65%	.69%	.49%
<b>Allowance for credit losses</b>					
Specific	\$ 487	\$ 757	\$ 894	\$ 951	\$ 747
Country risk	—	—	—	31	28
General allowance					
General allocated (3)	1,020	1,169	1,169	1,185	863
General unallocated	207	238	251	225	337
Total general allowance	1,227	1,407	1,420	1,410	1,200
Total	\$ 1,714	\$ 2,164	\$ 2,314	\$ 2,392	\$ 1,975
As a % of loans, acceptances and reverse repurchase agreements	.7%	1.0%	1.0%	1.1%	1.0%
As a % of impaired loans (coverage ratio), excluding LDCs	131%	118%	96%	93%	112%
<b>Provision for credit losses</b>					
Specific	\$ 521	\$ 721	\$ 1,065	\$ 1,049	\$ 571
General provision					
General allocated	(147)	6	(22)	205	73
General unallocated	(28)	(6)	22	(135)	47
Total general provision	(175)	—	—	70	120
Total	\$ 346	\$ 721	\$ 1,065	\$ 1,119	\$ 691
Credit derivative gains	—	(29)	(102)	—	—
Credit derivative losses	—	—	69	—	—
Total provision net of credit derivative gains/losses	\$ 346	\$ 692	\$ 1,032	\$ 1,119	\$ 691
Specific provision net of credit derivative gains/losses as a % of average loans, acceptances and reverse repurchase agreements	.23%	.32%	.49%	.53%	.32%
Specific provision as a % of average loans and acceptances	.28%	.41%	.62%	.62%	.36%
Specific provision as a % of related average loans, acceptances and reverse repurchase agreements					
Canada					
Residential mortgage	.01	.01	—	.01	—
Personal	.73	.90	1.05	.94	1.12
Credit card	2.92	2.92	3.10	2.73	2.87
Business and government	.06	.25	.20	.52	.22
	.26	.34	.33	.45	.36
United States (4)	.33	.34	1.38	—	—
Other International	(.04)	.30	.47	.74	.13
Total specific provision	.23%	.33%	.51%	.53%	.32%
Total provision for credit losses	.15	.33	.51	.56	.38
<b>Net write-offs (excluding LDCs) as a % of average loans, acceptances and reverse repurchase agreements</b>	.35%	.37%	.58%	.47%	.38%
<b>Net write-offs as a % of average loans, acceptances and reverse repurchase agreements</b>	.35%	.37%	.60%	.47%	.38%

(1) Loans include acceptances and reverse repurchase agreements.

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

(3) Includes the allowance for off-balance sheet and other items.

(4) As the information is not reasonably determinable, percentages for years prior to 2002 are not presented.

## RISK MANAGEMENT

### Overview

The mission of the risk management function is to build shareholder value through leadership in the strategic management of risk. Strategic priorities are to:

- Ensure alignment between risk appetite and business strategies
- Attract, develop and retain high-calibre risk management professionals
- Enhance communication of risk and risk appetite throughout the enterprise
- Invest in capabilities to better measure, understand and manage risk
- Strengthen the efficiency, accessibility and responsiveness of key risk processes and practices

Our business activities expose us to the risks outlined in the risk pyramid. We use the risk pyramid as a tool to identify and assess risk across the organization. Risks are shown within the pyramid according to the level of control and influence that we can exert to mitigate or manage each specific risk type.

### Controllable risks

- **Credit risk** is the risk of loss due to a counterparty's inability to fulfill its payment obligations. It also refers to a loss in market value due to the deterioration of a counterparty's financial position. A counterparty may be an issuer, debtor, borrower, policyholder, reinsurer or guarantor.
- **Market risk** is the risk of loss that results from changes in interest rates, foreign exchange rates, equity prices and commodity prices.
- **Liquidity risk** is the risk that we are unable to generate or obtain sufficient cash or equivalents on a cost-effective basis to meet our commitments as they fall due.

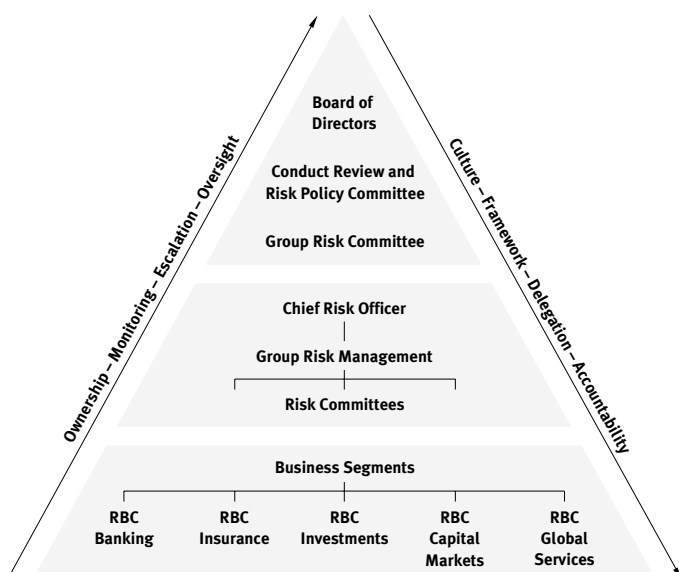
- **Insurance risk** is the risk inherent in the design and underwriting of insurance policies. The principal sources of Insurance risk are product design and pricing risk and insurance underwriting risk.
- **Operational risk** is the risk of direct or indirect loss resulting from inadequate or failed processes, technology, human performance or external events. The impact of Operational risk can be financial loss, loss of reputation, loss of competitive position, poor client service and legal or regulatory proceedings.



### An organizational perspective

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

#### The Risk Pyramid: An organizational perspective



Risk management professionals work in partnership with the business segment and corporate functions to identify risks, which are then measured, monitored and managed. In line with our group-wide portfolio management approach, portfolio analysis techniques are employed in an effort to optimize the risk-reward profile and ensure the efficient and appropriate attribution of capital.

A structure of management and Board of Directors (the board) committees provides oversight of the risk management process.

#### The Board of Directors and Group Risk Committee

The top level of the organizational perspective risk pyramid comprises the Board of Directors, the Conduct Review and Risk Policy Committee (CR&RPC) and Group Risk Committee (GRC). CR&RPC is a board committee while GRC is a senior executive committee.

Key responsibilities are to:

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

### Risk management

The middle level of the organizational perspective risk pyramid comprises the Chief Risk Officer, Group Risk Management and the various Risk Committees. The Risk Committees oversee such matters as policies, portfolios, governance, ethics, compliance and various specific risk areas (i.e., credit, market, liquidity, insurance and operational). In 2004, the Structured Transactions Oversight Committee was established to provide risk oversight through the review of structured transactions and complex credits with potentially significant reputational, legal, regulatory, accounting or tax risks.

Key responsibilities of the Chief Risk Officer, Group Risk Management and the various Risk Committees are to:

- Implement and maintain an integrated enterprise-wide risk measurement, management and reporting framework
- Establish a comprehensive risk assessment and approval process that ensures all risks are mitigated or that control gaps are addressed in a timely manner
- Maintain a comprehensive enterprise-wide risk policy framework to

ensure effective creation, approval and communication of policies and related documents

- Establish guidelines and risk limits to ensure appropriate risk diversification and optimization of risk-return on both a portfolio and transactional basis
- Advise the board and executive management of major risks being assumed by, or facing, the organization
- Partner with the business segments to identify, understand, measure, mitigate and monitor the risks being taken

### Business segments

The base level of the organizational perspective risk pyramid comprises the business segments. Their responsibilities include:

- Ownership and accountability of the risks of the business
- Alignment of business strategy with the corporate risk culture, risk appetite and policy
- Identification, understanding, mitigation and management of the risks being taken

## BASEL II

Basel II is a new capital adequacy framework that is intended to strengthen risk management and market discipline, and thereby the safety and soundness of the international financial industry. The Basel Committee on Banking Supervision, consisting of central banks and bank supervisors from 13 countries, approved the final text of the new framework in June 2004, after a five-year consultation period. This new accord will replace the current 1988 Basel Accord.

The next step for the countries involved with Basel II is implementation. The new framework, which is comprehensive and far-reaching, provides a menu of approaches to calculate regulatory capital. The

implementation timetable mandates compliance with the new rules by the end of 2006 for the basic approach and the end of 2007 for the advanced approaches.

We have created a Basel Program Management Office, which is responsible for co-ordinating the implementation initiative and ensuring enterprise-wide compliance with Basel II. While this is not a transformational initiative, there will be opportunities to achieve internal efficiencies through the modernization and upgrading of risk practices, policies, processes and technologies, which will enable us to manage credit, market and operational risk more efficiently and effectively.

## ECONOMIC CAPITAL

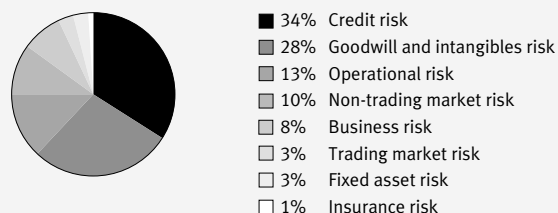
Economic Capital (EC) is management's estimate of the amount of common equity required to underpin all our risks. It is calculated by estimating the level of capital that is necessary to cover risks consistent with our desired solvency standard and AA debt rating. EC is attributed to our business segments to provide directly comparable performance measurements for each of our business activities and to assist senior management in strategic planning, resource allocation and capital management. EC analysis is intended to represent the shareholder's perspective and drives the optimization of shareholder returns in terms of risk/reward. Calculation and attribution of EC involves a number of assumptions and judgments, and changes to them may result in materially different amounts of EC being computed. Capital attribution methodologies are continually monitored to ensure risks are being consistently quantified, utilizing all available information. Periodically, improvements are made to these methodologies with the changes applied prospectively.

EC is calculated for various risk types. Credit, market (trading and non-trading), insurance and operational risk are detailed in the following sections. Business risk is the risk of loss due to variances in volumes, prices and costs caused by competitive forces, regulatory changes, and reputational and strategic risks. Goodwill and intangibles and fixed asset risks are defined as the risk that the value of these assets will be less than their net book value at a future date. For further details on goodwill and other intangibles, see Note 4 on page 86A. EC for liquidity risk is not calculated separately but is embedded within the other risk

types. The total required EC takes into account the diversification benefits between and within risk categories and lines of business. These diversification benefits are passed on to our businesses and are reflected in the EC levels used in their return on equity calculations.

The following chart represents the proportionate EC levels by risk type in fiscal 2004. Compared to 2003, there has been no significant change by risk type. Credit risk and goodwill and intangibles risk continue to be our largest risks. The goodwill risk is largely attributable to acquisitions we have made in the U.S. over the past several years.

Average Economic Capital by risk type (2004)



*The following sections describe how we manage the major controllable risks, which include credit, market, liquidity, insurance and operational risk.*

## CREDIT RISK

Our approach to credit risk management preserves the independence and integrity of risk assessment while being integrated into the portfolio management processes. Policies and procedures, which are communicated throughout the organization, guide the day-to-day management of credit risk exposure and are an essential part of our business culture.

The goal of credit risk management is to evaluate and manage credit risk in order to further enhance our strong credit culture.

We manage credit risk directly through key control processes, risk measurements used by management to monitor performance and through the use of certain risk mitigation strategies.

### Key control processes

Credit scoring models are used for underwriting and ongoing monitoring of consumer and certain small business credit. Applicant scoring is used for underwriting purposes and utilizes established statistical methods of analyzing applicant characteristics and past performance to determine the probability of the risk for future credit performance. Behavioural scoring is used for ongoing management of booked accounts and utilizes statistical techniques that capture past performance to predict future behaviour of existing accounts. Both applicant and behavioural scores use customer centric scoring models, which consider the strength of the entire client relationship, utilizing certain variables, to predict future behaviour. Vigorous testing methods are in place to monitor the performance of the credit models. During 2004, 35% of our credit scoring models were enhanced to improve their ability to identify risk.

For commercial and corporate clients, we assign an internal risk rating based on a detailed review of the borrower. This examination considers industry sector trends, market competitiveness, overall company strategy, financial strength, access to funds, financial management and any other risks facing the organization. Our rating system is based on a 22-point scale. The internal risk ratings are assessed and updated on a regular basis to ensure they accurately represent the risk profile of the counterparty they are attributed to and to ensure consistency in ratings across sector groups.

In addition to control processes for credit granting and ongoing monitoring, we have established risk limits to ensure that we do not become overexposed to any one borrower or family of related borrowers, industry sector or geographic area.

### Risk measurements

Credit risk is monitored on an ongoing basis with formal monthly and quarterly reporting to ensure senior management is aware of shifts in loan quality and portfolio performance. Critical components of this reporting framework include a dashboard for consumer and small business lending, and classification reporting and expected loss monitoring for commercial and corporate lending.

The dashboard is a monthly reporting mechanism in place for all consumer and small business loan portfolios. The performance of each portfolio is assessed against various risk-reward measures and assigned one of the following ratings – concern, monitor or good. At year-end, portfolios representing approximately 4% of consumer and small business loans outstanding at October 31, 2004, were rated concern. To monitor any shifts in portfolio quality, further assessment criteria are applied to each portfolio to generate one of the following portfolio quality trend indicators – declining, stable or improving. At year-end, most portfolios reflected a stable or improving portfolio quality trend, including the portfolios classified as concern from a risk-reward perspective.

Classification reporting is an ongoing process that is in place to ensure that Account and Risk Managers are effective in early problem recognition on commercial and corporate lending. Once any sign of weakness is identified or concern is raised, the exposure is classified as Especially Mentioned, Substandard, Doubtful or Loss. Total classified outstanding loans decreased by \$2.1 billion from a year ago to \$1.8 billion at October 31, 2004, and are at an all time low since this risk measurement process was introduced in 2002.

In addition, current one-year expected losses on our commercial and corporate loan portfolio provide a good indicator of credit quality trends. Expected loss is compared to long-term or through-the-cycle expected losses to assess where we are in the credit cycle. This analysis is performed at the single name and industry sector levels. The portfolio is further analyzed through stress testing and sensitivity analysis.

### Risk mitigation

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

Portfolio diversification remains the cornerstone of our risk mitigation activities and, as a result, our credit policies and limits are structured to ensure we are not overexposed to any given client, industry sector or geographic area.

To avoid excessive loss resulting from a particular counterparty being unable to fulfill its payment obligations, single-name limits are in place, with the limit set based on the applicable risk rating. In 2004, an additional limit on single-name exposure based on EC was put in place. This EC limit takes into account such factors as size, term, rating, sector, geography, collateral and seniority. In certain cases, loans are syndicated in order to reduce overall exposure to a single name. In the event of a limit exception, single names with approved limit exceptions are reported to senior management and to the CR&RPC in summary form on a quarterly basis. For certain exceptions, business units must provide a detailed action plan, including the expected timeframe for bringing the exposure back within the limit.

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

To mitigate risk on portions of our portfolio, we enter into credit derivative contracts. As at October 31, 2004, credit mitigation was in place to cover \$1.0 billion in corporate credit exposure.

Loan sales are also used to manage risk. We seek to identify and sell loans we have made to borrowers whose risk-reward profiles and borrower ratings no longer satisfy our requirements. Loan sales totalled approximately \$6 billion in 2004.

## MARKET RISK

Market risk is the risk of loss that results from changes in interest rates, foreign exchange rates, equity prices and commodity prices. The level of market risk to which we are exposed varies depending on market conditions, expectations of future price and market movements and the composition of our trading portfolio. We establish risk management policies and limits for our trading and asset/liability management activities that allow us to monitor and control our exposure to market risk resulting from these activities.

We conduct trading activities over-the-counter and on exchanges in the spot, forward, futures and options markets, and we also participate in structured derivative transactions. Market risks associated with trading activities are a result of market-making, positioning, and sales and arbitrage activities in the interest rate, foreign exchange, equity, commodities and credit markets. Our trading operation primarily acts as a market maker, executing transactions that meet the financial requirements of our clients and transferring the market risks to the broad financial market. We also act as principal and take proprietary market risk positions within the authorizations granted by the board.

The trading book consists of positions that are held for short-term resale, taken on with the intent of benefiting in the short term from actual or expected differences between their buying and selling prices or to lock in arbitrage profits.

### Components of market risk

**Equity risk** is the potential adverse impact on our earnings due to movements in individual equity prices or general movements in the level of the stock market. We are exposed to equity risk from the buying and selling of equities as principal in conjunction with our investment banking activities and also from our trading activities, which include the offering of tailored equity derivative products to clients, arbitrage trading and proprietary trading.

**Foreign exchange rate and commodity price risk** is the potential adverse impact on our earnings and economic value due to currency rate and commodity price movements and volatilities. In our proprietary positions, we are exposed to both the spot and forward foreign exchange markets, the derivatives markets and commodities markets.

**Table 21 Market risk measures – Trading activities** <sup>(1)</sup>

(C\$ millions)	2004				2003				2002			
	Year-end	High	Average	Low	Year-end	High	Average	Low	Year-end	High	Average	Low
<b>Global VAR by major risk category</b>												
Equity	\$ 4	\$ 20	\$ 8	\$ 4	\$ 4	\$ 12	\$ 7	\$ 4	\$ 7	\$ 12	\$ 8	\$ 6
Foreign exchange and commodity	2	5	2	1	2	7	3	1	2	9	3	1
Interest rate <sup>(2)</sup>	8	14	9	6	8	13	9	6	11	14	6	2
Debt specific <sup>(3)</sup>	2	2	1	1	—	—	—	—	—	—	—	—
<b>Global VAR <sup>(4)</sup></b>	<b>\$ 10</b>	<b>\$ 25</b>	<b>\$ 13</b>	<b>\$ 8</b>	<b>\$ 8</b>	<b>\$ 19</b>	<b>\$ 13</b>	<b>\$ 8</b>	<b>\$ 13</b>	<b>\$ 18</b>	<b>\$ 11</b>	<b>\$ 7</b>

(1) Amounts are presented on a pre-tax basis and represent one-day VAR at a 99% confidence level.

(2) Also includes credit spread risk.

(3) Prior to 2004, interest rate and debt specific risk were reported in aggregate as interest rate risk.

(4) Global VAR reflects the correlation effect from each of the risk categories through diversification.

**Interest rate risk** is the potential adverse impact on our earnings and economic value due to changes in interest rates. Most of our holdings in financial instruments result in exposure to interest rate risk.

**Debt specific risk** is the potential adverse impact on our earnings and economic value due to changes in the creditworthiness and credit ratings of issuers of bonds and money market instruments, or the names underlying credit derivatives.

**Credit spread risk** is the potential adverse impact on our earnings and economic value due to changes in the credit spreads associated with issuers of bonds and money market instruments, or the names underlying credit derivatives.

We are exposed to debt specific and credit spread risk through our positions in bonds, money market instruments and credit derivatives.

#### Monitoring market risk

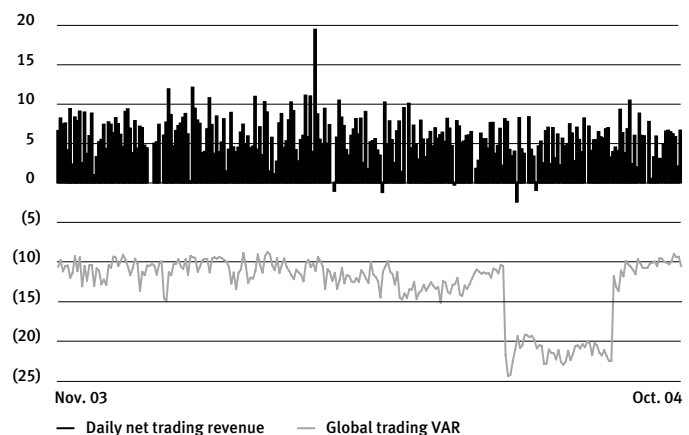
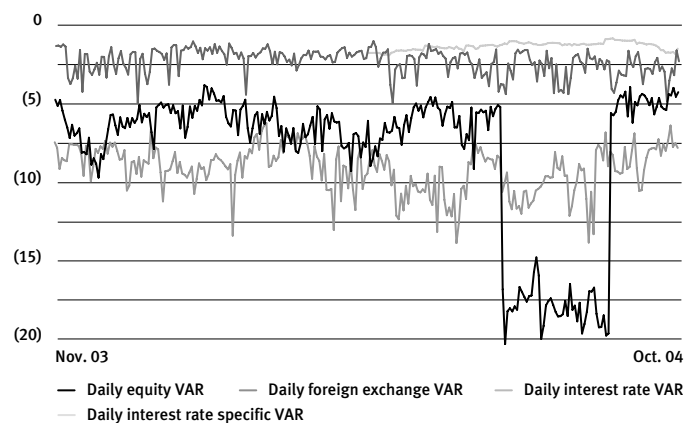
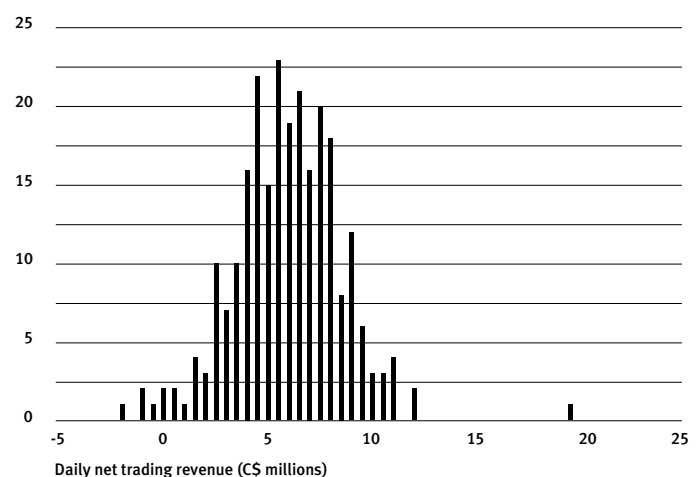
A comprehensive risk policy framework governs trading-related risks and activities and provides guidance to trading management, middle office compliance functions and operations areas. We employ an extensive set of principles, rules, controls and limits, which we believe conform to industry best practice. Our market risk management framework is designed to ensure that our risks are appropriately diversified on a global basis. The Market Risk group is a corporate function within Group Risk Management that is independent of the trading operations and is responsible for the daily monitoring of global trading risk exposures via risk measures such as Value-At-Risk (VAR), sensitivity analysis and stress testing. The Market Risk group uses these risk measures to assess global risk-return trends and to alert senior management in RBC Capital Markets and Group Risk Management and the CR&RPC of adverse trends or positions.

VAR, in simple terms, is a statistical technique that measures the range of market losses over a specified holding period expressed in terms of a specific confidence interval. VAR is the worst-case loss expected over the period within the probability set out by the confidence interval. Larger losses are possible, but with low probability. For example, our VAR model is based on a 99% confidence interval. Therefore, a portfolio with a VAR of \$15 million held over one day would have a 1 in 100 chance of suffering a loss greater than \$15 million in that day.

To ensure VAR effectively captures our market risk, we continuously monitor and enhance our methodology. The method used to attribute the components of global VAR to the various risk categories was enhanced in 2004. Any secondary interest rate risk related to foreign exchange of equity products is now isolated and included in the interest rate category. This change did not affect overall global VAR.

Daily back-testing against hypothetical profit and loss is used to monitor the statistical validity of VAR models. In fiscal 2004, there were no instances of the hypothetical net loss exceeding the VAR.

The year-end, high, average and low VAR by major risk category for our combined trading activities for the years ended October 31, 2004 and 2003, are shown in Table 21 above. The table also shows our global VAR, which incorporates the effects of correlation in the movements of interest rates, exchange rates, equity prices and commodity prices and the resulting benefits of diversification within our trading portfolio.

**DAILY NET TRADING REVENUE VS GLOBAL TRADING VAR**  
(C\$ millions)**GLOBAL VAR BY MAJOR RISK CATEGORY**  
(C\$ millions)**HISTOGRAM OF DAILY NET TRADING REVENUE**  
(number of days)

As the table illustrates, the average global VAR in 2004 was \$13 million, unchanged from 2003. The largest contributor to VAR is interest rate risk. The increase in equity VAR observed during the latter part of the third quarter and the beginning of the fourth quarter was due to higher equity trading inventory arising from equity underwriting activity. This increase in VAR was anticipated and pre-approved. By year-end, it returned to its typical historical range.

The first graph on page 60A compares the global trading VAR amounts to the relevant daily net trading revenue for the year ended October 31, 2004. During fiscal 2004, we experienced five days of net trading losses, and net trading losses in any single day did not exceed the VAR estimate for that day. The breadth of our trading activities is

designed to diversify market risk to any particular strategy, and to reduce trading revenue volatility.

In addition to VAR, extensive sensitivity analysis and stress testing are performed, monitored and reported on a daily basis as a supplementary control to our market risk exposure. Sensitivity analysis is used to measure the impact of small changes in individual risk factors such as interest rates and foreign exchange rates and is designed to isolate and quantify exposure to the underlying risk factors that affect option prices. Stress testing measures the impact of extreme market movements and is intended to alert senior management of our exposure to potential political, economic or other disruptive events.

## LIQUIDITY RISK

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

Liquidity risk is managed dynamically, and exposures are continually measured, monitored and mitigated. We have in place a comprehensive liquidity management framework comprising policies, procedures, methodologies and measurements. During the year, we operated under normal conditions and within approved net cash flow limits.

A detailed discussion of liquidity management is provided in the Liquidity management section on page 66A.

## INSURANCE RISK

Insurance risk is the risk inherent in the design and underwriting of insurance policies. The principal sources of insurance risk are product design and pricing risk and insurance underwriting risk.

Product design and pricing risk relates mainly to the possibility of differences between the assumptions made in pricing the insurance contract and actual subsequent company experience. This type of risk is especially evident in long-term insurance contracts under which our ability to adjust premiums or charges is limited. This risk is managed through detailed experience studies to support pricing assumptions, as well as scenario testing by our actuaries. In addition, a portion of policy benefits are held on-balance sheet allowing for misestimation and deterioration of assumptions. And, finally, reinsurance can be used to mitigate certain estimates in the pricing of a product.

Insurance underwriting risk relates to the mis-selection of the risks to be insured or an incorrect assessment of the frequency and/or amount of the future claims associated with those risks. To mitigate this risk, policy retention limits are in place that vary by market and geography. In addition, reinsurance mitigates exposure to large claims.

A dashboard reporting mechanism is in place to monitor the various insurance businesses we conduct. The performance of each business is assessed against various risk measures and assigned one of the following ratings: concern, monitor or good. At year-end, there were no businesses rated concern. To monitor any shifts in trending, further assessment criteria are applied to each portfolio to generate one of the following quality trend indicators – declining, stable or improving.

## OPERATIONAL RISK

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed processes, technology, and human performance or from external events. We experienced two notable operational losses during the year. The first item is related to a processing disruption, resulting from a programming update to one of our computer systems. The disruption impacted our ability to promptly reflect some transactions in client account balances and affected most of our business segments. We also experienced a loss on certain mortgage loans that are believed to have been fraudulently originated in 2001 and 2002.

To mitigate operational risks across the organization an Operational Risk Management Framework has been developed. This framework ensures that the appropriate infrastructure, controls, systems and people are in place throughout the organization. It encompasses a common language of risk to enable enterprise-wide programs, assessment techniques and management tools. Complementing these are strong principles of corporate governance, our corporate values and code of conduct, independent risk-based internal auditing and the existence of compliance functions at the corporate and business levels. Three key components of our operational risk framework are (i) Risk and Control Self-Assessment (RCSA), (ii) Loss Event Database (LED) and (iii) Key Risk Indicators (KRIs).

RCSA is a formal process to identify, document, assess and manage operational risks throughout the organization. To facilitate the RCSA, each business and functional area has been divided into its component activities to define the entities to be assessed. Each entity completes a

self-assessment to determine key risks, mitigating controls, the potential impact of a problem, the probability of an incident occurring and the acceptable level of risk. Where residual exposure is judged unacceptable, the group identifies root causes and agrees on an action plan and timeline.

The LED is a centralized database designed to capture information pertaining to operational losses with a financial impact exceeding \$10,000. Key information captured, such as the frequency, severity and nature of operational loss events, is used to better understand the root causes of operational failures, resulting in improved risk mitigation strategies. Data collected on operational events will also support the determination and attribution of capital for operational risk as the implementation of Basel II moves forward.

KRIs are used to assist us in recognizing and addressing our operational risk exposures and potential losses. The use of KRIs is a long-standing practice in several of our businesses and functional areas. In many cases, these are formal programs, used extensively as both business and risk management tools.

While operational risk is not a new risk, increased focus and renewed rigour in its management are evident throughout the financial services industry, be it with respect to capital reform or changing expectations for managing and reporting this risk. The initiatives outlined are key to our strategies for effectively managing operational risk. We will continue to refine and enhance these, as well as pursue research and development to ensure that we are at the forefront of operational risk management best practices.

## FINANCIAL PRIORITY: BALANCE SHEET AND CAPITAL MANAGEMENT

### Highlights

- Consumer loans up 10%
- Deposits up 5%
- Internally generated capital of \$1.5 billion
- Tier 1 and Total capital ratios 8.9% and 12.4%, respectively
- Common share repurchases of 14.6 million and issuances of 3.3 million, for a net reduction of 11.3 million

**Total assets** were \$429.2 billion at October 31, 2004, up \$26.2 billion or 6% from October 31, 2003.

**Securities** were unchanged from a year ago.

**Loans (before allowance for loan losses)** were up \$15.7 billion or 9%, reflecting strong loan demand in a low interest rate environment. Consumer loans (residential mortgage, personal and credit card loans) were up \$11.7 billion or 10%, with residential mortgages up \$5.4 billion or 7% (after \$5.0 billion of securitizations during the year), personal loans up \$4.7 billion or 14% and credit card balances up \$1.6 billion or 34%. Business and government loans were up \$4.0 billion or 7% (after \$5.5 billion of securitizations during the year), largely due to a growth in securities borrowing activity.

**Other assets** were up \$7.5 billion to \$68.9 billion. This was largely driven by higher derivative-related amounts due to an increase in value of currency contracts and an increase in receivables from brokers and dealers due to a growth in business activity.

**Deposits** were \$271.0 billion, up \$11.8 billion or 5% from October 31, 2003. Interest-bearing deposits were up \$7.8 billion or 3% and non-interest-bearing deposits were up \$4.0 billion or 15%. Personal deposits were up \$6.3 billion, business and government deposits were up \$2.2 billion and bank deposits were up \$3.3 billion. Further details on deposits are provided in Note 10 on page 91A.

The fair values of loans and deposits differ from their respective book values due to changes in the level of interest rates and changes in credit status. The estimated fair value of loans due from clients exceeded book values by \$1.5 billion at October 31, 2004, and \$1.9 billion at October 31, 2003. The estimated fair value of deposits owed to clients exceeded book value by \$1.0 billion at October 31, 2004, and \$1.4 billion at October 31, 2003. The net amount of the fair value excess of loans due from clients and the fair value excess of deposits due to clients was \$499 million at October 31, 2004, as shown in Note 23 on page 107A.

**Other liabilities** increased \$12.6 billion to \$129.5 billion. The growth was largely caused by an increase in derivative-related amounts due to a decline in the value of currency contracts and an increase in Other – other liabilities. Other – other liabilities increased due to a growth in securities lending activities and higher payables to broker-dealers due to a growth in business activity.

**Subordinated debentures (subordinated indebtedness)** increased by \$1.9 billion to \$8.1 billion due to issuances exceeding redemptions as described on page 63A in the Capital management section.

**Non-controlling interest in subsidiaries** consists primarily of our interest in RBC Capital Trust, a closed-end trust, and RBC Capital Trust II, an open-end trust, which have \$1.4 billion and \$9 billion of transferable trust units (RBC TruCS) outstanding, respectively. The RBC TruCS are included in Tier 1 capital under guidelines issued by OSFI.

**Shareholders' equity** was \$18.2 billion at October 31, 2004, down \$2 billion from a year ago. The decrease reflected a \$.8 billion increase in retained earnings offset by a \$.7 billion decline in foreign currency translation adjustments, and a \$.3 billion deduction from shareholders' equity for treasury stock relating to shares acquired and held by certain employee compensation vehicles and other subsidiaries for reasons other than cancellation.

We fund pension plans in compliance with applicable legislative and regulatory requirements, which require funding when there is a deficit on an actuarial funding basis. Different assumptions and methods are prescribed for regulatory funding purposes versus accounting purposes. This year we contributed \$285 million to pension plans. Note 17 on page 98A describes the funding position for accounting purposes and the sensitivity of key assumptions.

As of November 30, 2004, we had 644,069,606 common shares outstanding. In addition, as of November 30, 2004, we had 12,000,000 First Preferred Shares Non-cumulative Series N, 6,000,000 First Preferred Shares Non-cumulative Series O, 4,000,000 First Preferred Shares US\$ Non-cumulative Series P and 10,000,000 First Preferred Shares Non-cumulative Series S outstanding. Currently, subject to the approval of the Toronto Stock Exchange, we may convert the First Preferred Shares Series N, Series O and Series P into our common shares. As of August 24, 2006, subject to the approval of the Toronto Stock Exchange, we will be permitted to convert the First Preferred Shares Series S into our common shares. As of November 30, 2004, the aggregate number of common shares issuable on the conversion of the First Preferred Shares Series N, Series O and Series P by us was 9,757,728.



## CAPITAL MANAGEMENT

We actively manage our capital to balance the desire to maintain strong capital ratios and high debt ratings with the need to provide strong returns to our shareholders. In striving to achieve this balance, we consider the requirements of regulators, rating agencies, depositors and shareholders, as well as our future business plans, peer comparisons and our relative position to board-approved medium-term capital ratio goals. Additional considerations include the costs and terms of current and potential capital issuances and projected capital requirements.

We are committed to maintaining strong capital ratios through internal capital generation, the issuance of capital instruments when appropriate and controlled growth in assets. During 2004, we achieved strong internal capital generation, which enabled us to continue repurchasing shares and redeeming some of our outstanding capital instruments. Our debt ratings continue to favourably affect our ability to raise capital at competitive prices.

### Capital management activity

In 2004, the number of outstanding common shares decreased by 11.3 million. We repurchased 14.6 million common shares for \$892 million, of which 8.2 million shares were repurchased for \$504 million under a normal course issuer bid that expired in June 2004; and 6.4 million common shares were repurchased for \$388 million under a normal course issuer bid that commenced on June 24, 2004, for a one-year period and that allows for the repurchase of up to 25 million common shares, representing approximately 3.8% of outstanding common shares. We issued 3.3 million common shares for \$119 million in connection with the exercise of employee stock options.

During the year, we issued \$2.5 billion of subordinated debentures through the Canadian Medium Term Notes Program that qualify as Tier 2B capital for regulatory purposes as follows: \$1 billion on November 3, 2003, \$500 million on January 27, 2004, and \$1 billion on

April 13, 2004. In addition, we issued \$600 million of subordinated debentures that qualify as Tier 2A capital on June 18, 2004. During the year, we redeemed a total of \$1,025 million of subordinated debentures that qualify as Tier 2B capital as follows: \$350 million on April 12, 2004, \$350 million on June 11, 2004, \$175 million on July 7, 2004, and \$150 million on October 12, 2004.

### Dividends

Our common share dividend policy reflects our earnings outlook, desired payout ratios and the need to maintain adequate levels of capital to fund business opportunities. The targeted common share dividend payout ratio was raised from 35–45% to 40–50% in the first quarter of this year. In 2004, the dividend payout ratio was 47%, up from 38% a year ago. Common share dividends paid during the year were \$2.02, up 17% from a year ago.

### Regulatory capital

Capital levels for Canadian banks are regulated pursuant to guidelines issued by OSFI, based on standards issued by the Bank for International Settlements. Regulatory capital is allocated into two tiers. Tier 1 capital comprises the more permanent components of capital. The components of Tier 1 and Tier 2 capital are shown in Table 22.

Regulatory capital ratios are calculated by dividing Tier 1 and Total capital by risk-adjusted assets based on Canadian GAAP financial information. Risk-adjusted assets, as shown in Table 23 on page 64A, are determined by applying OSFI prescribed risk weights to balance sheet assets and off-balance sheet financial instruments according to the deemed credit risk of the counterparty. Risk-adjusted assets also include an amount for the market risk exposure associated with our trading portfolio.

**Table 22** Capital ratios <sup>(1)</sup>

(C\$ millions, except percentage amounts and assets-to-capital multiple)	2004	2003	2002
<b>Tier 1 capital</b>			
Common equity	\$ 17,349	\$ 17,543	\$ 17,238
Non-cumulative preferred shares	832	832	1,545
Non-controlling interest in subsidiaries			
RBC Capital Trust	1,400	1,400	1,400
RBC Capital Trust II	900	900	–
Other	27	27	29
Goodwill	(4,236)	(4,443)	(4,832)
	16,272	16,259	15,380
<b>Tier 2 capital</b>			
Permanent subordinated debentures <sup>(3)</sup>	954	396	467
Other subordinated debentures <sup>(2), (3)</sup>	7,131	5,847	6,147
General allowance <sup>(4)</sup>	1,227	1,407	1,420
	9,312	7,650	8,034
Investment in insurance subsidiaries	(2,532)	(2,143)	(2,014)
Other substantial investments	(302)	(371)	(368)
First-loss facility	(17)	(21)	(20)
<b>Total capital</b>	\$ 22,733	\$ 21,374	\$ 21,012
<b>Risk-adjusted assets</b>	\$ 183,409	\$ 166,911	\$ 165,559
<b>Capital ratios</b>			
Common equity to risk-adjusted assets	9.5%	10.5%	10.4%
Tier 1 capital to risk-adjusted assets	8.9%	9.7%	9.3%
Total capital to risk-adjusted assets	12.4%	12.8%	12.7%
<b>Assets-to-capital multiple <sup>(5)</sup></b>	18.1	18.2	17.3

(1) Calculated using guidelines issued by the Superintendent of Financial Institutions Canada (OSFI) and Canadian GAAP financial information.

(2) Subordinated debentures that are within five years of maturity are subject to straight-line amortization to zero during their remaining term and, accordingly, are included above at their amortized value.

(3) In 2004, we issued \$3.1 billion (2003 – nil; 2002 – US\$400 million) of subordinated debentures, which increased Total capital by the same amount. We redeemed \$1,025 million (2003 – \$100 million; 2002 – \$400 million) of subordinated debentures.

(4) The general allowance for credit losses may be included in Tier 2 capital up to a maximum of .875% (2003 – .875%; 2002 – .875%) of risk-adjusted assets.

(5) Total assets and specified off-balance sheet financial instruments, as prescribed by OSFI, divided by Total capital.

In 1999, OSFI formally established risk-based capital targets for deposit-taking institutions in Canada. These targets are a Tier 1 capital ratio of 7% and a Total capital ratio of 10%. As at October 31, 2004, our Tier 1 and Total capital ratios were 8.9% and 12.4%, respectively, compared to 9.7% and 12.8% as at October 31, 2003. Throughout 2004, we maintained capital ratios that exceeded our medium-term goals of 8.0–8.5% for the Tier 1 capital ratio and 11–12% for the Total capital ratio. In addition to the Tier 1 and Total capital ratios, Canadian banks need to operate within a leverage constraint, and ensure that their assets-to-capital multiple does not exceed the level prescribed by regulators. As at October 31, 2004, our assets-to-capital multiple was 18.1 times, which remains below the maximum permitted by OSFI and compares to 18.2 times as at October 31, 2003.

### Economic Capital

We also calculate capital requirements utilizing risk assessment methodologies, attributing risk capital to business units in proportion to the risk inherent in their business activities. Known as Economic Capital, this non-GAAP measure differs from regulatory capital in that the amount of capital required is based on in-house models used to determine credit, liquidity, operational, market and other risk, as opposed to regulatory guidelines established by OSFI and Canadian GAAP financial

information. Economic Capital levels have been consistently below Total regulatory capital indicating that we have adequate regulatory capital underpinning for the risks it assumes. An overview of Economic Capital is found on page 58A.

### Pending developments

Changes to the Basel II agreement for assessing capital adequacy were finalized in June of this year. The implementation will begin with a parallel run in fiscal 2006 and full compliance is expected by the end of 2007. We are actively preparing for the implementation of the Basel II framework as discussed on page 58A, in the Risk management section.

Several changes in accounting principles have either been introduced or are being proposed in the areas of consolidation of variable interest entities (as described in Note 1 on page 83A, and in Note 13 on page 93A), classification of certain financial instruments as either equity or liabilities, and accounting determination of certain asset balances. These changes could significantly affect our reporting of assets and capital instruments. We continue to closely monitor changes in the accounting framework and their potential impact on our capitalization levels through ongoing dialogue with our external auditors, other financial institutions, the Canadian Bankers Association and OSFI.

**Table 23 Risk-adjusted assets (1)**

			Risk-adjusted balance	
			2004	2003
(C\$ millions, except percentage amounts)				
	Balance sheet amount	Weighted average of risk weights (2)		
<b>Balance sheet assets</b>				
Cash and deposits with banks	\$ 11,096	17%	\$ 1,833	\$ 2,026
Securities				
Issued or guaranteed by Canadian or other OECD governments	29,536	—	30	28
Other	99,410	7%	7,062	4,557
Residential mortgages (3)				
Insured	36,321	1%	390	377
Conventional	47,822	51%	24,561	21,951
Other loans and acceptances (3)				
Issued or guaranteed by Canadian or other OECD governments	14,523	19%	2,828	3,778
Other	128,923	69%	88,412	82,169
Other assets	61,565	13%	7,852	6,996
	\$ 429,196		\$ 132,968	\$ 121,882
	Contract amount	Credit conversion factor	Credit equivalent amount	
<b>Off-balance sheet financial instruments</b>				
<b>Credit instruments</b>				
Guarantees and standby letters of credit				
Financial	\$ 15,097	100%	\$ 15,097	\$ 13,201
Non-financial	3,523	50%	1,761	1,519
Documentary and commercial letters of credit	592	20%	118	399
Securities lending	27,055	100%	27,055	1,087
Commitments to extend credit				
Original term to maturity of 1 year or less	45,682	—	—	—
Original term to maturity of more than 1 year	28,912	50%	14,456	13,357
Uncommitted amounts	60,972	—	—	—
Note issuance/revolving underwriting facilities	23	50%	12	12
	\$ 181,856		\$ 58,499	\$ 29,575
Derivatives (4)	2,522,309		33,954	6,320
<b>Total off-balance sheet financial instruments</b>	\$ 2,704,165		\$ 92,453	\$ 35,895
<b>Total specific and general market risk</b>			12,237	9,134
<b>Total risk-adjusted assets</b>			\$ 183,409	\$ 166,911

(1) Calculated using guidelines issued by the Superintendent of Financial Institutions Canada and Canadian GAAP financial information.

(2) Represents the weighted average of counterparty risk weights within a particular category.

(3) Amounts are shown net of allowance for loan losses.

(4) Includes non-trading credit derivatives given guarantee treatment for credit risk capital purposes.

## ASSET/LIABILITY MANAGEMENT

### Overview

Asset/liability management comprises the evaluation, monitoring and management of our non-trading portfolio, liquidity management and funding. It is important to note that liquidity and capital resources are likely to be affected by many of the same factors that are detailed in this section of management's discussion and analysis, the factors discussion

on pages 71A to 72A and the Risk management discussion on pages 57A to 61A. Additionally, off-balance sheet financing arrangements are often integral to both liquidity and capital resources, and are discussed in detail on pages 68A to 71A of this section.

### NON-TRADING PORTFOLIO

Traditional non-trading banking activities, such as deposit taking and lending, expose us to market risk, of which interest rate risk, as described on page 60A, is the largest component.

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

#### Policy

The CR&RPC approves the global policies governing interest rate risk management. The policies define the management standards and acceptable limits within which risks to net interest income over a 12-month horizon, and the economic value of equity, are to be contained. These ranges are based on immediate and sustained  $\pm 200$  basis point parallel shifts of the yield curve. The limit for net interest income risk is 6% of projected net interest income, and for economic value of equity risk is 12% of projected common equity. The economic value of equity is equal to the net present value of our assets, liabilities and off-balance sheet instruments.

#### Interest rate funds transfer pricing

We use a funds transfer pricing mechanism at the transaction level to transfer interest rate risk to Corporate Treasury and to quantify the spread earned by the various business units. The funds transfer pricing rates are market-based and are aligned with interest rate risk management principles. They are supported by empirical research into client behaviour and are an integral input to the retail business pricing decisions.

#### Applied research

We investigate best practices in instrument valuation, econometric modeling and new hedging techniques on an ongoing basis. Our investigations range from the evaluation of traditional asset/liability management processes to pro forma application of recent developments in quantitative methods to our processes.

We also focus on developing retail product valuation models that incorporate the impact of consumer behaviour. These valuation models are typically derived through econometric estimation of consumer exercise of options embedded in retail products. The most significant embedded options are mortgage rate commitments and prepayment options. On the liability side of the balance sheet, we focus on modeling the sensitivity of the value of deposits with an indefinite maturity to interest rate changes.

#### Risk measurement

We measure our risk position on a daily, weekly or monthly basis with the frequency employed commensurate with the size and complexity of the portfolio. Measurement of risk is based on client rates as well as funds transfer pricing rates. We continue to make investments in new technology to facilitate measurement and timely management of our interest rate risk position. Key Rate Analysis is utilized as a primary tool for risk management. It provides us with an assessment of the sensitivity of the exposure of our economic value of equity to instantaneous changes in individual points on the yield curve.

We supplement our assessment by measuring interest rate risk for a range of dynamic and static market scenarios. Dynamic scenarios simulate our interest income in response to various combinations of business and market factors. Business factors include assumptions about future pricing strategies and volume and mix of new business, whereas market factors include assumed changes in interest rate levels and changes in the shape of the yield curve. Static scenarios supplement dynamic scenarios and are also employed for assessing the risks to the value of equity and net interest income.

#### Interest rate risk management

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

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

We continually monitor the effectiveness of our interest rate risk mitigation activity within Corporate Treasury on a value basis. As a part of this exercise, the model assumptions are validated against actual client behaviour.

Table 24 below shows the potential impacts of 100 and 200 basis point increases and decreases in interest rates on economic value of equity and net interest income of our non-trading portfolio. These

**Table 24** Market risk measures – Non-trading activities <sup>(1)</sup>

	2004		2003		2002	
(C\$ millions)	Economic value of equity risk	Net interest income risk	Economic value of equity risk	Net interest income risk	Economic value of equity risk	Net interest income risk
100bp increase	\$ (412)	\$ 70	\$ (423)	\$ 115	\$ (309)	\$ 104
100bp decrease	215	(150)	261	(126)	145	(151)
200bp increase	\$ (882)	\$ 107	\$ (869)	\$ 207	\$ (662)	\$ 190
200bp decrease	405	(314)	545	(294)	345	(327)

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

measures are as of October 31, 2004, and are based on assumptions made by management and validated by empirical research. The methodology assumes that no further hedging is undertaken. We have defined a risk neutral balance sheet as one where the interest rate sensitivity of all the liabilities is matched by a portion of the assets, with the residual assets – representing the notional investment of equity – invested evenly over a five-year horizon. This establishes our preferred trade-off

between the risk to the value of our equity and the risk to the net interest income due to interest rate changes.

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

## LIQUIDITY MANAGEMENT

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

The Corporate Treasury function has global responsibility for the development of liquidity management policies, strategies and contingency plans and for recommending and monitoring limits within this framework. Our principal regional trading and funding platforms provide transactional support for liquidity management policies and strategies. The GRC and the Asset Liability Committee share management oversight responsibility for liquidity management and liquidity policies and receive regular reports detailing compliance with limits and guidelines. The Audit Committee and the CR&RPC approve our liquidity management framework and significant related policies, and the board is informed on a periodic basis about our current and prospective liquidity condition. Additionally, we have a liquidity contingency plan in place, which is maintained and administered by the Liquidity Crisis Team.

Since most of the funding of our subsidiaries is provided by the parent organization, we manage our liquidity position on a consolidated basis. When managing the flow of liquidity between different legal entities within the consolidated group, we take into account the tax and regulatory considerations associated with each jurisdiction. While such tax and regulatory considerations add a degree of complexity to internal fund flows, given intra-group funding arrangements, our consolidated liquidity management approach already takes into account the maximum estimated funding demands associated with intra-group requirements. Subsidiaries responsible for managing their own liquidity do so in compliance with policies and practices established by Corporate Treasury and with governing regulatory requirements.

We measure and monitor our liquidity condition from structural, tactical and contingent perspectives. The assessment of our liquidity position based on these measures reflects management estimates and judgments pertaining to the behaviour of our customers and future market conditions. We monitor industry practices and regulatory developments and, as appropriate, revise our liquidity management framework to reflect relevant developments. We consider our liquidity profile to be sound and there are no known trends, demands, commitments, events or uncertainties that are presently viewed as likely to materially change our current liquidity position.

### Structural liquidity risk management

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

We use a cash capital model to assist in the evaluation of balance sheet liquidity and in the determination of the appropriate term structure of our debt financing. This methodology provides a comprehensive, formula-based approach to assess our ability to continue as a going concern during a prolonged liquidity event, such as an unexpected

withdrawal of short-term funding. In the context of a sustainable business model, the cash capital model allows us to measure and monitor the relationship between illiquid assets and core funding. This reconstruction of our balance sheet enables us to more accurately estimate our exposure to, and make appropriate contingency plans for, a protracted loss of unsecured funding as well as to quantify our longer-term financing requirements.

### Tactical liquidity risk management

Tactical liquidity risk management addresses our normal day-to-day funding requirements and is managed by imposing limits on net fund outflows for specified periods, particularly for key short-term time horizons.

Scenario analysis is performed periodically on the assumed behaviour of cash flows under varying conditions to assess funding requirements and, as required, to update assumptions and limits. Detailed reports on our principal short-term asset/liability mismatches are monitored on a daily basis to ensure compliance with the prudential limits for overall group exposure and by major currency and geographic location that are approved by the GRC and confirmed by the Audit Committee of the board. Corporate Treasury issues procedural directives to the individual units engaged in executing policy to ensure consistent application of cash flow management principles across the entire organization.

### Contingent liquidity risk management

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

To address potential liquidity exposures identified by our scenario analyses, we maintain a pool of segregated and unencumbered marketable securities. These high-quality assets represent a dedicated and reliable source of emergency funding since they must be traded in broad and active secondary markets and/or be eligible collateral for central bank borrowings and can, therefore, be readily sold or pledged for secured borrowing. In our base case stress scenario, our holdings of segregated liquid assets are considered to be sufficient to meet all on- and off-balance sheet obligations if access to funding is temporarily impaired. In addition, we maintain a separate portfolio of eligible assets to support our participation in Canadian payment and settlement systems. All activities that encumber or otherwise restrict availability of assets are subject to a board-approved, enterprise-wide pledging framework, which imposes a global, risk-adjusted limit on pledged assets. Assets that are encumbered, dedicated to specific requirements or needed for collateral purposes are not accorded any liquidity value in our tactical and contingent liquidity calculations.

Liquid assets and assets purchased under reverse repurchase agreements (before pledging as detailed below) totalled \$187 billion or 43% of total assets at October 31, 2004, as compared to \$178 billion or 44% at October 31, 2003. Liquid assets are primarily diversified and

highly rated marketable securities. As at October 31, 2004, \$18 billion of assets had been pledged as collateral, up from \$14 billion at October 31, 2003. We have another \$47 billion in obligations related to assets sold under repurchase agreements and securities sold short at October 31, 2004, compared to \$46 billion at October 31, 2003. For further details, see Note 20 on page 102A.

### Funding strategy

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

### Credit ratings

Our ability to access unsecured funding markets and to engage in certain collateralized business activities on a cost-effective basis is primarily dependent upon maintaining competitive credit ratings, which in turn is largely determined by the quality of our earnings, the adequacy of our capital and the effectiveness of our risk management programs. We estimate, based on periodic reviews of ratings triggers embedded in our existing businesses and of our funding capacity sensitivity that a minor downgrade would not materially influence our funding access, collateral usage and associated costs. However, we recognize the importance of avoiding such an event and are committed to actions that should reinforce existing external assessments of our financial strength. A series of downgrades could have an adverse impact on our funding capacity and collateral requirements and on the results of our operations and financial condition.

### Deposit profile

The composition of our global deposit liabilities is summarized in Note 10 on page 91A. Personal deposits remain the prime source of funding for our Canadian dollar balance sheet while most foreign currency deposits originate from unsecured, wholesale sources, including large corporate and institutional clients and foreign commercial and central banks. Our personal deposit franchise constitutes the principal source of consistently dependable funding while certain commercial and institutional client groups also maintain relational balances with low volatility profiles. Taken together, these depositors represent a highly stable supply of core deposits under most contemplated conditions as they typically are less responsive to market developments than transactional lenders and investors due to the impact of deposit insurance and to extensive and, at times, exclusive relationships with us. Rather than contractual or repricing terms, expected behavioural characteristics, based on observed balance patterns and on assumed reactions to a range of circumstances for various deposit categories, are used to define core deposits. As at October 31, 2004, our core deposits represented about

60% of our total deposits. We also promote wholesale funding diversity and regularly review sources of short-term funds to ensure maintenance of wide diversification by provider, product and geographic origin. In addition, we maintain an ongoing presence in different funding markets, constantly monitoring market developments and trends in order to identify opportunities or risks and to take appropriate pre-emptive actions.

### Term funding sources

Long-term funding strategy is integrated with our current and estimated structural liquidity position as reflected in our cash capital position. Liquidity objectives, as well as market conditions, interest rates, credit spreads and desired financial structure, influence our long-term funding activities, including currency mix and market concentration decisions. Diversification into new markets and untapped investor segments is constantly evaluated against relative issuance costs. Our long-term funding sources are managed to minimize concentration by geographic location, investor segment, and currency and maturity profile. To achieve these objectives, we operate debt issuance programs in Canada, the United States and Europe. During fiscal 2004, we continued to expand our long-term funding base by issuing, either directly or through our subsidiaries, \$4.2 billion of senior deposit notes in various currencies and markets. Total long-term funding outstanding on October 31, 2004, was \$15.2 billion, compared to \$14.2 billion on October 31, 2003. Outstanding senior debt containing ratings triggers, which would accelerate repayment, constitutes a very small proportion of our overall outstanding debt.

We use commercial mortgage, residential mortgage and credit card receivable-backed securitization programs as alternative sources of funding and for liquidity and asset/liability management purposes. During 2004, we diversified our funding sources by establishing Real Estate Asset Liquidity Trust, a commercial mortgage-backed issuance vehicle. We sold \$242 million of commercial mortgages to this vehicle as well as \$244 million of commercial mortgages to a third-party securitization special purpose entity during the year. In addition, \$3.1 billion of new financing was obtained through the securitization and sale of government guaranteed residential mortgages. We hold retained interests in our residential mortgage and credit card securitization programs. Our total outstanding mortgage-backed securities (MBS) sold at October 31, 2004, was \$6.0 billion. As of October 31, 2004, \$1.9 billion of our credit card receivables were financed through notes issued by a securitization special purpose entity (see Note 7 on pages 89A and 90A, and off-balance sheet arrangements on page 68A).

### Contractual obligations

In the normal course of business, we enter into contracts that give rise to commitments of future minimum payments. Depending on the nature of these commitments, the obligation may be recorded on- or off-balance sheet. Table 25 below provides a summary of our future contractual funding commitments.

**Table 25 Contractual obligations**

(C\$ millions)	Within 1 year	1 to 3 years	Over 3 to 5 years	Over 5 years	Total
Unsecured long-term funding	\$ 1,787	\$ 6,225	\$ 6,076	\$ 1,132	\$ 15,220
Subordinated debentures	—	—	152	7,964	8,116
Obligations under capital leases	376	643	491	829	2,339
Obligations under operating leases	29	43	7	—	79
	\$ 2,192	\$ 6,911	\$ 6,726	\$ 9,925	\$ 25,754

## OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of business, we engage in a variety of financial transactions that, under GAAP, are either not recorded on our balance sheet or are recorded on our balance sheet in amounts that differ from the full contract or notional amounts. These transactions involve, among other risks, varying degrees of market, credit and liquidity risk, which are discussed in the Risk management section on pages 57A to 61A.

Off-balance sheet transactions are either proprietary or client transactions, represent an ongoing part of our business and are generally undertaken for risk management, capital management and/or funding management purposes. Off-balance sheet activities we undertake include derivative financial instruments, transactions with special purpose entities and issuance of guarantees. Each of these types of arrangements, including its nature, business purpose, importance and significant financial impact, as applicable, is discussed below.

### Derivative financial instruments

Derivatives are primarily used in sales and trading activities. Sales activities include the structuring and marketing of derivative products to clients to enable them to transfer, modify or reduce current or expected risks. Trading involves market-making, positioning and arbitrage activities. We also use derivatives to manage our exposures to interest, currency, credit and other market risks. To the extent that one or more of the derivative financial transactions we undertake involve amounts owing from third-party counterparties, we are exposed to counterparty credit risk (credit risk is discussed in more detail on pages 58A and 59A).

All derivatives except those that qualify for hedge accounting are recorded at fair value on our balance sheet (valuation methodologies are discussed on page 27A). Although derivative transactions are measured in terms of their notional amounts, these amounts are not recorded on our balance sheet, as the notional amounts serve as points of reference for calculating payments, and are not the actual amounts that are exchanged.

The total notional amount of our derivatives amounted to \$2,524 billion at October 31, 2004, compared to \$2,139 billion at October 31, 2003. The fair value of our trading and non-trading derivative assets totalled \$38.4 billion and \$2.0 billion compared to \$35.2 billion and \$1.6 billion, respectively, at October 31, 2003, while the fair value of our trading and non-trading derivative liabilities totalled \$41.9 billion and \$1.5 billion compared to \$37.6 billion and \$1.1 billion, respectively, at October 31, 2003. Changes in the fair value of our non-trading derivatives that do not qualify for hedge accounting and trading derivatives are recorded in non-interest income. Notes 1 and 21 on pages 79A to 84A, and 104A to 106A, respectively, provide more detail on our accounting for, and types of, derivatives.

### Special purpose entities

Special purpose entities (SPEs) are principally used to securitize financial and other assets in order to obtain access to funding, to mitigate credit risk and to manage capital. SPEs may also be used in connection with structured finance activities. SPEs are an important part of the financial markets, providing market liquidity by facilitating investors' access to specific portfolios of assets and risks in a form that meets their investment criteria. We use SPEs to securitize certain loans. We also act as an intermediary or agent for clients who want to use SPEs to securitize their own financial assets. We provide SPE repackaging services to clients who seek access to financial assets in a form different from what is conventionally available. We also use SPEs to make loan substitute investments and as a mechanism to indirectly invest in financial assets and financing businesses.

SPEs are typically set up for a single, discrete purpose, have a limited life and serve to legally isolate the financial assets held by the SPE from the selling organization. SPEs are not operating entities, usually have no employees and may be variable interest entities (VIEs) as

defined by the Canadian Institute of Chartered Accountants (CICA) Accounting Guideline 15, *Consolidation of Variable Interest Entities* (AcG 15). AcG 15 is applicable beginning November 1, 2004. As at October 31, 2004, we did not consolidate these SPEs unless we had control over them. Beginning November 1, 2004, we will not consolidate SPEs that are VIEs unless we are their Primary Beneficiary as defined in AcG 15. AcG 15 considers an enterprise to be the Primary Beneficiary of a VIE if it is exposed to a majority of the VIE's expected losses or expected residual returns or both. Expected losses and expected residual returns are specifically defined in AcG 15. Refer to Note 1 on page 83A for the impact of adopting AcG 15.

We provide services to, and/or may have variable interests in, SPEs through a number of different key arrangements as outlined below. Variable interests represent contractual, ownership or other pecuniary interests in an unconsolidated SPE that will absorb a portion of that SPE's expected losses if they occur, or receive portions of the SPE's expected residual returns if they occur.

We manage and monitor our involvement with SPEs through our Structured Transactions Oversight Committee and our SPE Risk Committee. The Structured Transactions Oversight Committee comprises senior executive representatives from risk management, finance, corporate treasury, law and the capital markets business. It is responsible for the review of structured transactions and complex credits with potentially significant reputational, legal, regulatory, accounting or tax risks, including transactions involving SPEs. The SPE Risk Committee, comprising representatives from functional areas including risk management, corporate treasury, finance, subsidiary governance, law and taxation, is responsible for formulating policies governing SPEs and for monitoring their ongoing activities.

### Securitization of our financial assets

#### Credit card receivables

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

The securitization of our credit card receivables is a sale from a legal perspective and qualifies for sale treatment from an accounting perspective. At the time of sale these receivables are removed from our balance sheet resulting in a gain or loss reported in non-interest income.

This SPE meets the criteria for a Qualifying SPE (QSPE) pursuant to CICA Accounting Guideline 12, *Transfers of Receivables* (AcG 12) and, accordingly, as the transferor of the credit card receivables, we are precluded from consolidating this SPE. We continue to service the credit card receivables sold to the QSPE for which we receive benefits equivalent to market-based compensation for such services. In addition, we perform an administrative role for the QSPE in which we are responsible for ensuring that the ongoing public filings of the QSPE are performed, as required, and that the investors in the QSPE's asset-backed securities receive interest and principal payments on a timely basis.

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

At October 31, 2004, total credit card receivables securitized and held off-balance sheet amounted to \$1.9 billion, compared to \$2.7 billion at October 31, 2003. The carrying value of our retained interests in securitized credit card receivables at October 31, 2004, was \$13 million compared to \$16 million in 2003, and amounts receivable under subordinated loan agreements were \$5 million compared to \$9 million in 2003.

#### Residential mortgage loans

We routinely securitize residential mortgage loans through the creation of mortgage-backed securities (MBS) and sell a portion of these MBS to an independent SPE. Due to the high quality of the residential mortgages backing the MBS, the securitization and subsequent sale provide a cost-effective source of liquidity and help diversify our funding sources. We retain interests in the excess spread on the sold MBS and continue to service the mortgages underlying these MBS for which we receive benefits, equivalent to market-based compensation. We do not consolidate this SPE.

At October 31, 2004, total residential mortgage loans securitized and held off-balance sheet amounted to \$6.0 billion, compared to \$2.9 billion at October 31, 2003. The carrying value of our retained interests in securitized residential mortgage loans at October 31, 2004, was \$127 million compared to \$95 million in 2003.

#### Commercial mortgage loans

We securitize commercial mortgages by selling them, in collateral pools that meet certain diversification and return criteria, to an SPE. The SPE finances the purchase of these pools by way of issuing notes that carry varying degrees of subordination and which, when rated, range from AAA to B-, and unrated, with the unrated tranches carrying deeper levels of subordination. The notes represent undivided interests in the collateral pool, and the SPE, having sold all undivided interests available in the pool, retains none of the risk of the collateral pools. The sale of our commercial mortgages to the SPE constitutes a true accounting sale and since we neither control the SPE nor carry any residual risk/returns in the mortgages, we do not consolidate the SPE. As part of the sales contract to the SPE, we continue to be the primary servicer of the loans, under contract with a master servicer for the SPE.

There are a variety of purposes for this securitization, which include increasing the velocity with which our capital is employed, optimizing the use of the resources we apply to real estate lending and diversification of funding. As at October 31, 2004, \$242 million of our originated commercial mortgages had been securitized through Real Estate Asset Liquidity Trust, an SPE sponsored by us, while \$244 million of commercial mortgages had been sold to a third-party sponsored SPE during the year. This compares with \$131 million sold to the third-party SPE during 2003.

Further details about the securitization of our financial assets during the year are shown in Note 7 on pages 89A to 90A.

#### Capital trusts

We sponsor two SPEs, RBC Capital Trust and RBC Capital Trust II, to raise capital (TruCS) that qualifies as Tier 1 regulatory capital. For further details on this capital trust activity and the terms of the TruCS issued and outstanding, refer to Note 13 on page 93A. The status of such instruments as Tier 1 regulatory capital is conditional upon their accounting treatment. We consolidated these SPEs as at October 31, 2004, under current Canadian GAAP. Certain changes to Canadian GAAP effective November 1, 2004, as described in Note 1 on pages 83A and 84A will result in classification of asset-backed TruCS issued by RBC Capital Trust as a liability and result in deconsolidation of loan-backed TruCS issued by RBC Capital Trust II. OSFI has grandfathered Tier 1 treatment for our existing TruCS. However, for future capital needs we continue to assess alternate structures to achieve consolidation and classification as equity, as preconditions to obtain Tier 1 treatment.

#### Securitization of client financial assets

Within our global securitization group, our principal relationship with SPEs comes in the form of administering multi-seller asset-backed commercial paper conduit programs (multi-seller conduits) totalling

\$25.6 billion as at October 31, 2004, and \$26.8 billion as at October 31, 2003. We currently administer five multi-seller conduits – three in Canada and two in the United States. These five multi-seller conduits have purchased financial assets from our clients totalling \$18.5 billion. The five multi-seller conduits that we administer are not consolidated on our balance sheet as at October 31, 2004. Under AcG 15, which comes into effect next year, these SPEs will be VIEs. Pursuant to a restructuring of these SPEs during 2004, we anticipate that we will not be the Primary Beneficiary of any of them. The two multi-seller conduits in the U.S. were restructured in January 2004 while the three in Canada were restructured in October 2004. While the form of the U.S. and Canadian restructurings differed due in part to structural differences, the economic substance of these restructurings was similar. As part of the restructurings, an unrelated third party (the “expected loss investor”) agreed to absorb credit losses (up to a maximum contractual amount) that may occur in the future on the assets in the multi-seller conduits (the “multi-seller conduit first-loss position”) before us and the multi-seller conduit’s debt holders. In return for assuming this multi-seller conduit first-loss position, the expected loss investor is paid by the multi-seller conduit a return commensurate with its risk position. Moreover, each multi-seller conduit has granted to the expected loss investor material voting rights including the right to approve any transaction prior to the multi-seller conduit purchasing and financing a transaction. We calculated our total expected losses and expected residual returns as defined in AcG 15 from our variable interests with each multi-seller conduit. We performed a similar calculation for the expected loss investor. We have concluded that for each of the five multi-seller conduits, the expected loss investor absorbs a majority of each multi-seller conduit’s expected losses and expected residual returns when compared to us and therefore we will not be the Primary Beneficiary of any of them.

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

The multi-seller conduits purchase various financial assets from clients and finance the purchases by issuing highly rated asset-backed commercial paper. The multi-seller conduits typically purchase the financial assets as part of a securitization transaction by our clients. In these situations, the sellers of the financial assets continue to service the respective assets and generally provide some amount of first-loss protection on the assets. While we do not maintain any ownership or retained interests, we do have variable interests in these multi-seller conduits. We provide or retain certain services such as transaction structuring and administration as specified by the multi-seller conduit program documents and based on rating agency criteria for which we receive fees. In addition, we provide backstop liquidity facilities and partial credit enhancement to the multi-seller conduits. We have no rights to, or control of, the assets owned by the multi-seller conduits.

Fee revenue for such services, which is reported as non-interest income, amounted to \$44 million during the year compared to \$34 million during 2003.

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

#### Asset class

(C\$ millions)	2004	2003
Credit cards	\$ 4,695	\$ 6,248
Equipment receivables	3,530	2,566
Trade receivables	3,193	3,680
Auto loans and leases	2,486	3,681
Asset-backed securities	1,799	952
Consumer loans	868	1,004
Residential mortgages	660	1,138
Other loans	584	1,159
Dealer floor plan receivables	–	1,269
Other	714	754
	<b>\$ 18,529</b>	<b>\$ 22,451</b>

The commercial paper issued by each multi-seller conduit is in the multi-seller conduit's own name with recourse to the financial assets owned by the multi-seller conduit. The multi-seller conduit commercial paper is non-recourse to us except through our participation in liquidity and/or credit enhancement facilities, and non-recourse to the other multi-seller conduits that we administer. Each multi-seller conduit is largely prohibited from issuing medium-term notes or other forms of indebtedness to finance the asset purchases. Consequently, each multi-seller conduit's commercial paper liabilities are generally equal to the assets owned by that multi-seller conduit. The small difference between each of the multi-seller conduit's asset and liability balances is mostly related to the discount or interest costs attributable to the commercial paper. As of October 31, 2004, the total face amount of commercial paper issued by the multi-seller conduits equaled \$18.58 billion, generating \$18.53 billion of cash proceeds, with the difference between these amounts representing the commercial paper discount.

At fiscal years ended October 31, total commitments and amounts outstanding under liquidity and credit enhancement facilities, which are also included in our discussion on Guarantees below, are shown in the following table:

#### *Liquidity and credit facilities*

(C\$ millions)	2004		2003	
	Committed (1)	Outstanding	Committed (1)	Outstanding
Liquidity facilities	\$ 25,443	\$ –	\$ 25,727	\$ –
Credit facilities	3,935	–	6,791	–

(1) Our maximum exposure to loss under these facilities is \$25.4 billion for 2004 and \$25.7 billion for 2003.

The economic exposure that we assume when we provide backstop liquidity commitments and partial credit enhancement is contingent in nature. We manage these exposures within our risk management functions in the same manner that we manage other contingent and non-contingent risk exposures. Our risk management process considers the credit, liquidity and interest rate exposure related to each of the assets. The risk exposure of each of these components individually and taken as a whole is deemed to be acceptable. All transactions are reviewed by external rating agencies. The weighted average credit quality of the assets supported by our backstop liquidity and partial credit enhancement is among the highest quality rating levels based on our internal risk rating system, which is described on page 59A. The liquidity risk to us is deemed to be low based on the historical performance and high credit quality of the multi-seller conduits' assets. Interest rate exposure is deemed to be low and is generally managed at the transaction level by passing on the funding cost variability to the securitization structures. Corporate Treasury scrutinizes contingent balance sheet risk, in effect monitoring the risk of drawdown under any of the credit facilities.

#### *Creation of investment products*

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

These SPEs often issue notes. Those notes may be rated by external rating agencies, as well as listed on a stock exchange, and are generally traded via recognized bond clearing systems. While the majority of the notes that are created in repackagings are expected to be sold on a

"buy & hold" basis, we may on occasion act as market maker. We do not, however, provide any repackaging SPE with any guarantees or other similar support commitments; rather we buy credit protection from these SPEs through credit derivatives. The investors in the notes ultimately bear any payments made by the SPE under these credit derivatives. There are many functions required to create a repackaged product. We fulfill some of these functions and independent third parties or specialist service providers fulfill the remainder. We do not consolidate these SPEs. Currently we act as sole arranger and swap provider for SPEs where we are involved and, in most cases, as paying and issuing agent as well. As with all our trading derivatives, the derivatives with these SPEs are carried at fair value in derivative-related assets and liabilities. The assets in these SPEs amounted to \$2.4 billion as at October 31, 2004 (2003 – \$1.5 billion).

#### *Asset management*

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

The notional amount of the CDOs we managed at the end of fiscal 2004 was US\$1.3 billion (2003 – US\$0.8 billion). Although we have nominal investments in the first-loss tranche of each of three CDOs with assets totalling US\$1.1 billion (2003 – one CDO with assets totalling US\$300 million), we provide no liquidity or credit support to these SPEs beyond this investment. The CDOs we manage may from time to time purchase collateral assets originated by us or third parties. We do not consolidate these CDOs.

The program documents covering the formation and operation of the individual CDOs provide strict guidelines for the purchase of such assets. We recognize fee income from structuring and collateral management services and, where indicated, interest income from investments in individual CDOs. These revenues totalled \$10 million during 2004 (2003 – \$3 million).

#### *Structured finance*

We occasionally make loan substitute and equity investments in off-balance sheet entities that are part of transactions structured to achieve a desired outcome such as limiting exposure to specific assets or risks, achieving indirect (and usually risk mitigated) exposure to financial assets, supporting an enhanced yield and meeting client requirements. These transactions usually yield a higher return, either before- or after-tax, than financing non-SPE counterparties, or holding an interest in financial assets directly. These transactions are structured to mitigate risks associated with directly investing in the underlying financial assets and may be structured so that our ultimate credit risk is that of the non-SPE, which in most cases is another financial institution. Exit mechanisms are built into these transactions to curtail exposure from changes in law or regulations. These entities had total assets of \$8.2 billion as at October 31, 2004. Our total exposure to these entities is \$3.3 billion, which is reflected on our balance sheet. Sometimes our control over such an entity results in consolidation.

For other types of off-balance sheet arrangements we enter into through VIEs, please refer to Note 1 on page 83A. As mentioned in Note 1, we continue to monitor developments that affect our current interpretation of AcG 15. These developments may change our anticipated conclusion whether to consolidate these entities or not. These changes may impact future usage of these arrangements.

#### **Guarantees**

We issue guarantee products, as defined by CICA Accounting Guideline 14, *Disclosure of Guarantees* (AcG 14), to our clients to help them meet their financing needs in return for fees recorded in non-interest income. Our significant types of guarantee products are back-stop liquidity facilities, credit derivatives, written put options, financial



standby letters of credit, credit enhancements, stable value products, performance guarantees and certain indemnification agreements.

Our maximum potential amount of future payments in relation to these items at October 31, 2004, amounted to \$83 billion (2003 – \$61 billion). 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 possible recoveries under recourse provisions, insurance policies or from collateral held or pledged.

Note 20 on pages 102A and 103A provides detailed information regarding the nature and maximum potential exposure for the types of guarantee products mentioned above.

In addition to guarantees, we also provide commercial commitments to our clients to help them meet their financing needs. On behalf of our clients we undertake written documentary and commercial letters of credit, authorizing a third party to draw drafts on us up to a stipulated amount and typically having underlying shipments of goods as collateral. We make commitments to extend credit, which represent unused portions of authorizations to extend credit in the form of loans, acceptances and letters of credit. We also have uncommitted amounts, where we retain the option to extend credit to a borrower. Table 26 below provides a summary of our off-balance sheet commercial commitments.

**Table 26 Commercial commitments (1)**

(C\$ millions)	Within 1 year	1 to 3 years	Over 3 to 5 years	Over 5 years	Total
Documentary and commercial letters of credit	\$ 500	\$ 65	\$ 2	\$ 25	\$ 592
Commitments to extend credit	45,682	15,778	9,319	3,815	74,594
Uncommitted amounts	60,972	–	–	–	60,972
	\$ 107,154	\$ 15,843	\$ 9,321	\$ 3,840	\$ 136,158

(1) Based on remaining term to maturity.

## FACTORS THAT MAY AFFECT FUTURE RESULTS

There are numerous factors, many beyond our control, that could cause results to differ significantly from our expectations. Some of these factors are described below. Other factors, including credit, market, liquidity, insurance, operational and other risks are described in the Risk management section beginning on page 57A.

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

### Industry and non-company factors

*As an integrated financial services company conducting business in Canada, the United States and other countries, our revenues and earnings are affected by the general economic conditions in each of the countries in which we conduct business.*

Factors such as interest rates, foreign exchange rates, consumer spending, business investment, government spending, the health of the capital markets, inflation and terrorism impact the business and economic environments in which we operate and, ultimately, the amount of business we conduct in a specific geographic region. For example, in an economic downturn in a particular country that is characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment and consumer spending, the demand for our loan and other products would be adversely affected and the provision for credit losses would likely increase, resulting in lower earnings. Similarly, a downturn in a particular equity market could cause a reduction in new issue and investor trading activity, assets under management and assets under administration, resulting in lower fee, commission and other revenues.

*The movement of the Canadian dollar relative to other currencies, particularly the U.S. dollar, may affect our revenues, expenses and earnings.* Our revenues, expenses and income denominated in currencies other than the Canadian dollar are subject to fluctuations in the movement of the Canadian dollar relative to such currencies. Such fluctuations may affect our overall business and financial results. Our most significant

exposure is to the U.S. dollar on account of our level of operations in the U.S., and the increase of the Canadian dollar compared to the U.S. dollar has had a material effect on our results in the past two years. Further appreciation of the Canadian dollar relative to the U.S. dollar would reduce the translated value of U.S. dollar-denominated revenues, expenses and earnings compared to prior periods.

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

Bond and money market expectations about inflation and central bank monetary policy decisions have an impact on the level of interest rates, fluctuation of which can have an impact on our earnings. Our policy for the non-trading balance sheet is to manage the interest rate risk to a target level. We have defined this target level as a risk neutral balance sheet where the interest rate exposures of most assets and liabilities are matched, with the residual assets representing a notional investment of equity spread evenly across a term of 60 months. As a result, our interest rate risk profile has slightly faster repricing of assets than liabilities. Consequently, a decline in interest rates would tend to reduce the net interest income earned on our non-trading portfolio as shorter-term assets reprice and to increase the value of our longer-term assets. Conversely, an increase in interest rates would result in an increase in the net interest income and a decrease in the value of our longer-term assets. For a more complete discussion of interest rate risk and its potential impact on our non-trading portfolio, please refer to the discussion of asset/liability management activities in our non-trading portfolio on page 65A. For a more complete discussion of interest rate risk and its potential impact on our trading business, please refer to the discussion of trading activities on page 60A.

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

The competition for customers among financial services companies in the consumer and business markets in which we operate is intense. Customer loyalty and retention can be influenced by a number of factors, including relative service levels, the prices and attributes of our products or services, our reputation and actions taken by our competitors. Non-financial companies can provide consumers with the option to pay bills and transfer funds without involving banks. Securities transactions

can be conducted through the Internet and other alternative, non-trading systems. Such disintermediation could also reduce fee revenues and adversely affect our earnings.

*Changes in the statutes, regulations and regulatory policies that govern activities in our various business lines could affect our results.*

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

*Judicial or regulatory judgments and legal proceedings against us may adversely affect our results.*

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

We are also subject to litigation arising in the ordinary course of our business. The adverse resolution of any litigation could have a material adverse effect on our results or could give rise to significant reputational damage, which could impact our future business prospects.

*Failure to obtain accurate and complete information from or on behalf of our customers and counterparties could adversely affect our results.*

When deciding to extend credit or enter into other transactions with customers and counterparties, we may rely on information provided to us by or on behalf of customers and counterparties, including audited financial statements and other financial information. We also may rely on representations of customers and counterparties as to the completeness and accuracy of that information. Our financial results could be adversely impacted if the financial statements and other financial information relating to customers and counterparties on which we rely do not comply with GAAP or are materially misleading.

#### **Company specific factors**

*Our financial performance may be affected by our ability to successfully complete our business realignment.*

Effective November 1, 2004, we realigned our organizational structure, resources and processes in order to serve our clients better and more efficiently across all our businesses, to find new ways to generate stronger revenue growth, and to streamline our organization and processes for faster decision-making, quicker implementation and better productivity. Although we believe that our initiatives will help us to better meet our clients' needs, accelerate revenue growth and control costs, there is no assurance that we will achieve these objectives and improve our financial performance.

*Our financial performance will be influenced by our ability to complete strategic acquisitions and to integrate acquisitions successfully, including our ability to successfully execute our U.S. expansion strategy.*

Although we regularly explore opportunities for strategic acquisitions of companies in our lines of business, there is no assurance that we will be able to complete acquisitions on terms and conditions that satisfy our investment criteria. There is also no assurance we will achieve anticipated cost savings following acquisitions. Our performance is contingent on retaining the clients and key employees of acquired companies, and there can be no assurance that we will always succeed in doing so.

The first phase of our U.S. expansion strategy consisted of putting together the original building blocks by acquiring businesses largely in the personal and commercial banking, wealth management and insurance areas. The second phase entailed adding to these original building blocks through additional strategic acquisitions, branch openings and greater market penetration. The third phase entails reducing costs and enhancing profitability by focusing on high-growth markets through

initiatives such as strategic branch openings and closing low performing branches. There are significant risks and uncertainties associated with our U.S. expansion including the risk of failure to realize anticipated savings, retain key employees, integrate new customers with our business and our ability to realize profitability improvement.

*The accounting policies and methods we utilize determine how we report our financial condition and results of operations, and they may require management to make estimates or rely on assumptions about matters that are inherently uncertain. Such estimates and assumptions may require revision, and changes to them may materially adversely affect our results of operations and financial condition.*

Our financial condition and results of operations are reported using accounting policies and methods prescribed by GAAP. In certain cases, GAAP allows accounting policies and methods to be selected from two or more alternatives, any of which might be reasonable, yet result in our reporting materially different amounts.

Management exercises judgment in selecting and applying our accounting policies and methods to ensure that, while GAAP compliant, they reflect our best judgment of the most appropriate manner in which to record and report our financial condition and results of operations. Significant accounting policies to the consolidated financial statements are described in Note 1 on pages 79A to 84A.

As detailed in Critical accounting policies and estimates section on pages 26A to 28A, four accounting policies have been identified as being "critical" to the presentation of our financial condition and results of operations as they (i) require management to make particularly subjective and/or complex judgments about matters that are inherently uncertain and (ii) carry the likelihood that materially different amounts could be reported under different conditions or using different assumptions and estimates. The reporting of such materially different amounts could materially and adversely affect our results of operations or reported financial condition. These critical accounting policies and estimates relate to the determination of our allowances for credit losses, the determination of the fair value of certain of our financial instruments, securitization and pensions.

*As a large corporation, we are exposed to operational and infrastructure risks.*

Similar to all large corporations, we are exposed to many types of operational risk, including the risk of fraud by employees or outsiders, unauthorized transactions by employees, or operational errors, including clerical or record keeping errors or errors resulting from faulty or disabled computer or telecommunications systems. Given the high volume of transactions we process on a daily basis, certain errors may be repeated or compounded before they are discovered and successfully rectified. Shortcomings or failures in our internal processes, people or systems, including any of our financial, accounting or other data processing systems, could lead to, among other consequences, financial loss and reputational damage. In addition, despite the contingency plans we have in place, our ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports our businesses and the communities in which they are located. This may include a disruption involving electrical, communications, transportation or other services used by us or third parties with which we conduct business.

#### **Other factors**

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

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

## 2003 COMPARED TO 2002

The following discussion and analysis provides a comparison of our results of operations for the years ended October 31, 2003, and October 31, 2002. This discussion should be read in conjunction with the consolidated financial statements and related Notes on pages 74A to 114A. Reference is also made to our 2003 report to shareholders for a much more detailed discussion.

Net income in 2003 increased \$243 million or 9% over 2002 despite a \$60 million decline in net income due to the strengthening of the Canadian dollar relative to the U.S. dollar, predominantly reflecting a reduction in the provision for credit losses of \$344 million.

### Business segment results

Net income from RBC Banking increased \$30 million or 2% to \$1,561 million in 2003 as higher earnings in Canada more than offset a \$41 million decline in U.S. earnings due to the strengthening of the Canadian dollar relative to the U.S. dollar (which accounted for \$18 million of the earnings decline) and higher costs associated with RBC Mortgage operations and with acquisitions completed during 2003. ROE increased from 19.1% to 21.0% due to lower common equity attributed to this segment and higher earnings.

Net income from RBC Investments was up \$67 million or 20% to \$410 million in 2003, driven primarily by improved earnings in the U.S. and ongoing cost-containment initiatives as well as higher earnings from the Canadian self-directed brokerage and asset management businesses. U.S. net income in 2003 was up \$89 million, with significantly improved performance in the full-service brokerage business, strong fixed income results and a decline in retention compensation costs. ROE improved 400 basis points to 15.0%, reflecting higher earnings in 2003, as well as a \$350 million reduction in average common equity attributed to this segment.

Net income from RBC Insurance increased \$99 million or 85% to \$216 million in 2003 due to strong profitability in the reinsurance business, and improvements in the Canadian and U.S. life businesses, which benefited from stronger equity markets and a more stable interest rate environment. U.S. net income in 2003 was \$4 million compared to a loss of \$19 million a year ago, largely due to the improvement in the life business noted above. ROE increased from 15.7% to 25.0% due to higher earnings.

Net income from RBC Capital Markets increased \$91 million or 22% to \$508 million in 2003, as a significant reduction in the provision for credit losses related to the U.S. corporate loan portfolio more than offset higher non-interest expense. ROE improved to 13.0% in 2003, due to higher net income as well as a \$150 million reduction in average common equity attributed to this segment.

Net income from RBC Global Services was up \$6 million or 4% to \$177 million in 2003, as higher revenues, a lower provision for credit losses and lower income taxes offset higher non-interest expense. ROE fell 90 basis points in 2003 to 27.5%, primarily reflecting \$50 million in additional average common equity attributed to this segment in 2003.

The Other segment's net income declined \$50 million to \$133 million in 2003 due largely to refinements in the methodology for attributing net interest income to our business segments. ROE fell to 5.6% from 24.8%.

### Net interest income

Net interest income decreased 5% to \$6.6 billion in 2003 from \$6.9 billion in 2002, reflecting a decline in the net interest margin due to price competition in retail banking and low interest rates, and a lower translated value of U.S. dollar-denominated net interest income due to the strengthening of the Canadian dollar relative to the U.S. dollar.

### Non-interest income

Non-interest income increased \$502 million or 5% to \$10.8 billion in 2003 primarily due to increased trading revenues, higher insurance premiums and gain on sale of available for sale securities, which more than offset a \$390 million decline in the translated value of U.S. dollar-denominated revenues due to the strengthening of the Canadian dollar relative to the U.S. dollar in 2003. Non-interest income accounted for 62% of total revenues.

### Non-interest expense

Non-interest expense was \$11 million lower in 2003. While the stronger Canadian dollar relative to the U.S. dollar reduced the translated value of non-interest expense by \$340 million, there were increases in pension and other postretirement benefit costs, costs related to further automating our retail banking technology infrastructure and expanding our retail sales force, and costs related to companies we acquired during the year.

### Provision for credit losses

The provision for credit losses decreased \$344 million or 32% to \$721 million in 2003 from \$1,065 million in 2002 largely due to improvements in the U.S. business and government loan portfolio. The total allowance for credit losses was \$2.2 billion, or 1.0% of total loans and acceptances, and reverse repurchase agreements, down from \$2.3 billion or 1.0% in 2002.

### Taxes

Income taxes were \$1.5 billion in 2003, up from 2002, while the effective income tax rate was 31.8% compared to 32.2% in 2002.

## QUARTERLY FINANCIAL INFORMATION

Selected financial information for the eight most recently completed quarters is shown on page 120A.

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