

Note 4: Loans, Customers' Liability under Acceptances and Allowance for Credit Losses

Change in Accounting Policy

Loan origination costs are included in our loan balances and are recognized in interest, dividend and fee income, loans, over the life of the resulting loan. Prior to November 1, 2006, an equal amount of loan origination costs was recognized in each year over the life of the resulting loan. The new rules require that we use the effective interest method to recognize loan origination costs, whereby the amount recognized varies over the life of the loan based on the principal outstanding.

As at November 1, 2006, we adjusted our deferred loan origination costs to reflect the balance that would have resulted if we had always used the effective interest method to recognize loan origination costs. The impact was a decrease in loans, residential mortgages of \$87 million, a decrease in future income tax liability of \$30 million and a decrease in retained earnings of \$57 million.

Loans

Loans are recorded at amortized cost using the effective interest method. This method allocates interest income over the expected term by applying the effective interest rate to the carrying amount of the loan. The effective interest rate is defined as the rate that exactly discounts estimated future cash receipts through the expected life of the loan. The treatment of interest income for impaired loans is described below.

Securities borrowed or purchased under resale agreements represent the amounts we will receive as a result of our commitment to resell securities that we have purchased back to the original seller, on a specified date at a specified price. We account for these instruments as loans.

Loan Fees

The accounting treatment for loan fees varies depending on the transaction. Loan origination, restructuring and renegotiation fees are recorded as interest income over the term of the loan. Commitment fees are recorded as interest income over the term of the loan, unless we believe the loan commitment will not be used. In the latter case, commitment fees are recorded as lending fees over the commitment period. Loan syndication fees are included in lending fees as the syndication is completed, unless the yield on any loans we retain is less than that of other comparable lenders involved in the financing. In the latter case, an appropriate portion of the syndication fee is recorded as interest income over the term of the loan.

Customers' Liability under Acceptances

Acceptances represent a form of negotiable short-term debt that is issued by our customers and which we guarantee for a fee. We have offsetting claims, equal to the amount of the acceptances, against our customers in the event of a call on these commitments. The amount due under acceptances is recorded in other liabilities and our corresponding claim is recorded as a loan in our Consolidated Balance Sheet.

Fees earned are recorded in lending fees in our Consolidated Statement of Income.

Impaired Loans

We classify residential mortgages as impaired when payment is contractually 90 days past due, or one year past due if guaranteed by the Government of Canada. Credit card loans are classified as impaired and immediately written off when principal or interest payments are 180 days past due. Consumer instalment and other personal loans are classified as impaired when principal or interest payments are 90 days past due, and are normally written off when they are one year past due.

Corporate and commercial loans are classified as impaired when we are no longer reasonably assured that principal or interest will be collected on a timely basis, or when payments are 90 days past due, or for fully secured loans, when payments are 180 days past due.

We do not accrue interest income on loans classified as impaired, and any interest income that is accrued and unpaid is reversed against interest income.

Payments received on corporate and commercial loans that have been classified as impaired are applied first to the recovery of collection costs, principal and any previous write-offs or allowances, and then as interest income. Payments received on impaired consumer instalment loans are applied first to outstanding interest and then to the remaining principal.

A loan will be reclassified back to performing status when it is determined that there is reasonable assurance of full and timely repayment of interest and principal in accordance with the terms and conditions of the loan, and that none of the criteria for classification of the loan as impaired continue to apply.

From time to time we will restructure a loan due to the poor financial condition of the borrower. If no longer considered impaired, interest on these restructured loans is recorded on an accrual basis.

Allowance for Credit Losses

The allowance for credit losses recorded in our Consolidated Balance Sheet is maintained at a level which we consider adequate to absorb credit-related losses on our loans, customers' liability under acceptances and other credit instruments (as discussed in Note 5). The portion related to other credit instruments is recorded in other liabilities in our Consolidated Balance Sheet.

The allowance comprises the following two components:

Specific Allowances

These allowances are recorded for specific loans to reduce their book value to the amount we expect to recover. We review our loans and acceptances on an ongoing basis to assess whether any loans should be classified as impaired and whether an allowance or write-off should be recorded (other than consumer instalment and credit card loans, which are written off when certain conditions exist, as discussed under impaired loans). Our review of problem loans is conducted at least quarterly by our account managers, who assess the ultimate collectibility and estimated recoveries on a specific loan based on all events and conditions that the manager believes are relevant to the condition of the loan. This assessment is then reviewed and concurred with by an independent credit officer.

To determine the amount we expect to recover from an impaired loan, we use the value of the estimated future cash flows discounted at the effective rate inherent in the loan. When the amounts and timing of future cash flows cannot be estimated with reasonable reliability, the expected recovery amount is estimated using either the fair value of any security underlying the loan, net of expected costs of realization and any amounts legally required to be paid to the borrower, or an observable market price for the loan. Security can vary by type of loan and may include cash, securities, real property, accounts receivable, guarantees, inventory or other capital assets.

General Allowance

We maintain a general allowance in order to cover any impairment in the existing portfolio that cannot yet be associated with specific loans. Our approach to establishing and maintaining the general allowance is based on the guideline issued by our regulator, the Superintendent of Financial Institutions Canada.

The general allowance is reviewed on a quarterly basis. A number of factors are considered when determining the appropriate level of the general allowance, including a general allowance model that applies historical expected and unexpected loss rates to current balances with sensitivity to risk ratings, industry sectors and credit products. Model results are then considered along with the level of the existing allowance, as well as management's judgment regarding portfolio quality, business mix, and economic and credit market conditions.

Provision for Credit Losses

Changes in the value of our loan portfolio due to credit-related losses or recoveries of amounts previously provided for or written off are included in the provision for credit losses in our Consolidated Statement of Income.

Foreclosed Assets

Property or other assets that we have received from borrowers to satisfy their loan commitments are recorded at fair value and are classified as either held for use or held for sale according to management's intention. Fair value is determined based on market prices where available. Otherwise, fair value is determined using other methods, such as analysis of discounted cash flows or market prices for similar assets.

Loans, including customers' liability under acceptances and allowance for credit losses by category, are as follows:

(Canadian \$ in millions)	Gross amount		Specific allowance		General allowance		Net amount	
	2007	2006	2007	2006	2007	2006	2007	2006
Residential mortgages	\$ 52,429	\$ 63,321	\$ 14	\$ 5	\$ 11	\$ 23	\$ 52,404	\$ 63,293
Credit card, consumer instalment and other personal loans	37,682	34,049	1	1	327	340	37,354	33,708
Business and government loans	62,650	56,030	142	147	517	506	61,991	55,377
Securities borrowed or purchased under resale agreements	37,093	31,429	—	—	—	—	37,093	31,429
Subtotal	189,854	184,829	157	153	855	869	188,842	183,807
Customers' liability under acceptances	12,389	7,223	—	—	43	36	12,346	7,187
Total	\$ 202,243	\$ 192,052	\$ 157	\$ 153	\$ 898	\$ 905	\$ 201,188	\$ 190,994
By geographic region (1):								
Canada	\$ 145,765	\$ 139,223	\$ 105	\$ 96	\$ 587	\$ 555	\$ 145,073	\$ 138,572
United States	51,634	50,227	51	53	311	350	51,272	49,824
Other countries	4,844	2,602	1	4	—	—	4,843	2,598
Total	\$ 202,243	\$ 192,052	\$ 157	\$ 153	\$ 898	\$ 905	\$ 201,188	\$ 190,994

(1) Geographic region is based upon the country of ultimate risk.

Restructured loans of \$3 million were classified as performing during the year ended October 31, 2007 (\$nil in 2006). No restructured loans were written off in the years ended October 31, 2007 and 2006.

Included in loans as at October 31, 2007 are \$56,356 million (\$53,750 million in 2006) of loans denominated in U.S. dollars and \$1,909 million (\$1,101 million in 2006) of loans denominated in other foreign currencies.

Impaired loans, including customers' liability under acceptances and the related allowances, are as follows:

(Canadian \$ in millions)	Gross impaired amount		Specific allowance		Net of specific allowance	
	2007	2006	2007	2006	2007	2006
Residential mortgages	\$ 126	\$ 115	\$ 14	\$ 5	\$ 112	\$ 110
Consumer instalment and other personal loans	55	48	1	1	54	47
Business and government loans	539	503	142	147	397	356
Total	\$ 720	\$ 666	\$ 157	\$ 153	\$ 563	\$ 513
By geographic region (1):						
Canada	\$ 454	\$ 391	\$ 105	\$ 96	\$ 349	\$ 295
United States	262	260	51	53	211	207
Other countries	4	15	1	4	3	11
Total	\$ 720	\$ 666	\$ 157	\$ 153	\$ 563	\$ 513

(1) Geographic region is based upon the country of ultimate risk.

Fully secured loans with past due amounts between 90 and 180 days that we have not classified as impaired totalled \$58 million and \$47 million as at October 31, 2007 and 2006, respectively.

No impaired loans were foreclosed during the years ended October 31, 2007 and 2006.

Our average gross impaired loans and acceptances were \$677 million for the year ended October 31, 2007 (\$729 million in 2006). Our average impaired loans, net of the specific allowance, were \$516 million for the year ended October 31, 2007 (\$552 million in 2006).

During the years ended October 31, 2007, 2006 and 2005, we would have recorded additional interest income of \$43 million, \$45 million and \$65 million, respectively, if we had not classified any loans as impaired. Cash interest income on impaired loans of \$nil was recognized during each of the years ended October 31, 2007, 2006 and 2005.

Concentration of Credit Risk

We are exposed to credit risk from the possibility that counterparties may default on their financial obligations to us. Credit risk arises predominantly with respect to loans, over-the-counter derivatives and other credit instruments.

Concentrations of credit risk exist if a number of clients are engaged in similar activities, are located in the same geographic region or have similar economic characteristics such that their ability

A continuity of our allowance for credit losses is as follows:

(Canadian \$ in millions)	Specific allowance			General allowance			Total		
	2007	2006	2005	2007	2006	2005	2007	2006	2005
Balance at beginning of year	\$ 153	\$ 169	\$ 298	\$ 905	\$ 959	\$ 1,010	\$ 1,058	\$ 1,128	\$ 1,308
Provision for credit losses	303	211	219	50	(35)	(40)	353	176	179
Recoveries	91	112	67	–	–	–	91	112	67
Write-offs	(391)	(338)	(419)	–	–	–	(391)	(338)	(419)
Foreign exchange and other	1	(1)	4	(57)	(19)	(11)	(56)	(20)	(7)
Balance at end of year	\$ 157	\$ 153	\$ 169	\$ 898	\$ 905	\$ 959	\$ 1,055	\$ 1,058	\$ 1,128

to meet their contractual obligations could be affected similarly by changes in economic, political or other conditions. Concentrations of credit risk indicate a related sensitivity of our performance to developments affecting a particular counterparty, industry or geographic location.

Information about our credit risk exposure is provided above in the classification of our loan assets both by type of loan and by geographic region.