

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

Change in Accounting Policy

On November 1, 2006, we adopted the CICA's new accounting requirements for loans. The new rules require us to amortize deferred loan origination costs using the effective interest method. We record the amortization in interest, dividend and fee income, loans, over the life of the resulting loan. Under the effective interest method, the amount recognized varies over the life of the loan based on the principal outstanding. Prior to November 1, 2006, an equal amount of loan origination costs was recognized in each year over the life of the resulting loan.

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 as described above. 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.

Lending Fees

The accounting treatment for lending 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 loans, other personal loans and some small business 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 any amounts remaining are then recorded 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 we determine 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 restructure a loan due to the poor financial condition of the borrower. If they are 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 OSFI.

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.

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

(Canadian \$ in millions)	Residential mortgages		Credit card, consumer instalment and other personal loans		Business and government loans		Customers' liability under acceptances		Total	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
As at October 31										
Gross amount at end of year	\$ 49,343	\$ 52,429	\$ 45,857	\$ 37,682	\$ 84,151	\$ 62,650	\$ 9,358	\$ 12,389	\$ 188,709	\$ 165,150
Specific allowance at beginning of year	\$ 14	\$ 5	\$ 1	\$ 1	\$ 142	\$ 147	\$ -	\$ -	\$ 157	\$ 153
Provision for credit losses	5	11	332	218	733	74	-	-	1,070	303
Recoveries	-	-	91	72	23	19	-	-	114	91
Write-offs	(6)	(2)	(422)	(287)	(542)	(102)	-	-	(970)	(391)
Foreign exchange and other	-	-	-	(3)	55	4	-	-	55	1
Specific allowance at end of year	13	14	2	1	411	142	-	-	426	157
General allowance at beginning of year	11	23	327	340	517	506	43	36	898	905
Provision for credit losses	(3)	(12)	(85)	(13)	350	68	(2)	7	260	50
Foreign exchange and other	-	-	-	-	163	(57)	-	-	163	(57)
General allowance at end of year	8	11	242	327	1,030	517	41	43	1,321	898
Total allowance	\$ 21	\$ 25	\$ 244	\$ 328	\$ 1,441	\$ 659	\$ 41	\$ 43	\$ 1,747	\$ 1,055
Net amount at end of year	\$ 49,322	\$ 52,404	\$ 45,613	\$ 37,354	\$ 82,710	\$ 61,991	\$ 9,317	\$ 12,346	\$ 186,962	\$ 164,095

Restructured loans of \$3 million were classified as performing during the year ended October 31, 2008 (\$3 million in 2007). No restructured loans were written off in the years ended October 31, 2008 and 2007.

Included in loans as at October 31, 2008 are \$78,782 million (\$56,356 million in 2007) of loans denominated in U.S. dollars and \$2,608 million (\$1,909 million in 2007) of loans denominated in other foreign currencies.

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

(Canadian \$ in millions)	Gross amount		Specific allowance		General allowance		Net amount	
	2008	2007	2008	2007	2008	2007	2008	2007
By geographic region (1):								
Canada	\$ 139,849	\$ 145,765	\$ 129	\$ 105	\$ 579	\$ 587	\$ 139,141	\$ 145,073
United States	64,975	51,634	256	51	742	311	63,977	51,272
Other countries	11,918	4,844	41	1	-	-	11,877	4,843
Total	\$ 216,742	\$ 202,243	\$ 426	\$ 157	\$ 1,321	\$ 898	\$ 214,995	\$ 201,188

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

Impaired loans, including the related allowances, are as follows:

(Canadian \$ in millions)	Gross impaired amount		Specific allowance		Net of specific allowance	
	2008	2007	2008	2007	2008	2007
Residential mortgages	\$ 224	\$ 126	\$ 13	\$ 14	\$ 211	\$ 112
Consumer instalment and other personal loans	182	55	2	1	180	54
Business and government loans	1,981	539	411	142	1,570	397
Total	\$ 2,387	\$ 720	\$ 426	\$ 157	\$ 1,961	\$ 563
By geographic region (1):						
Canada	\$ 803	\$ 454	\$ 129	\$ 105	\$ 674	\$ 349
United States	1,494	262	256	51	1,238	211
Other countries	90	4	41	1	49	3
Total	\$ 2,387	\$ 720	\$ 426	\$ 157	\$ 1,961	\$ 563

(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 \$68 million and \$58 million as at October 31, 2008 and 2007, respectively.

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.

During the year ended October 31, 2008, we foreclosed on impaired loans and received \$45 million in real estate properties that we classified as held for sale (no impaired loans were foreclosed in 2007). Assets held for sale are disposed of in an orderly fashion.

Our average gross impaired loans and acceptances were \$1,568 million for the year ended October 31, 2008 (\$677 million in 2007). Our average impaired loans, net of the specific allowance, were \$1,245 million for the year ended October 31, 2008 (\$516 million in 2007).

During the years ended October 31, 2008, 2007 and 2006, we would have recorded additional interest income of \$102 million, \$43 million and \$45 million, respectively, if we had not classified any loans as impaired. Cash interest income on impaired loans of \$nil was recognized during the years ended October 31, 2008, 2007 and 2006.

Sale of Impaired Loans

During the year ended October 31, 2008, we recorded a net gain on the sale of impaired loans of \$2 million (\$12 million in 2007).