Factors That May Affect Future Results

As noted in the Caution regarding forward-looking statements on page 9 of this Annual Report, all forward-looking statements, by their very nature, are subject to inherent risks and uncertainties, general and specific, which may cause the Bank's actual results to differ materially from the expectations expressed in the forward-looking statements. Some of these factors are discussed below. Other factors, including strategic, credit, market, liquidity, interest rate, operational, regulatory and other risks are discussed in the Managing Risk section of this Annual Report starting on page 33 and in other regulatory filings made in Canada and with the U.S Securities and Exchange Commission (SEC).

Industry factors

General business and economic conditions in the regions in which we conduct business

The Bank operates in Canada, the United States, and other countries. As a result, the Bank's earnings are significantly affected by the general business and economic conditions in the geographic regions in which it operates. These conditions include short-term and long-term interest rates, inflation, fluctuations in the debt and capital markets, exchange rates, the strength of the economy, threats of terrorism and the level of business the Bank conducts in a specific region.

Monetary policy

The Bank's earnings are affected by the monetary policies of the Bank of Canada and the Federal Reserve System in the United States and other financial market developments. Changes in the supply of money and the general level of interest rates can impact the Bank's profitability. A change in the level of interest rates affects the interest spread between the Bank's deposits and loans and as a result impacts the Bank's net interest income. Changes in monetary policy and in the financial markets are beyond the Bank's control and difficult to predict or anticipate.

Level of competition

The Bank's performance is impacted by the level of competition in the markets in which it operates. The Bank currently operates in a highly competitive industry. Customer retention can be influenced by many factors such as the pricing of products or services, changes in customer service levels and changes in products or services offered.

Changes in laws and regulations

Laws and regulations have been put in place by various governments and regulators to protect the financial and other interests of the Bank's customers, employees and shareholders. Changes to laws and regulations, including changes in their interpretation or implementation, could affect the Bank by limiting the products or services it can provide and increasing the ability of competitors to compete with its products and services. Also, the Bank's failure to comply with applicable laws and regulations could result in sanctions and financial penalties that could adversely impact its earnings and damage the Bank's reputation.

Accuracy and completeness of information on customers and counterparties

The Bank depends on the accuracy and completeness of information about customers and counterparties. In deciding whether to extend credit or enter into other transactions with customers and counterparties, the Bank may rely on information furnished by them, including financial statements and other financial information. The Bank may also rely on the representations of customers and counterparties as to the accuracy and completeness of that information and with respect to financial statements, on the reports of auditors. The Bank's financial condition and earnings could be negatively impacted to the extent it relies on financial statements that do not comply with generally accepted accounting principles, that are materially misleading, or that do not fairly present, in all material respects, the financial condition and results of operations of the customers and counterparties.

Bank specific factors

New products and services to maintain or increase market share

The Bank's ability to maintain or increase its market share depends, in part, on its ability to adapt products and services to evolving industry standards. There is increasing pressure on financial services companies to provide products and services at lower prices. This can reduce the Bank's net interest income and revenues from fee-based products and services. In addition, the widespread adoption of new technologies, including internet-based services, could require the Bank to make substantial expenditures to modify or adapt existing products and services. The Bank might not be successful in introducing new products and services, achieving market acceptance of its products and services, and/or developing and maintaining loyal customers.

Acquisitions

The Bank regularly explores opportunities to acquire other financial services companies. The Bank's ability to successfully complete an acquisition is often subject to regulatory approval, and the Bank cannot be certain when or if, or on what terms and conditions, any required regulatory approvals will be granted. Acquisitions can affect future results depending on management's success in integrating the acquired business. If the Bank encounters difficulty in integrating the acquired business, this can prevent the Bank from realizing expected revenue increases, cost savings, increases in market share and other projected benefits from the acquisition. Also, the negative impact of any divestitures required by regulatory authorities in connection with acquisitions may be greater than expected.

Ability to attract and retain key executives

The Bank's future performance depends to a large extent on its ability to attract and retain key executives. There is intense competition for the best people in the financial services sector. There is no assurance that the Bank will be able to continue to attract and retain key executives, although this is the goal of the Bank's management resources policies and practices.

Business infrastructure

Third parties provide key components of the Bank's business infrastructure such as internet connections and network access. Disruptions in internet, network access or other voice or data communication services provided by these third parties could adversely affect the Bank's ability to deliver products and services to customers and otherwise conduct business.

Other factors

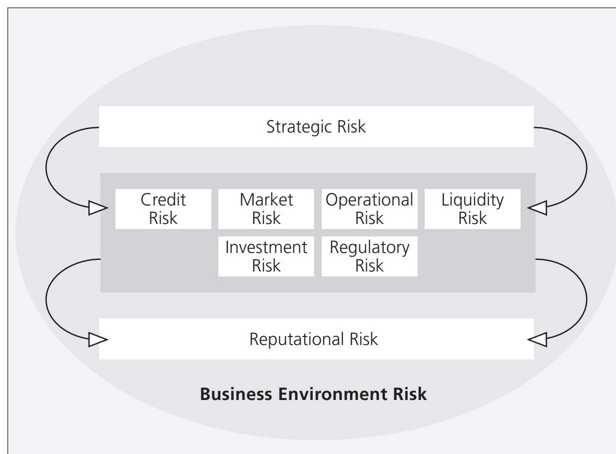
Other factors beyond the Bank's control that may affect the Bank's future results include changes in tax laws, unexpected changes in consumer spending and saving habits, technological changes, the possible impact on the Bank's businesses of international conflicts and terrorism, natural disasters, such as earthquakes, and the Bank's anticipation of and success in managing the risks implied by the factors discussed above within a disciplined risk environment.

The Bank cautions that the preceding discussion of factors that may affect future results is not exhaustive. When relying on forward-looking statements to make decisions with respect to the Bank, investors and others should carefully consider these factors as well as other uncertainties, potential events and industry and Bank specific factors that may adversely impact the Bank's future results. The Bank does not undertake to update any forward-looking statements, written or oral, that may be made from time to time by or on its behalf.

Managing Risk

At TD Bank Financial Group, our goal is to earn satisfactory returns from our various business activities within an acceptable level of risk. To do this, we need to understand the risks involved in our businesses and ensure that the risks we assume are within prudent limits. Managing risk means assessing the potential impact of each risk, and establishing policies, procedures and internal controls to mitigate them to an acceptable level.

The Enterprise Risk Framework
To effectively manage risk, we first consider the different kinds of risk to which we are exposed. Our Enterprise Risk Framework forms the basis of communicating, monitoring and reporting on risks within the Bank. It is a dynamic model, reflecting those key risks that could impact the achievement of our business objectives and strategies. The major categories of risk and their relationships to each other are set out in our Enterprise Risk Framework:



Through our strategic planning process and within the context of the environments in which we operate, we develop strategies for our various business units. In implementing those strategies, we expose ourselves to the credit, market, operational, liquidity, investment and regulatory risks shown in the centre of the Framework. It is our ability to manage risks in those areas that determines the extent to which the Bank's overall reputation and capital is at risk.

Governance framework for risk management
Our governance framework for Risk Management has been put in place to ensure effective decision making, prioritization and resource allocation regarding risk, and establishes the following accountabilities:

- Business units own and are accountable for managing risk within the business unit. The business unit ensures that policies, processes and internal controls are in place to manage the business and the risks inherent to that business;
- The Risk Management function of the Bank is responsible for setting standards and policies that reflect the risk appetite of the Bank through which they enable the business to manage its risk. They also facilitate the identification and escalation of significant, aggregate risks for resolution at the Executive level;
- The Compliance and Audit functions report to management and the Board that appropriate risk management policies, procedures and internal controls are in place and are being followed;
- The Senior Executive Team monitors, evaluates and manages risk from the enterprise perspective. To enable this, information flows to the Senior Executive Team from the business units and from the corporate oversight functions, which are Risk Management, Audit, Legal, Compliance, Finance and Human Resources. The President and CEO and the EVP and Chief Risk Officer with the support of the other members of the Senior Executive Team, are accountable for identifying and communicating to the Board those risks deemed significant; and
- The Board and the Senior Executive Team establish the control culture for the organization through the clear communication of mandates and accountabilities and through the articulation of the organization's operational and strategic goals with respect to risk and control. This message is carried to all employees through the business units and the corporate oversight functions.

Risk management governance structure
To ensure that information about significant risks flow to the Board and the Senior Executive Team from the business units and corporate oversight functions, the Bank has established a formal risk management governance structure. Illustrated below, this structure is closely aligned with the Enterprise Risk Framework.

The Bank has a comprehensive ongoing risk management approach that incorporates the experience and specialized knowledge of our business units, as well as the corporate oversight functions. Key strategic elements of our approach are governance and senior management oversight. This includes:

- An annual review of significant risk policies and critical assessment of the Bank's business strategies from a risk perspective by the Risk Committee of the Board;
- A comprehensive strategic planning process and regular monitoring of strategies by the Senior Executive Team;
- A regular review of risk management policies, strategies, and key initiatives by the appropriate Executive Management Committees;
- Formal review of risk issues by both the business unit and the Senior Executive Team;
- Standard risk reporting throughout the Bank, to the Board and the Senior Executive Team captures and presents all elements of the Bank's risk profile, both qualitatively and quantitatively;
- Comprehensive reviews by Audit to provide senior management with reports as to the quality of the internal control environment and compliance with established risk management policies and procedures; and
- Annual self assessments by the significant business and corporate oversight functions of their key risks and internal controls. These assessments use the Bank's internal control framework. The Bank's framework is consistent with the most widely used framework developed by the Committee of Sponsoring Organizations of the Treadway Committee (COSO).

The following pages describe the main risks we face and our strategies for managing them.

STRATEGIC RISK

Strategic risk is the potential for loss arising from ineffective business strategies, the absence of integrated business strategies, the inability to implement those strategies, and the inability to adapt the strategies to changes in the business environment.

We are exposed to strategic risk at all levels of the organization, in every aspect of our business. The most significant strategic risks faced by the Bank are assessed, managed and mitigated by Executive Management with oversight by the Board.

Who manages strategic risk

The Senior Executive Team manages the Bank's strategic risk and is comprised of the 18 most senior executives of the Bank. Every senior executive who manages a significant business or corporate oversight function with the Bank is represented on the Senior Executive Team.

The Bank's overall strategy is established by the President and CEO and the Senior Executive Team, including a consultation and approval process with the Board. Each executive is responsible for managing strategies within their business or functional area and for ensuring that those strategies align with the Bank's overall strategy. They are accountable to the President and CEO and the Senior Executive Team to monitor, manage and report on business risks inherent in their strategies.

The President and CEO reports to the Board on the implementation of Bank strategies, identifying business risks within these strategies and how these risks are being managed.

How we manage strategic risk

The Senior Executive Team, chaired by the President and CEO, reviews overall strategies and operating performance of the Bank's significant business units and corporate functions in business performance review sessions. The frequency of strategy review in these sessions depends on the risk profile and magnitude of the business employing the strategy.

CREDIT RISK

Credit risk is the potential for financial loss if a borrower or counterparty in a transaction fails to meet its obligations.

We are exposed to credit risk through our traditional lending activities and transactions involving settlements between us and our counterparties, including other financial institutions. These include direct loans, commitments to extend credit, settlement exposures, derivative transactions and securities inventories.

Who manages credit risk

Risk Management sets the policies and procedures for managing credit risk on a global basis. Its responsibilities include:

- Setting guidelines that limit portfolio concentrations of credit exposure by country, industry and affiliated group;
- Approving discretionary limits of officers throughout the Bank for extending lines of credit;
- Setting standards for measuring credit exposure;
- Approving the scoring techniques used in extending personal credit;
- Approving all policies relating to all products and services that have credit risk; and
- Setting the criteria for rating risk on business accounts, based on a 21-category rating system.

The Risk Committee of the Board reviews and approves all major credit risk policies periodically.

Each business unit has a credit group that is primarily responsible for adjudication, and it operates under the policies and strict authorization and exposure limits established by Risk Management. Our strategy makes it clear that we are lending on a business relationship basis.

We manage all of our businesses in an extremely disciplined and conservative manner, with a strict focus on economic returns for all client relationships.

The Credit and Market Risk Committee, which is chaired by the President and CEO, reviews and approves large individual credits, reviews industry concentrations and resolves any major policy issues involving market or credit risk.

How we manage credit risk

By country

Country risk is the risk that economic or political change in a country could affect cross-border payments for goods and services, loans, trade-related finance and dividends, as well as the repatriation of the Bank's capital from the foreign country. We currently have exposure in 57 countries, with the largest portion in North America. We establish country exposure guidelines based on an internal risk rating system. Country limits cover all aspects of credit exposure across our various businesses.

Business and government loans

We also establish industry and group limits for credit exposure to businesses and governments. We use a systematic approach to set and communicate risk guidelines for each business industry in our loan portfolio. These guidelines are based on a risk assessment of the industry. We have identified 28 major business industry groups and divided them into 117 segments. We assign a risk rating to each industry segment on a scale of one to six.

Our analysis focuses on key risks inherent in a given industry, such as its cycles, exposure to technological change, political influence, regulatory change or barriers to entry. If we believe that several industry segments are affected by common risk factors, we assign a single exposure guideline to them. Risk Management assigns a concentration limit for each industry as a percentage of total industrial exposure. We also conduct ongoing reviews of industry risk ratings and segmentation.

We assign each business or government borrower a risk rating using our 21-category rating system. We set limits on credit exposure to related business or government accounts based on these ratings. In addition, we use a Risk Adjusted Return on Capital model to assess the return on credit relationships in relation to the structure and maturity of the loans and internal ratings of the borrowers. We review the rating and return on capital for each borrower every year.

For accounts where exposures include derivatives, we use master netting agreements or collateral wherever possible to reduce our exposure.

Wholesale Banking is split into two distinct business groups: the core business and the non-core business. The non-core portfolio consists of relationships we intend to exit over the next two years. The core portfolio represents the clients in Canada and abroad where we have or have potential to have a broader long-term relationship.

Financial institutions

Our financial institutions portfolio is divided into 15 major groups. Individual companies in each group have similar attributes and common risk factors. We have developed specific exposure guidelines for 24 segments within these groups. Risk Management conducts ongoing reviews of the segment and exposure guidelines for each group.

We assign each group a risk rating using our 21-category rating system. These ratings are based on the strength of each firm's parent institution. We assign each group a credit rating based on each firm's net worth, the quality of its assets, the consistency and level of its profits, as well as the ratings of the major credit rating agencies. We may use additional criteria for certain types of financial institutions.

Personal credit

Credit requests are evaluated using automated credit scoring systems or are directed to regional credit centres operating within clear authority limits. Once retail credits are funded, they are continually monitored within quantitative account management programs to identify changes in risk and to provide opportunities that increase risk-adjusted performance. The centralized approach to reviewing retail credits has resulted in well-balanced portfolios with predictable performance characteristics. We are increasing our investment in automated decision technology and credit scoring techniques that improve our ability to control retail credit losses within predictable ranges.

Classified risk

Classified risk refers to loans and other credit exposures that pose a higher credit risk than normal, based on our standards.

A loan is considered impaired when, in management's opinion, we can no longer be reasonably assured that we will be able to collect the full amount of the principal and interest when it is due.

We establish specific allowances for impaired loans when a loss is likely or when the estimated value of the loan is less than its recorded value, based on discounting expected future cash flows.

Allowances for our personal credit portfolios are based on delinquency and type of security.

See Supplementary information **page 51**, table 12

See Notes to Consolidated Financial Statements **page 59**, Note 1, (g) and (h)

See Notes to Consolidated Financial Statements **page 63,** Note 3

Specific allowances

Specific allowances for credit losses are established to reduce the book values of loans to estimated realizable amounts in the ordinary course of business. Specific allowances for the corporate and commercial portfolios are established by borrower and reviewed quarterly. For the retail portfolio, provisions are calculated on an aggregated facility basis using a formula which takes into account recent loss experience.

General allowances

General allowances for credit risk are established to recognize losses that management estimates to have occurred in the portfolio as at the balance sheet date relating to loans or credits not yet specifically identified as impaired. The level of general allowances reflects exposures across all portfolios and categories that give rise to credit risk and fluctuates in accordance with the nature and composition of our portfolio, shifts in the economic and credit cycles, our historic and expected loss experience, and other relevant factors.

General allowances are computed on a periodic basis using credit risk models developed by the Bank. The level of allowances is based on the probability of a borrower defaulting on a loan obligation (loss frequency), the loss given default (loss severity) and the expected exposure at the time of default. For the corporate and commercial portfolios, allowances are computed at the borrower level. The probability of default is assigned based on the risk rating of the borrower. The loss given default is based upon the security of the facility. Exposure at default is a function of current usage, borrower risk rating and the committed amount. For the retail portfolio, the general allowance is computed on a portfolio-level and is based on a statistical estimate of loss using historical loss and recovery data models and forecast balances. Model parameters are validated against historical experience and are updated annually. The general allowance methodology is approved by the Board periodically.

Our general allowance for loan losses was $984 million at October 31, 2003, compared with $1,141 million last year. The reduction in the general allowance reflects the reduced risk in our portfolio. We also had a general credit reserve for certain derivative financial instruments of $65 million such that general allowances totalled $1,049 million at October 31, 2003. This represented 1% of risk-weighted assets of which $947 million qualifies as Tier 2 capital, equal to .875% of risk-weighted assets under guidelines issued by the Office of the Superintendent of Financial Institutions Canada.

Sectoral allowances

Where the losses are not adequately covered by the general allowances noted above, sectoral allowances for credit losses are established for industry sectors and geographic regions that have experienced specific adverse events or changes in economic conditions, even though the individual loans comprising each group are not classified as impaired.

Sectoral allowances are reviewed quarterly, on a portfolio basis, taking into account the expected loss of the portfolio of borrowers in the sector under review. The analysis includes a review of probabilities of default, loss given default and the expected loss on sale. The sectoral methodology and model inputs are reviewed on a quarterly basis.

When accounts, which were identified as part of a group of loans upon which a sectoral allowance has been established, become impaired, any sectoral allowances on these loans are transferred to specific allowances.

Our sectoral allowance for credit losses at October 31, 2003 was $541 million.

See Notes to Consolidated Financial Statements **page 63**, Note 3

Provision for credit losses
The provision for credit losses is the amount added to the specific, general and sectoral allowances to bring them up to a level that management considers adequate to absorb all probable credit-related losses in the loan portfolio. The net provision for the year is reduced by any recoveries from loans previously written-off.

The Bank recorded a provision for credit losses of $186 million in 2003, including a $80 million release of the sectoral allowance and a $157 million release of the general allowance, compared with $2,925 million in 2002. This level of provision for credit losses represents .15% of net average loans and customer's liability under acceptances compared with 2.24% in the prior year.

See Notes to Consolidated Financial Statements **page 63,** Note 3

See Supplementary information **page 52**, table 14

Net impaired loans
The Bank monitors the level of net impaired loans in its portfolio, which it defines as the gross amount of impaired loans less the total of all specific, general and sectoral allowances for credit losses. For the year ended October 31, 2003, the total of all the above allowances exceeded gross impaired loans, resulting in excess allowances of $641 million, compared to an excess of $975 million a year ago.

See Supplementary information **page 51**, table 12

MARKET RISK

Market risk is the potential for loss from changes in the value of financial instruments. The value of a financial instrument can be affected by changes in:
- Interest rates;
- Foreign exchange rates;
- Equity and commodity prices; and
- Credit spreads.

We are exposed to market risk in both our trading and investment portfolios and through our non-trading activities. In our trading and investment portfolios, we are active participants in the market and seek to realize returns for the Bank from the careful management of our positions and our inventories. In our non-trading banking activities, we are exposed to market risk through the transactions our customers execute with us.

Market risk in our trading activities
We are exposed to market risk when we enter into financial transactions through our four main trading activities:
- Market-making. We provide markets for a large number of securities and other traded products. We keep an inventory of these securities to buy from and sell to investors. We profit from the spread between bid and ask prices. Profitability is driven by trading volume.
- Sales. We provide a wide variety of financial products to meet the needs of our clients. We earn money on these products from price mark-ups or commissions. Profitability is driven by sales volume.
- Arbitrage. We take positions in certain markets or products and offset the risk in other markets or products. Our knowledge of various markets and products and how they relate to each other allows us to identify and benefit from pricing anomalies.
- Positioning. We aim to make profits by taking positions in certain financial markets in anticipation of changes in those markets. This is the riskiest of our trading activities and we use it selectively.

Who manages market risk in our trading activities
Wholesale Banking has primary accountability for managing market risk while the Market Risk Group within Risk Management oversees their activities. Operational support for the market risk monitoring and regulatory capital calculations is provided by Wholesale Banking's Finance and Operations department.

The Market Risk Group is not accountable for trading revenues. Its responsibilities include:
- Designing methods for measuring and reporting market risk;
- Determining market risk policy, which includes designing and setting all trading limits for Wholesale Banking's businesses;
- Enforcing approved market risk limits;
- Approving all new trading products from a market risk perspective;
- Independent testing of all pricing models, risk models, and trading systems;
- Approving all market rates and prices used in valuing the Bank's trading positions and estimating market risk;
- Stress testing the portfolio to determine the effect of large, unusual market movements; and
- Designing and validating the models used to calculate regulatory capital required for market risk.

The Market Risk and Capital Committee meets every two weeks for a peer review of the market risk profile of our trading businesses, to approve changes to risk policies, to review underwriting inventories, and to review the usage of capital and assets in Wholesale Banking. The committee is chaired by the Senior Vice President, Market Risk and includes members of senior management of Wholesale Banking and Audit. Significant market risk issues are escalated to the Credit and Market Risk Committee, which is chaired by the Bank's President and CEO, and includes senior management of Wholesale Banking and the EVP and Chief Risk Officer. The Risk Committee of the Board oversees the management of market risk and approves all major market risk policies periodically.

How we manage market risk in our trading activities
Managing market risk is a key part of our business planning process. We begin new trading operations and expand existing ones only if:
- The risk has been thoroughly assessed and is judged to be within our risk capacity and business expertise; and
- We have the infrastructure in place to monitor, control and manage the risk.

We manage market risk primarily by enforcing trading limits and by "stress testing" our trading activities.

Trading limits
We set trading limits that are consistent with the approved business plan for each business and our tolerance for the market risk of that business. When setting these limits, we consider market volatility, market liquidity, trader experience and business strategy.

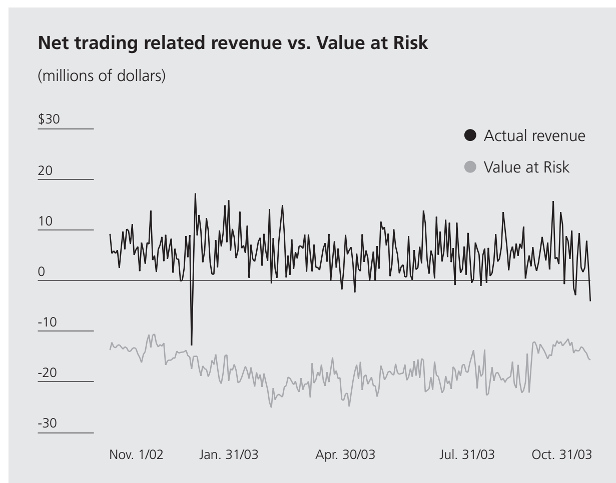
Our primary measure for setting trading limits is Value at Risk (VaR). VaR measures the adverse impact that potential changes in market rates and prices could have on the value of a portfolio over a specified period of time. We use VaR to monitor and control overall risk levels and to calculate the regulatory capital required for market risk.

We may also apply specialized limits, such as notional limits, credit spread limits, yield curve shift limits, loss exposure limits, stop loss limits and other limits, if it is appropriate to do so. These additional limits reduce the likelihood that trading losses will exceed VaR limits.

At the end of every day, Risk Management reviews daily trading exposure reports and compares the risks with their limits. If a trading limit has been exceeded, the trading desk must immediately bring the position within the limit, unless Risk Management or a designated business head approves an exception. An escalation process has been established for approving exceptions to established limits. If, during the day, it appears that a trading limit will be exceeded, the trader must receive approval before carrying the position overnight.

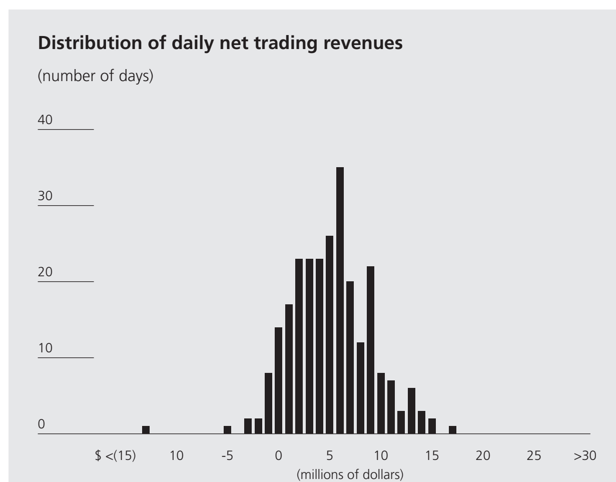
Calculating VaR
First we estimate VaR by creating a distribution of potential changes in the market value of the current portfolio. We value the current portfolio using the most recent 259 trading days of market price and rate changes. Then we calculate the VaR as the threshold level which potential portfolio losses are not expected to exceed more than one out of every 100 trading days.

The graph below compares net revenues in our trading businesses to daily VaR usage. Our VaR on October 31, 2003 was $15.6 million, up $1.0 million from October 31, 2002. The average VaR for fiscal year 2003 was $17.4 million. Increases in VaR are attributable to the addition of credit spread risk to the Bank's VaR model.



Net trading related revenue vs. Value at Risk
(millions of dollars)

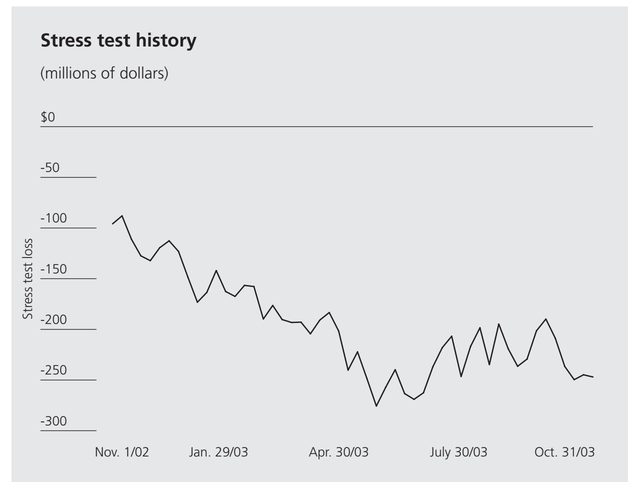
The graph below shows the frequency distribution of our net trading revenue for fiscal 2003. Daily net trading revenues in 2003 were positive on 94.6% of the trading days in the year. Losses never exceeded our statistically predicted VaR for the total of our trading related businesses. Our worst daily loss was approximately $12.8 million. The distribution of trading revenues reflects the broad diversification of trading activities in Wholesale Banking and shows that the probability of losses exceeding our reported VaR is low.



Distribution of daily net trading revenues
(number of days)

Stress testing
We use stress testing to quantify the largest quarterly loss we are prepared to take in our trading activities. Our trading business is subject to an overall global stress test limit and each global business has a stress test limit. Also, each broad risk class has an overall stress limit. Stress tests are produced and reviewed each week with the EVP and Chief Risk Officer. They are reviewed with the Market Risk and Capital Committee every two weeks and throughout the year with the Risk Committee of the Board. Stress scenarios are designed to model extreme economic events, replicate worst case historical experiences or introduce large but plausible moves in key market risk factors.

The following graph is a history of our weekly stress test results, which shows the instantaneous impact of large market disturbances. Our credit trading businesses modified their exposure in the first half of 2003, in response to an improving credit environment.



Stress test history
(millions of dollars)

Market risk in our investment activities
In the Bank's own investment portfolio and in the Merchant Banking business, we are exposed to market risk.

Risks are managed by identifying our specific risks, determining their potential impact, and then establishing policies and procedures to monitor, measure, and mitigate those risks.

Who manages market risk in our investment activities
The Risk Committee of the Board reviews and approves the investment policies for the Bank's own portfolio and for the Merchant Banking business.

The Investment Committee meets regularly to review the performance of the Bank's investments and to assess the performance of the portfolio managers.

How we manage market risk in our investment activities
We use advanced systems and related measurement tools to manage portfolio risk. Risk intelligence is imbedded in the investment decision making process by the integration of performance targets, risk/return tradeoffs, and quantified risk tolerances. Performance attribution identifies performance drivers such as sector and security exposures, as well as the impact of certain processes like trade execution.

Market risk in our non-trading banking transactions
We are exposed to market risk when we enter into non-trading banking transactions with our customers. These transactions primarily include deposit taking and lending, which are also referred to as our "asset and liability" positions.

ASSET LIABILITY MANAGEMENT

Asset liability management deals with managing the market risks of our traditional banking activities. Market risks primarily include interest rate risk and foreign exchange risk.

Who is responsible for asset liability management
The Treasury and Balance Sheet Management department within Finance measures and manages the market risks of our non-trading banking activities. The Asset/Liability Committee, which is chaired by the EVP and CFO and includes other senior executives, oversees and directs Treasury and Balance Sheet Management. The Risk Committee of the Board reviews and approves all asset liability management market risk policies periodically.

How we manage our asset and liability positions
We measure all product risks when products are issued, using a fully-hedged option-adjusted transfer pricing framework. This framework allows Treasury and Balance Sheet Management to measure and manage risk within a target risk profile. It also ensures that the Bank's business units engage in risk-taking activities only if they are productive.

Managing interest rate risk

Interest rate risk is the impact changes in interest rates could have on our margins, earnings and economic value. Rising interest rates could, for example, increase our funding costs, which would reduce the net interest income earned on certain loans.

The objective of interest rate risk management is to ensure stable and predictable earnings are realized over time. In this context, the Bank has adopted a "fully-hedged" approach to profitability management of its asset and liability positions. Key aspects of this approach are:
- Negating the impact of interest rate risk on net interest income and economic value;
- Measuring the contribution of each product on a risk-adjusted, fully-hedged basis, including the impact of financial options granted to customers; and
- Developing and implementing strategies to stabilize Personal and Commercial Banking's net interest income from all products.

We are exposed to interest rate risk when asset and liability principal and interest cash flows have different interest payment or maturity dates. These are called "mismatched positions". An interest-sensitive asset or liability is repriced when interest rates change or when there is cash flow from final maturity, normal amortization or when customers exercise prepayment, conversion or redemption options.

Our exposure depends on the size and direction of interest rate changes, and on the size and maturity of the mismatched positions. It is also affected by new business volumes, renewals of loans and deposits, and how actively customers exercise options like prepaying or redeeming a loan or deposit before its maturity date.

Interest rate risk is measured using interest rate shock scenarios to estimate the impact of changes in interest rates on both the Bank's annual Earnings at Risk (EaR) and Economic Value at Risk (EVaR). EaR is defined as the change in the Bank's annual net interest income for a 100 basis point unfavourable interest rate shock due to mismatched cash flows. EVaR is defined as the combined difference in the present value of the Bank's asset portfolio and the change in the present value of the Bank's liability portfolio, including off-balance sheet instruments, for a 100 basis point unfavorable interest rate shock.

We perform valuations of all asset and liability positions as well as all off-balance sheet exposures every week, and value certain option positions daily. Our objective is to preserve or immunize the present value of the margin booked at the time of inception for fixed rate assets and liabilities and to reduce the volatility of net interest income over time. Our approach is to value the assets and liabilities by discounting future cash flows at a yield curve indicative of the blended cost or credit of funds for each asset or liability portfolio. The resulting net present value incorporates the present value of margins booked. We then hedge the resulting financial position to the target risk profile of minimal residual economic exposure. We use derivative financial instruments, wholesale instruments and other capital market alternatives and, less frequently, product pricing strategies to manage interest rate risk.

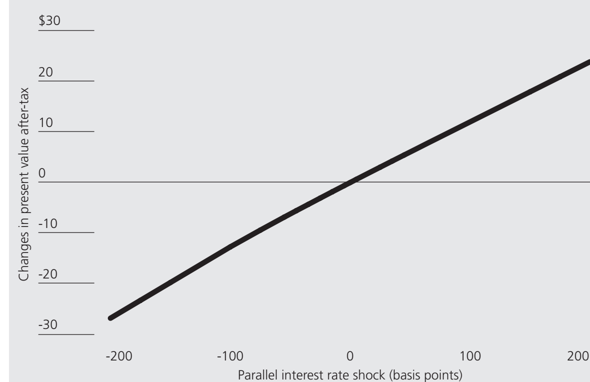
Within the financial position, we measure and manage interest rate risk exposure from instruments with closed (non-optioned) fixed rate cash flows separately from product options. Instruments in the closed book exhibit the traditional, almost linear or symmetrical payoff profile to parallel changes in interest rates (i.e. asset values increase as rates fall and decrease as rates rise). Included in future cash flows are modeled exposures for:
- An assumed maturity profile for the Bank's core deposit portfolio; and
- The Bank's targeted investment profile on its net equity position.

Non-rate sensitive assets, liabilities and shareholders' equity are modeled on a consistent basis, assuming an intermediate term using a rolling 60 month maturity profile resulting in a two and a half year average duration. Significant assumptions included in the valuation of fixed cash flows include the liquidation assumptions on mortgages not due to embedded optionality. The portfolio management objective within the closed book is to eliminate cash flow mismatches thereby preserving the present value of product margins.

The graph below shows our interest rate risk exposure on October 31, 2003 on the closed (non-optioned) instruments within the financial position. If this portfolio had experienced an immediate and sustained 100 basis point decrease in rates on October 31, 2003, the economic value of shareholders' equity would have decreased by $13 million after-tax as compared with $6 million in 2002 for a 100 basis point decrease in rates. This same shock would reduce net income after-tax by $14 million over the next 12 months as compared with $2 million in 2002. Our EVaR in the closed book ranged from $1 to $32 million during the year ended October 31, 2003.

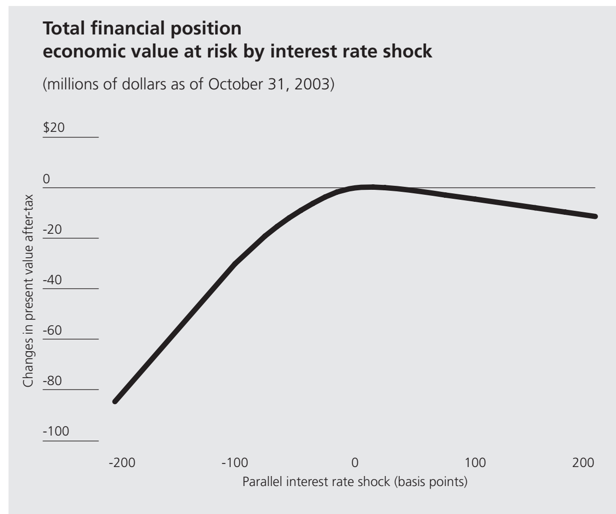
Closed (non-optioned) instruments portfolio economic value at risk by interest rate shock

(millions of dollars as of October 31, 2003)



Product options, which expose the Bank to a non-linear or asymmetrical payoff profile, represent a significant financial risk, whether they are freestanding, such as mortgage rate commitments or embedded in loans and deposits. Freestanding mortgage rate commitment options are modeled based on an expected funding ratio derived from historical experience. The written option exposures contained in products with embedded options to early prepay or redeem are modeled based on an assumed percentage rational exercise derived from customer behaviour analysis. Economic capital is held to guard against worst case losses in the event rational exercise assumptions are exceeded. We also model an exposure to declining interest rates resulting in margin compression on certain interest rate sensitive demand deposit accounts. Product option exposures are managed by purchasing options or through a dynamic hedging process designed to replicate the payoff of a purchased option. Dynamic hedging involves rebalancing the hedging instruments we hold for small changes in interest rates.

The following graph shows our interest rate risk exposure on October 31, 2003 on all instruments within the financial position – the closed (non-optioned) instruments plus product options. The modeled exposures described above define the Bank's risk neutral position. The only residual exposure arises from dynamic hedging. The following graph assumes that the dynamic hedging portfolios held on October 31 are not rebalanced for the interest rate shock. An immediate and sustained 100 basis point decrease in rates would have decreased the economic value of shareholders' equity by $30 million after-tax or .3% of common equity as compared with $46 million in 2002. Our EVaR for the total portfolio ranged from $23 million to $66 million during the year ended October 31, 2003. The Bank's policy sets overall limits on EVaR and EaR. EVaR arising from mismatched asset liability positions cannot exceed 3% of the Bank's common equity or $347 million. EaR exposure may not exceed 3% of the Bank's annualized net interest income or $175 million.



Managing foreign exchange risk

Foreign exchange risk refers to losses that could result from changes in foreign currency exchange rates. Assets and liabilities that are denominated in foreign currencies have foreign exchange risk.

We are exposed to foreign exchange risk:

- When our foreign currency assets are greater or less than our liabilities in that currency, creating a foreign currency open position; or
- From our investments in foreign operations.

Our objective is to minimize the impact of an adverse foreign exchange rate change on reported net income and equity, and to minimize the impact of an adverse foreign exchange rate change on the Bank's capital ratios. Minimizing the impact of an adverse foreign exchange rate change on reported equity will cause some variability in the capital ratios due to the amount of risk-weighted assets that are denominated in a foreign currency. In the event that the Canadian dollar weakens, the Canadian dollar equivalent of the Bank's risk-weighted assets in a foreign currency increases thereby increasing the Bank's capital requirement. As a result, the foreign exchange risk arising from the Bank's net investment in foreign operations is hedged up to the point where the capital ratios change by no more than a tolerable amount for a given change in foreign exchange rates. The tolerable amount increases as the Bank's capital ratio increases.

The Bank's policy related to open currency exposure is to limit exposure to no more than $200 million in aggregate. Our policy related to foreign exchange capital exposure is to minimize an adverse foreign exchange rate change on reported equity subject to the constraint that the Bank's capital ratios can change by no more than 10 basis points for a 5% change in foreign exchange rates. If target capital ratios are exceeded, the Bank's policy is to allow for a 25 basis point change in capital ratios for a 5% change in foreign exchange rates.

Why product margins fluctuate over time

Implementing a fully-hedged approach to asset liability management locks in margins on fixed rate loans and deposits as they are booked. The process mitigates the impact of an instantaneous interest rate shock on the level of net interest income to be earned over time due to cash flow mismatches and the exercise of embedded options. Despite a fully-hedged position, the margin on average earning assets is subject to change over time due to the following:

- Margins earned on new and renewing fixed rate products relative to the margin previously earned on matured products will impact the existing portfolio margin;
- The weighted average margin on average earning assets will shift due to changes in the mix of business;
- The risk of changes in the prime-BA basis and the lag in changing product pricing may have an impact on margins earned; and
- The general level of interest rates will impact the return the Bank generates on its modeled maturity profile for core deposits and the investment profile for its net equity position as it evolves over time. The general level of interest rates is also a key driver of some modeled option exposures, and will affect the cost of hedging such exposures.

By implementing a fully-hedged approach, the impact of these contributions to changing margins is muted over time resulting in a more stable and predictable earnings stream.

LIQUIDITY RISK

Liquidity risk is the risk that we cannot meet a demand for cash or fund our obligations as they come due. Demand for cash can arise from withdrawals of deposits, debt maturities and commitments to provide credit. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price.

It is the Bank's policy to ensure that there is adequate liquidity coverage across all business units to sustain our ongoing operations in the event of a funding disruption with limited reliance on the forced sale of assets. We also ensure that there is sufficient liquidity available to fund asset growth and strategic opportunities.

Who manages liquidity risk
The Asset/Liability Committee oversees the liquidity risk management program and ensures that there is an effective management structure in place to properly measure and manage liquidity risk. The Global Liquidity Forum, comprised of senior management from Finance, Risk Management and Wholesale Banking, is responsible for identifying and monitoring our liquidity risks and recommending action as necessary to the Asset/Liability Committee to maintain our liquidity position within limits in both normal and stress conditions.

While the Bank operates under one global liquidity risk policy, measurement and management of our liquidity risks are separated into the major operating areas best positioned to manage the risks. The Treasury and Balance Sheet Management department within Finance is responsible for consolidating and reporting the Bank's global liquidity risk position and for managing the Personal and Commercial Banking liquidity position. Wholesale Banking is responsible for managing the liquidity risks inherent in the wholesale and corporate banking portfolios and TD Waterhouse is responsible for managing its liquidity position. Each area must adhere to the Global Liquidity Risk Management policy that is reviewed and approved by the Risk Committee of the Board periodically.

How we manage liquidity risk
The Bank's overall liquidity requirement is defined as the amount of liquidity required to fund expected cash outflows as well as a prudent liquidity reserve to fund potential cash outflows in the event of a disruption in the capital markets or other event that could affect our access to liquidity. The Bank does not rely on short-term wholesale funding for purposes other than funding marketable securities or short-term assets. Liquidity requirements are measured under different stress scenarios with a base case scenario defining the minimum amount of liquidity that must be held at all times. This scenario provides coverage for 100% of our unsecured wholesale debt coming due as well as other potential deposit run-off and contingent liabilities for a minimum period of ninety days. Other scenarios may require greater coverage. We also use an extended liquidity coverage test to monitor our ability to fund our operations on a fully collateralized basis, in the event that we are unable to replace our short-term unsecured debt beyond this timeframe for a period up to one year.

Liquidity requirements are met by holding sufficient assets that can be readily converted into cash and managing our cash flows. Assets that qualify for liquidity purposes must be currently marketable, of sufficient credit quality and be available for sale. Liquid assets are represented in a cumulative liquidity gap framework based on settlement timing and current market depth. Assets that are encumbered or needed for collateral purposes are not included for liquidity purposes.

We manage liquidity on a global basis, ensuring the prudent management of liquidity risk in all of our operations. On October 31, 2003, our consolidated surplus liquid asset position up to 90 days was $8.7 billion in Canadian dollars, compared with a surplus liquid asset position of $4.2 billion Canadian on October 31, 2002. The surplus liquid asset position is total liquid assets less the Bank's unsecured wholesale funding requirements, potential non-wholesale deposit run-off and contingent liabilities coming due in 90 days.

If there was a liquidity crisis, we have contingency plans in place to make sure we meet all of our obligations as they come due.

Funding
The Bank has a large base of stable retail and commercial deposits making up over 60% of our total funding. In addition, the Bank has an active wholesale funding program, which incorporates the asset securitization infrastructure necessary to ensure we have access to widely diversified funding sources. The Bank's wholesale funding is also diversified geographically, by currency and by distribution networks. Depositor concentration limits are in place to ensure that we do not overly rely on one or a small group of customers as a source of funding.

In fiscal 2003, the Bank securitized and sold $7.3 billion of mortgages and issued $5.7 billion of other medium and long term funding. All funding amounts are represented in Canadian dollars.

OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external sources.

Operational risk is inherent in all business activities. Operational risk encompasses a broad range of risks, including transaction processing errors, fiduciary breaches, technology failures, business disruption, fraud and damage to physical assets originating from internal or outsourced business activities. Its impact can result in financial and reputational loss, regulatory penalties and censure.

Managing operational risk is essential to protecting, enhancing and creating shareholder value, operating efficiency and providing a safe working environment for staff and customers. While operational risk cannot be fully eliminated, proactive management of operational risk exposures to acceptable levels is a key objective of the Bank.

Who manages operational risk
Risk Management is responsible for establishing and coordinating the implementation of a global operational risk management framework, which consists of the policies and processes for the identification, assessment, mitigation and control of operational risk. Through the framework, corporate policies and standards are defined and reporting requirements are established. In addition, Risk Management coordinates strategic operational risk management activities throughout the organization, including any reporting to senior management, the Operational Risk Oversight Committee and the Risk Committee of the Board on the level of operational risk within the Bank and the effectiveness of enterprise risk management practices.

Primary responsibility for the day-to-day management of operational risk lies with business unit management, with the support of specialist groups such as Information Technology, Finance, Compliance and Human Resources. Business unit management is responsible for ensuring that the business complies with the operational risk management framework through the establishment and maintenance of appropriate policies, procedures, internal controls and business continuity plans. Each business unit operates a Risk Management Committee, comprised of the senior executives in the unit.

The Audit department reports to business unit management, senior management, the Audit Committee and the Risk Committee of the Board on operational risk management practices, the quality and effectiveness of the system of internal controls and identifies any significant weaknesses in the Bank.

How we manage operational risk
Risk Management works closely with the risk management functions in the business units to facilitate the implementation of the operational risk management framework and the implementation of leading industry practices. Risk Management is responsible for:
- Continually identifying, measuring and reporting on the operational risk exposures of our businesses;
- Allocating economic capital based on assessments of operational risk;
- Overseeing the execution of key enterprise-wide risk management practices including an extensive system of internal controls, trained and competent people, segregating incompatible functions and clearly defined operating practices;

- Assessing, on a continuous basis, the Bank's insurable risk exposures, developing and implementing appropriate risk management solutions. These include managing a broad portfolio of insurance coverage combined with other risk transfer vehicles that protect the Bank from the adverse impact of internal and external events in the course of doing business; and
- Managing a comprehensive Business Recovery Planning program, which includes standard policies and management oversight to minimize risk, duration and cost arising from unexpected disruptions affecting our operations.

Each of the Bank's business units has defined an independent risk management function that:

- Oversees the implementation of enterprise-wide risk management practices within their business unit;
- Coordinates the completion of proactive Risk and Control Self Assessments in the business units and monitors the implementation of any required additional risk mitigation strategies;
- Identifies, measures and reports on the operational risk exposures of their business; and
- Works with business unit management to identify, develop and implement risk management practices specific to their business, including comprehensive business recovery plans.

Our focus in 2004 is on the further integration of the qualitative and quantitative aspects of our Operational Risk Management program as well as the implementation of improved operational risk reporting to the Board and to all levels of management.

REGULATORY RISK

Regulatory risk is the risk of non-compliance with applicable legislation, regulation and regulatory directives.

Due to the highly regulated nature of our businesses and the high standards that management of a financial services business is expected to meet, we are exposed to regulatory risk in virtually all of our business activities. Regulatory risk differs from other banking risks, such as credit risk or liquidity risk, because it is typically not a risk actively and consciously taken or assumed by management in return for an expected reward. It occurs as part of the normal course of operation of our businesses. Failure to meet applicable regulatory requirements poses a risk of reputational loss to the Bank, as well as a risk of regulatory penalty or censure.

Who manages regulatory risk

Proactive management of regulatory risk is a key objective of the Bank. It is carried out primarily through the operation of an enterprise-wide regulatory risk management framework called the "Legislative Compliance Management Framework" (LCMF). Compliance department in Legal is responsible for the effective operation of the LCMF.

The LCMF establishes two levels of controls through which regulatory risk is managed: controls to meet day-to-day regulatory requirements; and independent oversight controls.

Day-to-day responsibility for regulatory risk lies with business unit management. Each business unit makes compliance an integral part of their business operations and demonstrates compliance to regulatory authorities.

To assist the business units in discharging their responsibilities, they receive advice and assistance from corporate oversight functions. The corporate oversight functions also provide an independent review of controls in the business unit and escalate significant issues to senior management and the Board.

Through monitoring, testing and reporting, the Compliance and Audit departments report to business unit management, senior management and the Audit Committee of the Board on the extent to which business units adhere to the regulatory requirements, and on the effectiveness of the internal controls.

The Compliance department reports to the Audit Committee of the Board on the LCMF and advises them of any material compliance-related issues twice a year.

How we manage regulatory risk

The business units manage the day-to-day regulatory risk primarily by educating and training their employees about regulatory requirements, and establishing and maintaining appropriate policies and procedures to promote compliance and monitoring for compliance.

The corporate oversight functions promote a compliance culture within the Bank by:

- Advising and communicating the regulatory requirements to each business;
- Ensuring the businesses have appropriate policies and procedures in place, and are appropriately training their staff to meet regulatory requirements;
- Independently monitoring the businesses for adherence to the policies, procedures and requirements; and
- Tracking and escalating issues and findings.

Documentation of adherence to regulatory requirements is also carried out regularly through a formal business unit management certification process. In addition to processes throughout the year, on an annual basis, Canadian business units review regulatory requirements relating to the Bank's governing legislation and update their risk assessments and the controls that they have in place to mitigate those risks. The higher the risk, the more rigorous the control process must be to minimize the risk of non-compliance. The Compliance department reviews the assessments to determine the effectiveness of the business unit controls. Once the annual review process is completed, senior management of the business units certify in writing whether they are in compliance with applicable regulatory requirements, or whether any gaps or weaknesses exist. In the latter case, an action plan must be established and implemented to remedy the gap or weakness.

REPUTATIONAL RISK

Reputational risk is the risk to earnings, capital or brand arising from negative public or employee opinion.

A solid corporate reputation is essential to optimizing shareholder value. Reputational risk is not managed in isolation of other types of risk. Be it credit, market, operational, liquidity, investment or regulatory risk, all these elements must be managed effectively in order to mitigate any negative impact to the Bank's reputation. In light of the events of the last few years and as business practices evolve to address new operating paradigms with respect to reputational risk, we, like others in our industry, have enhanced our existing focus on this issue. Managing reputational risk is necessary in order to avoid negative impact to the brand, earnings or capital.

Who manages reputational risk

While the ultimate responsibility for the Bank's reputation lies with the Senior Executive Team and the executive committees that examine reputational risk as part of their ongoing mandate, anyone who is employed by the Bank has a responsibility to contribute in a positive way to the Bank's reputation. This means ensuring that ethical practices are maintained at all times, that interactions with our stakeholders are positive and that all policies, legislation and regulations are adhered to. Reputational risk is most effectively managed when everyone is working to enhance and protect the Bank's reputation.