Managing capital

Capital structure and ratios at year end

(millions of dollars)	2002	2001	2000
Tier 1 capital			
Retained earnings	$ 8,710	$ 9,653	$ 9,039
Common shares	2,846	2,259	2,060
Qualifying preferred shares	1,485	1,492	1,251
Non-controlling interest in subsidiaries	962	1,272	1,471
Less: goodwill and intangibles in excess of 5% limit	(4,213)	(4,041)	(4,458)
Total Tier 1 capital	9,790	10,635	9,363
Tier 2 capital			
Subordinated notes and debentures	4,343	4,892	4,883
Qualifying preferred shares and non-controlling interest in subsidiaries	157	–	185
General allowance for credit losses included in capital	1,056	1,112	862
Less: amortization of subordinated notes and debentures	(357)	(545)	(488)
Total Tier 2 capital	5,199	5,459	5,442
Investment in unconsolidated subsidiaries/substantial investments	870	697	461
First loss protection	159	288	301
Total regulatory capital	$ 13,960	$ 15,109	$ 14,043
Capital ratios			
To risk-weighted assets			
Tier 1 capital	8.1%	8.4%	7.2%
Total regulatory capital	11.6	11.9	10.8
Assets to capital multiple[1]	18.9	18.3	18.4

[1] Total assets plus off-balance sheet credit instruments such as letters of credit and guarantees less investments in associated corporations and goodwill and net intangibles divided by total regulatory capital.

Our goals
We want to provide enough capital to maintain the confidence of investors and depositors, while providing our common shareholders with a satisfactory return.

Our goals are to:
- be an appropriately capitalized institution, as defined by regulatory authorities and compared to our peers
- maintain strong ratings and to protect us against unexpected events
- make sure that we have enough capital and the right type of capital on hand or readily available at a reasonable cost to help us expand
- achieve the lowest overall cost of capital consistent with preserving the appropriate mix of capital elements
- provide a satisfactory return to our common shareholders.

Where capital comes from
Most of our capital comes from common shareholders. Other sources of capital come from our preferred shareholders and holders of our subordinated debt.

Who manages our capital
Group Finance manages capital for TD. They're responsible for acquiring, maintaining and retiring capital. The Board of Directors oversees capital management.

How we managed our capital
Tier 1 capital
Retained earnings declined by $943 million during the year. However, we raised $587 million of common stock, principally from a $400 million new issue of common stock and from common stock issued under the dividend reinvestment plan of $174 million. In addition, we issued $350 million of TD Capital Trust Securities (TDCaTS II) during the year. Further increases in retained earnings and common equity are required for the TD CaTS II issue to fully qualify as Tier 1 capital.

Minority interest decreased as a result of acquiring the 11% minority interest in TD Waterhouse Group, Inc.

In fiscal 2002, goodwill and net intangibles (above 5% of gross Tier 1 capital), which are deducted from capital for regulatory purposes, increased by $172 million as acquisitions during the year more than offset the amortization of intangibles.

Tier 2 capital
Actions taken to manage our capital during the year included redeeming US$500 million and $25 million of debentures and issuing $550 million of replacement subordinated medium term notes. See Notes 8 to 10 to the Bank's consolidated financial statements for more details.

Dividends
The Bank's dividend policy is approved by the Board of Directors. The Bank's ability to pay dividends is subject to the Bank Act and the regulations of the Superintendent of Financial Institutions Canada. Note 10 of the Bank's consolidated financial statements provides further details.

Ratings
On December 5, 2002, Standard & Poor's (S&P) announced that it had downgraded the senior debt rating of the Bank from AA- to A+. S&P cited concerns about weaker profitability and capital levels combined with deteriorating credit quality. Prospectively certain funding and capital costs and revenues will likely be affected. The annual impact on earnings is estimated to be between three and five cents per share.

Capital ratios
Our Tier 1 and total capital ratios were 8.1% and 11.6%, respectively, on October 31, 2002 compared with 8.4% and 11.9% on October 31, 2001. The principal factors for the year-over-year decline were the lower earnings in 2002 combined with increases in goodwill.

The Office of the Superintendent of Financial Institutions Canada (OSFI) measures the capital adequacy of Canadian banks according to its instructions for determining risk-adjusted capital, risk-weighted assets and off-balance sheet exposures. This approach is based on the Bank for International Settlements' (BIS) agreed framework for achieving a more consistent way to measure the capital adequacy and standards of banks engaged in international business.

About capital ratios

Capital ratios are measures of financial strength and flexibility.

OSFI defines two primary ratios to measure capital adequacy, the Tier 1 capital ratio and the total capital ratio. OSFI sets target levels for Canadian banks:

- The Tier 1 capital ratio is defined as Tier 1 capital divided by risk-weighted assets. OSFI has established a target Tier 1 capital requirement of 7%.
- The total capital ratio is defined as total regulatory capital divided by risk-weighted assets. OSFI has established a target total capital requirement of 10%.

Risk-weighted assets

Our total balance sheet assets decreased by $10 billion or 3% in 2002. Total risk-weighted assets decreased as a result of our ongoing management of risk-weighted assets across all of our businesses.

We review balance sheet and off-balance sheet exposures when assessing risk.

See Managing risk **page 25** and Off-balance sheet arrangements **page 11**

Interest coverage on subordinated notes and debentures

The Bank is required to disclose certain information to its noteholders. The Bank's interest requirements on all subordinated notes and debentures, after adjustment for new issues and retirement of subordinated debt, amounted to $286 million for the year ended October 31, 2002. The Bank reported a net loss, before interest on subordinated debt and income tax, of $234 million for the year ended October 31, 2002, and accordingly did not provide interest coverage on its subordinated notes and debentures. On an operating cash basis, the Bank's interest requirements on all subordinated notes and debentures, after adjustment for new issues and retirement of subordinated debt, amounted to $286 million and the Bank's operating cash basis net income before interest on subordinated debt and income tax was $724 million which was 2.5 times our interest requirement for this period. Operating cash basis measurements are defined in the "How the Bank reports" section on page 7 of this annual report.

Revised capital accord

Last year, the Basel Committee on Banking Supervision published for consultation the New Basel Capital Accord to replace the accord originally introduced in 1988 and supplemented in 1996. The underlying principles of the new Accord are intended to be suitable for application to banks of varying levels of complexity and sophistication. The proposed Accord will allow banks to determine capital levels consistent with the manner in which they measure, manage and mitigate risk. The new framework provides a spectrum of methodologies, from simple to advanced, for the measurement of both credit and operational risk.

By providing a flexible approach to measurement methodology, each bank will be able, subject to review by regulators, to adopt approaches which best fit its level of sophistication and risk profile. The objective of the framework is to provide rewards for more rigorous and accurate risk management by reducing regulatory capital required under weaker or less sophisticated approaches. While the overall objective of the new Accord is to neither increase nor decrease the level of overall capital in the system, some financial institutions will see an increase in regulatory capital, while others will see a decrease. The impact will depend upon the approach used by a particular institution and its own risk profile. The impact on the Bank remains unclear since the Accord continues to be revised. A quantitative impact study has been performed and is currently being reviewed. OSFI expects that the major Canadian banks will adopt the most sophisticated methods.

The global financial services industry uniformly commented that it is not clear that the stated objective of the Accord, which is to reward banks for more accurate risk measurement by assessing a lower capital requirement, would in fact be achieved with the capital factors which were proposed. There have been numerous positive revisions to the Accord to reflect these comments. The scope of the revisions has resulted in the delay of implementation of the new Capital Accord by one year to the beginning of fiscal 2006. The Bank is actively participating in the consultative process and quantitative impact studies. The Bank is making plans to implement the systems and procedural changes required to meet the requirements of the New Basel Capital Accord in fiscal 2006.

Risk-weighted assets at year end

(millions of dollars)		**2002**		2001		2000
	Balance	**Risk-weighted balance**	Balance	Risk-weighted balance	Balance	Risk-weighted balance
Balance sheet assets						
Cash resources	**$ 6,538**	**$ 1,108**	$ 5,945	$ 991	$ 4,187	$ 657
Securities purchased under resale agreements	**13,060**	**282**	20,205	324	13,974	238
Securities	**82,197**	**6,247**	97,194	6,946	85,387	8,286
Loans	**122,627**	**63,965**	119,673	66,514	120,721	72,351
Customers' liability under acceptances	**7,719**	**7,066**	9,122	8,246	9,812	9,008
Other assets	**45,899**	**6,288**	35,699	6,342	30,737	7,704
Total balance sheet assets	**$ 278,040**	**$ 84,956**	$ 287,838	$ 89,363	$ 264,818	$ 98,244
Off-balance sheet assets						
Credit instruments		**14,559**		18,350		16,130
Derivative financial instruments		**6,259**		6,373		4,661
Total off-balance sheet assets		**20,818**		24,723		20,791
Total risk-weighted asset equivalent – credit risk		**105,774**		114,086		119,035
– market risk		**14,859**		13,032		11,125
Total risk-weighted assets		**$ 120,633**		$ 127,118		$ 130,160