DBRS Canada Newsletter

Volume 1, Issue 24, September 30, 2009

Peter Bethlenfalvy
Co-President, Canada
+1 416 597 7361
pbethlenfalvy@dbrs.com

Steven Bavaria
Managing Director,
Leveraged Finance
+1 212 806 3285
sbavaria@dbrs.com

Eric Beauchemin, CFA
Managing Director,
Public Finance
+1 416 597 3619
ebeauchemin@dbrs.com

Michael Caranci
Managing Director,
Energy
+1 416 597 7304
mcaranci@dbrs.com

Paul Holman, CMA
Managing Director,
Communications, Media,
Retailing, Consumer
Products and Real Estate
+1 416 597 3617
pholman@dbrs.com

Kam Hon
Managing Director,
Natural Resources,
Industrials and Auto
+1 416 597 7543
khon@dbrs.com

Brenda Lum
Managing Director,
Canadian Financial
Institutions
+1 416 597 7569
blum@dbrs.com

Larry J. White
Managing Director,
Business Development
and Originations
+1 416 597 7457
lwhite@dbrs.com

Toronto
DBRS Tower
181 University Avenue
Suite 700
Toronto, ON M5H 3M7
+1 416 593 5577

Caroline Creighton
Coordinator,
Senior Vice President,
Communications and
Media
+1 416 597 7317
ccreighton@dbrs.com

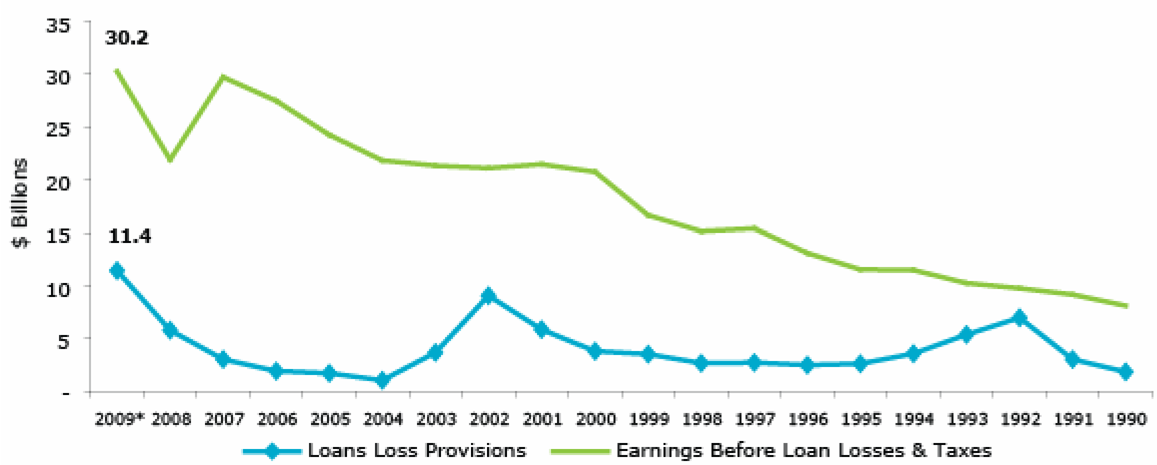
CANADIAN BANKING INDUSTRY – CORE EARNINGS ROBUST

The Canadian banking industry's core earnings levels are strong and are expected to absorb rising credit costs in the near term. Core earnings are one of the five building blocks DBRS focuses on in its analysis of Canadian banks. In assessing core earnings, DBRS takes into account, among other things, business mix, concentrations, exposure to stress scenarios and the bank's ability to manage risk.

In assessing a bank's earnings power, DBRS looks at the composition of the underlying earnings and the ability to withstand stress. Revenue diversification, net interest income, contribution of fees and commissions, the efficiency of the operating platform and the amount of loan loss provisions recognized all influence earnings and profitability. Ultimately, core earnings, as defined by revenue less operating expenses but before loan loss provisions and taxes, are the first line of defence against loan loss provisions. Over time, the Canadian banking industry has demonstrated the resilience of core earnings.

During this period of the credit cycle, considerable attention is paid to core earnings and the extent to which these levels are able to absorb increasing credit costs. The industry's core earnings have been able to weather many events since the early 1990s, including syndicated lending and commercial real estate losses. DBRS anticipates that the Canadian banking industry's aggregate credit costs will remain manageable relative to earnings before loan losses and taxes.

Earnings Before Loan Losses & Taxes versus Loan Loss Provisions



* 2009 is annualized for 9 months 2009
Source: DBRS.

Core earnings

DBRS anticipates that the growth of core earnings will be relatively modest over the next year in light of a weak domestic economy impacting retail businesses and consumer borrowing, as well as lower levels of interest rates. The growth in corporate lending is likely to moderate as funding opportunities in the capital markets increase for many corporations.

With the uncertainty and volatility in the capital markets abating from the highs of the early part of fiscal 2009, it will be challenging to replicate the levels of trading revenue. Structured credit losses may persist as de-leveraging of financial institutions and hedge funds continues.

DBRS expects that the Canadian banking industry will make progress in generating positive operating leverage as the banks have put many expense initiatives into place over the last two years. During the first nine months of 2009, revenue growth exceeded expense growth for the industry as a whole.

Loan loss provisions

Loan loss provisions have been steadily rising over the past two years. DBRS expects this growth to continue in all segments of the loan portfolio over the next year. DBRS continues to expect further increases from the U.S. loan portfolios and more pronounced losses from the domestic portfolio due to the effects of a weak Canadian economy.

So far, deterioration in the retail portfolios, including mortgages, home equity lines of credit and credit cards (reflecting higher unemployment rates, personal bankruptcy rates and credit card delinquency rates), have been the primary cause of higher domestic loan loss provisions. Even if the economy stabilizes, DBRS expects loan loss provisions to rise in the near term. Non-domestic banking businesses are also likely to continue to experience high loss provisions, due to ongoing weakness in U.S. residential real estate and the U.S. economy in general, which impacts the U.S. residential builder finance business, as well as retail and commercial loans.

For further information, please contact Brenda Lum at blum@dbrs.com or Robert Long at rlong@dbrs.com.

If you would like your name added to the mailing list for the DBRS Canada Newsletter, please e-mail info@dbrs.com.