# Q3 2011 | *Third* quarter results

REPORT TO SHAREHOLDERS

THIRD QUARTER FINANCIAL MEASURES

| EARNINGS PER SHARE (DILUTED) OF $1.11 | NET INCOME OF $1,285 MILLION | RETURN ON EQUITY OF 17.8% | PRODUCTIVITY RATIO OF 54.5% | QUARTERLY DIVIDEND 52 CENTS PER COMMON SHARE |
|---|---|---|---|---|

## Scotiabank reports strong third quarter earnings of $1.3 billion, up 18%

**YEAR-TO-DATE PERFORMANCE** versus key 2011 financial and operational objectives was as follows:

### TARGETS

1. Earn a return on equity (ROE)[1] of 16 to 20%. For the nine months Scotiabank earned an ROE of 19.6%.
2. Generate growth in earnings per common share (diluted) of 7 to 12%. Our year-over-year growth in earnings per share was 22.0%.
3. Maintain a productivity ratio[1] of less than 58%. Scotiabank's ratio was 53.6% for the nine months.
4. Maintain strong capital ratios. At 12.3%, Scotiabank's Tier 1 capital ratio remains strong.

Live audio Web broadcast of the Bank's analysts' conference call. See page 41 for details.

[1] Refer to page 5 for a discussion of non-GAAP measures.

Scotiabank

**Toronto, August 30, 2011** – Scotiabank reported third quarter income of $1.3 billion compared with net income before non-controlling interests of $1.1 billion in the same period last year. Year over year, net income was up 18%.

Diluted earnings per share were $1.11, compared to $0.98 in the same period a year ago. Return on equity remained strong at 17.8%, compared to 18.2% last year. A dividend of 52 cents per common share was announced.

"This quarter's results again demonstrate our ability to earn through challenging times by remaining focused on our core businesses and emphasizing strong risk management practices," said Rick Waugh, Scotiabank President and CEO. "While we are not immune to the volatility in world markets, consistent execution of our straightforward and diversified business strategy will continue to deliver sustainable profitability and growth.

"Canadian Banking had a strong quarter and achieved net income of $461 million. Revenues increased from volume growth in residential mortgages, higher small business deposits and stronger commercial banking, partially offset by ongoing competitive pricing pressures.

"International Banking reported a solid quarter with net income of $350 million. This business line delivered solid asset growth, particularly in Asia and Latin America. We continue to explore opportunities for expansion in both existing and new markets.

"Global Wealth Management delivered net income of $256 million, driven by growth in both its wealth and insurance businesses, with positive contributions from DundeeWealth, particularly through Dynamic Funds. Integration of the DundeeWealth operations is progressing well.

"Scotia Capital reported net income of $289 million this quarter. While challenging market conditions negatively impacted trading revenues, this was partially offset by higher client trading in precious metals and foreign exchange. Year over year there were also stronger investment banking and lending revenues. Provisions were modest this quarter compared to recoveries in the prior year and portfolios remain in good shape.

"As these results clearly demonstrate, our effective execution of strategies and strong risk management continue to deliver sustainable and growing profitability. Our capital levels remain strong, underpinned by high and consistent internal capital generation and supplemented by continued dividend reinvestment by our shareholders. We have very limited exposures in international areas of concern. In contrast, we are well positioned in areas of strength – Canada, the Americas and Asia. Consequently, we are confident of our future and fully expect to meet our financial targets this year, which positions us for continued solid performance in 2012."

| (Unaudited) | As at and for the three months ended | | | For the nine months ended | |
|---|---|---|---|---|---|
| | **July 31 2011** | April 30 2011 | July 31 2010 | **July 31 2011** | July 31 2010 |
| **Operating results** *($ millions)* | | | | | |
| Net interest income | **2,358** | 2,214 | 2,173 | **6,872** | 6,378 |
| Net interest income (TEB[1]) | **2,431** | 2,283 | 2,243 | **7,085** | 6,594 |
| Total revenue | **4,300** | 4,517 | 3,784 | **12,942** | 11,563 |
| Total revenue (TEB[1]) | **4,373** | 4,586 | 3,854 | **13,155** | 11,779 |
| Provision for credit losses | **243** | 262 | 276 | **774** | 985 |
| Non-interest expenses | **2,381** | 2,378 | 2,023 | **7,045** | 5,999 |
| Provision for income taxes | **391** | 334 | 399 | **1,095** | 1,355 |
| Provision for income taxes (TEB[1]) | **464** | 403 | 469 | **1,308** | 1,571 |
| Net income | **1,285** | 1,543 | 1,062[2] | **4,028** | 3,147[2] |
| Net income available to common shareholders of the Bank | **1,204** | 1,464 | 1,011 | **3,791** | 2,998 |
| **Operating performance** | | | | | |
| Basic earnings per share *($)* | **1.11** | 1.36 | 0.98 | **3.55** | 2.91 |
| Diluted earnings per share *($)* | **1.11** | 1.36 | 0.98 | **3.55** | 2.91 |
| Diluted cash earnings per share[1] *($)* | **1.14** | 1.38 | 0.99 | **3.61** | 2.95 |
| Return on equity[1] *(%)* | **17.8** | 22.9 | 18.2 | **19.6** | 18.5 |
| Productivity ratio *(%)* (TEB[1]) | **54.5** | 51.8 | 52.5 | **53.6** | 50.9 |
| Net interest margin on total average assets *(%)* (TEB[1]) | **1.67** | 1.68 | 1.68 | **1.70** | 1.72 |
| **Balance sheet information** *($ millions)* | | | | | |
| Cash resources and securities | **184,408** | 200,327 | 167,396 | | |
| Loans and acceptances | **301,102** | 294,412 | 286,462 | | |
| Total assets | **567,689** | 571,541 | 523,424 | | |
| Deposits | **390,157** | 396,054 | 365,241 | | |
| Preferred shares | **4,384** | 4,384 | 3,975 | | |
| Common shareholders' equity | **27,363** | 26,398 | 22,500 | | |
| Assets under administration[1] | **329,840** | 332,997 | 229,289 | | |
| Assets under management[1][3] | **104,878** | 106,802 | 49,943 | | |
| **Capital measures** | | | | | |
| Tier 1 capital ratio *(%)* | **12.3** | 12.0 | 11.7 | | |
| Total capital ratio *(%)* | **14.1** | 13.9 | 13.8 | | |
| Tangible common equity to risk-weighted assets[1][4] *(%)* | **9.6** | 9.3 | 9.4 | | |
| Assets-to-capital multiple | **17.0** | 17.6 | 17.1 | | |
| Risk-weighted assets *($ millions)* | **224,773** | 222,304 | 213,021 | | |
| **Credit quality** | | | | | |
| Net impaired loans *($ millions)* | **2,771** | 2,881 | 2,598 | | |
| General allowance for credit losses *($ millions)* | **1,382** | 1,412 | 1,450 | | |
| Net impaired loans as a % of loans and acceptances[5] | **0.92** | 0.98 | 0.91 | | |
| Specific provision for credit losses as a % of average loans and acceptances (annualized) | **0.38** | 0.38 | 0.43 | **0.38** | 0.51 |
| **Common share information** | | | | | |
| Share price *($)* | | | | | |
| High | **59.73** | 61.28 | 52.89 | **61.28** | 55.33 |
| Low | **53.77** | 56.25 | 47.71 | **52.11** | 44.12 |
| Close | **54.18** | 57.69 | 51.59 | | |
| Shares outstanding *(millions)* | | | | | |
| Average – Basic | **1,082** | 1,079 | 1,034 | **1,068** | 1,030 |
| Average – Diluted | **1,084** | 1,080 | 1,036 | **1,069** | 1,032 |
| End of period | **1,085** | 1,082 | 1,038 | | |
| Dividends per share *($)* | **0.52** | 0.52 | 0.49 | **1.53** | 1.47 |
| Dividend yield[6] *(%)* | **3.7** | 3.5 | 3.9 | **3.6** | 3.9 |
| Market capitalization *($ millions)* | **58,799** | 62,434 | 53,556 | | |
| Book value per common share *($)* | **25.21** | 24.39 | 21.67 | | |
| Market value to book value multiple | **2.1** | 2.4 | 2.4 | | |
| Price to earnings multiple (trailing 4 quarters) | **11.9** | 13.1 | 13.8 | | |
| **Other information** | | | | | |
| Employees | **74,902** | 73,558 | 69,950 | | |
| Branches and offices[7] | **2,910** | 2,853 | 2,747 | | |

*(1) Refer to page 5 for a discussion of non-GAAP measures.*
*(2) Non-controlling interest has been deducted from net income. Refer to Note 1 of the consolidated financial statements for the impact of the new accounting standards related to business combinations adopted effective November 1, 2010.*
*(3) Comparative amounts have been restated to reflect the updated definition of assets under management. Refer to page 5 for a discussion on non-GAAP measures.*
*(4) Comparative amounts have been restated to reflect the revised definition of tangible common equity to risk-weighted assets. Refer to page 5 for a discussion of non-GAAP measures.*
*(5) Net impaired loans are impaired loans less the specific allowance for credit losses.*
*(6) Based on the average of the high and low common share price for the period.*
*(7) Comparative amounts have been restated to more accurately reflect the acquisition of DundeeWealth Inc.*

## Contents


4 Notable Business Highlights

**Management's Discussion and Analysis**

6 Group Financial Performance and Financial Condition
- 6 Financial results
- 9 Risk management
- 10 Balance sheet
- 11 Capital management
- 12 Common dividend
- 12 Financial instruments
- 12 Selected credit instruments
- 12 Off-balance sheet arrangements

13 Accounting Policies and Controls
- 13 Accounting policies and estimates
- 14 Future accounting changes
- 16 Changes in internal control over financial reporting
- 16 Related party transactions

17 Outlook

17 Business Segment Review

23 Quarterly Financial Highlights

24 Share Data

**Interim Consolidated Financial Statements**

25 Interim Consolidated Financial Statements

29 Notes to the Interim Consolidated Financial Statements

**41 Shareholder Information**


**Forward-looking statements** Our public communications often include oral or written forward-looking statements. Statements of this type are included in this document, and may be included in other filings with Canadian securities regulators or the U.S. Securities and Exchange Commission, or in other communications. All such statements are made pursuant to the "safe harbour" provisions of the United States. Private Securities Litigation Reform Act of 1995 and any applicable Canadian securities legislation. Forward-looking statements may include comments with respect to the Bank's objectives, strategies to achieve those objectives, expected financial results (including those in the area of risk management), and the outlook for the Bank's businesses and for the Canadian, United States and global economies. Such statements are typically identified by words or phrases such as "believe," "expect," "anticipate," "intent," "estimate," "plan," "may increase," "may fluctuate," and similar expressions of future or conditional verbs, such as "will," "should," "would" and "could."

By their very nature, forward-looking statements involve numerous assumptions, inherent risks and uncertainties, both general and specific, and the risk that predictions and other forward-looking statements will not prove to be accurate. Do not unduly rely on forward-looking statements, as a number of important factors, many of which are beyond our control, could cause actual results to differ materially from the estimates and intentions expressed in such forward-looking statements. These factors include, but are not limited to: the economic and financial conditions in Canada and globally; fluctuations in interest rates and currency values; liquidity; significant market volatility and interruptions; the failure of third parties to comply with their obligations to us and our affiliates; the effect of changes in monetary policy; legislative and regulatory developments in Canada and elsewhere, including changes in tax laws; the effect of changes to our credit ratings; amendments to, and interpretations of, risk-based capital guidelines and reporting instructions and liquidity regulatory guidance; operational and reputational risks; the risk that the Bank's risk management models may not take into account all relevant factors; the accuracy and completeness of information the Bank receives on customers and counterparties; the timely development and introduction of new products and services in receptive markets; the Bank's ability to expand existing distribution channels and to develop and realize revenues from new distribution channels; the Bank's ability to complete and integrate acquisitions and its other growth strategies; changes in accounting policies and methods the Bank uses to report its financial condition and the results of its operations, including uncertainties associated with critical accounting assumptions and estimates; the effect of applying future accounting changes; global capital markets activity; the Bank's ability to attract and retain key executives; reliance on third parties to provide components of the Bank's business infrastructure; unexpected changes in consumer spending and saving habits; technological developments; fraud by internal or external parties, including the use of new technologies in unprecedented ways to defraud the Bank or its customers; consolidation in the Canadian financial services sector; competition, both from new entrants and established competitors; judicial and regulatory proceedings; acts of God, such as earthquakes and hurricanes; the possible impact of international conflicts and other developments, including terrorist acts and war on terrorism; the effects of disease or illness on local, national or international economies; disruptions to public infrastructure, including transportation, communication, power and water; and the Bank's anticipation of and success in managing the risks implied by the foregoing. A substantial amount of the Bank's business involves making loans or otherwise committing resources to specific companies, industries or countries. Unforeseen events affecting such borrowers, industries or countries could have a material adverse effect on the Bank's financial results, businesses, financial condition or liquidity. These and other factors may cause the Bank's actual performance to differ materially from that contemplated by forward-looking statements. For more information, see the discussion starting on page 62 of the Bank's 2010 Annual Report.

The preceding list of important factors is not exhaustive. When relying on forward-looking statements to make decisions with respect to the Bank and its securities, investors and others should carefully consider the preceding factors, other uncertainties and potential events. The Bank does not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on its behalf.

The "Outlook" sections in this document are based on the Bank's views and the actual outcome is uncertain. Readers should consider the above-noted factors when reviewing these sections.

Additional information relating to the Bank, including the Bank's Annual Information Form, can be located on the SEDAR website at www.sedar.com and on the EDGAR section of the SEC's website at www.sec.gov.

# 2011 Objectives

## Our Balanced Scorecard

### Financial

- Return on equity of 16-20%
- Diluted earnings per common share-growth of 7-12%
- Strong capital ratios
- Long-term shareholder value through increases in dividends and stock price appreciation

### People

- High levels of employee satisfaction and engagement
- Enhance diversity of workforce
- Collaboration

### Customer

- High levels of customer satisfaction and loyalty
- Deeper relationships with existing customers
- New customer acquisition

### Operational

- Productivity ratio of <58%
- Strong practices in corporate governance and compliance processes
- Efficiency and expense management
- Commitment to corporate social responsibility and strong community involvement

## Notable Business Highlights

### Growing our business

The Bank enhanced its Latin American footprint, closing a transaction to acquire Nuevo Banco Commercial, Uruguay's fourth largest private bank in terms of loans and deposits.

In Canada, positive sales momentum continued for both ScotiaFunds and Dynamic Funds throughout the third quarter of fiscal 2011, with $1.1 billion of net sales. With assets under management of $64 billion, their combined market share of banks is 18.7%.

### Recognized for success

*Trade Finance* magazine's annual Awards for Excellence acknowledged Scotiabank as the Best Overall Trade Bank in Central America and the Caribbean for the third year in a row, and Best International Trade Bank in Peru for the second consecutive year.

Dynamic U.S. Growth was ranked the number one Multi-Cap Growth Equity Fund by the *Wall Street Journal* for one-year performance as of July 31, 2011.

Scotiabank and Digicel won the 2011 Global Telecoms Business Innovation Award for Consumer Service Innovation for TchoTcho Mobile in Haiti. The service allows customers to perform basic banking functions using mobile devices.

Scotia Waterous is acting as financial advisor to BHP Billiton on its announced acquisition of Petrohawk Energy Corporation for a total enterprise value of approximately US$15.1 billion. This transaction is the largest oil and gas M&A deal in the world since 2009, and the largest non-Canadian deal ever advised by a member of a Canadian bank group.

### Serving our clients

Scotia Capital participated in the US$5.45 billion IPO of Hutchison Port Holdings Trust on the Singapore Stock Exchange. The offering represented the largest-ever IPO in Singapore and South East Asia. Scotiabank acted as Co-Manager and also provided loan underwriting services in association with this transaction, acting as Underwriter and Mandated Lead Arranger in an accompanying US$3 billion loan.

The Scotia Moneyback bank account and the Scotia Momentum Infinite VISA card have joined the Scotia Momentum VISA to solidify Scotiabank's position in Canada as a leader in the cash back loyalty space.

Scotia iTRADE launched FlightDesk, a powerful, customizable and intuitive market data platform designed to offer active traders complete control, with advanced tools, flexibility and in-depth analysis.

Scotia Capital acted as joint lead manager and bookrunner, and lead hedge provider, for the Sydney Airport C$225 million inaugural bond issue in the Canadian market. This was the first Australian non-financial issuer to access the Maple bond market since 2006. The deal also included a cross currency interest rate swap and a syndicated loan.

### Serving our communities

HIV testing sites for more than 10,000 people across 15 countries in the Caribbean were hosted by Scotiabank for the third year in a row. This initiative supports HIV/AIDS awareness.

Scotiabank and Green Living Enterprises announced the winners of the ScotiabankEcoLiving Awards recognizing Canadian businesses, innovators and students for excellence in the development of home energy efficiency initiatives.

# Non-GAAP Measures

The Bank uses a number of financial measures to assess its performance. Some of these measures are not calculated in accordance with Generally Accepted Accounting Principles (GAAP), are not defined by GAAP and do not have standardized meanings that would ensure consistency and comparability between companies using these measures. These non-GAAP measures are used throughout this report and defined below.

### Taxable equivalent basis

The Bank analyzes net interest income and total revenues on a taxable equivalent basis (TEB). This methodology grosses up tax-exempt income earned on certain securities reported in net interest income to an equivalent before tax basis. A corresponding increase is made to the provision for income taxes; hence, there is no impact on net income. Management believes that this basis for measurement provides a uniform comparability of net interest income arising from both taxable and non-taxable sources and facilitates a consistent basis of measurement. While other banks also use TEB, their methodology may not be comparable to the Bank's. The TEB gross-up to net interest income and to the provision for income taxes in the current period is $73 million, compared to $70 million in the same quarter last year and $69 million in the prior quarter. For the nine months, the TEB gross-up to net interest income and the provision for income taxes was $213 million compared to $216 million for the same period last year. For purposes of segmented reporting, a segment's net interest income and provision for income taxes are grossed up by the taxable equivalent amount. The elimination of the TEB gross up is recorded in the "Other" segment.

### Diluted cash earnings per share

The diluted cash earnings per share is calculated by adjusting the diluted earnings per share to add back the non-cash after–tax amortization of intangible assets.

### Productivity ratio (TEB)

Management uses the productivity ratio as a measure of the Bank's efficiency. This ratio represents non-interest expenses as a percentage of total revenue on a taxable equivalent basis.

### Net interest margin on total average assets (TEB)

This ratio represents net interest income on a taxable equivalent basis as a percentage of total average assets.

### Operating leverage

The Bank defines operating leverage as the rate of growth in total revenue, on a taxable equivalent basis, less the rate of growth in expenses.

### Return on equity

Return on equity is a profitability measure that presents the net income available to common shareholders as a percentage of common shareholders' equity. The Bank calculates its return on equity using average common shareholders' equity.

### Economic equity and return on economic equity

For internal reporting purposes, the Bank attributes capital to its business segments based on their risk profile and uses a methodology that considers credit, market, operational and other risks inherent in each business segment. The amount of risk capital attributed is commonly referred to as economic equity. Commencing this year, return on economic equity for the business segments is calculated as a ratio of Adjusted Net Income of the business segment and the economic equity attributed. Adjusted Net Income is net income available to common shareholders grossed up for the incremental cost of non-common equity capital instruments. Return on economic equity for the business segments for comparative periods has been restated.

### Tangible common equity to risk-weighted assets

Tangible common equity to risk-weighted assets is an important financial measure for rating agencies and the investing community. Tangible common equity is total common shareholders' equity plus non-controlling interest in subsidiaries, less goodwill and unamortized intangible assets (net of taxes). Tangible common equity is presented as a percentage of risk-weighted assets. Regulatory capital ratios, such as Tier 1 and Total Capital ratios, have standardized meanings as defined by the Office of the Superintendent of Financial Institutions Canada (OSFI).

### Assets under administration (AUA)

AUA are assets administered by the Bank which are beneficially owned by clients and therefore not reported on the Bank's balance sheet. Services provided for AUA are of an administrative nature, such as trusteeship, custodial, safekeeping, income collection and distribution; securities trade settlements, customer reporting, and other similar services.

### Assets under management (AUM)

AUM are assets managed by the Bank on a discretionary basis and in respect of which the Bank earns investment management fees. AUM are beneficially owned by clients and are therefore not reported on the Bank's balance sheet. Some AUM are also administered assets and are therefore included in assets under administration, under these circumstances.

# Group Financial Performance Financial Condition

August 30, 2011

## Financial results

Scotiabank's net income for the third quarter was $1,285 million. This is up from net income before non-controlling interests of $1,086 million for the same period last year, reflecting growth in net interest income and fee revenues. Quarter over quarter, net income declined from the record $1,543 million reported last quarter, as last quarter included the recognition of gains of $286 million related to the accounting for certain acquisitions under new accounting standards "the acquisition-related gains".

Diluted earnings per share were $1.11, compared to $0.98 in the same period a year ago and $1.36 last quarter. Last quarter's results included gains of $0.26 per share related to the accounting of certain acquisitions under new accounting standards. Return on equity remained strong at 17.8%, compared to 18.2% last year and 22.9% last quarter.

### *Impact of foreign currency translation*

The table below reflects the impact of foreign currency translation on the year-over-year and quarter-over-quarter change in key income statement items.

| ($ millions except per share amounts) | For the three months ended | | For the nine months ended |
|---|---|---|---|
| | Jul. 31, 2011 vs. Jul. 31, 2010 | Jul. 31, 2011 vs. Apr. 30, 2011 | Jul. 31, 2011 vs. Jul. 31, 2010 |
| U.S./Canadian dollar exchange rate (average) | | | |
| July 31,2011 | $ 1.034 | $ 1.034 | $ 1.018 |
| April 30, 2011 | | $ 1.027 | |
| July 31, 2010 | $ 0.960 | | $ 0.961 |
| % change | 8% | 1% | 6% |
| Impact on income: | | | |
| Net interest income | $ (46) | $ 1 | $ (102) |
| Other income | (26) | 1 | (90) |
| Non-interest expenses | 25 | (2) | 60 |
| Other items (net of tax) | 13 | – | 35 |
| Net income before non-controlling interests | $ (34) | $ – | $ (97) |
| Earnings per share (diluted) | (0.03) | – | (0.09) |
| Impact by business line: | | | |
| Canadian Banking | (2) | – | (5) |
| International Banking | (18) | – | (40) |
| Global Wealth Management | (5) | – | (12) |
| Scotia Capital | (6) | 1 | (31) |
| Other | (3) | (1) | (9) |

## Q3 2011 vs Q3 2010

### *Net income*

Scotiabank's net income was $1,285 million in the third quarter, which compares to net income before non-controlling interests of $1,086 million in the same period last year, an increase of $199 million or 18%. Excluding the negative impact of foreign currency translation of $34 million, net income grew $233 million or 21%. This quarter's net income reflected solid organic growth and increased contributions from recent acquisitions, which resulted in greater net interest income and fee revenues, partially offset by higher non-interest expenses. There were also improved provisions for credit losses and lower trading revenues from volatile markets.

### *Total revenue*

Total revenue (on a taxable equivalent basis) was $4,373 million this quarter, up $519 million or 13% from the same period last year, or $591 million or 15% excluding the negative impact of foreign currency translation. The year-over-year growth reflected higher net interest income, greater contributions from recent acquisitions of $251 million, growth in transaction-based fees and higher securitization revenues, partly offset by lower trading revenues.

### *Net interest income*

Net interest income (on a taxable equivalent basis) was $2,431 million, up $188 million or 8% over the same quarter last year, notwithstanding the negative impact of foreign currency translation of $46 million. The underlying increase was due mainly to asset growth as the net interest margin was relatively flat year over year. The asset growth was primarily in residential mortgages in Canada and commercial lending in International Banking. There was also growth in securities purchased under resale agreements and trading securities in Scotia Capital.

The Bank's net interest margin was 1.67%, compared to 1.68% last year. The slight reduction in the net interest margin was a result of a higher level of low spread assets, such as trading securities, securities purchased under resale agreements, and deposits with banks, and growth in non-earning assets.

### *Other income*

This quarter's other income was $1,942 million, up $331 million or 21% from the same period last year, despite the negative impact of foreign currency translation of $26 million. This growth was attributed mainly to higher mutual fund and brokerage fees from the combination of a recent acquisition and growth in assets under management in existing operations. There were also higher transaction-based fees from credit, payment and underwriting activities, and increased securitization revenues. These items were partly offset by a decline in trading revenues primarily in the fixed income business in Scotia Capital reflecting weaker market conditions.

*Provision for credit losses*

The provision for credit losses was $243 million this quarter, down $33 million from $276 million in the same period last year. The year-over-year decline was due primarily to lower provisions in Canadian Banking and International Banking, partly offset by modestly higher provisions in Scotia Capital. The provision this quarter also benefitted from a reduction in the general allowance of $30 million, while last year there was a reversal of $24 million of the sectoral allowance. Further discussion on credit risk is provided on page 9.

*Non-interest expenses and productivity*

Non-interest expenses of $2,381 million rose $358 million or 18% above last year, or $383 million or 19% excluding the favourable impact of foreign currency translation. Acquisitions accounted for $173 million of the increase. The remaining increase was in compensation-related expenses that reflected higher staffing levels and pension costs from changes in actuarial assumptions and plan asset values. The growth in performance-based commission was in line with higher revenues. The increases in other expense categories reflected the Bank's growth initiatives.

The Bank's productivity ratio was 54.5% this quarter, compared to 52.5% for the same period last year.

*Taxes*

The effective tax rate for this quarter was 23.3% compared to 26.8% in the same quarter last year. This decrease was due primarily to a decrease in the statutory tax rate in Canada along with lower future tax adjustments.

## Q3 2011 vs Q2 2011

*Net income*

Net income of $1,285 million declined $258 million or 17% from last quarter's $1,543 million. The second quarter included the recognition of the acquisition-related gains of $286 million. Excluding these gains, net income was up $28 million or 2% quarter over quarter. The current quarter's earnings reflected growth in net interest income, contributions from recent acquisitions, higher transaction-based fees, and lower provisions for credit losses. These items were partly offset by lower trading and investment banking revenues, and the impact of a higher effective income tax rate.

*Total revenue*

Total revenue (on a taxable equivalent basis) of $4,373 million was down $213 million or 5% from last quarter's $4,586 million. The quarter-over-quarter decline was due mainly to last quarter's recognition of the acquisition-related gains of $286 million. Solid underlying net interest income, higher transaction-based fees and contributions from recent acquisitions in International Banking, were offset by a reduction in trading and investment banking revenues and unfavourable changes in the fair value of non-trading financial instruments.

*Net interest income*

Net interest income (on a taxable equivalent basis) grew $148 million from $2,283 million last quarter. The quarter-over-quarter increase was attributable to asset growth, primarily in low-spread deposits with banks and trading assets, and three additional days in the quarter. The net interest margin was relatively flat at 1.67% compared to 1.68% last quarter.

The slight quarter-over-quarter decline in net interest margin was due to higher volumes of low-spread trading securities and deposits with banks, an unfavourable change in the fair value of financial instruments used for asset/liability management purposes and higher levels of non-earning assets. These items were partly offset by a higher contribution from associated corporations, particularly Thanachart Bank in Thailand, and higher income from fixed income trading operations.

*Other income*

Compared to the previous quarter, other income of $1,942 million was down $361 million or 16%, or $75 million or 4% excluding the acquisition-related gains of $286 million. The decline was due primarily to a reduction in trading revenues, primarily in the fixed income business reflecting weaker market conditions, lower underwriting and non-trading foreign-exchange revenues. The decline in wealth management revenues and unfavourable changes in the fair value of non-trading financial instruments also contributed to the quarter-over-quarter decrease in other income. Offsetting these declines were increases in transaction-based fees due primarily to three additional days in the quarter.

*Provision for credit losses*

The provision for credit losses was $243 million this quarter, down $19 million from the prior quarter. Moderately higher provisions in International Banking were more than offset by this quarter's reduction in the general allowance, which was unchanged in the prior quarter. Further discussion on credit risk is provided on page 9.

*Non-interest expenses and productivity*

Non-interest expenses of $2,381 million were marginally higher compared to last quarter. Increases in remuneration-related expenses were offset by reductions in other operating expenses. The increases in remuneration expenses reflected three additional days in the quarter and higher staffing levels, partially offset by lower performance-based compensation in line with the lower trading and commissionable revenues.

The productivity ratio was 54.5% this quarter, compared to 51.8% last quarter.

*Taxes*

The effective tax rate for this quarter was 23.3% compared to 17.8% last quarter. The increase from last quarter was substantially due to the non-taxable acquisition-related gains of $286 million recorded in the prior quarter. There was also a lower level of tax-exempt income in the current quarter, partly offset by lower taxes in foreign subsidiaries.

## Year-to-date Q3 2011 vs Year-to-date Q3 2010

*Net income*

Net income for the nine months was $4,028 million, which compares to net income before non-controlling interests of $3,224 million for the same period last year. This was $804 million or 25% higher than last year, or $901 million or 28% excluding the negative impact of foreign currency translation of $97 million. The year-over-year increase includes the current period's acquisition-related gains and reflects both organic growth and contributions from recent acquisitions, with increased net interest income and higher transaction-based fees. Strong investment banking and securitization revenues, lower provisions for credit losses, and the impact of a lower effective tax rate also contributed to the growth in net income. These items were partly offset by higher non-interest expenses, lower net gains on securities and reduced trading revenues.

*Total revenue*

For the nine months, total revenue (on a taxable equivalent basis) of $13,155 million was up $1,376 million or 12% from the same period last year. Excluding the negative impact of foreign currency translation of $192 million, total revenue was up $1,568 million or 13%. In addition to the acquisition-related gains in the current year of $286 million, the year-over-year increase was due primarily to higher net interest income and increased wealth management revenues with contributions from both recent acquisitions and existing mutual fund operations. Recent acquisitions accounted for $639 million of the increase. There were also increases in underwriting and other transaction-based fees, higher securitization revenues and favorable changes in the fair value of non-trading financial instruments. These items were partly offset by lower net gains on securities and a decline in trading revenues, primarily in fixed income.

*Net interest income*

Year-to-date net interest income (on a taxable equivalent basis) was $7,085 million up $491 million or 7% from the same period last year, despite the negative impact of foreign currency translation of $102 million. The increase was driven by organic asset growth, primarily in residential mortgages in Canadian Banking and retail and commercial lending in International, partly offset by a lower net interest margin.

The year-to-date net interest margin of 1.70% declined from 1.72% in the same period last year, due mainly to growth in low-spread trading securities and securities purchased under resale agreements. These factors were partly offset by the favorable changes in the fair value of financial instruments used for asset/liability management purposes and the higher spread on the loan portfolio of R-G Premier Bank.

*Other income*

For the nine-month period, other income was $6,070 million, an increase of $885 million or 17% from the same period last year. Excluding the negative impact of foreign currency translation of $90 million, other income grew by $975 million or 19%. The results include the acquisition-related gains of $286 million. The year-over-year increase reflects higher wealth management revenues as a result of the recent acquisition of DundeeWealth Inc (DundeeWealth) and growth in the existing mutual funds business. There were also higher transaction-based fees and increased securitization and investment banking revenues. In addition, last year's results included a loss on the Bank's investment in an affiliate in Venezuela, from a significant devaluation in the Venezuelan bolivar, offset by a one-time gain on the sale of the pension administration business in Mexico. These items were partly offset by a reduction in fixed income trading revenues and lower net gains on securities.

*Provision for credit losses*

For the nine-month period, total provisions for credit losses were $774 million, down $211 million from $985 million during the same period last year. The majority of the decrease was attributable to lower provisions in International Banking and, to a lesser extent, in Canadian Banking, somewhat offset by modestly higher provisions in Scotia Capital. In the current period, the provision for credit losses benefitted from a reversal of $30 million of the general allowance, while over the same period last year there was a reversal of the sectoral allowance of $44 million. Further discussion on credit risk is provided on page 9.

*Non-interest expenses and productivity*

For the nine-month period, non-interest expenses were $7,045 million, up $1,046 million or 17% from $5,999 million last year. Excluding the positive impact of foreign currency translation of $60 million, expenses were up $1,106 million or 18%. Recent acquisitions accounted for $432 million of the increase. The remaining growth of $673 million was due mainly to higher remuneration-related expenses as a result of increased staffing levels and higher stock-based compensation. Performance based compensation was also up from volume-related commissionable revenues and increases across most incentive plans

based on results to date. There were higher pension and benefits expenses from changes in actuarial assumptions and plan asset values. The remaining growth across the expense categories was to support ongoing growth initiatives.

The year-to-date productivity ratio was 53.6% compared to 50.9% for the same period last year.

### *Taxes*

The year-to-date effective tax rate was 21.4%, compared to 29.6% for the same period last year. This decrease was due mainly to the non-taxable acquisition-related gains, higher tax-exempt income and a reduction in the statutory tax rates in Canada. There were also lower taxes in foreign subsidiaries and lower future tax adjustments.

## Risk management

The Bank's risk management policies and practices are unchanged from those outlined in pages 62 to 77 of the 2010 Annual Report.

### *Credit risk*

#### *Provision for credit losses*

The provision for credit losses was $243 million this quarter, compared to $276 million in the same period last year and $262 million in the previous quarter. This included reductions in the general allowance of $30 million this quarter and a reversal of the sectoral allowance of $24 million in the same period last year. Specific provisions for credit losses were $273 million this period, down from $300 million in the same period last year and slightly up from $262 million last quarter.

The provision for credit losses was $145 million in Canadian Banking, down from $163 million in the same quarter last year but unchanged from the previous quarter. Compared to the same quarter last year, lower retail provisions were partly offset by higher commercial provisions related to one account, as well as the benefit last year of a $6 million reversal of the sectoral allowance specific to the automotive industry. Compared to the prior quarter, lower retail provisions were fully offset by higher commercial provisions.

International Banking's provision for credit losses was $120 million this quarter, compared to $138 million in the same period last year, and $106 million last quarter. Compared to the same quarter last year, retail provisions declined, primarily in Mexico, and commercial provisions improved across most regions. Compared to last quarter, retail provisions remained relatively unchanged, while commercial provisions were higher.

Scotia Capital's provision for credit losses was $8 million this quarter, compared to net reversals and recoveries of $25 million in the same period last year, and $10 million in provisions in the prior quarter. Last year's results included an $18 million reversal of the sectoral allowance specific to the automotive industry. In the current period, new provisions in Canada were partially offset by net reversals and recoveries in the U.S.

Global Wealth Management did not incur any provisions for credit losses this quarter.

#### *Allowances for credit losses*

The total allowance for credit losses increased to $2,824 million as at July 31, 2011, from $2,796 million as at October 31, 2010.

Specific allowances in Canadian Banking increased to $664 million as at July 31, 2011, from $608 million as at October 31, 2010 due to an increase in commercial portfolios specific allowances.

In International Banking, specific allowances were $705 million unchanged from the year end.

Scotia Capital's specific allowances declined to $63 million from $64 million as at October 31, 2010.

The general allowance for credit losses decreased to $1,382 million as at July 31, 2011, from $1,410 million last year end, due primarily to lower estimates of inherent losses in the non-retail portfolio.

#### *Impaired loans*

Total gross impaired loans at July 31, 2011, were $4,205 million, down $216 million from October 31, 2010, attributable to declines in most business lines.

Total net impaired loans in Canadian Banking were $534 million, down from $608 million at October 31, 2010, due to declines in retail and commercial net impaired loans.

International Banking's total net impaired loans decreased to $2,046 million from $2,209 million as at October 31, 2010, also due to declines in both retail and commercial portfolios. Included in impaired loans are $427 million (October 31, 2010 - $553 million) of purchased impaired loans from the 2010 R-G Premier Bank acquisition. The loans purchased are recorded at fair value on acquisition date and no allowance is recorded on acquisition date as credit losses are included in the determination of the fair value. Under IFRS, these purchased impaired loans will not be included in impaired loans as long as expected cash flows continue to equal or exceed the amounts expected at acquisition.

In Scotia Capital, total net impaired loans were $179 million at the end of this quarter, compared to $227 million at the end of last year, due to reductions in net impaired loans in the U.S. and Canadian portfolios.

#### *Overview of loan portfolio*

A large portion of the Bank's loan portfolio is comprised of residential mortgages and consumer loans, which are well diversified by borrower and geography. As at July 31, 2011, these loans amounted to $184 billion or 61% of the Bank's total loans outstanding, in line with last quarter (after specific allowances but before general allowances for credit losses). A