'ALLETTE BENOIT BOULANGER RONDEAU & ASSOCIES
Mallette, Benoit, Boulanger, Rondeau & Associés — Michel Bélanger

OFFERING CIRCULAR

AYMOND CHABOT MARTIN Raymond Chabot, Martin, Paré & Associés — MICHEL BELANGER
'ARÉ & ASSOCIÉS — CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER

U.S. $200,000,000

PRICE WATERHOUSE — Price Waterhouse

NATIONAL BANK OF CANADA

(A bank governed by the Bank Act (Canada))

Floating Rate Notes Due 2085
Convertible into Floating Rate Subordinated Capital Debentures
Due 99 years after Conversion

The issue price of the Notes is 100 per cent. of their principal amount.

Interest, which will be payable semi-annually in arrear in February and August, will be at a rate of 1/8 per cent. per annum above the London inter-bank offered rate for six-month U.S. dollar deposits, unless adjusted as described herein, all as described under "Description of the Notes and Debentures—Interest".

Principal of and interest on the Notes will be paid as described under "Description of the Notes and Debentures—Payments". Payments will be made without deduction for Canadian withholding taxes, as described under "Description of the Notes and Debentures—Taxation".

The Notes will, subject as mentioned below, mature on the Interest Payment Date falling in August 2085 and, except as described below, are not redeemable prior to maturity. The Notes are subject to redemption on any Interest Payment Date falling in or after August 1991 at the option of National Bank of Canada, in whole or in part, at par. The Notes are also subject to redemption at the option of National Bank of Canada at any time in the event of certain changes affecting Canadian taxes. See "Description of the Notes and Debentures—Redemption and Purchase".

National Bank of Canada may, on any Interest Payment Date, convert all, but not some only, of the Notes into Floating Rate Subordinated Capital Debentures Due 99 years after such Interest Payment Date. Such Debentures will, in the event of insolvency or winding-up of National Bank of Canada, be subordinate in right of payment to the deposit liabilities of National Bank of Canada and all other liabilities except liabilities which by their terms rank equally with or subordinate to such Debentures. See "Description of the Notes and Debentures—Status" and "Description of the Notes and Debentures—Conversion by the Bank".

Application has been made to list the Notes and Debentures on the Luxembourg Stock Exchange.

The Notes will initially be represented by a temporary global Note to be deposited on or about August 28, 1986 with a common depositary on behalf of Euro-clear and CEDEL S.A. The temporary global Note will be exchangeable for definitive Notes as described under "Description of the Notes and Debentures—Form, Denominations and Title".

Credit Suisse First Boston Limited
Goldman Sachs International Corp.
Morgan Stanley International
Société Générale

E F Hutton & Company (London) Ltd
Samuel Montagu & Co. Limited
Westdeutsche Landesbank Girozentrale
Bank of America International Limited
Bank of Tokyo International Limited
Bank of Yokohama (Europe) S.A.
Bankers Trust International Limited
Banque Bruxelles Lambert S.A.
Banque Indosuez
Banque Nationale de Paris
Banque Paribas Capital Markets Limited
Citicorp Investment Bank Limited
Dai-Ichi Kangyo International Limited
First Interstate Capital Markets Limited
LTCB International Limited
Manufacturers Hanover Limited
Mitsubishi Finance International Limited
The Nikko Securities Co., (Europe) Ltd.
Nippon Credit International Limited
Saitama Bank (Europe) S.A.
Sanwa International Limited
Taiyo Kobe International Limited
Takugin International Bank (Europe) S.A.
Tokai International Limited
Yasuda Trust Europe Limited

The date of this Offering Circular is August 7, 1986

This Offering Circular has been prepared for the purpose of giving information with regard to National Bank of Canada (the "Bank") and its subsidiaries and the U.S. $200,000,000 Floating Rate Notes Due 2085 (the "Notes") convertible into Floating Rate Subordinated Capital Debentures Due 99 years after Conversion (the "Debentures").

No person is authorised to give any information or to make any representation not contained in this Offering Circular and any information or representation not contained in this Offering Circular must not be relied upon as having been authorised by or on behalf of the Bank or the managers named in the Subscription Agreement referred to in "Subscription and Sale" (the "Managers"). The delivery of this Offering Circular at any time does not imply that the information contained herein is correct at any time subsequent to its date.

The Bank, having made all reasonable enquiries, confirms that this Offering Circular contains all information with regard to the Notes, the Debentures and the Bank which is material in the context of the issue of the Notes, that the information contained in this Offering Circular is true and accurate in all material respects and is not misleading, that the opinions expressed herein are honestly held, and that there are no other facts the omission of which makes this Offering Circular as a whole or any such information or the expression of any of the opinions misleading.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Bank or the Managers to subscribe for or purchase, any of the Notes.

The Notes have not been, and will not be, registered under the United States Securities Act of 1933 and may not be offered, sold or delivered, directly or indirectly, in the United States (including the States and the District of Columbia), its territories, its possessions and other areas subject to its jurisdiction or to U.S. persons (except, subject to certain restrictions, branches of United States banks located outside the United States) as part of the distribution of the Notes.

The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Bank and the Managers to inform themselves about and to observe any such restrictions. For a further description of certain restrictions on offers and sales of Notes and on distribution of this Offering Circular see "Subscription and Sale".

On February 10, 1986, the Minister of Finance of Canada issued letters patent under the Bank Act (Canada) (the "Bank Act") amalgamating National Bank of Canada and The Mercantile Bank of Canada and continuing them as one bank under the name "Banque Nationale du Canada" and its English version "National Bank of Canada", effective November 1, 1985. In this Offering Circular, unless the context otherwise indicates, the term "Bank" refers to the bank created on February 10, 1986 by the amalgamation of National and Mercantile; the term "National" refers to National Bank of Canada as it existed prior to the amalgamation with Mercantile; and the term "Mercantile" refers to The Mercantile Bank of Canada as it existed prior to the amalgamation with National.

Unless otherwise indicated, dollar amounts in this Offering Circular are expressed in Canadian dollars. On October 31, 1985 (the date of the latest audited Consolidated Statement of Assets and Liabilities of National contained herein), the closing rate for the United States dollar in Canada, as reported by the Bank of Canada, was $1(U.S.) = $1.3675 (Can.). On April 30, 1986, the closing rate for the United States dollar in Canada, as reported by the Bank of Canada, was $1(U.S.) = $1.3767 (Can.). On August 5, 1986, such rate was $1(U.S.) = $1.3796 (Can.).

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In connection with the offering of the Notes, the Managers may over-allot or effect transactions in the Notes, in the open market or otherwise with a view to stabilising or maintaining the market price of the Notes at levels other than those which might otherwise prevail in the open market. Such transactions, if commenced, may be discontinued at any time.

DESCRIPTION OF THE NOTES AND DEBENTURES

General

The Notes and the Debentures, into which the Notes may be converted at the option of the Bank (as provided in "Conversion by the Bank" below), will be issued under a Trust Indenture (the "1986 Trust Indenture") to bear formal date of August 28, 1986, between the Bank and Trust Général du Canada, as trustee (the "Trustee"). The holders of the Notes or (as the case may be) the holders of the Debentures, and the holders of interest coupons and talons for further interest coupons appertaining thereto (together, where the context so permits the "Coupons") will be entitled to the benefit of, be bound by and be deemed to have notice of all provisions contained in the 1986 Trust Indenture. The following is a summary of, and is subject to, the detailed provisions of the 1986 Trust Indenture.

Form, Denominations and Title

The Notes will initially be represented by a temporary global Note in bearer form without interest coupons (the "Temporary Global Note") to be deposited with a common depositary (the "Common Depositary") for Morgan Guaranty Trust Company of New York, Brussels office, as operator of the Euro-clear System ("Euro-clear"), and CEDEL S.A., on or about August 28, 1986.

The Bank will undertake to exchange the Temporary Global Note, in whole or in part, for definitive Notes not earlier than the date (the "Exchange Date") which is 90 days after the completion of the distribution of the Notes as determined by Credit Suisse First Boston Limited, which will notify the Bank, the Trustee, the Common Depositary, Euro-clear and CEDEL S.A. in writing of such completion. Such exchange will only be made upon certification that (i) the beneficial owners of the Notes are not U.S. persons; and (ii) the beneficial owners of the Notes are not residents of Canada or, if any Notes are beneficially owned by residents of Canada, that such Notes have been acquired in accordance with the securities laws of Canada and of the applicable province or territory thereof. A beneficial owner must exchange his share of the Temporary Global Note for definitive Notes before principal or interest can be collected by such owner, except as provided under "Initial Interest Payments".

The definitive Notes will be issued in bearer form only in the denominations of U.S. $10,000 and U.S. $100,000 with Coupons attached. Upon conversion of the Notes into Debentures, each Note will be exchanged for a Debenture of equivalent denomination, with Coupons attached (as provided in "Conversion by the Bank" below). Title to the Notes, the Debentures and the Coupons will pass by delivery. The Bank, the Trustee and the Principal Paying Agent and the other Paying Agents (as referred to in "Payments" below) may deem and treat the bearer of any Note ("Noteholder") or (as the case may be) the bearer of any Debenture ("Debentureholder") or the bearer of any Coupon ("Couponholder") as the absolute owner thereof (whether or not such Note or (as the case may be) Debenture or Coupon shall be overdue and notwithstanding any notice of ownership or writing thereon or notice of any previous loss or theft thereof) for the purpose of receiving payment thereof or on account thereof and for all other purposes.

All Notes, Debentures and Coupons will carry the following legends: "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in sections 165(j) and 1287(a) of the Internal Revenue Code" and "This is not a deposit insured under the Canada Deposit Insurance Corporation Act".

Status

The Notes when issued will be direct unsecured obligations of the Bank ranking equally and rateably with all deposit liabilities of the Bank (except as otherwise prescribed by law) and without any preference among themselves.

Upon conversion of the Notes into Debentures (as provided in "Conversion by the Bank" below), the Debentures will be direct, unsecured obligations of the Bank. The 1986 Trust Indenture will provide that in the event of insolvency or winding-up of the Bank, the indebtedness evidenced by the Debentures will be subordinate in right of payment to the prior payment in full of the deposit liabilities of the Bank and all other liabilities of the Bank except liabilities which by their terms rank in right of payment equally with or subordinate to all such Debentures. The Bank has not created and the 1986 Trust Indenture will provide in effect that the Bank will not create, any indebtedness subordinate in right of payment to the deposit liabilities of the Bank which, on the insolvency or winding-up of the Bank, would rank for payment prior to the Debentures, other than liabilities having priority to the Debentures by virtue of any statute or law now or hereafter in force. Under the Bank Act all debentures issued by the Bank from time to time rank equally on the insolvency or winding-up of the Bank. Prior to such insolvency or winding-up individual issues of debentures may be accelerated and paid by the Bank in accordance with their respective terms.

Interest

(a) *Coupons*

Interest payments will be made against surrender of the appropriate Coupons in accordance with the provisions described under "Payments" below. However, if the principal of any Note or (as the case may be) Debenture becomes due for payment other than on an Interest Payment Date (as defined below) or if payment of principal is improperly withheld or refused in respect of such Note or (as the case may be) Debenture, interest accrued in respect of such Note or (as the case may be) Debenture from the last preceding Interest Payment Date or from the Closing Date (as defined below) or (as the case may be) Conversion Date (as defined in "Conversion by the Bank" below), whichever is later, will be paid against presentation and surrender of such Note or (as the case may be) Debenture and no Coupon shall be deemed to evidence the right to receive such accrued interest.

(b) *Accrual of Interest*

The Notes will bear interest from the Closing Date (which expression means August 28, 1986 or, in the event that the Closing Date is deferred, such later date as shall be the Closing Date) and (as the case may be) the Debentures will bear interest from the Conversion Date and interest on each Note will cease to accrue on the Conversion Date. Interest on each Note or (as the case may be) Debenture will cease to accrue on the date fixed for redemption thereof unless, upon due presentation of such Note or (as the case may be) Debenture, payment of principal is improperly withheld or refused. In such event, interest will continue to accrue (as well after as before any judgment) up to but excluding the date on which, upon further presentation, payment in full of the principal thereof is made or (if earlier) the seventh day after notice is duly given to the holder of such Note or (as the case may be) Debenture (either in accordance with "Notices" below or individually) that upon further presentation of such Note or (as the case may be) Debenture being duly made such payment will be made, provided that upon further presentation thereof being duly made such payment is in fact made. Interest will be calculated on the basis of the actual number of days elapsed divided by 360.

(c) *Initial Interest Payments*

Except as provided below, a beneficial owner must exchange his share of the Temporary Global Note for definitive Notes before interest can be collected. The Temporary Global Note will provide that payment of interest on any Interest Payment Date (as defined below) occurring prior to the Exchange Date will be made to Euro-clear and CEDEL S.A. which will credit interest received in respect of the Temporary Global Note to the respective accounts of the beneficial owners of the Temporary Global Note, only upon receipt of a certificate that as of such Interest Payment Date the portion of the Temporary Global Note on which interest is to be so credited (i) is not beneficially owned by a U.S. person and (ii) is not beneficially owned by a resident of Canada or, if such portion is beneficially owned by a resident of Canada, that such portion has been acquired in accordance with the securities laws of Canada and of the applicable province or territory thereof. Interest in respect of any portion of the Temporary Global Note payable prior to the Exchange Date but as to which no such certificate has been presented will be paid to the holder of the definitive Notes at the time of issuance thereof. Interest payable on or after the Exchange Date may be collected only after issuance of the definitive Notes.

(d) *Interest Payment Dates and Interest Periods*

Interest will be payable in arrear on Interest Payment Dates being, save as mentioned below, the date falling six calendar months after the Closing Date or (as the case may be) the Conversion Date, and thereafter each date which falls six calendar months after the preceding Interest Payment Date. If any Interest Payment Date would otherwise fall on a day which is not a business day, it shall be postponed to the next business day unless it would thereby fall in the next calendar month. In the latter event, the Interest Payment Date shall be the immediately preceding business day and each subsequent Interest Payment Date shall be the last business day of the sixth calendar month after the calendar month in which the preceding Interest Payment Date shall have fallen. The period beginning on the Closing Date or (as the case may be) the Conversion Date, and ending on the first Interest Payment Date and each successive period beginning on an Interest Payment Date and ending on the next succeeding Interest Payment Date is referred to herein as an Interest Period and the expression "business day" as used in "Interest" shall mean a day on which banks are open for business in both London and New York City.

(e) *Rate of Interest*

For the purpose of determining the rate of interest on the Notes or (as the case may be) Debentures, the Bank will enter into an agreement (the "Reference Agent Agreement") with Kredietbank S.A. Luxembourgeoise (the "Reference Agent", which expression shall include any duly appointed substitute Reference Agent). The rate of interest from time to time payable in respect of the Notes or (as the case may be) Debentures (the "Rate of Interest") shall be determined by the Reference Agent on the basis of the following provisions (unless adjusted as provided in "Adjustment of Rate of Interest" below):

(i) On the second business day prior to the commencement of each Interest Period (the "Interest Determination Date"), the Reference Agent will request the principal London office of each of the Reference Banks (as described in "Reference Agent and Reference Banks" below) to provide the Reference Agent with its offered quotation to leading banks for deposits of U.S. dollars in the London Inter-bank Market for such Interest Period as at 11:00 a.m. (London time) on the Interest Determination Date in question. The Rate of Interest for such Interest Period shall be ⅛ per cent. per annum above the arithmetic mean (rounded upwards if necessary to the nearest 1/16 per cent.) of the offered quotations of the Reference Banks, as determined by the Reference Agent.

(ii) If on any Interest Determination Date two or three only of the Reference Banks provide the Reference Agent with such offered quotations, the Rate of Interest for the relevant Interest Period shall be determined in accordance with (i) above on the basis of the offered quotations of those Reference Banks providing such quotations.

(iii) If on any Interest Determination Date one only or none of the Reference Banks provides the Reference Agent with such offered quotation, the Rate of Interest for the relevant Interest Period shall be whichever is the higher of:

(A) the Rate of Interest in effect for the Interest Period to which (i) or (ii) above shall have applied which last preceded the relevant Interest Period; and

(B) the rate per annum which the Reference Agent determines to be either (i) ⅛ per cent. per annum above the arithmetic mean (rounded upwards if necessary to the nearest 1/16 per cent.) of the U.S. dollar lending rates which leading New York City banks selected by the Reference Agent are quoting, on the relevant Interest Determination Date, for the next Interest Period, to the Reference Banks or those of them (being at least two in number) to which such quotations are, in the opinion of the Reference Agent, being so made, or (ii) in the event that the Reference Agent can determine no such arithmetic mean, ⅛ per cent. per annum above the lowest U.S. dollar lending rate which leading New York City banks selected by the Reference Agent are quoting on such Interest Determination Date to leading banks which have their head offices in Europe for the next Interest Period, provided that if the banks selected as aforesaid by the Reference Agent are not quoting as mentioned above, the Rate of Interest shall be the Rate of Interest specified in (A) above.

(f) *Determination of Rate of Interest and Calculation of Coupon Amounts*

The Reference Agent will, on each Interest Determination Date, determine the Rate of Interest and calculate the amount of interest payable in respect of each U.S. $10,000 principal amount of Notes or (as the case may be) Debentures (the "Interest Amount") for the relevant Interest Period. The amount of interest shall be calculated by applying the Rate of Interest to the principal amount of U.S. $10,000, multiplying such sum by the actual number of days in the Interest Period concerned divided by 360 and rounding the resultant figure to the nearest cent (half a cent being rounded upwards). The amount of interest payable on the presentation and surrender of each Coupon (the "Coupon Amount") for the relevant Interest Period shall be the Interest Amount in respect of each Note or (as the case may be) Debenture of U.S. $10,000 and ten times the Interest Amount in respect of each Note or (as the case may be) Debenture of U.S. $100,000. The Trustee shall, if the Reference Agent does not at any material time for any reason determine the Rate of Interest in accordance with "Rate of Interest" above, determine the Rate of Interest at such rate as, in its absolute discretion (having such regard as it shall think fit to the procedure described in "Rate of Interest" above), it shall deem fair and reasonable in all the circumstances and such determination shall be deemed to be a determination thereof by the Reference Agent.

(g) *Publication of Rate of Interest and Coupon Amounts*

The Reference Agent will cause the Rate of Interest and the Coupon Amounts for each Interest Period and the relevant Interest Payment Date to be notified to the Luxembourg Stock Exchange and will use its best endeavours to cause the same to be published in accordance with "Notices" below as soon as possible but not later than two business days after the date of commencement of the relevant Interest Period. The Coupon Amounts and the Interest Payment Date so published may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice in the event of an extension or shortening of the Interest Period.

(h) *Adjustment of Rate of Interest*

If the last regular dividend declared by the Board of Directors of the Bank on its common shares (the "Common Shares") prior to any Interest Period is less than the Reference Dividend (as defined below), then the Rate of Interest will be adjusted for such Interest Period in accordance with the following formula:

$$\text{Adjusted Rate of Interest} = \frac{\text{Regular dividend declared}}{\text{Reference Dividend}} \times \text{Rate of Interest}$$

The Rate of Interest shall continue to be adjusted according to this formula until the Interest Period next following that in which the last dividend declared by the Bank on the Common Shares is equal to or greater than the Reference Dividend.

If the Board of Directors of the Bank fails to declare a regular dividend on the Common Shares within 30 days following the date upon which the Board of Directors would normally have declared a regular dividend on the Common Shares, the Adjusted Rate of Interest shall be nil commencing with the Interest Period following such failure to declare a regular dividend until such time as the Board of Directors declares a regular dividend on the Common Shares, in which case the Notes or (as the case may be) Debentures will bear interest commencing with the Interest Period following such declaration at the Adjusted Rate of Interest determined in accordance with the aforementioned provisions and formula if the regular dividend is less than the Reference Dividend or otherwise at the Rate of Interest.

If the Rate of Interest is adjusted as described above, the Bank will notify the Noteholders or (as the case may be) Debentureholders in accordance with "Notices" below.

The 1986 Trust Indenture will provide for the adjustment of the Reference Dividend upon the happening of certain events including the following:

(i) the subdivision, consolidation or reclassification of the outstanding Common Shares or the consolidation, amalgamation or merger of the Bank with another entity;

(ii) the issue of Common Shares to all or substantially all the holders of Common Shares by way of a stock dividend or otherwise, other than the issue from time to time of Common Shares pursuant to a stock dividend or dividend reinvestment plan to shareholders who elect to receive dividends in Common Shares in lieu of receiving cash dividends paid in the ordinary course;

(iii) the Board of Directors of the Bank declaring regular dividends on the Common Shares of the Bank more or less frequently than the frequency of the Reference Dividend; and

(iv) the Board of Directors of the Bank declaring regular dividends in a currency other than the currency of the Reference Dividend.

Provided, however, that the Rate of Interest on the Notes or (as the case may be) Debentures will not be reduced as a result of any reduction of the Reference Dividend pursuant to the above.

The 1986 Trust Indenture will contain, among others, the following definition: "Reference Dividend" means the greater of Can. $0.25 per Common Share (the current regular quarterly dividend) and the highest regular quarterly dividend paid by the Bank on each of its Common Shares after the issuance of the Notes, provided that no such dividend shall be the Reference Dividend unless and until each of the regular dividends paid by the Bank during the nine month period following the payment of such dividend has been equal to or in excess of such dividend.

(i) *Reference Agent and Reference Banks*

So long as any of the Notes or (as the case may be) Debentures remains outstanding, the Bank shall ensure that there shall at all times be a Reference Agent and four Reference Banks (collectively the "Reference Banks") for the purpose of determining the Rate of Interest on the Notes or (as the case may be) Debentures. The initial Reference Banks shall be the principal London offices of The Bank of Tokyo, Ltd., Banque Nationale de Paris, Citibank, N.A. and Westdeutsche Landesbank Girozentrale. In the event of the principal London office of any such bank being unable or unwilling to continue to act as a Reference Bank, the Bank shall appoint another bank as may be approved by the Trustee to act as such in its place. The Bank may terminate the appointment of the Reference Agent and, in addition, the Reference Agent may resign as such, provided that neither the removal nor the resignation of the Reference Agent shall take effect until another bank, which shall have been approved by the Trustee, has been appointed by the Bank to act as Reference Agent.

(j) *Notifications*

All notifications, determinations, calculations and quotations given, expressed, made or obtained pursuant to these provisions, whether by the Reference Banks (or any of them), the Reference Agent or the Trustee, shall (in the absence of manifest error) be binding on the Bank, the Trustee, the Reference Banks, the Reference Agent, the Paying Agents and all holders of Notes or (as the case may be) Debentures and Coupons and no liability to the holders of Notes or (as the case may be) Debentures or Coupons shall attach to the Bank, the Trustee, the Reference Banks, the Reference Agent or any of them in connection with the exercise by the Reference Banks, the Reference Agent, the Trustee or any of them of their powers, duties or discretions under or in respect of these provisions.

Payments

(a) Payments of principal in respect of the Notes or (as the case may be) Debentures will be made against surrender of the relevant Notes or (as the case may be) Debentures and payment of interest in respect of the Notes or (as the case may be) Debentures will be made, subject to "Coupons" above, against surrender of the relevant Coupons, in each case, at the specified office of any of the Paying Agents from time to time appointed by the Bank. Such payments will be made, at the option of the holder, by a U.S. dollar cheque drawn on a bank in New York City or by transfer to a U.S. dollar account maintained by the payee with a bank in a city outside the United States. In all cases, payments will be made subject to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to provisions of "Taxation" below. Notwithstanding the foregoing, payments of interest in respect of the Notes (or as the case may be) Debentures will be made at the office of a Paying Agent in New York City if (i) the Bank shall have appointed Paying Agents outside the United States with the reasonable expectation that such Paying Agents would be able to make payment of the full amount of the interest on the Notes or (as the case may be) Debentures in U.S. dollars when due, (ii) payment of the full amount of such interest at the offices of all such Paying Agents is illegal or effectively precluded by exchange controls or similar restrictions, and (iii) payment is permitted by applicable United States law.

(b) The initial Paying Agents and their specified offices are shown herein. The Bank reserves the right, subject to the approval of the Trustee, at any time and from time to time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents, provided that it will at all times maintain Paying Agents with specified offices in London and, so long as the Notes or (as the case may be) Debentures are listed on the Luxembourg Stock Exchange, in Luxembourg. Notice of any such termination or appointment and of any changes in the specified offices of the Paying Agents will be given to the Noteholders or (as the case may be) Debentureholders in accordance with "Notices" below.

(c) Upon the due date for redemption of, or upon the purchase and cancellation pursuant to "Redemption and Purchase" below of, any Note or (as the case may be) Debenture, all unmatured Coupons (if any) appertaining thereto (whether or not attached thereto or surrendered therewith) shall become void and no payment shall be made in respect thereof.

(d) Upon the Conversion Date, all Notes and all unmatured Coupons (if any) appertaining thereto (whether or not attached thereto or surrendered therewith) shall become void and no payment shall be made thereon.

(e) If the due date for payment of any amount of principal or interest in respect of any Note or (as the case may be) Debenture is not at any place of payment a business day, then the holder of such Note or (as the case may be) Debenture or of the relevant Coupon shall not be entitled to payment at that place of payment of the amount due until the next following business day at that place of payment and shall not be entitled to any further interest or other payment in respect of any such delay. For this purpose, "business day" means any day on which banks are open for business in the relevant place of payment and (in the case of payment by transfer to a U.S. dollar account as mentioned above) on which dealings in foreign currency may be carried on both in New York City and in such place of payment.

Redemption and Purchase

(a) *Maturity*

(i) Unless previously redeemed or purchased and cancelled as provided below, or converted as provided in "Conversion by the Bank" below, the Bank shall redeem the Notes at their principal amount on the Interest Payment Date falling in August 2085.

(ii) Unless previously redeemed or purchased and cancelled as provided below, the Bank shall redeem the Debentures at their principal amount on the Interest Payment Date falling 99 years after the Conversion Date.

(b) *Redemption by the Bank*

(i) The Bank may, at its option, upon not less than 30 nor more than 60 days' notice (which notice shall be irrevocable), on or after the Interest Payment Date falling in August 1991, redeem all or some of the outstanding Notes on any Interest Payment Date at a redemption price equal to 100 per cent. of their principal amount.

(ii) If, as a result of any change in the laws of Canada or any province of Canada on the occasion of the next payment due in respect of the Notes or Coupons attached thereto, the Bank would be required to pay additional amounts as provided in "Taxation" below, the Bank may at its option, on any Interest Payment Date and on not less than 30 nor more than 60 days' notice (which notice shall be irrevocable and shall state the nature of such change), redeem all (but not some only) of the Notes at a redemption price equal to 100 per cent. of their principal amount.

(iii) The Bank, with the prior written approval of the Inspector General of Banks of Canada (the "Inspector General") and not otherwise, may at its option, upon not less than 30 nor more than 60 days' notice (which notice shall be irrevocable), on or after the Interest Payment Date falling 5 years after the Conversion Date, redeem all or some of the outstanding Debentures on any Interest Payment Date at a redemption price equal to 100 per cent. of their principal amount.

(iv) Notice of redemption will be published once not less than 30 days prior to the date fixed for redemption in accordance with "Notices" below. Notices of redemption will specify the date fixed for redemption, the redemption price and the place of payment and, in the case of partial redemption, the aggregate principal amount of Notes or (as the case may be) Debentures to be redeemed, the aggregate principal amount of the Notes or (as the case may be) Debentures which will be outstanding after such partial redemption and the serial numbers of the Notes or (as the case may be) Debentures selected for redemption. In the event that some only of the outstanding Notes or (as the case may be) Debentures are at any time to be redeemed, the Notes or (as the case may be) Debentures so to be redeemed shall be selected by the Trustee by lot or in such other manner as the Trustee may deem equitable. The Notes or (as the case may be) Debentures will cease to bear interest from and after the date fixed for redemption unless payment of principal or interest is improperly withheld or refused.

(c) *Purchase by the Bank*

(i) The Bank or any of its subsidiaries may at any time purchase Notes in the open market or by tender or by private contract at any price.

(ii) The Bank, with the prior written approval of the Inspector General and not otherwise, may at any time after the Interest Payment Date falling 5 years after the Conversion Date purchase Debentures in the open market or by tender or by private contract at any price.

(d) *Cancellation*

(i) All Notes which are redeemed or purchased by the Bank or any of its subsidiaries will forthwith be cancelled (together with all unmatured Coupons appertaining thereto) and accordingly may not be reissued or resold. Notwithstanding the foregoing, any subsidiary of the Bank may purchase Notes in the ordinary course of its business of banking or dealing in securities and may, at its option, hold, resell or surrender such Notes for cancellation.

(ii) All Debentures which are redeemed or purchased by the Bank will forthwith be cancelled (together with all unmatured Coupons appertaining thereto) and accordingly may not be reissued or resold. Notwithstanding the foregoing, any subsidiary of the Bank may, with the prior written consent of the Inspector General and not otherwise, purchase the Debentures in the ordinary course of its business of banking or dealing in securities. Debentures so purchased shall be cancelled as provided above unless the Bank has obtained the prior written consent of the Inspector General to such subsidiary holding or reselling such Debentures.

Conversion by the Bank

On any Interest Payment Date (the "Conversion Date") the Bank may, at its option, upon not less than 30 nor more than 60 days' notice in accordance with "Notices" below (which notice shall be irrevocable), convert all (but not some only) of the Notes then outstanding into an equal aggregate principal amount of Debentures. Notes (together with all unmatured Coupons appertaining thereto) should be presented for conversion on or after the Conversion Date at the specified office of the Principal Paying Agent or may be converted through Euro-clear and CEDEL S.A. The Bank will procure (at its expense) the issue of a Debenture, in the equivalent denomination to the Note surrendered, to the bearer of each Note upon surrender of such Note for conversion.

The Bank Act contains a restriction the effect of which at the present time is that the Bank may not issue any bank debentures as described in the Bank Act, including any Debentures under the 1986 Trust Indenture, if, as a result of such issue, the aggregate principal amount of all bank debentures outstanding that have a stated maturity after the end of the financial year of the Bank in which the issue is made would exceed one-half of the total of the paid-in capital, contributed surplus, retained earnings and general reserve of the Bank at the time of the issue.

Taxation

All payments of principal and interest will be made without withholding of, or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of the Government of Canada or any province of Canada or any political subdivision thereof or any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges by the Bank or the Trustee is required by law or by the application, administration or interpretation thereof. In that event, the Bank will pay (subject to the Bank's right of redemption under "Redemption by the Bank" above), such additional amounts as may be necessary in order that the net amounts received by the holders of the Notes or (as the case may be) Debentures and Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would have been received by them in respect of the Notes or (as the case may be) Debentures or Coupons in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Note or (as the case may be) Debenture or Coupon presented for payment:

(i) by or on behalf of a holder who is liable to such taxes, duties, assessments or governmental charges thereon by reason of his being connected with Canada otherwise than merely by the holding or ownership of such Note or (as the case may be) Debenture or Coupon;

(ii) by or on behalf of a holder in respect of whom such taxes, duties, assessments or governmental charges are required to be withheld or deducted by reason of the holder being a person with whom the Bank is not dealing at arms's length within the meaning of the Income Tax Act (Canada); or

(iii) more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to additional amounts on presenting the same for payment on the expiry of such period of 30 days.

As used herein the "Relevant Date" means whichever is the later of (a) the date on which such payment first becomes due and (b) if the full amount of the moneys payable has not been received by the Principal Paying Agent (as defined in the Paying Agency Agreement) or the Trustee on or prior to such due date, the date on which, the full amount of such moneys having been so received, notice to that effect shall have been duly published in accordance with "Notices" below.

Any reference herein to principal or interest shall be deemed also to refer to any additional amounts which may be payable hereunder.

Acceleration

Payment of the principal of the Notes or (as the case may be) Debentures may be accelerated only in the case of the insolvency or winding-up of the Bank. There is no right of acceleration in the case of a default in the performance of any covenant of the Bank contained in the 1986 Trust Indenture, including the payment of interest. If the Bank shall not have paid any interest payable on the Notes or (as the case may be) Debentures when due, the Trustee may and shall upon the request in writing of the holders of 25 per cent. in principal amount of the Notes or (as the case may be) Debentures then outstanding or pursuant to an extraordinary resolution (as defined below) institute judicial proceedings for the collection of the full amount of such interest.

Enforcement of Rights

No holder of a Note or (as the case may be) Debenture or Coupon shall be entitled to proceed directly against the Bank unless the Trustee, having become bound so to proceed, fails to do so.

Modification

The 1986 Trust Indenture will provide that, subject to the requirement of the consent of the Inspector General described below, modifications and alterations of the 1986 Trust Indenture and the Notes or (as the case may be) Debentures may be made if authorized by extraordinary resolution. The term "extraordinary resolution" will be defined in the 1986 Trust Indenture to mean, in effect, a resolution passed by the affirmative vote of the holders of not less than 66⅔ per cent. of the outstanding principal amount of the Notes or (as the case may be) Debentures represented and voted at a meeting of Noteholders or (as the case may be) Debentureholders or an instrument or instruments in writing signed by the holders of not less than 66⅔ per cent. of the principal amount of the Notes or (as the case may be) Debentures then outstanding.

The 1986 Trust Indenture will provide that no modification or alteration to the terms of the Debentures will be permitted without the prior written consent of the Inspector General, except for modifications or alterations required for the purpose of curing or correcting any ambiguity or defective or inconsistent provisions or clerical omission or mistake or manifest error contained in the 1986 Trust Indenture.

Indemnification of the Trustee

The 1986 Trust Indenture will contain provisions for the indemnification of the Trustee and for its relief from responsibility, including provisions relieving it from taking proceedings to enforce repayment, unless indemnified to its satisfaction.

Prescription

While it is not clear under the laws of the Province of Quebec what period of prescription would apply to any amount payable in respect of the principal of or interest on the Notes or (as the case may be) Debentures and from what date prescription would commence, the shortest prescriptive period which could apply to any such amount would be five years and the earliest date from which it would commence would be the day following the date when the Notes, Debentures or Coupons, as the case may be, become due.

Replacement

If any Note or (as the case may be) Debenture or Coupon is mutilated, lost, destroyed or stolen, it may be replaced at the specified office of the Paying Agent in Luxembourg for the time being on payment by the claimant of such costs as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Bank and the Trustee may reasonably require. A mutilated Note or (as the case may be) Debenture or Coupon must be surrendered before a new Note or (as the case may be) Debenture or Coupon will be issued

Notices

All notices to the holders of Notes or (as the case may be) Debentures will be published in Luxembourg in the *Luxemburger Wort*, and in London in the *Financial Times*. If at any time publication in any such newspaper or newspapers is not practicable, notices will be valid if published in such other newspaper or newspapers as the Bank with the approval of the Trustee shall determine. Any notice shall be deemed to be given on the date upon which it is first published.

Governing Law

The 1986 Trust Indenture, the Notes, the Debentures and the Coupons shall be governed by and construed in accordance with the laws of the Province of Quebec and the laws of Canada applicable therein.

USE OF PROCEEDS

The net proceeds of the issue of the Notes are estimated to amount to U.S. $199,400,000 and will be used for the general corporate purposes of the Bank.

CAPITALISATION

Maturity Date		Interest Rate	Characteristics	As at April 30, 1986 Authorized (thousands of dollars) (unaudited)	As at April 30, 1986 Outstanding (thousands of dollars) (unaudited)	As at August 7, 1986 Outstanding (as adjusted) (note 12)
Debentures (note 1):						
May	1986	10.40%	—	$ 16,400	$ 16,400	
December	1987	7.50%	Sinking fund debentures	25,000	631	
February	1988	16.50%	—	50,000	50,000	
March	1988	floating	Bearing interest at an annual rate of 1/4% above the mean of the offered and bid quotations for six month Eurodollar deposits in London	50,000 U.S.	68,835	
May	1988	9.75%	With holder's option to extend maturity to 1998 at the rate of 10%	10,000	10,000	
February	1990	10.25%	—	50,000	50,000	
March	1992	7.50%	Sinking fund debentures	20,000	751	
October	1995	floating	Redeemable at the Bank's option on or after October 5, 1986 and bearing interest at a rate of 1/2% below the Prime Lending Rate of the Bank (note 2)	15,000	15,000	
March	1996	floating	Redeemable at the Bank's option on or after March 15, 1989 and bearing interest at a rate 5/8% above the average yield on 91-day Government of Canada Treasury bills, and not less than 8 1/2% per annum	75,000	75,000	
January	1997	9.00%	Redeemable at the holder's option on January 3, 1987 and at the Bank's option on or after that date, subject to certain conditions	30,000	30,000	
March	1998	floating	Bearing interest at an annual rate of 1/8% above the offered quotation for six month Eurodollar deposits in London	150,000 U.S.	206,505	
June	2001	12.50%	Convertible into 1,190,000 common shares, redeemable on or after June 5, 1986 on certain conditions (note 3)	20,000	20,000	
October	2083	floating	Redeemable at the Bank's option on or after October 1, 1989 and bearing interest at a rate 1/2% above the yield on 30-day bankers' acceptances published by the Bank of Canada	100,000	100,000	
Total of Debentures					643,122	
Capital and Reserves:						
Appropriations for contingencies (note 4)						
Appropriations – tax paid					30,480	
Appropriations – tax deductible					90,817	
Total appropriations for contingencies					121,297	

Shareholders' equity:

Authorized	Description	Authorized	Outstanding	As adjusted
Preferred Share Capital				
20,000,000	First preferred shares, without par value, which may be issued for an aggregate consideration of not more than $400,000,000	400,000		
	Series 1 (issued: 21,500 shares) (note 5)		21,500	
	Series 2 (issued: 800,000 shares) (note 5)		2,000	
	Series 3 (issued. 300,000 shares) (note 6)		1,500	
	Series 4 (issued: 1,100,000 shares) (note 7)		27,500	
	Series 5 (issued: 750,000 shares) (note 8)		75,000	
	Series 6 (issued: 1,200,000 shares) (note 9)		41,301	
	Series 7 (issued: 1,480,000 shares) (note 10)		37,000	
	Series 8 (issued: 4,000,000 shares) (note 11)		100,000	
15,000,000	Second preferred shares without par value, which may be issued for an aggregate consideration of not more than $300,000,000	300,000	—	
			305,801	
Common Share Capital				
75,000,000	Common shares of a par value of $2 each (issued: 48,370,270 shares) (note 3)	150,000	96,741	
Contributed surplus			465,998	
Retained earnings			400,285	
Total of Capital and Reserves			1,390,122	
Total of Debentures and Capital and Reserves			$2,033,244	

Notes:

(1) Bank debentures are subordinate in right of payment to the prior payment in full of the deposit liabilities of the Bank and of all other liabilities of the Bank except those that by their terms rank equally with or subordinate to such debentures.

(2) The Board of Directors of the Bank has approved the redemption on October 6, 1986 of the $15,000,000 Floating Rate Debentures due October 1995.

(3) As at April 30, 1986, 1,190,000 common shares were reserved for issue pending the eventual exercise of the conversion privileges pertaining to the convertible bank debentures.

(4) These appropriations for contingencies are in addition to specific and general provisions deducted from the loan portfolio in respect of projected losses and are available to provide for possible unforeseen future losses which may be incurred in the realization of existing loans and other assets. These appropriations for contingencies may consist of two portions: tax-deductible and tax-paid. The maximum amount of tax-deductible transfers from retained earnings is prescribed under regulations issued by the Minister of Finance of Canada. The tax-paid portion comprises after-tax transfers from retained earnings and the net difference between loan losses and provisions for loan losses in respect of subsidiaries.

(5) Redeemable at the holder's option on November 1, 1991 and at the Bank's option after such date at a price equal to the aggregate consideration received upon issue together with accrued and unpaid dividends; cumulative dividends equal to 2% plus one half of the average of the Bank's Prime Lending Rate in effect on each day of the quarter ending on the first day of January, April, July and October of each year and immediately preceding the payment date.

(6) Redeemable at the holder's option on November 1, 1991 and at the Bank's option after such date at a price equal to the aggregate consideration received upon issue together with accrued and unpaid dividends; cumulative dividends of $0.70 per share per annum.

(7) Redeemable at the holder's option on February 16, 1987 and at the Bank's option after such date at $25 per share plus accrued and unpaid dividends; cumulative dividends at a rate equal to the greater of 15% or the rate obtained, if applicable, by adding 15% to one half of the difference between 23% and the average (if such average exceeds 23%) of the Bank's Prime Lending Rate in effect on each day of the quarter ending on the first day of January, April, July and October of each year and immediately preceding the payment date.

(8) Redeemable at the Bank's option after July 5, 1989 at $104 per share (decreasing thereafter to $100 per share on July 6, 1993) plus accrued and unpaid dividends; cumulative dividends at a quarterly rate equal to one quarter of 70% of the average of the Bank's Prime Lending Rate in effect on each day during the three months ending on the first day of January, April, July and October of each year and immediately preceding the payment date.

(9) Redeemable at the Bank's option from and after January 1, 1993 at U. S. $26.20 per share (decreasing thereafter to U. S. $25 per share on January 1, 1995); cumulative fixed dividends of U. S. $2.6875 per share per annum up to and including December 31, 1992, and thereafter at a quarterly rate equal to one quarter of 70% of the average of the U. S. Base Rate in effect on each day during the three months ending on the first day of the month preceding the month during which the dividend payment is made, provided that the floating quarterly dividend rate shall be not less than 2.6875% (10.75% per annum) in respect of each dividend payment.

(10) Redeemable at the Bank's option after August 31, 1989 at $26 per share (decreasing thereafter to $25 per share on September 1, 1994); cumulative floating dividends at a quarterly rate equal to one quarter of 73% of the average of the Bank's Prime Lending Rate in effect on each day during the three months ending on the first day of the month preceding the month during which the dividend payment is made, provided that the quarterly dividend rate shall be not less than 2.125% (8.50% per annum) in respect of each dividend payment to and including August 15, 1990.

(11) Redeemable at the Bank's option after May 15, 1991 at $25 per share plus accrued and unpaid dividends; cumulative dividends are payable quarterly at a rate per annum of 8% in the case of dividends payable on or before May 15, 1991 and at a rate per annum of 70% of the average of the Bank's Prime Lending Rate for specified three-month periods in the case of dividends payable after May 15, 1991.

(12) More recent figures are not yet available. The Notes are not capital but deposit liabilities of the Bank. The Debentures into which the Notes are convertible, meet the present definition of base capital established by the Inspector General. However, the proportion of the Debentures which may qualify as base capital will depend upon the Capital Adequacy Guidelines of the Inspector General which are subject to periodic review and revision

THE BANK

The Bank was formed through a series of amalgamations, including the amalgamation of Bank Canadian National and The Provincial Bank of Canada, in 1979, and the amalgamation with Mercantile effective November 1, 1985. Its roots date back to 1859 with the founding of Banque Nationale in Quebec City.

The Bank used the "purchase method of accounting" for the amalgamation of National and Mercantile. Therefore, historical financial data of the Bank for the six months ended April 30, 1985 and for the fiscal years 1981 to 1985 inclusive are National's while the results for the six months ended April 30, 1986 reflect the consolidated results of National and Mercantile. Certain pro forma financial data has been included in this Offering Circular and is derived by combining information concerning National and Mercantile and making certain pro forma eliminations, adjustments and reclassifications described under "Pro Forma Adjustments" in the section entitled "Summary Financial Data on a Pro Forma Basis".

As at October 31, 1985, Mercantile had total assets of $3,912 million, deposit liabilities of $3,582 million, eight branches in Canada and a total of 634 employees. On February 10, 1986, National integrated the operations of Mercantile. The Bank ranks sixth among Canadian banks in terms of total assets, and, as at April 30, 1986, had 574 banking outlets in Canada, 463 of which were located in Quebec, 63 in Ontario and Manitoba, 11 in the Western Provinces and 37 in the Atlantic Provinces.

As a Canadian bank, the Bank is governed by the Bank Act. The Bank's head office and principal place of business is located at the National Bank Tower, 600 de La Gauchetière West, Montreal, Quebec, Canada, H3B 4L2.

RECENT DEVELOPMENTS

The amalgamation of National and Mercantile was completed on February 10, 1986 with effect retroactive to November 1, 1985. Accordingly, the results of the Bank for the first six months of fiscal 1986 consolidate the operations of National and Mercantile since November 1, 1985, while the comparative results for fiscal 1985 are those of National.

Net income for the first six months of fiscal 1986 amounted to $89.4 million, an increase of $14.1 million or 19% over the first six months of fiscal 1985. Return on average assets was 0.70%, compared to 0.75% in the first six months of fiscal 1985.

Net interest income and other income, which amounted to $375.1 million and $116.4 million, respectively, during the first six months of fiscal 1986, increased by 22% and 37%, respectively, over the corresponding amounts during the first six months of fiscal 1985. Non-interest expenses amounted to $256.0 million during the first six months, representing a 14% increase over those in the first six months of fiscal 1985. These increases were due to the growth in the Bank's business volumes and to the amalgamation with Mercantile, and also reflect certain adjustments made to the accounts of Mercantile following the amalgamation. As a percentage of average assets, non-interest expenses were 2.00% in the first six months of fiscal 1986, compared to 2.25% in the first six months of fiscal 1985.

The provision for loan losses, calculated according to the 5-year moving average method prescribed by the Minister of Finance of Canada, was $99.4 million for the first six months of fiscal 1986, representing an increase of $37.0 million over the same period last year; this rise is due to the increase in eligible loans and projected losses for the current fiscal year, particularly in the energy sector. Non-performing loans amounted to $367 million as at April 30, 1986. During the first six months of fiscal 1986, the Bank increased its general provisions on international sovereign risk loans; as at April 30, 1986, these provisions represented approximately 15% of outstanding loans to countries on the Inspector General of Banks' surveillance list.

Total assets amounted to $25.9 billion as at April 30, 1986, compared to $20.9 billion as at the same date last year, and $23.3 billion as at October 31, 1985 (including $1.6 billion of advances by National to Mercantile as at October 31, 1985).

Capital and reserves of the Bank, not including bank debentures, amounted to $1,390 million as at April 30, 1986, compared to $1,150 million as at November 1, 1985 and, in the case of National, $995 million as at April 30, 1985.

BUSINESS OF THE BANK

The Bank maintains offices and provides services in each of the Canadian provinces. It offers an extensive range of financial services to individuals, commercial enterprises, financial institutions and governments both in Canada and abroad.

As at April 30, 1986, the Bank had total assets of $25.9 billion, including loans of $20 billion. As at the same date, deposit liabilities amounted to $21.8 billion, debentures to $643 million, shareholders' equity to $1,269 million and appropriations for contingencies to $121 million. The Bank ranks sixth among Canadian banks in terms of total assets.

As at April 30, 1986, the Bank had 574 banking outlets in Canada, 463 of which were located in Quebec, 63 in Ontario and Manitoba, 11 in the Western Provinces and 37 in the Atlantic Provinces. In addition, it had a network of 105 automated banking machines which operate around the clock at the Bank's branches, as well as 11 off-site units. Since October 1, 1985, the Bank has shared with another Canadian bank a network which gives its customers access to some 320 automated banking machines situated across Canada.

Outside Canada, the Bank has offices in London (a branch and a subsidiary), Paris (a representative office), New York (a branch), Chicago (a branch), Dallas (a representative office and a subsidiary), Atlanta (a representative office), Seattle (a subsidiary), Nassau (a subsidiary), Hong Kong (a branch and three subsidiaries), Seoul (a representative office), Tokyo (a representative office), Los Angeles and Newport Beach (a subsidiary), Amsterdam (a subsidiary) and Curaçao (a subsidiary).

Furthermore, the Bank conducts business principally through the following direct or indirect wholly-owned subsidiaries:

	Jurisdiction of Incorporation	Principal Activity
National Bank Leasing Inc.	Canada Business Corporations Act (Canada)	leasing
National Bank Mortgage Corporation	Loan Companies Act (Canada)	mortgage loans
National Bank Export Finance Co. Inc.	Canada Business Corporations Act (Canada)	export financing
National Bank Realty Inc.	Canada Business Corporations Act (Canada)	bank service corporation
Laurentide Financial Inc.	General Corporation Law of the State of Delaware (U.S.A.)	loan company
Natcan Finance (Asia) Ltd.	Companies Ordinance, Chapter 32 (Hong Kong)	banking
National Bank of Canada (International) Limited	Commonwealth of the Bahamas Bank and Trust Companies Regulation Act	banking
Natcan (U.K.) Limited	Companies Act 1985 (United Kingdom)	banking
Mercantile Canada Corporation	General Corporation Law of the State of Delaware (U.S.A.)	corporate lending
The Mercantile Bank of Canada International N.V.	Laws of the Netherlands Antilles	banking

In addition, the Bank owns 50% and 34%, respectively, of the voting shares of St-Cyrille Realties Ltd. and RoyNat Inc.

The Bank's activities are consolidated into five major divisions: Branch Operations, Commercial Lending, Corporate Banking, International and Treasury.

Branch Operations Division

The Branch Operations Division administers the Bank's branch network. Branch activity focuses on services to individuals and serves as support to the commercial lending centres and the Corporate Banking and International Commercial Operations divisions.

Through this network, the Bank and its subsidiaries, in addition to personal loans and mortgage credit facilities, offer a full range of deposit and investment vehicles including savings accounts, no-charge chequing savings accounts, daily interest accounts, Progress accounts (where the interest varies depending on the balance), fixed-rate term deposits and investment certificates. As well, the Bank offers the Progress RRSP and a group RRSP program for small and medium-sized businesses.

The Bank has continued to expand its office automation and data-processing systems; during the first six months of fiscal 1986, 25 central tellers were installed in the branches, bringing the total to 150 at April 30, 1986. Also, administrative terminals have been installed in 191 branches to handle transactions formerly processed at head office or posted manually.

In addition, the Inter-Access system, an inter-branch system which accesses a central data bank, covers over 99% of the domestic branch network and expedites account management, allowing customers to access their accounts at any computerized branch in the network. The Bank has 105 "Day and Night" automated banking machines (ABM) in operation at its branches, as well as 11 off-site units. An agreement was reached with another Canadian bank to share ABM facilities allowing customers to access their accounts directly through this Canada-wide network of some 320 ABMs.

Through its association with MasterCard International, the Bank offers the MasterCard credit card service to its customers throughout Canada and travelers' cheques in U.S. funds under the MasterCard banner; it also offers American Express travelers' cheques. During 1985, the Bank installed 770 point-of-sale terminals on the premises of MasterCard merchant members. Customers of the Bank, through the Interac Network, are expected to have access to approximately 3,500 automated banking machines across Canada before the end of 1986.

The Bank's mortgage credit activities consist mainly of granting residential mortgage loans through its branch network at competitive rates. The Bank and its mortgage loan subsidiary generally finance their mortgage loans with funds obtained for equivalent maturities. As at April 30, 1986, the mortgage loan portfolios of the Bank and its subsidiary amounted to about $3.6 billion.

Commercial Lending Division

The Commercial Lending Division is responsible for managing commercial lending centres, which administer credit to small and medium-sized businesses and offer them a number of other complementary services. All centres are staffed by account managers, each of whom services a small number of business clients. Indeed, more than 80% of all credit decisions are now generally made at the lending centre level.

At April 30, 1986, there were 39 commercial lending centres in operation: four in the Atlantic Provinces, 25 in Quebec and ten in Ontario and Manitoba. In the Western Provinces, branch managers continue to serve business clients.

In 1985, teams were set up in certain commercial divisions to handle specialized financing packages. These teams have the expertise to handle more sophisticated projects such as takeovers, mergers or financings, and they ensure that credit decisions are made more quickly.

The Bank has made available to medium-sized businesses a range of services including bankers' acceptances, operating loans and fixed or floating rate term loans, as well as computerized payroll, reconciliation of consignment cheques and pre-authorized payments. These services are complemented by other specialized services provided by Treasury, International Commercial Operations and Leasing.

The Bank also offers a leasing service to businesses through National Bank Leasing Inc.

Corporate Banking Division

The Corporate Banking Division was established to respond to the needs of large corporations and consists of specialized teams in Montreal, Toronto, Calgary, Vancouver, New York, Chicago, Dallas and Atlanta. Syndication teams are located in Toronto and Montreal to increase the Bank's participation in large corporate projects, either as lead manager or co-lead manager. Following the amalgamation with Mercantile, the Bank established a Real Estate division in Toronto with offices in Montreal, Ottawa, Winnipeg, Calgary, Vancouver, Dallas and Newport Beach and an Energy division in Calgary with an office in Dallas.

Together with the Bank's other divisions, Corporate Banking offers a complete range of services, including foreign exchange transactions, domestic and international money market transactions and import-export operations. In addition, the Bank offers a range of credit facilities including interest rate swaps, cap-rate loans, short- or long-term financing with a choice of options, and limited-recourse project financing. The Corporate Banking Division also specializes in financing mergers and acquisitions.

International Division

The activities of the Bank's International Division focus on credit, treasury and international commercial operations.

The Bank is consolidating its sovereign loan portfolio and is involved in asset swaps with other financial institutions to improve its international loan portfolio mix. As a matter of policy, the Bank is increasing its loss provisions for sovereign risk loans. As at April 30, 1986, the Bank's prudential provisions were $377 million and represented approximately 15% of outstanding loans to countries on the Inspector General of Banks' surveillance list.

The International Division is seeking to increase its share of the international loan market with loans to private corporations, notably in the United States, Europe and the Far East.

Abroad, the Bank operates branches in London, New York, Hong Kong and Chicago; and has representative offices in Paris, Seoul, Tokyo, Dallas and Atlanta. It has four banking subsidiaries: National Bank of Canada (International) Ltd. in the Bahamas, Natcan Finance (Asia) Ltd. and its subsidiary, National Bank of Canada (Pacific) Ltd. in Hong Kong, and Natcan (U.K.) Limited in London; a loan company, Laurentide Financial Inc. in Seattle, U.S.A.; two export financing subsidiaries, National Bank Export Finance Co. Inc. (Banatex) in Montreal, and Natcan International Trade Financing Company Ltd. in Hong Kong; a holding company, Mercantile Canada Finance B.V. in Amsterdam and its subsidiaries Mercantile Canada Corporation in Dallas, Los Angeles and Newport Beach and The Mercantile Bank of Canada International N.V. in Curaçao.

The International Commercial Operations Division offers more than 25 different services at all of the Bank's branches.

Through its subsidiary, National Bank Export Finance Co. Inc. (Banatex), the Bank provides support to Canadian exporters by financing and purchasing their foreign receivables. It also obtains credit analyses on foreign buyers and handles credit insurance.

The Bank also operates a Canada-wide network of international centres staffed by experts in international trade. These centres are located in Halifax, Quebec City, Montreal, Toronto, Winnipeg and Vancouver and are complemented by a worldwide network of over 2,000 banking correspondents.

Through its subsidiary Natcan International Trade Financing Company Ltd., the Bank offers to businesses already operating in international markets assistance in diversifying and increasing their trade by researching various target markets and by facilitating client contacts. The Bank also advises companies in the negotiation of commercial contracts and promotes client services and products.

Treasury Division

The Treasury Division manages the Bank's liquidity, maintains the reserves required under the Bank Act, handles day-to-day business with the Bank of Canada and actively participates in a wide range of activities on behalf of other divisions of the Bank. It maintains close ties with the various financial markets on which are traded traditional securities such as treasury bills or municipal bonds, as well as new instruments, such as currency options, financial futures, floating-rate notes and swaps.

Treasury provides expertise and operational support to the Bank's other divisions. It is also a market-maker on the currency options market of The Montreal Exchange and is a primary distributor of government bonds at the federal, provincial and municipal levels. Treasury manages investments for the Bank's pension funds and the portfolio of stocks and bonds resulting from the Bank's participation in various financing operations.

Most of the Treasury Division's activities take place in Montreal and Toronto. It also has offices in Hong Kong, Nassau, London and New York.

Distribution of Average Assets and Operating Results

The following table sets forth National's average assets and operating results for its Canadian and international operations:

	Year ended October 31				
	1985	1984	1983	1982	1981
	(millions of dollars, except where noted)				
CANADIAN					
Average assets	$14,210	$12,603	$11,977	$12,272	$12,274
Income (loss) before taxes	168	122	69	(49)	(56)
Net income (loss)	112	82	85(2)	(44)	(21)(1)
Return on assets					
before taxes	1.18%	0.97%	0.58%	(0.40%)	(0.46%)
net	0.79%	0.65%	0.71%	(0.36%)	(0.17%)
INTERNATIONAL					
Average assets	$ 6,744	$ 5,847	$ 5,522	$ 6,915	$ 5,134
Income before taxes	50	36	50	40	33
Net income	42	32	41	35	33
Return on assets					
before taxes	0.74%	0.63%	0.91%	0.58%	0.64%
net	0.62%	0.56%	0.74%	0.51%	0.64%
TOTAL					
Average assets	$20,954	$18,450	$17,499	$19,187	$17,408
Income (loss) before taxes	218	158	119	(9)	(23)
Net income (loss)	154	114	126(2)	(9)	12(1)
Return on assets					
before taxes	1.04%	0.85%	0.68%	(0.05%)	(0.13%)
net	0.73%	0.62%	0.72%	(0.05%)	0.07%

Notes:

(1) Includes an extraordinary item, i.e., a profit of $5 million (net of income taxes of $1 million) and minority interest in subsidiaries of $3 million.

(2) Includes an extraordinary item of $37 million, resulting from the recognition in 1983 of 1982 unrecorded tax benefits.

Reference is made to "Summary Financial Data on a Pro Forma Basis" for the Bank's pro forma consolidated net income and return on average assets for the years ended October 31, 1981 to 1985.

Geographic Distribution of Net Total Assets by Ultimate Risk

The following table breaks down National's assets as at September 30, 1983, 1984 and 1985, as well as the Bank's assets on a pro forma basis as at September 30, 1985, according to the location of ultimate risk, namely the geographic location of the borrower or, if the loan is guaranteed, of the guarantor. Moreover, assets are shown net of general and specific provisions and separately for each country where exposure, as at September 30, 1985, exceeded 3/4% of National's aggregate securities, deposits with other banks, customers' liability under acceptances and loans, excluding mortgages.

	Assets as at September 30			
	Pro forma	National's historic		
	1985	1985	1984	1983
		(millions of dollars)		
Canada	$18,845	$16,082	$14,236	$13,166
United States	2,692	1,541	1,152	688
Europe				
United Kingdom	821	819	636	375
France	315	315	84	116
Spain	45	30	118	122
Other	628	553	620	858
Latin America and the Caribbean				
Brazil	653	571	591	545
Mexico	636	581	576	543
Venezuela	191	178	171	145
Argentina	178	142	159	159
Other	334	329	373	388
Far East and Asia				
Republic of Korea	142	123	161	163
Other	389	374	200	299
Middle East and Africa	114	106	149	188
Total	$25,983	$21,744	$19,226	$17,755

The Bank's operations in foreign exchange markets, conducted mainly in Montreal, New York, London and Hong Kong, enable the Bank to provide customers and correspondents with a wide range of foreign currency services for both spot and forward transactions. To minimize the inherent risks of foreign exchange operations, limits on spot and forward transactions are set to control positions for each currency in which the Bank's traders are authorized to deal. Specific guidelines, including credit limits, have been established for customers and banks doing business with the Bank. All foreign exchange positions and all credit risks are monitored regularly at the branch, division and head office levels.

Foreign exchange restrictions apply in certain countries in which the Bank conducts its operations. However, these restrictions do not have any material effect on the Bank's international activities.

As at April 30, 1986, the total assets of the International Division amounted to $8.3 billion and deposit liabilities to $8.4 billion; financing of these assets was mainly obtained from the Euro-currency market.

Distribution of Assets and Liabilities

The table below shows the percentage breakdown of National's assets and liabilities as at the following dates:

	October 31				
	1985	1984	1983	1982	1981
Assets					
Cash Resources					
Cash and deposits with Bank of Canada	1.3%	1.6%	1.9%	2.2%	2.3%
Deposits with other banks	15.9[1]	5.6	5.1	6.9	12.2
Cheques and other items in transit, net	—	0.1	0.3	—	—
Securities					
Issued or guaranteed by Canada	3.1	3.9	5.9	4.2	4.2
Issued or guaranteed by provinces and by municipal or school corporations	0.5	0.3	0.6	0.4	0.5
Other	4.9	3.8	4.9	3.5	2.8
Loans					
Day, call and short loans to investment dealers and brokers, secured	0.4	0.4	0.3	0.3	1.4
To banks	2.7	4.6	5.3	2.2	1.5
Mortgages	14.6	16.0	15.6	13.6	13.4
Other	49.8	57.0	53.1	62.1	58.1
Other Assets					
Customers' liability under acceptances	4.7	3.6	3.7	1.4	0.8
Fixed assets	1.1	1.2	1.3	1.0	0.6
Other	1.0	1.9	2.0	2.2	2.2
	100.0%	100.0%	100.0%	100.0%	100.0%
Liabilities					
Deposits					
Payable on demand	5.4%	5.5%	7.5%	8.4%	9.1%
Payable after notice	19.1	19.8	20.6	16.8	16.7
Payable on a fixed date	60.8	60.6	59.6	64.8	64.4
Other Liabilities					
Cheques and other items in transit, net	0.6	—	—	0.2	—
Acceptances	4.7	3.6	3.7	1.4	0.8
Liabilities of subsidiaries	1.1	1.1	1.5	1.5	2.0
Other liabilities	2.2	2.7	2.2	2.9	3.3
Bank Debentures	1.7	1.8	1.1	1.2	1.0
Capital and Reserves					
Appropriations for contingencies	0.4	0.5	0.3	0.2	0.2
Shareholders' equity	4.0	4.4	3.5	2.6	2.5
	100.0%	100.0%	100.0%	100.0%	100.0%

(1) Includes $1.6 billion of deposits of National with Mercantile, representing approximately 7% of total assets of National. See note 17 to the Consolidated Financial Statements of National.

The table below shows the composition of National's assets and their relative contribution to its gross income for the years ended on these dates:

	October 31					
	1985		1984		1983	
	As a percentage		As a percentage		As a percentage	
	of assets	of gross income	of assets	of gross income	of assets	of gross income
Loans including mortgages	67.5%	77.6%	78.0%	81.1%	74.3%	83.6%
Investments in securities issued by the Government of Canada, the provinces, municipalities or school corporations	3.5	3.7	4.2	2.9	6.5	3.4
Investments in other securities	4.9	5.1	3.8	2.6	4.9	3.5
Deposits with other banks	15.9	6.2	5.6	6.2	5.1	2.8
Other assets	8.2	7.4	8.4	7.2	9.2	6.7
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

The Bank's pro forma consolidated statement of assets and liabilities as at October 31, 1985 is shown under "Summary Financial Data on a Pro Forma Basis".

Matching of Assets and Liabilities

To reduce the impact of cyclical fluctuations in interest rates and to realize a reasonably constant return on its assets, the Bank strives to match the maturity dates of its assets and liabilities to the extent permitted by the varying demands of its customers. In pursuing this policy, the Bank measures and assesses its position on an ongoing basis. The following table contains, as at October 31, a summary of the balance of the Canadian assets and liabilities of National and its subsidiaries which are sensitive to fluctuations in interest rates within and beyond one year. The analysis of these figures reveals that the gap between assets and liabilities, where interest rates are sensitive to change within one year or less, has remained narrow. With respect to the other categories, the Bank has time to react in the event of major interest rate fluctuations.

	As at October 31		
	1985	1984	1983
	(billions of dollars, except where noted)		
Assets			
Sensitive to interest rate fluctuations within one year(1)	$11.2	$ 9.0	$ 8.8
Sensitive to interest rate fluctuations beyond one year(2)	3.6	3.0	2.5
Non-income producing	0.9	1.2	1.1
	$15.7	$13.2	$12.4
Liabilities			
Sensitive to interest rate fluctuations within one year(1)	$10.9	$ 8.9	$ 9.0
Sensitive to interest rate fluctuations beyond one year(2)	2.3	2.3	1 8
Non-interest incurring	2.5	2.0	1.6
	$15.7	$13.2	$12.4
Assets less liabilities which are sensitive to interest rate fluctuations within one year(3)	$ 0.3	$ 0.1	$ (0.2)
As a percentage of total Canadian assets(3)	1.9%	0.8%	1.6%

Notes:

(1) The assets and liabilities which are sensitive to interest rate fluctuations within one year are defined as those which mature within one year or bear interest generally at floating rates in relation to a base rate such as the Bank's prime lending rate

(2) Including certain components of assets and liabilities which are not sensitive to interest rate fluctuations.

(3) As at April 30, 1986 these items were $(0 2) and 1.2% respectively.

Securities

In addition to holding securities in order to comply with the liquidity requirements of the Bank Act, the Bank holds securities in order to meet its normal liquidity requirements, to temporarily employ surplus funds, to provide an inventory for trading purposes and, from time to time, as long-term investments.

The following table shows the composition of the securities portfolio of National:

	As at October 31					
	1985		1984		1983	
	(millions of dollars, except where noted)					
Investment Securities Issued or Guaranteed by						
Canada	$ 712	35.9%	$ 754	48.7%	$1,057	52.0%
Provinces	100	5.0	39	2.5	81	4.0
Municipalities and school corporations	16	0.8	26	1.7	21	1.0
	828	41.7	819	52.9	1,159	57.0
Debt Securities						
Income debentures	1	0.1	124	8.0	124	6.0
Small Business Development Bonds	25	1.3	36	2.3	42	2.1
Other	683	34.4	225	14.6	425	20.9
	709	35.8	385	24.9	591	29.0
Equity Securities						
Floating rate preferred shares	184	9.3	204	13.2	199	9.8
Fixed rate preferred shares	186	9.4	87	5.6	36	1.8
Other	76	3.8	52	3.4	50	2.4
	446	22.5	343	22.2	285	14.0
Total	$1,983	100.0%	$1,547	100.0%	$2,035	100.0%

Note.

See note 1 to the Consolidated Financial Statements of National for the accounting policies relative to securities.

As at October 31, 1985, the market value (including the estimated market value of certain unlisted securities) of National's securities portfolio was $1,991 million (1984: $1,544 million; 1983: $2,028 million).

The Bank's pro forma securities portfolio as at October 31, 1985 is shown under "Summary Financial Data on a Pro Forma Basis".

Loan Portfolio

The table below shows the breakdown of National's loan portfolio, as well as the Bank's pro forma loan portfolio, by borrower category:

	As at September 30							
	Pro forma		National's historic					
	1985		1985		1984		1983	
			(millions of dollars, except where noted)					
Canadian Residents(1)								
Mortgages	$ 3,447	17.7%	$ 3,372	21.2%	$ 3,044	20.5%	$ 2,740	20.7%
Personal	2,273	11.7	2,240	14.1	2,010	13.5	1,808	13.6
Agricultural	418	2.1	398	2.5	400	2.7	376	2.8
Financial institutions	587	3.0	444	2.8	328	2.2	292	2.2
Commercial	1,742	8.9	1,101	6.9	1,040	7.0	843	6.4
Manufacturing and industrial	2,541	13.0	1,843	11.5	1,489	10.0	1,219	9.2
Construction and real estate	1,452	7.5	765	4.8	790	5.3	600	4.5
Governments and other public bodies	445	2.3	445	2.8	593	4.0	452	3.4
Other	1,707	8.8	1,701	10.7	1,580	10.6	1,627	12.3
	14,612	75.0	12,309	77.3	11,274	75.8	9,957	75.1
Non-Residents(2)(3)	4,860	25.0	3,611	22.7	3,602	24.2	3,302	24.9
Total	$19,472	100.0%	$15,920	100.0%	$14,876	100.0%	$13,259	100.0%

Notes

(1) As at September 30, 1985, National had outstanding $5.8 billion of fixed-rate loans to Canadian residents, for the most part consisting of consumer loans and residential mortgages

(2) National's portfolio of loans to non-residents consisted of credits granted to governments, government agencies, banks or industrial and business corporations according to the usual terms of such market; almost all such loans are granted at variable interest rates.

(3) The majority of Mercantile's non-resident loans were real estate and construction loans and loans to governments.

Credit applications for both Canadian and international operations are approved or rejected at the branch, commercial lending centre, division or head office level depending on the size and nature of a particular application. The more important credit applications are referred for approval to the Credit Committee, the Credit Committee of the Board, the Executive Committee or the Board of Directors, as the case may be. In addition, all loans are reviewed on an annual basis by credit officers of the Bank, and new accounts and bad accounts receive special review and are closely monitored. Lending limits for certain countries or regions are established and are continually reassessed in light of the prevailing economic and political conditions. The Bank's aim is to maintain a quality loan portfolio, while at the same time meeting certain commercial development objectives.

Fixed Assets

As at October 31, 1985, National, either directly or through its subsidiary National Bank Realty Inc., owned its head office, the National Bank Tower, its data processing center in Montreal and 127 other properties used in its operations. National Bank Realty Inc. also administered the leased premises in which 436 branches are located.

National's consolidated fixed assets at cost, less accumulated depreciation and excluding furniture, fixtures and leasehold improvements, amounted to $162.5 million as at October 31, 1985. The market value of National's fixed assets is not available.

Deposit Liabilities

The following table shows the breakdown of National's deposit liabilities by currency and type of deposit:

	As at October 31					
	1985		1984		1983	
	(millions of dollars, except where noted)					
Canadian currency						
Payable on demand	$ 1,162	5.8%	$ 975	5.9%	$ 1,178	7.6%
Payable after notice	4,435	22.3	3,793	22.9	3,635	23.3
Payable on a fixed date	6,798	34.1	5,952	36.0	5,697	36.6
Foreign currency						
Payable on demand	90	0.5	92	0.6	158	1.0
Payable after notice	25	0.1	22	0.1	20	0.1
Payable on a fixed date	7,399	37.2	5,716	34.5	4,900	31.4
Total deposits	$19,909	100.0%	$16,550	100.0%	$15,588	100.0%

The Bank's pro forma deposit liabilities as at October 31, 1985 are shown under "Summary Financial Data on a Pro Forma Basis".

Appropriations for Contingencies and Loan Losses

The following table shows National's actual loan loss experience and the amount of its loan loss provision, as well as the Bank's corresponding pro forma data:

	Year ended October 31			
	Pro forma	National's historic		
	1985	1985	1984	1983
	(millions of dollars, except where noted)			
Provisions for loan losses	$ 163.7	$ 129.5	$ 115.1	$ 98.3
Charge to appropriations for contingencies	89.1	59.5	1.1	22.2
Loan loss experience for the year	$ 252.8	$ 189.0	$ 116.2	$ 120.5
Breakdown of loan loss experience for the year:				
International				
Sovereign risks	$ 149.4	$ 128.5	$ 65.1	$ 35.7
Private risks	48.3	21.9	2.9	7.8
	197.7	150.4	68.0	43.5
Canada	55.1	38.6	48.2	77.0
Total	$ 252.8	$ 189.0	$ 116.2	$ 120.5
Eligible assets (Note):				
International	$ 6,235	$ 4,923	$ 4,713	$ 3,992
Canada	11,882	9,318	8,064	7,817
Total	$ 18,117	$ 14,241	$ 12,777	$ 11,809
Loan loss experience as a percentage of eligible assets:				
International	3.17%	3.05%	1.44%	1.09%
Canada	0.46%	0.41%	0.60%	0.99%
Total loan loss experience as a percentage of eligible assets	1.39%	1.33%	0.91%	1.02%

Note: Eligible assets include letters of credit, acceptances and guarantees as well as loans, with the exception of those to, or guaranteed by, the government of Canada or a province thereof.

Reference is made to note 1 to the Consolidated Financial Statements of National for accounting policies relative to Loans and Appropriations for Contingencies.

National's loan loss experience, which is closely linked to non-performing loans, totalled $189.0 million in the fiscal year ended October 31, 1985 compared to $116.2 million the previous fiscal year. In the Canadian sector, loan losses, which stood at $48.2 million in fiscal year 1984, declined by 20% during the fiscal year 1985 to $38.6 million. In the International sector, these losses amounted to $150.4 million in fiscal year 1985, compared to $68.0 million in the previous year, because of additional general provisions on sovereign risk loans. These general provisions are progressively established by the Bank with respect to total credit outstanding in a given country, when, in the opinion of management, that country may experience difficulties in meeting its international financial obligations on time. They are established quarterly at rates based on the Bank's evaluation of risk and are taken as a precautionary measure. The Bank does not actually project, nor has it yet experienced, any substantial losses in this loan category. National's accumulated general provisions on sovereign risk loans stood at $251.9 million as at October 31, 1985 compared to $116.6 million at the same date the previous year.

National's non-performing loans, net of specific and general provisions, were $183.1 million as at October 31, 1985, compared to $222.4 million a year earlier.

Mercantile's loan loss experience for fiscal 1985 was increased by approximately $31 million in the last quarter. The total loss experience for fiscal 1985 was $63.9 million, compared to $31.4 million in 1984 and $23.8 million in 1983. In order to facilitate the amalgamation with National, Mercantile adjusted its reserve for sovereign risk loans to be in accord with the practice of National. This adjustment resulted in an increase in Mercantile's loan loss experience of $15 million in the last quarter of fiscal 1985, which amount is included in the $31 million mentioned above.

SELECTED FINANCIAL INFORMATION

The following table is a summary of certain financial information of National for the fiscal years 1981 to 1985 and for the six months ended April 30, 1985, and of the Bank for the six months ended April 30, 1986 and, on a pro forma basis, for the fiscal year 1985. The information is only a summary of the more detailed information presented elsewhere in this Offering Circular or available at the specified office of the Paying Agent in Luxembourg.

	Six months ended April 30		Year ended October 31					
			National's historic					Pro forma
	1986	1985	1985	1984	1983	1982	1981	1985(1)
	(unaudited)		(millions of dollars, except where noted)					(unaudited)
Total assets	$25,909	$20,940	$23,340	$19,250	$17,774	$18,775	$19,767	$25,559
Loan portfolio	19,956	15,895	15,750	14,996	13,206	14,675	14,697	19,186
Securities	1,991	1,759	1,983	1,547	2,035	1,525	1,491	2,111
Deposit liabilities	21,821	18,052	19,909	16,550	15,588	16,905	17,838	21,847
Long-term debt								
Bank debentures	643	391	391	339	198	218	192	436
Liabilities of subsidiaries	277	247	264	220	209	226	261	264
Appropriations for contingencies	121	93	88	88	43	30	30	88
Preferred shares	306	177	129	177	102	102	75	207
Common shareholders' equity	963	725	815	673	512	389	423	855
Capital funds(2)	2,033	1,386	1,423	1,277	855	739	720	1,586
Net interest income	375	309	637	554	510	408	378	712
Net income (loss) before extraordinary item	89	75	154	114	89	(9)	7	164
Net income (loss) for the period	89	75	154	114	126(3)	(9)	12(4)	170
Return on average assets	0.70%	0.75%	0.73%	0.62%	0.72%	(0.05%)	0.07%	0.67%
Return on average capital funds(2)	11.91%	13.23%	13.02%	12.58%	17.68%	(0.80%)	3.48%	12.72%
Return on average common shareholders' equity plus appropriations for contingencies(5)	15.2%	17.0%	16.7%	14.7%	16.3%	(4.6%)	1.0%	16.68%
Number of branches in Canada	574	572	571	577	580	610	753	—
Number of employees in Canada	10,798	10,783	10,693	11,173	11,626	12,553	14,633	—
Number of employees outside Canada	219	170	184	159	198	194	145	—

Notes:

(1) The pro forma financial information is derived by combining information concerning National and Mercantile and making certain pro forma eliminations, adjustments and reclassifications described under "Pro Forma Adjustments" in the section entitled "Summary Financial Data on a Pro Forma Basis".

(2) Capital funds include shareholders' equity, appropriations for contingencies and bank debentures.

(3) The 1983 extraordinary item of $37 million resulted from the recognition of 1982 unrecorded tax benefits.

(4) Includes an extraordinary item, i.e., a profit of $5 million (net of income taxes of $1 million) and minority interest in subsidiaries of $3 million

(5) Before extraordinary item and revised for the years 1981 to 1985 to eliminate income taxes deducted from tax-deductible appropriations for contingencies.

The Bank has not reduced its regular quarterly dividend and has not omitted its regular quarterly dividend since 1974, except as described below. Quarterly dividends of $0.30 per share were paid on Common Shares for the year ended October 31, 1981. However, when it became apparent that profit levels were still significantly lower than an average of $0.30 per share per quarter for a second consecutive year, the Bank considered it appropriate to reduce the quarterly dividend on Common Shares to a rate of $0.15 per share for the quarters ended January 31 and April 30, 1982. It subsequently decided not to declare dividends on Common Shares, given the results of the first six months of fiscal 1982. Nevertheless, in light of the positive results of the subsequent quarters, the Bank decided to reinstate dividend payments of $0.15 per share on Common Shares for the quarter ended July 31, 1983. Since that time, the Bank has paid a dividend each quarter on its Common Shares, such dividend being increased from time to time in accordance with the financial results obtained. The Bank declared a dividend of $0.18 per share for the quarters ended January 31, April 30 and July 31, 1984; a dividend of $0.20 per share for the quarters ended October 31, 1984 and January 31, 1985 and a dividend of $0.23 per share for the quarters ended April 30, July 31 and October 31, 1985 and the Bank declared a dividend of $0.25 per share for the quarters ended January 31 and April 30, 1986.

Under the Bank Act, the Bank is prohibited from paying or declaring a dividend while or if its paid-in capital is impaired or in an amount exceeding 8% per annum of its paid-in capital unless, after the payment, its retained earnings and general reserve are equal in total to at least 20% of its paid-in capital and contributed surplus. Currently, these limitations do not restrict the Bank from paying dividends

DIRECTORS AND SENIOR OFFICERS

Board of Directors

Robin J. Abercrombie	President Roberts Creek Resources Ltd. (Oil and gas exploration)
Sam Abramovitch	Chairman United Westburne Industries Limited (Wholesale construction supplies)
Michel Baribeau	President Baribeau & Fils Inc. (Holding company)
Laurent Beaudoin	Chairman and Chief Executive Officer Bombardier Inc. (Manufacturers of recreational, industrial and mass transit vehicles)
Marcel Bélanger	President Gagnon et Bélanger Inc. (Management consultants)
Michel Bélanger	Chairman of the Board and Chief Executive Officer National Bank of Canada
Hervé Belzile	Chairman of the Board Alliance Mutual Life Insurance Company (Insurance company)
André Bérard	President and Chief Operating Officer National Bank of Canada
William E. Bergen	Consultant
Marc Bourgie	Chairman of the Board and Chief Executive Officer Urgel Bourgie Ltée (Funeral homes)
Jean Charton	President Herdt & Charton Inc. (Importers and distributors of perfumes, cosmetics, wines, spirits and food products)
J. V. Raymond Cyr	Chairman of the Board and Chief Executive Officer Bell Canada (Telecommunications)
Claude Ducharme	Partner Desjardins, Ducharme, Desjardins & Bourque (Advocates)
Marcel Dutil	Chairman of the Board, President and Chief Executive Officer Canam Manac Group Inc. (Holding company – joists and steel decks, trailers and office furnishings)
Gilbert Finn	Chairman Assumption Mutual Life Insurance Company (Insurance company)
Roland Giguère	Chairman of the Board and Chief Executive Officer Télé-Métropole Inc. (Television broadcasting)
Bernard Lamarre	President and General Manager Lavalin Inc (Engineers, builders)
Mary Schaefer Lamontagne	Corporate Director
André Latreille	President Bélair Insurance Company (General insurance company) and Alta Construction (1964) Limited (General contractors)

J. Conrad Lavigne	President J C L Corporation (Radio and television broadcasting consultants)
Bernard Lemaire	President Cascades Inc. (Manufacturers of paper and plastic products)
Pierre Lortie	President and Chief Executive Officer Provigo Inc. (Wholesale and retail distributors of consumer goods)
George S. Mann	Chairman of the Board Unicorp Canada Corporation (Investment company)
Gilles Mercure	Special Consultant National Bank of Canada
J.-Robert Ouimet	President and Chief Executive Officer Entreprises J.-R. Ouimet Inc. (Holding company)
Robert Parizeau	President and Chief Executive Officer Sodarcan Inc. (Insurance and re-insurance holding)
Michel Perron	Chairman and Chief Executive Officer Normick Perron Inc. (Forest products)
Yves Pratte	Partner Clarkson, Tétrault (Advocates)
James David Raymond	President Cemp Investments Ltd. (Holding company)
Gilles Roch	Vice-Chairman of the Board National Bank of Canada
Maurice W. Soucy	President Nap Dumont Ltée (Wholesalers of construction materials)
H. Arnold Steinberg	Executive Vice-President, Finance and Development Steinberg Inc. (Retail supermarkets)
Guy St-Germain	President and Chief Executive Officer Commerce Group Insurance Company (General insurance company)
Paul-Gaston Tremblay	President Primo-Gestion Inc. (Management consultant and corporate director)
Antoine Turmel	President Placements Turan Inc. (Holding company)
Louise B. Vaillancourt	President Fondation Armand Frappier (Non-profit organization – financing of research programs at the Institut Armand Frappier)

Senior Officers
as at August 1, 1986

Michel Bélanger	Chairman of the Board and Chief Executive Officer
André Bérard	President and Chief Operating Officer
Gilles Roch	Vice-Chairman of the Board
Jean-Pierre Bélanger	Executive Vice-President – Corporate Banking
Edward Lyssan	Executive Vice-President – Finance and Control
Roland Robichaud	Executive Vice-President – Commercial Lending
Humberto Santos	Executive Vice-President – Branch Operations
Jean Turmel	Executive Vice-President – Treasury
Thomas J. Baribault	Senior Vice-President – Data Processing
Jacques Gagné	Senior Vice-President – International
Léon Courville	Senior Vice-President – Economic and International Affairs
Jacques Daoust	Senior Vice-President – Human Resources
Roger P. Smock	Senior Vice-President – Corporate Banking
Gaby Touma	Senior Vice-President – International Commercial Operations
Barrie F. Usher	Senior Vice-President – Real Estate
Louise Vaillancourt-Châtillon	Vice-President and Secretary
Michel Brunet	Vice-President and Controller
Robert Cardinal	Chief Accountant
Monique Archambault	Assistant Secretary
Claudine Tremblay	Assistant Secretary

CAPITAL CHARACTERIZATION

The Bank is required under the Bank Act to maintain an adequate capital base. Under definitions established by the Inspector General, the total capital of a bank is segregated into two categories – base capital and supplementary capital. Base capital includes those elements of capital which are generally permanent in nature, subordinate to other creditors and free of mandatory fixed charges against earnings. Base capital is therefore comprised of retained earnings, common shares and certain types of preferred shares and debentures, with the latter two components not to exceed in the aggregate 20 per cent. of total base capital. Supplementary capital includes all other preferred shares and debentures which do not have all the required properties of base capital. These characterizations of capital are used by the Inspector General to assess the adequacy of a bank's capital base in relation to its total assets.

The Notes are not capital but deposit liabilities of the Bank ranking equally and rateably with all other deposit liabilities of the Bank (except as otherwise prescribed by law) and without any preference among themselves.

The Debentures meet the present definition of base capital established by the Inspector General. However, the proportion of the Debentures which may qualify as base capital will depend upon the Capital Adequacy Guidelines of the Inspector General which are subject to periodic review and revision.

THE BANK ACT

General

The operations of the Bank are governed by the Bank Act and also by the respective laws of the various jurisdictions in which it carries on its operations. The Bank Act provides for the appointment of an Inspector General of Banks who is responsible for examination and inquiry into the affairs and business of each Canadian bank for the purpose of satisfying himself that the provisions of the Bank Act, having reference to the safety of the interest of depositors, creditors and shareholders of the bank, are being duly observed and that each bank is in a sound financial position. At the conclusion of each examination and inquiry a report thereon is submitted to the Minister of Finance of Canada. The Bank Act is scheduled for review and revisions decennially. The most recent Bank Act came into force on December 1, 1980. Under the Bank Act the Bank may engage in and carry on such business generally as appertains to the business of banks. In addition, the Bank Act permits banks to control leasing, mortgage loan and venture capital corporations. The Bank carries on leasing operations through its subsidiary, National Bank Leasing Inc., and mortgage loan operations through its subsidiary, National Bank Mortgage Corporation. These provisions also provide greater flexibility in raising capital by permitting the issue of preferred shares, convertible securities and bank debentures denominated in currencies other than Canadian currency. The Bank Act facilitates the formation of new banks in Canada and also the conversion of Canadian financial institutions and Canadian affiliates of foreign banks into banks.

Primary and Secondary Reserve Requirements

The Bank Act requires that a bank maintain a primary reserve in the form of specified coinage and notes of, and deposits in Canadian currency with, the Bank of Canada. This reserve must not be less, on the average during any month, than an amount equal to the aggregate of 10% of Canadian currency demand deposit liabilities, 2% of Canadian currency notice deposit liabilities, 1% of the amount by which Canadian currency notice deposit liabilities exceed $500 million, and 3% of the foreign currency deposits held in Canada by Canadian residents in respect of the bank concerned. The assets comprising the primary reserve of a bank are non-income producing.

The Bank Act also empowers the Bank of Canada to require a bank to maintain, in addition to the primary reserve, a secondary reserve in the form of specified coinage and notes of, and deposits in Canadian currency with, the Bank of Canada, or Government of Canada treasury bills or day loans to investment dealers at such percentage of its deposit liabilities as are subject to primary reserve requirements as may be fixed by the Bank of Canada pursuant to the Bank of Canada Act. Under this Act the secondary reserve requirement may not be greater than 12% of deposit liabilities. The present requirement is 4%.

Liabilities of subsidiaries that are factoring or leasing corporations, and Canadian currency deposits of Canadian residents with foreign branches or wholly-owned foreign subsidiaries of a bank, are included in calculating reserve requirements; liabilities of other subsidiaries, including mortgage loan corporations, are not included.

For the month of April 1986, National complied with the primary and secondary reserve requirements, having maintained in its primary reserve a daily average of $154.0 million, as against a requirement of $146.3 million, and a daily average of $497.4 million in its secondary reserve, as against a requirement of $358.1 million.

CANADIAN TAX LEGISLATION AFFECTING THE NOTES AND DEBENTURES

The Bank and the Managers have been advised by their respective Canadian legal counsel as follows:

Withholding Tax

Under the Income Tax Act (Canada) in effect at the date hereof principal or interest paid or credited by the Bank on the Notes or (as the case may be) Debentures will not be subject to Canadian non-resident withholding tax to the extent that such amounts are paid or credited to any non-resident of Canada with whom the Bank is dealing at arm's length within the meaning of such Act.

A Notice of Ways and Means Motion to amend the Income Tax Act (Canada), tabled in the House of Commons on June 11, 1986, contains a proposal that the exemptions from non-resident withholding tax for interest do not apply to any interest paid or credited on a debt obligation issued after February 25, 1986 where the interest is computed, in whole or in part, by reference to revenue, profit, cash flow or other similar criteria. The Bank has been informed in a letter received from the Department of Finance, Canada, dated July 29, 1986 that such proposal will not affect the tax treatment of interest paid on the Notes. However, this letter is not legally binding and no absolute assurance can be given that legislation implementing this proposal will not subject interest paid or credited by the Bank on the Notes or (as the case may be) Debentures to Canadian non-resident withholding tax

Income Tax

No other tax on income or capital gains is payable under the laws of Canada or the Province of Quebec in respect of the Notes or (as the case may be) Debentures or the interest thereon by holders who are neither residents nor deemed to be residents of Canada under such laws, and who do not use or hold and are not deemed by such laws to use or hold the Notes or (as the case may be) Debentures in carrying on business in Canada. In certain situations, holders of the Notes or (as the case may be) Debentures who are non-resident insurers carrying on an insurance business in Canada and elsewhere may be subject to such tax.

Estate Taxes and Succession Duties

There are no estate taxes or succession duties imposed by Canada or the Province of Quebec in respect of the Notes or (as the case may be) Debentures or the interest thereon.

CONSOLIDATED FINANCIAL STATEMENTS OF NATIONAL

INDEX

AUDITORS' REPORT

To the Directors of National Bank of Canada

We have examined the Consolidated Statement of Assets and Liabilities of National Bank of Canada as at October 31, 1985, October 31, 1984 and October 31, 1983 and the Consolidated Statements of Income, Appropriations for Contingencies and Changes in Shareholders' Equity for the three years ended October 31, 1985. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Bank as at October 31, 1985, October 31, 1984 and October 31, 1983 and the results of its operations for the three years ended October 31, 1985 in accordance with the accounting principles prescribed by the Bank Act applied on a consistent basis.

Mallette, Benoit, Boulanger, Rondeau & Associés
Chartered Accountants
As to the years ended
October 31, 1983, 1984 and 1985

Raymond, Chabot, Martin, Paré & Associés
Chartered Accountants
As to the year ended
October 31, 1985

Price Waterhouse
Chartered Accountants
As to the years ended
October 31, 1983 and 1984

Montreal, November 28, 1985
(except for note 18 for which
the date is August 7, 1986)

CONSOLIDATED STATEMENT OF INCOME

for the year ended October 31 (thousands of dollars)

	1985	1984	1983
Interest income and dividends			
Loans	**$ 1,835,611**	$ 1,759,844	$ 1,723,640
Lease financing	**27,570**	24,628	23,559
Securities	**212,477**	122,308	142,694
Deposits with banks	**149,340**	136,469	59,424
	2,224,998	2,043,249	1,949,317
Interest expense			
Deposits	**1,513,357**	1,433,611	1,380,632
Bank debentures	**43,793**	28,778	25,038
Other	**31,115**	26,826	33,671
	1,588,265	1,489,215	1,439,341
Net interest income	**636,733**	554,034	509,976
Provision for loan losses	**129,494**	115,069	98,297
Net interest income after loan loss provision	**507,239**	438,965	411,679
Other income	**176,035**	157,864	139,919
Net interest and other income	**683,274**	596,829	551,598
Non-interest expenses			
Salaries	**250,239**	242,293	239,901
Pension contribution and other staff benefits (Note 11)	**25,676**	24,639	26,559
Premises, equipment and furniture, including depreciation (Note 4)	**89,014**	83,388	80,347
Other expenses	**100,774**	88,273	85,853
	465,703	438,593	432,660
Income before income taxes	**217,571**	158,236	118,938
Income taxes (Note 12)	**63,839**	44,010	29,900
Net income before extraordinary item	**153,732**	114,226	89,038
Extraordinary item (Note 12)	—	—	36,700
Net income for the year	**$ 153,732**	$ 114,226	$ 125,738
Net income per common share (Note 13)			
Before extraordinary item			
– basic	**$ 3.56**	$ 2.84	$ 2.80
– fully diluted	**$ 3.27**	$ 2.68	$ 2.61
After extraordinary item			
– basic	**$ 3.56**	$ 2.84	$ 4.12
– fully diluted	**$ 3.27**	$ 2.68	$ 3.75

CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES

as at October 31
(thousands of dollars)

Assets	1985	1984	1983
Cash resources			
Cash and deposits with Bank of Canada	$ 317,212	$ 315,961	$ 334,654
Deposits with other banks (Note 17)	3,703,037	1,080,814	903,199
Cheques and other items in transit, net	—	15,683	46,012
	4,020,249	1,412,458	1,283,865
Securities (Note 2)			
Issued or guaranteed by Canada	712,157	753,709	1,057,241
Issued or guaranteed by provinces and municipal or school corporations	115,584	64,992	102,063
Other	1,154,859	728,291	876,134
	1,982,600	1,546,992	2,035,438
Loans			
Day, call and short loans to investment dealers and brokers, secured	85,026	84,923	53,474
To banks	642,066	884,544	947,951
Mortgages	3,403,851	3,071,343	2,770,135
Other (Note 3)	11,618,663	10,954,873	9,434,406
	15,749,606	14,995,683	13,205,966
Other assets			
Customers' liability under acceptances	1,093,905	683,772	660,734
Fixed assets (Note 4)	253,672	248,121	231,918
Other (Note 5)	239,755	363,055	356,565
	1,587,332	1,294,948	1,249,217
	$23,339,787	$19,250,081	$17,774,486

Liabilities	1985	1984	1983
Deposits (Note 6)			
Payable on demand	$ 1,252,058	$ 1,067,122	$ 1,336,262
Payable after notice	4,459,786	3,815,267	3,654,737
Payable on a fixed date	14,197,280	11,667,335	10,597,091
	19,909,124	16,549,724	15,588,090
Other liabilities			
Acceptances	1,093,905	683,772	660,734
Liabilities of subsidiaries (Note 7)	263,677	219,891	274,022
Other liabilities (Note 8)	508,297	519,391	396,502
Cheques and other items in transit, net	141,323	—	—
	2,007,202	1,423,054	1,331,258
Subordinated debt			
Bank debentures (Note 9)	391,223	338,634	198,215
Capital and reserves			
Appropriations for contingencies	88,176	88,344	43,057
Shareholders' equity			
Capital stock, issued and fully paid (Note 10)	213,271	252,170	159,972
Contributed surplus	364,388	295,658	197,655
Retained earnings	366,403	302,497	256,239
	1,032,238	938,669	656,923
	$23,339,787	$19,250,081	$17,774,486

CONSOLIDATED STATEMENT OF APPROPRIATIONS FOR CONTINGENCIES

for the year ended October 31
(thousands of dollars)

	1985	1984	1983
Opening balance	**$ 88,344**	$ 43,057	$ 30,227
Loss experience on loans for the year	**(189,023)**	(116,186)	(120,467)
Provision for loan losses included in the Consolidated Statement of Income	**129,494**	115,069	98,297
	(59,529)	(1,117)	(22,170)
Transfer from retained earnings	**59,361**	46,404	35,000
Net change during the year	**(168)**	45,287	12,830
Closing balance (including tax-paid appropriations of $ nil; 1984: $ nil; 1983: $8,953; 1982: $17,772)	**$ 88,176**	$ 88,344	$ 43,057

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

for the year ended October 31
(thousands of dollars)

	1985	1984	1983
Capital stock (Note 10)			
Opening balance	**$ 252,170**	$ 159,972	$ 152,569
Capital stock issues			
Common	**8,895**	17,258	7,403
Preferred	**—**	75,000	—
Conversion of preferred shares	**(47,794)**	(60)	—
Closing balance	**$ 213,271**	$ 252,170	$ 159,972
Contributed surplus (Note 10)			
Opening balance	**$ 295,658**	$ 197,655	$ 168,718
Additions from issues of			
Common shares	**61,130**	98,003	28,937
Warrants	**7,600**	—	—
Closing balance	**$ 364,388**	$ 295,658	$ 197,655
General reserve			
Opening balance	**$ —**	$ —	$ 22,824
Transfer to retained earnings	**—**	—	(22,824)
Closing balance	**$ —**	$ —	$ —
Retained earnings			
Opening balance	**$ 302,497**	$ 256,239	$ 146,539
Net income for the year	**153,732**	114,226	125,738
Gain on translation of investments in subsidiaries and branches abroad, net of taxes of $283 (1984: $21)	**2,929**	511	—
Dividends — Common shares	**(34,186)**	(26,075)	(8,563)
— Preferred shares	**(16,906)**	(13,151)	(10,899)
Expenses related to the issue of shares and warrants, net of taxes of $265 (1984: $850)	**(337)**	(1,099)	—
Transfer to appropriations for contingencies	**(59,361)**	(46,404)	(35,000)
Income taxes related to the above transfer (Note 12)	**18,035**	18,250	15,600
Transfer from general reserve	**—**	—	22,824
Closing balance	**$ 366,403**	$ 302,497	$ 256,239

1- Statement of significant accounting policies

The presentation of the financial statements and the accounting policies followed are prescribed by the Bank Act and regulations thereunder.

The accounting policies followed conform with accounting principles generally accepted in Canada and with the International Accounting Standards, except for certain differences resulting from the provisions of the Bank Act. The deferral of gains and losses on the disposal of certain securities and the accounting for appropriations for contingencies constitute the principal differences.

Consolidation

The consolidated financial statements of the Bank are consolidated according to the purchase method and include the assets and liabilities and results of operations of the following subsidiaries:

Canadian subsidiaries:
- National Bank Leasing Inc.
- National Bank Mortgage Corporation
- National Bank Realty Inc.
- National Bank Export Finance Co. Inc.

Foreign subsidiaries:
- National Bank of Canada (International) Ltd.
- Natcan Finance (Asia) Ltd. and its subsidiaries
- Laurentide Financial Inc.
- Natcan (U.K.) Limited

Interest in the following affiliates, that is, corporations in which the Bank owns 20% to 50% of the voting shares, is accounted for at equity value using the purchase method and presented in the Consolidated Statement of Assets and Liabilities under the heading "Other Securities":
- RoyNat Inc.
- St-Cyrille Realties Ltd.

Securities

Fixed maturity securities held for investment are presented at their amortized cost. Shares held for investment in corporations in which the Bank holds a minority interest of less than 20% are carried at cost. Any permanent impairment in the value of securities held for investment is charged to the year's income. Trading account securities are presented at their market value.

Gains and losses on the disposal of fixed maturity securities are amortized to income from securities over a five-year period, using the straight-line method. Gains and losses on the disposal of Treasury bills are recorded directly in the year's income. Gains and losses on the disposal of shares and securities from the trading account are included in income from securities in the year realized. Interest income from securities is recorded in the Consolidated Statement of Income on the accrual basis.

Futures contracts are used for the purpose of reducing risks related to the matching of investments and financing sources. Gains or losses on the disposal of these contracts are amortized over a three-month period, commencing on the contract maturity date.

Loans

Loans are recorded at their principal amounts, less unearned interest, if applicable, and less specific and general provisions for losses.

The loss experience on loans for the year consists of the net change in specific provisions for non-performing loans and general provisions deemed necessary or prudent for sovereign risk loans in foreign countries, plus write-offs for the year, less recoveries. The loss experience on loans is not charged directly to income for the year, but is deducted from appropriations for contingencies.

The provision for loan losses, charged to income and credited to appropriations for contingencies, is determined by applying the moving weighted average ratio of the actual loan loss experience of the Bank and each of its subsidiaries for the year and the previous four years to their respective eligible loans outstanding, in accordance with the rules and definitions prescribed by the Minister of Finance.

A loan is classified as non-performing when, in the opinion of management, there is reasonable doubt as to the ultimate collectibility of a portion of principal or interest or where interest is contractually past due by 90 days, unless there is no doubt as to the collectibility of principal and interest. Previously accrued interest is then reversed against income for the year and a specific provision for losses is made, if applicable. The amounts subsequently received on these loans are recorded as interest income when management determines that there is no longer any doubt as to their ultimate and full collectibility. Non-performing loans may revert to performing status only when principal and interest payments have become fully current again.

Loan fees and commissions are included in the year's income insofar as they offset any charges directly related to the negotiation or restructuring of credit conditions; the remainder is amortized over the life of the loan.

Lease financing

Lease receivables are presented net of unearned finance income and any specific provisions deemed necessary. Lease income is recorded in the Consolidated Statement of Income so as to produce a constant rate of return over the term of the leases. For leases past due by 90 days and over, the unearned finance income, extension fees and penalties for late payment are included in income at the time of receipt.

Appropriations for contingencies

In addition to specific and general provisions deducted from its loan portfolio in respect of projected losses, appropriations for contingencies, comprised of amounts set aside by the Bank, are available to provide for possible unforeseen future losses which may be incurred in the realization of existing loans and other assets.

These appropriations for contingencies may consist of two portions: tax-deductible and tax-paid. The maximum amount of tax-deductible transfers from retained earnings is prescribed under regulations issued by the Minister of Finance. The tax-paid portion comprises after-tax transfers from retained earnings and the net difference between loan losses and provisions for loan losses in respect of subsidiaries.

Customers' liability under acceptances

The contingent liability of the Bank under acceptances is reported as a liability in the Consolidated Statement of Assets and Liabilities. The Bank's contingent recourse is recorded as an equivalent offsetting asset.

Fixed assets

Fixed assets are recorded at cost and depreciated over their estimated useful lives according to the following methods and rates:

	Methods	Rates
Buildings	(a) or (b)	2% to 10%
Equipment and furniture	(a) or (b)	20% to 30%
Leasehold Improvements	(a)	(c)

(a) straight-line
(b) diminishing-balance
(c) over the lease term plus the first renewal option

Translation of foreign currencies

Amounts in foreign currencies included in the Consolidated Statement of Assets and Liabilities are translated into Canadian dollars at the exchange rates prevailing at year-end. Income and expenses in foreign currencies are translated at the average exchange rates prevailing during the year.

Foreign exchange positions are hedged as much as practicable by spot and forward exchange contracts. Any realized or unrealized gains and losses on these positions are reported in the Consolidated Statement of Income for the year, except for i) premiums and discounts on swapped deposits which, like interest, are amortized until maturity, and ii) gains and losses on the translation of investments in subsidiaries and branches abroad, which, effective November 1, 1983, are recorded under retained earnings.

Pension funds

The Bank's contributions to pension funds are recorded in the Consolidated Statement of Income and include contributions for past service determined by an actuarial valuation.

Income taxes

The Bank provides for income taxes under the income tax allocation method. Deferred income taxes result from various items reported for tax purposes in different periods than for financial reporting purposes and relate principally to the provision for loan losses. They represent tax benefits with respect to deductions the Bank may claim to reduce its taxable income of future years. Deferred income taxes are recorded under the heading "Other Assets" or "Other Liabilities", depending on whether they are debits or credits.

2- Securities

(thousands of dollars)

	One year and under	Over 1 to 3 years	Over 3 to 5 years	Over 5 to 10 years	Over 10 years	No maturity date	1985 Total	1984 Total	1983 Total
Investment securities issued or guaranteed by:									
Canada	$615,670	$ 19,677	$ 39,148	$ 34,622	$ 3,040	$ —	**$ 712,157**	$ 753,709	$ 1,057,241
Provinces	85,112	5,591	1,840	1,667	5,363	—	**99,573**	39,128	81,478
Municipalities or school corporations	6,484	1,420	1,835	5,179	1,093	—	**16,011**	25,864	20,585
	707,266	26,688	42,823	41,468	9,496	—	**827,741**	818,701	1,159,304
Debt securities:									
Income debentures	—	—	557	—	—	—	**557**	124,061	124,269
Small business development bonds	13,679	7,803	2,171	1,558	—	—	**25,211**	35,936	42,468
Other	151,873	349,093	32,709	79,954	57,097	12,500	**683,226**	225,488	424,560
	165,552	356,896	35,437	81,512	57,097	12,500	**708,994**	385,485	591,297
Equity securities:									
Floating rate preferred shares	4,103	19,721	49,581	53,399	—	57,000	**183,804**	203,661	198,620
Fixed rate preferred shares	11,746	39,165	50,743	44,599	—	40,242	**186,495**	87,414	35,705
Other	—	—	—	—	—	75,566	**75,566**	51,731	50,512
	15,849	58,886	100,324	97,998	—	172,808	**445,865**	342,806	284,837
	$888,667	$442,470	$178,584	$220,978	$ 66,593	$185,308	**$ 1,982,600**	$ 1,546,992	$ 2,035,438

The estimated market value of securities amounted to $1,991,226 (1984: $1,544,089; 1983: $2,028,341).

3- Other loans

(thousands of dollars)

	1985	1984	1983
Provinces and municipal or school corporations in Canada	**$ 334,505**	$ 306,197	$ 373,010
Lease financing receivables	**252,332**	216,648	188,147
Other loans in Canadian currency	**7,204,476**	6,843,733	5,972,707
Other loans in foreign currencies	**3,827,350**	3,588,295	2,900,542
	$11,618,663	$10,954,873	$ 9,434,406

4- Fixed assets

(thousands of dollars)

	Cost	Accumulated depreciation	1985 Net book value	1984 Net book value	1983 Net book value
Land	$ 18,652	$ —	**$ 18,652**	$ 18,803	$ 18,642
Buildings	154,487	10,661	**143,826**	145,394	135,408
Equipment and furniture	176,413	118,115	**58,298**	51,856	47,402
	$ 349,552	$ 128,776	**220,776**	216,053	201,452
Leasehold improvements			**32,896**	32,068	30,466
			$ 253,672	$ 248,121	$ 231,918

Depreciation for the year charged to the Consolidated Statement of Income amounted to $24,413 (1984: $19,295; 1983: $15,920).

5- Other assets
(thousands of dollars)

	1985	1984	1983
Accrued interest	**$ 175,126**	$ 201,588	$ 181,088
Income taxes (Note 12)	**—**	43,162	65,470
Sundry	**64,629**	118,305	110,007
	$ 239,755	$ 363,055	$ 356,565

6- Deposits
(thousands of dollars)

				1985	1984	1983
	Demand	Notice	Fixed date	**Total**	Total	Total
Canada	$ 308,617	$ —	$ —	**$ 308,617**	$ 128,907	$ 214,412
Provinces	1,959	8,413	145,071	**155,443**	258,919	37,114
Banks	32,081	4,322	5,137,152	**5,173,555**	3,808,946	3,641,081
Individuals	210,142	3,306,385	4,975,495	**8,492,022**	7,512,462	6,895,509
Other	699,259	1,140,666	3,939,562	**5,779,487**	4,840,490	4,799,974
	$ 1,252,058	$ 4,459,786	$14,197,280	**$19,909,124**	$16,549,724	$15,588,090

7- Liabilities of subsidiaries
(thousands of dollars)

	1985	1984	1983
National Bank Mortgage Corporation			
Bonds	**$ 34,620**	$ 34,820	$ 34,820
Long-term notes	**30,000**	30,000	30,000
	64,620	64,820	64,820
Laurentide Mortgage Corporation (a)			
Short-term notes	**—**	—	64,616
Imnat Ltd. (b)			
Secured bonds	**—**	—	9,291
Debentures and notes	**—**	—	10,000
	—	—	19,291
National Bank Leasing Inc.			
Secured term notes (c)	**136,863**	98,465	60,192
Debentures, notes and acceptances	**32,194**	26,606	35,103
	169,057	125,071	95,295
National Bank Realty Inc.			
Debentures	**30,000**	30,000	30,000
	$ 263,677	$ 219,891	$ 274,022

(a) Corporation dissolved.

(b) Corporation in the process of being dissolved.

(c) Certain finance receivables under finance leases of National Bank Leasing Inc. have been deposited as collateral for certain term notes. These debts are also secured by a first floating charge on all other assets of this corporation.

8- Other liabilities
(thousands of dollars)

	1985	1984	1983
Accrued interest	**$ 371,087**	$ 397,981	$ 307,304
Income taxes (Note 12)	**634**	—	—
Sundry	**136,576**	121,410	89,198
	$ 508,297	$ 519,391	$ 396,502

9- Bank debentures
(thousands of dollars)

The debentures, subordinated in right of payment to the claims of depositors and certain other creditors, consist of:

Maturity Date		Interest Rate	Characteristics	1985	1984	1983
December	1983	8.75%	—	**$ —**	$ —	$ 30,000
May	1984	10.35%	—	**—**	—	8,600
May	1986	10.40%	—	**16,400**	16,400	16,400
December	1987	7.50%	Sinking fund debentures	**666**	701	736
February	1988	16.50%	—	**50,000**	50,000	50,000
March	1988	floating	U.S. $50 million bearing interest at an annual rate of ¼% above the mean of the offered and bid quotations for Eurodollar deposits in London	**68,375**	65,720	61,635
May	1988	9.75%	With holder's option to extend maturity to 1998 at the rate of 10%	**10,000**	10,000	10,000
February	1990	10.25%	—	**50,000**	—	—
March	1992	7.50%	Sinking fund debentures	**782**	813	844
March	1996	floating	Redeemable at the Bank's option on or after March 15, 1989 and bearing interest at a rate ⅝% above the average yield on 91-day Government of Canada Treasury bills, and not less than 8½% per annum	**75,000**	75,000	—
June	2001	12.50%	Convertible into 1,190,000 common shares, redeemable on or after June 5, 1986 on certain conditions	**20,000**	20,000	20,000
October	2083	floating	Redeemable at the Bank's option on or after October 1, 1989 and bearing interest at a rate ½% above the yield on 30-day bankers' acceptances published by the Bank of Canada	**100,000**	100,000	—
				$ 391,223	$ 338,634	$ 198,215

The maximum sinking fund requirements and the maturities of debentures for future years, assuming the earliest possible maturity dates, are as follows:

1986:	$ 16,466
1987:	$ 66
1988:	$129,002
1989:	$ 31
1990:	$ 50,031
1991 and following:	$195,627

10- Capital stock

Authorized:

15,000,000	First Preferred Shares, without par value, issuable for a maximum aggregate consideration of $300,000,000
1,600,000	Class A Convertible Preferred Shares, with a cumulative dividend of $2.94, of a par value of $31 each, convertible at the holder's option, until November 1, 1990, into 3,200,000 Common Shares
15,000,000	Class B Preferred Shares, without par value, issuable for a maximum aggregate consideration of $300,000,000
75,000,000	Common Shares, with a par value of $2 each

Issued and fully paid:

		1985	1984	1983
		(thousands of dollars)		
21,500	First Preferred Shares, Series 1	**$ 21,500**	$ 21,500	$ 21,500
800,000	First Preferred Shares, Series 2	**2,000**	2,000	2,000
300,000	First Preferred Shares, Series 3	**1,500**	1,500	1,500
1,100,000	First Preferred Shares, Series 4	**27,500**	27,500	27,500
750,000	First Preferred Shares, Series 5	**75,000**	75,000	—
56,251	Class A Convertible Preferred Shares (1984: 1,598,000 shares; 1983: 1,599,950 shares)	**1,744**	49,538	49,598
42,013,738	Common Shares (1984: 37,566,240 shares; 1983: 28,937,129 shares)	**84,027**	75,132	57,874
		$ 213,271	$ 252,170	$ 159,972

Increase in authorized capital

On March 7, 1985, following the approval of the Minister of Finance, the authorized common share capital of the Bank was increased from 50,000,000 to 75,000,000 Common Shares, with a par value of $2 each.

Dividends

The First Preferred Shares, Series 1 and 2, have cumulative dividends equal to 2% plus one half of the average of the Bank's daily Prime Lending Rate for the quarter ending on the 1st day of January, April, July or October each year and immediately preceding the payment date. The First Preferred Shares, Series 3, have a cumulative dividend of $0.70 per share per annum. The First Preferred Shares, Series 4, have a cumulative dividend at a rate equal to the greater of i) 15% or ii) the rate obtained, if applicable, by adding 15% and one half of the difference between 23% and the average (if such average exceeds 23%) of the Bank's daily Prime Lending Rate for the quarter ending on the 1st day of January, April, July or October each year and immediately preceding the payment date. The First Preferred Shares, Series 5, have a cumulative dividend at a rate equal to one quarter of 70% of the Bank's average daily Prime Lending Rate during the three-month period ending on the last day of March, June, September or December each year and immediately preceding the scheduled payment date. All these dividends are payable quarterly.

Redemption privileges

First Preferred Shares and Class A Convertible Preferred Shares are redeemable in whole or in part, at the Bank's option, after November 1, 1991 in the case of Series 1, 2 and 3 Shares; on or after February 17, 1987 for Series 4 Shares; after July 5, 1989 for Series 5 Shares; and on or after November 1, 1985 for Class A Shares. Series 1, 2 and 3 Shares are redeemable at a price equal to the aggregate consideration received upon issue; Series 4 Shares are redeemable at $25 per share; Series 5 Shares are redeemable at $104 per share (decreasing thereafter to $100 per share on July 6, 1993); and Class A Shares are redeemable at $32.55, together with, in each case, accrued and unpaid dividends.

Retraction privileges

Holders of First Preferred Shares have the right, on November 1, 1991 for Series 1, 2 and 3, and on February 16, 1987 for Series 4, to ask the Bank to redeem all or part of their shares, at a price equal to the aggregate consideration received upon issue for Series 1, 2 and 3 Shares, and at $25 per share for Series 4 Shares, together with, in each case, accrued and unpaid dividends.

Issue of Warrants

On June 14, 1985, the Bank issued 4,000,000 Warrants for proceeds of $7,600,000 which were credited to contributed surplus. Each Warrant entitles the holder to purchase one Common Share at a price of $18.50 no later than December 13, 1985.

Issue of Common Shares

During the year ended October 31, 1985, 997,822 Common Shares were issued under the Shareholder Dividend Reinvestment, Optional Stock Dividend and Share Purchase Plan for an aggregate amount of $15,456,636, of which $13,460,992 was credited to contributed surplus; 366,178 Common Shares were issued for an aggregate amount of $6,774,293, of which $6,041,937 was credited to contributed surplus following the exercise of Warrants; upon the conversion of 1,541,749 Class A Convertible Preferred Shares, 3,083,498 Common Shares were also issued for an aggregate amount of $47,794,219, of which $41,627,223 was credited to contributed surplus.

Shares reserved for future issue

The Bank has reserved 1,190,000 Common Shares for issue pending the eventual exercise of the conversion privileges pertaining to the convertible bank debentures, and 3,633,822 Common Shares pending the eventual exercise of the Warrants.

Redemption of Class A Preferred Shares

On November 1, 1985, the Bank redeemed the 56,251 Class A Convertible Preferred Shares outstanding as at October 31, 1985 for an aggregate consideration of $1,830,970, of which $87,189 will be deducted from retained earnings.

11- Pension funds

The Pension Fund Society of the National Bank of Canada is the Bank's principal pension plan in Canada. As at December 31, 1984, the date of the latest valuation, the actuarial surplus was $13,268,700 (December 31, 1983: actuarial surplus of $10,464,000; December 31, 1982: actuarial deficit of $1,647,000). The Bank's contributions charged to expenses for the year amounted to $125,945 (1984: $535,000; 1983: $2,901,000).

12- Income taxes

(thousands of dollars)

The income taxes shown in the financial statements were as follows:

	1985	1984	1983
Consolidated Statement of Income:			
Charged to the year's income			
Current (recovered)	$ **25,470**	$ 23,179	$ (2,705)
Deferred	**38,369**	20,831	32,605
	$ **63,839**	$ 44,010	$ 29,900
Extraordinary item			
Previously unrecorded tax benefit	$ **—**	$ —	$ 36,700
Statement of Retained Earnings:			
Taxes recovered as a result of transfer to appropriation for contingencies	$ **18,035**	$ 18,250	$ 15,600
Other	**548**	871	—
	$ **18,583**	$ 19,121	$ 15,600
Consolidated Statement of Assets and Liabilities:			
Receivable (payable)	$ **(6,156)**	$ 2,059	$ 3,747
Deferred — debit	**5,522**	41,103	61,723
	$ **(634)**	$ 43,162	$ 65,470

The deferred income taxes in the Consolidated Statement of Income are primarily derived from the timing difference related to recognition of the provision for loan losses for tax and financial statement purposes.

The Bank's effective tax rate is calculated as follows:

	1985		1984		1983	
Income before income taxes	**$217,571**	**100.0%**	$158,236	100.0%	$118,938	100.0%
Income taxes at Canadian statutory tax rates	**$ 94,426**	**43.4%**	$ 68,674	43.4%	$ 53,046	44.6%
Reduction of combined tax rate due to:						
Dividends from Canadian corporations	**11,564**	**5.3**	8,766	5.5	8,306	7.0
Capital gain (losses), tax-exempt portion	**3,466**	**1.6**	167	0.1	(37)	—
Interest on income debentures and small business development bonds	**3,636**	**1.7**	4,766	3.0	5,389	4.5
Lower tax rates applicable to certain subsidiaries	**12,048**	**5.6**	9,789	6.2	10,360	8.7
Other items	**(127)**	**(0.1)**	1,176	0.8	(872)	(0.7)
	30,587	**14.1**	24,664	15.6	23,146	19.5
Income taxes at effective tax rate	**$ 63,839**	**29.3%**	$ 44,010	27.8%	$ 29,900	25.1%

13- Net income per common share

Basic net income per share was calculated on the average number of Common Shares outstanding after deducting dividends on Preferred Shares. For the year ended October 31, 1985, this average was 38,428,609 (1984: 35,645,281; 1983: 27,875,616).

Fully diluted net income per share was calculated on the average number of Common Shares which would have been outstanding each year, if all convertible debentures and Class A Convertible Preferred Shares outstanding had been converted at the beginning of each year, and the Warrants, on their issue date. The fully diluted average number of Common Shares outstanding for the year ended October 31, 1985 was 44,175,662 (1984: 40,031,281; 1983: 32,265,516). For purposes of this calculation, net income was adjusted to reflect the income generated by the additional capital that would have resulted from the exercise of the Warrants. The additional capital, at the average Prime Lending Rate of 10.35%, is assumed to have generated net income of $1,623,000.

14- Commitments under leases
(thousands of dollars)

As at October 31, 1985, minimum commitments under leases were as follows:

	Premises	Equipment and Furniture	**Total**
1986	$ 24,255	$ 3,748	**$ 28,003**
1987	23,864	2,080	**25,944**
1988	23,078	877	**23,955**
1989	22,048	230	**22,278**
1990	21,310	222	**21,532**
1991 and following	166,073	39	**166,112**
	$ 280,628	$ 7,196	**$ 287,824**

15- Commitments under guarantees and letters of credit
(thousands of dollars)

The Bank's contingent liability under guarantees and letters of credit and the Bank's recourse against the customer, which are not shown in the Consolidated Statement of Assets and Liabilities, were as follows:

	1985	1984	1983
Guarantees	**$ 398,906**	$ 388,645	$ 310,941
Letters of credit	**276,651**	320,887	197,192
	$ 675,557	$ 709,532	$ 508,133

Guarantees provided by the Bank and letters of credit relating to corporations in which the Bank owns between 10% and 50% of voting shares, amounting to $288 (1984: $257; 1983: $10,943), are included in the above guarantees and letters of credit.

16- Commitments under agreements for assignment of loans

Under the terms and conditions of various agreements for the assignment of Canadian dollar and foreign currency loans, the Bank may be required to repurchase a number of such loans in the event the assignees exercise their right of reassignment to the Bank. These rights with respect to foreign currency loans may be exercised over variable periods and on specified dates, provided the loans are not in default; such rights, as at October 31, 1985, related to $916,000,000 of loans sold (1984: $795,000,000; 1983: $971,000,000). The rights of the assignees of Canadian dollar loans may be exercised at any time regardless of whether the loans are in default; such rights, as at October 31, 1985, related to $8,000,000 of loans sold.

17- Planned amalgamation with The Mercantile Bank of Canada

On October 21, 1985, the Board of Directors ratified the agreement in principle regarding the proposed amalgamation with The Mercantile Bank of Canada. The amalgamation will be retroactive to November 1, 1985 following the approval, in due course, of the shareholders of the two banks and the competent authorities. The bank resulting from the amalgamation will carry on business under the name of "National Bank of Canada".

The Common Shares of the Mercantile Bank will be converted into shares of the amalgamated bank on the basis of one Common Share and, as the case may be, one Second Preferred Share of the amalgamated bank for every four Shares of the Mercantile Bank. Each Common Share of the Bank will be converted into a Common Share of the amalgamated bank. The First Preferred Shares of the Bank and the Preferred Shares of the Mercantile Bank will be converted into First Preferred Shares of the amalgamated bank and will retain substantially their respective rights, privileges, conditions and restrictions.

Under the agreement, the Bank has agreed to maintain sufficient amounts on deposit with the Mercantile Bank to ensure continued liquidity for its operations. These advances bear interest at competitive rates and are fully secured by the assets of the Mercantile Bank. Deposits with other banks included $1.6 billion of such advances as at October 31, 1985.

18- Subsequent Events

a) During the six months ended April 30, 1986, the Bank issued 3,616,097 common shares to the holders of warrants mentioned in note 10 for a consideration of $66,897,795 of which $59,665,601 was credited to contributed surplus and $7,232,194 to capital stock.

b) On January 30 and 31, 1986 respectively, the shareholders of National Bank of Canada and of The Mercantile Bank of Canada approved the amalgamation of the two banks on the basis mentioned in note 17 except that the 8,000,000 common shares of The Mercantile Bank of Canada will be converted into 2,400,000 common shares of the amalgamated bank.

c) On February 10, 1986, the Minister of Finance of Canada issued letters patent under the Bank Act (Canada) amalgamating the two former banks and continuing them as one bank under the name "National Bank of Canada". The authorized capital stock of the amalgamated bank is as follows:

   i) 20,000,000 First Preferred Shares, without par value, which may be issued for an aggregate consideration of not more than $400,000,000

   ii) 15,000,000 Second Preferred Shares, without par value, which may be issued for an aggregate consideration of not more than $300,000,000

   iii) 75,000,000 Common Shares, with a par value of $2 each.

d) On March 4, 1986, the amalgamated bank issued 4,000,000 Series 8, First Preferred Shares for an aggregate issue price of $100,000,000.

e) On March 19, 1986, the amalgamated bank issued U.S. $150,000,000 principal amount of Floating Rate Debentures, Series 7, Due 1998, at a price equal to 100% of such principal amount.

f) On May 29, 1986, the Board of Directors of the amalgamated bank approved the redemption on October 6, 1986 of the $15,000,000 Floating Rate Debentures Due October 1995 which had been issued by The Mercantile Bank of Canada.

g) On July 9, 1986, the amalgamated bank issued U.S. $200,000,000 principal amount of Floating Rate Deposit Notes Due July 1996, at a price equal to 100% of such principal amount.

h) On August 7, 1986, the amalgamated bank entered into an agreement relating to the sale of U.S. $200,000,000 principal amount of Floating Rate Notes Due 2085, convertible at the Bank's option into Floating Rate Subordinated Capital Debentures Due 99 years after Conversion, at a price equal to 100% of such principal amount.

SIX-MONTH RESULTS*

Consolidated Statement of Income
(thousands of dollars)

	Six months ended April 30 1986	Six months ended April 30 1985	% change
	(unaudited)		
Interest Income and Dividends			
Loans	$1,120,885	$ 914,018	23
Lease financing	16,488	12,979	27
Securities	80,953	110,976	(27)
Deposits with banks	87,877	66,735	32
	1,306,203	1,104,708	18
Interest Expense			
Deposits	888,017	759,758	17
Bank debentures	26,328	21,899	20
Other	16,714	14,293	17
	931,059	795,950	17
Net Interest Income	375,144	308,758	22
Provision for loan losses	99,367	62,390	59
Net Interest Income After Loan Loss Provision	275,777	246,368	12
Other income	116,427	85,257	37
Net Interest and Other Income	392,204	331,625	18
Non-Interest Expenses			
Salaries	134,657	121,824	11
Pension contributions and other staff benefits	14,911	12,592	18
Premises, equipment and furniture, including depreciation	48,740	44,467	10
Other expenses	57,709	46,444	24
	256,017	225,327	14
Income Before Income Taxes	136,187	106,298	28
Income taxes	46,815	31,013	51
Net Income	$ 89,372	$ 75,285	19
Dividends on preferred shares	$ 11,613	$ 8,789	32
Net income available for common shares	$ 77,759	$ 66,496	17
Number of common shares			
Average	47,496	38,036	25
End of period	48,370	38,182	27
Net Income Per Common Share			
Basic	$ 1.64	$ 1.75	(6)
Fully diluted	$ 1.60	$ 1.64	(2)

Condensed Consolidated Statement of Assets and Liabilities
(millions of dollars)

	As at April 30		%
	1986	1985	change
	(unaudited)		
Assets			
Cash resources	$ 2,243	$ 2,006	12
Securities	1,991	1,759	13
Loans	19,956	15,895	26
Other	1,719	1,280	34
	$ 25,909	$ 20,940	24
Liabilities			
Deposits	$ 21,821	$ 18,052	21
Other	2,055	1,502	37
Bank debentures	643	391	64
Capital and reserves	1,390	995	40
	$ 25,909	$ 20,940	24

Condensed Consolidated Statement of Capital and Reserves
(millions of dollars)

	Six Months ended April 30		%
	1986	1985	change
	(unaudited)		
Opening balance	$ 1,032	$ 938	10
Capital stock issues — common	115	8	—
— preferred	176	—	—
Net income	89	75	19
Dividends	(36)	(25)	44
Loss experience on loans	(98)	(67)	46
Provision for loan losses included in the Consolidated Statement of Income	99	62	59
Income taxes related to transfer to appropriations for contingencies	13	—	—
Other	—	4	—
Closing balance	$ 1,390	$ 995	40
Appropriations for contingencies	$ 121	$ 93	30
Shareholders' equity — preferred	306	177	73
— common	963	725	33
Closing balance	$ 1,390	$ 995	40

*The results of the Bank for the first six months of fiscal 1986 consolidate the operations of National and Mercantile since November 1, 1985, while the comparative results for fiscal 1985 are those of National.

SUMMARY FINANCIAL DATA ON A PRO FORMA BASIS (unaudited)

The following pro forma financial data as at October 31, 1985 and for the years ended October 31, 1981 to 1985 is based on the Consolidated Statement of Assets and Liabilities as at October 31, 1985 and the Consolidated Statement of Income for each of the years ended October 31, 1981 to 1985 of National and Mercantile.

This pro forma financial data gives effect to the conversion of common shares of Mercantile into common shares of the Bank on the basis of 1.2 common shares of the Bank for every four Mercantile common shares. The pro forma eliminations, adjustments and reclassifications are described below in the section entitled "Pro Forma Adjustments".

Pro Forma Consolidated Statement of Assets and Liabilities
as at October 31, 1985
(thousands of dollars)

	Historic				
	National	Mercantile	Combined	Adjustments	Pro forma (unaudited)
Assets					
Cash resources					
Cash and deposits with Bank of Canada	$ 317,212	$ 51,699	$ 368,911	$ —	$ 368,911
Deposits with other banks	3,703,037	63,495	3,766,532	(1,644,000)	2,122,532
Cheques and other items in transit, net	—	19,893	19,893	(19,893)	—
	4,020,249	135,087	4,155,336	(1,663,893)	2,491,443
Securities					
Issued or guaranteed by Canada	712,157	73,550	785,707	(1,787)	783,920
Issued or guaranteed by provinces and municipal or school corporations	115,584	—	115,584	—	115,584
Other	1,154,859	57,966	1,212,825	(1,040)	1,211,785
	1,982,600	131,516	2,114,116	(2,827)	2,111,289
Loans					
Day, call and short loans to investment dealers and brokers, secured	85,026	—	85,026	—	85,026
To banks	642,066	121,368	763,434	—	763,434
Mortgages	3,403,851	70,897	3,474,748	—	3,474,748
Other	11,618,663	3,271,064	14,889,727	(26,490)	14,863,237
	15,749,606	3,463,329	19,212,935	(26,490)	19,186,445
Other assets					
Customers' liability under acceptances	1,093,905	29,922	1,123,827	—	1,123,827
Fixed assets	253,672	16,456	270,128	—	270,128
Other	239,755	135,307	375,062	1,227	376,289
	1,587,332	181,685	1,769,017	1,227	1,770,244
	$23,339,787	$ 3,911,617	$27,251,404	$(1,691,983)	$25,559,421
Liabilities					
Deposits					
Payable on demand	$ 1,252,058	$ 125,304	$ 1,377,362	$ —	$ 1,377,362
Payable after notice	4,459,786	1,653,973	6,113,759	(1,644,000)	4,469,759
Payable on a fixed date	14,197,280	1,802,439	15,999,719	—	15,999,719
	19,909,124	3,581,716	23,490,840	(1,644,000)	21,846,840
Other liabilities					
Acceptances	1,093,905	29,922	1,123,827	—	1,123,827
Liabilities of subsidiaries	263,677	—	263,677	—	263,677
Other liabilities	508,297	77,073	585,370	31,700	617,070
Cheques and other items in transit, net	141,323	—	141,323	(19,893)	121,430
	2,007,202	106,995	2,114,197	11,807	2,126,004
Subordinated debt					
Bank debentures	391,223	45,000	436,223	—	436,223
Capital and reserves					
Appropriations for contingencies	88,176	8,320	96,496	(8,320)	88,176
Shareholders' equity					
Capital stock, issued and fully paid	213,271	118,025	331,296	(35,200)	296,096
Contributed surplus	364,388	11,950	376,338	23,341	399,679
Retained earnings	366,403	39,611	406,014	(39,611)	366,403
	1,032,238	177,906	1,210,144	(59,790)	1,150,354
	$23,339,787	$ 3,911,617	$27,251,404	$(1,691,983)	$25,559,421

Pro Forma Consolidated Statement of Income (unaudited)
for the year ended October 31
(thousands of dollars, except where noted)

	1985	1984	1983	1982	1981
Interest income and dividends					
Loans	$2,266,643	$2,193,217	$2,111,328	$2,939,789	$2,814,218
Lease financing	27,570	24,628	26,742	25,330	20,805
Securities	258,453	168,435	189,834	235,182	220,938
Deposits with banks	158,003	154,746	70,937	201,042	195,789
	2,710,669	2,541,026	2,398,841	3,401,343	3,251,750
Interest expense					
Deposits	1,901,648	1,843,172	1,742,797	2,859,100	2,737,003
Bank debentures	48,149	33,226	29,456	33,010	23,294
Other	48,642	42,677	45,485	46,513	41,323
	1,998,439	1,919,075	1,817,738	2,938,623	2,801,620
Net interest income	712,230	621,951	581,103	462,720	450,130
Provision for loan losses	163,734	138,564	115,023	113,158	87,426
Net interest income after loan loss provision	548,496	483,387	466,080	349,562	362,704
Other income	201,121	185,431	164,763	159,238	132,145
Net interest and other income	749,617	668,818	630,843	508,800	494,849
Non-interest expenses					
Salaries	275,106	266,942	263,815	286,680	268,712
Pension contributions and other staff benefits	29,506	28,066	29,348	33,398	30,070
Premises, equipment and furniture, including depreciation	99,152	95,209	90,949	85,173	72,704
Other expenses	119,513	106,247	104,439	104,028	108,758
	523,277	496,464	488,551	509,279	480,244
Income (loss) before income taxes	226,340	172,354	142,292	(479)	14,605
Income taxes	62,434	48,252	35,313	64	(24,168)
Net income (loss) before minority interest and extraordinary item	163,906	124,102	106,979	(543)	38,773
Minority interest	—	—	—	187	3,264
Net income (loss) before extraordinary item	163,906	124,102	106,979	(730)	35,509
Extraordinary item	5,716	—	36,700	—	4,660
Net income (loss) for the year	$ 169,622(1)	$ 124,102	$ 143,679(2)	$ (730)	$ 40,169(3)
Average assets(5) (millions of dollars)	$ 25,432	$ 22,869	$ 21,676	$ 23,574	$ 21,448
Return on average assets	0.67%	0.54%	0.66%	—	0.19%
Per common share (dollars)					
Net income					
Before extraordinary item(4)					
– basic	$ 3.41	$ 2.79	$ 3.04	$ (0.41)	$ 1.38
– fully diluted	$ 3.16	$ 2.64	$ 2.83	—	$ 1.30
After extraordinary item(4)					
– basic	$ 3.55(1)	$ 2.79	$ 4.25(2)	$ (0.41)	$ 1.58(3)
– fully diluted	$ 3.28(1)	$ 2.64	$ 3.89(2)	—	$ 1.47(3)
Net book value(5)	$ 21.49	$ 21.41	$ 21.05	$ 18.85	$ 22.28

(1) Includes an extraordinary gain of $5.7 million, including deferred income tax recovery of $1.7 million, on the sale of a building.

(2) Includes an extraordinary item of $36.7 million, resulting from the recognition of 1982 unrecorded tax benefits.

(3) Includes an extraordinary item, i.e a profit of $4 7 million (net of income taxes of $1.2 million) and minority interest in subsidiaries of $3.3 million.

(4) Includes the issue of 2,400,000 additional common shares.

(5) Includes the adjustments described in paragraphs 1) and 2) under the heading "Pro Forma Adjustments" which were charged retroactively, as applicable, to the fiscal years 1981 to1985. Revised to eliminate income taxes deducted from tax-deductible appropriations for contingencies

Pro Forma Adjustments

The pro forma adjustments take the following into account:

(1) Adjustments, net of income taxes, of $59.8 million made to the net value of Mercantile, as agreed upon by the management of National and Mercantile.

(2) The conversion of the 8,000,000 Mercantile common shares into 2,400,000 common shares of the Bank, as agreed upon by the management of National and Mercantile.

(3) The eliminations relative to advances by National to Mercantile in the amount of $1,644 million as at October 31, 1985.

(4) The reclassification of cheques and other float items of Mercantile of $19.9 million with those of National; the cheques and other float items of the Bank must be shown at their net value.

SUBSCRIPTION AND SALE

Credit Suisse First Boston Limited, Goldman Sachs International Corp., Morgan Stanley International, Société Générale, E F Hutton & Company (London) Ltd, Samuel Montagu & Co. Limited, Westdeutsche Landesbank Girozentrale, Bank of America International Limited, Bank of Tokyo International Limited, Bank of Yokohama (Europe) S.A., Bankers Trust International Limited, Banque Bruxelles Lambert S.A., Banque Indosuez, Banque Nationale de Paris, Banque Paribas Capital Markets Limited, Citicorp Investment Bank Limited, Dai-Ichi Kangyo International Limited, First Interstate Capital Markets Limited, LTCB International Limited, Manufacturers Hanover Limited, Mitsubishi Finance International Limited, The Nikko Securities Co., (Europe) Ltd., Nippon Credit International Limited, Saitama Bank (Europe) S.A., Sanwa International Limited, Taiyo Kobe International Limited, Takugin International Bank (Europe) S.A., Tokai International Limited and Yasuda Trust Europe Limited (the "Managers") have, pursuant to a Subscription Agreement dated August 7, 1986, jointly and severally agreed with the Bank, subject to the satisfaction of certain conditions, to subscribe and pay for, or procure subscription and payment for, the Notes at 100 per cent. of their principal amount less a selling group concession of 0.125 per cent. of their principal amount. The Bank will pay a combined management and underwriting commission of 0.125 per cent. of the principal amount of the Notes. In addition, the Bank has agreed to reimburse the Managers for certain of their expenses in connection with the issue of the Notes. The Managers are entitled to terminate the Subscription Agreement in certain circumstances prior to the issue of the Notes. The Bank has agreed to indemnify the Managers against certain liabilities in connection with the offer and sale of the Notes.

The Managers, on behalf of the Bank, have invited certain banks, brokers and dealers (the "Selling Group") to subscribe for Notes at 100 per cent. of their principal amount less a selling group concession of 0.125 per cent. of their principal amount.

The Notes have not been and will not be registered under the United States Securities Act of 1933 (the "Securities Act") and (except as otherwise mentioned herein) may not be offered, sold or delivered, directly or indirectly, in the United States or to any U.S. person, as part of the distribution of the Notes. Each Manager and member of the Selling Group has represented and agreed that it is not purchasing any Notes for the account of any U.S. person and that it has not offered, sold or delivered, and will not offer, sell or deliver, directly or indirectly, any Notes acquired by it as part of the distribution of the Notes in the United States or to any U.S. person (except to a member of the Selling Group who is a U.S. person or, with the prior written approval of Credit Suisse First Boston Limited, a U.S. bank branch outside the United States). Each Manager and member of the Selling Group has further agreed that it will not, as principal or agent, make any offers, sales or deliveries of any Notes, otherwise acquired, in the United States or to any U.S. person prior to the date 90 days after completion of the distribution of the Notes, as determined by Credit Suisse First Boston Limited. As used herein, "United States" means the United States of America (including the States and the District of Columbia), its territories, its possessions and other areas subject to its jurisdiction and "U.S. person" means a citizen or resident of the United States, a corporation, partnership or other entity created or organised in or under the laws of the United States and an estate or trust the income of which is subject to United States federal income taxation regardless of its source. Offers and sales of Notes in the United States or to any U.S. person would constitute a violation of United States law unless made in compliance with the registration requirements of the Securities Act or pursuant to an exemption therefrom. Neither the Bank nor the Managers make any representation in respect of, and do not assume responsibility for, the registration of the Notes or the availability of any such exemption and neither the Bank nor the Managers make any representation as to when, if at any time, the Notes may lawfully be sold into the United States or to any U.S. person.

Each Manager and member of the Selling Group has agreed that it has not offered or sold, and will not offer or sell, any Notes in Great Britain other than to persons whose ordinary business it is to buy or sell shares or debentures, whether as principal or agent (except in circumstances which do not constitute an offer to the public within the meaning of the Companies Act 1985) and, unless it is permitted to do so under the securities laws of Great Britain, it has not distributed or caused to be distributed, and will not distribute or cause to be distributed, any offering material relating to the Notes in or from Great Britain otherwise than to persons whose business involves the acquisition and disposal, or the holding, of securities whether as principal or as agent.

The Notes have not been and will not be qualified for sale under the securities laws of Canada or any province or territory thereof. Each Manager and member of the Selling Group has agreed that it will not distribute the Notes in Canada or to, or for the benefit of, any resident thereof, or distribute any offering material, including the Offering Circular, in Canada in contravention of the securities laws of Canada or any province or territory thereof.

GENERAL INFORMATION

Application has been made to list the Notes and the Debentures on the Luxembourg Stock Exchange. In connection with such application, the Charter and By-laws of the Bank and a legal notice relating to the Notes and Debentures will be deposited prior to listing with the Chief Registrar of the District Court in Luxembourg (*"Greffier en Chef du Tribunal de et à Luxembourg"*) where such documents may be examined and copies obtained.

The issue of the Notes and the creation of the Debentures by the Bank were authorised by resolution of its Board of Directors passed on July 31, 1986.

Since October 31, 1985, the date of the last audited consolidated financial statements referred to herein, there has been no change nor any development or event involving a prospective change which is materially adverse to the condition (financial or other), prospects or results of operations of the Bank or of the Bank and its subsidiaries taken as a whole.

There are no pending actions, suits or proceedings against or affecting the Bank or any of its subsidiaries or any of their respective properties, which, if determined adversely to the Bank or such subsidiaries, would individually or in the aggregate have a material adverse effect on the condition (financial or other), prospects or results of operations of the Bank or of the Bank and its subsidiaries taken as a whole or which are otherwise material in the context of the issue of the Notes and, to the best of the knowledge of the Bank, no such actions, suits or proceedings are threatened or contemplated.

Copies of the 1986 Trust Indenture may be inspected during normal business hours at the office of Kredietbank S.A. Luxembourgeoise where copies of the most recent annual report, together with copies of the quarterly reports, if any, of the Bank will be available upon request as long as the Notes or (as the case may be) Debentures are listed on the Luxembourg Stock Exchange.

The Notes have been accepted for clearance through Euro-clear (reference no. 17822) and CEDEL S.A. (reference no. 136565).

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