12. ENTERPRISE RISKS AND RISK MANAGEMENT

The Company is committed to establishing a framework that ensures risk management is an integral part of its activities. To ensure the continued growth and success of the Company, risks are managed through an Enterprise Risk Management (“ERM”) program. The Board has approved an ERM policy and oversees the ERM program, which assists all areas of the business in achieving the Company’s strategic objectives by bringing a systematic approach, methodology and tools for evaluating and improving the effectiveness of risk management and control. The results of the ERM program and other business planning processes are used to prioritize risk management activities, allocate resources effectively and develop a risk-based internal audit plan.

The Company identifies and manages its risks in support of its vision, mission and goals to assist in achieving its strategic objectives. Risk is not eliminated through the ERM program; rather, risks are identified and managed within acceptable risk tolerances. The ERM program is designed to:

- promote a cultural awareness of risk management and compliance within the Company;
- facilitate corporate governance by providing a consolidated view of risks across the Company and insight into the identification, assessment, measurement and monitoring of the risks;
- ensure that resources are acquired economically, used efficiently and adequately protected; and
- allow the Company to focus on its key risks in the business planning process and optimize financial performance through responsible risk management.

An annual ERM assessment is completed to assist in the update and identification of financial, operational or reputational risks affecting the Company. The ERM program is primarily carried out through interviews and risk assessments with senior management. Risks are assessed based on the likelihood and impact that the underlying risk would have on the Company’s ability to execute its strategies and achieve its objectives. Each quarter, management provides an update to the Audit Committee as to the status of the top ten risks in relation to how they have changed from the previous quarter. The accountability for oversight of the management of each risk is allocated by the Audit Committee to either the full Board or to a Committee of the Board. At least once a year, the relevant business owners update the applicable Committee or the full Board on their risk management activities over the course of the preceding year.

In the normal course of business, the Company is exposed to financial and market risks that have the potential to negatively affect its financial performance. As such, the Company operates with policies and guidelines covering funding, investing, equity, commodity, foreign currency exchange and interest rate risk management. Policies and guidelines prohibit the use of any financial derivative instrument for trading or speculative purposes.

The operating, financial and reputational risks and risk management strategies identified by management are discussed below. Any of these risks has the potential to negatively affect financial performance. The Company has risk management strategies, including insurance programs, which are intended to mitigate the potential impact of these risks. Although these strategies are designed to minimize these risks, some of which are discussed below, the strategies do not guarantee that the associated risks will be mitigated or not materialize or that events or circumstances will not occur which could negatively affect the Company’s financial condition or performance.

12.1 OPERATING RISKS AND RISK MANAGEMENT

Strategic

The Company engages in strategic acquisitions and dispositions when it is in the best interests of its shareholders to do so. As a result of recent dispositions, the Company holds significant cash and short term investments and is continuing to assess strategic opportunities for the deployment of these funds. Strategies related to growth initiatives, product offerings and retail marketplace positioning must be understood and properly managed in order to deliver long term growth for the Company. The deployment of the funds and the execution of the Company's capital plans could pose a risk if they are not aligned with the strategy of the Company. In addition, the Company’s ability to operate in the long term is affected by long term investment decisions, the development and location of real estate and spending decisions made in the short term. Decisions related to rebuilding old networks of assets or increasing new assets could affect the Company’s ability to compete in the long term. The strategy is formulated annually by the Company's senior management and is communicated throughout the organization. It is reviewed on a periodic basis to drive execution and ensure ongoing relevance. If the Company’s strategy is not effectively communicated and executed, performance of the Company could suffer.
Management’s Discussion and Analysis

Change Management and Execution
Significant initiatives in support of Loblaw’s multi-year turnaround plan are currently underway or in the planning stages. These initiatives include the restructuring of Loblaw’s supply chain, execution of its information technology strategic plan and changes in its organizational structure. Success of these initiatives is dependent on management effectively realizing the intended benefits. Ineffective change management may result in disruptions to the operations of the business or affect the ability of Loblaw to change or implement and achieve its long term strategic objectives. In addition, the centralization of Loblaw may create synergies in some areas of the business but also increase the risk of losing valuable market knowledge at the regional levels and across the various banners.

To assist in the management of change throughout the organization, the Company has positioned teams to support its major change initiatives. Certain employees are dedicated to business change management and have a focus on communication, training and other support functions for major change initiatives within the Company. In addition, Loblaw has a Strategic Program Office which tracks progress on strategic initiatives and reviews new initiatives for alignment to the strategy. Despite these activities, any of the events noted above could negatively impact the Company’s performance. The Company may not always achieve the expected cost savings and other benefits of its initiatives.

Information Technology, Integrity and Reliability
To support the current and future requirements of the business in an efficient, cost-effective and well-controlled manner, the Company is reliant on information technology (“IT”) systems. These systems are essential in providing management with relevant, reliable and accurate information for decision making, including its key performance indicators. Any significant failure or disruption of these systems or the failure to successfully migrate from legacy systems to new systems as part of Loblaw’s significant IT infrastructure initiatives could negatively affect the Company’s reputation, ability to carry on business, revenues and financial performance. If the information provided by the IT systems is inaccurate, the risk of disclosing inaccurate or incomplete information is increased.

IT systems have been assessed by Loblaw management as needing significant upgrading in certain areas in order to act as an enabler for the businesses. An IT strategic plan was developed to guide the new systems environment that Loblaw requires. Loblaw recently completed the first year of its ERP implementation to integrate and simplify finance and general ledger systems across Loblaw Properties Limited and President’s Choice Financial. Loblaw is planning for additional system implementations in 2010 to streamline merchandising and operations activities. Completing these system implementations will require intense focus and significant investment over the next two years.

Change management risk and other associated risks will arise from the various projects which will be undertaken to upgrade existing systems and introduce new systems to effectively manage the business going forward. Failure by the Company to appropriately invest in IT or failure to implement IT infrastructure in a timely or effective manner may negatively impact the Company’s financial performance.

Information security risk and other associated risks will also arise from undertaking the various projects to upgrade existing systems and introduce new systems. The IT strategic plans include upgrading information security systems through adherence to information security standards by instituting stricter security system protocols and corporate information security policies. However, any failures in the Company’s information security systems or non-compliance with information security standards, including those in relation to personal information belonging to the Company’s customers, could result in harm to the reputation or competitive position of the Company and could negatively affect financial performance.

Economic Environment
The Company remains cautious that the economic factors that impact consumer spending patterns could deteriorate. These factors include continued high levels of unemployment, changes in interest rates, household debt, reduced disposable incomes and access to consumer credit, and changes in inflation. Management regularly monitors economic conditions and estimates their impact on the Company’s operations and incorporates these estimates in short term operating and longer term strategic decisions. Despite these activities, one or more of these factors could negatively affect the Company’s sales and margins. Inflationary trends are unpredictable and changes in the rate of inflation will affect consumer prices, which in turn could have a negative impact on the results of the Company.
Competitive Environment
The North American food processing and retail industries are evolving and operate in increasingly competitive markets. Consumers’ needs drive changes in the industries, and are impacted by changing demographic and economic trends such as changes in disposable income, ethnic diversity, health and environmental awareness and time availability. Customer satisfaction is central to the Company’s business. Over the past several years, consumers have demanded more choice, value and convenience. If the Company is ineffective in responding to these trends or ineffective in executing its strategies, its financial performance could be negatively impacted.

The Company reviews and monitors operating plans and results, including market share in its reportable operating segments. When necessary, the operating segments will modify their operating strategies, including but not limited to, relocating production facilities or stores, closing underperforming assets, relocating stores or reformatting them under a different banner, reviewing and adjusting pricing, product offerings, brand positioning and/or marketing programs to take into account competitive activity. A significant competitive advantage the Company has developed is its brands. Both operating segments focus on brand development and building upon their core brand equity. Weston Foods’ premium and mainstream brands provide Weston Foods with strong core brands and product lines that enhance consumer loyalty, trusted as they are for quality, great taste and freshness. Loblaw’s control label program represents a competitive advantage because it enhances customer loyalty by offering superior value and provides some protection against national brand pricing strategies.

As cost pressures remain in the food processing industry and the competitive sales environment, Weston Foods anticipates that industry restructurings are likely. Although the outcome and the impact, if any, on the Company’s consolidated financial results from this anticipated restructuring are uncertain, Weston Foods will closely monitor developments in the food processing industry and food retail market and, if required, adjust its strategies and programs as necessary.

Loblaw’s competitors include traditional supermarket operators, as well as mass merchandisers, warehouse clubs, drugstores, limited assortment stores, discount stores, convenience stores and specialty stores. Many of these competitors now offer a selection of food, drugstore and general merchandise. Others remain focused on supermarket-type merchandise.

The Company is also subject to competitive pressures from new entrants into the marketplace and from the expansion or combination of existing competitors, particularly those expanding into the grocery market. These competitors may have extensive resources to allow them to compete effectively with the Company in the long term. Several of the Company’s competitors operate in a non-union environment. These competitors may benefit from lower labour costs and more favourable operating efficiencies, making it more difficult for the Company to compete. Increased competition could adversely affect the Company’s ability to achieve its objectives.

The Company is subject to risks associated with food safety and non-food product defects. These risks may arise as part of the manufacturing, procurement, storage, distribution, preparation and display of products and, with respect to the Company's control label or branded products and contract manufactured products, in relation to the production, packaging and design of products. A majority of the Company’s sales are generated from food products and thus the Company could be vulnerable in the event of a significant outbreak of food-borne illness or other public health concerns related to food products. Such an event could negatively affect the Company’s financial performance. The traceability of products and ingredients may affect the Company’s ability to be effective in a recall situation.

Product recall programs are in place to manage such events, should they occur. The programs identify risks, provide procedures for communication to employees and consumers and are aimed at ensuring that potentially harmful products are expeditiously removed from inventory and are not available for sale. The Company has food safety procedures and training programs which address safe food handling and preparation standards. The Company endeavours to employ current best practices for the procurement, distribution, preparation and display of food products. Also, it actively supports customer awareness of safe food handling and healthy choices.

The Company places special focus on applying safety and quality management systems to ensure control label products meet all food safety, regulatory nutritional requirements and quality standards for today's health conscious consumer to make informed choices. The ability of these programs and procedures to address such events is dependent on their successful execution. The existence of these procedures does not mean that the Company will in all circumstances be able to mitigate the underlying risks and any event related to these matters has the potential to adversely affect the Company’s reputation and its financial performance.
Management’s Discussion and Analysis

Employee Attraction, Development and Retention
The degree to which the Company is not effective in attracting and retaining talented employees, developing its employees, managing performance and implementing appropriate succession planning processes and retention strategies could lead to a lack of requisite knowledge, skills and experience. Effective talent attraction, employee development, performance management, succession planning and employee retention are essential to sustaining the growth and success of the Company. Loblaw has implemented new programs throughout 2009 which will be ongoing into 2010 to assist in employee attraction, retention and development. The initiatives are focused on improving employee engagement and supporting Loblaw’s “Be a Great Place to Work” principle. Should these initiatives not be successful, the Company may not be able to execute its strategies, efficiently run its operations and its goals for financial performance may be adversely affected.

Distribution and Supply Chain
The need to invest in and improve the Company's supply chain may adversely affect the Company's capacity to effectively and efficiently attract and retain current and potential customers. A significant restructuring of Loblaw's supply chain will continue for the next two years. Although this initiative is expected to result in improved service levels for Loblaw's stores, the scale of the change and the implementation of new processes could cause disruption in the flow of goods to stores, which would negatively affect sales.

Labour Relations
A significant portion of the Company’s workforce is unionized. Renegotiating collective agreements may result in work stoppages or slowdowns, which could negatively affect the Company’s financial performance, depending on their nature and duration. In 2010, 80 collective agreements affecting approximately 35,800 employees will expire, including the Company’s single largest agreement covering approximately 13,700 employees. The Company will also continue to negotiate the 68 collective agreements carried over from 2005 to 2009 inclusively. The Company is willing to accept the short term costs of labour disruption in order to negotiate competitive labour costs and operating conditions for the longer term. Although the labour relations leadership team attempts to mitigate work stoppages and disputes through early negotiations, where possible, or by delaying negotiations through busy periods, work stoppages or slowdowns are possible.

Merchandising and Excess Inventory
Loblaw’s merchandising processes may create inventory that customers don’t want or need, is not reflective of current trends in customer tastes or habits, is priced at a level customers are not willing to pay, or is late in reaching the market. The Company’s operations as they relate to food, sales volume and product mix are impacted to some degree by certain holiday periods in the year. Certain of Loblaw’s general merchandise items are subject to more seasonal fluctuations. Loblaw focuses effort on reducing inventory levels and early identification of inventory at risk. New information systems are being implemented that are expected to improve demand forecasting. In order to reduce the amount of excess inventory, Loblaw monitors the impact of customer trends. Innovation is critical to Loblaw in order to respond to these customer demands and to stay competitive in the marketplace. Despite these efforts, Loblaw may experience excess inventory that cannot be sold profitably, which may negatively impact the Company’s financial performance.

Vendor Management and Business Partnership
Certain aspects of the Company’s business rely on third-party providers of goods and services. Although appropriate contractual arrangements are put in place with these suppliers, the Company has no direct influence over how the companies are managed. Negative events affecting the suppliers could in turn negatively impact the Company’s operations and its financial performance. Inefficient, ineffective or incomplete supplier management strategies, policies and/or procedures may impact the Company’s ability to optimize financial performance, meet customer needs and/or control costs and quality.

Certain of Weston Foods’ products and Loblaw’s control label products are manufactured under contract by third-party suppliers. In order to preserve the brands’ equity, these suppliers are held to high standards of quality. The Company also uses third-party logistic services including the operation of dedicated warehouse and distribution facilities and third-party common carriers. The Company maintains a strategy of multiple sources for logistics providers so that in the event of a disruption of service from one supplier, their services can be replaced by another. However, disruption in these services is possible, which could interrupt the flow of goods and therefore could negatively impact sales.
Offshore sourcing could provide products which contain harmful or banned substances or that do not meet Canadian standards. The Company continues to implement practices and performance expectations with its supplier base, including asking suppliers to support sales plans, cost reduction initiatives and to align with major program changes. Failure to effectively implement this program will have an impact on the Company’s ability to realize the expected benefits.

*President’s Choice Financial* banking services are provided by a major Canadian chartered bank. PC Bank uses third-party service providers to process credit card transactions, operate call centres and operationalize certain risk management strategies for the *President’s Choice Financial* MasterCard®. To minimize operating risk, PC Bank and Loblaw actively manage and monitor their relationships with all third-party service providers. PC Bank has developed a vendor management policy, approved by its Board of Directors, and has established a vendor management team that provides its Board of Directors with regular reports on vendor management and risk assessment.

The Company relies on third parties for investment management, custody and other services for its cash equivalents, short term investments, security deposits and pension assets. Any disruption in the services provided by these suppliers could affect the return on these assets or liquidity of the Company.

**Business Continuity**

Events or series of events may cause business interruptions which could potentially impact sales, profitability, colleague safety, reputation and customer service. The Company has a business continuity program which is being continually matured. However, there can be no assurance that the existence of a business continuity program will ensure the Company responds appropriately in the event of business interruptions, crises and potential disasters.

**Trademark and Brand Protection**

Decrease in value of the Company’s trademarks or brands, either because of adverse events or otherwise over time may threaten the demand for the Company’s products or services or damage the Company’s reputation. The Company endeavours to have the appropriate contractual protections in Loblaw’s arrangements with control label vendors and suppliers of all marketing elements (printing, flyers, advertising, etc.), and Weston Foods’ arrangements with contract manufacturers, distributors and customers. The Company actively monitors and manages its trademark portfolio. Notwithstanding these activities, any negative impact to the value of the Company’s trademarks or brands may impair its ability to maintain or grow current and future sales and profitability.

**Commodity Prices**

Weston Foods costs are directly impacted by fluctuations in the price of commodities such as wheat, flour, sugar, vegetable oil, cocoa, natural gas and fuel. Increases in the price of these commodities could adversely affect the Company’s financial performance. In order to minimize the economic effect of these price fluctuations on current operating results and to lessen the resulting uncertainty of future financial results, Weston Foods hedges a portion of its anticipated commodity purchases. Weston Foods enters into contracts that mitigate price fluctuations on some commodities for approximately 6 months, on average. There can be no assurance that the Company’s hedging arrangements will continue to achieve the purpose for which they are intended.

**Tax and Regulatory**

Changes to any of the laws, rules, regulations or policies related to the Company’s business including taxation, accounting and the production, processing, preparation, distribution, packaging and labelling of its products could have an adverse impact on its financial and operational performance. In the course of complying with such changes, the Company may incur significant costs.

Changing regulations or enhanced enforcement of existing regulations could threaten the Company’s competitive position and its capacity to efficiently conduct business. Failure by the Company to fully comply with applicable laws, rules, regulations and policies may subject it to civil or regulatory actions or proceedings, including fines, assessments, injunctions, recalls or seizures, which may have an adverse effect on the Company’s financial results.

The Company is subject to various laws regarding the protection of personal information and has adopted a Privacy Code setting out guidelines for the handling of personal information. Any failure of the Company to comply with these laws may result in damage to its reputation and negatively affect financial performance.

There can be no assurance that the tax laws and regulations in the jurisdiction affecting the Company will not be changed in a manner which could adversely affect the Company. New accounting pronouncements introduced by appropriate authoritative bodies may also impact the Company’s financial results.
Management’s Discussion and Analysis

Franchise and Independent Business Relationships
A significant portion of the Company’s revenues and earnings arise from franchisee type relationships. Franchisees and independent operators are independent businesses and, as such, their operations may be negatively affected by factors beyond the Company’s control, which in turn may damage the Company’s reputation and potentially affect revenues and earnings. Revenues and earnings could also be negatively affected, and Loblaw’s reputation could be harmed, if a significant number of retail franchisees were to experience operational failures, including health and safety exposures, experience financial difficulty, be unwilling or unable to pay Loblaw for products, rent or other fees, or fail to enter into renewals of franchise agreements. Loblaw’s franchise system is also subject to franchise legislation enacted by a number of provinces. Any new legislation or failure to comply with existing legislation may negatively affect operations and could add administrative costs and burdens, any of which could affect the Company’s relationship with its franchisees and independent operators. Relationships with franchisees could pose significant risks if they are disrupted which could result in legal action, reputational damage and/or adverse financial consequences.

Environmental, Health and Safety
The Company maintains a large portfolio of real estate and is subject to environmental risks associated with the contamination of such properties, whether by previous owners or occupants, neighbouring properties or from its own operations. The Company could be subject to increased or unexpected costs associated with the related remediation activities.

The Company has environmental, health and workplace safety programs and has established policies and procedures aimed at ensuring compliance with applicable environmental legislative requirements. To this end, the Company employs environmental risk assessments and audits using internal and external resources together with employee awareness programs throughout its operating locations. In the area of health and safety, the Company has established a national health and safety policy, and an injury reduction plan, which is administered by functional corporate and regional safety steering committees.

The Environmental, Health and Safety Committee of the Board receives regular reporting from management addressing current and potential future issues, risks, programs/initiatives, identifying new regulatory concerns and related communication efforts. The Company’s dedicated Environmental Affairs department works closely with the operations to help ensure requirements are met. Despite these efforts, adverse environmental, health and safety events could negatively affect the Company’s reputation and financial performance. In addition, in recent years, provincial and municipal governments have introduced legislation that imposes liabilities on retailers, brand owners and importers for costs associated with recycling and disposal of consumer goods packaging and printed materials distributed to consumers. This is a growing trend and the Company expects to be subject to increased costs associated with these laws.

Employee Future Benefit Contributions
The Company manages the assets in its defined benefit pension plans by engaging professional investment managers who operate under prescribed investment policies and procedures in respect of permitted investments and asset allocations. The future contributions to the Company’s pension plans are impacted by the investment performance of the plan assets and the discount rate used to value the liabilities of the plans. The Company regularly monitors and assesses plan experience and the impact of changes in participant demographics, changes in capital markets and other economic factors that may impact funding requirements, employee future benefit costs and actuarial assumptions. If capital market returns are below assumed levels or if the discount rate drops, the Company may be required to make contributions to its funded defined benefit pension plans in excess of those currently contemplated, which in turn may have a negative effect on the Company’s financial performance and cash flow.

Multi-Employer Pension Plans
In addition to the Company-sponsored pension plans, the Company participates in various multi-employer pension plans, providing pension benefits in which approximately 38% (2008 – 39%) of employees of the Company and of its independent franchisees participate. The administration of these plans and the investment of their assets are legally controlled by boards of independent trustees generally consisting of an equal number of union and employer representatives. In some circumstances, the Company may have a representative on the board of trustees of these multi-employer pension plans. The Company’s responsibility to make contributions to these plans is limited by the amounts established pursuant to its collective agreements; however, poor performance of these plans could have an adverse impact on the Company’s employees and former employees who are members of these plans. Pension cost for these plans is recognized as contributions are due.
Real Estate and Store Renovations
Real estate development plans may be contingent on successful negotiation of labour agreements with respect to same-site expansion or redevelopment. Loblaw maintains a significant portfolio of owned retail real estate and, whenever practical, pursues a strategy of purchasing sites for future store locations. This enhances Loblaw’s operating flexibility by enabling Loblaw to introduce new departments and services that could be precluded under third-party operating leases. As part of its ongoing review of the performance of, and customer satisfaction with, its stores, Loblaw from time to time undertakes store renovations and remodelling. Efforts are made to minimize the duration of renovation and remodelling projects in order to limit the disruption at store level. However, Loblaw could be negatively impacted if such renovations and remodelling are carried out in a manner that is disruptive to the ongoing store operations or results in a poor customer experience.

Utility and Fuel Prices
The Company is a significant consumer of electricity, other utilities and fuel. The Company has entered into contracts to fix the price of a portion of its future variable costs associated with electricity, natural gas and fuel. However, cost increases in these items could negatively affect the Company’s financial performance.

Ethical Business Conduct
Any failure of the Company or its vendors to adhere to ethical business conduct policies, the law or ethical business practices could significantly affect the Company’s reputation and brands and could, therefore, negatively impact the Company’s financial performance.

The Company has adopted a Code of Business Conduct which employees and directors of the Company are required to acknowledge on a regular basis. The Company has in place an Ethics and Business Conduct Committee which monitors compliance with the Code of Business Conduct and determines how the Company can best ensure it is conducting its business in an ethical manner. The Company encourages reporting of unethical conduct and has established a toll-free anonymous response line, which can be used by employees to report suspected accounting, internal control or auditing irregularities and unethical behaviour impacting the Company. Loblaw has also adopted a Vendor Code of Conduct which outlines its ethical expectations to its vendor community in a number of areas, including social responsibility.

Holding Company Structure
GWL is a holding company. As such, it does not carry on business directly but does so through its subsidiaries. It has no major source of income or assets of its own, other than the interests it has in its subsidiaries, which are all separate legal entities. GWL is therefore financially dependent on dividends and other distributions it receives from its subsidiaries.

12.2 FINANCIAL RISKS AND RISK MANAGEMENT

Foreign Currency Exchange Rate
The Company’s consolidated financial statements are expressed in Canadian dollars, however a portion of the Company’s (excluding Loblaw’s) net assets are denominated in U.S. dollars through both its net investment in self-sustaining foreign operations in the United States, and its investment in integrated foreign subsidiaries through Dunedin and certain of its affiliates. The U.S. dollar denominated net assets are translated into Canadian dollars at the foreign currency exchange rate in effect at the balance sheet date. As a result, the Company is exposed to exchange rate gains and losses. Prior to the sale of the U.S. fresh bakery business, all of the Company’s (excluding Loblaw’s) U.S. dollar denominated net assets were held in self-sustaining foreign operations. Exchange rate gains and losses due to the translation of these self-sustaining foreign operations’ net assets were recorded in accumulated other comprehensive loss. After the sale of the U.S. fresh bakery business in 2009, Dunedin and certain of its affiliates became integrated foreign subsidiaries for accounting purposes. As a result, gains and losses arising from the translation of the U.S. dollar denominated assets of these integrated foreign subsidiaries are included in operating income. In addition, revenues and expenses of these integrated and self-sustaining foreign operations are translated into Canadian dollars at the foreign currency exchange rates that approximate the rates in effect at the dates when such items are recognized. An appreciating Canadian dollar relative to the U.S. dollar will negatively impact year-over-year changes in reported sales, operating income and net earnings, while a depreciating Canadian dollar relative to the U.S. dollar will have the opposite impact.

Loblaw is exposed to foreign currency exchange rate variability, primarily on U.S. dollar denominated cash and cash equivalents, short term investments and security deposits held by Glenhuron, foreign denominated and foreign currency based purchases in accounts payable and accrued liabilities, and U.S. dollar private placement notes included in long term debt. Loblaw and Glenhuron have cross currency swaps that partially offset their respective exposure to fluctuations in foreign currency exchange rates. Cross currency swaps are transactions in which interest payments and principal amounts in one currency are exchanged against the receipt of interest payments and principal amounts in a second currency.
Management’s Discussion and Analysis

Credit
The Company is exposed to credit risk resulting from the possibility that counterparties may default on their financial obligations. Exposure to credit risk relates to derivative instruments, cash equivalents, short term investments, security deposits, pension assets held in the Company’s defined benefit plans, PC Bank’s credit card receivables and other receivables from Weston Foods’ customers and suppliers and Loblaw’s independent franchisees, associated stores and independent accounts.

The Company may be exposed to losses if a counterparty to the Company’s financial or non-financial derivative agreements fails to fulfill its obligations. Potential counterparty risk and losses are limited to the net amounts recoverable under such derivative agreements with any specific counterparty. These risks are further reduced by entering into agreements with counterparties that have a minimum long term “A” credit rating from a recognized credit rating agency and by placing risk adjusted limits on exposure to any single counterparty for financial derivative agreements. Internal policies, controls and reporting processes are in place which require ongoing assessment and corrective action, if necessary, with respect to derivative transactions.

Credit risk associated with cash equivalents, short term investments and security deposits results from the possibility that a counterparty may default on the repayment of a security. Policies and guidelines that require issuers of permissible investments to have a minimum long term “A” credit rating from a recognized credit rating agency and that specify minimum and maximum exposures to specific industries, issuers and types of investment instruments mitigate credit risk. These investments are purchased and held directly in custody accounts and have limited exposure to third-party money market portfolios and funds.

Credit risk associated with investments in the Company’s defined benefit pension plans is described in the Employee Future Benefits Contributions discussion in Section 12.1 of this MD&A.

Credit risk from PC Bank’s credit card receivables, receivables from Weston Foods’ customers and suppliers and Loblaw’s independent franchisees, associated stores and independent accounts results from the possibility that customers may default on their payment obligations. PC Bank manages the credit card receivable risk by employing stringent credit scoring techniques, actively monitoring the credit card portfolio and reviewing techniques and technology that can improve the effectiveness of the collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers.

Receivables from Weston Foods’ customers and suppliers and Loblaw’s independent franchisees, associated stores and independent accounts are actively monitored and counterparties are assessed for credit risk on an ongoing basis.

Commodity Price
Weston Foods costs are directly impacted by fluctuations in the prices of commodities such as wheat, flour, sugar, vegetable oil, cocoa, natural gas and fuel. Loblaw is exposed to increases in the prices of commodities in operating its stores and distribution centres, as well as the indirect link of commodities to its consumer products. To manage a portion of this exposure, Loblaw uses purchase commitments for a portion of its needs for certain consumer products that may be commodities based and Loblaw expects to take delivery of these consumer products in the normal course of business. In addition, both Weston Foods and Loblaw use financial and non-financial derivative instruments in the form of futures contracts, option contracts and forward contracts to manage their current and anticipated exposure to fluctuations in commodity prices.

Interest Rate
Interest rate risk arises from the issuance of short term debt and equity derivatives, net of cash and cash equivalents, short term investments and security deposits. The Company is exposed to changes in short term interest rate volatility which are offset partly by Glenhuron’s and Loblaw’s interest rate swaps. Interest rate swaps are transactions in which interest flows are exchanged with a counterparty on a specified notional amount for a pre-determined period based on agreed-upon fixed and floating interest rates.

Common Share Market Price
GWL and Loblaw issue stock-based compensation to their employees in the form of stock options and RSUs based on their respective underlying common shares. Consequently, operating income is negatively impacted when the common share prices increase and positively impacted when the share prices decline. The equity derivatives provide a partial offset to fluctuations in stock-based compensation cost. The equity derivatives allow for settlement in cash, common shares or net settlement. These derivatives change in value as the market prices of the respective underlying common shares change and provide a partial offset to fluctuations in stock-based compensation costs, including RSU plan expense. The partial offset between stock-based compensation costs, including RSU plan expense, and the equity derivatives is more effective when the market price of the respective underlying common shares exceeds the exercise price of the employee stock options. When the market price of the respective underlying common shares is lower than the exercise price of the
employee stock options, these equity derivatives provide a partial offset only to the RSU plan expense. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs, their vesting schedules relative to the number of respective underlying common shares on the equity derivatives and the level of fluctuations in the market price of the respective underlying common shares.

Changes in the Loblaw common share price impact the Company's interest and other financing charges. In 2001, Weston Holdings Limited (“WHL”) entered into an equity forward sale agreement based on 9.6 million Loblaw common shares at an original forward price of $48.50 per Loblaw common share which, under the terms of the agreement, had increased to a forward price of $80.28 (2008 – $76.52) per Loblaw common share as at December 31, 2009. The forward matures in 2031 and will be settled in cash as follows: WHL will receive the forward price and will pay the market value of the underlying Loblaw common shares at maturity. The obligation of WHL under this forward is secured by the underlying Loblaw common shares. WHL recognizes a non-cash charge or income, which is included in consolidated interest expense and other financing charges, representing the fair value adjustment of WHL's forward sale agreement for 9.6 million shares. The fair value adjustment in the forward contract is a non-cash item resulting from fluctuations in the market price of the underlying Loblaw shares that WHL owns. WHL does not record any change in the market price associated with the Loblaw shares it owns. At maturity, if the forward price is greater than the market price, WHL will receive a cash amount equal to the difference. If the forward price is less than the market price, WHL will pay a cash amount equal to the difference. Any cash paid under the forward contract could be offset by the sale of Loblaw shares.

**Liquidity and Capital Availability**

Liquidity risk is the risk that the Company cannot meet a demand for cash or fund its obligations as they come due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. Insufficient access to capital would impair the Company's capacity to grow, execute its business model and generate financial returns.

Should the Company's financial performance and condition deteriorate or downgrades in the Company's credit ratings occur, the Company's ability to obtain funding from external sources may be restricted. In addition, credit and capital markets are subject to inherent global risks that may negatively affect the Company's short term investments as well as its access to external capital to fund its liabilities, including financial liabilities. The Company mitigates these risks by maintaining appropriate levels of cash and cash equivalents and short term investments in highly rated liquid securities, committed lines of credit and by diversifying the sources and maturity profile of its external capital.

In March 2011, $500 million of credit card receivables-backed notes issued by Eagle will mature. The notes were issued by Eagle to fund the purchase of an interest in PC Bank originated credit card receivables. An accumulation period that requires PC Bank to set aside cash collections will begin approximately 6 months prior to the maturity of the notes, or at such earlier or later date declared by the Trust. PC Bank and Loblaw expect to have sufficient access to short term liquidity to fund the accumulation and long term funding and securitization facilities to replace or refinance this facility.

**Derivative Instruments**

Over-the-counter derivative instruments offset certain risks. The fair value of derivative instruments is subject to changing market conditions which could negatively impact earnings. Policies and guidelines prohibit the use of any derivative instrument for trading or speculative purposes. See notes 1 and 26 to the consolidated financial statements for additional information about the Company’s financial derivative instruments.

13. RELATED PARTY TRANSACTIONS

The Company's majority shareholder, Wittington Investments, Limited (“Wittington”), and its affiliates are related parties. The Company, in the normal course of business, has routine transactions with these related parties, including the rental of office space at market prices from Wittington. In 2009, rental payments amounted to approximately $3 million (2008 – $3 million). It is the Company’s policy to conduct all transactions and settle balances with related parties on market terms and conditions.

From time to time, the Company and Wittington may make elections that are permitted or required under applicable income tax legislation with respect to affiliated corporations and, as a result, may enter into agreements in that regard. These elections and accompanying agreements do not have any material impact on the Company.