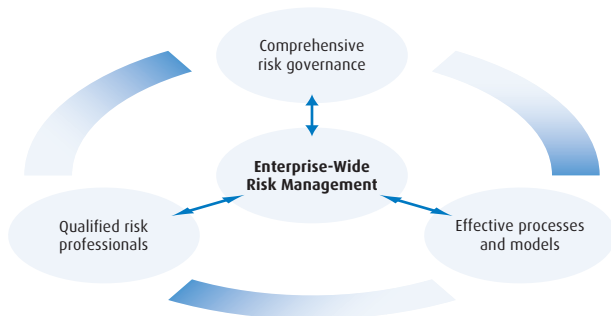


Enterprise-Wide Risk Management

BMO Financial Group has an enterprise-wide capability to recognize, understand, measure, assess and manage the risks taken across the organization. These risks are classified as credit and counterparty, market, liquidity and funding, operational, and business risk due to earnings volatility.



Our risk framework guides our risk-taking activities and ensures that they are aligned with our clients' needs, our shareholders' expectations and regulatory requirements. It provides not only for the direct management of each individual risk type but also for the management of risks on an integrated basis. The framework is built on the following elements: comprehensive risk governance, effective processes and models, and qualified risk professionals.

Comprehensive Risk Governance

BMO's risk governance structure promotes making sound business decisions by balancing risk and reward. It promotes revenue-generating activities that are consistent with our risk appetite and standards, and drives the maximization of total shareholder return.

Our comprehensive risk governance structure (see box below) includes a body of corporate policies approved by the Board of Directors. These and subordinate risk management



Ronald G. Rogers
Deputy Chair, Enterprise Risk and Portfolio Management, BMO Financial Group

policies, standards and procedures are continually reviewed to ensure that they provide effective and superior governance of our risk-taking activities.

Risk limits, which define BMO's risk appetite, are reviewed and approved annually by Risk Review Committee for:

- credit and counterparty risk – limits on country, industry, portfolio products/segments, group and single name exposures;
- market risk – limits on Market Value Exposure (MVE), Earnings Volatility (EV) and stress testing; and
- liquidity and funding risk – limits for liquid assets, liability diversification, credit and liquidity commitments, asset pledging and cash flow mismatches.

These risk limits generally encompass both on and off-balance sheet arrangements.

Individual risk committees establish and monitor comprehensive risk management limits consistent with the Board-approved limits. Loss limits are also in place to provide an early warning mechanism to effectively address potential loss situations. In each line of business, management ensures that governance activities, controls and management processes are consistent with risk management policies and corporate standards.

Risk Review Committee of the Board of Directors (RRC) assists the Board in fulfilling its oversight responsibilities in relation to BMO's identification and management of risk, adherence to internal risk management policies and procedures, and compliance with risk-related regulatory requirements.

The President and Chief Executive Officer (CEO) is directly accountable to the Board for all of BMO's risk-taking activities. Risk Management Committee and its sub-committees and Enterprise Risk and Portfolio Management support the CEO.

Risk Management Committee (RMC), BMO's senior risk committee, reviews and discusses significant risk issues and action plans that arise in executing the organization's strategy. RMC ensures that risk oversight and governance occur at the highest levels of management.

RMC sub-committees have oversight responsibility for management strategy, governance, risk measurement and contingency planning. RMC and its sub-committees ensure that the risks incurred across the organization are consistent with strategy and are identified, measured, monitored and reported in accordance with policy and within delegated limits.

Enterprise Risk and Portfolio Management (ER&PM) encompasses credit adjudication, risk management and audit functions. It ensures consistency of risk management practices and standards throughout the enterprise. ER&PM facilitates a disciplined approach to risk-taking through the execution of transactional and portfolio management, policy formulation, risk reporting, modelling, vetting and risk education responsibilities. This ensures corporate objectives are met while risks taken are consistent with BMO's risk appetite.

Effective Processes and Models

Rigorous processes, periodically reviewed by Corporate Audit, are used across BMO to:

- develop policies and limits for approval by senior governance committees;
- monitor policy compliance;
- maintain contingency plans;
- track variables for changing risk conditions; and
- provide timely reports to senior management and the appropriate governance committees.

Models used range from the very simple to those that value complex transactions or involve sophisticated portfolio and capital management methodologies. These models are used to guide strategic decisions and to assist in making daily lending, trading, underwriting, funding, investment and operational decisions. Models have also been developed to measure exposure to risk and to measure total risk on an integrated basis, using capital at risk (CaR). We have strong controls over the development, implementation and application of these models, which are subject to a periodic independent model risk vetting process.

BMO also utilizes various processes and models within risk types to:

- assess the correlation of credit risks before authorizing new exposures;
- measure and value portfolio exposures and calculate related market risk exposure;
- measure the business and operational risk for each line of business; and
- estimate liquidity and funding risk based on expected and stressed operating conditions.

Qualified Risk Professionals

Sound enterprise-wide risk management relies upon the competence and experience of our risk professionals to:

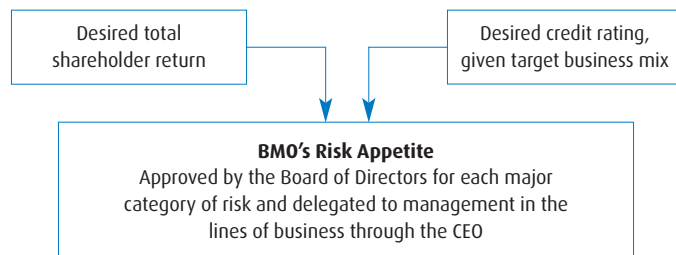
- promote a culture that places high value on disciplined and effective risk management processes and controls;
- ensure adherence to established risk management standards for the evaluation and acceptance of risk; and
- apply sound business judgment, using effective business models in our decision-making.

We offer a risk curriculum program, now in its second year, developed and delivered in partnership with York University's Schulich School of Business. This graduate certificate program enhances our existing risk management capabilities and promotes the development of our risk professionals.

Additionally, risk managers and lenders may be required to complete a progressive curriculum of credit risk courses offered by BMO's Institute for Learning in order to be considered appropriately qualified for their positions. These courses, together with defined job exposures, provide training and practice in sound credit risk management as a prerequisite to the granting of appropriate discretionary lending authority to qualified professionals.

Integrated Risk Management

The management of risk is integrated with our management of capital and strategy. This ensures that risks incurred in pursuit of BMO's strategic objectives are consistent with desired total shareholder return as well as BMO's desired credit rating and risk levels, or risk appetite.



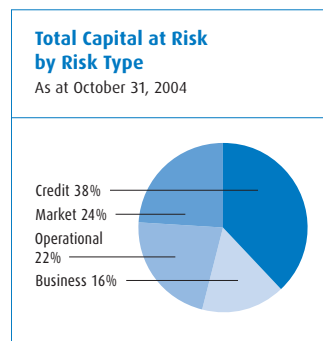
Two frameworks support the management of risk: change management and integrated risk management. They are designed to:

- ensure that changes to the organization's risk profile associated with new business initiatives are correctly identified and receive appropriate approvals before implementation; and
- assess the relative magnitude of risks taken and the distribution of those risks across the organization's activities.

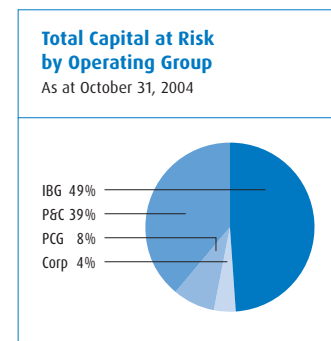
Integrated risk management activities are supported by the use of capital at risk (CaR) measures, scenario analysis and stress testing.

CaR provides a single measure of risk that can be compared across business activities and risk types. It is the foundation for risk-based capital management and permits the cost of capital to be charged to the lines of business. CaR indicates, in terms of capital, the likely magnitude of losses that could occur if adverse situations arise, and allows returns to be adjusted for risks. For each risk type noted in the chart below, CaR measures are based on a confidence level of 99.95% and a time horizon of one year.

As noted in the chart below, BMO's largest exposure is credit risk.



Credit risk is the largest contributor to CaR.



CaR by operating group was relatively unchanged in 2004, with Investment Banking Group having the largest CaR.

Scenario analysis assists in measuring the impact of extreme, but plausible, operational, political, economic and market events on our operations. Scenarios may be based on historical or hypothetical events, or a combination thereof. They are applied to all significant risk-taking activities across the organization.

We also conduct ongoing industry stress tests designed to stress BMO's credit exposures to a specific industry or to several industries that are highly correlated. These tests attempt to gauge the effect of various scenarios on default probabilities and loss rates in the portfolio under review. This provides significant insight into the sensitivity of our exposures to the underlying risk characteristics of the industries under review.

Basel II (International Convergence of Capital Measurement and Capital Standards: A Revised Framework)

The Basel Committee on Banking Supervision finalized the development of the "Basel II" framework in June of 2004. Basel II provides guidelines for the calculation of regulatory capital required to support credit and operational risk exposures. The framework allows internationally active banks to use either advanced or standardized approaches to calculate regulatory capital associated with credit and operational risks.

The Office of the Superintendent of Financial Institutions (OSFI), the Canadian regulator, requires internationally active Canadian banks to adopt an advanced approach for the calculation of credit risk regulatory capital. However, for the calculation of operational risk regulatory capital, OSFI allows banks to choose from among any of the approaches identified in Basel II. Canadian banks will implement the framework on October 31, 2007, following a two-year parallel run with the existing Basel I regulatory capital rules.

BMO is implementing an Advanced Internal Ratings-Based approach for credit risk regulatory capital calculations and is adopting a Standardized Approach for operational risk capital calculations. An integrated enterprise-wide program links business requirements with the "design and build" of technology solutions. Leadership and oversight are provided by a steering committee comprising senior executives from all stakeholder groups.

BMO views Basel II as an important step in the alignment of regulatory and economic capital requirements.

Credit and Counterparty Risk

BMO incurs credit and counterparty risk primarily in its lending activities (including the sale of Treasury products and other risk management products) and, to a lesser extent, by holding investment securities. We employ comprehensive governance and management processes surrounding credit risk management activities. These include:

- corporate policies, standards and procedures governing the philosophy, principles and conduct of credit risk management activities;
- a well-developed limit-setting and monitoring process;
- oversight by senior governance committees;
- independent Credit Risk Management units and Corporate Audit functions within ER&PM; and
- a rigorous lender qualification process.

BMO's credit risk management process is well established and effective, as evidenced by our historic low loan loss experience, which compares favourably to our Canadian peer group. The process involves the use of skilled and qualified professional lenders and risk managers, clear delegation of decision-making authority, personal accountability, specific borrower limits and account monitoring, and dynamic portfolio management. Credit decisions are made at a management level appropriate to the size and risk of each transaction.

We have a well-diversified portfolio, focused on North America and comprising credit relationships with millions of clients, the majority of them consumers and small to medium-sized businesses. BMO's credit risk governance policies ensure that an acceptable level of diversification is maintained at all times.

Credit and counterparty risk is the potential for loss due to the failure of a borrower, endorser, guarantor or counterparty to repay a loan or honour another financial obligation. This is the most significant measurable risk that BMO faces.

Operating practices include ongoing monitoring of credit risk exposures, regular review on an account and portfolio basis, and frequent portfolio and sector reporting to RMC and RRC. All borrowing accounts are reviewed regularly, with most individual commercial and corporate accounts reviewed no less than annually. Corporate Audit reviews management processes as well as a representative sample of credit transactions for adherence to sound credit risk management principles, practices, policies and procedures. In addition, BMO carries out regular portfolio sector reviews, including stress testing and scenario analysis, which are based on current, emerging or prospective risks.

For the consumer and small business portfolios, credit risk models and decision-making methodologies are developed using established statistical techniques and expert systems for underwriting and monitoring purposes. Adjudication models, behavioural scorecards, decision trees and expert knowledge are combined to produce optimal credit decisions in an automated environment. Application characteristics and past performance are used to predict the credit performance risk of new accounts. Past performance is used to identify likely future behaviour of existing accounts for ongoing credit risk management purposes.

BMO utilizes an enterprise-wide risk rating framework that is applied to all our sovereign, bank, corporate and commercial counterparties. Ratings are assessed and assigned on two separate and distinct planes: (i) individual counterparty risk characteristics and (ii) transaction-specific factors. We believe

that our risk rating framework is consistent with the principles of Basel II, under which future minimum regulatory capital requirements for credit risk will be determined. The default probabilities of individual counterparties over a one-year time horizon are assessed using methodologies and rating criteria tailored to the nature of the various counterparties. A borrower risk rating is derived from this assessment. Borrower risk ratings rank credit default risk on a sixteen-point scale, including two categories for accounts that have defaulted and/or are impaired. Fixed probabilities of default are assigned to the individual rating grades; consequently, counterparties migrate between grades as our assessment of their probability of default changes. The borrower risk rating scale is shown below.

BMO's Borrower Risk Rating Scale			
BMO rating	Description of risk	Moody's Investor Services implied equivalent	Standard & Poor's implied equivalent
I-1	Undoubted sovereign	Aaa Sovereign	AAA Sovereign
I-2	Undoubted	Aaa/Aa1	AAA/AA+
I-3	Minimal	Aa2/Aa3	AA/AA-
I-4	Modest	A1/A2/A3	A+/A/A-
I-5		Baa1	BBB+
I-6	Average	Baa2	BBB
I-7		Baa3	BBB-
S-1	Acceptable	Ba1	BB+
S-2		Ba2	BB
S-3	Marginal	Ba3	BB-
S-4		B1	B+
P-1	Uncertain	B2	B
P-2	Watch list	B3	B-
P-3		Caa/C	CCC/C
D-1	Default	C	D
D-2	Default and impaired	C	D

Two transaction-specific factors are assessed to estimate the severity of the loss should a counterparty default occur. The first factor is an estimate of the likely future exposure to the counterparty at the time of default. This expected future exposure is determined on a case-by-case basis by examining the specific characteristics of both the transaction and the counterparty. The second factor is an estimate of the proportion of the exposure that will be lost if a counterparty default occurs. This factor is assessed for each transaction by the analysis of transaction-specific factors such as collateral and the seniority of our claim.

BMO utilizes various models to assess the extent and correlation of risks before authorizing new exposures on large corporate credit transactions. Expected loss (EL) and unexpected loss (UL) are calculated for large individual transactions and for the portfolio as a whole. EL and UL are determined using inputs that calculate the capital at risk for each of the relevant lines of business. The estimates of EL and UL rely upon:

- management's judgment;
- probabilities of default;
- amounts of outstanding exposures at the time of default;
- differences between the book value and the market value or realizable value of loans, if default occurs; and
- effects of economic and industry cycles on asset quality and loan values.

Credit derivative products are increasingly important tools used to enhance the management of BMO's portfolio of credit risk assets, primarily the corporate loan portfolio. Currently, BMO uses single-name credit default swaps to mitigate the credit risk related to specific client credit exposures, and uses structured credit default swaps to mitigate identified sectoral risk concentrations.

BMO's provisioning approach embodies disciplined loan loss management and evaluation, with prompt identification of problem loans being a key risk management objective. All problem accounts are subject to close monitoring and are reviewed no less than quarterly.

BMO employs two key credit measures:

- Gross impaired loans and acceptances as a percentage of equity and allowances for credit losses is used to assess the condition of a portfolio by comparing the level of impaired loans to the capital and reserves available to absorb loan losses.
- Provision for credit losses as a percentage of average net loans and acceptances (including securities purchased under resale agreements) is a measure of our credit losses occurring in the year relative to the size of our portfolio. It is a measure of credit quality experience and is monitored for both specific and total provisions.

Page 19 includes a historical comparison of BMO's performance on these key measures relative to our Canadian and North American peers. Our 2004 provision for credit losses is discussed on page 31.

Note 4 on page 91 of the financial statements and Tables 11 to 19 on pages 76 to 79 provide details of BMO's loan portfolio, impaired loans and provisions and allowances for credit losses. Portfolio diversification is shown in the graph on page 50.

BMO maintains specific allowances and general allowances for credit losses. The specific allowances reduce the aggregate carrying value of credit assets that bear evidence of deterioration in credit quality to their estimated realizable amounts. The general allowance is maintained in order to absorb any impairment in the existing portfolio that cannot yet be associated with specific credit assets. The sum of these allowances must always be sufficient to reduce the book value of credit assets to their estimated realizable value. In 2004, we reduced our general allowance for credit losses by \$170 million to \$1,010 million.

Market Risk

BMO incurs market risk in its trading and underwriting activities and structural banking activities.

As part of our enterprise-wide risk management framework, we employ comprehensive governance and management processes surrounding market risk-taking activities. These include:

- oversight by senior governance committees, including Market Risk Committee (MRC), RMC and RRC;
- independent market risk oversight functions;
- independent process and internal control reviews by Corporate Audit;
- effective processes to measure market risks linked to the allocation of economic capital and the valuation of positions;
- a well-developed limit-setting and monitoring process;
- effective controls over processes and models used; and
- a framework of scenario and stress tests for worst-case events.

BMO's primary market risk measures are Market Value Exposure (MVE) and Earnings Volatility (EV). The aggregate market value and earnings volatility exposures at October 31, 2004 are summarized in the following table. MVE has increased modestly relative to last year, primarily due to growth in common shareholders' equity in the structural balance sheet. EV exposure has declined relative to last year due to decreased exposure in the money market accrual portfolios and a lower risk assessment of the mark-to-market portfolios. The decrease in mark-to-market portfolio risk is the result of the implementation of our Comprehensive Value at Risk model, which better reflects the correlations between different classes of market risk.

Aggregate MVE and EV Exposure for Trading and Underwriting and Structural Positions (\$ millions)*

As at October 31 (After-tax Canadian equivalent)	Market value exposure		12-month earnings volatility	
	2004	2003	2004	2003
Trading and underwriting	10.0	18.0	18.0	33.4
Structural	340.2	311.6	28.0	24.8
Total	350.2	329.6	46.0	58.2

*Measured at a 99% confidence level.

Trading and Underwriting Market Risk

BMO's trading and underwriting activities include portfolios that are marked to market daily, as well as some portfolios (such as money market assets) that are subject to accrual accounting rules under generally accepted accounting principles. For these activities, VaR measures the magnitude of BMO's market risk.

During fiscal 2004, we implemented our Comprehensive Value at Risk model for market risk management and reporting of exposures in the mark-to-market trading and underwriting portfolios. The new model better reflects the correlations between the different classes of market risk and incorporates methodology improvements for more complex trading products. At year-end, the Comprehensive VaR model had not yet been approved for use in calculating regulatory capital.

Market risk is the potential for a negative impact on the balance sheet and/or income statement resulting from adverse changes in the value of financial instruments as a result of changes in certain market variables. These variables include interest rates, foreign exchange rates, equity or commodity prices and their implied volatilities, as well as credit spreads, credit migration and default.

Market Value Exposure (MVE) is a measure of the adverse impact of changes in market parameters on the market value of a portfolio of assets, liabilities and off-balance sheet positions, measured at a 99% confidence level over a specified holding period. The holding period considers current market conditions and composition of the portfolios to determine how long it would take to neutralize the market risk without adversely affecting market prices. For trading and underwriting activities, MVE is comprised of VaR and issuer risk.

Earnings Volatility (EV) is a measure of the adverse impact of potential changes in market parameters on the projected 12-month after-tax net income of a portfolio of assets, liabilities and off-balance sheet positions, measured at a 99% confidence level over a specified holding period.

Value at Risk (VaR) is measured for specific classes of risk in BMO's trading and underwriting activities: interest rate, currency, equity and commodity prices and implied volatilities. This measure calculates the maximum likely loss from portfolios, over an appropriate holding period, measured at a 99% confidence level.

Issuer risk arises in BMO's trading and underwriting portfolios, and measures the adverse impact of credit spread, credit migration and default risks on the market value of non-sovereign fixed income instruments and similar securities. Issuer risk MVE is measured at a 99% confidence level over an appropriate holding period.

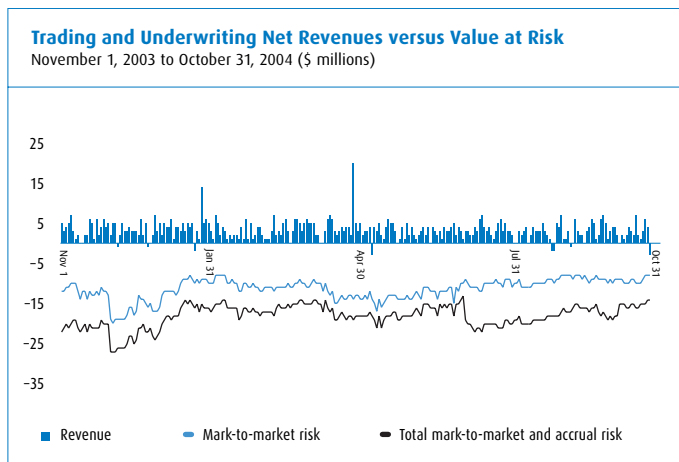
Various VaR models are used to determine market risk capital at risk for each of the lines of business, and are also used to determine regulatory capital under the standards of the 1998 Basel I Accord. For capital calculation purposes, longer holding periods and/or higher confidence levels are used than are employed for day-to-day risk management. Models used to determine EV exposures are the same as or similar to those used to determine VaR exposures.

Market risk exposures arising from trading and underwriting activities are summarized in the following table.

Total Trading and Underwriting VaR Summary (\$ millions)*

For the year ended October 31, 2004 (Pre-tax Canadian equivalent)	Year-end	Average	High	Low
Commodity VaR	1.1	1.3	3.3	0.5
Equity VaR	3.9	4.4	13.1	2.3
Foreign exchange VaR	0.5	1.4	3.8	0.1
Interest rate VaR (mark-to-market)	3.8	5.2	11.2	3.4
Correlation effect	(4.6)	(5.4)	(8.8)	(1.4)
Comprehensive VaR	4.7	6.9	14.9	4.2
Interest rate VaR (accrual)	6.3	7.5	11.9	4.3
Credit spread VaR	4.0	4.5	7.0	2.9
Total VaR	15.0	18.9	28.4	14.1

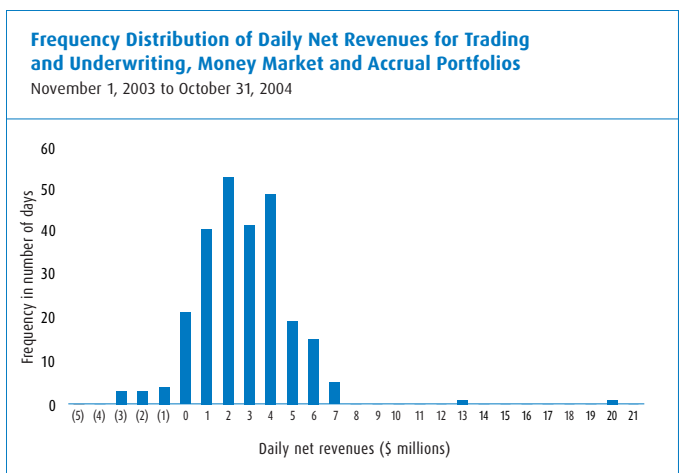
*One-day measure using a 99% confidence level.



BMO did not experience a loss in 2004 in the trading and underwriting portfolios that exceeded the overall VaR measure.

We also measure exposure to concentrations of market risk, such as changes in particular interest rates, foreign exchange rates, equity or commodity prices and their related implied volatilities.

Effective controls over the revaluation of trading and underwriting portfolios and the determination of daily revenue from these activities enable us to monitor the revenue generated by each of the lines of business in relation to their business strategies and their level of market risk.



The distribution of our daily net revenue for the portfolios reflects the broad diversification of risk in our trading activities, designed to reduce the volatility of daily net revenues. There were two occasions in 2004 when unusually favourable market conditions contributed to particularly high daily net revenue.

Trading revenues include amounts from all trading and underwriting activities, whether accounted for on a mark-to-market basis or an accrual basis, and also include certain fees and commissions directly related to those activities.

We monitor the application of our models to ensure that they are appropriate to the particular portfolio to which they are applied, and we take corrective action, including making adjustments to the determination of daily net trading revenues, when model limitations are identified.

We use a variety of methods to ensure the integrity of these models, including the application of backtesting against hypothetical losses. This process assumes there are no changes in the previous day's closing positions. The process then isolates the effects of each day's price movements against these closing positions. Models are considered to be validated by such testing if, on average, calculated hypothetical losses exceed the VaR measure only one time out of 100. Results of this testing confirm the reliability of our models.

The models used to measure market risks are effective at measuring risks under normal market conditions. In addition, we perform scenario analysis and stress testing to determine the impact of unusual and/or unexpected market changes on our portfolios. We use a comprehensive set of scenarios and stress tests, and the results are reported to MRC, RMC and RRC on a regular basis.

Structural Market Risk

Structural market risk is comprised of interest rate risk arising from our structural banking activities (loans and deposits), and foreign exchange risk arising from our foreign currency operations. Structural market risk is managed by BMO's Corporate Treasury in support of stable, high-quality earnings.

Structural interest rate risk arises primarily from interest rate mismatches and embedded options. Interest rate mismatches result from differences in the scheduled maturity or repricing dates of assets, liabilities and off-balance sheet items. Embedded option risk results from product features that allow customers to modify scheduled maturity or repricing dates. Embedded options include loan prepayment and deposit redemption privileges and committed rates on unadvanced mortgages. The net interest rate mismatch, representing residual assets funded by common shareholders' equity, is maintained at a target duration of between two and three years and embedded options are managed to low risk levels. The interest rate mismatch is primarily managed with interest rate swaps and securities. Embedded option exposures are managed by purchasing options or through a dynamic hedging process.

Structural foreign exchange risk arises primarily from translation risk associated with the net investment in our U.S. operations, and from transaction risk associated with our U.S. dollar net income. Translation risk is managed by funding our net U.S. investment in U.S. dollars. Transaction risk is managed by entering into foreign exchange forward contract hedges each quarter that are expected to partially offset the effects of Canadian/U.S. dollar exchange rate fluctuations on the quarter's net income. The impact of exchange rate fluctuations on BMO's 2004 net income is reviewed on page 27.

Structural MVE and EV measures both reflect holding periods of between one and three months and incorporate the impact of correlations between market variables. Structural MVE (see page 62) increased modestly over the past year due to growth in common shareholders' equity, while EV continues to be managed to low levels.

In addition to MVE and EV, simulations, sensitivity analysis, stress testing and gap analysis, which is disclosed in Note 17 on page 107 of the financial statements, are also used to measure and manage interest rate risk.

Structural balance sheet earnings and value sensitivity to an immediate parallel interest rate increase or decrease of 100 and 200 basis points is disclosed in the adjacent table. This sensitivity analysis is performed and disclosed by many financial institutions and facilitates comparison with our peer group.

Models used to measure structural market risk help forecast how interest rates and foreign exchange rates may change and predict how customers would likely react to the changes. These models have been developed using statistical analysis and are validated through regular model vetting and backtesting processes and ongoing dialogue with the lines of business. Models used to predict consumer behaviour are also used in support of product pricing and performance measurement.

Liquidity and Funding Risk

Managing liquidity and funding risk is essential to maintaining both depositor confidence and stability in earnings.

It is BMO's policy to ensure that sufficient liquid assets and funding capacity are available to meet financial commitments, even in times of stress.

Our liquidity and funding risk management framework includes:

- oversight by senior governance committees, including the Liquidity and Funding Management Committee, RMC and RRC;
- an independent oversight group within Corporate Treasury;
- independent process and internal control reviews by Corporate Audit;
- an RRC-approved limit structure to support risk management;
- effective processes and models to monitor and manage risk;
- strong controls over processes and models and their uses;
- a framework of scenario tests for stressed operating conditions; and
- contingency plans to facilitate managing through a disruption.

Data provided in this section reflect BMO's consolidated position. BMO subsidiaries include regulated and foreign entities, and therefore movements of funds between companies in the group are necessarily subject to the liquidity, funding and capital adequacy considerations of the subsidiaries as well as tax considerations. Such matters do not materially affect BMO's liquidity and funding.

BMO's liquidity and funding position remains sound and there are no trends, demands, commitments, events or uncertainties that are reasonably likely to materially impact the position.

Structural Balance Sheet Earnings and Value Sensitivity to Changes in Interest Rates (\$ millions)*

(After-tax Canadian equivalent)	As at October 31, 2004		As at October 31, 2003	
	Economic value sensitivity	Earnings sensitivity over the next 12 months	Economic value sensitivity	Earnings sensitivity over the next 12 months
100 basis point increase	(224.3)	9.2	(202.3)	10.8
100 basis point decrease	183.7	(20.2)	142.7	(17.6)
200 basis point increase	(470.4)	22.2	(431.8)	15.7
200 basis point decrease	332.3	(62.9)	181.2	(61.6)

*Exposures are in brackets and benefits are represented by positive amounts.

Liquidity and funding risk is the potential for loss if BMO is unable to meet financial commitments in a timely manner at reasonable prices as they fall due. Financial commitments include liabilities to depositors and suppliers, and lending and investment commitments.

We actively manage liquidity and funding risk globally by holding liquid assets in excess of an established minimum amount at all times. Liquid assets include unencumbered, high credit-quality assets that are marketable, can be pledged as security for borrowings, or mature in a time frame that meets our liquidity and funding requirements. Liquidity and funding requirements consist of expected and potential cash outflows. These arise from obligations to repay deposits that are withdrawn or not renewed, and the need to fund asset growth, strategic investments, drawdowns on credit and liquidity facilities and purchases of collateral for pledging. Liquidity and funding requirements are assessed under expected and stressed economic, market, political and enterprise-specific environments, and these assessments determine the minimum amount of liquid assets to be held at all times.

In addition, we use two primary measures to evaluate liquidity and funding risk. The first measure is the cash and securities-to-total assets ratio. This measure provides an assessment of the extent to which assets can be readily converted into cash or cash substitutes to meet financial commitments, as cash resources and securities are more liquid than loans. The ratio represents the sum of cash resources and securities as a percentage of total assets. BMO's cash and securities-to-total assets ratio at October 31, 2004 was 25.8%, down from 29.1% at October 31, 2003. The decrease in the ratio was primarily attributable to a decline in investment securities and U.S. deposits with other banks in response to expectations of rising interest rates.

Cash and securities totalled \$68.5 billion at the end of the year, down from \$74.7 billion in 2003, while total assets increased \$8.7 billion to \$265.2 billion.

Liquidity from cash and securities is supplemented by securities purchased under resale agreements, which also can be readily converted into cash or cash substitutes to meet financial commitments. Securities purchased under resale agreements totalled \$17.1 billion at the end of the year, up from \$13.3 billion in 2003.

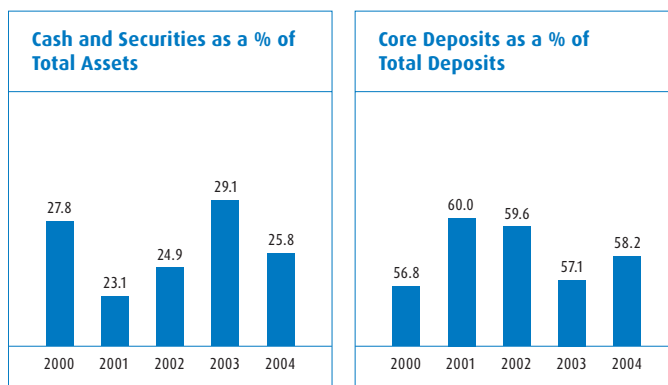
In the ordinary course of business, a portion of cash, securities and securities purchased under resale agreements is pledged as collateral to support trading activities and participation in clearing and payment systems, in Canada and abroad. At October 31, 2004, \$18.8 billion of cash and securities had been pledged, which is in line with \$18.7 billion pledged a year earlier. At October 31, 2004, \$13.7 billion of securities purchased under resale agreements had been pledged, an increase from \$10.4 billion pledged a year earlier. In addition, BMO is a party to certain agreements that could require incremental collateral under certain circumstances. These potential incremental collateral requirements are not material. Additional information on cash and securities can be found in Table 5 on page 71 and in Notes 2 and 3 on page 88 of the financial statements.

The second measure is the core deposits-to-total deposits ratio. This measure provides an assessment of the stability of BMO's deposit base, as core deposits are more stable than other deposit sources. Core deposits are comprised of operating deposits and smaller fixed-date deposits, which generally are less responsive to changes in the market environment than larger fixed-date deposits. The ratio represents total deposits less fixed-date deposits greater than 100,000 units of any currency as a percentage of total deposits. BMO's core deposits-to-total deposits ratio at October 31, 2004 was 58.2%, up from 57.1% in the prior year. The ratio increased as core deposits grew while non-core deposits remained stable. Growth in core deposits was used to fund growth in loans.

Operational Risk

Operational risk is inherent in all business activities. Although operational risk can never be entirely eliminated, shareholder value can be preserved and enhanced by managing, mitigating, and in some cases insuring against operational risk. To achieve this goal, we have developed, using regulatory guidelines, an Operational Risk Framework, which includes identification, measurement, analysis, monitoring, capital at risk attribution, and risk control/mitigation elements. A variety of underlying processes and controls have been developed as part of this framework. These include risk and control self-assessments, business contingency plans, event management, change management and outsourcing, acquisition and integration management.

BMO's operational risk governance structure includes the Operational Risk Committee (ORC), a sub-committee of RMC. The ORC has oversight responsibility for operational risk strategy and governance. It provides advice and guidance to the lines of business on operational risk assessments, measurement and mitigation, and related monitoring and change initiatives.



The cash and securities-to-total assets ratio reflects a sound liquidity position.

Core deposits represent a stable source of funding.

Core deposits totalled \$101.9 billion at the end of the year, up from \$98.0 billion in 2003, while total deposits increased \$3.6 billion to \$175.2 billion. Our large base of core deposits, along with our strong capital base, reduces reliance on less stable wholesale funding. Wholesale funding is largely short-term in nature and primarily supports trading and underwriting assets and investment securities. Wholesale funding is diversified by customer, type, market, maturity term, currency and geography.

Information on deposit maturities can be found in Table 24 on page 81.

Our liquidity and funding position could potentially be affected by off-balance sheet arrangements and other credit instruments through our obligation to fund drawdowns. These exposures are captured within our risk management framework. Off-balance sheet arrangements are discussed on page 53. Information on other credit instruments can be found in Note 5 on page 93 of the financial statements.

Operational risk is the potential for loss resulting from inadequate or failed internal processes or systems, human error or external events not related to credit, market or liquidity risks. Operational risk includes fiduciary risk, legal risk and business risk due to operational failure, but excludes business risks of a strategic nature such as business risk due to earnings volatility.

Each line of business is responsible for managing its operational risk within the guidelines established by corporate policy and standards, using the aforementioned framework processes and control programs. To ensure that all operational risks to which a line of business is exposed are adequately managed, specialized functions such as Finance, Taxation, Legal, Compliance, Privacy, Human Resources and Systems and Information Management are also involved in the measurement process, as appropriate. An independent Enterprise Operational Risk Management unit exists within ER&PM.

BMO purchases insurance in such amounts and in such areas as will provide protection against unexpected material loss and where insurance is required by law, regulatory requirement or contractual agreement.

Operational risk is measured using an actuarial methodology that combines the likelihood of an operational risk event occurring with the probable loss if it does occur, to arrive at the loss distribution. The loss distribution is then used to determine the capital at risk for each line of business.

A tailored measurement process and model are used to determine the operational risk for each line of business.

Corporate Audit regularly reports on the effectiveness of internal controls for operational risk and management processes to the CEO and to the Board's Audit Committee.

BMO's goal is to make operational risk, like all other risks, transparent throughout the enterprise. Therefore, this framework includes regular reporting of relevant operational risk management activities and processes to senior line and corporate management, the ORC and the Board of Directors.

Every process included in the operational risk framework is at a different stage of development. Our approach is to continuously improve each in a way that is useful to business and risk management while also meeting external needs such as the Basel II regulatory requirements, anti-money laundering requirements, Canada Deposit Insurance Corporation standards and Federal Deposit Insurance Corporation requirements.

Business Risk due to Earnings Volatility

BMO faces many risks that are similar to those faced by non-financial firms, principally that its profitability (and hence value) may be eroded by changes in the business environment or by failures of strategy or execution. Sources of these risks include volatile economic market activity, changing client expectations, adverse business developments and relatively ineffective responses to industry changes. Risks to BMO's margins and volumes are categorized as business risk due to earnings volatility.

Business risk due to earnings volatility captures the possibility that volumes will decrease or margins will shrink with no opportunity being available to offset the revenue declines with a reduction in costs.

Reputation Risk

Reputation is one of BMO's most valuable assets. Key components of the effective management of reputation risk include:

- fostering a business culture that incorporates integrity and ethical conduct as core values; and
- promoting a conviction that every business decision must reflect the enterprise's core ethical values.

Reputation risk falls under the Operational Risk Framework as a component of business risk due to operational failure.

Reputation risk is a risk that BMO has always faced. We believe that active, ongoing and effective management of reputation risk is best achieved through integration of explicit assessments of reputation risk into strategy development, strategic and operational implementation, transactional decision-making and risk management and control processes.

Reputation risk is the risk of negative impacts resulting from the deterioration of BMO's reputation with key stakeholders. These impacts include revenue loss, reductions in our customer/client base, costly litigation, regulatory sanctions and declines in BMO's share price.

It is the responsibility of all employees to conduct themselves in such a way as to maintain and build BMO's reputation. Reputation Risk Management Committee – a new management committee – has been formed to consider potential reputation risks to the enterprise that are identified in the review and approval of complex and structured financings. The committee is also responsible for monitoring overall governance of reputation risk.

Environmental Risk

BMO is committed to the principles of sustainable development and, in particular, to the belief that the quality of our lives improves when economic growth is integrated with respect for the environment. We implement practices across the enterprise that reduce waste, conserve energy and recycle materials.

In providing credit to customers, we take reasonable precautions to ensure that we deal with environmentally responsible borrowers.

BMO will continue to demonstrate a willingness to work with government, industry and all relevant constituencies to support environmental issues. We are committed to open dialogue with all relevant constituencies including governments, customers, employees, shareholders and the public at large.

At BMO Financial Group, we believe that social responsibility begins with a commitment to ethical behaviour. By conducting our business and serving our customers and communities according to the principles of honesty, transparency and accountability, we earn the trust that is the foundation of our business.

BMO maintains a comprehensive code of conduct – *FirstPrinciples, Our Code of Business Conduct and Ethics* – and has established specific behavioural standards through FirstPrinciples and related policies, standards and guidelines.

We exercise the fundamental rule of good banking practice, “Know your customer,” in the course of all business dealings with customers and in the evaluation of prospective customers.

- We will not knowingly conduct any type of business with customers whose money is derived from illegal activities. Management considers the reputation, integrity and character of a counterparty and/or its management in deciding whether to conduct business with that counterparty.
- We will not complete any transaction of any type or operate any account for customers who fail to provide evidence of their identity, source of funds, or any other information we require to establish the good faith of a customer.

Furthermore, we avoid providing preferential treatment when entering into banking transactions with a political party, constituency association, candidate, leadership contestant or any other public official (including any such individual’s family and/or related business enterprises).

BMO adheres to the principles of confidentiality and privacy in customer relations. We follow applicable codes of conduct and legislation that protect and respect personal information and initiate fair and timely redress of customer complaints and concerns. We also maintain strict conflict of interest rules for employees, officers and directors.

In the development of foreign business, we consider ethical, political, social and economic factors in addition to other more traditional lending considerations. We do not knowingly lend, in North America or internationally, for purposes that support the suppression of basic individual freedoms, encourage racial discrimination or national hatreds, or promote the use of violence or repression.

We are committed to truthful and ethical practices in advertising.

We champion principles of inclusion through our diverse workforce and supportive and equitable workplace.

Quarterly Earnings Trends

BMO’s quarterly earnings, revenue and expense are modestly affected by seasonal factors. Since our second fiscal quarter has 89 days (90 days in a leap year) and other quarters have 92 days, second-quarter results are lower relative to other quarters because there are 3% fewer calendar days, and thus fewer business days. The months of July (third quarter) and August (fourth quarter) are typically characterized by lower levels of capital markets activity, which has an effect on results in Private Client Group and Investment Banking Group. The December holiday season also contributes to a slowdown in some activities; however, credit card purchases are particularly robust in that first quarter period, as well as in the back-to-school period that falls in our fourth quarter.

Quarterly results and statistics for the past eight quarters are outlined on page 69. The most compelling trend, albeit one that was not sustained in the last quarter of 2004, was that of increasing earnings. Net income had risen in nine consecutive quarters until then. Nonetheless, we continued to benefit from focusing on improving productivity and from superior credit management, and through the last quarter of 2004, we had achieved nine consecutive quarters of year-over-year quarterly earnings growth.

The most significant factor contributing to the trend of increasing earnings was a lowering of provisions for credit losses, although improvements were broadly based, with

earnings generally trending higher in all operating groups. The provision totalled \$150 million in the first quarter of fiscal 2003, but declined in each quarter, totalling only \$5 million in the second quarter of 2004 and improving to a net recovery in the third and fourth quarters. The improvements reflected improving credit quality that reduced the incidence of new problem loan formations and expected losses when they occur. Recoveries of allowances established in prior periods and of amounts previously written off also contributed to the improvement. These recoveries can be quite unpredictable and were particularly high in the third quarter of 2004. Improving credit quality and lower corporate loan balances also contributed to reductions of the general allowance for loan losses, which was reduced in each quarter of 2004 and by \$170 million for the year, the first time in more than 10 years that any portion of the general allowance had been released.

Other notable trends were the weakening of the U.S. dollar, which has reduced revenues and expenses, general improvements in the results of Private Client Group and Investment Banking Group, which benefited from more activity in capital markets and higher equity valuations, and higher earnings in Personal and Commercial Client Group related to higher volumes. Improved results in Corporate Support were largely due to lower provisions for credit losses.