

2005 Financial Performance Review

This section provides a review of our enterprise financial performance for 2005 that focuses on the Consolidated Statement of Income included in our consolidated financial statements, which begin on page 92. A summary of the enterprise financial performance for 2004 is outlined on page 78. A review of our operating groups' strategies and performance follows the enterprise review.

Highlights

- Revenue increased \$470 million or 5% in 2005.
- Revenue growth was attributable to improved product volumes in Personal and Commercial Client Group and the benefits of revenue-generating initiatives and improved market fundamentals in Private Client Group. Higher trading revenues and advisory fees in Investment Banking Group were offset by reduced revenue from interest-rate-sensitive businesses.
- The provision for credit losses was \$282 million higher than a year ago but, at \$179 million, was the second-lowest since 1998 (2004 was the lowest). Specific provisions for credit losses increased \$152 million, due to lower recoveries and reversals, and the reduction in the general allowance was \$130 million lower.
- Non-interest expense increased 3% in 2005, growing at a lower rate than revenues. The increase was driven by acquired businesses and higher performance-based compensation, consistent with Private Client Group's improved performance and Investment Banking Group's improved results in fee-based businesses.
- The expense-to-revenue ratio (or productivity ratio) improved by 140 basis points to 63.5%. The cash productivity ratio improved by 120 basis points to 62.6%, following total improvement of 420 basis points in the two prior years.

Non-GAAP Measures

BMO uses both GAAP and non-GAAP measures to assess performance. Securities regulators require that companies caution readers that earnings and other measures adjusted to a basis other than generally accepted accounting principles (GAAP) do not have standardized meanings under GAAP and are unlikely to be comparable to similar measures used by other companies.

Cash earnings and productivity measures may enhance comparisons between periods when there has been an acquisition, particularly because the purchase decision may not consider the amortization of intangible assets to be a relevant expense. Cash EPS measures are also useful because analysts often focus on this measure, and cash EPS is used by Thomson First Call to track third-party earnings estimates that are frequently reported in the media. Cash measures add the after-tax amortization of intangible assets to GAAP earnings to derive cash net income (and associated EPS) and deduct the amortization of intangible assets from non-interest expense to derive cash productivity measures.

BMO, like many banks, analyzes revenue, and ratios computed using revenue, on a taxable equivalent basis (teb). This basis includes an adjustment that increases GAAP revenues and the GAAP provision for income taxes by an amount that would raise revenues on certain tax-exempt securities to a level equivalent to amounts that would incur tax at the statutory rate. The effective income tax rate is also analyzed on a taxable equivalent basis for consistency in approach.

Net economic profit is another non-GAAP measure. It represents cash earnings available to common shareholders less a charge for capital, and is considered an effective measure of added economic value.

GAAP and Related Non-GAAP Measures Used in the MD&A

(\$ millions, except as noted)

	2005	2004	2003
Net interest income per financial statements (a)	4,787	4,798	4,777
Non-interest revenue	5,052	4,551	4,220
Revenue per financial statements (b)	9,839	9,349	8,997
Taxable equivalent basis (teb) adjustment (c) (see page 37)	119	139	152
Net interest income (teb) (a+c) (d) (1)	4,906	4,937	4,929
Non-interest revenue	5,052	4,551	4,220
Revenue (teb) (e) (1)	9,958	9,488	9,149
Provision for income taxes per financial statements	875	972	652
Taxable equivalent basis (teb) adjustment	119	139	152
Provision for income taxes (teb) (1)	994	1,111	804
Non-interest expense (f)	6,327	6,157	6,087
Amortization of intangible assets	(94)	(104)	(105)
Cash-based expense (g) (1)	6,233	6,053	5,982
Net income	2,400	2,306	1,781
Amortization of intangible assets (net of income tax)	74	78	79
Cash net income (1)	2,474	2,384	1,860
Preferred share dividends	(30)	(31)	(38)
Charge for capital (1)	(1,324)	(1,230)	(1,119)
Net economic profit (1)	1,120	1,123	703
Non-interest expense-to-revenue ratio (2) (%) ((f/b) x 100)	64.3	65.9	67.7
Non-interest expense-to-revenue (teb) ratio (1) (2) (%) ((f/e) x 100)	63.5	64.9	66.5
Cash non-interest expense-to-revenue (teb) ratio (1) (2) (%) ((g/e) x 100)	62.6	63.8	65.4
Net interest margin annualized (%) ((a/average assets) x 100)	1.58	1.78	1.81
Net interest margin (teb) annualized (1) (%) ((d/average assets) x 100)	1.62	1.83	1.87
EPS (uses net income) (\$)	4.64	4.42	3.44
Cash EPS (1) (uses cash net income) (\$)	4.79	4.57	3.59

(1) These are non-GAAP amounts or non-GAAP measures.

(2) Also referred to as productivity ratio and cash productivity ratio.

Foreign Exchange

The Canadian dollar equivalents of BMO's U.S.-dollar-denominated net income, revenues, expenses, income taxes and provision for credit losses in 2005 and 2004 were lowered relative to the preceding year by the weakening of the U.S. dollar. The adjacent table indicates average Canadian/U.S. dollar exchange rates in 2005, 2004 and 2003 and the impact of lower rates.

At the start of each quarter, BMO enters into hedging transactions that are designed to partially offset the pre-tax effects of exchange rate fluctuations in the quarter on our expected U.S.-dollar-denominated net income for that quarter. As such, these activities partially mitigate the impact of exchange rate fluctuations within a single quarter, but the sum of the hedging gains/losses for the four quarters in a year is not directly comparable to the impact of year-over-year exchange rate fluctuations on earnings for the year.

Each one-cent decrease (increase) in the Canadian/U.S. dollar exchange rate, expressed in terms of how many Canadian dollars one U.S. dollar buys, decreases (increases) BMO's quarterly earnings by approximately \$1.5 million before income taxes, in the absence of hedging activity.

The gain or loss from hedging transactions in future periods will be determined by both future exchange rate fluctuations

Effects of the Weaker U.S. Dollar on BMO's Results

(\$ millions, except as noted)

	2005 vs. 2004	2004 vs. 2003
Canadian/U.S. dollar exchange rate (average)		
2005	1.214	
2004	1.313	1.313
2003		1.435
Reduced revenues	(213)	(243)
Reduced expenses	145	177
Reduced provision for credit losses	1	11
Reduced income taxes	19	15
Reduced net income before hedging gains	(48)	(40)
Hedging gains	10	8
Income taxes thereon	(4)	(3)
Reduced net income	(42)	(35)

and the amount of the underlying future hedging transactions, since the transactions are entered into each quarter in relation to expected U.S.-dollar-denominated net income for the next three months. The effect of exchange rate fluctuations on our net investment in foreign operations is discussed in the Provision for Income Taxes section on page 42.

Acquired Businesses

BMO Financial Group has selectively acquired a number of businesses in advancing our North American growth strategy. These acquisitions have incremental effects on revenue and expenses that affect the year-over-year comparison of operating results. The adjacent table outlines acquisitions by operating group that had an incremental effect on BMO's revenue, expenses and net income for 2005 relative to 2004, and for 2004 relative to 2003, to assist in analyzing changes in results.

For the acquisition completed in fiscal 2005, the incremental effects are the revenues and expenses of that business that are included in results in fiscal 2005. For acquisitions completed in fiscal 2004, the incremental effects on results in 2005 are the revenues and expenses of those businesses from the beginning of fiscal 2005 until the one-year anniversary of their respective dates of acquisition.

For 2004 acquisitions, the incremental effects on results for 2004 relative to 2003 are the revenues and expenses of those businesses that are included in results in fiscal 2004, and for acquisitions completed in fiscal 2003, the incremental effects on results in 2004 are the revenues and expenses of those businesses from the beginning of fiscal 2004 until the one-year anniversary of their respective dates of acquisition.

Impact of Business Acquisitions on Year-over-Year Comparisons (\$ millions)

Business acquired	Increase (decrease) in:			
	Revenue	Expense	Net income	Cash net income
Personal and Commercial Client Group				
Mercantile Bancorp, Inc.				
Acquired December 2004 for \$194 million				
New Lenox State Bank				
Acquired June 2004 for \$314 million				
Lakeland Community Bank				
Acquired March 2004 for \$49 million				
Total purchases of \$557 million				
Incremental effects on results for: 2005	75	51	13	17
2004	20	15	3	4
Private Client Group				
Sullivan, Bruyette, Speros & Blayney Inc.				
Acquired January 2003 for \$20 million				
Incremental effects on results for: 2005	-	-	-	-
2004	2	4	(2)	(2)
Investment Banking Group				
Gerard Klauer Mattison*				
Acquired July 2003 for \$40 million				
Incremental effects on results for: 2005	-	-	-	-
2004	69	87	(11)	(10)
BMO Financial Group				
Purchases of \$617 million				
Incremental effects on results for: 2005	75	51	13	17
2004	91	106	(10)	(8)

*Renamed Harris Nesbitt Gerard

Revenue

Revenue on a taxable equivalent basis (see page 35) rose \$470 million or 5.0% in 2005 to \$9,958 million, driven by growth in Personal and Commercial Client Group and Private Client Group. The weaker U.S. dollar lowered revenue growth in each of the operating groups and reduced BMO's overall revenue growth by \$213 million or 2.2 percentage points, while the incremental effects of acquired businesses added \$75 million or 0.8 percentage points to revenue growth. The \$470 million increase was entirely due to increased non-interest revenue, as higher net interest income in Personal and Commercial Client Group and Private Client Group was offset by a decline in Investment Banking Group.

BMO, like many banks, analyzes revenue on a taxable equivalent basis (teb). The teb adjustments for fiscal 2005 totalled \$119 million, down from \$139 million a year ago.

There was strong revenue growth in Personal and Commercial Client Group, driven by higher product volumes, insurance income and card fees. Private Client Group revenue also increased, as successful revenue-generating initiatives and improved market fundamentals drove higher full-service investing, mutual fund and term investment product revenues, which more than offset lower direct investing revenues. Investment Banking Group revenue declined as increased trading revenues and advisory fees were more than offset by reduced revenue from interest-rate-sensitive businesses. Those businesses were adversely affected by rising short-term interest rates and the resulting flatter yield curve and by competitive market conditions. Corporate Support revenue also declined, due primarily to lower net investment securities gains.

Net Interest Income

Net interest income for the year was \$4,906 million, a reduction of \$31 million from 2004. The incremental effects of acquired businesses increased net interest income by \$58 million, while the impact of the weaker U.S. dollar reduced net interest income by \$87 million. A significant decline in Investment Banking Group's net interest income offset strong growth in the other operating groups. There was strong volume growth as average assets increased by \$33 billion. Overall net interest margin was lower, as only Private Client Group benefited from improved margins.

On November 1, 2004, we commenced the consolidation of certain of our customer securitization vehicles, pursuant to the adoption of the Canadian Institute of Chartered Accountants'

Taxable equivalent basis (teb)

Revenues reflected in our MD&A are presented on a taxable equivalent basis (teb). The teb adjustment increases GAAP revenues and the provision for income taxes by an amount that would increase revenues on certain tax-exempt securities to a level that would incur tax at the statutory rate, to facilitate comparisons. The effect is disclosed on page 35 and in Table 10 on page 82.

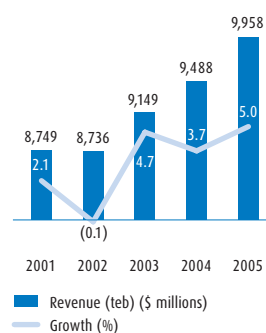
Net interest income is comprised of earnings on assets, such as loans and securities, including interest and dividend income and BMO's share of income from investments accounted for using the equity method of accounting, less interest expense paid on liabilities, such as deposits.

Net interest margin is the ratio of net interest income to average assets, expressed as a percentage or in basis points.

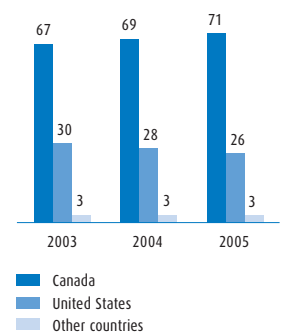
Revenue (\$ millions)

For the year ended October 31	2005	2004	2003	2002	2001
Net interest income (teb)	4,906	4,937	4,929	4,812	4,527
Year-over-year growth (%)	(0.6)	0.2	2.4	6.3	6.6
Non-interest revenue	5,052	4,551	4,220	3,924	4,222
Year-over-year growth (%)	11.0	7.8	7.6	(7.1)	(2.4)
Total revenue (teb)	9,958	9,488	9,149	8,736	8,749
Year-over-year growth (%)	5.0	3.7	4.7	(0.1)	2.1

Revenue and Annual Growth



Revenue by Country (teb) (%)



Revenue growth was solid for the third consecutive year.

The weak U.S. dollar has limited the proportion of U.S. revenue in the past two years.

Change in Net Interest Income, Average Assets and Net Interest Margin

For the year ended October 31	Net interest income (teb) (\$ millions)				Average assets (\$ millions)				Net interest margin (in basis points)		
	2005	2004	\$	%	2005	2004	\$	%	2005	2004	Change
P&C Canada	2,829	2,674	155	6	105,963	99,231	6,732	7	267	269	(2)
P&C Chicagoland Banking	732	678	54	8	21,055	17,895	3,160	18	348	379	(31)
Personal and Commercial Client Group (P&C)	3,561	3,352	209	6	127,018	117,126	9,892	8	280	286	(6)
Private Client Group (PCG)	577	533	44	9	7,061	7,145	(84)	(1)	819	746	73
Investment Banking Group (IBG)	965	1,260	(295)	(23)	163,848	141,691	22,157	16	59	89	(30)
Corporate Support, including Technology and Solutions	(197)	(208)	11	5	5,233	3,830	1,403	37	nm	nm	nm
Total	4,906	4,937	(31)	(1)	303,160	269,792	33,368	12	162	183	(21)

nm – not meaningful

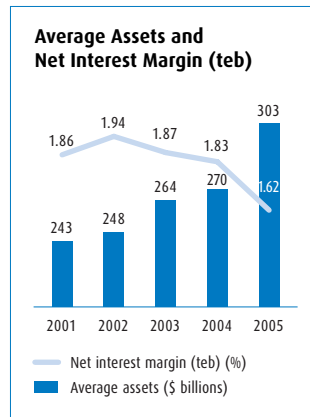
(CICA's) new accounting requirement on the consolidation of VIEs. This lowered net interest margin in the first and second quarters of 2005 relative to comparable periods as it resulted in the inclusion of approximately \$21 billion of average assets in BMO's balance sheet. On April 29, 2005, we completed the restructuring of these VIEs; consequently, the VIE assets were no longer included in BMO's balance sheet as of that date. BMO's net interest margin in the first and second quarters was approximately 12 basis points lower and for fiscal 2005 was approximately 6 basis points lower than it would have been if we had not been required to consolidate VIE assets in those periods. Investment Banking Group's net interest margin was approximately 9 basis points lower than it would have been in the first and second quarters and approximately 4.5 basis points lower for the year.

There was strong volume growth in Personal and Commercial Client Group in both Canada and the United States. In Canada, there was volume growth in all major products, with a modest decline in net interest margin. A continuation of the shift in customer preferences toward lower-spread products, such as residential mortgages and lines of credit, and the competitive marketplace pressured margins. In the United States, there was robust consumer and small business loan growth, with a more pronounced reduction in net interest margin, due to competitive pressures on loan pricing and the impact of lower investment rates earned on longer-term liabilities. Private Client Group assets declined modestly, but net interest income was up strongly because of improved margins in term investment products. The group's net interest margin is significantly higher than other groups, as the net interest margin calculation represents net interest income as a percentage of total assets. The group's primary source of net interest income is term investment products, which are liabilities. Investment Banking Group's average assets increased \$22 billion, of which half related to the VIE assets recorded in BMO's balance sheet in the first six months of the year. The remaining increase was largely due to higher levels of low-margin assets, driven by client demand in the capital markets businesses. The group's net interest margin declined sharply due to the funding of trading positions, lower spreads on corporate loans in the competitive rate environment in the United States and lower spreads in interest-rate-sensitive businesses in the rising interest rate environment.

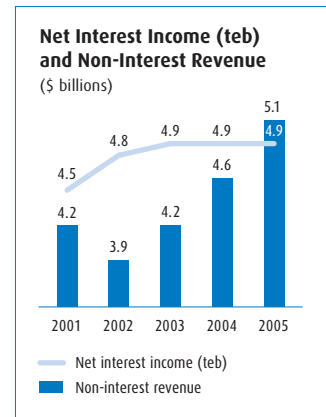
Non-Interest Revenue

Non-interest revenue, which comprises all revenues other than net interest income, increased \$501 million or 11% from 2004. The incremental effects of acquired businesses increased non-interest revenue by \$17 million, while the impact of the weaker U.S. dollar reduced 2005 non-interest revenue by \$126 million.

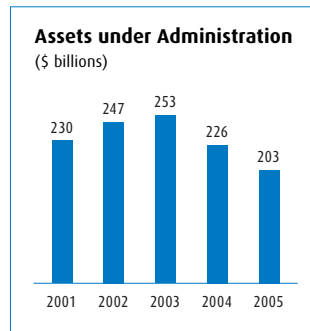
Securities commissions and fees were up 4%. These fees consist largely of full-service and self-directed retail brokerage commissions within Private Client Group, which account for about three-quarters of the balance, and institutional equity trading commissions within Investment Banking Group. Fees increased in both operating groups, a result of higher equity market valuations and higher client trading volumes.



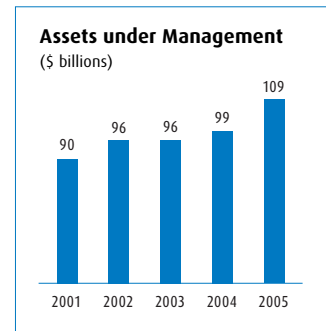
Asset growth was strong while net interest margins declined in both P&C and IBG.



Lower net interest margin has caused growth in net interest income to stall, while non-interest revenue grows strongly.



Assets under administration declined because of the weaker U.S. dollar and the sale of Harrisdirect.



Mutual fund growth drove an increase in assets under management, despite the weaker U.S. dollar.

Non-Interest Revenue (\$ millions)

For the year ended October 31	2005	2004	2003	Change from 2004	
				\$	%
Securities commissions and fees	1,092	1,055	894	37	4
Deposit and payment service charges	734	746	756	(12)	(2)
Trading revenues	413	200	275	213	+100
Lending fees	313	317	293	(4)	(1)
Card fees	334	261	290	73	28
Investment management and custodial fees	305	307	303	(2)	(1)
Mutual fund revenues	437	378	321	59	16
Securitization revenues	113	177	244	(64)	(36)
Underwriting and advisory fees	357	343	268	14	4
Investment securities gains (losses)	165	175	(41)	(10)	(6)
Foreign exchange, other than trading	180	177	160	3	2
Insurance income	162	139	124	23	17
Other	447	276	333	171	62
Total	5,052	4,551	4,220	501	11

Deposit and payment service charges, which represent income earned on retail, commercial and corporate deposit accounts, declined \$12 million due to lower income from Investment Banking Group's cash management services.

Lending fees fell \$4 million, as \$11 million of lending fees earned by Investment Banking Group were recorded as other revenue during the period we consolidated the VIEs.

Card fees rose \$73 million or 28%. Further refinements made to the methodology used to determine the liability associated with our customer loyalty rewards program resulted in a \$40 million reduction in credit card fees in 2005. In 2004, we recorded \$65 million of adjustments to credit card fees to increase the recorded liability because of rising reward redemption rates. Otherwise, the increase in card fees was driven in part by the continued success of our Mosaik® MasterCard[®] and by the maturity of a portion of our credit card loans securitization.

Investment management and custodial fees were relatively unchanged, as they were again affected by the weaker U.S. dollar.

Mutual fund revenues increased \$59 million or 16%, after having increased 18% in 2004, again reflecting volume growth and improved equity market valuations.

Securitization revenues decreased \$64 million or 36%, primarily due to lower gains on sales and the maturity of the credit card loans securitizations. Securitization revenues are detailed in Note 7 on page 103 of the financial statements.

Underwriting and advisory fees increased \$14 million. Merger and acquisition fees were sharply higher in a strong market, while equity and debt underwriting fees were both down slightly relative to strong activity in 2004.

Investment securities gains were \$165 million, compared with net gains of \$175 million in 2004. In 2005, net investment securities gains were increased \$50 million by gains recognized on a change in accounting for merchant banking investments and \$50 million by a gain on sale of TSX common shares. There were \$11 million of write-downs in 2005, compared with \$63 million in 2004. Investment securities gains in 2004 were offset in part by a \$58 million reduction in net interest income related to losses on unwinding hedges associated with investment securities that were sold. Unrealized gains on investment securities declined \$89 million to -\$3 million, partially due to realized gains in 2005.

Foreign exchange, other than trading, was relatively unchanged.

Insurance income increased 17%, continuing its strong growth from a year ago.

Other revenue increased \$171 million due primarily to \$44 million of revenue recognized on restructuring VIEs, a \$29 million gain on sale of the First Canadian Centre® Calgary tower and the \$49 million gain on sale of Harrisdirect.

Table 10 on page 82 provides further detail on revenue and revenue growth.

Trading-related revenues include net interest income and non-interest revenue earned from on and off-balance sheet positions undertaken for trading purposes. The management of these positions typically includes marking them to market on a daily basis. Trading revenues include income (expense) and gains (losses) from both on-balance sheet instruments and off-balance sheet interest rate, foreign exchange (including spot positions), equity, commodity and credit contracts.

Interest and Non-Interest Trading-Related Revenues (\$ millions)

For the year ended October 31	2005	2004	2003	Change from 2004	
				\$	%
Interest rates	247	204	241	43	21
Foreign exchange	89	85	69	4	5
Equities	145	152	86	(7)	(5)
Other	107	31	112	76	+100
Total	588	472	508	116	25
Reported as:					
Net interest income	175	272	233	(97)	(36)
Non-interest revenue – trading revenues	413	200	275	213	+100
Total	588	472	508	116	25

Trading-Related Revenues

Trading-related revenues are primarily dependent on the volume of activities undertaken for clients, who enter into transactions with BMO to mitigate their risks or to invest. BMO earns a spread or profit on the net sum of its client positions by profitably neutralizing, within prescribed limits, the overall risk of the net positions. BMO also assumes proprietary positions with the goal of earning trading profits. While proprietary positions expose the organization to profit or loss, the positions and their risks are closely managed and profit or loss from these activities is generally not the most significant factor affecting the level of trading-related revenues.

Trading-related revenues were very strong in 2005, particularly in the fourth quarter. Trading-related revenues include both net interest income and non-interest revenue. Net interest trading-related revenues were slightly negative in the fourth quarter of 2005 as the associated funding costs of the assets exceeded interest earned on them. Many of our trading assets are non-interest bearing and, net of associated funding costs, most trading revenue in 2005 consisted of mark-to-market gains, which are included in non-interest trading revenues.

Revenues from trading-related activities totalled \$588 million, compared with \$472 million in 2004. Trading-related revenues included net interest income of \$175 million and non-interest revenue of \$413 million. The \$116 million increase in interest and non-interest trading-related revenues from 2004 was largely attributable to commodity derivative and interest rate trading revenues. Commodities trading revenue, which is included in Other trading revenues in the table above, was up appreciably due to high volatility and active markets. Interest rate trading revenues increased due to increased client demand, while equity trading revenues declined from the strong levels of 2004. Foreign exchange trading revenues rose modestly. The Market Risk section on page 70 provides further information on trading-related revenues.

Provision for Credit Losses

Favourable credit conditions continued in 2005, resulting in BMO recording a \$179 million provision for credit losses, consisting of \$219 million of specific provisions partially offset by a \$40 million reduction in the general allowance for credit losses. This compares with a net recovery of \$103 million in 2004, comprised of specific provisions of \$67 million and a \$170 million reduction in the general allowance. Reversals and recoveries were particularly high in 2004.

As illustrated in the adjoining table, in this current credit cycle, specific provisions for credit losses peaked in the 2001–2002 period, declined sharply in 2003 and 2004, and returned to a more moderate but still low level in 2005. The \$152 million increase in specific provisions in 2005 was primarily attributable to reduced levels of reversals of previous allowances and recoveries of past write-offs, which together declined by \$254 million to \$189 million in 2005. This reduction more than offset a \$102 million decline in new specific provisions, which totalled \$408 million in 2005.

Lower levels of reversals and recoveries in 2005 were expected at this point in the credit cycle. The relatively high level of reversals and recoveries in 2004 was largely due to the success of our effective loan realization practices, including strong cash collections and loan sales. Sales of gross impaired loans were facilitated by higher levels of impaired loans from which to effect sales, as well as a receptive secondary market. In 2004, sales of gross impaired loans totalled \$440 million with resulting reversals and recoveries totalling \$71 million. This contrasts with sales of \$102 million and resulting reversals and recoveries of \$22 million in 2005.

The most significant factor influencing the provision for credit losses is the level of formations of new impaired loans – identified as additions to impaired loans and acceptances in the Changes in Gross Impaired Loans and Acceptances table. As with specific provisions, these formations peaked in the 2001–2002 period at about \$2 billion per year, steadily declining thereafter to a current low of \$423 million in 2005. Partially as a result, at October 31, 2005, gross impaired loans and acceptances totalled \$804 million, the lowest level in seven years, with notable reductions occurring in the telecom and power generation sectors over the past two years.

At October 31, 2005, the allowance for credit losses totalled \$1,128 million, compared with \$1,308 million a year earlier. The decline was attributable to improved credit quality in the performing loan portfolio and lower levels of impaired loans and acceptances. The general allowance, which totalled \$959 million at year-end, remains adequate, representing 64 basis points of risk-weighted assets. In addition, BMO uses credit default swaps to mitigate credit exposures. At October 31, 2005, the notional value of these instruments totalled \$1,274 million, compared with \$830 million a year earlier.

BMO's loan book continues to be comprised largely of more stable consumer and commercial portfolios, which, excluding securities borrowed or purchased under resale agreements, represented 86.7% of the loan portfolio at year-end, compared with 86.3% in 2004. Moreover, BMO currently has no material exposures at risk to industry sectors considered to be of most concern in today's economy. These include the airline, automotive, forestry, feedstock, chemicals and petroleum-based products sectors. Nonetheless, we remain attentive to those factors that could affect credit quality in the consumer and

corporate and commercial portfolios. These include continuing high energy costs, the impact on export sectors of the sharp appreciation of the Canadian dollar relative to the U.S. dollar and the potential impact of rising interest rates. Credit risk management is discussed further on page 69.

Looking forward, we expect the credit environment to remain stable in 2006, with potential weakness developing in the latter part of the year. This outlook is based on our expectations of continuing low corporate default rates, low levels of impaired loan formations and stable economic conditions across North America. Accordingly, we expect the 2006 provision for credit losses to be \$400 million or less, with the increase over the current year largely related to the credit cycle and an expectation of increasing levels of new specific provisions and somewhat lower levels of reversals and recoveries.

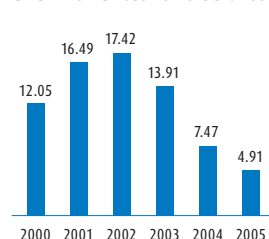
Provision for (Recovery of) Credit Losses (PCL) (\$ millions, except as noted)

For the year ended October 31	2005	2004	2003	2002	2001	2000
New specific provisions	408	510	846	1,063	1,023	458
Reversals of previous allowances	(122)	(312)	(303)	(175)	(103)	(124)
Recoveries of prior write-offs	(67)	(131)	(88)	(68)	(40)	(44)
Specific provisions for credit losses	219	67	455	820	880	290
Increase in (reduction of):						
General allowance	(40)	(170)	–	–	100	110
Country risk allowance	–	–	–	–	–	(42)
Provision for (recovery of) credit losses	179	(103)	455	820	980	358
PCL as a % of average net loans and acceptances	0.11%	(0.07)%	0.30%	0.56%	0.66%	0.25%

Changes in Gross Impaired Loans (GIL) and Acceptances

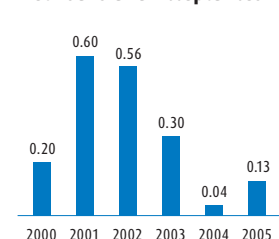
	2005	2004	2003	2002	2001	2000
GIL, beginning of year	1,119	1,918	2,337	2,014	1,501	1,092
Additions to impaired loans and acceptances	423	607	1,303	1,945	2,041	1,106
Reductions in impaired loans and acceptances	(319)	(936)	(1,156)	(738)	(830)	(446)
Write-offs	(419)	(470)	(566)	(884)	(698)	(251)
GIL, end of year	804	1,119	1,918	2,337	2,014	1,501
GIL as a % of gross loans and acceptances	0.46%	0.71%	1.30%	1.54%	1.37%	1.04%

Gross Impaired Loans and Acceptances as a % of Equity and Allowances for Credit Losses



Lower impaired loans and higher equity have led to an improvement in BMO's credit condition.

Specific Provision for Credit Losses as a % of Average Net Loans and Acceptances



Provisions have begun to increase, as reversals and recoveries likely peaked in 2004.

Non-Interest Expense

Non-interest expense increased \$170 million or 2.8% to \$6,327 million. In 2004, non-interest expense had risen \$70 million or 1.1%. The factors affecting the low levels of expense growth in the past two years are quite similar in nature and in their impact. The dollar and percentage changes in expenses by category are outlined in the Non-Interest Expense table. The factors contributing to the 2.8% increase in 2005 are set out in the Contribution to Non-Interest Expense Growth table.

As explained on page 36, the incremental effects of businesses acquired in 2005 and 2004 increased expenses in 2005 relative to 2004 by \$51 million (0.8%). As further explained on page 36, the lower Canadian/U.S. dollar exchange rate reduced costs in 2005 by \$145 million (-2.4%). Higher performance-based compensation costs increased expenses by \$124 million (2.0%). This latter increase was primarily in Private Client Group, in line with its significantly higher revenues and earnings, and in Investment Banking Group, where fee-based revenues, which typically have relatively higher variable costs, were strong relative to 2004. Revenues in interest-rate-sensitive businesses, which typically have relatively lower variable costs, were down appreciably in 2005. Other expenses in 2005 include a \$25 million litigation charge, higher mutual fund trailer fees, increased marketing costs and higher capital taxes.

Productivity

The expense-to-revenue ratio (productivity ratio) improved 140 basis points to 63.5% in 2005. BMO's overall ratio in any year is affected by the relative strength of the revenues in each operating group. The expense-to-revenue ratio of each group is typically quite different because of the nature of their businesses. In 2005, both Personal and Commercial Client Group and Private Client Group increased revenues more than expenses, in both absolute and percentage terms, thereby improving their expense-to-revenue ratios.

Personal and Commercial Client Group is BMO's largest operating group and its productivity ratio of 60.2% improved by 290 basis points from last year, surpassing its target. Productivity improved in both Canada and the United States but the improvement was more pronounced in Canada. U.S. results were affected by expenses of \$20 million to integrate acquired businesses and consolidate bank charters.

Private Client Group's expense-to-revenue ratio was 74.6%, a 670 basis point improvement from a year ago, but would have improved 380 basis points excluding \$74 million of gains on asset sales. As in 2004, the improvement was reflected in significantly higher earnings. The group has been successful with revenue-generating initiatives, aided by an overall improvement in market conditions, and surpassed its productivity target in 2005.

Investment Banking Group's expense-to-revenue ratio deteriorated by 310 basis points to 53.9%. Revenue declined while expenses rose, as reduced revenues were primarily concentrated in businesses with relatively lower variable costs. Although the group's productivity ratio deteriorated, it was the second best of its Canadian peer group in 2005.

We improved our overall cash productivity ratio in 2005 by 120 basis points to 62.6%, building on the significant improvements of the past two years, during which the cash productivity ratio improved by 420 basis points. However, we fell short of

The **expense-to-revenue ratio (or productivity ratio)** is our key measure of productivity. It is calculated as non-interest expense divided by total revenues (on a taxable equivalent basis), expressed as a percentage. See page 35.

The **cash productivity ratio** is calculated in the same manner, after removing the amortization of intangible assets from non-interest expenses. See page 35.

our annual target of improving enterprise-wide productivity by 150 to 200 basis points, as we continued to invest in our businesses to achieve future earnings growth.

Examples of initiatives to enhance productivity are outlined in the 2005 Review of Operating Groups Performance that starts on page 43. In 2006, a top BMO priority is to focus on revenue growth to improve productivity, as we are targeting a 100 to 150 basis point improvement in the cash productivity ratio.

Table 11 on page 83 provides further detail on expenses and expense growth.

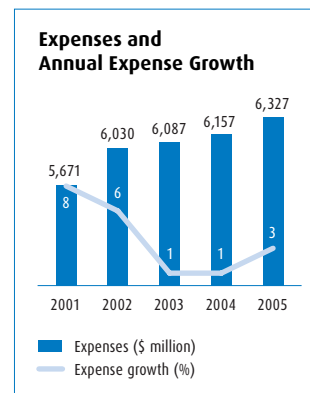
Non-Interest Expense (\$ millions)

For the year ended October 31	2005	2004	2003	Change from 2004	
				\$	%
Performance-based compensation	1,272	1,148	1,058	124	11
Other employee compensation	2,474	2,484	2,520	(10)	—
Total employee compensation	3,746	3,632	3,578	114	3
Premises and equipment	1,264	1,252	1,264	12	1
Communications	122	138	162	(16)	(12)
Other	1,101	1,031	978	70	7
Amortization of intangible assets	94	104	105	(10)	(10)
Total	6,327	6,157	6,087	170	3

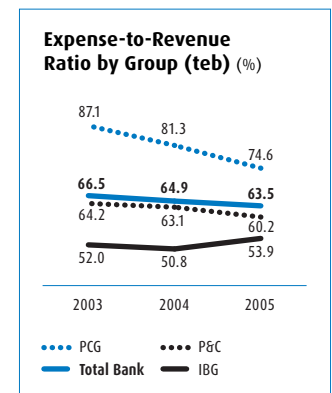
Contribution to Non-Interest Expense Growth (%)

For the year ended October 31	2005	2004	2003
Acquired businesses	0.8	1.7	3.0
Currency translation effect	(2.4)	(2.9)	(2.9)
Performance-based compensation	2.0	1.5	1.5
Pension expense	(0.2)	0.5	1.3
Other*	2.6	0.3	(2.0)
Total non-interest expense growth	2.8	1.1	0.9

*Other includes the offset of the impact of currency translation on performance-based compensation and pension expense.



Expenses continue to grow at relatively modest levels.



BMO, P&C and PCG continue to improve their productivity.

Provision for Income Taxes

The provision for income taxes reflected in the Consolidated Statement of Income is based upon transactions recorded in income, regardless of when such transactions are subject to taxation by tax authorities, with the exception of the repatriation of retained earnings from foreign subsidiaries, as outlined in Note 23 on page 124 of the financial statements.

As explained on pages 35 and 37, BMO adjusts revenue to a taxable equivalent basis for analysis, with an offsetting adjustment to the provision for income taxes. As such, unless indicated otherwise, the provision for income taxes and associated tax rates are stated on a taxable equivalent basis in this MD&A.

The provision for income taxes in the Consolidated Statement of Income was \$994 million, compared with \$1,111 million in 2004. In 2005, there were \$66 million of recoveries of prior years' income taxes, a high tax rate on the gain on sale of *Harrisdirect*, primarily due to tax elections, and \$29 million of non-taxable revenue on restructuring VIEs. In 2004, there was a \$19 million increase to the provision for future income tax liabilities related to U.S. real estate. The effective tax rate in 2005 was 28.8% (30.5% excluding the aforementioned items). This compares with an effective tax rate of 32.4% in 2004 (31.8% excluding the \$19 million increase to the future income tax liabilities). In 2005, there was a higher proportion of income from lower tax rate jurisdictions. The components of variances between the effective and statutory Canadian tax rates are outlined in Note 23 on page 125 of the financial statements.

Excluding any special adjustments, we estimate that the effective tax rate in 2006 should be 30% to 31% and consider that rate to be sustainable.

BMO hedges the foreign exchange risk arising from our net investment in our U.S. operations by funding the net investment in U.S. dollars. Under this program, the gain or loss on hedging and the unrealized gain or loss on translation of the net investment in U.S. operations are charged or credited to retained earnings, but usually are approximately equal and offsetting. For income tax purposes, the gain or loss on hedging activities incurs an income tax charge or credit in the current period, which is charged or credited to retained earnings; however, the associated unrealized gain or loss on the net investment in U.S. operations does not incur income taxes until the investment is liquidated. The income tax charge/benefit arising from a hedging gain/loss is a function of fluctuations in exchange rates from period to period. The \$297 million gain on hedging our net investment in U.S. operations in 2005 was subject to an income tax charge in retained earnings of \$101 million, compared with a \$710 million gain on hedging and a \$254 million income tax charge in 2004. Refer to the Consolidated Statement of Changes in Shareholders' Equity on page 94 of the financial statements for further details.

Table 11 on page 83 details the \$1,407 million of total government levies and taxes incurred by BMO in 2005.

Non-Controlling Interest in Subsidiaries

Non-controlling interest in subsidiaries increased \$41 million to \$58 million in 2005, largely due to the issuance of \$1,050 million of BMO BOaTS, comprised of \$600 million Series D issued

in late fiscal 2004 and \$450 million Series E issued in late fiscal 2005. Note 18 on page 116 of the financial statements provides more detail on non-controlling interest in subsidiaries.

Transactions with Related Parties

In the ordinary course of business, we provide banking services to our joint ventures and equity-accounted investees on the same terms that we offer to our customers. A select suite of customer loan and mortgage products is offered to our employees at rates normally accorded to our preferred customers. We also offer employees a subsidy on annual credit card fees.

Preferred rate loan agreements are discussed in Note 26 on page 128 of the financial statements. There were no amounts advanced under these preferred rate loan agreements in 2005.

The foregoing "Provision for Credit Losses", "Non-Interest Expense" and "Provision for Income Taxes" sections and the following "2005 Review of Operating Groups Performance" section of this Annual Report contain certain forward-looking statements, in particular regarding our outlook for certain aspects of the Canadian and U.S. business environments in 2006, our productivity ratio, effective income tax rates and our strategies and priorities for 2006. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Please refer to the Caution Regarding Forward-Looking Statements on page 29 of this Annual Report for a discussion of such risks and uncertainties and the material factors and assumptions related to the statements set forth in such sections.