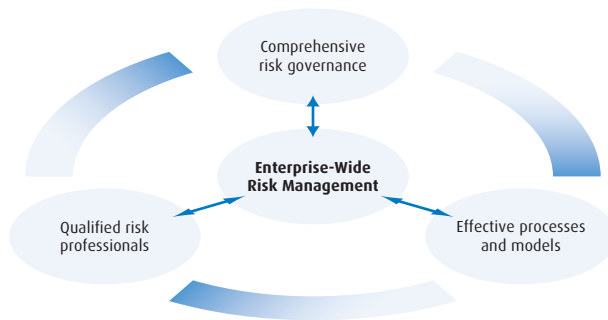


Enterprise-Wide Risk Management



Robert McGlashan
Executive Vice-President and
Chief Risk Officer, Enterprise Risk
and Portfolio Management,
BMO Financial Group

BMO Financial Group has an enterprise-wide approach to the recognition, measurement, assessment and management of risks faced across the organization. These risks are classified as credit and counterparty, market, liquidity and funding, operational and business risk.



BMO's risk framework guides our risk-taking activities and ensures that they are aligned with client needs, shareholder expectations and regulatory requirements. The framework provides for not only the direct management of each individual risk type but also the management of risks on an integrated basis. It consists of 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 consistent with our risk tolerance and standards and drives the maximization of long-term shareholder return.

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

management corporate policies and corporate standards and procedures, are reviewed on an ongoing basis to ensure that they provide effective and superior governance over our risk-taking activities. In each line of business, management ensures that governance activities, controls and management processes are consistent with our risk management corporate policies and corporate standards.

Risk limits, which define BMO's risk tolerance, are reviewed and approved annually by the Risk Review Committee of the Board for:

- credit and counterparty risk – limits on country, industry, portfolio/product 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 on minimum levels of 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 governance committees establish and monitor comprehensive risk management limits consistent with the Board-approved limits. Loss limits are also in place, providing an early warning mechanism to effectively address potential loss situations.

Effective Processes and Models

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

- develop policies and limits for approval by senior management 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,

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 as well as 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 and oversight as well as the management and oversight of the operational and market risk 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 tolerance.

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

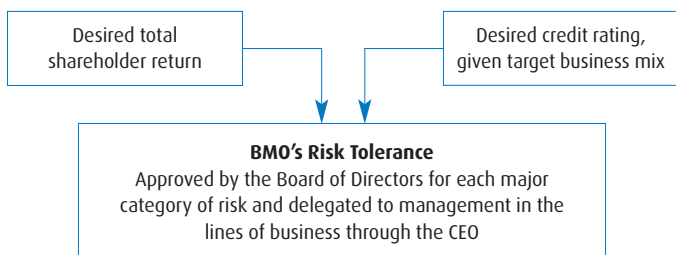
Sound enterprise-wide risk management relies upon the competence and experience of our risk professionals to:

- 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 decision-making.

To enhance existing risk management capabilities, managers and lenders are offered a progressive curriculum of credit risk courses by BMO's Institute for Learning. 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 limits 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 tolerance.

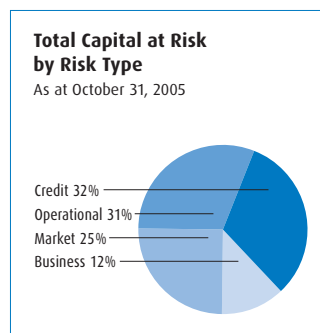


BMO's risk management is supported by the Initiative Decisioning Process model, which ensures that changes to the organization's risk profile associated with new business initiatives are correctly identified and receive appropriate approvals before the initiatives are implemented. Risk management is also supported by processes which use capital at risk measures, scenario analysis and stress testing to assess the relative magnitude of risks taken and the distribution of those risks across the organization's activities.

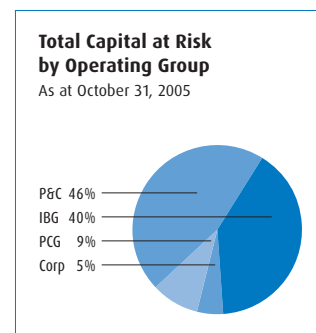
CaR provides a single enterprise-wide measure of risk that can be compared across business activities and risk types.

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 economic losses that could occur if adverse situations arise and allows returns to be adjusted for risks. CaR is calculated for various types of risk – Credit, Market (trading and non-trading), Operational and Business – where measures are based on a time horizon of one year.

As noted in the charts below, BMO's largest exposure in 2005 by type of risk was credit risk. Operational risk capital has increased from 2004 as a result of the inclusion of the Basel II Standardized Approach into the internal economic capital measure.



Credit risk remains the largest contributor to CaR by risk type.



P&C carries the largest share of CaR in 2005, versus IBG in 2004.

Stress testing and scenario analysis assist 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, a combination thereof, or significant economic developments such as a rapid increase in either the value of the Canadian dollar or energy costs. These tests and analyses are applied to all significant risk-taking activities across the organization.

We also conduct ongoing industry stress testing and scenario analysis 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 underlying risk characteristics of the industries under review.

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

The final Basel II Framework was issued by the Basel Committee on Banking Supervision in June 2004. The Framework was developed to strengthen the soundness and stability of the international banking system, promote the adoption of stronger risk management practices and develop more risk-sensitive capital requirements. The Framework allows banks to choose from several increasingly risk-sensitive approaches to the calculation of credit and operational risk regulatory capital requirements and promotes the use of a bank's own internal estimates.

OSFI's implementation date for Basel II is November 1, 2007. OSFI has issued a Draft Revised Capital Adequacy Requirements (CAR) Guideline that incorporates the Framework's principles.

BMO is implementing an Advanced Internal Ratings-Based Approach for credit risk regulatory capital calculations and adopting a Standardized Approach for operational risk capital calculations. BMO has an integrated enterprise-wide program

for managing the implementation of Basel II. Leadership and oversight are provided by an Executive Steering Committee.

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 and other risk management products and, to a lesser extent, in its holding of investment securities. Effective credit risk management begins with BMO's experienced and skilled professional lending and credit risk officers, who together operate in a dual control structure to authorize credit risk transactions. These individuals are subject to a rigorous lender qualification process, and operate in a disciplined environment with clear delegation of decision-making authority, including established lending limits. Credit decision-making is conducted at the management level appropriate to the size and risk of each transaction in accordance with comprehensive corporate policies, standards and procedures governing the conduct of credit risk activities.

Operating practices include the ongoing monitoring of credit risk exposures and regular portfolio and sector reporting to the Board and senior management committees. Performing accounts are reviewed on a regular basis, with most commercial and corporate accounts reviewed at least annually. The frequency of reviews is increased proportionally in accordance with the likelihood and size of potential credit loss. Corporate Audit Division reviews management processes and controls and samples credit transactions for adherence to credit terms and conditions. In addition, BMO carries out regular portfolio sector reviews, including stress testing and scenario analysis based on current, emerging or prospective risks.

For the consumer and small business portfolios, credit risk models and decision systems 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. The characteristics of both the borrower and the loan, along with past portfolio experience, are used to predict the credit performance of new accounts. Past performance is also used to predict the likely future behaviour of existing accounts for ongoing credit risk management.

For the commercial and corporate portfolios, BMO utilizes an enterprise-wide risk rating framework that applies to all our sovereign, bank, corporate and commercial counterparties. We believe the framework to be consistent with the principles of Basel II under which future minimum regulatory capital requirements for credit risk will be determined. One key element of this framework is the assignment of appropriate borrower risk ratings to help quantify potential credit risk.

Under the risk rating framework, a counterparty's default probability over a one-year time horizon is assessed using methodologies and rating criteria tailored to the specific risk characteristics of the counterparty. A borrower risk rating is derived from this assessment. Counterparties migrate between ratings as our assessment of their probability of

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 predetermined financial obligation. This is the most significant measurable risk that BMO faces.

default changes. Losses are estimated based on the proportion of the exposure that will be lost if a counterparty default occurs, through an analysis of transaction-specific factors such as the nature and terms of the loan, collateral held and the seniority of our claim.

We also employ a disciplined approach to provisioning and loan loss evaluation, with prompt identification of problem loans being a key risk management objective. BMO maintains both specific and general allowances for credit losses. Specific allowances reduce the aggregate carrying value of credit assets where there is evidence of deterioration in credit quality. The general allowance is maintained to absorb probable credit losses in the existing portfolios for which specific provisions cannot yet be identified. The sum of these allowances must always be sufficient to reduce the book value of credit assets to their estimated realizable value.

BMO increasingly uses credit derivative products to enhance the management of its portfolio of credit risk assets, in particular its corporate loan book. In 2005, we were active in the use of single-name credit default swaps to mitigate the credit risk related to specific client credit exposures, and we used structured credit default swaps to mitigate identified sectoral risk concentrations. BMO is not an active seller of credit protection by way of credit default swaps.

BMO's credit risk governance policies ensure that an acceptable level of diversification is maintained at all times. For large corporate transactions, we utilize expected loss models to assess the extent and correlation of risks before authorizing new exposures. At year-end, our credit assets consisted of a well-diversified portfolio comprised of millions of clients, the majority of them consumers and small to medium-sized businesses. Note 4 on page 100 of the financial statements and Tables 14 to 22 on pages 86 to 89 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 58.

Our credit risk management processes are both well-established and effective. In 14 of the past 15 years, BMO's specific credit losses relative to loans and acceptances, including securities borrowed or purchased under resale agreements, were the lowest of our Canadian peer group. Over this 15-year period, BMO's average loss rate was 38 basis points, compared with an average of 59 basis points for our largest peers. The favourable results were achieved in consumer loans, as well as corporate and commercial loans.

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;
- 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, 2005 are summarized in the following table. MVE has decreased over the past year due to a reduction in the structural duration, reflecting normal variability within the target structural duration range. EV exposure has decreased relative to last year due to the implementation in the first quarter of fiscal 2005 of a one-day correlated EV model for accrual portfolios in trading and underwriting.

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

As at October 31 (After-tax Canadian equivalent)	Market value exposure		12-month earnings volatility	
	2005	2004	2005	2004
Trading and underwriting	11.6	10.0	9.1	18.0
Structural	326.3	340.2	28.1	28.0
Total	337.9	350.2	37.2	46.0

*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, Value at Risk (VaR) measures the magnitude of BMO's market risk.

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 during fiscal 2004. The 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.

Various VaR models are used to determine market risk capital at risk for each of the lines of business and to determine regulatory capital. 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 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, foreign exchange, 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 (or Credit Spread) 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 is measured at a 99% confidence level over an appropriate holding period.

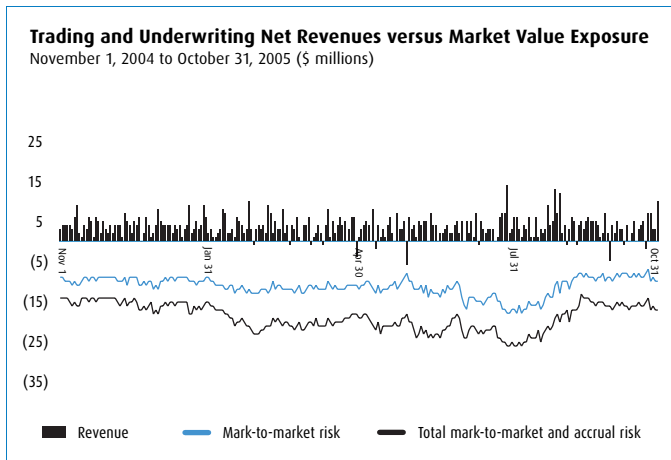
Market risk exposures arising from trading and underwriting activities are summarized in the following table.

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

For the year ended October 31, 2005 (Pre-tax Canadian equivalent)	Year-end	Average	High	Low
Commodity VaR	3.2	4.2	13.0	1.0
Equity VaR	3.8	4.9	7.1	2.8
Foreign exchange VaR	0.4	0.6	2.2	0.1
Interest rate VaR (mark-to-market)	3.8	4.4	8.9	2.5
Correlation	(5.5)	(6.6)	(10.2)	(3.7)
Comprehensive VaR	5.7	7.5	14.7	4.0
Interest rate VaR (accrual)	8.0	8.5	12.3	5.6
Issuer Risk	4.1	3.9	5.6	2.7
Total MVE	17.8	19.9	27.4	14.1

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	(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
Issuer Risk	4.0	4.5	7.0	2.9
Total MVE	15.0	18.9	28.4	14.1

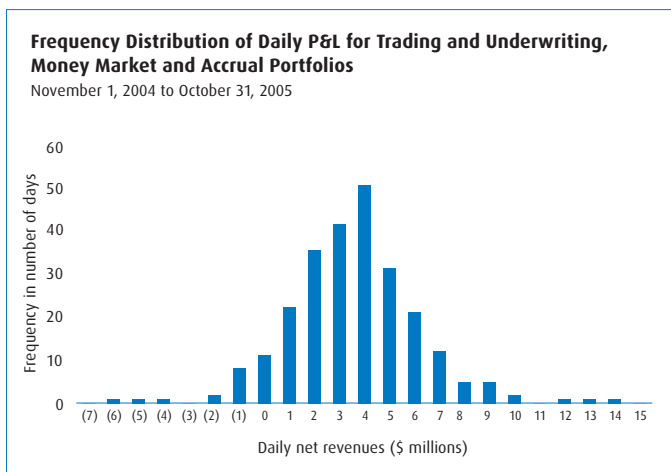
*One-day measure using a 99% confidence level.



There were no losses in fiscal 2005 in the trading and underwriting portfolios that exceeded the overall MVE 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.

Trading revenues include amounts from all trading and underwriting activities, whether accounted for on a mark-to-market basis or an accrual basis, as well as 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 MVE 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 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 2005 net income is reviewed on page 36.

Structural MVE and EV measures both reflect holding periods of between one and three months and incorporate the impact of correlation between market variables. Structural MVE (see page 70) has decreased over the past year due to a reduction in duration, reflecting normal variability within the target duration range. EV continues to be managed to low levels.

In addition to MVE and EV, we also use simulations, sensitivity analysis, stress testing and gap analysis, which is disclosed in the table on page 72, to measure and manage interest rate risk.

Structural interest rate sensitivity to an immediate parallel 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.

Structural Interest Rate Sensitivity (\$ millions)*

(After-tax Canadian equivalent)	As at October 31, 2005		As at October 31, 2004	
	Economic value sensitivity	Earnings sensitivity over the next 12 months	Economic value sensitivity	Earnings sensitivity over the next 12 months
100 basis point increase	(228.8)	25.1	(224.3)	9.2
100 basis point decrease	191.9	(22.4)	183.7	(20.2)
200 basis point increase	(478.0)	44.1	(470.4)	22.2
200 basis point decrease	347.3	(45.8)	332.3	(62.9)

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

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;
- 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 corporate group are 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 affect the position.

We actively manage liquidity and funding risk globally by holding liquid assets in excess of an established minimum level 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 from 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, which determines the minimum amount of liquid assets to be held at all times.

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, investment and pledging commitments.

In addition, we use two primary measures to evaluate liquidity and funding risk. The first measure is the liquidity ratio. This ratio 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. It represents the sum of cash resources and securities as a percentage of total assets. BMO's liquidity ratio at October 31, 2005 was 26.2%, up from 25.8% at October 31, 2004. The increase in the ratio was primarily attributable to growth in securities associated with trading activities.

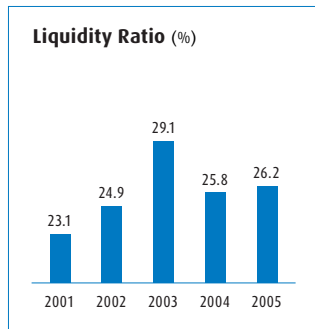
Cash and securities totalled \$78.0 billion at the end of the year, up from \$68.5 billion in 2004, while total assets increased \$32.3 billion to \$297.5 billion.

Liquidity provided by 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 \$20.7 billion at the end of the year, up from \$17.1 billion in 2004.

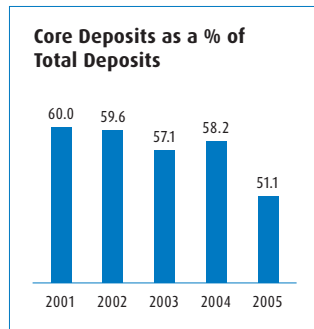
In the ordinary course of business, a portion of cash, securities and securities purchased under resale agreements is pledged as collateral to support trading activities and participation in clearing and payment systems, in Canada and abroad. At October 31, 2005, \$27.8 billion of cash and securities and \$13.3 billion of securities purchased under resale agreements had been pledged, compared with \$18.8 billion and \$13.7 billion, respectively, in 2004. These changes were primarily driven by trading activities. 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 80 and in Notes 2 and 3 on page 97 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 individual

customer operating and savings deposits and smaller fixed-date deposits, which generally are less responsive to changes in the market environment than larger institutional 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, 2005 was 51.1%, down from 58.2% in the prior year.



The ratio of cash and securities as a percentage of total assets reflects a sound liquidity position.



Core deposits represent a stable source of funding.

The ratio decreased primarily due to an increase in non-core deposits that supported growth in loans and securities. Wholesale funding used to support loan growth was primarily longer term in order to better match the maturity of loans.

Core deposits totalled \$99.0 billion at the end of the year, down from \$101.9 billion in 2004, while total deposits increased \$18.6 billion to \$193.8 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 8 on page 81.

Liquidity and funding 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 61, and information on other credit instruments can be found in Note 5 on page 102 of the financial statements.

Operational Risk

Operational risk is inherent in all business activities. Operational risk can never be entirely eliminated; however, 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, outsourcing management, and acquisition and integration management.

BMO's operational risk governance structure includes the Operational Risk Committee (ORC), a sub-committee of RMC. 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.

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, ORC, RMC and the Board of Directors.

Each line of business is responsible for using the aforementioned framework processes and control programs to manage its operational risk within the guidelines established by corporate policy and standards. To ensure that all operational risks to which a line of business is exposed are adequately managed, specialized functions are also involved in the management of risks as appropriate, including Finance, Taxation, Legal, Compliance, Privacy, Human Resources, and Systems and Information Management.

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.

We purchase 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.

BMO has adopted an operational risk capital measure consistent with the Basel II Standardized Approach and a separate measure for Business Risk due to Operational Failure. We continue to improve our measurement capabilities by reviewing internal and external operational loss data, key risk indicators and operational risk scenarios as a means to better understand and measure risk.

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

The various processes included in the operational risk framework are at different stages of development. Our approach is to continuously improve each in a way that supports business activities while also meeting external requirements.

Business Risk due to Operational Failure

Business Risk due to Operational Failure is the risk of losses or reductions in revenue arising from the indirect effects of operational risks, including reputation risk. BMO attributes economic capital for this risk to the business units using a scenario-based model and reports this capital as a component of operational risk capital.

Business Risk due to Earnings Volatility

Business risk due to earnings volatility measures the risk that volumes will decrease or margins will shrink with no opportunity being available to offset the revenue declines with a reduction in costs. BMO faces many risks that are similar to those faced by non-financial firms, principally that our 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.

Corporate Responsibility and Sustainability

BMO has an ongoing commitment to responsible, ethical and sustainable corporate behaviour. It is our responsibility as a public corporation to conduct our business in such a way as to deliver value to our shareholders while also benefiting society and protecting our environment. We measure success in all we do by applying the principles of excellence, accountability, transparency and integrity.

At BMO, Corporate Responsibility and Sustainability objectives are integrated into long-term strategic decision-making. BMO's strategies address our interactions and overall relationship with all of our stakeholders, including customers, employees, owners and investors, governments, suppliers, competitors and environmental interests.

Trust is a key element in BMO's ongoing success. Shareholders trust BMO to provide responsible and successful stewardship of their financial investments. Clients trust BMO to help them achieve their financial goals. Our employees and the communities in which we operate trust our commitments to contribute to their continued well-being and success. Finally, governments trust our respect for the standards required of our industry.

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. This policy applies to all activities undertaken by both BMO's Board of Directors and our employees. Policy requirements cannot be compromised by virtue of third-party outsourcing or joint venture arrangements.

Corporate Responsibility and Sustainability is not a project or an initiative – it is a way of doing business. Behaving responsibly in the pursuit of our corporate goals protects our reputation and is necessary to ensure the long-term sustainability of the enterprise.

Our annual Corporate Social Responsibility Report, including our Public Accountability Statement, documents how BMO Financial Group plays a role in the growth, success and well-being of the citizens and communities of the countries in which we operate.

A focus on Corporate Responsibility and Sustainability is an essential element in reputation risk management, as stakeholders are interested not only in financial performance but also in how that performance is achieved.

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 or client base and declines in BMO's share price.

Reputation Risk

BMO's reputation is one of our most valuable assets. Key to effectively building and maintaining BMO's reputation is fostering a business culture that:

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

The potential for damage to our corporate reputation exists in every business decision. Therefore, 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, operational implementation, transactional decision-making and risk management and control processes.

It is the responsibility of all employees to conduct themselves in such a way as to maintain and build BMO's reputation. The Reputation Risk Management Committee considers potential reputation risks to the enterprise and specifically reviews complex credits and structured financings as required.

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 to reduce waste, conserve energy and recycle materials, and take reasonable precautions to ensure that we deal with environmentally responsible customers in the course of our credit-granting activities.

BMO is willing to work with governments, industries and all relevant constituencies to address environmental issues and challenges, and has shown such willingness through the adoption and incorporation of environmental best practices into our decision-making policies and processes. This is evidenced by actions such as BMO being a signatory to the United Nations Environmental Programme Statement by Financial Institutions on the Environment and Sustainable Development and to the Carbon Disclosure Project, as well as adoption of The Equator Principles.