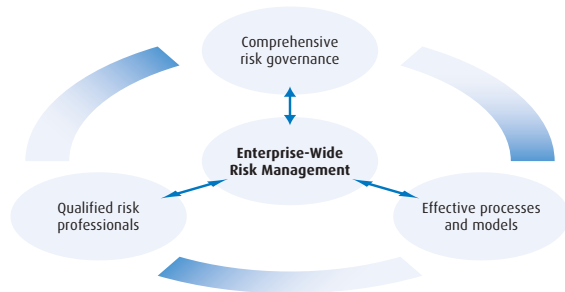


Enterprise-Wide Risk Management



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 identification, measurement, monitoring 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 management 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 standards and risk tolerance levels 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, corporate standards and operating procedures, are reviewed on an ongoing basis to ensure that they provide effective and superior governance of our risk-taking activities. In each line of business, management ensures that governance activities, controls and management processes and procedures 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 exposures; 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 further establish and monitor comprehensive risk management limits consistent with and subordinate to 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 and the appropriate governance committees;
- monitor compliance with policies and limits;
- maintain contingency plans;
- track variables for changing risk conditions; and
- provide timely reports to senior management and the appropriate governance committees.

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.

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 specific risks 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 operational and business risk for each line of business; and
- estimate liquidity and funding risk based on expected and stressed operating conditions.

Qualified Risk Professionals

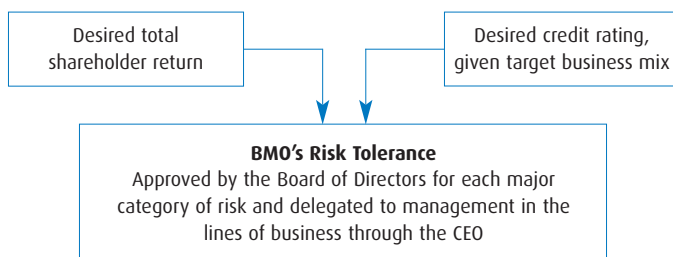
Sound enterprise-wide risk management relies upon the competence and experience of our risk professionals to:

- 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

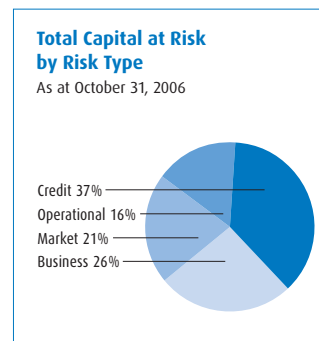
The management of risk is integrated with our strategy and management of capital. This ensures that risks incurred in pursuit of BMO's strategic objectives are consistent with desired total shareholder return as well as BMO's desired credit rating and risk tolerance.



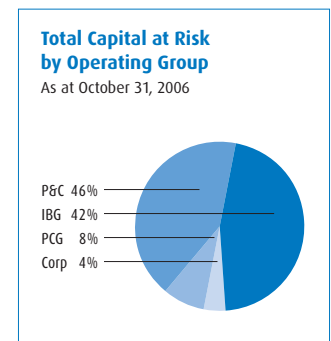
BMO's risk management is supported by the Initiative Decisioning Process model, which ensures that changes to the organization's risk profile associated with new business initiatives are correctly identified and receive appropriate approvals prior to acceptance or implementation. Risk management is also supported by processes that use economic capital measures, stress testing and scenario analysis 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.

Beginning in fiscal 2005, the Basel II Standardized Approach for operational risk capital has been included in the internal economic capital measure. Furthermore, during fiscal 2006, CaR for Business Risk due to operational failures was reclassified to the Business Risk category from Operational Risk to align with Basel II standard measures of Operational Risk.



Credit risk remains the largest component of CaR by risk type.



P&C carries the largest share of CaR in 2006, as in 2005.

Stress testing and scenario analysis assist in measuring the impact on our operations of extreme but plausible operational, political, economic and market events. Scenarios designed in collaboration with our economists, equity research and business units are based on historical or hypothetical events, a combination thereof, or significant economic developments such as a rapid increase in the value of the Canadian dollar, a real estate downturn or higher energy costs. These tests and analyses are then applied to all significant and relevant risk-taking portfolios across the organization.

We also conduct ongoing cross-business and wholesale (Corporate and Commercial) 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 senior management with 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 (BCBS) 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. In July 2005, the BCBS issued a follow-up paper, "The Application of Basel II to Trading Activities and the Treatment of Double Default Effects."

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

BMO is implementing Basel II in accordance with OSFI's guidance and timelines. We are implementing an Advanced Internal Ratings-Based Approach for credit risk regulatory capital

calculations and the 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 capital markets 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 transactions that expose us to credit risk. These individuals are subject to a rigorous lender qualification process, and operate in a disciplined environment with clear delegation of decision-making authority, including individually delegated 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 in accordance with the likelihood and size of potential credit losses, with deteriorating higher-risk situations referred to specialized account management groups for closer attention where appropriate. 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, as appropriate, 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. This framework is 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 BMO's risk rating framework, a counterparty's risk rating is assessed using methodologies and rating criteria tailored to the specific risk characteristics of the counterparty, and the resulting rating is then mapped to a predetermined default probability over a one-year time horizon. As counterparties migrate between risk ratings, their probability of default changes.

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.

Losses are estimated based on the expected 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. For large corporate transactions, we also utilize expected loss models to assess the extent and correlation of risks before authorizing new exposures. Portfolio diversification is shown in the graph on page 57.

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 estimated 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 uses credit derivative products to enhance the management of its portfolio of credit risk assets, in particular its corporate loan book. In 2006, we were again 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 does not actively use credit derivative swaps to provide credit protection to other lenders.

BMO's credit risk governance policies ensure that an acceptable level of diversification is maintained at all times. 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.

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 lower than the average of our Canadian peer group. Over this 15-year period, BMO's average loss rate was 34 basis points, compared with an average of 56 basis points for our largest peers. These favourable results were achieved in consumer loans, as well as corporate and commercial loans.

Provisions for credit losses are discussed on page 39. Note 4 on page 100 of the financial statements and Tables 11 to 19 on pages 84 to 87 provide details of BMO's loan portfolio, impaired loans and provisions and allowances for credit losses.

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), Balance Sheet Management Committee (BSMC), 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, 2006 are summarized in the following table. Total MVE has decreased over the past year largely as a result of lower modelled structural interest rate volatility. Structural interest rate volatility is derived from 10 years of historical data that in fiscal 2006 excludes the high volatility associated with fiscal 1995. Total EV exposure is higher relative to last year largely as a result of increased position-taking activity across a broad range of mark-to-market, trading and underwriting portfolios.

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

As at October 31, 2006 (After-tax Canadian equivalent)	Market value exposure		12-month earnings volatility	
	2006	2005	2006	2005
Trading and underwriting	(23.4)	(11.6)	(17.5)	(9.1)
Structural	(267.0)	(326.3)	(24.1)	(28.1)
Total	(290.4)	(337.9)	(41.6)	(37.2)

*Measured at a 99% confidence interval.

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 Canadian 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 (Comprehensive 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 factors 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 exposures arising from trading and underwriting activities are summarized in the adjacent table. Trading and underwriting Market Value Exposure has increased year-over-year due to additional longer-term, U.S.-dollar-denominated

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 is measured at a 99% confidence level over an appropriate holding period.

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

For the year ended October 31, 2006 (Pre-tax Canadian equivalent)	Year-end	Average	High	Low
	Commodity risk	(8.4)	(5.9)	(13.8)
Equity risk	(9.8)	(4.6)	(10.5)	(2.6)
Foreign exchange risk	(3.3)	(1.4)	(5.1)	(0.1)
Interest rate risk (mark-to-market)	(7.1)	(4.0)	(9.8)	(1.9)
Diversification	10.4	6.7	12.4	3.7
Comprehensive risk	(18.2)	(9.2)	(19.1)	(4.2)
Interest rate risk (accrual)	(12.0)	(10.8)	(34.7)	(5.6)
Issuer risk	(5.8)	(4.7)	(8.3)	(2.8)
Total MVE	(36.0)	(24.7)	(53.3)	(16.2)

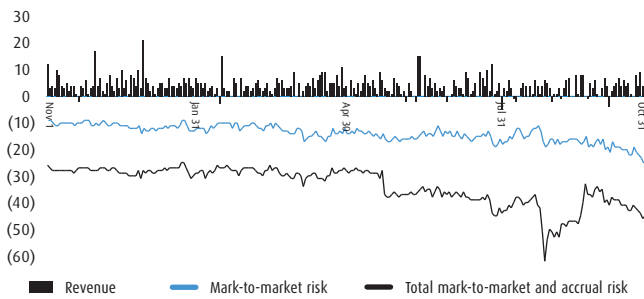
For the year ended October 31, 2005 (Pre-tax Canadian equivalent)	Year-end	Average	High	Low
	Commodity risk	(3.2)	(4.2)	(13.0)
Equity risk	(3.8)	(4.9)	(7.1)	(2.8)
Foreign exchange risk	(0.4)	(0.6)	(2.2)	(0.1)
Interest rate risk (mark-to-market)	(3.8)	(4.4)	(8.9)	(2.5)
Diversification	5.5	6.6	10.2	3.7
Comprehensive risk	(5.7)	(7.5)	(14.7)	(4.0)
Interest rate risk (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)

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

assets in the interest rate accrual portfolios, coupled with a general increase in position-taking activities across a broad range of mark-to-market portfolios.

Trading and Underwriting Net Revenues versus Market Value Exposure

November 1, 2005 to October 31, 2006 (Pre-tax \$ millions)



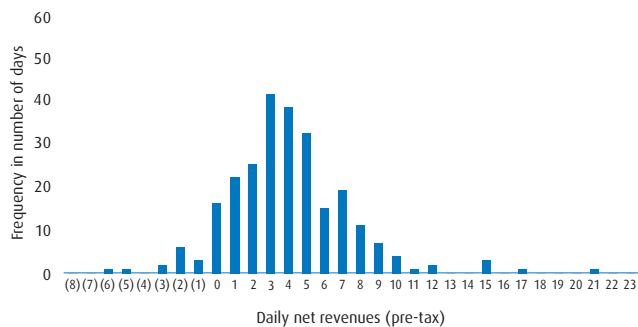
There were no losses in fiscal 2006 in the trading and underwriting portfolios that exceeded the overall MVE measure.

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.

Frequency Distribution of Daily Net Revenues for Trading and Underwriting, Money Market and Accrual Portfolios

November 1, 2005 to October 31, 2006 (\$ millions)



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 official valuation models to ensure that they are appropriate to the particular product to which they are applied, and we take corrective action, including making adjustments to the determination of net trading revenues, when model limitations are identified.

We use a variety of methods to ensure the integrity of our risk 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 on a daily basis 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 and maximization of sustainable product spreads.

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 managed to a target duration, which is currently between two and three years, while 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-denominated 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 2006 net income is reviewed on page 35.

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 69) has decreased in fiscal 2006 as a result of lower modelled interest rate volatility. Interest rate volatility is derived from 10 years of historical data that in fiscal 2006 excludes the high volatility associated with fiscal 1995. 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 to measure and manage interest rate risk. Sensitivity analysis is disclosed in the table on page 71. Gap analysis is disclosed in Note 19 on page 116 of the financial statements.

Structural interest rate sensitivity to an immediate parallel increase or decrease of 100 and 200 basis points is disclosed in the table on page 71. 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 project how interest rates and foreign exchange rates may change and predict how customers would likely react to the changes. For customer loans and deposits with scheduled maturity and repricing dates

(e.g. mortgages and term deposits), our models measure how customers use embedded options to modify those terms. For customer loans and deposits without scheduled maturity and repricing dates (e.g. credit card loans and chequing accounts), our models impute a maturity profile that considers pricing and volume strategies and is reflective of the associated uncertainties. 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 BSMC, 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 determine the minimum amount of liquid assets to be held at all times.

Two of the measures we use to evaluate liquidity and funding risk are the liquidity ratio and the core deposit ratio. The liquidity ratio represents the sum of cash resources and securities as a percentage of total assets. 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. BMO's liquidity ratio at October 31, 2006 was 27.2%, up from 26.5%

Structural Interest Rate Sensitivity (\$ millions)*

(After-tax Canadian equivalent)	As at October 31, 2006		As at October 31, 2005	
	Economic value sensitivity	12-month earnings sensitivity	Economic value sensitivity	12-month earnings sensitivity
100 basis point increase	(237.4)	10.9	(228.8)	25.1
100 basis point decrease	181.6	(10.5)	191.9	(22.4)
200 basis point increase	(508.0)	12.1	(478.0)	44.1
200 basis point decrease	318.3	(4.1)	347.3	(45.8)

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

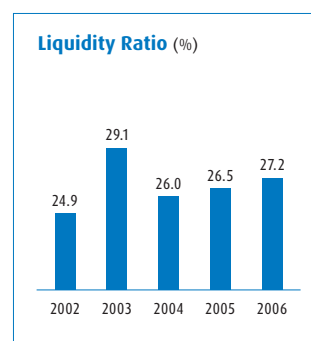
Liquidity and funding risk is the potential for loss if BMO is unable to meet financial commitments in a timely manner at reasonable prices as they fall due. Financial commitments include liabilities to depositors and suppliers, and lending, investment and pledging commitments.

at October 31, 2005. The increase in the ratio was primarily attributable to securities growth during the year.

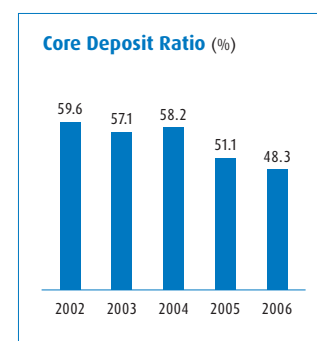
Cash and securities totalled \$87.0 billion at the end of the year, up from \$77.8 billion in 2005, while total assets increased \$26.1 billion to \$320.0 billion.

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 borrowed or purchased under resale agreements totalled \$31.4 billion at the end of the year, up from \$28.3 billion in 2005.

In the ordinary course of business, a portion of cash, securities and securities borrowed or 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, 2006, \$26.3 billion of cash and securities and \$25.4 billion of securities borrowed or purchased under resale agreements had been pledged, compared with \$27.8 billion and \$16.8 billion, respectively, in 2005. 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 79 and in Notes 2 and 3 on page 97 of the financial statements.



The ratio reflects a sound liquidity position.



The ratio reflects stable core deposits and growth in non-core deposits.

The core deposit ratio represents total deposits less fixed-date deposits greater than 100,000 units of any currency as a percentage of total deposits. This ratio 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. BMO's core deposit ratio at October 31, 2006 was 48.3%, down from 51.1% in the prior year. The ratio decreased primarily due to an increase in non-core deposits that were raised to support loan and securities growth.

Core deposits totalled \$98.5 billion at the end of the year, down from \$99.0 billion in 2005, while total deposits increased \$10.1 billion to \$203.8 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 used to support loans is primarily longer-term to better match the maturity of loans. Our 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 89.

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 60, 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 an operational risk framework, which includes identification, measurement, management, 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 intention 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

Operational risk is the potential for loss resulting from inadequate or failed internal processes or systems, human interactions or external events not related to credit, market or liquidity risks.

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, Corporate Support areas are also involved in the management of risks as appropriate. These include finance, taxation, legal, compliance, privacy, human resources, and systems and information management areas.

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. We continue to improve our measurement capabilities by reviewing internal and external operational loss data and key risk indicators as a means to better understand and measure risk.

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

Business Risk due to Operational Failure

Business risk due to operational failure, previously reported as a part of operational risk, is the risk of losses or reductions in revenue arising from the indirect effects of operational risks, including reputation risk. During the past year, it was reclassified to the Business Risk category to align operational risk capital measures with the Basel II Standardized Approach. BMO attributes economic capital for this risk to the business units using a scenario-based model and reports this capital as a component of business capital at risk.

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

Business risk is the risk associated with specific business activities of a company, as they might affect the earnings stream of that company. BMO recognizes two distinct types of business risk: business risk due to operational failure and business risk due to earnings volatility.

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.

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 conducted through integration of explicit assessments of reputation risk into strategy development, operational implementation and transactional decision-making.

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 is also managed through our corporate governance practices, code of conduct and risk management framework. It is the responsibility of all employees to conduct themselves in accordance with *FirstPrinciples*, BMO's code of conduct, and thus build and maintain BMO's reputation.

The Legal and Reputation Risk Management Committee considers potential reputation risks to the enterprise, specifically reviewing 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.

BMO continues to work with stakeholders to understand and address environmental issues and challenges, and considers the application of environmental best practices in decision-making policies and processes.

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 clients in the course of our credit-granting activities. Strict procedures exist to ensure environmental risks are identified, reviewed and sufficiently mitigated during the credit adjudication process.