

Note 8: Variable Interest Entities

Change in Accounting Policy

On November 1, 2004, we adopted the CICA's new accounting requirements on the consolidation of variable interest entities ("VIEs"). VIEs include entities where the equity is considered insufficient to finance the entity's activities or for which the equity holders do not have a controlling financial interest. The new rules require that we consolidate VIEs if the investments we hold in these entities and/or the relationships we have with them result in us being exposed to the majority of their expected losses, being able to benefit from a majority of their expected residual returns, or both, based on a calculation determined by standard setters. We consolidated our customer securitization vehicles as at November 1, 2004. Results for prior periods were not restated for this change.

On April 29, 2005, we completed the restructuring of our customer securitization vehicles by either terminating or changing the terms of our swaps with the VIEs and amending some of the rights of note-holders in the VIEs. As a result, they no longer met the criteria for consolidation. The impact on our Consolidated Statement of Income

of deconsolidating these vehicles on April 29, 2005 was an increase in non-interest revenue, other of \$44 million, an increase in income taxes of \$7 million and an increase in net income of \$37 million, representing the reversal of the unamortized mark-to-market losses on swaps that had been charged against opening retained earnings.

During the year ended October 31, 2006, we adopted new accounting guidance that provides additional clarification on VIEs and their consolidation requirements. There was no material impact on our consolidated financial statements as a result of this accounting guidance.

Customer Securitization Vehicles

Customer securitization vehicles (also referred to as bank-sponsored multi-seller conduits) assist our customers with the securitization of their assets to provide them with alternate sources of funding. Total assets held in unconsolidated customer securitization vehicles amounted to \$25,465 million as at October 31, 2007 (\$25,791 million in 2006), of which \$17,536 million relates to Canadian assets, and the balance are U.S. assets. These vehicles provide clients with access

to financing in the commercial paper markets by allowing them to sell their assets into these vehicles, which then issue commercial paper to investors to fund the purchases. In almost all cases, the seller continues to service the transferred assets. If there are losses on the assets, the seller is the first to take the loss. We do not sell assets to or service the assets held by these customer securitization vehicles. We earn fees for providing services related to the securitizations, including liquidity, distribution and financial arrangement fees for supporting the ongoing operations of the vehicles.

In general, investors in the commercial paper have recourse only to the assets of the related VIE and do not have recourse to us. Our exposure to losses relates to our investment in commercial paper issued by the vehicles, derivative contracts we have entered into with the vehicles and the liquidity support we provide through standby letters of credit and commitments to extend credit. We use our credit adjudication process in deciding whether to enter into these agreements just as we do when extending credit in the form of a loan. To the extent that we have purchased commercial paper, our exposure under the liquidity facilities is reduced by an equal amount. As at October 31, 2007, we had a net exposure of \$5,564 million from commercial paper held (\$448 million in 2006) classified as trading securities.

During the year ended October 31, 2007, we changed the nature of the liquidity lines offered to certain of our Canadian customer securitization vehicles to global style liquidity lines, which have objective criteria for determining when they can be drawn upon. Previously, we offered market disruption liquidity lines, which had more subjective criteria. The total contractual amount of this support was \$31,475 million as at October 31, 2007 (\$32,603 million in 2006), of which \$20,756 million related to Canadian facilities and the balance related to U.S. facilities. No amounts were drawn as at October 31, 2007 and 2006. Included in backstop liquidity facilities in 2006 was \$634 million related to a credit facility that has since been terminated. None of these facilities were drawn upon as at October 31, 2007 and 2006.

Derivative contracts entered into with these vehicles enable the vehicles to manage their exposures to interest and foreign exchange rate fluctuations. The fair value of derivatives outstanding with these VIEs and recorded in our Consolidated Balance Sheet was a derivative liability of \$20 million as at October 31, 2007 (\$5 million in 2006).

Our ownership of asset-backed commercial paper in two of the vehicles caused us to be exposed to the majority of the expected losses and they have been consolidated. Included in our Consolidated Balance Sheet at October 31, 2007 were assets of \$311 million classified as other assets and commercial paper of \$65 million classified as a deposit liability.

Structured Finance Vehicles

We facilitate development of investment products by third parties including mutual funds, unit investment trusts and other investment funds that are sold to retail investors. We enter into derivatives with these funds to provide the investors their desired exposure and hedge our exposure from these derivatives by investing in other funds. We also sponsor VIEs that provide investors access to debt portfolios through the issuance of commercial paper. We consolidate those VIEs where our interests expose us to a majority of the expected losses or residual returns, or both. Total assets and our exposure to losses in these consolidated VIEs were \$440 million as at October 31, 2007 (\$470 million in 2006). Total assets held by the VIEs in which we have a significant variable interest but we do not consolidate totalled \$2,365 million as at October 31, 2007 (\$762 million in 2006). Our exposure to loss from VIEs related to this activity is limited to the amount of our investment, which totalled \$553 million as at October 31, 2007 (\$216 million in 2006).

Bank Securitization Vehicles

We use bank securitization vehicles to securitize our Canadian mortgage loans and Canadian credit card loans either for capital management purposes or to obtain alternate sources of funding. The structure of

these vehicles limits the types of activities they can undertake and the types of assets they can hold, and they have limited decision-making authority. Total assets held by these vehicles amounted to \$6,552 million as at October 31, 2007 (\$6,803 million in 2006), all of which relate to assets in Canada. We are not required to consolidate our bank securitization vehicles. More information on our rights and obligations related to these vehicles can be found in Note 7. In addition to the interests described in Note 7, we also provide liquidity support to our bank securitization vehicles for the face value of the commercial paper outstanding. We use our credit adjudication process in deciding whether to enter into these agreements, just as we do when extending credit in the form of a loan. The total contract amount of the liquidity support was \$5,100 million and \$5,000 million as at October 31, 2007 and 2006, respectively. No amounts were drawn at October 31, 2007 and 2006. At October 31, 2007, we held \$367 million of the commercial paper issued by these vehicles.

During the year ended October 31, 2007, we changed the nature of the liquidity lines offered to bank securitization vehicles to global style liquidity lines, which have objective criteria for determining when they can be drawn upon.

Derivative contracts entered into with these vehicles enable the vehicles to manage their exposure to interest rate fluctuations. The fair value of derivatives outstanding with these vehicles and recorded in our Consolidated Balance Sheet was a derivative liability of \$52 million as at October 31, 2007 (\$27 million in 2006).

Credit Investment Management Vehicles

Credit investment management vehicles provide investment opportunities in customized, diversified debt portfolios in a variety of asset and rating classes. We earn investment management fees for managing these portfolios.

We hold interests in high grade Structured Investment Vehicles ("SIVs") and act as asset manager. Total assets held by these SIVs totalled \$22,754 million as at October 31, 2007 (\$28,892 million in 2006).

Our exposure to loss relates to our investments in these vehicles, derivatives contracts we have entered into with the vehicles and the liquidity support we provide through standby letters of credit, and commitments to extend credit or purchase senior debt issued by the SIVs. Our investment in the capital notes of the SIVs is recorded in available-for-sale securities in our Consolidated Balance Sheet, and was \$53 million as at October 31, 2007 (\$76 million in 2006). We have provided a funding commitment of \$1.3 billion to purchase senior notes issued by the SIVs. As at October 31, 2007, \$350 million was drawn and included in the amount disclosed as available-for-sale securities. The total contract amount of letters of credit for backstop liquidity facilities was \$221 million as at October 31, 2007 (\$184 million in 2006); no amounts were drawn at October 31, 2007 and 2006. The fair value of our derivative contracts outstanding with the SIVs and recorded in our Consolidated Balance Sheet was a derivative liability of \$11 million as at October 31, 2007 (\$18 million in 2006). We are not required to consolidate these SIVs. Subsequent to the year ended October 31, 2007, an additional \$904 million was drawn against the funding commitment for the purchase of senior debt.

Compensation Trusts

We have established trusts in order to administer our employee share ownership plan. Under this plan, we match 50% of employees' contributions when they choose to contribute a portion of their gross salary toward the purchase of our common shares. Our matching contributions are paid into trusts, which purchase our shares on the open market for payment to employees once employees are entitled to the shares under the terms of the plan. Total assets held by our compensation trusts amounted to \$825 million as at October 31, 2007 (\$890 million in 2006). We are not required to consolidate these compensation trusts and we have no exposure to loss from these trusts.

Capital Trusts

BMO Subordinated Notes Trust (the "SN Trust") was created in 2007 to issue \$800 million of BMO Trust Subordinated Notes – Series A. SN Trust used the proceeds of the offering to purchase a senior deposit note from the Bank. We are not required to consolidate the SN Trust. Refer to Note 18 for more details on the subordinated notes issued by the SN Trust.

We also provide liquidity support amounting to \$30 million to the SN Trust. As at October 31, 2007, \$5 million had been drawn.

BMO Capital Trust (the "Trust") was created to issue BMO Capital Trust Securities ("BOaTS"). As at October 31, 2007, the Trust had assets of \$3,140 million (\$3,180 million in 2006). The Trust is a VIE which we are required to consolidate. Refer to Note 19 for more details on the BOaTS.

Other VIEs

We are involved with other entities that may potentially be VIEs. This involvement can include, for example, acting as a derivatives counterparty, liquidity provider, investor, fund manager or trustee. These activities do not cause us to be exposed to a majority of the expected losses of these VIEs or allow us to benefit from a majority of their expected residual returns. As a result, we are not required to consolidate these VIEs. Transactions with these VIEs are conducted at market rates, and individual credit or investment decisions are based upon the analysis of the specific VIE, taking into consideration the quality of the underlying assets. We record and report these transactions in the same manner as other transactions. For example, derivatives contracts are recorded in accordance with our derivatives accounting policy as outlined in Note 9. Liquidity facilities are described in Note 6.