

2008 Financial Performance Review

This section provides a review of our enterprise financial performance for 2008 that focuses on the Consolidated Statement of Income included in our consolidated financial statements, which begin on page 104. A review of our operating groups' strategies and performance follows the enterprise review. A summary of the enterprise financial performance for 2007 is outlined on page 89.

Highlights

- Revenue increased \$856 million or 9.2% in 2008 to a record \$10.2 billion despite difficult capital markets conditions.
- Revenue growth in P&C Canada was primarily attributable to volume growth across its three lines of business. P&C U.S. revenue growth was attributable to acquisitions, a gain on Visa's initial public offering and improved core revenues. Private Client Group revenues increased despite difficult market conditions, certain charges and the weaker U.S. dollar. BMO Capital Markets revenues were up significantly due to strength in interest-rate-sensitive businesses in 2008 and commodities losses in 2007.
- The provision for credit losses increased to \$1,330 million from \$353 million in 2007. Specific provisions were up \$767 million to \$1,070 million and there was a \$260 million increase in the general allowance, compared with a \$50 million increase a year ago. Credit market conditions were much weaker in 2008.
- Non-interest expense increased 4.4% in 2008, growing at slightly less than half the rate of revenue growth. Expenses reflected the addition of front-line staff and business initiatives.
- The effective income tax rate was a recovery of 3.6%, compared with 7.9% in 2007. The reduced rate was due to a relatively higher proportion of income from lower-tax-rate jurisdictions and recoveries of prior-year income taxes.

Notable Items

We have designated certain charges as notable items to assist in discussing their impact on our financial results. These items reduced net income by \$585 million in 2008 and \$787 million in 2007, as set out in the adjacent table.

In 2008, revenue was reduced by charges of \$625 million related to difficulties in the capital markets environment. These charges reduced trading non-interest revenues by \$212 million, securities gains by \$347 million and other income by \$66 million. In 2007, revenue was reduced by \$318 million of such charges and by losses of \$853 million recorded in our commodities trading business. The charges in 2007 reduced trading revenue by \$1,156 million and securities gains by \$15 million.

Charges in 2008 included: \$230 million (\$80 million in 2007) in respect of BMO's investment in notes issued by Apex Trust, a Canadian credit protection vehicle, and a related total return swap (see page 65); \$158 million (\$nil in 2007) in respect of exiting positions related to monoline insurer ACA Financial Guarantee Corporation in the first quarter of 2008; \$70 million (\$54 million in 2007) related to third-party Canadian asset-backed commercial paper (see page 64); \$57 million (\$15 million in 2007) for capital notes in the Links Finance Corporation and Parkland Finance Corporation structured investment vehicles (see page 65); and \$110 million (\$169 million in 2007) in respect of certain other trading activities and valuation adjustments, including \$29 million for other-than-temporary impairment in respect of securities transferred from the trading to the available-for-sale portfolio. This transfer is explained more fully in the Trading-Related Revenues section on page 40. Further details on the effects of notable items can be found on page 34.

Notable Items

(\$ millions)	2008	2007	2006
Charges related to deterioration			
in capital markets environment	625	318	–
Related income taxes	206	107	–
Net impact of charges related to deterioration in capital markets environment (a)	419	211	–
Commodities losses (1)	–	853	–
Performance-based compensation	–	(120)	–
Related income taxes	–	293	–
Net impact of commodities losses (b)	–	440	–
Increase (decrease) in general allowance	260	50	(35)
Related income taxes	94	17	(12)
Net impact of increase (decrease) in general allowance (c)	166	33	(23)
Restructuring charge (1)	–	159	–
Related income taxes	–	56	–
Net impact of restructuring (d)	–	103	–
Total reduction (increase) in net income (a + b + c + d)	585	787	(23)

(1) Further charges were recorded for commodities losses in 2008 but those losses were more modest at \$18 million and as such have been excluded from notable items in 2008. For the same reason, a modest recovery of restructuring charges of \$8 million in 2008 has also been excluded.

Foreign Exchange

The Canadian dollar equivalents of BMO's U.S.-dollar-denominated net income, revenues, expenses, income taxes and provision for credit losses in 2008 and 2007 were lowered relative to the preceding year by the weakening of the U.S. dollar. The adjacent table indicates average Canadian/U.S. dollar exchange rates in 2008, 2007 and 2006 and the impact of lower average rates. At October 31, 2008, the Canadian dollar traded at \$1.2045 per U.S. dollar, as the U.S. dollar strengthened appreciably in the fourth quarter, particularly in October.

At the start of each quarter, BMO enters into hedging transactions that are designed to partially offset the pre-tax effects of exchange rate fluctuations in the quarter on our expected U.S.-dollar-denominated net income for that quarter. As such, these activities partially mitigate the impact of exchange rate fluctuations, but only within that quarter. As a result, the sum of the hedging gains/losses for the four quarters in a year is not directly comparable to the impact of year-over-year exchange rate fluctuations on earnings for the year. Hedging transactions resulted in an after-tax loss of \$11 million in 2008 (\$14 million gain in 2007).

The gain or loss from hedging transactions in future periods will be determined by both future exchange rate fluctuations and the amount of the underlying future hedging transactions, since the transactions are entered into each quarter in relation to expected U.S.-dollar-denominated net income for the next three months. The effect of exchange rate fluctuations on our net investment in foreign operations is discussed in the Provision for Income Taxes section on page 43.

BMO's U.S.-dollar-denominated results are affected, favourably or unfavourably, by movements in the Canadian/U.S. dollar exchange rate. Rate movements affect future results measured in Canadian dollars

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

(\$ millions, except as noted)	2008 vs. 2007	2007 vs. 2006
Canadian/U.S. dollar exchange rate (average)		
2008	1.032	
2007	1.093	1.093
2006		1.132
Reduced net interest income	(48)	(39)
Reduced non-interest revenue	(15)	(48)
Reduced revenues	(63)	(87)
Reduced expenses	93	57
Reduced provision for credit losses	28	9
Reduced (increased) income taxes	(6)	5
Increased (reduced) net income	52	(16)

and the impact on results is a function of the periods in which revenues, expenses and provisions for credit losses arise. If future results are consistent with the range of the past three years, U.S.-dollar-denominated income before income taxes would range from a loss of US\$900 million to income of US\$700 million. On that basis, each one cent decrease in the Canadian/U.S. dollar exchange rate, expressed in terms of how many Canadian dollars one U.S. dollar buys, would be expected to change net income before income taxes by between \$9 million at the lower end of the range and -\$7 million at the higher end. An increase of one cent would have the opposite effect.

Impact of Business Acquisitions and Sales

BMO Financial Group has selectively acquired a number of businesses in advancing our North American growth strategy. These acquisitions increase revenues and expenses, affecting year-over-year comparisons of operating results. The adjacent table outlines acquisitions by operating group and their impact on BMO's revenues, expenses and net income for 2008 relative to 2007 and 2007 relative to 2006, to assist in analyzing changes in results.

In respect of fiscal 2008 results relative to fiscal 2007, for the acquisitions completed in fiscal 2008, the incremental effects are the revenues and expenses of those businesses that are included in results for fiscal 2008. For the acquisition completed in fiscal 2007, the incremental effects on results for 2008 relate to the inclusion of 12 months of results in 2008 and a lesser number of months in 2007.

In respect of fiscal 2007 results relative to fiscal 2006, for the acquisition completed in fiscal 2007, the incremental effects are the revenues and expenses of that business that are included in results for fiscal 2007. For the acquisitions completed in fiscal 2006, the incremental effects on results for 2007 relate to the inclusion of 12 months of results in 2007 and a lesser number of months in 2006.

Impact of Business Acquisitions on Year-over-Year Comparisons*

Business acquired/sold	Increase (decrease) in:			
	Revenue	Expense	Net income	Cash net income
Personal and Commercial Banking				
Incremental effects on results for: 2008	51	46	(1)	3
2007	52	46	2	5
Merchants and Manufacturers Bancorporation, Inc. Acquired February 2008 for \$135 million				
Ozaukee Bank Acquired February 2008 for \$180 million				
First National Bank & Trust Acquired January 2007 for \$345 million				
bcpbank Canada Acquired December 2006 for \$41 million				
Villa Park Trust and Savings Bank Acquired December 2005 for \$76 million				
Private Client Group				
Incremental effects on results for: 2008	11	12	(1)	-
Pyrford International plc Acquired December 2007 for \$41 million				
BMO Capital Markets				
Incremental effects on results for: 2008	14	16	(1)	(1)
Griffin, Kubik, Stephens & Thompson, Inc. Acquired May 2008 for \$31 million				
BMO Financial Group				
Incremental effects on results for: 2008	76	74	(3)	2
2007	52	46	2	5
Purchases of businesses in 2008 for \$387 million				

*The impact excludes integration costs.

Revenue

Revenue increased \$856 million or 9% in 2008 to a record \$10,205 million. Revenue was reduced by charges of \$625 million related to the impact of the capital markets environment in 2008. In 2007, revenue was reduced by \$1,171 million of notable items, consisting of charges of \$853 million related to our commodities trading business and charges of \$318 million for certain trading activities and valuation adjustments related to the deterioration in capital markets. The lower charges in 2008 accounted for \$546 million of the revenue increase. There was solid revenue growth in each of the operating groups. The weaker U.S. dollar reduced overall revenue growth by \$63 million or 0.7 percentage points, while the net impact of acquired businesses increased growth by \$76 million or 0.8 percentage points.

Effective in 2008, BMO analyzes revenue at the consolidated level based on GAAP revenues reflected in the financial statements rather than on a taxable equivalent basis (teb), consistent with our Canadian peer group. Like many banks, we continue to analyze revenue on a teb basis at the operating group level. The teb adjustments for fiscal 2008 totalled \$195 million, up from \$180 million in 2007.

P&C Canada revenue increased \$293 million or 6%. The segment's revenue growth was increased by \$38 million or 0.8 percentage points by certain items that reduced its revenues in 2007. These included a \$185 million adjustment to increase our liability for future redemptions related to our customer loyalty rewards program net of a \$107 million gain on sale of MasterCard International Inc. (MasterCard) shares and \$40 million of other items. There was good volume growth in the three lines of business. P&C U.S. revenue increased US\$126 million or 15% as a result of acquisitions, a gain recognized on Visa's initial public offering and core performance improvement. Private Client Group revenue increased \$15 million or 1%, its growth having been reduced \$31 million or 1% by notable items recorded in the fourth quarter of 2008. Growth was attributable to improved net interest income. BMO Capital Markets revenue increased \$443 million or 23%, as charges for notable items fell \$577 million from 2007. There was considerable growth in net interest income due to strong returns from interest-rate-sensitive businesses and trading revenues.

Net Interest Income

Net interest income for the year was \$5,087 million, an increase of \$244 million or 5% from 2007. The net effect of businesses acquired increased net interest income by \$48 million, while the impact of the weaker U.S. dollar reduced net interest income by \$47 million. All the operating groups achieved strong volume growth, and average earning assets increased \$22 billion. The resulting growth in net interest income was partly offset by a reduction in Corporate Services due to higher net funding costs. BMO's overall net interest margin was slightly lower in 2008 due to reduced earnings in Corporate Services. P&C Canada's margin was relatively unchanged. The two main drivers of BMO's overall net interest margin are the individual group margins and changes in the magnitude of each operating group's assets.

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

For the year ended October 31	Net interest income (teb) (\$ millions)				Average earning assets (\$ millions)				Net interest margin (in basis points)		
	2008	2007	\$	%	2008	2007	\$	%	2008	2007	Change
P&C Canada	3,236	3,066	170	6	121,381	115,147	6,234	5	267	266	1
P&C U.S.	748	730	18	3	24,913	21,658	3,255	15	300	337	(37)
Personal and Commercial Banking (P&C)	3,984	3,796	188	5	146,294	136,805	9,489	7	272	277	(5)
Private Client Group (PCG)	671	612	59	9	7,474	6,352	1,122	18	898	966	(68)
BMO Capital Markets (BMO CM)	1,179	974	205	21	176,080	162,309	13,771	8	67	60	7
Corporate Services, including Technology and Operations	(747)	(539)	(208)	(39)	(3,045)	(995)	(2,050)	(+100)	nm	nm	nm
Total BMO (1)	5,087	4,843	244	5	326,803	304,471	22,332	7	156	159	(3)

nm – not meaningful

(1) Total BMO net interest margin is stated on a GAAP basis. The operating groups net interest margins are stated on a teb basis.

Taxable equivalent basis (teb)

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

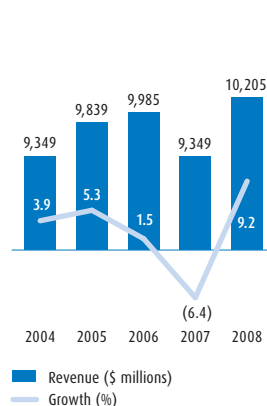
Net interest income is comprised of earnings on assets, such as loans and securities, including interest and dividend income and BMO's share of income from investments accounted for using the equity method of accounting, less interest expense paid on liabilities, such as deposits.

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

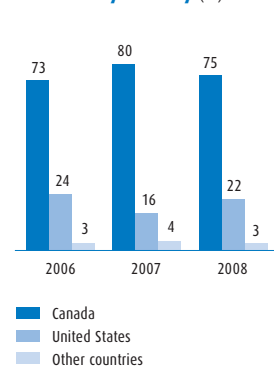
Revenue (\$ millions)

For the year ended October 31	2008	2007	2006	2005	2004
Net interest income	5,087	4,843	4,744	4,787	4,798
Year-over-year growth (%)	5.0	2.1	(0.9)	(0.2)	0.4
Non-interest revenue	5,118	4,506	5,241	5,052	4,551
Year-over-year growth (%)	13.6	(14.0)	3.8	11.0	7.8
Total revenue	10,205	9,349	9,985	9,839	9,349
Year-over-year growth (%)	9.2	(6.4)	1.5	5.3	3.9

Revenue and Annual Growth



Revenue by Country (%)



BMO earned record revenue despite difficult capital markets conditions.

U.S. revenues rebounded from commodities losses recorded in 2007.

In P&C Canada, there was a solid increase in net interest income. Volume growth remained strong for all major product categories except mortgages, where we had chosen in 2007 to exit mortgage broker channels. In P&C U.S., there was solid loan growth enhanced by acquisitions, but the contribution to total growth in net interest income was reduced by the weaker U.S. dollar. The net interest margin in Canada was up 1 basis point as higher volumes in more profitable products were offset by increased funding costs. In P&C U.S., the net interest margin was lower largely due to the 22 basis point impact of a transfer of a portfolio from Corporate Services, higher levels of non-performing loans and the highly competitive environment. The overall decline in net interest margin was mitigated by pricing actions in certain loan and deposit categories.

Private Client Group net interest income increased strongly, primarily due to increased deposit balances in our brokerage businesses and term investment products. The group's net interest margin is significantly higher than other groups, as the net interest margin calculation represents net interest income as a percentage of average earning assets. The group's primary source of net interest income is term investment products, which are liabilities.

BMO Capital Markets net interest income increased \$205 million or 21%. Revenues from interest-rate-sensitive businesses were significantly higher and trading net interest income also increased, partially offset by lower corporate banking net interest income and increased funding costs. The group's average earning assets increased \$14 billion. Corporate banking assets increased during the year, primarily due to clients accessing undrawn commitments. Corporate banking revenues were lower as a result of higher funding costs and reduced cash collections from impaired loans, partially offset by increased revenues due to higher asset volumes. The group's net interest margin was higher than in the previous year due to increased trading net interest income and higher spreads in interest-rate-sensitive businesses.

Corporate Services net interest income decreased due to higher net funding costs. Its net interest income also fluctuates in response to activities related to certain balance sheet positions and BMO's overall asset-liability position.

Table 9 on page 94 and table 10 on page 95 provide further details on net interest income and net interest margin.

Non-Interest Revenue

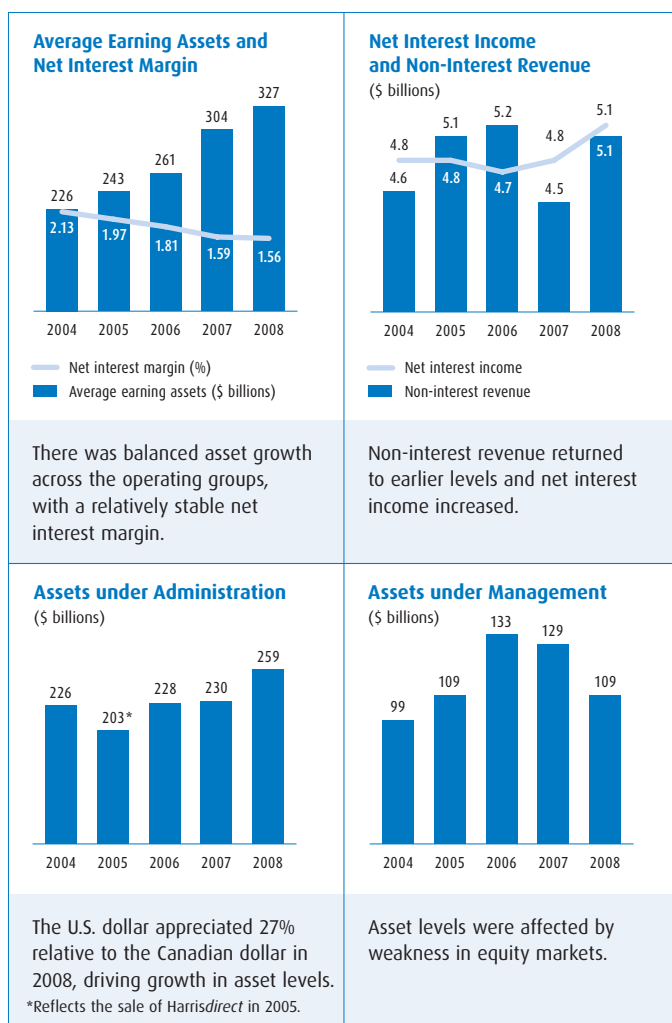
Non-interest revenue, which comprises all revenues other than net interest income, was \$5,118 million in 2008, an increase of \$612 million or 14% from 2007. Lower charges in respect of notable items added \$546 million or 12% to growth in 2008. The net impact of acquired businesses increased 2008 non-interest revenue by \$29 million, while the impact of the weaker U.S. dollar reduced non-interest revenue by \$15 million.

Securities commissions and fees decreased \$40 million or 3%. These fees consist largely of full-service and online brokerage commissions within Private Client Group, which account for about two-thirds of the balance, and institutional equity trading commissions within BMO Capital Markets. The decrease was due to reductions in equity market valuations and client trading volumes in full-service investing in Private Client Group, as well as competitive pricing pressures, partially offset by strong growth in transaction volumes in direct investing.

Deposit and payment service charges increased \$28 million or 4%, largely due to volume growth. Approximately \$17 million of the growth was attributable to P&C Canada, two-thirds of which related to a one-time adjustment.

Lending fees increased \$23 million or 6%.

Card fees increased \$184 million to \$291 million. The increase reflected the \$185 million adjustment to P&C Canada's customer loyalty rewards program liability recorded in 2007. Card fees also reflected higher activity levels and increased Moneris revenues, largely offset by reductions related to increased securitization activity.



Non-Interest Revenue (\$ millions)

For the year ended October 31	2008	2007	2006	Change from 2007	
				\$	%
Securities commissions and fees	1,105	1,145	1,051	(40)	(3)
Deposit and payment service charges	756	728	729	28	4
Trading revenues	546	(487)	718	1,033	+100
Lending fees	429	406	337	23	6
Card fees	291	107	396	184	+100
Investment management and custodial fees	339	322	298	17	5
Mutual fund revenues	589	576	499	13	2
Securitization revenues	513	296	100	217	73
Underwriting and advisory fees	353	528	407	(175)	(33)
Securities gains (losses)	(315)	246	145	(561)	(+100)
Foreign exchange, other than trading	80	132	102	(52)	(39)
Insurance income	222	230	204	(8)	(3)
Other	210	277	255	(67)	(24)
Total	5,118	4,506	5,241	612	14

Investment management and custodial fees increased \$17 million or 5%, primarily due to higher investment and trust revenue in North American Private Banking. Growth was reduced by the weaker U.S. dollar.

Mutual fund revenues increased \$13 million or 2%, after having increased 14% to 16% annually in each of the past three years. The increase was attributable to a switch to a fixed administration fee that had the effect of increasing both revenues and costs. Fees were affected by reduced managed asset values in the difficult market conditions.

Securitization revenues increased \$217 million or 73% to \$513 million. The increase was attributable to \$107 million from securitizing credit card loans and \$115 million from securitizing residential mortgages, net of a \$5 million decline from securitizing other loans. Revenues included gains of \$136 million on the sale of loans for new securitizations, up \$125 million from 2007, and gains of \$284 million on sales of loans to revolving securitization vehicles, up \$93 million from 2007. The securitization of assets results in the recognition of less interest income (\$234 million less in 2008), reduced credit card fees (\$211 million less in 2008) and lower provisions for credit losses (\$52 million less in 2008). As such, securitizations increased pre-tax income by approximately \$120 million in 2008. We securitize loans for capital management purposes and to obtain alternate sources of funding. In 2008, we securitized \$8.5 billion (\$3.4 billion in 2007) of residential mortgage loans and \$3.2 billion (\$nil in 2007) of credit card loans. Securitization revenues are detailed in Note 8 on page 118 of the financial statements.

Underwriting and advisory fees decreased \$175 million or 33% from the record levels of 2007, after having increased 30% in 2007 and 14% in 2006. Merger and acquisition fees and equity underwriting fees were particularly low. Debt underwriting fees decreased but more modestly. Lower levels of investment banking activity became apparent in the fourth quarter of fiscal 2007.

Securities gains decreased \$561 million to a net loss of \$315 million in 2008. The notable items discussed on page 36 included charges of \$347 million related to the deterioration in the capital markets environment that were recorded in securities gains (losses). They included certain charges related to Apex, other-than-temporary impairments and investments in capital notes of the structured investment vehicles (SIVs). Securities gains in 2007 included a \$107 million gain on the sale of MasterCard shares.

Income from foreign exchange, other than trading, decreased \$52 million or 39% due to unusually high gains in 2007 and the effects of high volatility in the fourth quarter of 2008.

Insurance income decreased \$8 million or 3% after having increased in recent years. The decrease was attributable to a one-time gain of \$26 million in 2007. Volumes and premiums increased in 2008.

Other revenue includes various sundry amounts and fell \$67 million or 24%.

Table 7 on page 92 provides further details on revenue and revenue growth.

Trading-Related Revenues

Trading-related revenues are dependent on, among other things, the volume of activities undertaken for clients, who enter into transactions with BMO to mitigate their risks or to invest. BMO earns a spread or profit on the net sum of its client positions by profitably neutralizing, within prescribed limits, the overall risk of the net positions. BMO also assumes proprietary positions with the goal of earning trading profits.

The capital markets environment was extremely unsettled in 2008, having been affected by significantly diminished business and investor confidence that reduced liquidity in the marketplace, widened credit spreads and resulted in significant reductions in both fixed income and equity valuations. The Notable Items section on page 36 outlines charges related to difficulties in the capital markets environment that reduced trading revenue by \$212 million and total revenue by \$625 million in 2008. The section also outlines similar charges totalling \$318 million recorded in the fourth quarter of 2007 that were largely applied to non-interest revenue. The section also refers readers to Financial Instruments in the Difficult Credit Environment, which starts on page 62 and provides detailed information on a number of the instruments on which losses were recorded in the year.

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

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

For the year ended October 31	2008	2007	2006	Change from 2007	
				\$	%
Interest rates	176	15	227	161	+100
Foreign exchange	379	273	204	106	39
Equities	110	189	173	(79)	(42)
Commodities	(18)	(852)	124	834	98
Other	18	42	22	(24)	(57)
Total	665	(333)	750	998	+100
Reported as:					
Net interest income	119	154	32	(35)	(23)
Non-interest revenue – trading revenues	546	(487)	718	1,033	+100
Total	665	(333)	750	998	+100

As explained in Note 3 to the financial statements, during the fourth quarter of 2008 the CICA amended accounting and reporting rules applicable to financial instruments. As a result of the amendments, we elected to transfer certain securities from our trading portfolio to our available-for-sale portfolio. We subsequently recorded mark-to-market charges on these securities totalling \$212 million (\$143 million after tax), of which \$29 million (\$20 million after tax) was charged to earnings as part of the other-than-temporary impairments outlined in the Notable Items section on page 36, and \$183 million (\$123 million after tax) was charged to other comprehensive income rather than to trading revenues (losses) in the statement of income.

Losses in the commodities trading business totalled \$18 million in 2008, reflecting risk reduction in the portfolio. In 2007, we recorded \$853 million of losses in our commodities trading business. On November 18, 2008, a number of proceedings were commenced by securities, commodities, banking and law enforcement authorities against certain parties that were involved in activities related to the 2007 commodities trading losses. BMO is not a party to these proceedings.

Trading-related revenues increased \$998 million from the particularly weak results in 2007, largely due to the commodities losses in the prior year.

Excluding the \$212 million impact of notable items in the current year and the \$1,156 million impact of notable items in the prior year included in trading revenues, trading-related revenues increased \$54 million. Fixed income trading revenues were very volatile during the year, with strong revenues in the first and third quarters. Foreign exchange trading revenues were strong throughout the year, with particularly robust growth in the fourth quarter. Equities trading revenues began the year very weak but improved appreciably in the second and third quarters, before falling significantly in the fourth quarter with the substantial decreases in valuations in global equity markets.

The Market Risk section on page 77 provides more information on trading-related revenues.

Provision for Credit Losses

Credit conditions during 2008 were difficult as the U.S. housing market softened significantly and the North American economic environment weakened.

BMO recorded a \$1,330 million provision for credit losses in 2008, consisting of \$1,070 million of specific provisions and a \$260 million increase in the general allowance for credit losses. These amounts compare to the \$353 million provision recorded in 2007, comprised of specific provisions of \$303 million and a \$50 million increase in the general allowance. The 2008 increase in the general allowance was primarily due to credit deterioration within the loans portfolio and to the weakening economy.

As illustrated in the adjoining table, specific provisions for credit losses during the year were higher than in prior periods. The 2008 specific provisions included provisions of \$336 million for two corporate accounts related to the U.S. housing market that were identified as impaired during the year. The size of these provisions reflected the continued weakness in the U.S. residential real estate market and the specific nature of the underlying loans. One of the accounts provided funding to a company that was in the business of buying distressed mortgages and the other was related to the residential real estate development business.

The most significant factor influencing the provision for credit losses is the level of formations of new impaired loans – identified as additions to impaired loans and acceptances in the adjacent Changes in Gross Impaired Loans and Acceptances table. As with specific provisions, impaired loan formations increased from the low levels of 2007 and 2006, totalling \$2,506 million in 2008, up from \$588 million in 2007. Exposures related primarily to the manufacturing, oil and gas and U.S. residential real estate sectors increased formations in 2008.

In 2008, formations of \$621 million were attributable to the U.S. commercial real estate sector and \$426 million to the manufacturing sector.

BMO's credit portfolio showed the effects of some erosion of loan quality, primarily in the U.S. markets, with gross impaired loans increasing this year to \$2,387 million from \$720 million in 2007. Factors contributing to the change are outlined in the accompanying table.

In 2008, sales of gross impaired loans totalled \$16 million, with related reversals and recoveries of \$3 million. This compares with sales of \$28 million and related reversals and recoveries of \$5 million in 2007.

The total allowance for credit losses increased \$692 million in 2008 to \$1,747 million, comprised of a specific allowance of \$426 million and a general allowance of \$1,321 million.

The general allowance is maintained to absorb impairment in the existing credit portfolio that cannot yet be associated with specific credit assets. It is assessed on a quarterly basis and has increased \$423 million from the end of the previous fiscal year. Of this, \$260 million was due to increases in the allowance recorded during the year, with the remainder attributable to the impact of changes in the Canadian/U.S. dollar exchange rate and the acquisition of Merchants and Manufacturers and Ozaukee. The general allowance remains adequate and, as at October 31, 2008, represented 0.69% of risk-weighted assets.

Overall, BMO's loan book continues to be comprised primarily of the more stable consumer and commercial portfolios that, excluding securities borrowed or purchased under resale agreements, represented 73.8% of the loan portfolio at year-end, declining from 78.6% in 2007 on strong growth in the corporate portfolio. Residential mortgages represented 21.5% of the portfolio, down from 24.4% in 2007. Business and government loans represented 44.4% of the portfolio, up from 38.6% in 2007. We continue to monitor industry sectors that we consider to be of most concern in the current economic conditions, including the automotive, real estate and forestry sectors. BMO's exposure to these sectors remains within acceptable levels.

Provision for (Recovery of) Credit Losses (PCL)

(\$ millions, except as noted)

For the year ended October 31	2008	2007	2006	2005	2004	2003	2002
New specific provisions	1,242	460	410	407	510	846	1,063
Reversals of previous allowances	(58)	(66)	(87)	(121)	(312)	(303)	(175)
Recoveries of prior write-offs	(114)	(91)	(112)	(67)	(131)	(88)	(68)
Specific provisions for credit losses	1,070	303	211	219	67	455	820
Increase in (reduction of) general allowance	260	50	(35)	(40)	(170)	–	–
Provision for (recovery of) credit losses	1,330	353	176	179	(103)	455	820
PCL as a % of average net loans and acceptances (%)	0.60	0.17	0.09	0.11	(0.07)	0.30	0.56

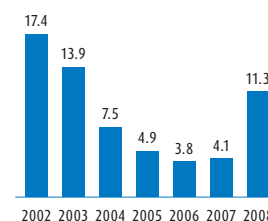
Changes in Gross Impaired Loans (GIL) and Acceptances

(\$ millions, except as noted)

	2008	2007	2006	2005	2004	2003	2002
GIL, beginning of year	720	666	804	1,119	1,918	2,337	2,014
Additions to impaired loans and acceptances	2,506	588	420	423	607	1,303	1,945
Reductions in impaired loans and acceptances (1)	131	(143)	(220)	(319)	(936)	(1,156)	(738)
Write-offs	(970)	(391)	(338)	(419)	(470)	(566)	(884)
GIL, end of year	2,387	720	666	804	1,119	1,918	2,337
GIL as a % of gross loans and acceptances (%)	1.10	0.36	0.35	0.46	0.71	1.30	1.54

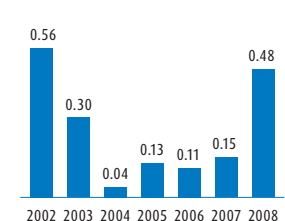
(1) Includes the impact of foreign exchange and write-offs of consumer loans included in additions to impaired loans in the period.

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



Fiscal 2008 marked a sharp return to the weaker phase of the credit cycle.

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



Provisions have increased in conjunction with the levels of impaired loans.

Looking forward, we expect the credit environment to continue to be challenging through 2009 given the probability of continuing economic contraction.

Credit risk management is discussed further on page 76. Note 4 on page 113 of the financial statements and Tables 11 to 19 on pages 96 to 99 provide details of BMO's loan portfolio, impaired loans and provisions and allowances for credit losses.

Non-Interest Expense

Non-interest expense increased \$293 million or 4.4% to \$6,894 million in 2008. The factors contributing to the increase are set out in the Contribution to Non-Interest Expense Growth table. Notable items in 2007 included \$159 million in restructuring charges and a \$120 million reduction in performance-based compensation.

As explained on page 37, the net effect of businesses acquired in 2008 and 2007 increased expenses in 2008 relative to 2007 by \$74 million (1.1%). As further explained on page 37, the weaker U.S. dollar reduced costs in 2008 by \$93 million (-1.4%). The change in restructuring charges reduced expenses by \$167 million (-2.5%).

Higher performance-based compensation costs increased expenses by \$22 million (0.3%). An increase in BMO Capital Markets was largely offset by a reduction in Private Client Group.

The dollar and percentage changes in expenses by category are outlined in the Non-Interest Expense table. Table 8 on page 93 provides more detail on expenses and expense growth.

Other employee compensation expense, which includes salaries and employee benefits, was \$129 million or 5% higher than in 2007 due to increased salaries expense. Salaries expense changed little in 2006 and 2005 as staffing levels were relatively constant in those years (see page 93). However, staffing increased in the latter part of 2007 and in 2008 with the addition of front-line sales and service staff in P&C Canada, growth in Private Client Group's sales force and business acquisitions in P&C U.S. Our staffing levels increased in 2008 by more than 1,200 or 3.5% to 37,073 full-time equivalent staff. In P&C U.S., cost increases primarily reflected acquisition-related expenses. In Private Client Group, there were increased investments in our sales force.

Premises and equipment costs increased \$79 million or 6%, primarily due to higher computer and equipment costs related to increased consulting, project and service bureau costs.

Other expenses increased \$234 million or 18%. Communication costs increased due to a new fixed administration fee in BMO Mutual Funds. Effective December 1, 2007, Private Client Group absorbed the operating expenses of its funds in return for a fixed administration fee. The effect was an increase in both non-interest revenue and expenses. There were higher professional fees, primarily due to our Basel II and Anti-Money Laundering compliance projects and other business initiatives. Travel and business development expense increased, primarily due to higher costs in P&C Canada related to AIR MILES rewards associated with our debit card initiative.

Productivity

The productivity ratio (expense-to-revenue ratio) improved by 300 basis points to 67.6% in 2008. BMO's overall ratio in any year is affected by the relative strength of the revenues in each operating group. The productivity ratio of each group over the years has typically been quite different because of the nature of their businesses as well as the external environment. There was convergence in 2008, however.

P&C Canada is BMO's largest operating segment, and its productivity ratio of 55.4% improved by 30 basis points from last year, after having improved by 40 basis points in 2007. The productivity ratio for Private Client Group in 2008 deteriorated by 110 basis points to 71.5%, almost entirely due to the effects of the notable items that affected revenues. The productivity ratio in P&C U.S. deteriorated by 470 basis points largely because revenues and expenses were impacted by the difficult U.S. credit market conditions as well as increased acquisition integration costs. BMO Capital Markets' productivity ratio improved substantially, moving 730 basis points. Excluding the notable items that affected results in both 2008 and 2007, BMO's productivity ratio deteriorated by 130 basis points to 63.7%, reflecting the difficult capital market conditions.

The **productivity ratio** (or **expense-to-revenue ratio**) is our key measure of productivity. It is calculated as non-interest expense divided by total revenues (on a taxable equivalent basis in the operating groups), expressed as a percentage. See page 85. The **cash productivity ratio** is calculated in the same manner, after removing the amortization of intangible assets from non-interest expenses. See page 85.

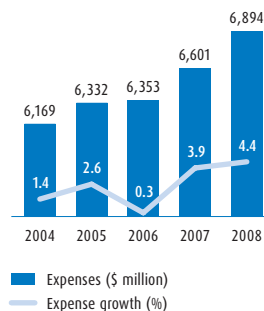
Contribution to Non-Interest Expense Growth (%)

For the year ended October 31	2008	2007	2006
Businesses acquired (sold)	1.1	0.7	(3.1)
Restructuring charge	(2.5)	2.5	-
Currency translation effect	(1.4)	(0.9)	(1.6)
Performance-based compensation	0.3	(0.7)	0.6
Other factors	6.9	2.3	4.4
Total non-interest expense growth	4.4	3.9	0.3

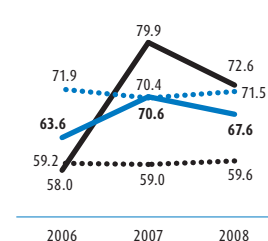
Non-Interest Expense (\$ millions)

For the year ended October 31	2008	2007	2006	Change from 2007	
				\$	%
Performance-based compensation	1,297	1,275	1,322	22	2
Other employee compensation	2,679	2,550	2,502	129	5
Total employee compensation	3,976	3,825	3,824	151	4
Premises and equipment	1,382	1,303	1,211	79	6
Restructuring charge	(8)	159	-	(167)	(+100)
Other	1,502	1,268	1,274	234	18
Amortization of intangible assets	42	46	44	(4)	(9)
Total	6,894	6,601	6,353	293	4

Expenses and Annual Expense Growth



Productivity Ratio by Group (teb) (%)



*Non-teb

Higher front-line staffing and compliance projects drove the expense increase.

Better productivity in P&C Canada and BMO CM drove improved BMO productivity.

BMO's cash productivity ratio was 67.1%, a 300 basis point improvement from 70.1% in 2007, largely due to the lower amount of notable items charged to revenue in 2008.

Examples of initiatives to enhance productivity are outlined in the 2008 Review of Operating Groups Performance, which starts on page 44. Our medium-term goal is to achieve average annual cash operating leverage of at least 2%, increasing revenues each year by an average of at least two percentage points more than the rate of cash-based expense growth. We plan to achieve this by driving revenues through an increased customer focus and ongoing expense management, and by working to create greater efficiency and effectiveness in all support functions, groups and business processes that support the front line.

Provision for Income Taxes

The provision for income taxes reflected in the Consolidated Statement of Income is based upon transactions recorded in income, regardless of when such transactions are subject to taxation by tax authorities, with the exception of the repatriation of retained earnings from foreign subsidiaries, as outlined in Note 25 on page 142 of the financial statements.

In 2008, we discontinued reporting on a taxable equivalent basis when reporting consolidated results, as explained further on pages 38 and 85. However, we continue to assess the performance of the operating groups and associated income taxes on a taxable equivalent basis and to report their results accordingly.

The recovery of income taxes was \$71 million in 2008, compared with income taxes of \$189 million charged against earnings in 2007. The effective tax rate in 2008 was a recovery rate of 3.6%, compared with a tax expense rate of 7.9% in 2007. The low effective rate is mainly attributable to the recovery of prior-period income taxes and a higher proportion of income from lower-tax-rate jurisdictions. Excluding the impact of the notable items listed on page 36, tax recoveries and a higher proportion of income from lower-tax-rate jurisdictions, the effective rate for fiscal 2008 would be in our expected sustainable range of 16% to 20%. The components of variances between the effective and statutory Canadian tax rates are outlined in Note 25 on page 142 of the financial statements.

The effective income tax rate can vary, as it depends on the timing of resolution of certain tax matters, recoveries of prior-period income

taxes and the relative proportion of earnings attributable to the different jurisdictions in which we operate. Our current estimate is that the sustainable effective tax rate for 2009 will be between 16% and 20% due to statutory rate reductions.

BMO hedges the foreign exchange risk arising from its investments in U.S. operations by funding the investments in U.S. dollars. Under this program, the gain or loss on hedging and the unrealized gain or loss on translation of the investments in U.S. operations are charged or credited to shareholders' equity. For income tax purposes, the gain or loss on the hedging activities attracts an income tax charge or credit in the current period, which is charged or credited to shareholders' equity, while the associated unrealized gain or loss on the investments in U.S. operations does not attract income taxes until the investments are liquidated. The income tax charge/benefit arising from a hedging gain/loss is a function of the fluctuations in exchange rates from period to period. Hedging of the investments in U.S. operations has given rise to income tax recoveries in shareholders' equity of \$881 million for the year, compared with a \$575 million income tax charge in 2007. Refer to the Consolidated Statement of Changes in Shareholders' Equity on page 106 of the financial statements for further details.

Table 8 on page 93 details the \$431 million of total net government levies and income tax recovery incurred by BMO in 2008. The reduction in 2008 was primarily due to income tax recoveries on the hedging loss.

Transactions with Related Parties

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

Stock options and deferred share units granted to directors and preferred rate loan agreements for executives, relating to transfers we initiate, are discussed in Note 28 on page 146 of the financial statements.

The foregoing Provision for Credit Losses, Non-Interest Expense and Provision for Income Taxes sections and the following 2008 Review of Operating Groups Performance and Quarterly Earnings Trends sections of this Annual Report contain certain forward-looking statements, in particular regarding our outlook for certain aspects of the Canadian and U.S. business environments in 2009, effective income tax rates and our strategies and priorities for 2009. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Please refer to the Caution Regarding Forward-Looking Statements on page 30 of this Annual Report for a discussion of such risks and uncertainties and the material factors and assumptions related to the statements set forth in such sections.