

Note 23: Employee Compensation – Stock-Based Compensation

We determine the fair value of stock options on their grant date and record this amount as compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these stock options are exercised, we record the amount of proceeds, together with the amount recorded in contributed surplus, in share capital.

Stock Option Plan

We maintain a Stock Option Plan for designated officers, employees and directors. Options are granted at an exercise price equal to the closing

price of our common shares on the day prior to the grant date. Options granted under the plan from 1995 to 1999 vested five fiscal years from November 1 of the year in which the options were granted to the officer or employee, if we had met certain performance targets. Options granted since 1999 vest 25% per year over a four-year period starting from their grant date. A portion of the options granted since 1999 can only be exercised once certain performance targets are met. All options expire 10 years from their grant date.

The following table summarizes information about our Stock Option Plan:

(Canadian \$, except as noted)	2008		2007		2006	
	Number of stock options	Weighted-average exercise price	Number of stock options	Weighted-average exercise price	Number of stock options	Weighted-average exercise price
Outstanding at beginning of year	20,656,713	\$ 41.55	23,254,639	\$ 38.55	26,919,349	\$ 35.86
Granted	1,442,833	59.14	1,229,500	68.96	1,390,700	63.04
Exercised	1,778,586	31.65	3,774,644	31.86	5,014,557	30.87
Forfeited/cancelled	2,700	50.23	43,882	54.42	37,053	46.77
Expired	262,558	42.63	8,900	19.93	3,800	15.50
Outstanding at end of year	20,055,702	43.68	20,656,713	41.55	23,254,639	38.55
Exercisable at end of year	14,332,077	37.69	15,585,532	36.01	17,947,453	34.35
Available for grant	2,985,056		4,116,301		2,047,729	
Outstanding stock options as a percentage of outstanding shares	3.96%		4.14%		4.64%	

Certain comparative figures have been reclassified to conform with the current year's presentation.

Employee compensation expense related to this plan for the years ended October 31, 2008, 2007 and 2006 was \$12 million, \$11 million and \$14 million before tax, respectively (\$11 million, \$10 million and \$13 million after tax, respectively).

The intrinsic value of a stock option grant is the difference between the current market price of our common shares and the strike price of

the option. The aggregate intrinsic value of stock options outstanding at October 31, 2008, 2007 and 2006 was \$104 million, \$443 million and \$719 million, respectively. The aggregate intrinsic value of stock options exercisable at October 31, 2008, 2007 and 2006 was \$101 million, \$421 million and \$629 million, respectively.

Options outstanding and options exercisable as at October 31, 2008 and 2007 by range of exercise price were as follows:

(Canadian \$, except as noted)	2008						2007			
	Options outstanding			Options exercisable			Options outstanding		Options exercisable	
Range of exercise prices	Number of stock options	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Number of stock options	Weighted-average exercise price	Number of stock options	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Number of stock options	Weighted-average exercise price
\$20.01 to \$30.00	2,227,815	1.0	\$ 25.60	2,227,815	\$ 25.60	2,492,855	2.0	\$ 25.60	2,492,855	\$ 25.60
\$30.01 to \$40.00	9,056,151	2.3	36.32	8,683,171	36.23	10,604,596	3.1	35.69	10,184,016	35.57
\$40.01 to \$50.00	1,991,004	4.2	41.16	1,720,703	40.90	2,019,800	4.8	40.95	1,855,104	40.96
\$50.01 to \$60.00	2,907,571	5.5	55.20	1,228,076	55.02	2,940,660	6.5	55.19	887,709	54.94
\$60.01 and over	3,873,161	7.7	63.94	472,312	64.85	2,598,802	8.5	65.83	165,848	63.05

Certain comparative figures have been reclassified to conform with the current year's presentation.

The following table summarizes nonvested stock option activity for the years ended October 31, 2008 and 2007:

(Canadian \$, except as noted)	2008		2007	
	Number of stock options	Weighted-average grant date fair value	Number of stock options	Weighted-average grant date fair value
Nonvested at beginning of year	5,071,181	\$ 8.74	5,307,186	\$ 8.89
Granted	1,442,833	8.24	1,229,500	7.56
Vested	790,389	10.61	1,442,754	8.25
Forfeited/cancelled	—	—	22,751	10.16
Nonvested at end of year	5,723,625	\$ 8.36	5,071,181	\$ 8.74

The following table summarizes further information about our Stock Option Plan:

(Canadian \$ in millions, except as noted)	2008	2007	2006
Unrecognized compensation cost for nonvested stock option awards	\$ 8	\$ 10	\$ 12
Weighted-average period over which it is recognized (in years)	2.7	2.6	3.0
Total intrinsic value of stock options exercised	\$ 30	\$ 138	\$ 170
Cash proceeds from stock options exercised	\$ 56	\$ 120	\$ 155
Actual tax benefits realized on stock options exercised	\$ 14	\$ 4	\$ 14

We determine the fair value of options granted using a trinomial option pricing model. Expected volatility is based on the implied volatility from traded options on our share price and the historical volatility of our share price. The weighted-average fair value of options granted during the years ended October 31, 2008, 2007 and 2006 was \$8.24, \$7.56 and \$10.17, respectively. The following weighted-average assumptions were used to determine the fair value of options on the date of grant:

	2008	2007	2006
Expected dividend yield	4.1%	4.2%	3.4%
Expected share price volatility	19.5%	15.6%	20.2%
Risk-free rate of return	4.0%	4.0%	4.0%
Expected period until exercise (in years)	7.3	7.4	7.2

Changes to the input assumptions can result in materially different fair value estimates.

Other Stock-Based Compensation Plans

Share Purchase Plan

We offer our employees the option of directing a portion of their gross salary toward the purchase of our common shares. We match 50% of employee contributions up to 6% of their individual gross salaries. The shares in the employee share purchase plan are purchased on the open market and are considered outstanding for purposes of computing earnings per share. The dividends earned on our common shares held by the plan are used to purchase additional common shares on the open market.

We account for our contribution as employee compensation expense when it is contributed to the plan.

Employee compensation expense related to this plan for the years ended October 31, 2008, 2007 and 2006 was \$41 million, \$36 million and \$35 million, respectively. There were 14,958,315, 13,148,902 and 12,852,477 common shares held in this plan for the years ended October 31, 2008, 2007 and 2006, respectively.

Mid-Term Incentive Plans

We offer mid-term incentive plans for executives and certain senior employees. Depending on the plan, these pay either a single cash payment at the end of the three-year period of the plan, or three annual cash payments in each of the three years of the plan. The amount of the payment is adjusted to reflect dividends and changes in the market value of our common shares. For the majority of executive and some senior employee grants, a portion of the incentive payment also varies based on performance targets driven by annualized total shareholder return compared with that of our competitors.

Mid-term incentive plan units granted during the years ended October 31, 2008, 2007 and 2006 totalled 4,548,827, 3,210,864 and 3,387,493, respectively. We entered into agreements with third parties to assume most of our obligations related to these plans in exchange for cash payments of \$267 million, \$220 million and \$202 million in the years ended October 31, 2008, 2007 and 2006, respectively. Amounts paid under these agreements were recorded in our Consolidated Balance Sheet in other assets and are recorded as employee compensation expense evenly over the period prior to payment to employees. Amounts related to units granted to employees who are eligible

to retire are expensed at the time of grant. We no longer have any liability for the obligations transferred to third parties because any future payments required will be the responsibility of the third parties. The amount deferred and recorded in other assets in our Consolidated Balance Sheet totalled \$135 million and \$104 million as at October 31, 2008 and 2007, respectively. The deferred amount as at October 31, 2008 is expected to be recognized over a weighted-average period of 1.8 years (1.8 years in 2007). Employee compensation expense related to these plans for the years ended October 31, 2008, 2007 and 2006 was \$239 million, \$202 million and \$185 million before tax, respectively (\$160 million, \$131 million and \$119 million after tax, respectively).

For the remaining obligations related to plans for which we have not entered into agreements with third parties, the amount of compensation expense is amortized over the period prior to payment to employees and adjusted to reflect the current market value of our common shares. The liability related to these plans as at October 31, 2008 and 2007 was \$24 million and \$19 million, respectively.

Employee compensation expense related to plans for which we have not entered into agreements with third parties for the years ended October 31, 2008, 2007 and 2006 was \$4 million, \$10 million and \$5 million before tax, respectively (\$3 million, \$7 million and \$3 million after tax, respectively). We commenced economically hedging the impact of the change in the market value of our common shares in fiscal 2008 by entering into total return swaps with an external counterparty. Hedging gains (losses) of \$(4) million before tax (\$(3) million after tax) were recognized for the year ended October 31, 2008.

A total of 9,900,297, 8,298,718 and 8,272,824 share units were outstanding for the years ended October 31, 2008, 2007 and 2006, respectively.

Deferred Incentive Plans

We offer deferred incentive plans for members of our Board of Directors, certain senior executives, and key employees in our BMO Capital Markets and Private Client Groups. Under these plans, fees, annual incentive payments and/or commissions can be deferred as stock units of our common shares. The amount of fees, deferred incentive payments and/or commissions is adjusted to reflect dividends and changes in the market value of our common shares.

Depending on the plan, deferred incentive payments can be paid upon retirement or resignation, over the three-year period of the plan or at the end of the three-year period of the plan. The deferred incentive payments can be made in cash, shares or a combination of both.

Employee compensation expense for these plans is recorded in the year the incentive payment and/or commission is earned. Changes in the amount of the incentive payments as a result of dividends and share price movements are recorded as employee compensation expense in the period of the change.

Deferred incentive plan units granted during the years ended October 31, 2008, 2007 and 2006 totalled 379,034, 442,583 and 471,662, respectively. We have entered into derivative instrument contracts to hedge our exposure to these plans. Changes in the fair value of these derivatives are recorded as employee compensation expense in the period in which they arise.

Liabilities related to these plans are recorded in other liabilities in our Consolidated Balance Sheet and totalled \$136 million and \$169 million as at October 31, 2008 and 2007, respectively.

Employee compensation expense (recovery) related to these plans for the years ended October 31, 2008, 2007 and 2006 was \$(46) million, \$13 million and \$33 million before tax, respectively (\$(31) million, \$8 million and \$21 million after tax, respectively). Hedging gains (losses) of \$(52) million, \$6 million and \$25 million before tax, respectively, were also recognized, resulting in net employee compensation expense of \$6 million, \$7 million and \$8 million before tax, respectively (\$4 million, \$5 million and \$5 million after tax, respectively).

A total of 3,101,995, 2,686,903 and 2,542,696 deferred stock units were outstanding for the years ended October 31, 2008, 2007 and 2006, respectively.