Note 9: Variable Interest Entities

Variable interest entities ("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. We are required to 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 qualitative estimation process involving estimating the future cash flows and performance of the VIE.

Canadian 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. 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.

Assets held by our unconsolidated Canadian customer securitization vehicles amounted to $11,106 million as at October 31, 2008 ($17,536 million in 2007). 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 backstop liquidity facilities. 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, 2008, we had an exposure of $2,139 million from commercial paper held ($5,564 million in 2007) 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 for when they could be drawn upon. The total undrawn backstop liquidity facilities was $11,040 million as at October 31, 2008 ($20,756 million in 2007). No amounts have been drawn against the facilities as at October 31, 2008 and 2007.

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 was recorded in our Consolidated Balance Sheet as a derivative asset of $55 million as at October 31, 2008 (derivative liability of $20 million in 2007).

Our ownership of asset-backed commercial paper ("ABCP") 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 as at October 31, 2008 were assets of $265 million classified as other assets, and commercial paper of $nil classified as a deposit liability ($311 million and $65 million, respectively, in 2007).

U.S. Customer Securitization Vehicle

Assets held by our unconsolidated U.S. customer securitization vehicle amounted to $7,993 million as at October 31, 2008 ($7,929 million in 2007). Our exposure to losses in our U.S. customer securitization vehicle relates to liquidity support we provide through backstop liquidity facilities. 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. As at October 31, 2008, our exposure related to undrawn backstop liquidity facilities amounted to $10,015 million ($10,719 million in 2007). As at October 31, 2008, we have provided funding of US$851 million in accordance with the terms of these liquidity facilities ($nil in 2007). We are not required to consolidate our U.S. customer securitization vehicle. The fair value of derivative contracts we have outstanding with our U.S. customer securitization vehicle was recorded on our Consolidated Balance Sheet as a derivative asset of $1 million as at October 31, 2008 ($nil in 2007).

Bank Securitization Vehicles

We use bank securitization vehicles to securitize our Canadian mortgage loans and Canadian credit card loans 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. These vehicles issue commercial paper to fund their activities. Total assets held by these vehicles amounted to $9,719 million as at October 31, 2008 ($6,552 million in 2007), all of which relate to assets in Canada. We are not required to consolidate our bank securitization vehicles. More information on our investments, rights and obligations related to these vehicles can be found in Note 8. In addition to the interests described in Note 8, we also provide liquidity support to our Canadian mortgage bank securitization vehicles for the face value of the commercial paper outstanding.

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. 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 as at October 31, 2008 and 2007. No amounts were drawn as at October 31, 2008 and 2007. As at October 31, 2008, we held $509 million of the commercial paper issued by these vehicles ($367 million in 2007), which was classified as trading securities.

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 was recorded in our Consolidated Balance Sheet as a derivative asset of $121 million as at October 31, 2008 (derivative liability of $52 million in 2007).

Credit Protection Vehicle

We sponsor Apex Trust ("Apex") (formerly Apex/Sitka Trusts), a VIE that provides credit protection to investors on investments in corporate debt portfolios through credit default swaps. Assets held by Apex were $2,794 million as at October 31, 2008 ($2,012 million in 2007). A senior funding facility of $1,130 million is available to Apex, of which we provide $1,030 million. As at October 31, 2008, $553 million had been drawn against our facility. Under the terms of the restructuring, we also entered into credit default swaps with swap counterparties and offsetting swaps with Apex.

In May 2008, upon the restructuring of Apex, we purchased mid-term notes ("MTNs") with a face value of $815 million which are classified as available-for-sale securities. As at October 31, 2008, we had recorded the MTNs at a fair value of $625 million. A third party holds its exposure to Apex through a total return swap with us on $600 million of MTNs. The total return swap and underlying MTNs are classified as trading instruments.

We do not consider the May 2008 purchase of the Apex MTNs described above to imply or indicate our intent to provide support to other mid-term noteholders or provide additional subordinated support to Apex. Instead, the purchase was a one-time, isolated event related to the restructuring of Apex. We do not intend to purchase additional MTNs of Apex nor do we intend to reimburse any other mid-term noteholder for any loss they may incur. We are not required to consolidate Apex.

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 related to these derivatives by investing in other funds. 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 $450 million as at October 31, 2008 ($440 million in 2007). Assets held by the VIEs in which we have a significant variable interest but which we do not consolidate totalled $132 million as at October 31, 2008 ($353 million in 2007). Our exposure to loss from non-consolidated VIEs is limited to the amount of our investment, which totalled $40 million as at October 31, 2008 ($99 million in 2007).

Structured Investment Vehicles

Structured investment vehicles ("SIVs") provide investment opportunities in customized, diversified debt portfolios in a variety of asset and rating classes. We hold interests in two SIVs and act as asset manager. Assets held by these SIVs totalled $9,291 million as at October 31, 2008, including cash of $nil (total assets of $22,754 million in 2007, including cash of $697 million).

Our exposure to loss relates to our investments in these vehicles, derivative contracts we have entered into with the vehicles and senior funding we provide through a liquidity facility in order to fund the repayment of senior notes. Our investment in the capital notes of the SIVs is recorded in available-for-sale securities in our Consolidated Balance Sheet, and was $nil as at October 31, 2008 ($53 million in 2007), net of write-downs of $57 million for the year ended October 31, 2008 ($13 million in 2007). Amounts drawn on the liquidity facility provided to the SIVs totalled $5,208 million as at October 31, 2008 ($350 million in 2007). Our exposure includes undrawn facilities of $5,063 million as at October 31, 2008 ($1,158 million in 2007). The fair value of the derivative contracts we have outstanding with the SIVs was recorded in our Consolidated Balance Sheet as a derivative asset of $57 million as at October 31, 2008 (derivative liability of $11 million in 2007). We are not required to consolidate these VIEs.

Capital and Funding Trusts

BMO Covered Bond Trust (the "CB Trust") was created in 2007 to guarantee payments due to the bondholders in respect of €1 billion BMO Covered Bonds we issued in 2008. We sold assets to the CB Trust in exchange for a promissory note. The assets of the CB Trust have been pledged to secure payment of the bonds we issued. The CB Trust is a VIE which we are required to consolidate as we are exposed to the majority of its expected losses and residual returns. Total assets in the vehicle as at October 31, 2008 were $6.0 billion. Our exposure includes drawn facilities of $5,849 million and undrawn facilities of $5,151 million as at October 31, 2008. The fair value of derivative contracts outstanding with the CB Trust was a derivative asset of $112 million as at October 31, 2008.

BMO Subordinated Notes Trust ("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 SN Trust. See Note 18 for further information related to SN Trust.

We also provide liquidity support amounting to $30 million to SN Trust. As at October 31, 2008, $5 million of the amount provided had been drawn ($5 million in 2007).

BMO Capital Trust (the "Trust") was created to issue BMO Capital Trust Securities ("BOaTS"). As at October 31, 2008, the Trust had assets of $3,187 million ($3,140 million in 2007). The Trust is a VIE which we are required to consolidate. Securities of $2.2 billion issued by the Trust are reported as either non-controlling interest or capital trust securities in our Consolidated Balance Sheet. Refer to Note 19 for more details on BOaTS.

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 $618 million as at October 31, 2008 ($825 million in 2007). We are not required to consolidate these compensation trusts and we have no exposure to loss related to these trusts.

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 underlying assets. We record and report these transactions in the same manner as other transactions. For example, derivative contracts are recorded in accordance with our derivatives accounting policy as outlined in Note 10. Liquidity facilities are described in Note 7.