



BMO Financial Corp.

**2014 Mid-Cycle Dodd-Frank Act Stress
Test Disclosure**

September 19, 2014

Overview

BMO Financial Corp. (BFC), a U.S. bank and financial holding company, is a wholly-owned subsidiary of Bank of Montreal (BMO) and is regulated by the Board of Governors of the Federal Reserve System (FRB).

As a bank holding company with total consolidated assets of \$50 billion or more, BFC is subject to the **Supervisory and Company-Run Stress Test Requirements for Covered Companies**¹ rule issued by the FRB to implement the stress test requirements established in section 165(i)(1) and (2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

The 2014 Dodd-Frank Act mid-cycle stress test results presented in this report estimate the impact of a hypothetical severely adverse macro-economic scenario (Firm Severely Adverse Scenario) selected by BFC to test its key vulnerabilities and to reflect severity similar to the 2014 CCAR Supervisory Severely Adverse Scenario. BFC performed its internal stress tests using its own models, practices, methodologies and assumptions to project pre-provision net revenue, provisions, losses and capital ratios under the Firm Severely Adverse Scenario except in those cases where practices, methodologies and assumptions were specifically prescribed by rules, instructions or guidance published by the FRB².

In addition, companies are required to assume a uniform set of conditions regarding capital actions over the planning horizon to enable comparison of results across institutions and neutralize the effect of company-specific assumptions regarding capital actions. Under this requirement, BFC must calculate its pro forma capital ratios using the following factors and assumptions regarding its capital actions over the planning horizon for the Firm Severely Adverse Scenario:

1. For the initial quarter of the planning horizon (Q1 2014), take into account actual capital actions taken throughout the quarter;
2. For each of the subsequent quarters (Q2 2014 through Q2 2016), include in the projection of capital;
 - i. common stock dividends equal to the quarterly average dollar amount of common stock dividends that the company paid in the previous year (i.e., the initial quarter of the planning horizon and the preceding three calendar quarters);
 - ii. payments on any other instrument that is eligible for inclusion in the numerator of a regulatory capital ratio equal to the stated dividend, interest, or principal due on such instrument during the quarter; and
 - iii. an assumption of no redemption or repurchase of any capital instrument that is eligible for inclusion in the numerator of a regulatory capital ratio.³

¹ 'Supervisory and Company-Run Stress Test Requirements for Covered Companies' Final Rule, 12 C.F.R Part 252

² 'Comprehensive Capital Analysis and Review 2014 Summary Instructions and Guidance' published by FRB on November 1, 2013

³ For similar reasons, the supervisory guidance requires that a company assume that it will not issue any new common stock, preferred stock, or other instrument that would be included in regulatory capital in the second through ninth quarters of the planning horizon, except for any common stock issuances associated with expensed employee stock compensation.

In actual practice, if a severely adverse scenario were to occur, BFC would take capital and other management actions mandated by its internal policies and which are necessary or appropriate to respond to such stress.

BFC is well-capitalized with a strong, pre-stress actual Basel I Tier 1 common capital ratio of 11.38% at March 31, 2014. As depicted by the results presented below, BFC maintains strong capital levels with a minimum Tier 1 common ratio of 9.03% over the planning horizon, which is considerably higher than the applicable Basel I regulatory minimum value of 5.0%. BFC maintains pro-forma regulatory capital ratios that are higher than the regulatory minimums throughout the planning horizon despite reduced pre-provision net revenue, higher losses and the mandated capital actions described above.

Firm Severely Adverse Scenario

The Firm Severely Adverse Scenario is characterized by economic and political stresses flaring up in the Euro area periphery, precipitated by bank failures and requirements for additional bailouts. In addition to very high unemployment in peripheral Europe, growing popular dislike for austerity and economic reforms stalls progress in narrowing the competitive and fiscal gaps among Euro area members. Fragile coalition governments in the debtor group unravel as minority members are no longer able to support what they see as increasingly objectionable adjustment measures. Pressure by the ECB, EU, and IMF on the peripherals to accelerate reforms and implement fresh austerity measures are rejected, prompting financial markets to once again price in the possibility of a Euro break-up. Fear of insolvency causes risk spreads to rise for financial institutions and other corporations, leading to a sell-off in the high-yield market in Europe.

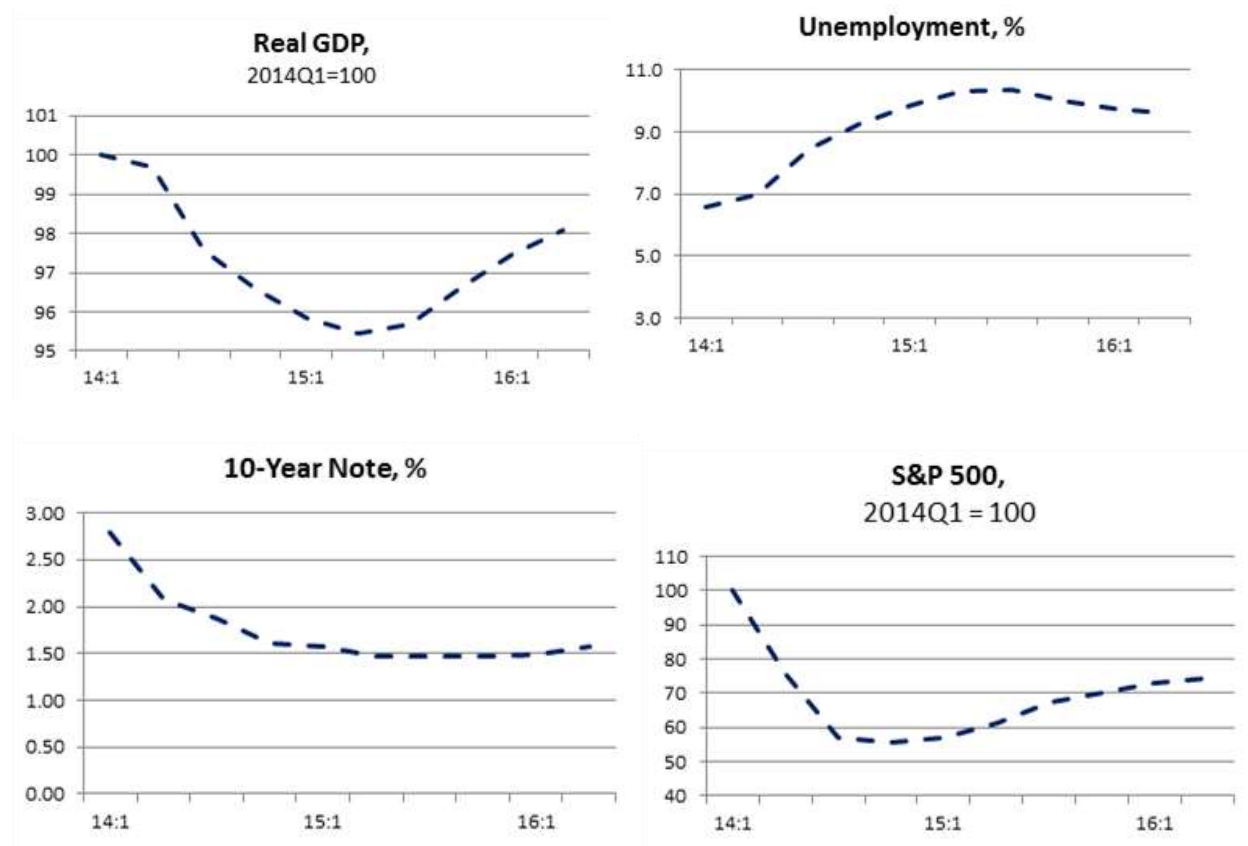
Credit markets in North America tighten sharply as a result, with interbank spreads peaking at 2.23 percentage points (ppt) by Q3 2014, slightly below the record highs of the financial crisis. The pullback in credit effectively stalls momentum in the United States economy. Household and business confidence and spending fall sharply and the economy slips back into a deep recession, in which real GDP declines 4.5% peak-to-trough over five quarters. This causes the national unemployment rate to rise significantly, to above 10%. The severity of this scenario overcomes resistance to another round of quantitative easing and the use of other non-conventional monetary tools are not effective due to limits to fiscal policy and resistance to taxpayer funded bailouts. Rising unemployment, tightened credit markets, and reduced institutional support for housing result in renewed decline in residential demand and construction causing prices and home equity to drop over 20% after several quarters. Commercial real estate prices in the United States fall 29% while the Midwest market prices drop 33%. The global turmoil sparks a flight-to-safety, reducing the 10-year treasury yield to a low of 1.47% in 2015. Reflecting the shock of a potential euro breakup and sharply elevated default risk, the risk spread on corporate BBB bonds rises from 2.0 ppt to 6.0 ppt in Q3 2014. In the face of mounting counterparty risk, credit markets tighten. Business credit drops 16% and consumer credit drops 6% over the course of the shock period.

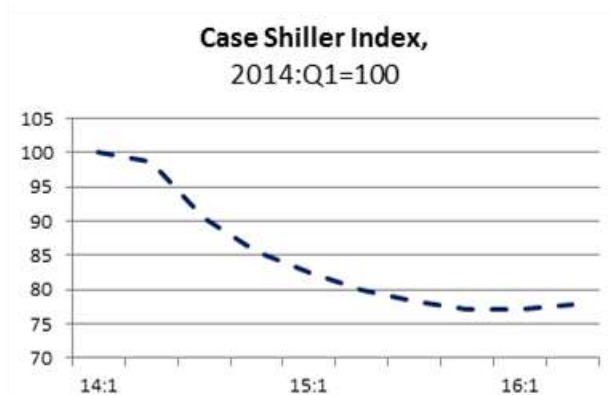
The retrenchment in the global economy impacts commodity markets. U.S. benchmark West Texas Intermediate falls from an average of US\$94/barrel during Q1 2014 to US\$45 by the end

of 2014. Producers are heavily impacted as prices fall below the break-even rates for most projects and the “shale boom” in the United States slows significantly. Market contagion from Europe spreads to North America resulting in a 45% drop in the S&P 500.

Given heavier industrial concentration and the more sensitive conditions now found in the real estate market, the American Midwest experiences a greater economic shock with a 6.5% peak-to-trough decline in GDP, pushing unemployment rates well into the teens. As a consequence, housing prices in Milwaukee, Indianapolis and Chicago plunge below their lowest points of the 2008-2009 financial crisis. The regional commercial property market sees vacancy rates increase to historical highs, chopping property values and sending the Midwest NCREIF index down significantly. BFC’s Midwestern portfolio holdings are stressed significantly: loan volumes shrink, the rate of residential and commercial mortgage delinquencies and foreclosures rise sharply, and business and personal bankruptcies and defaults all surpass the heights reached during the financial crisis.

The charts below provide a view of the path followed by specific variables that are drivers of the estimation process.





Firm Severely Adverse Scenario Estimates

BFC maintains strong regulatory capital ratios throughout the planning horizon from Q2, 2014 through Q2, 2016. The minimum and ending values are depicted below.

Projected stressed capital ratios through Q2 2016			
(%)	Actual Q1 2014	Stressed capital ratios ¹	
		Ending	Minimum
Tier 1 common ratio ²	11.38%	9.03%	9.03%
Common equity tier 1 capital ratio ³	N/A	9.67%	9.67%
Tier 1 risk-based capital ratio	11.38%	9.67%	9.67%
Total risk-based capital ratio	15.51%	13.57%	13.57%
Tier 1 leverage ratio	8.43%	6.57%	6.57%

¹ The pro forma stressed capital ratios are calculated using capital action factors and assumptions as described above. These projections represent hypothetical estimates under severely adverse economic conditions specified in the Firm Severely Adverse Scenario, which are more adverse than expected. These estimates are not forecasts of actual financial results. The minimum capital ratio presented is for the period Q2 2014 to Q2 2016. The pro forma stressed capital ratios reflect the decision of BFC to not include Accumulated Other Comprehensive Income in regulatory capital, as permitted under U.S. Basel III Standardized Rules

² BFC has calculated the Basel I tier 1 common ratio for applicable quarters in 2015 and 2016

³ Common equity tier 1 capital ratio is the Basel III ratio adopted by the Federal Reserve pursuant to the U.S. Basel III Final Rule and is effective for BFC beginning Q1 2015

Actual Q1 2014 and projected Q2 2016 risk-weighted assets ¹			
Billions of dollars	Actual Q1 2014	Projected Q2 2016	
		Current General Approach	Basel III Standardized Approach
BFC Risk-Weighted Assets	\$76.16	\$64.72	\$70.14

¹ For each quarter in 2014, risk-weighted assets are calculated using the current general risk-based capital approach. For each quarter in 2015 and 2016, risk-weighted assets are calculated under the Basel III standardized risk-based capital approach, except for the tier 1 common ratio which uses the general risk-based capital approach for all quarters

Projected loan losses, by type of loan, Q2 2014 – Q2 2016		
(%)	Billions of dollars	Portfolio loss rates (%) ¹
Loan Losses	2.60	5.3%
First-lien mortgages	0.40	5.6%
Junior liens and HELOCs	0.28	6.0%
Commercial and industrial ²	0.83	5.7%
Commercial real estate ³	0.58	7.7%
Credit cards	0.08	14.9%
Other consumer ⁴	0.13	2.1%
Other loans	0.31	3.6%

¹ Average loan balances used to calculate portfolio loss rates exclude loans held for sale and are calculated over nine quarters.

² Commercial and Industrial loans include small and medium enterprise loans and corporate cards

³ Commercial real estate loans include loans secured by farmland

⁴ Other consumer loans include student loans and automobile loans

Projected losses, revenue, and net income before taxes from Q2 2014 through Q2 2016		
(%)	Billions of dollars	Percentage of average assets
Pre-provision net revenue ¹	0.46	0.4%
Other revenue ²	-	-
<i>Less</i>		
Provisions	3.19	2.9%
Realized losses/gains on securities (AFS/HTM)	-	-
Trading and counterparty losses ³	0.04	0.04%
Other losses/gains ⁴	-	-
<i>Equals</i>		
Net income before taxes ⁵	-2.77	-2.5%

¹ Pre-provision net revenue includes losses from operational-risk events, mortgage repurchase expenses, and other real estate owned (OREO) costs

² Other revenue includes one-time income (and expense) items not included in pre-provision net revenue

³ Trading and counterparty losses include mark-to-market and credit valuation adjustment (CVA) losses and losses arising from the counterparty default scenario component applied to derivatives, securities lending, and repurchase agreement activities

⁴ Other losses/gains includes projected change in fair value of loans held for sale and loans held for investment measured under the fair-value option, and goodwill impairment losses

⁵ Numbers in the table might not foot due to rounding

Stress Testing Methodologies

The stress testing methodologies used by BFC are focused on defining the relationship between macroeconomic variables and business volumes, revenues and losses in order to develop pro-forma financial statements and estimate impact on capital availability. Key outputs from these processes are pro-forma balance sheets and income statements, which are used to develop risk-weighted assets, average leverage assets and capital projections and which are used to

estimate stressed regulatory capital ratios. BFC uses models, methodologies and management judgement, where applicable, to produce a comprehensive projection of business performance under a hypothetical severe stress scenario. The risks evaluated consist of a broad spectrum that includes credit risk, market risk, operational risk, other-than-temporary-impairment (OTTI) of securities, business risk, and other applicable risks.

The macroeconomic variables from the BFC Firm Severely Adverse Scenario are expanded as required, and these assumptions and interest rate curves are used to make projections. The specific methodologies employed are described below:

Credit and Other Losses:

BFC loss estimation processes are supported by well-established frameworks complemented by robust governance. Loss estimation for each scenario is driven by scenario-specific inputs, credit migrations, and Probability of Default (PD) and Loss Given Default (LGD) stress models. Results are benchmarked against key internal and external metrics of performance. All losses are reviewed and challenged by teams of experts, and senior cross-functional and multi-disciplinary management committees and the Capital Committee of the BFC Board of Directors.

Commercial net charge-offs are estimated using stress PD, transition matrices, stress LGD and exposure at default primarily calibrated to BFC's loss experience. These models are tailored to particular commercial loan portfolios.

Consumer net charge-offs are estimated using PD, LGD and exposure at default models, calibrated to BFC's loss experience. These models incorporate quantitatively predictive portfolio segments and their risk characteristics.

Operational losses are estimated using a loss distribution approach model that predicts losses across the spectrum of operational losses, which includes legal settlements, ongoing fees and reserves. This modeled stress result uses a higher percentile confidence level to account for increased potential tail risk in periods of stress.

Trading losses are estimated using market-risk stress testing models. OTTI on available-for-sale securities and equity investments is estimated at an individual investment level.

Pre-provision Net Revenue:

BFC uses quantitative and qualitative methodologies based on applicable macro-economic variables to estimate net-interest income, non-interest revenue and non-interest expense. Net-interest income components are estimated using the balance sheet (structural and non-structural), non-performing loan migration, net charge-offs, loan and deposit purchase accounting and non-contractual net-interest income. Non-interest revenue and non-interest expense are estimated utilizing historical experience, expert judgement and quantitative approaches. While a majority of the categories are judgementally derived, certain categories are quantitatively modeled.

Provision for Loan and Lease Losses:

BFC utilizes the loss estimates generated by its methodologies in quantifying its allowance for loan and lease losses. The provisions for loan and lease losses are estimated to ensure that they are more than adequate to absorb quarterly losses through the planning horizon.

Capital Position:

The impact of estimated pre-provision net revenue and losses, changes in asset levels, permitted capital and other management actions and changes in risk-weighted assets are used to estimate BFC's capital position. Risk-weighted assets, average assets for leverage purposes and regulatory capital were calculated based on the current Basel I methodology for the initial 3 quarters in the stress test horizon, Q2 2014 through Q4 2014, and based on applicable transitional Basel III methodology for non-advanced approaches institutions for the last 6 quarters of the stress test horizon, Q1 2015 through Q2 2016. The tier 1 common equity ratio is calculated based on the current Basel I methodology throughout the stress horizon. The decline in capital ratios from actual Q1 2014 levels to the minimums projected in the hypothetical Firm Severely Adverse Scenario primarily reflects the impact of higher credit losses combined with reduced pre-provision net revenue, partly offset by lower asset levels.

The Mid-cycle Dodd-Frank Act company-run stress test results presented in this report (Stress Test Results) have been prepared in accordance with U.S. GAAP. The Stress Test Results present certain projected financial measures for BFC under the hypothetical economic and market scenario and assumptions designed by BFC. The Stress Test Results are not forecasts of actual financial results for BFC. Investors in securities issued by Bank of Montreal and its affiliates should not rely on the Stress Test Results as being indicative of expected future results.