Financial Condition Review

Summary Balance Sheet

(Canadian $ in millions) As at October 31	**2018**	2017	2016
Assets			
Cash and interest bearing deposits with banks	**50,447**	39,089	36,102
Securities	**180,935**	163,198	149,985
Securities borrowed or purchased under resale agreements	**85,051**	75,047	66,646
Net loans	**383,991**	358,507	357,518
Derivative instruments	**26,204**	28,951	39,183
Other assets	**47,420**	44,788	38,501
Total assets	**774,048**	709,580	687,935
Liabilities and Shareholders' Equity			
Deposits	**522,051**	479,792	470,281
Derivative instruments	**24,411**	27,804	38,227
Securities lent or sold under repurchase agreements	**66,684**	55,119	40,718
Other liabilities	**108,393**	97,482	91,942
Subordinated debt	**6,782**	5,029	4,439
Shareholders' equity	**45,727**	44,354	42,304
Non-controlling interest in subsidiaries	**–**	–	24
Total liabilities and shareholders' equity	**774,048**	709,580	687,935

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

MD&A

Overview

Total assets of $774.0 billion increased $64.5 billion from October 31, 2017. The stronger U.S dollar increased assets by $6.5 billion, excluding the impact on derivative assets. Total liabilities of $728.3 billion increased $63.1 billion from October 31, 2017. The stronger U.S dollar increased liabilities by $6.3 billion, excluding the impact on derivative liabilities. Shareholders' equity increased $1.4 billion from October 31, 2017.

Cash and Interest Bearing Deposits with Banks

Cash and interest bearing deposits with banks increased $11.4 billion, or $10.6 billion excluding the impact of the stronger U.S. dollar, due to higher balances held with central banks.

Securities

(Canadian $ in millions) As at October 31	**2018**	2017	2016
Trading	**99,697**	99,069	84,458
FVTPL (1)	**11,611**	na	na
FVOCI – Debt and equity (2)	**62,440**	na	na
Available-for-sale	**na**	54,075	55,663
Amortized cost (3)	**6,485**	na	na
Held-to-maturity	**na**	9,094	8,965
Other	**702**	960	899
Total securities	**180,935**	163,198	149,985

(1) Comprised of $2,828 million mandatorily measured at fair value and $8,783 million designated at fair value.
(2) Includes allowances for credit losses on FVOCI debt securities of $2 million (na at October 31, 2017).
(3) Net of allowances for credit losses of $1 million (na at October 31, 2017).
na – Not applicable due to IFRS 9 adoption.

Securities increased $17.7 billion, or $16.0 billion excluding the impact of the stronger U.S. dollar, as a result of liquidity management activities and higher balances in BMO Capital Markets reflecting the acquisition.

Securities Borrowed or Purchased Under Resale Agreements

Securities borrowed or purchased under resale agreements increased $10.0 billion, or $9.2 billion excluding the impact of the stronger U.S. dollar, driven by higher liquid asset levels in Corporate Services and higher balances in BMO Capital Markets.

Net Loans

(Canadian $ in millions) As at October 31	**2018**	2017	2016
Residential mortgages	**119,620**	115,258	112,277
Non-residential mortgages	**14,017**	11,744	11,376
Consumer instalment and other personal	**63,225**	61,944	64,680
Credit cards	**8,329**	8,071	8,101
Businesses and governments	**180,439**	163,323	163,009
Gross loans	**385,630**	360,340	359,443
Allowance for credit losses	**(1,639)**	(1,833)	(1,925)
Total net loans	**383,991**	358,507	357,518

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

Net loans increased $25.5 billion, or $22.7 billion excluding the impact of the stronger U.S. dollar, largely due to an increase in business and government loans in the Personal and Commercial Banking businesses and BMO Capital Markets, and higher residential mortgages, in part due to the purchase of a mortgage portfolio in U.S. P&C.

Table 7 on page 132 of the Supplemental Information provides a comparative summary of loans by geographic location and product. Table 9 on page 133 provides a comparative summary of net loans in Canada by province and industry. Loan quality is discussed on page 91 and further details on loans are provided in Notes 4, 6 and 24 on pages 157, 164 and 201 of the consolidated financial statements.

Derivative Financial Assets

Derivative financial assets decreased $2.7 billion, primarily due to a decrease in the fair value of foreign exchange contracts partially offset by an increase in the fair value of commodity and equity contracts.

Other Assets

Other assets include customers' liability under acceptances, premises and equipment, goodwill and intangible assets, current and deferred tax asset, accounts receivable and prepaid expenses. Other assets increased $2.6 billion, primarily due to a $2.0 billion increase in customers' liability under acceptances.

Deposits

(Canadian $ in millions) As at October 31	**2018**	2017	2016
Banks	**27,907**	28,205	31,489
Businesses and governments	**313,300**	283,276	275,905
Individuals	**180,844**	168,311	162,887
Total deposits	**522,051**	479,792	470,281

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

Deposits increased $42.3 billion, or $37.2 billion excluding the impact of the stronger U.S. dollar, reflecting higher levels of customer and wholesale deposits. Deposits by businesses and governments increased $26.7 billion, reflecting higher wholesale funding for loan and liquid asset growth and growth in customer balances. Deposits by individuals increased $11.3 billion. Deposits by banks decreased $0.8 billion. Further details on the composition of deposits are provided in Note 13 on page 178 of the consolidated financial statements and in the Liquidity and Funding Risk section on page 100.

Derivative Financial Liabilities

Derivative liabilities decreased $3.4 billion, due to a decline in the fair value of foreign exchange and equity contracts, partially offset by an increase in the fair value of commodity and interest rate contracts.

Securities Lent or Sold Under Repurchase Agreements

Securities lent or sold under repurchase agreements increased $11.6 billion, or $10.8 billion excluding the impact of the stronger U.S. dollar, driven by activity in BMO Capital Markets, including the acquisition.

Other Liabilities

Other liabilities primarily include securities sold but not yet purchased, securitization and structured entities' liabilities, acceptances and Federal Home Loan Bank (FHLB) advances. Other liabilities increased $10.9 billion, primarily due to a $4.3 billion increase in FHLB advances and securitization and structured entities liabilities to fund loan and liquid asset growth, a $3.6 billion increase in securities sold but not yet purchased and a $2.0 billion increase in acceptances. Further details on the composition of other liabilities are provided in Note 14 on page 179 of the consolidated financial statements.

Subordinated Debt

Subordinated debt increased $1.8 billion from the prior year, as new issuances exceeded a redemption. Further details on the composition of subordinated debt are provided in Note 15 on page 181 of the consolidated financial statements.

Equity

(Canadian $ in millions) As at October 31	**2018**	2017	2016
Share capital			
Preferred shares	**4,340**	4,240	3,840
Common shares	**12,929**	13,032	12,539
Contributed surplus	**300**	307	294
Retained earnings	**25,856**	23,709	21,205
Accumulated other comprehensive income	**2,302**	3,066	4,426
Total shareholders' equity	**45,727**	44,354	42,304
Non-controlling interest in subsidiaries	**–**	–	24
Total equity	**45,727**	44,354	42,328

Total equity increased $1.4 billion due to a $2.1 billion increase in retained earnings, partially offset by a $0.8 billion decrease in accumulated other comprehensive income. Retained earnings increased as a result of net income in the current year, partially offset by dividends and common shares repurchased for cancellation. Accumulated other comprehensive income decreased, primarily due to the impact of higher interest rates.

Share capital was unchanged, as an increase in preferred shares was offset by a decrease in common shares. Preferred shares increased due to a new issuance, net of redemptions. Common shares decreased due to the repurchase of shares for cancellation, partially offset by the issuance of shares under the Stock Option Plan. Our Consolidated Statement of Changes in Equity on page 146 provides a summary of items that increase or reduce shareholders' equity, while Note 16 on page 182 of the consolidated financial statements provides details on the components of, and changes in, share capital. Details on our enterprise-wide capital management practices and strategies can be found on the following page.

Enterprise-Wide Capital Management

Capital Management

Objective

BMO is committed to a disciplined approach to capital management that balances the interests and requirements of shareholders, regulators, depositors, fixed income investors and rating agencies. Our objective is to maintain a strong capital position in a cost-effective structure that:

- is appropriate given our target regulatory capital ratios and internal assessment of required economic capital;
- is consistent with our target credit ratings;
- underpins our operating groups' business strategies; and
- supports depositor, investor and regulator confidence, while building long-term shareholder value.

Capital Management Framework

Capital Demand		Capital Supply
Capital Demand Capital required to support the risks underlying our business activities	Capital adequacy assessment of capital demand and supply	**Capital Supply** Capital available to support risks

The principles and key elements of BMO's capital management framework are outlined in our Capital Management Corporate Policy and in our annual capital plan, which includes the results of our comprehensive Internal Capital Adequacy Assessment Process (ICAAP).

ICAAP is an integrated process that involves the application of stress testing and other tools to evaluate capital adequacy on both a regulatory and an economic capital basis. The results of this process are used in the establishment of capital targets and the implementation of capital strategies that take into consideration the strategic direction and risk appetite of the enterprise. The capital plan is developed considering the results of our ICAAP and in conjunction with our annual business plan, promoting alignment between our business and risk strategies, regulatory and economic capital requirements and the availability of capital. Enterprise-wide stress testing and scenario analysis are conducted in order to assess the impact of various stress conditions on BMO's risk profile and capital requirements. The capital management framework seeks to ensure that we are adequately capitalized given the risks we take in the normal course of business, as well as under stress, and it supports the determination of limits, targets and performance measures that are used to manage balance sheet positions, risk levels and capital requirements at both the consolidated entity and operating group levels. BMO evaluates assessments of actual and forecast capital adequacy against the capital plan throughout the year, and updates the plan to reflect changes in business activities, risk profile, operating environment or regulatory expectations.

BMO uses regulatory and economic capital to evaluate business performance and considers capital implications in its strategic, tactical and transactional decision-making. By allocating our capital to operating groups, setting and monitoring capital limits and metrics, and measuring the groups' performance against these limits and metrics, we seek to optimize our risk-adjusted return to shareholders, while maintaining a well-capitalized position. This approach aims to protect our stakeholders from the risks inherent in our various businesses, while still allowing the flexibility to deploy resources in support of the strategic growth activities of our operating groups.

Refer to the Enterprise-Wide Risk Management section on page 78 for further discussion of the risks underlying our business activities.

Governance

The Board of Directors, either directly or in conjunction with its Risk Review Committee, provides ultimate oversight and approval of capital management, including our Capital Management Corporate Policy framework, capital plan and capital adequacy assessments. The Board regularly reviews BMO's capital position and key capital management activities, and the Risk Review Committee reviews the ICAAP-determined capital adequacy assessment results. The Balance Sheet and Capital Management Committee provides senior management oversight, including the review of significant capital management policies, issues and activities and, along with the Risk Management Committee, the capital required to support the execution of our enterprise-wide strategy. Finance and Risk Management are responsible for the design and implementation of the corporate policies and the frameworks related to capital and risk management, as well as the ICAAP. The Corporate Audit Division, as the third line of defence, verifies our adherence to controls and identifies opportunities to strengthen our processes.

Regulatory Capital Requirements

Regulatory capital requirements for BMO are determined in accordance with the Capital Adequacy Requirements (CAR) Guideline of the Office of the Superintendent of Financial Institutions Canada (OSFI), which is based on the capital standards developed by the Basel Committee on Banking Supervision (BCBS). The minimum capital ratios set out in the CAR Guideline are a 4.5% Common Equity Tier 1 (CET1) Ratio, 6% Tier 1 Capital Ratio and 8% Total Capital Ratio, which are calculated using a nine-year transitional phase-out of non-qualifying capital instruments that ends in 2022. In addition to the minimum capital requirements, OSFI also expects domestic systemically important banks (D-SIBs) to hold Pillar 1 and Pillar 2 buffers, which are meant to be used as a normal first step in periods of stress. The Pillar 1 buffers include a Capital Conservation Buffer of 2.5%, a D-SIB Common Equity Tier 1 surcharge of 1%, and the Countercyclical Buffer (which can range from 0% to 2.5%, depending on the bank's exposure to jurisdictions that have activated the buffer). The Domestic Stability Buffer is a Pillar 2 buffer and is currently set at 1.5%. OSFI's capital requirements are summarized in the following table.

(% of risk-weighted assets)	Minimum capital requirements	Pillar 1 Capital Buffers (1)	Domestic Stability Buffer (2)	OSFI capital requirements including capital buffers	BMO Capital and Leverage Ratios as at October 31, 2018
Common Equity Tier 1 Ratio	4.5%	3.5%	1.5%	9.5%	11.3%
Tier 1 Capital Ratio	6.0%	3.5%	1.5%	11.0%	12.9%
Total Capital Ratio	8.0%	3.5%	1.5%	13.0%	15.2%
Leverage Ratio	3.0%	na	na	3.0%	4.2%

(1) The minimum 4.5% CET1 Ratio requirement is augmented by 3.5% in Pillar 1 Capital Buffers, which can absorb losses during periods of stress. The Pillar 1 Capital Buffers include a 2.5% Capital Conservation Buffer, a 1.0% Common Equity Tier 1 Surcharge for D-SIBs and a Countercyclical Buffer as prescribed by OSFI (immaterial for the fourth quarter of 2018). If a bank's capital ratios fall within the range of this combined buffer, restrictions on discretionary distributions of earnings (such as dividends, share repurchases and discretionary compensation) would ensue, with the degree of such restrictions varying according to the position of the bank's ratios within the buffer range.

(2) OSFI requires all D-SIBs to maintain a Domestic Stability Buffer (DSB) against Pillar 2 risks associated with systemic vulnerabilities. The DSB can range from 0% to 2.5% of total RWA and is currently set at 1.5%. Breaches of the DSB will not result in a bank being subject to automatic constraints on capital distributions.

na – not applicable

Regulatory Capital Ratios

The **Common Equity Tier 1 Ratio** reflects CET1 capital divided by CET1 capital RWA.

The **Tier 1 Capital Ratio** reflects Tier 1 capital divided by Tier 1 capital RWA.

The **Total Capital Ratio** reflects Total capital divided by Total capital RWA.

The **Leverage Ratio** reflects Tier 1 capital divided by the sum of on-balance sheet items and specified off-balance sheet items, net of specified adjustments.

Regulatory Capital Elements

BMO maintains a capital structure that is diversified across instruments and tiers to ensure an appropriate mix of loss absorbency. The major components of our regulatory capital are summarized as follows:

CET1 Capital

- Common Shareholders' Equity
- Less regulatory deductions for items such as:
  - Goodwill
  - Intangible assets
  - Defined benefit pension assets
  - Certain deferred tax assets
  - Certain other items

Additional Tier 1 Capital

- Preferred shares
- Innovative hybrid instruments
- Less certain regulatory deductions

Tier 1 Capital

Tier 2 Capital

- Subordinated debentures
- May include certain loan loss allowances
- Less certain regulatory deductions

Total Capital

OSFI's CAR Guideline also requires the implementation of BCBS guidance on non-viability contingent capital (NVCC). NVCC provisions require the conversion of certain capital instruments into a variable number of common shares in the event that OSFI announces that a bank is, or is about to become, non-viable, or if a federal or provincial government in Canada publicly announces that the bank has accepted or agreed to accept a capital injection, or equivalent support, to avoid non-viability.

Under OSFI's CAR Guideline, non-common share capital instruments that do not meet Basel III requirements, including NVCC requirements, will be fully phased out by 2022.

Canada's Bank Recapitalization (Bail-In) Regime became effective on September 23, 2018. Eligible senior debt (described below) issued after this date is subject to statutory conversion requirements. Canada Deposit Insurance Corporation has the power to trigger the conversion of bail-in debt into common shares. This statutory conversion supplements NVCC securities, which must be converted, in full, prior to the conversion of bail-in debt.

Risk-Weighted Assets

Risk-Weighted Assets (RWA) measure a bank's exposures, weighted for their relative risk and calculated in accordance with OSFI's regulatory capital rules. RWA are calculated for credit, market and operational risks based on OSFI's prescribed rules.

BMO primarily uses the Advanced Internal Ratings Based (AIRB) Approach to determine credit RWA in our portfolio. The AIRB Approach utilizes sophisticated techniques to measure RWA at the exposure level based on sound risk management principles, including estimates of the probability of default, the downturn loss given default and exposure at default risk parameters, term to maturity and asset class type, as prescribed by the OSFI rules. These risk parameters are determined using historical portfolio data supplemented by benchmarking and are updated periodically. Validation procedures related to these parameters are in place and are enhanced periodically in order to quantify and differentiate risks appropriately to reflect changes in economic and credit conditions. Credit RWA related to certain Canadian and U.S. portfolios are determined using the Standardized Approach.

BMO's market risk RWA are primarily determined using the more advanced Internal Models Approach, but the Standardized Approach is used for some exposures.

BMO uses the Advanced Measurement Approach, a risk-sensitive capital model, along with the Standardized Approach in certain areas under OSFI rules, to determine capital requirements for operational risk.

For institutions using advanced approaches for credit risk or operational risk, there is a capital floor as prescribed in OSFI's CAR Guideline. In calculating regulatory capital ratios, there is a requirement to increase RWA when an amount calculated under the Standardized Approach (covering RWA and allowances) is higher than the result of a similar calculation under the more risk-sensitive modelled approach. The capital floor was operative for the bank in 2017 and in the first quarter of 2018, and a floor adjustment was reflected in our total RWA for those periods. We have not had a floor-based RWA adjustment since the revised floor calculation, as outlined below, became effective in the second quarter of 2018.

In accordance with guidance from OSFI, the credit valuation adjustment (CVA) risk capital charge for Canadian banks has been phasing in since the first quarter of 2014. In 2017 and 2018, the CVA risk capital charge applicable to CET1 was 72% and 80% of the fully implemented charge, respectively. The charge will be fully phased in by 2019.

Capital Regulatory Developments

A number of regulatory capital changes, some finalized and some under development, will lead to upward pressure on the amount of capital BMO is required to hold over time. The nature of these changes is outlined below.

In October 2018, OSFI issued the updated version of the CAR Guideline for implementation in the first quarter of 2019. The most significant revisions include the domestic implementation of the Standardized Approach for counterparty credit risk (SA-CCR) and revised capital requirements for bank exposures to central counterparties, as well as a revised securitization framework. The update provides for transitional arrangements under which certain aspects of the revised securitization framework will not apply until fiscal 2020 or 2021. These changes are expected to modestly increase the amount of capital we are required to hold upon implementation. The revised CAR Guideline also incorporates the changes to the capital floor, announced by OSFI in January 2018, which include a shift to the Basel II Standardized Approach and a reduced floor factor transitioning from 70% in the second quarter of fiscal 2018 and 72.5% in the third quarter to 75% from the fourth quarter onward. In October 2018, OSFI issued the final version of the Leverage Requirements (LR) Guideline for implementation in the first quarter of 2019 to align with the changes related to counterparty credit risk and the securitization framework in the revised CAR Guideline. In November 2018, OSFI issued revisions to the Leverage Ratio Disclosure Requirements Guideline, which reflect the changes to the LR and CAR Guidelines, effective for the first quarter of 2019.

In June 2018, OSFI published details on the Domestic Stability Buffer (DSB), which it expects to be maintained by D-SIBs against Pillar 2 risks associated with systemic vulnerabilities. The DSB, which is met with CET1 capital, will range between 0% and 2.5% of a bank's total RWA and is currently set at 1.5%.

In April 2018, the Government of Canada published the final regulations on Canada's Bank Recapitalization (Bail-In) Regime, which became effective on September 23, 2018. The Bail-In Regime is consistent with the international standards developed by the Financial Stability Board, but is tailored to the Canadian context. Bail-in debt includes senior unsecured debt, issued directly by the bank on or after September 23, 2018, which has an original term greater than 400 days and is marketable, subject to certain exceptions. Some or all of this debt may be statutorily converted into common shares of the bank under the Bail-In Regime if the bank enters resolution. In conjunction with the regulations, OSFI released its final Total Loss Absorbing Capacity (TLAC) guideline for D-SIBs, which establishes minimum standards for a risk-based TLAC ratio and TLAC leverage ratio that come into effect on November 1, 2021. In August 2018, OSFI set the minimum requirements as a risk-based TLAC ratio of 21.5% RWA and a TLAC leverage ratio of 6.75%. In addition, D-SIBs will be expected to maintain buffers above the minimum TLAC ratios, including the DSB (currently 1.5% of total RWA) and any capital add-ons for idiosyncratic Pillar 2 risks. The D-SIBs' supervisory target risk-based TLAC ratio is expected to be 23.0% when the minimum requirements come into effect on November 1, 2021, inclusive of buffers as currently set. In May 2018, OSFI issued the final TLAC Disclosure Requirements Guideline effective for the first quarter of fiscal 2019.

In July 2018, OSFI issued for consultation a discussion paper on the proposed domestic implementation of the final Basel III reforms, which include a revised Standardized Approach for credit risk, constraints on the use of internal ratings-based approaches, revisions to the credit valuation adjustment (CVA) framework, a revised Standardized Approach for operational risk, revisions to the leverage ratio framework, and calibration of standardized output floors. The discussion paper sets out OSFI's preliminary views on the scope and timing of the implementation of the final Basel III reforms in Canada. While the BCBS outlined a five-year transition period for the RWA output floor from 50% in 2022 to 72.5% in 2027, OSFI's discussion paper proposes to set the output floor at 72.5% upon implementation of the reforms in the first quarter of 2022.

In March 2018, the BCBS issued a consultative document on revisions to the minimum capital requirements for market risk, commonly referred to as the fundamental review of the trading book. The consultative document proposes a number of revisions to the market risk standard published in January 2016, including a simplified alternative to the revised Standardized Approach. The implementation date of the revised market risk standard has been extended to January 1, 2022, allowing additional time for banks to develop the systems infrastructure needed to apply the standard and for BCBS to address certain outstanding issues.

2018 Regulatory Capital Review

BMO is well capitalized, with capital ratios that exceed OSFI's published requirements for large Canadian banks, including the 1.5% DSB. Our CET1 Ratio was 11.3% at October 31, 2018, compared with 11.4% at October 31, 2017. The CET1 Ratio decreased from the end of fiscal 2017 as higher CET1 capital from retained earnings growth, net of share repurchases, was more than offset by higher RWA, including an acquisition.

Our Tier 1 Capital and Total Capital Ratios were 12.9% and 15.2%, respectively, at October 31, 2018, compared with 13.0% and 15.1%, respectively, at October 31, 2017. The decrease in the Tier 1 Capital Ratio was mainly due to the factors impacting the CET1 Ratio discussed above. The increase in the Total Capital Ratio was mainly due to the issuances of subordinated notes, net of redemptions, partially offset by the factors impacting the Tier 1 Ratio.

The impact of foreign exchange movements on capital ratios was largely offset. BMO's investments in foreign operations are primarily denominated in U.S. dollars, and the foreign exchange impact of U.S.-dollar-denominated RWA capital deductions may result in variability in the bank's capital ratios. BMO may manage the impact of foreign exchange movements on its capital ratios and did so during 2018. Any such activities could also impact our book value and return on equity.

BMO's Leverage Ratio was 4.2% at October 31, 2018, down from 4.4% at October 31, 2017, due to higher leverage exposures driven mainly by business growth.

While the ratios discussed above reflect the bank's consolidated capital base, BMO conducts business through a variety of corporate structures, including subsidiaries. A framework is in place such that capital and funding are managed appropriately at the subsidiary level.

As a U.S. bank holding company with total consolidated assets of US$50 billion or more, our subsidiary BMO Financial Corp. (BFC) is subject to the Federal Reserve Board's (FRB) Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Act Stress Test (DFAST) requirements. CCAR is an annual exercise conducted by the FRB to assess whether the largest bank holding companies operating in the United States have sufficient capital to support operations throughout periods of economic and financial stress and have robust, forward-looking capital planning processes that address their unique risks. DFAST is a forward-looking exercise complementary to CCAR and conducted by the FRB to assess whether the financial companies that it supervises have sufficient capital to absorb losses and support operations during adverse economic conditions. In June 2018, the FRB announced its decision not to object to BFC's capital plan as evaluated under the 2018 CCAR assessment. Results under the DFAST supervisory severely adverse scenario indicate that the capital ratios for BFC and its bank subsidiary BMO Harris Bank N.A. are above well-capitalized levels, as disclosed in their results in June 2018. BFC's own mid-cycle company-run stress tests (under DFAST) also indicate that the capital ratios for BFC are above well-capitalized levels, as disclosed in their results in October 2018.

Regulatory Capital (1)

(Canadian $ in millions) As at October 31	**2018**	2017
Common Equity Tier 1 capital: instruments and reserves		
Directly issued qualifying common share capital plus related stock surplus	**13,229**	13,339
Retained earnings	**25,856**	23,709
Accumulated other comprehensive income (and other reserves)	**2,302**	3,066
Goodwill and other intangibles (net of related tax liability)	**(8,261)**	(7,885)
Other common equity Tier 1 capital deductions	**(405)**	(1,596)
Common Equity Tier 1 capital (CET1)	**32,721**	30,633
Additional Tier 1 capital: instruments		
Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	**4,050**	3,650
Directly issued capital instruments subject to phase-out from Additional Tier 1	**740**	1,040
Additional Tier 1 instruments (and CET1 instruments not otherwise included) issued by subsidiaries and held by third parties (amount allowed in group AT1)	**–**	–
of which: instruments issued by subsidiaries subject to phase-out	**–**	–
Total regulatory adjustments applied to Additional Tier 1 capital	**(291)**	(215)
Additional Tier 1 capital (AT1)	**4,499**	4,475
Tier 1 capital (T1 = CET1 + AT1)	**37,220**	35,108
Tier 2 capital: instruments and provisions		
Directly issued qualifying Tier 2 instruments plus related stock surplus	**6,639**	3,976
Directly issued capital instruments subject to phase-out from Tier 2 capital	**143**	1,053
Tier 2 instruments (and CET1 and AT1 instruments not included) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	**–**	–
of which: instruments issued by subsidiaries subject to phase-out	**–**	–
General allowance	**235**	509
Total regulatory adjustments to Tier 2 capital	**(121)**	(50)
Tier 2 capital (T2)	**6,896**	5,488
Total capital (TC = T1 + T2)	**44,116**	40,596

(1) Non-qualifying Tier 1 and Tier 2 capital instruments are phased out at a rate of 10% per year from January 1, 2013 to January 1, 2022.

Our CET1 capital and Tier 1 capital levels were $32.7 billion and $37.2 billion, respectively, at October 31, 2018, up from $30.6 billion and $35.1 billion, respectively, at October 31, 2017. CET1 capital increased, largely driven by retained earnings growth net of share repurchases. The increase in Tier 1 capital since October 31, 2017 was mainly due to the factors impacting CET1 capital.

Total capital was $44.1 billion at October 31, 2018, up from $40.6 billion at October 31, 2017, attributable to the growth in Tier 1 capital discussed above, and the issuances of subordinated notes, net of redemptions.

Changes in Risk-Weighted Assets

Total CET 1 Capital RWA were $289.2 billion at October 31, 2018, up from $269.5 billion at October 31, 2017. Credit Risk RWA were $240.5 billion at October 31, 2018, up from $219.8 billion at October 31, 2017. The increase was largely due to business growth and foreign exchange impacts, partially offset by positive asset quality changes. As noted above, the impact of foreign exchange movements is largely offset in the CET1 Ratio. Market Risk RWA were $13.5 billion at October 31, 2018, up from $8.4 billion at October 31, 2017, largely attributable to business growth, mainly driven by an acquisition, and market variables, partially offset by methodology and policy changes. Operational Risk RWA were $35.2 billion at October 31, 2018, up from $32.8 billion at October 31, 2017, primarily due to growth in the bank's average gross income. There was no capital floor RWA adjustment at October 31, 2018, down from $8.4 billion at October 31, 2017.

(Canadian $ in millions) As at October 31	**2018**	2017
Credit Risk		
Wholesale		
Corporate, including specialized lending	**112,394**	100,421
Corporate small and medium-sized enterprises	**39,496**	35,246
Sovereign	**3,323**	1,627
Bank	**4,790**	5,892
Retail		
Residential mortgages, excluding home equity line of credit	**9,527**	7,984
Home equity line of credit	**4,846**	5,426
Qualifying revolving retail	**5,452**	5,465
Other retail, excluding small and medium-sized enterprises	**12,078**	11,258
Retail small and medium-sized enterprises	**7,264**	7,582
Equity	**1,971**	1,626
Trading book	**9,693**	9,542
Securitization	**2,295**	2,476
Other credit risk assets – non-counterparty managed assets	**16,776**	15,631
Scaling factor for credit risk assets under AIRB Approach (1)	**10,595**	9,648
Total Credit Risk	**240,500**	219,824
Market Risk	**13,532**	8,448
Operational Risk	**35,205**	32,773
CET1 Capital Risk-Weighted Assets before Capital floor	**289,237**	261,045
Basel I Capital Floor (2)	**–**	8,421
CET1 Capital Risk-Weighted Assets	**289,237**	269,466
Tier 1 Capital Risk-Weighted Assets before CVA and Capital floor	**289,237**	261,045
Additional CVA adjustment, prescribed by OSFI, for Tier 1 Capital	**183**	290
Basel I Capital Floor (2)	**–**	8,131
Tier 1 Capital Risk-Weighted Assets	**289,420**	269,466
Total Capital Risk-Weighted Assets before CVA and Capital floor	**289,237**	261,045
Additional CVA adjustment, prescribed by OSFI, for Total Capital	**367**	522
Basel I Capital Floor (2)	**–**	7,899
Total Capital Risk-Weighted Assets	**289,604**	269,466

(1) The scaling factor is applied to RWA amounts for credit risk under the AIRB Approach.

(2) For institutions using advanced approaches for credit risk or operational risk, there is a capital floor as prescribed in OSFI's CAR Guideline. OSFI revised its capital floor calculation effective second quarter of fiscal 2018 as discussed in the Regulatory Capital Developments section.

Economic Capital

Economic capital is an expression of the enterprise's capital demand requirement relative to the bank's view of the economic risks in its underlying business activities. It represents management's estimation of the likely magnitude of economic losses that could occur should severely adverse situations arise, and allows returns to be measured on a consistent basis across such risks. Economic loss is the loss in economic or market value incurred over a specified time horizon at a defined confidence level, relative to the expected loss over the same time horizon. Economic capital is calculated for various types of risk, including credit, market (trading and non-trading), operational and business, based on a one-year time horizon using a defined confidence level.

Economic Capital and RWA by Operating Group and Risk Type

(As at October 31, 2018)

BMO Financial Group

Operating Groups	Personal and Commercial Banking	BMO Wealth Management	BMO Capital Markets	Corporate Services
Economic Capital by Risk Type (%)				
Credit	78%	29%	69%	55%
Market	5%	23%	14%	25%
Operational/Other	17%	48%	17%	20%
RWA by Risk Type (Canadian $ in millions)				
Credit	158,975	12,990	57,286	11,249
Market	–	37	13,495	–
Operational	19,338	6,042	9,825	–

Capital Management Activities

On June 1, 2018, we renewed our normal course issuer bid (NCIB) effective for one year. Under this NCIB, we may purchase up to 20 million of our common shares for cancellation. The NCIB is a regular part of BMO's capital management strategy. The timing and amount of purchases under the NCIB are subject to management discretion based on factors such as market conditions and capital levels. The bank will consult with OSFI before making purchases under the NCIB. During 2018, we repurchased and cancelled 10 million of our common shares as part of the NCIB at an average cost of $99.05 per share, totalling $991 million. Of these common shares, 7 million were purchased on the TSX and 3 million were purchased pursuant to a specific share repurchase program. Specific share repurchases were made from an arm's-length third-party seller at a discount to the prevailing market price of our common shares on the TSX at the time of the purchases.

During 2018, BMO issued approximately 1.5 million common shares through the exercise of stock options.

During 2018, BMO completed the following Tier 1 and Tier 2 capital instrument issuances, redemptions and conversions.

Share Issuances, Redemptions and Conversions

(in millions) As at October 31, 2018	Issuance or redemption date	Number of shares	Amount
Common shares issued			
Stock options exercised		1.5	$ 99
Tier 1 Capital (1)			
Issuance of Non-Cumulative 5-Year Rate Reset Class B Preferred Shares, Series 44	September 17, 2018	16	$ 400
Redemption of Non-Cumulative 5-Year Rate Reset Class B Preferred Shares, Series 16	August 25, 2018	(6.3)	$ (157)
Redemption of Non-Cumulative Floating Rate Class B Preferred Shares, Series 17	August 25, 2018	(5.7)	$ (143)
Tier 2 Capital (1)			
Issuance of 3.803% Subordinated Notes due 2032	December 12, 2017		US$1,250
Issuance of 4.338% Subordinated Notes due 2028	October 5, 2018		US$ 850
Redemption of Series F Medium-Term Notes, First Tranche	March 28, 2018		$ (900)

(1) For further details on subordinated debt and share capital, see Notes 15 and 16 of the consolidated financial statements on pages 181 and 182, respectively.

If an NVCC trigger event were to occur, our NVCC capital instruments would be converted into BMO common shares pursuant to automatic conversion formulas, with a conversion price based on the greater of: (i) a floor price of $5.00; and (ii) the current market price of our common shares at the time of the trigger event (calculated using a 10-day weighted average). Based on a floor price of $5.00, these NVCC capital instruments would be converted into approximately 2.87 billion BMO common shares, assuming no accrued interest and no declared and unpaid dividends.

On November 16, 2018, BMO Capital Trust II, a subsidiary of Bank of Montreal, announced its intention to redeem all of its $450 million issued and outstanding BMO Tier 1 Notes – Series A on December 31, 2018.

Further details are provided in Notes 15 and 16 of the consolidated financial statements on pages 181 and 182, respectively.

Outstanding Shares and NVCC Capital Instruments

As at October 31, 2018	Number of shares or dollar amount (in millions)	Dividends declared per share		
		2018	2017	2016
Common shares	639	**$ 3.78**	$ 3.56	$ 3.40
Class B Preferred shares				
Series 14 (1)	–	**–**	$ 0.66	$ 1.31
Series 15 (1)	–	**–**	$ 0.73	$ 1.45
Series 16 (2)	–	**$ 0.64**	$ 0.85	$ 0.85
Series 17 (2)	–	**$ 0.52**	$ 0.55	$ 0.53
Series 25 (3)	$ 236	**$ 0.45**	$ 0.45	$ 0.84
Series 26 (3)	$ 54	**$ 0.59**	$ 0.43	$ 0.10
Series 27*	$ 500	**$ 1.00**	$ 1.00	$ 1.00
Series 29*	$ 400	**$ 0.98**	$ 0.98	$ 0.98
Series 31*	$ 300	**$ 0.95**	$ 0.95	$ 0.95
Series 33*	$ 200	**$ 0.95**	$ 0.95	$ 0.95
Series 35*	$ 150	**$ 1.25**	$ 1.25	$ 1.25
Series 36*	$ 600	**$58.50**	$58.50	$65.03
Series 38*	$ 600	**$ 1.21**	$ 1.33	–
Series 40*	$ 500	**$ 1.13**	$ 0.80	–
Series 42*	$ 400	**$ 1.10**	$ 0.45	–
Series 44*	$ 400	**–**	–	–
Medium-Term Notes				
Series H – First Tranche* (4)	$1,000	**na**	na	na
Series H – Second Tranche* (4)	$1,000	**na**	na	na
Series I – First Tranche* (4)	$1,250	**na**	na	na
Series I – Second Tranche* (4)	$ 850	**na**	na	na
3.803% Subordinated Notes* (4)	US$1,250	**na**	na	na
4.338% Subordinated Notes* (4)	US$ 850	**na**	na	na
Stock options				
Vested	3.8			
Non-vested	2.3			

* Convertible into common shares
(1) Redeemed in May 2017.
(2) Redeemed in August 2018.
(3) In August 2016, approximately 2.2 million Series 25 Preferred Shares were converted into Series 26 Preferred Shares on a one-for-one basis.
(4) Note 15 of the consolidated financial statements on page 181 includes details on the Series H Medium-Term Notes, First Tranche and Second Tranche and Series I Medium-Term Notes, First Tranche and Second Tranche, USD 3.803% Subordinated Notes and USD 4.338% Subordinated Notes.
na – not applicable
Note 16 of the consolidated financial statements on page 182 includes details on share capital.

Dividends

Dividends declared per common share in fiscal 2018 totalled $3.78. Annual dividends declared represented 50.9% of reported net income and 43.8% of adjusted net income available to common shareholders on a last twelve months basis.

Our target dividend payout range (common share dividends as a percentage of net income available to shareholders, less preferred share dividends, based on earnings over the last twelve months) is 40% to 50%, providing shareholders with a competitive dividend yield. BMO's target dividend payout range seeks to provide shareholders with stable income while ensuring sufficient earnings are retained to support anticipated business growth, fund strategic investments and support capital adequacy.

At year end, BMO's common shares provided a 3.9% annualized dividend yield based on the year-end closing share price. On December 4, 2018, BMO announced that the Board of Directors had declared a quarterly dividend on common shares of $1.00 per share, up $0.04 per share or 4% from the prior quarter and up $0.07 per share or 8% from a year ago. The dividend is payable on February 26, 2019, to shareholders of record on February 1, 2019.

Common shareholders may elect to have their cash dividends reinvested in common shares of BMO in accordance with the Shareholder Dividend Reinvestment and Share Purchase Plan (DRIP). In fiscal 2018, common shares to supply the DRIP were purchased on the open market.

Eligible Dividends Designation

For the purposes of the *Income Tax Act (Canada)* and any similar provincial and territorial legislation, BMO designates all dividends paid or deemed to be paid on both its common and preferred shares as "eligible dividends", unless indicated otherwise.

Caution
This Enterprise-Wide Capital Management section contains forward-looking statements. Please see the Caution Regarding Forward-Looking Statements.

Select Financial Instruments

The Financial Stability Board (FSB) issued a report in 2012 encouraging enhanced disclosure related to financial instruments that market participants had come to regard as carrying higher risk. An index of the disclosures recommended by the Enhanced Disclosure Task Force of the FSB and the pages on which these disclosures appear in our Annual Report or Supplementary Financial Information is provided on page 126.

Consumer Loans

In Canada, our Consumer Lending portfolio is comprised of three main asset classes: real estate secured lending (including residential mortgages and home equity products), instalment and other personal loans (including indirect automobile loans) and credit card loans. We do not have any subprime or Alt-A mortgage or home equity loan programs, nor do we purchase subprime or Alt-A loans from third-party lenders.

In the United States, our Consumer Lending portfolio is primarily comprised of three asset classes: residential first mortgages, home equity products and indirect automobile loans. The impact of aggressive market lending practices (e.g., high loan-to-value ratios and limited documentation), which were prevalent leading up to the global recession and drove high losses, continues to moderate. These lending practices were discontinued early in the recession, and our existing portfolio has performed well within our risk appetite.

In both Canada and the United States, consumer lending products are underwritten to prudent standards relative to credit scores, loan-to-value ratios and capacity assessment. Our lending practices consider the ability of our borrowers to repay and the underlying collateral value.

Further discussion of the Consumer Lending portfolio related to the Canadian housing market is provided in the Top and Emerging Risks That May Affect Future Results section on page 79.

Leveraged Finance

Leveraged finance loans are defined by BMO as loans to private equity businesses and mezzanine financings for which our assessment indicates a higher level of credit risk. BMO has some exposure to leveraged finance loans, which represented 1.7% of our total assets, with $13.5 billion outstanding at October 31, 2018 (1.8% and $12.7 billion, respectively, in 2017). Of this amount, $129 million or 1.0% of leveraged finance loans were classified as impaired ($197 million or 1.6% in 2017).

BMO-Sponsored Securitization Vehicles

BMO sponsors various vehicles that fund assets originated by either BMO (which are then securitized through a bank securitization vehicle) or its customers (which are then securitized through three Canadian customer securitization vehicles and one U.S. customer securitization vehicle). We earn fees for providing services related to these customer securitization vehicles, including liquidity, distribution and financial arrangement fees for supporting the ongoing operations of the vehicles. These fees totalled approximately $97 million in 2018 ($104 million in 2017).

Canadian Customer Securitization Vehicles

The customer securitization vehicles we sponsor in Canada provide our customers with access to financing either from BMO or in the asset-backed commercial paper (ABCP) markets. Customers sell their assets either directly into these vehicles, or indirectly by selling an interest in the securitized assets into these vehicles, which then issue ABCP to either investors or BMO in order to fund the purchases. In all cases, the sellers remain responsible for servicing the transferred assets and are first to absorb any losses realized on the assets. None of the sellers are affiliated with BMO.

Our exposure to potential losses arises from our purchase of ABCP issued by the vehicles, any related derivative contracts we have entered into with the vehicles and the liquidity support we provide to the market-funded vehicles. We use our credit adjudication process in deciding whether to enter into these arrangements, just as we do when extending credit in the form of a loan.

Two of these customer securitization vehicles are market-funded, while the third is funded directly by BMO. BMO does not control these entities and therefore they are not consolidated. Further information on the consolidation of customer securitization vehicles is provided in Note 7 on page 165 of the consolidated financial statements. No losses were recorded on any of BMO's exposures to these vehicles in 2018 and 2017.

The market-funded vehicles had a total of $4.1 billion of ABCP outstanding at October 31, 2018 ($3.8 billion in 2017). The ABCP issued by the market-funded vehicles is rated R-1(high) by DBRS and P1 by Moody's. BMO's purchases of ABCP, as distributing agent of ABCP issued by the market-funded vehicles, totalled $12 million at October 31, 2018 ($6 million in 2017).

BMO provided liquidity support facilities for the market-funded vehicles totalling $5.6 billion at October 31, 2018 ($5.0 billion in 2017). This amount comprised part of our commitments outlined in Note 24 on page 201 of the consolidated financial statements. All of these facilities remain undrawn. The assets of each of these market-funded vehicles consist primarily of exposure to diversified pools of Canadian automobile-related receivables and Canadian insured and conventional residential mortgages. These two asset classes represent 82% (90% in 2017) of the aggregate assets of these vehicles.

U.S. Customer Securitization Vehicle

We sponsor one customer securitization vehicle in the United States that we consolidate under IFRS. Further information on consolidation of customer securitization vehicles is provided in Note 7 on page 165 of the consolidated financial statements. This market-funded customer securitization vehicle provides our customers with access to financing in the U.S. ABCP markets. Our customers remain responsible for servicing the assets involved in the related financing and are first to absorb any losses realized on those assets. None of the sellers are affiliated with BMO.

Our exposure to potential losses arises from our purchase of ABCP issued by the vehicle, any related derivative contracts we have entered into with the vehicle and the liquidity support we provide to the vehicle. We use our credit adjudication process in deciding whether to enter into these arrangements, just as we do when extending credit in the form of a loan. No losses were recorded on any of BMO's exposures to the vehicle in 2018 and 2017.

The vehicle had US$2.9 billion of ABCP outstanding at October 31, 2018 (US$3.1 billion in 2017). The ABCP issued by the vehicle is rated A1 by S&P and P1 by Moody's. In order to comply with U.S. risk retention rules that came into effect in 2017, BMO held US$159 million of the vehicle's ABCP at October 31, 2018 (US$185 million in 2017).

BMO provides a committed liquidity support facility to the vehicle, with the undrawn amount totalling US$5.4 billion at October 31, 2018 (US$5.2 billion in 2017). This amount comprised part of our commitments outlined in Note 24 on page 201 of the consolidated financial statements. The assets of this customer securitization vehicle consist primarily of exposure to diversified pools of U.S. automobile-related receivables and U.S. government-guaranteed Federal Family Education Loan Program loans. These two asset classes represent 74% (78% in 2017) of the aggregate assets of the vehicle.

Caution

This Select Financial Instruments section contains forward-looking statements. Please see the Caution Regarding Forward-Looking Statements.

Off-Balance Sheet Arrangements

BMO enters into a number of off-balance sheet arrangements in the normal course of operations.

Credit Instruments

In order to meet the financial needs of our clients, we use a variety of off-balance sheet credit instruments. These include guarantees and standby letters of credit, which represent our obligation to make payments to third parties on behalf of a customer if the customer is unable to make the required payments or meet other contractual requirements. We also write documentary and commercial letters of credit, which represent our agreement to honour drafts presented by a third party upon completion of specified activities. Commitments to extend credit are off-balance sheet arrangements that represent our commitment to customers to grant them credit in the form of loans or other financings for specific amounts and maturities, subject to meeting certain conditions.

There are a large number of credit instruments outstanding at any time. Our customers are broadly diversified, and we do not anticipate events or conditions that would cause a significant number of our customers to fail to perform in accordance with the terms of their contracts with us. We use our credit adjudication process in deciding whether to enter into these arrangements, just as we do when extending credit in the form of a loan. We monitor off-balance sheet credit instruments in order to avoid undue concentrations in any geographic region or industry.

The maximum amount payable by BMO in relation to these credit instruments was approximately $163 billion at October 31, 2018 ($147 billion in 2017). However, this amount is not representative of our likely credit exposure or the liquidity requirements for these instruments, as it does not take into account customer behaviour, which suggests that only a portion of our customers would utilize the facilities related to these instruments, nor does it take into account any amounts that could be recovered under recourse and collateral provisions.

Further information on these instruments can be found in Note 24 on page 201 of the consolidated financial statements.

For the credit commitments outlined in the preceding paragraphs, in the absence of an event that triggers a default, early termination by BMO may result in a breach of contract.

Structured Entities (SEs)

We carry out certain business activities through arrangements involving SEs, using them to raise capital, secure customer transactions or obtain sources of liquidity by securitizing certain of our financial assets. Note 6 on page 164 of our consolidated financial statements describes our loan securitization activities carried out through third-party programs. Under IFRS, we consolidate SEs if we control the entity.

Our interests in SEs are discussed in detail on page 76 in the BMO-Sponsored Securitization Vehicles section and in Note 7 on page 165 of the consolidated financial statements, which discusses our interests in both consolidated and unconsolidated SEs. We consolidate our securitization vehicles, U.S. customer securitization vehicles, and certain capital and funding vehicles. We do not consolidate our Canadian customer securitization vehicles, certain capital vehicles, various BMO managed funds and various other structured entities where we hold investments.

Guarantees

Guarantees include contracts under which we may be required to make payments to a counterparty based on changes in the value of an asset, liability or equity security that the counterparty holds. Contracts under which we may be required to make payments if a third party does not perform according to the terms of a contract and contracts under which we provide indirect guarantees of indebtedness are also considered guarantees. In the normal course of business, we enter into a variety of guarantees, including standby letters of credit, backstop and other liquidity facilities and derivatives contracts or instruments (including, but not limited to, credit default swaps), as well as indemnification agreements.

The maximum amount payable by BMO in relation to these guarantees was approximately $25 billion at October 31, 2018 ($24 billion in 2017). However, this amount is not representative of our likely exposure, as it does not take into account customer behaviour, which suggests that only a portion of the guarantees would require us to make any payments, nor does it take into account any amounts that could be recovered under recourse and collateral provisions.

For a more detailed discussion of these arrangements, please see Note 24 on page 201 of the consolidated financial statements.

Caution

This Off-Balance Sheet Arrangements section contains forward-looking statements. Please see the Caution Regarding Forward-Looking Statements.