2018 Financial Performance Review

This section provides a review of our enterprise financial performance for 2018 that focuses on the Consolidated Statement of Income included in our consolidated financial statements, which begin on page 143. A review of our operating groups' strategies and performance follows the enterprise review. A summary of the enterprise financial performance for 2017 appears on page 65.

Foreign Exchange

The Canadian dollar equivalents of BMO's U.S. results that are denominated in U.S. dollars decreased relative to 2017 due to the weaker U.S. dollar. The table below indicates the relevant average Canadian/U.S. dollar exchange rates and the impact of changes in the rates on our U.S. segment results. References in this document to the impact of the U.S. dollar do not include U.S. dollar-denominated amounts recorded outside of BMO's U.S. segment.

Changes in the exchange rate will affect future results measured in Canadian dollars, and the impact on those results is a function of the periods in which revenues, expenses and provisions for (recoveries of) credit losses arise. If future results are consistent with results in 2018, each one cent increase (decrease) in the Canadian/U.S. dollar exchange rate, expressed in terms of how many Canadian dollars one U.S. dollar buys, would be expected to increase (decrease) the Canadian dollar equivalent of our U.S. segment net income before income taxes for the year by $14 million, in the absence of hedging transactions.

Economically, our U.S. dollar income stream was unhedged to changes in foreign exchange rates during 2018 and 2017. During 2016, a portion of the BMO Capital Markets U.S. dollar net income was economically hedged. We regularly determine whether to execute hedging transactions in order to mitigate the impact of foreign exchange rate movements on net income.

See the Enterprise-Wide Capital Management section on page 69 for a discussion of the impact that changes in foreign exchange rates can have on our capital position.

Changes in foreign exchange rates will also affect accumulated other comprehensive income primarily, as a result of the translation of our investment in foreign operations. Each one cent increase (decrease) in the Canadian/U.S. dollar exchange rate, expressed in terms of how many Canadian dollars one U.S. dollar buys, would be expected to increase (decrease) the translation of the unhedged portion of our investment in foreign operations by $148 million.

Effects of Changes in Exchange Rates on BMO's U.S. Segment Reported and Adjusted Results

(Canadian $ in millions, except as noted)	**2018 vs. 2017**	2017 vs. 2016
Canadian/U.S. dollar exchange rate (average)		
2018	**1.2878**	
2017	**1.3071**	1.3071
2016		1.3251
Effects on U.S. segment reported results		
Decreased net interest income	**(58)**	(51)
Decreased non-interest revenue	**(47)**	(40)
Decreased revenues	**(105)**	(91)
Decreased provision for credit losses	**3**	–
Decreased expenses	**76**	68
Decreased income taxes	**21**	6
Decreased reported net income	**(5)**	(17)
Effects on U.S. segment adjusted results		
Decreased net interest income	**(58)**	(51)
Decreased non-interest revenue	**(47)**	(40)
Decreased revenues	**(105)**	(91)
Decreased provision for credit losses	**4**	2
Decreased expenses	**74**	66
Decreased income taxes	**5**	5
Decreased adjusted net income	**(22)**	(18)

Adjusted results in this section are non-GAAP and are discussed in the Non-GAAP Measures section on page 27.

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

Caution
This Foreign Exchange section contains forward-looking statements. Please see the Caution Regarding Forward-Looking Statements.

Net Income

Reported net income was $5,450 million in 2018, an increase of $100 million or 2% from the prior year. Adjusted net income was $5,979 million, an increase of $471 million or 9%. Adjusted net income excludes a one-time non-cash charge related to the revaluation of our U.S. net deferred tax asset due to U.S. tax reform and a benefit of the remeasurement of an employee benefit liability in the current year, restructuring and acquisition integration costs and the amortization of acquisition-related intangible assets in both years, and a decrease in the collective allowance in the prior year. For more information, see the Non-GAAP Measures section on page 27. The impact of the weaker U.S. dollar on net income was not significant.

Reported and adjusted net income growth largely reflects the benefit of good performance in U.S. P&C, Wealth Management and Canadian P&C. BMO Capital Markets results declined, while Corporate Services net loss was higher on a reported basis, but lower on an adjusted basis.

Canadian P&C reported net income of $2,554 million increased $43 million or 2%, and adjusted net income of $2,556 million, which excludes the amortization of acquisition-related intangible assets, increased $42 million or 2% from the prior year. The prior year benefited from a $168 million after-tax gain on the sale of Moneris Solutions Corporation (Moneris US), which had a negative impact of approximately 7% on net income growth in 2018. Excluding the gain, net income increased as a result of higher balances across most products, higher non-interest revenue, and wider margins, partially offset by higher expenses.

U.S. P&C reported net income of $1,394 million increased $367 million or 36%, and adjusted net income of $1,439 million increased $366 million or 34% from the prior year. Adjusted net income excludes the amortization of acquisition-related intangible assets. On a U.S. dollar basis, reported net income of $1,083 million increased $296 million or 37%, and adjusted net income of $1,118 million increased $295 million or 36% from the prior year, due to higher revenue, the benefit of U.S. tax reform and lower provisions for credit losses, partially offset by higher expenses. The benefit of U.S. tax reform was approximately $91 million in reported net income and $95 million in adjusted net income. The prior year results included a $27 million after-tax loss on a loan sale.

Wealth Management reported net income of $1,072 million increased $105 million or 11% from the prior year. Adjusted net income of $1,113 million, which excludes the amortization of acquisition-related intangible assets, increased $81 million or 8%. Traditional wealth reported net income of $805 million increased $76 million or 11% from the prior year. Adjusted net income in traditional wealth of $846 million increased $52 million or 7%, primarily due to growth from our diversified businesses and higher equity markets on average, partially offset by higher expenses and a legal provision. Net income in insurance of $267 million increased $29 million or 12%, primarily due to less elevated reinsurance claims in the current year and business growth, partially offset by unfavourable market movements in the current year relative to favourable market movements in the prior year.

BMO Capital Markets reported net income of $1,156 million decreased $119 million or 9% from the prior year. Adjusted net income of $1,169 million, which excludes the amortization of acquisition-related intangible assets and acquisition integration costs, decreased $108 million or 8%, primarily due to lower revenue.

Corporate Services reported net loss for the year was $726 million, compared with a reported net loss of $430 million a year ago. The adjusted net loss for the year was $298 million, compared with an adjusted net loss of $388 million a year ago. The adjusted net loss excludes a one-time non-cash charge of $425 million related to the revaluation of our U.S. net deferred tax asset due to U.S. tax reform and a benefit of $203 million as a result of the remeasurement of an employee benefit liability in the current year, restructuring costs and acquisition integration costs in both years with higher costs incurred in 2018, and a $54 million decrease in the collective allowance in the prior year. The adjusted net loss improved primarily due to lower expenses and higher revenue, excluding the taxable equivalent basis (teb) adjustment. The reported net loss increased $296 million from the prior year, due to the impact of the adjusting items and other drivers noted above.

Further discussion is provided in the 2018 Operating Groups Performance Review section on pages 43 to 61.

Adjusted results in this section are non-GAAP and are discussed in the Non-GAAP Measures section on page 27.

Revenue (1)

Revenue of $23,037 million increased $777 million or 3% from $22,260 million in the prior year. On a basis that nets insurance claims, commissions and changes in policy benefit liabilities (CCPB) against insurance revenue (net revenue), revenue increased $963 million or 5% to $21,685 million, driven by good performance in U.S. P&C, Canadian P&C, Wealth Management and higher Corporate Services revenue, partially offset by a decrease in revenue in BMO Capital Markets. The impact of the weaker U.S. dollar on revenue growth was not significant.

BMO analyzes revenue at the consolidated level based on GAAP revenue as reported in the consolidated financial statements, and on an adjusted basis. Consistent with our Canadian peer group, we analyze revenue on a taxable equivalent basis (teb) at the operating group level. The teb adjustments for 2018 totalled $313 million, down from $567 million in 2017.

Canadian P&C revenue increased $269 million or 4% from the prior year. Revenue increased due to higher balances across most products, higher non-interest revenue, including a $39 million gain related to the restructuring of Interac Corporation in the current year, and wider margins. The prior year benefited from a $187 million gain on the sale of Moneris US, which had a negative impact of approximately 3% on revenue growth in 2018.

U.S. P&C revenue increased $366 million or 8% from the prior year on a Canadian dollar basis. On a U.S. dollar basis, revenue of $3,869 million increased $334 million or 9%, mainly due to higher deposit revenue and loan volumes in the current year, and the impact of a loss on a loan sale in the prior year, net of loan spread compression.

Wealth Management revenue, net of CCPB, of $4,942 million increased $266 million or 6% from the prior year. Revenue in traditional wealth of $4,463 million increased $257 million or 6%, due to growth in client assets, including a benefit from higher equity markets on average, and higher deposit and loan revenue, partially offset by the impact of the divestiture of a non-core business in the prior year. Insurance revenue, net of CCPB, of $479 million increased $9 million or 2%, due to less elevated reinsurance claims in the current year and business growth, partially offset by unfavourable market movements in the current year relative to favourable market movements in the prior year.

BMO Capital Markets revenue of $4,355 million decreased $214 million or 5% from the prior year, or 4% excluding the impact of the weaker U.S. dollar, driven by lower revenue in our Trading Products business, primarily in interest rate trading, and lower revenue in Investment and Corporate Banking due to lower underwriting and advisory revenue, partially offset by higher corporate banking-related revenue.

Corporate Services reported and adjusted revenue both increased $276 million from the prior year, largely driven by a lower teb adjustment.

Further discussion is provided in the 2018 Operating Groups Performance Review section on pages 43 to 61.

(1) Insurance revenue can experience variability arising from fluctuations in the fair value of insurance assets, caused by movements in interest rates and equities markets. The investments which support policy benefit liabilities are predominantly fixed income assets recorded at fair value, with changes in fair value recorded in insurance revenue in the Consolidated Statement of Income. These fair value changes are largely offset by changes in the fair value of policy benefit liabilities, the impact of which is reflected in insurance claims, commissions and changes in policy benefit liabilities. The discussion of revenue on a net basis reduces this variability in results, which allows for a better discussion of operating results. For additional discussion of insurance claims, commissions and changes in policy benefit liabilities, see page 39.

Taxable equivalent basis (teb) Revenues of operating groups are presented in our MD&A on a taxable equivalent basis (teb). Revenue and the provision for income taxes are increased on tax-exempt securities to an equivalent before-tax basis to facilitate comparisons of income between taxable and tax-exempt sources. This adjustment is offset in Corporate Services.

Revenue and Adjusted Revenue

(Canadian $ in millions, except as noted) For the year ended October 31	2018	2017	2016	Change from 2017 (%)
Net interest income	**10,313**	10,007	9,872	**3**
Non-interest revenue	**12,724**	12,253	11,215	**4**
Total revenue	**23,037**	22,260	21,087	**3**
Total revenue, net of CCPB	**21,685**	20,722	19,544	**5**
Adjusted net interest income	**10,313**	10,007	9,872	**3**
Adjusted non-interest revenue	**12,724**	12,253	11,299	**4**
Total adjusted revenue	**23,037**	22,260	21,171	**3**
Total adjusted revenue, net of CCPB	**21,685**	20,722	19,628	**5**

Net Interest Income

Net interest income of $10,313 million increased $306 million or 3%, due to increased loan volumes and higher deposit volumes and margins in the P&C businesses, partially offset by lower net interest income in BMO Capital Markets, due to certain trading businesses where the related revenue is recorded in trading income, non-interest revenue.

Net interest income excluding trading of $10,735 million increased $595 million or 6%, due to increased loan and deposit volumes, and wider margins in the P&C businesses.

Average earning assets of $682.9 billion increased $36.1 billion or 6%, due to loan growth, higher securities, increased cash resources and higher securities borrowed or purchased under resale agreements.

BMO's overall net interest margin of 1.51% decreased 4 basis points, primarily due to lower net interest income from trading businesses. Net interest margin on an excluding trading basis of 1.87% was flat, compared with the prior year, as higher margins in the P&C businesses were mostly offset by higher volume of lower spread assets.

Table 3 on page 128 provides further details on net interest income and net interest margin.

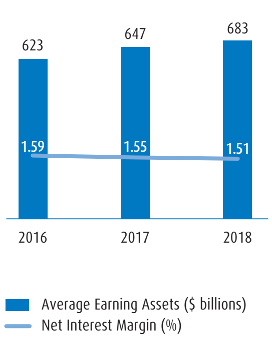
Adjusted results in this section are non-GAAP and are discussed in the Non-GAAP Measures section on page 27.

Net interest income is comprised of earnings on assets, such as loans and securities, including interest and certain dividend income, less interest expense paid on liabilities, such as deposits.

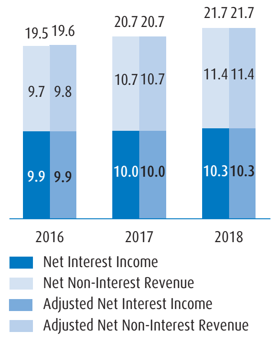
Net interest margin is the ratio of net interest income to average earning assets, expressed as a percentage or in basis points.

Net non-interest revenue is non-interest revenue, net of insurance claims, commissions and changes in policy benefit liabilities (CCPB).

Average Earning Assets and Net Interest Margin

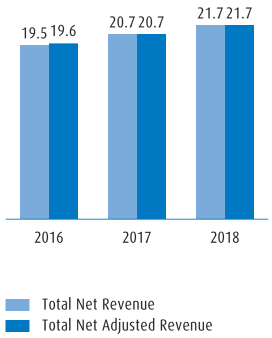


Net Interest Income and Net Non-Interest Revenue*
($ billions)



*Numbers may not add due to rounding.

Net Revenue
($ billions)



MD&A

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

(Canadian $ in millions, except as noted) For the year ended October 31	Net interest income (teb) 2018	2017	Change %	Average earning assets 2018	2017	Change %	Net interest margin (in basis points) 2018	2017	Change
Canadian P&C	**5,541**	5,261	**5**	**212,965**	207,815	**2**	**260**	253	**7**
U.S. P&C	**3,843**	3,551	**8**	**103,394**	96,363	**7**	**372**	368	**4**
Personal and Commercial Banking (P&C)	**9,384**	8,812	**6**	**316,359**	304,178	**4**	**297**	290	**7**
Wealth Management	**826**	722	**14**	**31,167**	28,026	**11**	**265**	257	**8**
BMO Capital Markets	**659**	1,233	**(47)**	**271,839**	263,128	**3**	**24**	47	**(23)**
Corporate Services	**(556)**	(760)	**27**	**63,580**	51,467	**24**	**nm**	nm	**nm**
Total BMO reported	**10,313**	10,007	**3**	**682,945**	646,799	**6**	**151**	155	**(4)**
U.S. P&C (US$ in millions)	**2,983**	2,718	**10**	**80,255**	73,752	**9**	**372**	369	**3**

Certain comparative figures have been reclassified to conform with the current year's presentation.
nm – not meaningful

Non-Interest Revenue

Non-interest revenue, which comprises all revenues other than net interest income, increased $471 million or 4% to $12,724 million in 2018. Reported and adjusted non-interest revenue, net of CCPB, both increased $657 million or 6% to $11,372 million with the majority of the growth driven by BMO Capital Markets. Excluding trading revenue, non-interest revenue, net of CCPB, increased $179 million or 2%.

Trading revenues increased $478 million and are discussed in the Trading-Related Revenues section that follows.

Investment management and custodial fees increased $120 million from the prior year, mainly due to business growth in Wealth Management, partially offset by the impact of a divestiture of a non-core business in the prior year. Mutual fund revenue increased $62 million. Both investment management and custodial fees and mutual fund revenues benefited from higher equity markets on average, compared with the prior year.

Card fees increased $85 million, driven by higher interchange revenue in Canadian P&C.

Lending fees increased $80 million, primarily due to increased lending activity in Canadian P&C and in BMO Capital Markets.

Securities gains, other than trading, increased $68 million, due to higher net securities gains in Corporate Services, Canadian P&C and U.S. P&C, partially offset by lower net securities gains in BMO Capital Markets and Wealth Management.

Securities commissions and fees increased $60 million. These revenues largely consist of brokerage commissions within Wealth Management and institutional equity trading commissions within BMO Capital Markets. The increase was due to growth in fee-based businesses in Wealth Management and higher levels of client activity in both Wealth Management and BMO Capital Markets.

Deposit and payment service charges increased $21 million and other non-interest revenue increased $16 million.

Investments in associates and joint ventures decreased $219 million, primarily due to the $187 million pre-tax gain on sale of Moneris US in 2017.

Gross insurance revenue decreased $191 million from 2017, due to higher increases in long-term interest rates decreasing the fair value of insurance investments in the current year, and stronger equity markets in the prior year, partially offset by higher annuity sales and underlying business growth in the current year. Insurance revenue can experience variability arising from fluctuations in the fair value of insurance assets, caused by movements in interest rates and equity markets. The investments that support policy benefit liabilities are predominantly fixed income and equity assets recorded at fair value, with changes in fair value recorded in insurance revenue in the Consolidated Statement of Income. These fair value changes are largely offset by changes in the fair value of policy benefit liabilities, the impact of which is reflected in insurance claims, commissions and changes in policy benefit liabilities (CCPB), as discussed on page 39.

Underwriting and advisory fees decreased $100 million, primarily due to lower equity underwriting activity.

Foreign exchange, other than trading, decreased $9 million.

Table 3 on page 128 provides further details on revenue and revenue growth.

Adjusted results in this section are non-GAAP and are discussed in the Non-GAAP Measures section on page 27.

Non-Interest Revenue

(Canadian $ in millions) For the year ended October 31	2018	2017	2016	Change from 2017 (%)
Securities commissions and fees	**1,029**	969	924	**6**
Deposit and payment service charges	**1,144**	1,123	1,076	**2**
Trading revenues	**1,830**	1,352	1,192	**35**
Lending fees	**997**	917	859	**9**
Card fees	**564**	479	526	**18**
Investment management and custodial fees	**1,742**	1,622	1,556	**7**
Mutual fund revenues	**1,473**	1,411	1,364	**4**
Underwriting and advisory fees	**936**	1,036	820	**(10)**
Securities gains, other than trading	**239**	171	84	**39**
Foreign exchange, other than trading	**182**	191	162	**(5)**
Insurance revenue	**1,879**	2,070	2,023	**(9)**
Investments in associates and joint ventures	**167**	386	140	**(57)**
Other	**542**	526	489	**3**
Total reported	**12,724**	12,253	11,215	**4**
Reported, net of CCPB	**11,372**	10,715	9,672	**6**
Total adjusted	**12,724**	12,253	11,299	**4**
Adjusted, net of CCPB	**11,372**	10,715	9,756	**6**
Insurance revenue, net of CCPB	**527**	532	480	**(1)**

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

Trading-Related Revenues

Trading-related revenues are dependent on, among other things, the volume of activities undertaken for clients who enter into transactions with BMO to mitigate their risks or to invest and market conditions. BMO earns a spread or profit on the net sum of its client positions by profitably managing, within prescribed limits, the overall risk in its net positions. On a limited basis, BMO also earns revenue from principal trading positions.

Interest and non-interest trading-related revenues on a taxable equivalent basis (teb) decreased $39 million or 2%. Interest rate trading-related revenues decreased $43 million or 9%, primarily due to decreased client activity. Foreign exchange trading-related revenues increased $8 million or 2%, driven by increased client activity. Equities trading-related revenues decreased $18 million or 2%, reflecting lower activity with corporate clients. Commodities trading-related revenues decreased $21 million or 25%, due to decreased client hedging activity in energy products. Other trading-related revenues increased $35 million or 76%, primarily due to fair value gains associated with hedging exposures in our structural balance sheet. These fair value gains were largely offset by lower net interest income.

The Market Risk section on page 95 provides more information on trading-related revenues.

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

Adjusted results in this section are non-GAAP and are discussed in the Non-GAAP Measures section on page 27.

Interest and Non-Interest Trading-Related Revenues (1)

(Canadian $ in millions) (taxable equivalent basis) For the year ended October 31	**2018**	2017	2016	**Change from 2017 (%)**
Interest rates	**437**	480	663	**(9)**
Foreign exchange	**377**	369	349	**2**
Equities	**709**	727	629	**(2)**
Commodities	**63**	84	66	**(25)**
Other (2)	**82**	47	25	**76**
Total (teb)	**1,668**	1,707	1,732	**(2)**
Teb offset	**260**	488	441	**(47)**
Reported total	**1,408**	1,219	1,291	**16**
Reported as:				
Net interest income	**(162)**	355	540	**(+100)**
Non-interest revenue – trading revenues	**1,830**	1,352	1,192	**35**
Total (teb)	**1,668**	1,707	1,732	**(2)**
Teb offset	**260**	488	441	**(47)**
Reported total, net of teb offset	**1,408**	1,219	1,291	**16**
Adjusted net interest income, net of teb offset	**(422)**	(133)	99	**(+100)**
Adjusted non-interest revenue – trading revenues	**1,830**	1,352	1,192	**35**
Adjusted total, net of teb offset	**1,408**	1,219	1,291	**16**

(1) Trading-related revenues are presented on a taxable equivalent basis.
(2) Includes nominal revenues from run-off structured credit activities and hedging exposures in BMO's structural balance sheet.

Adjusted results in this section are non-GAAP and are discussed in the Non-GAAP Measures section on page 27.

Insurance Claims, Commissions and Changes in Policy Benefit Liabilities

Insurance claims, commissions and changes in policy benefit liabilities (CCPB) were $1,352 million in 2018, a decrease of $186 million pre-tax from $1,538 million in 2017, due to the impact of higher increases in long-term interest rates decreasing the fair value of policy benefit liabilities in the current year, stronger equity markets in the prior year and less elevated reinsurance claims in the current year, partially offset by higher annuity sales and underlying business growth in the current year. The decrease related to the fair value of policy benefit liabilities and the increase related to annuity sales were largely offset in revenue, as discussed on page 37.

Provision for Credit Losses

Effective the first quarter of 2018, the bank prospectively adopted IFRS 9. Under IFRS 9, we refer to the provision for credit losses on impaired loans and the provision for credit losses on performing loans. The provision for credit losses on impaired loans under IFRS 9 is consistent with the specific provision under IAS 39 in prior years. The provision for credit losses on performing loans replaces the collective provision under IAS 39. Refer to Note 4 on page 157 of the consolidated financial statements for an explanation of the provision for credit losses. Prior periods have not been restated.

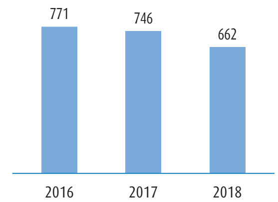
The total provision for credit losses (PCL) was $662 million in the current year, down from $746 million in 2017. Adjusted PCL, which excludes a $76 million pre-tax decrease in the collective allowance in the prior year, decreased $160 million. The PCL on impaired loans of $700 million decreased from $822 million in the prior year, reflecting a net recovery of credit losses in BMO Capital Markets in the current year, compared with net provisions in the prior year, lower provisions in Canadian and U.S. P&C and Wealth Management, and higher recoveries in Corporate Services. There was a $38 million net recovery of credit losses on performing loans in the current year, primarily in the U.S. P&C business.

Total PCL as a percentage of average net loans and acceptances was 0.17% in 2018, down from 0.20% in the prior year. PCL on impaired loans as a percentage of average net loans and acceptances was 0.18%, down from 0.22% in the prior year.

Total PCL in Canadian P&C decreased $14 million to $469 million, due to lower commercial provisions, partially offset by higher consumer provisions. Total U.S. P&C provisions of $220 million decreased $69 million, reflecting lower consumer and commercial PCL on impaired loans, and a $38 million net recovery of credit losses on performing loans. BMO Capital Markets had a net recovery of credit losses of $18 million, compared with net provisions of $44 million in the prior year. Corporate Services total recoveries of credit losses of $15 million decreased $63 million, due to the $76 million collective allowance reduction in the prior year.

On a geographic basis, the majority of our provisions relate to our Canadian loan portfolio, reflecting the larger size of this portfolio compared with our U.S. and international loan portfolios. Total PCL in Canada and other countries (excluding the U.S.) was $424 million, compared with $452 million in 2017. Total PCL in the U.S. was $238 million, down from $294 million in 2017. Note 4 on page 157 of the consolidated financial statements provides provision for credit losses information on a geographic basis. Table 15 on page 138 provides further provision for credit losses segmentation information.

Provision for Credit Losses ($ millions)



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Provision for Credit Losses by Operating Group (1)

(Canadian $ in millions)	Canadian P&C	U.S. P&C	Total P&C	Wealth Management	BMO Capital Markets	Corporate Services (2)	Total Bank
2018							
Provision for (recovery of) credit losses on impaired loans	**466**	**258**	**724**	**6**	**(17)**	**(13)**	**700**
Provision for (recovery of) credit losses on performing loans	**3**	**(38)**	**(35)**	**–**	**(1)**	**(2)**	**(38)**
Total provision for (recovery of) credit losses	**469**	**220**	**689**	**6**	**(18)**	**(15)**	**662**
2017							
Total specific and collective provision for (recovery of) credit losses	483	289	772	8	44	(78)	746
2016							
Total specific and collective provision for (recovery of) credit losses	506	249	755	9	81	(74)	771

(1) Effective the first quarter of 2018, the bank prospectively adopted IFRS 9, *Financial Instruments* (IFRS 9). Under IFRS 9, we refer to the provision for credit losses on impaired loans and the provision for credit losses on performing loans. Prior periods have not been restated. The provision for credit losses in periods prior to 2018 is comprised of specific provisions for operating groups and includes both specific and collective provisions for Corporate Services. Refer to the Changes in Accounting Policies section on page 121 for further details.

(2) In prior years the reduction in the collective provision for credit losses was recorded in Corporate Services.

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

Provision for Credit Losses Performance Ratios

	2018	2017	2016
Total PCL-to-average net loans and acceptances (annualized) (%)	**0.17**	0.20	0.22
PCL on impaired loans-to-average net loans and acceptances (annualized) (%)	**0.18**	0.22	0.22

Non-Interest Expense

Non-interest expense increased $283 million or 2% to $13,613 million in 2018.

Adjusted non-interest expense excludes a benefit from the remeasurement of an employee benefit liability in the current year, restructuring costs, the amortization of acquisition-related intangible assets and acquisition integration costs in both years. The benefit from the remeasurement was $277 million pre-tax in the current year and was recorded in other employee compensation. Restructuring costs were $260 million and $59 million in 2018 and 2017, respectively. The amortization of acquisition-related intangible assets was $116 million and $149 million in 2018 and 2017, respectively. Acquisition integration costs were $34 million and $87 million in 2018 and 2017, respectively.

Adjusted non-interest expense increased $445 million or 3% to $13,480 million, primarily due to increased technology investments and higher employee-related expenses, partially offset by benefits from disciplined expense management. Reported non-interest expense increased $283 million or 2%, due to the same drivers as adjusted non-interest expense growth, partially offset by the net benefit of the adjusting items noted above. The impact of the weaker U.S. dollar on non-interest expense growth was not significant.

The dollar and percentage changes in expense by category are outlined in the Non-Interest Expense and Adjusted Non-Interest Expense tables below. Table 4 on page 129 provides more detail on expenses and expense growth.

Performance-based compensation on a reported basis increased $124 million or 5% and on an adjusted basis increased $127 million or 5%, primarily due to improved performance across most operating groups and growth initiatives. Other employee compensation, which includes salaries, benefits and severance, on a reported basis decreased $132 million or 3%, reflecting the benefit resulting from a remeasurement of an employee benefit liability, partially offset by higher restructuring costs in the current year. Other employee compensation decreased $13 million on an adjusted basis, mainly reflecting lower pension costs.

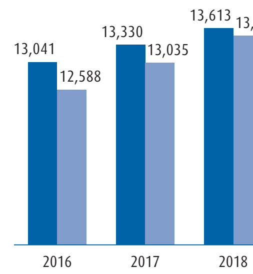
Premises and equipment costs on a reported basis increased $262 million or 11% and on an adjusted basis increased $308 million or 13%, primarily due to an increase in technology investments. Other reported expenses increased $11 million and adjusted other expenses decreased $28 million or 1%.

BMO's reported efficiency ratio improved 80 basis points to 59.1% and the adjusted efficiency ratio improved 10 basis points to 58.5% in 2018. On a net revenue basis(1), the reported efficiency ratio improved 150 basis points to 62.8% and the adjusted efficiency ratio improved 70 basis points to 62.2% in 2018.

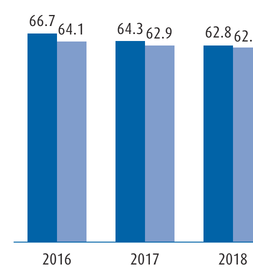
On a net revenue basis (1), reported operating leverage was 2.5% and adjusted operating leverage was 1.2%.

(1) This ratio is calculated excluding insurance claims, commissions and changes in policy benefit liabilities (CCPB).

Non-Interest Expense ($ millions)



Net Efficiency Ratio (%)



The **efficiency ratio** (or **expense-to-revenue ratio**) is a measure of productivity. It is calculated as non-interest expense divided by total revenue (on a taxable equivalent basis in the operating groups), expressed as a percentage. The **adjusted efficiency ratio** is calculated in the same manner, utilizing adjusted revenue and adjusted non-interest expense.

Operating leverage is the difference between revenue and expense growth rates. **Adjusted operating leverage** is the difference between adjusted revenue and adjusted expense growth rates.

Non-Interest Expense

(Canadian $ in millions) For the year ended October 31	2018	2017	2016	Change from 2017 (%)
Performance-based compensation	**2,510**	2,386	2,278	**5**
Other employee compensation	**4,949**	5,081	5,104	**(3)**
Total employee compensation	**7,459**	7,467	7,382	**–**
Premises and equipment	**2,753**	2,491	2,393	**11**
Other	**2,898**	2,887	2,822	**–**
Amortization of intangible assets	**503**	485	444	**4**
Total non-interest expense	**13,613**	13,330	13,041	**2**

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

Adjusted Non-Interest Expense (1)

(Canadian $ in millions) For the year ended October 31	2018	2017	2016	Change from 2017 (%)
Performance-based compensation	**2,508**	2,381	2,248	**5**
Other employee compensation	**4,994**	5,007	4,894	**–**
Total employee compensation	**7,502**	7,388	7,142	**2**
Premises and equipment	**2,738**	2,430	2,357	**13**
Other	**2,853**	2,881	2,805	**(1)**
Amortization of intangible assets	**387**	336	284	**15**
Total adjusted non-interest expense	**13,480**	13,035	12,588	**3**

(1) Adjusted non-interest expense excludes restructuring costs, the amortization of acquisition-related intangible assets, acquisition integration costs, and the benefit on an employee future benefit liability.

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

Adjusted results in this section are non-GAAP and are discussed in the Non-GAAP Measures section on page 27.

Provision for Income Taxes

The provision for income taxes reflected in the Consolidated Statement of Income is based upon transactions recorded in income, regardless of when such transactions are subject to taxation by taxing authorities, with the exception of the repatriation of retained earnings from subsidiaries, as outlined in Note 22 on page 198 of the consolidated financial statements.

Management assesses BMO's consolidated results and associated provision for income taxes on a GAAP basis. We assess the performance of the operating groups and associated income taxes on a taxable equivalent basis and report accordingly.

On December 22, 2017, the U.S. *Tax Cuts and Jobs Act* (the Act) was signed into law in the United States. Consequently, effective January 1, 2018, the U.S. federal corporate tax rate was reduced from 35% to 21%. The tax rate change resulted in a one-time non-cash charge of $425 million to our net income due to the revaluation of our U.S. net deferred tax asset to the lower tax rate. This one-time non-cash charge for the reduction in the U.S. federal tax rate was recorded in income taxes in the current year. For more information on the impact of U.S. tax reform, see the discussion in the Critical Accounting Estimates section on page 117.

The provision for income taxes was $1,960 million in 2018, compared with $1,296 million in 2017. The reported effective tax rate in 2018 was 26.5%, compared with 19.5% in 2017. The higher reported effective tax rate was primarily due to the one-time non-cash charge due to the revaluation of our U.S. net deferred tax asset noted above. The adjusted provision for income taxes(1) was $1,564 million in 2018, compared with $1,357 million in 2017. The adjusted effective tax rate in 2018 was 20.7%, compared with 19.8% in 2017. The higher adjusted effective tax rate was primarily due to lower tax-exempt income from securities and changes in earnings mix, partially offset by the benefit of U.S. tax reform of approximately US$100 million. On a teb basis, the reported effective tax rate was 29.4% in 2018, compared with 25.8% in 2017. On a teb basis, the adjusted effective tax rate was 23.9% in 2018, compared with 25.9% in 2017.

BMO partially hedges, for accounting purposes, the foreign exchange risk arising from its foreign operations by funding the investments in the corresponding foreign currency. A gain or loss on hedging and an unrealized gain or loss on translation of foreign operations is charged or credited to shareholders' equity. For income tax purposes, a gain or loss on the hedging activities results in an income tax charge or credit in the current period that is charged or credited to shareholders' equity, while the associated unrealized gain or loss on the foreign operations does not incur income taxes until the investments are liquidated. The income tax charge/benefit arising from a hedging gain/loss is a function of the fluctuations in exchange rates from period to period. Hedging of foreign operations has given rise to an income tax recovery in shareholders' equity of $56 million for the current year, compared with an income tax expense of $8 million in 2017. Refer to the Consolidated Statement of Changes in Equity on page 146 of the consolidated financial statements for further details.

Legislative changes and changes in tax policy, including their interpretation by taxing authorities and the courts, may impact our earnings. See the discussion in the Critical Accounting Estimates section on page 117 for additional related details. For instance, the 2018 Canadian federal budget introduced a rule that impacts the tax deductibility of Canadian dividends in certain circumstances, which was effective February 27, 2018. The impact of this rule is to increase our effective tax rate.

Table 4 on page 129 details the $2,714 million of total government levies and taxes incurred by BMO in 2018. $1,539 million of this amount is incurred in Canada, with $990 million included in our provision for income taxes and the remaining $549 million included in total government levies other than income taxes. The increase from $2,025 million in 2017 was primarily due to a higher provision for income taxes.

(1) The adjusted rate is computed using adjusted net income rather than reported net income in the determination of income subject to tax.

Adjusted results in this section are non-GAAP and are discussed in the Non-GAAP Measures section on page 27.