RISK MANAGEMENT OVERVIEW
INVESTOR COMMUNITY BREAKFAST

BMO Financial Group

January 26 • 06
8:30 am EST

RISK MANAGEMENT OVERVIEW
INVESTOR COMMUNITY BREAKFAST

SUSAN A. PAYNE
Senior Vice President
Investor Relations
January 26 • 06

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# FORWARD-LOOKING STATEMENTS

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

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# RISK MANAGEMENT OVERVIEW
# INVESTOR COMMUNITY BREAKFAST

KAREN MAIDMENT
Senior Executive Vice President and
Chief Financial Officer

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# AGENDA

| | |
|---|---|
| **Opening Comments** | **Karen Maidment**<br>Senior Executive Vice President & Chief Financial Officer |
| **BMO Risk Management** | **Bob McGlashan**<br>Executive Vice President & Chief Risk Officer |
| **Market Risk** | **Penny Somerville**<br>Executive Vice President & Senior Market Risk Officer |
| **U.S. Perspective** | **Mike Frow**<br>Senior Vice President, Enterprise Policy |
| | |
| | **Available for Q&A:** |
| | **Neil Macmillan**<br>Executive Vice President & Senior Risk Officer, IBG |
| | **Wendy Millar**<br>Executive Vice President & Senior Risk Officer, PCCG/PCG |



RISK MANAGEMENT OVERVIEW
INVESTOR COMMUNITY BREAKFAST

BOB McGLASHAN
Executive Vice President and
Chief Risk Officer
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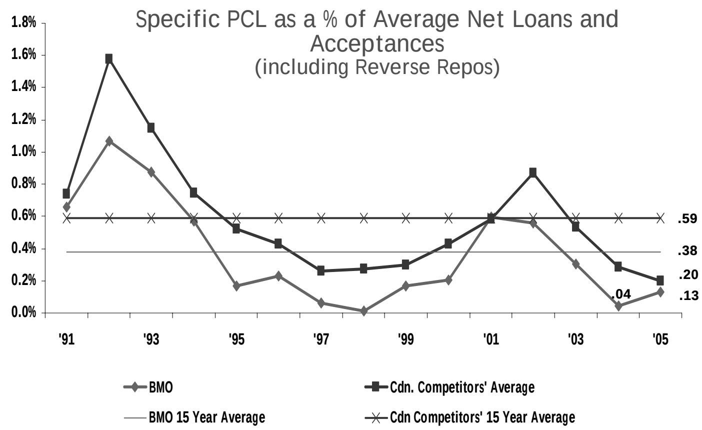
## BMO RISK MANAGEMENT – OVERVIEW

- Excellent credit performance
- Industry loan loss volatility should be more moderate
- BMO's unique approach to credit risk management
- We are not unduly exposed to sectors of concern

# SUPERIOR ASSET QUALITY

BMO's average credit loss was 36% below the average of its Canadian peer group over the past 15 years








# INDUSTRY LOAN LOSS VOLATILITY SHOULD BE MORE MODERATE

- Credit Derivative Swaps (CDS) market and Hedge Funds
- Liquid secondary market
- Sensitivity to reputation / Enron
- Enhanced technology and tools
  - KMV Moody's Risk Calc
  - Automated Lending Decision (ALD) engines
- Risk adjusted capital
- Basel driving:
  - granularity of risk rating
  - consistency across the industry
  - advances in operational risk science
  - broad based industry limits
- Fiscal policy – inflation
- Portfolio mix and hold limits

## WHAT DIFFERENTIATES BMO EXPERIENCE VS. TECHNICAL TOOLS

- Independence of credit
  - a second look
  - dual signature
- Independence of monitoring
- Decentralized and large discretionary limits
- Quality and experience – qualification / risk curriculum
- Active but prudent participation in CDS and hedge funds (originate to hold / sell)
- Balance of technical science and experience / process
- Early identification of deteriorating accounts
- Know your customer

CONSISTENCY THROUGH THE CYCLE



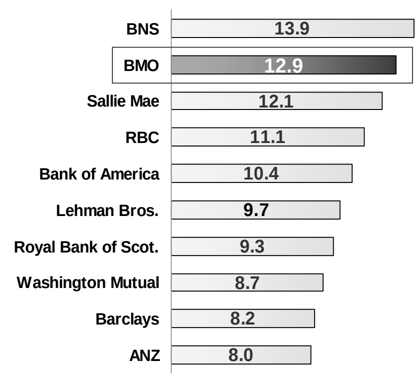


## BMO IS A HIGH-RETURN, LOW-RISK BANK

- Solid risk adjusted Total Shareholder Return (TSR)
- Would BMO make more money if we took more risk?
- Risk of changing risk appetite
- Point in the cycle vs. through the cycle (short vs. long term approach)

### BMO RANKS #2 WORLDWIDE IN *RR*TSR*

*RR*TSR* (%) 2000 – 2004




*** Risk-adjusted Relative Total Shareholder Return (RR*TSR) adjusts for risk and the impact of national markets**

Source: Boston Consulting Group Analysis “Creating Value in Banking 2005”

## GETTING MEASUREMENT RIGHT IS CRITICAL

- Drives desired behaviour
- Revenue
- Balances
- ROE
- Profit

Transaction vs. portfolio

- Provision for credit losses (GILs) – general allowance (performing portfolio)



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## WE ARE NOT UNDULY EXPOSED TO SECTORS OF CONCERN

- Credit cycle is turning – nature of market
- FX sensitivity
- Much higher energy cost baseline
- Hedge funds → retail investors
- Domestic automotive and suppliers
- Real Estate

# RISK MANAGEMENT OVERVIEW
# INVESTOR COMMUNITY BREAKFAST

PENNY SOMERVILLE
Executive Vice President and
Senior Market Risk Officer
January 26 • 06

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## MARKET RISK IN THE TRADING & UNDERWRITING PORTFOLIOS

- Key factors in market risk assessment
  - Value at Risk (VaR)
  - Stress testing analysis
  - Variability in daily P&L returns





## RISK DISCLOSURE BY CANADIAN BANKS

- VaR is the key risk variable disclosed by Canadian Banks
- A breakdown of VaR exposures by risk category can identify any risk concentrations within the overall portfolio
- Direct comparison of risks between banks is not always possible, as published information may not be presented consistently between banks

| FY Average VaR | BMO | | TD | | RBC | | BNS | | CIBC | |
|---|---|---|---|---|---|---|---|---|---|---|
| (CAD MM) | FY 05 | FY 04 | FY 05 | FY 04 | FY 05 | FY 04 | FY 05 | FY 04 | FY 05 | FY 04 |
| Equities | 4.9 | 4.4 | 5.4 | 5.3 | 6.0 | 8.0 | 3.9 | 4.3 | 6.0 | 5.2 |
| Commodities | 4.2 | 1.3 | 0.8 | 0.8 | 1.0 | - | 1.0 | 0.8 | 1.3 | 1.5 |
| Foreign Exchange | 0.6 | 1.4 | 2.8 | 2.6 | 2.0 | 2.0 | 2.0 | 1.4 | 0.3 | 0.7 |
| Interest Rate: MTM | 4.4 | 5.2 | 8.0 | 9.1 | 10.0 | 9.0 | 6.0 | 7.9 | 4.3 | 4.4 |
| Interest Rate: Accrual | 8.5 | 7.5 | | | | | | | | |
| Credit Spread | 3.9 | 4.5 | - | - | - | - | - | - | 2.7 | 2.7 |
| Debt Specific | - | - | - | - | 2.0 | 1.0 | - | - | - | - |
| Correlation | -6.6 | -5.4 | -7.3 | -6.9 | -9.0 | -7.0 | -5.3 | -5.6 | -6.7 | -7.2 |
| Total | 19.9 | 18.9 | 9.7 | 10.9 | 12.0 | 13.0 | 7.6 | 8.8 | 7.9 | 7.3 |

The table above is prepared based on available published information.

## VALUE AT RISK (VaR)

- Usually measured at a 99% confidence interval and assumes that changes in rates and prices are correlated

- Methodologies have been endorsed by bank regulators for calculating the market risk against which prescribed amounts of regulatory capital are to be maintained

> *Example: A VaR measure of $100 calculated for a 1-day time horizon at a 99% confidence level would signify that for 99 days out of 100 the 1-day loss would be expected not to exceed $100. Note that, by implication, the expectation is that for one day out of 100 the 1-day loss would exceed $100, possibly significantly.*

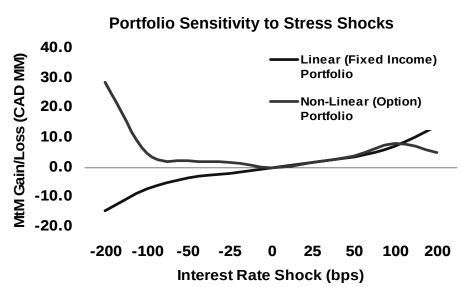
- **VaR is a means to measure the overall risk across the Trading and Underwriting portfolios on a consistent basis. It provides a high confidence estimate of the potential loss the Bank could incur in these portfolios.**



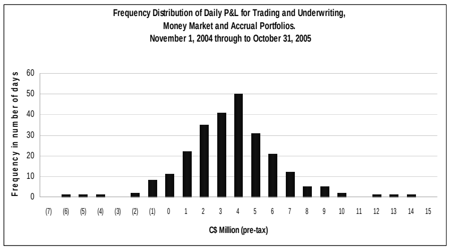
## STRESS TESTING ANALYSIS

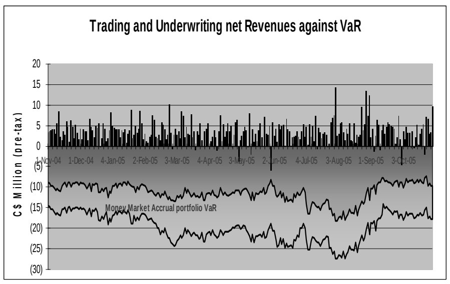
- Stress tests are intended to identify exposures that may exist under much larger market and credit shocks than those embodied in the VaR measures
- Unlike VaR, Stress is not reported at a consistent confidence interval by Canadian banks. The choice of stress methodology and scenario selection may also differ across banks.
- On-going review and development of stress test methodologies by many of the banks may result in greater consistency of reporting in the future

- Portfolios with option-type exposures may exhibit risk characteristics more readily seen under stress rather than VaR measures



## THE VaR MEASURE HAS IMPLICATIONS FOR DAILY TRADING P&L




- A larger VaR would normally be associated with a broader distribution of daily trading gains and losses
- Conversely, a small VaR implies little variation in expected daily P&L

- A 99% confidence VaR number would imply 2-3 daily trading losses every year in excess of the VaR level
- In practice this frequency is less as a result of non-risk income and trader intervention, a characteristic shared with other Canadian banks





## SUMMARY

- VaR comparisons across Banks are difficult given the non-uniform disclosure of detailed information and the variability in methodologies
- While VaR is a useful tool in assessing risk, a broader set of risk measures and controls is essential for sound risk management across Trading and Underwriting portfolios
- Governance and sound risk management is in place to accommodate growth in risk

# RISK MANAGEMENT OVERVIEW
# INVESTOR COMMUNITY BREAKFAST

MIKE FROW
Senior Vice President
Enterprise Policy
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## STRONG BANKING ENVIRONMENT IN THE U.S.

- Solid asset quality
  - Federal Reserve 7th District (including Chicagoland) key asset quality indicators are at or near seven year lows. Relative to one year ago, nonperforming loans, past dues, and net charge-offs have improved between 10-15 basis points.
  - Positive NPL trend is noted in all major loan categories
  - The banking environment is highly competitive being driven by new entrants to Chicago, de novo expansion and increased competition from non-bank lenders
- Areas of regulatory focus
  - Non-traditional mortgage lending
  - Commercial Real Estate
  - Generally raised regulatory expectations (e.g. operational risks)

Source: Federal Reserve Board.



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## INTEGRATION YIELDS RESULTS

- Strong risk governance framework
  - U.S. Risk functions now fully integrated within Enterprise Risk from an organizational, policy and process perspective
  - Integrated across risk types
- Credit quality is strong
  - Sustained reducing trend as consumer assets represent an increasing proportion of the portfolio
  - Consumer assets are very low risk – do not offer higher risk products such as Option Adjustable Rate Mortgages
  - Unsecured consumer loans represent less than 0.5% of consumer loans
- Increasing focus on operational risk
  - Business Continuity
  - Anti–Money Laundering
  - Outsourcing
  - Reputation Risk

# BROADLY DIVERSIFIED PORTFOLIO

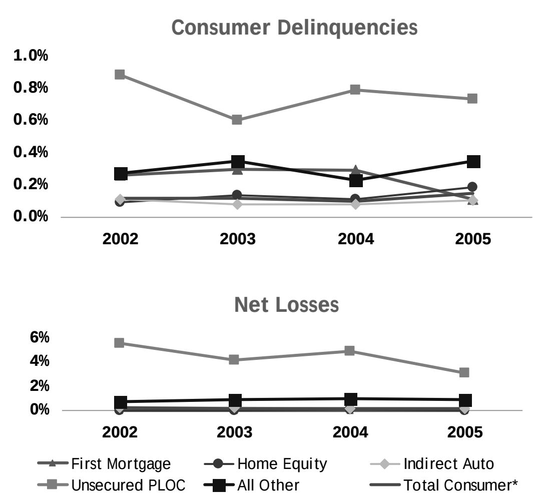
- Portfolio remains well diversified with strong growth in lower risk consumer assets
- Acquisition activity and a strengthening economy have driven commercial loan growth over the past twelve months
- Commercial Loan Portfolio is broadly diversified with no material risk concentrations





# LOW OVERALL CONSUMER NET LOSSES

- Overall 91+ day consumer delinquency is low and has remained relatively stable over the past 3 years, reflecting strong borrower risk profile and strong economic conditions
- Overall consumer net losses are low and have remained relatively stable over the past 6 years

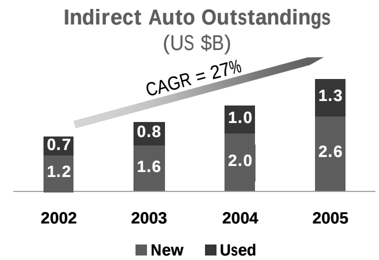


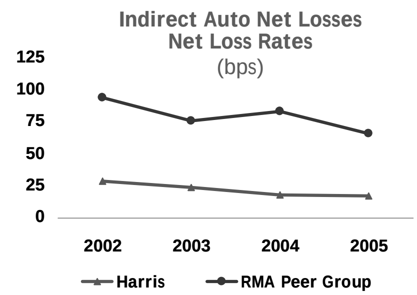

*Excludes First Mortgage Portfolio

# INDIRECT AUTO LENDING

## Continued profitable growth and expansion

- The indirect auto portfolio remains a strong performer, with low losses that continue to compare favorably to peers
- Loan losses have been 75% below the industry average
- High quality A paper; no dealer floor plans, no leasing








# CONSISTENT APPROACH TO ACQUISITION INTEGRATION

- Due diligence processes include a review of the acquired bank portfolio, credit practices and overall risk culture
- Thorough review of loan assets and adoption of BMO Financial Group loan evaluation and valuation standards. Senior credit oversight from day one.
- The transition to the Commercial Lending Process (CLP) commences at the legal closing of the deal including Lending Transaction Summary (LTS) preparation
- On-going monitoring occurs to ensure timely and complete transition to BMO/Harris Polices and Standards
- Operational risk controlled by employing Project Management discipline and careful coordination of opportunities, activities and resolution

### Recent Acquisitions

| | |
|---|---|
| 2005 | Edville Bankcorp, Inc. (Villa Park Bank) |
| 2004 | Mercantile National Bank |
| | New Lenox State Bank |
| | Lakeland Community Bank |
| 2001 | First National Bank of Joliet |




## SUMMARY

- Benign credit conditions, corporate and personal but not sustainable
- Economy remains relatively strong but …
  - Higher energy prices
  - Slowing real estate appreciation
  - Re-pricing of “affordability products”
  - Higher interest rates
- Rising regulatory expectations/costs



# Q & A

BMO Financial Group

## INVESTOR RELATIONS • CONTACT INFORMATION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