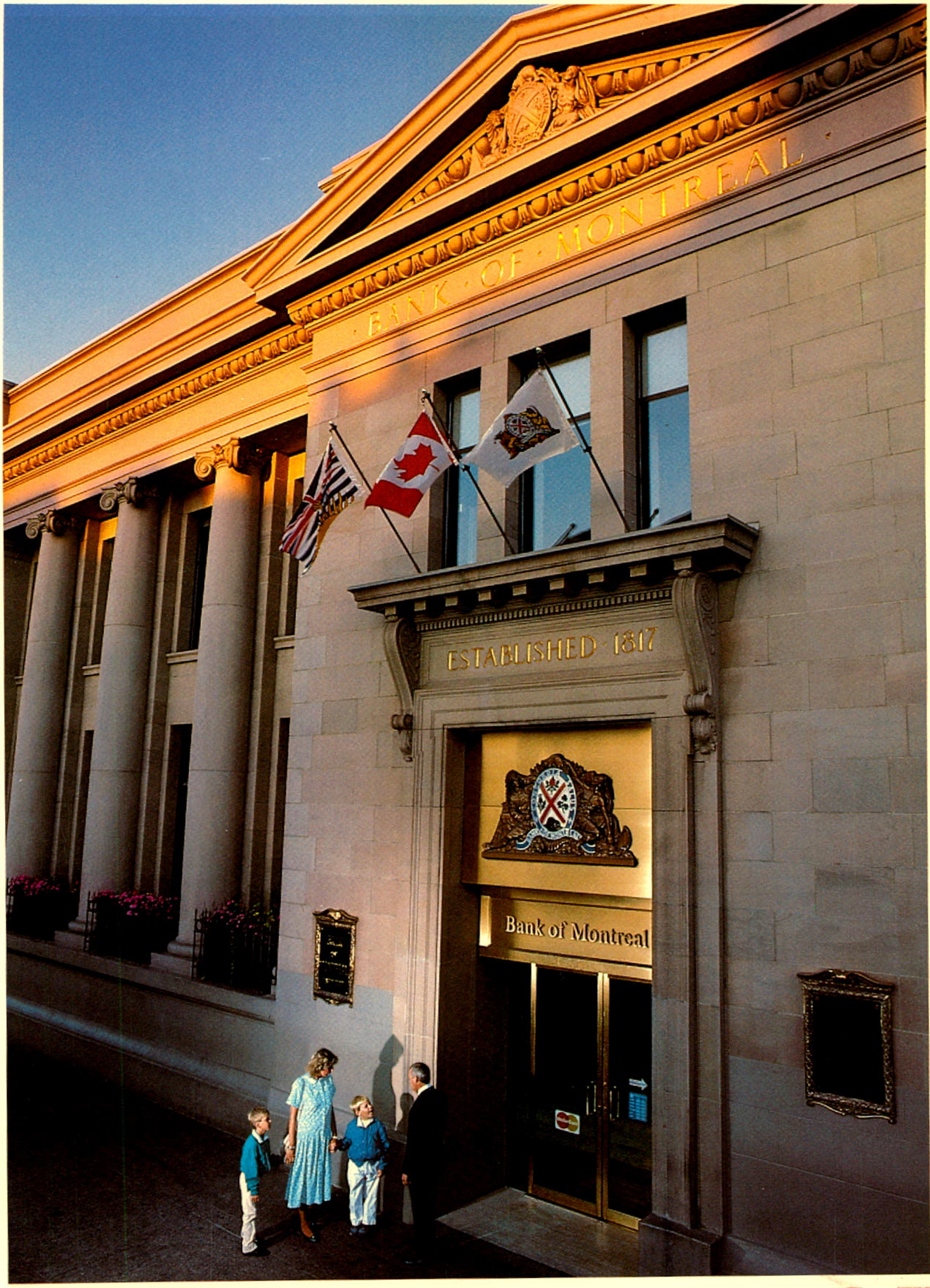
BANK OF MONTREAL

170TH ANNUAL REPORT



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Cover

Bank of Montreal's history of service to the people of British Columbia goes back 100 years. Victoria Main branch, built in 1907, was originally an office of the Merchant's Bank, which merged with Bank of Montreal in 1922. Its architect, Francis M. Rattenbury, also designed the British Columbia Legislative Building. The branch was altered several times over the years, the last time in 1958. It was renovated in 1986 to accommodate modern banking needs while preserving its distinctive architectural features.

The Year's Highlights

For the Year Ended October 31
($ in millions except per common share amounts)

	1986	1987	Increase (Decrease) %
Earnings Information			
Net income (loss) – before special provision	$ 353	$ 413	17
– after special provision		(352)	N/A
Dividends			
Common shares	158	184	16
Preferred shares	57	45	(21)
Balance Sheet Information			
Total assets	$ 87,180	$ 84,228	(3)
Liquid assets	24,422	24,591	1
Loans (net of reservations for losses)	54,471	52,558	(4)
Reservations for losses on loans	1,586	2,646	67
Deposits	74,876	72,084	(4)
Capital and contingency reserves	3,645	3,463	(5)
Common Share Information			
Number of common shares	81,264,666	102,090,754	26
Number of common shareholders	91,225	90,506	(1)
Net income (loss) per common share			
Basic – before special provision	$ 3.70	$ 4.09	11
– after special provision		(4.42)	N/A
Fully diluted – before special provision	3.59	4.01	12
– after special provision		(4.42)	N/A
Dividends declared per common share	1.96	2.00	2
Book value per common share	36.85	29.51	(20)
Contribution to shareholders' equity from Shareholder Dividend Reinvestment and Equity Purchase Plans	122	82	(33)
Other Information			
Number of bank branches	1,220	1,220	–
Number of employees	32,988	34,482	5

Our industry is going through an historic process of change.

The two great areas of change – technology and regulation – are without question generating challenges. They are also generating opportunities at a very rapid rate.

While it may not yet be clear as to where it will all lead, there is no doubt about either the significance or the rapidity of change.

Technology alone has already brought about a virtual revolution in the daily conduct of our business. The same may be said of "deregulation", which actually involves a more complex process that embraces both deregulation and reregulation – both more and less regulation.

Restrictions upon access to financial markets have traditionally been imposed in two dimensions: geographic and functional. Geographic barriers protect institutions in a particular jurisdiction – county, province, state or country – from outside competition; functional barriers restrict certain institutions (such as banks) from competing with others (such as trust companies). Every country has had its own unique blend of competitive restrictions. In some cases they appear to have reflected special pleading more than genuine prudential considerations or the requirements of the market.

These legislative barriers have resulted in costly duplication of financial infrastructure. Their removal, in an increasingly competitive environment, is likely at first to exacerbate the world-wide overcapacity in financial services.

As the barriers come down, economies of scale will permit some institutions to expand their services without a commensurate increase in their own overheads. Others will adopt a niche strategy, attempting to high-grade the market and thereby accentuating competitive pressures in some of the more attractive market sectors. Still others will opt for higher return strategies – with, of course, the higher risks that go with it. However, the overall market is unlikely to expand sufficiently either to float the less efficient firms on-side or to accommodate the ambitions of all market participants. Some institutions will be unable to meet the competitive pressures, and will inevitably disappear. How rapidly this rationalization occurs, and how well it is managed, will in large part determine whether this process of change occurs in a gradual, orderly manner – or otherwise.

A second challenge facing the financial industry stems from the enormous fiscal and trade imbalances afflicting the world's important economies. Although these imbalances have been with us for many years, their impact has been aggravated by their cumulative nature. Every year's deficit adds to the burden and, accordingly, to the difficulty of restoring equilibrium. The view, once widely held, that these imbalances could be adequately addressed through the workings of the international financial system, in the absence of basic policy changes, is increasingly difficult to sustain.

Third World debt poses such a problem. The problem had its roots in many cases in the massive international imbalances of several years ago, aggravated by world-wide inflation, high interest rates, recession and the massive reversal of the terms of trade which affected most of the Third World countries.

Now, if borrowing is incurred to service outstanding debt, a country's foreign currency interest obligations are compounded; debtor countries then have to expand their exports and cut their imports even more vigorously if they are to service their growing foreign debt. It is hard to see how this can be managed successfully except in an environment which sustains real economic growth.

While Third World debt is perceived to be a financial problem – which it certainly is – it constitutes a long-term problem of even more far-reaching dimensions for the rest of the world. Not only has a large part of the world's population already become, practically speaking, out of reach as a customer for the products of Canada and other industrial economies, but the dynamics of this situation also put increasing pressure upon these countries to join the competitive scramble for markets in the industrialized countries. The fact that they are motivated increasingly by their need for foreign exchange rather than by considerations of efficiency and profitability simply worsens the situation. Whatever the outcome of the political battles over protectionism, this development is not good news for world trade nor for those whose living depends upon it.

The longer the delay in addressing these cumulative problems, the more serious they are likely to become and the more painful the eventual adjustment. Taken together, they add up to a serious source of instability. While these issues are often perceived to be economic, their persistence reflects an almost total absence of political will to deal effectively with the problems. The world's financial markets will, therefore, continue to reflect their participants' unease with political drift and their concern with the consequences.

A related challenge facing our industry is the increasing tendency of the financial markets to become decoupled from the world of real economic activity. In the last few years, technological advances in data processing and transmission have facilitated international money flows to the point where they dwarf the real economy. This trend has been magnified by excessive liquidity and by enormous fiscal and trade imbalances. Global trade in goods and services, running at more than $3 trillion annually, is only about one-tenth the volume of foreign exchange trading and one twenty-fifth that of Eurodollar trading. It is clear that the flow of goods and services is no longer the major determinant of international capital flows and exchange rates.

As a result, more and more financial transactions have no source in production, trade or in the creation of value or employment. They are simply financial transactions.

It is possible that the public will come to take an increasingly negative view of this paper capitalism, particularly if it fails the test of contributing to broadly-based real economic growth.

Well-publicized insider dealing scandals, fraud and examples of political or financial favouritism further undermine public confidence in established public and private institutions.

Our liberal, democratic capitalistic system is by far the most productive system that the world has ever seen. In creating wealth, and in the benefits it has conferred on the population in general, there has been no other economic system or political structure that has come anywhere near it. By one means or another, the benefits have been broadly spread. Public support for that system depends on it continuing to be perceived as being in the best interests of all the people, not a few.

If the public comes to believe that the system is not working well or that they cannot trust those charged with managing its great public and private institutions, then this marvelous system will be imperiled. I cannot imagine anything nearly as good replacing it. It is important therefore that it be, and be seen by the public to be, responsive to the needs of society in general, and that those who manage it continue to be trusted to act intelligently and fairly, with restraint, and with the common good in mind.

Underlying the service provided by this Bank and by the other institutions in our society are the basic values of integrity, fairness and prudence which are as important today as they ever were – perhaps more so. It is significant that the economic growth experienced by the free market economies over the last half-century was accompanied by a large measure of self-discipline exercised by our society's political and economic leaders. Their respect for public values and their restraint contributed importantly to public acceptance of their authority to make key economic decisions.

When so much else in the world is changing, it is even more important to have a very firm grasp on these fundamentals. If we want to preserve the system that has worked for so long to the benefit of so many, and if we want to conquer the problems and grasp the opportunities that lie ahead, we need our moral anchors more than ever.

The next decade will be one in which we hold our fate in our own hands. While the problems are clearly serious, the opportunities have never been greater.

Obviously, the current environment calls for a measure of caution and prudence and we have, as you know, taken a number of steps to protect the Bank against external developments of a negative nature and will continue to do so.

We cannot, however, prosper by hiding in the storm cellar, so we have also taken steps to position the Bank to take advantage of the new opportunities opening up to us. These prospects are exciting and one would have to be unfeeling indeed not to experience a sense of anticipation. The fact that a new generation of leadership is emerging in the Bank is timely, and I am confident that – in collaboration with our partners in Harris Bankcorp, Nesbitt, Thomson and Banco de Montreal Investimento – they will write a bright new chapter in the history of this Bank.

Directors and Executive Changes

Grant L. Reuber, O.C. was elected Deputy Chairman effective November 1, 1987, succeeding William E. Bradford, who has become President and Chief Executive Officer of North American Life Assurance Company. Mr. Bradford, who joined the Bank in 1975 and the Board of Directors in 1981, served in a number of posts including that of President. His service was marked by dedication and distinction, for which we would like to record our appreciation. He carries with him the warm good wishes of his friends and former colleagues as he undertakes his new responsibilities.

Matthew W. Barrett was appointed to the Board of Directors on November 1, 1987, concurrent with his election as President and Chief Operating Officer. Mr. Barrett, 43, joined the Bank twenty-five years ago and has had extensive experience in various operating and staff areas, most recently as Executive Vice-President and Group Executive, Personal Banking.

Other senior executive appointments include those of Alan G. McNally, 42, who succeeds Mr. Barrett as Executive Vice-President and Group Executive, Personal Banking. Mr. McNally, who joined the Bank in 1975, has served in a number of executive positions on the corporate staff and in both domestic and international banking; his most recent post was Deputy Group Executive, Commercial Banking Group. F. Anthony Comper, 42, a twenty-year veteran, has been appointed Executive Vice-President, Operations. He will be responsible for both the domestic and international operations departments and for the Electronic Data Processing Group.

During the year, Mr. Edmund B. Fitzgerald, a director since January 14, 1985, resigned in compliance with Section 35(2) of the Bank Act, which limits the number of bank directors who may also serve as directors of another company.

William D. Mulholland
Chairman of the Board

In 1987 the Bank focused specifically on improving its asset mix, reducing loan losses and lowering its cost of funds. These efforts have led to substantially better performance in most of its operations.

The Year's Results

Net income before the special provision for losses on loans to the 34 countries designated by the Superintendent of Financial Institutions was $413 million, compared with $353 million last year. On a loan loss experience basis, earnings were $550 million compared with $311 million on a similar basis for the previous year. Although comparisons are made more difficult by the accounting treatment required for the special provision, the year's results reflect major improvements in the rest of the loan portfolio. Loan loss experience excluding the special provision was $75 million, reflecting both improved loss experience and reversals of provisions made in previous years and no longer deemed necessary. The Bank has continued to sharpen credit policies and loan monitoring procedures. Combined with other, ongoing efforts to strengthen the loan portfolio and operations, this measure has in my view established a solid foundation for future profits.

Other operating income was up by almost $100 million, or 12%, and reflects continuing efforts to supplement traditional interest income through new transactional services.

Consolidated assets at year-end stood at $84.2 billion, 3.4% lower than in 1986. This is largely a result of actions taken to reduce the proportion of lower yielding assets. The improved asset mix provided a net interest spread of 2.62% and net interest income of $2,080 million, virtually the same levels as 1986 despite non-payment of interest by Brazil and Ecuador for most of the year. Shortly after the end of the Bank's fiscal year, Brazil and its leading creditor banks announced an agreement regarding the resumption of interest payments.

Liquid assets stood at 29% of total assets at year-end. The Bank maintains a strong liquidity position as a matter of policy. Despite the special provision, the Bank was also able to maintain its ratio of equity capital and contingency reserves to total assets virtually unchanged from last year.

Harris Bank's net income was $40 million after a special provision of $49 million net of income taxes for sovereign loans.

The Year's Activities

Bank of Montreal's business strategy is to maximize the value of banking relationships with both individual and business clients. With the acquisition this year of a 75% interest in Nesbitt, Thomson Inc., one of Canada's most respected investment firms, the Bank moves closer to offering customers a comprehensive group of financial services.

Attractive savings and investment vehicles are critical in maintaining a deposit base. The Investment Savings™ Account, with its tiered rate of interest and full access to funds, proved very successful in attracting new deposits by combining safety, flexibility and a competitive rate of return. The Bank's aggressive pursuit of residential mortgage business, combined with record-level volumes of home purchases in key market areas, led to significant revenue gains. Personal loans also increased as the Bank devoted additional resources to this important market.

Other activities include major financings in the petroleum sector and the Eurobond market. These transactions, along with a substantial increase in the level of cash management and other services provided to non-bank financial institutions, represent important sources of fee income for the Bank. Foreign exchange trading activities and MasterCard® transactions also accounted for increased fee income.

Productivity

Parent Bank non-interest expenses rose by 6% this year. The rise was attributable in part to salary increases and to increases in premises, equipment and computer costs. Harris non-interest expenses also rose by 6%.

The Bank's continuing investment in advanced data processing and communications technology has helped to control non-interest expenses and enhance customer service. One notable example is an automated consumer credit support system, which is now assisting personal loans officers. The Account Management Support System, piloted this year in Commercial Banking, will expedite document processing and credit approvals. Finally, the Customer Profitability Model, which provides on-line profit analyses of individual companies and of industry sectors, was fully installed by the Corporate and Government Banking Group.

The Bank's systems for controlling credit risk have resulted in significantly lower loan losses as a percentage of assets. Delinquency rates reached a six-year low in Personal Banking. Other aspects of the Bank's approach to risk management are discussed elsewhere in this Annual Report.

Training is a high priority, as it must be if the Bank is to remain fully competitive in a demanding marketplace. Over the past few years, the emphasis upon improving the credit skills of account managers has contributed to lower loan losses. This is of course continuing, while

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increased attention is also being directed to marketing. A wide variety of courses is available to employees at all levels to keep their job-related skills current.

The Year Ahead

A stable, low-cost deposit base, high quality loan portfolio, productive asset mix, strong growth in non-interest revenue and continued emphasis on expense control are fundamental to the Bank's financial health and earnings performance. Operating results this year indicate solid gains. These gains should continue to be realized next year and well into the future.

The Bank has strong partners in Harris and Nesbitt. Plans are well advanced for a trust subsidiary in anticipation of enabling legislation. As an interim step, newly-incorporated Bank of Montreal Investment Management Limited will provide specialized portfolio management services which will ultimately be offered by the trust company. The Bank will continue to seek opportunities to expand the range and quality of services, to improve productivity and to maximize the benefits of advanced operations capabilities in North America and abroad.

G. L. Reuber

Corporate Profile

Continuing regulatory changes in Canada blurred still further the traditional lines of demarcation among banks, insurance companies, trust companies and investment dealers. Barriers to the entry of foreign institutions into investment dealing were lowered. Customers demanded both a range and depth of services to meet their complex financial requirements.

Bank of Montreal's business strategy is to focus upon the services and the supporting technology which meet customer needs in clearly targeted markets.

In Canada, the Bank serves some four million individual customers with deposit, personal loan, mortgage and credit card services. Retail customers conduct daily banking transactions at 1,175 branches and at 689 Bank of Montreal Instabank® machines. They can also withdraw funds from a shared network of over 22,500 automated banking machines throughout North America.

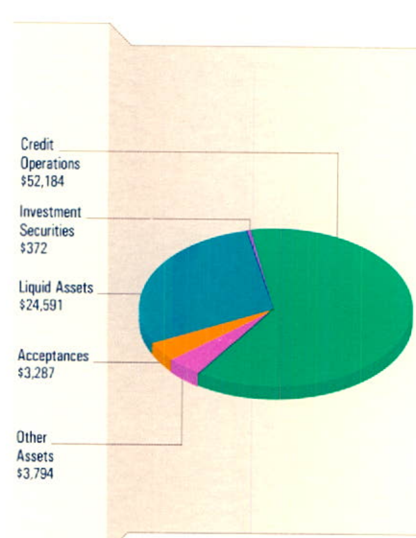
MasterCard continues to be a major market leader for the Bank. Its "no fee" and other features are a major attraction to Canadian consumers.

Canadian businesses from small to nation-wide in scope are served by a cross-country network of specialized Commercial Banking officers who provide them with credit, deposit and payment services. Their business transactions are conducted through any Bank branch across the country. Special attention was paid in 1987 to the needs of franchises and the automotive market.

Corporate and Government Banking officers similarly provide multinational corporations, financial institutions and government entities with treasury, cash management, loans and other financial services. The customers of all Canadian-based groups receive transactional support from the Bank's Domestic Operations and Electronic Data Processing Systems groups. Bank of Montreal has a strong presence in the United States and is a

Use of Funds

–as at October 31, 1987
($ in millions)



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leader in cross-border banking services through its own offices and those of Harris Bankcorp, Inc. The focus in this important market is on personal and commercial business in the Chicago area, and commercial banking and trust-related business across the country.

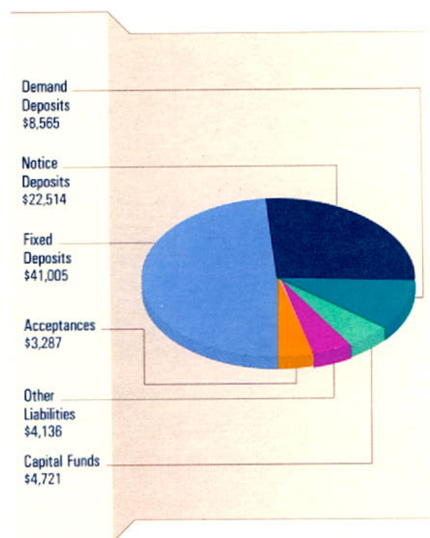
Abroad, the Bank operates in key financial centres in Europe, South America, the Far East and Australia. It also maintains a correspondent banking network in 200 countries.

The purchase this year of a 75% interest in the investment firm Nesbitt, Thomson Inc. adds full brokerage, underwriting, investment and advisory services to our existing banking and other financial services. The Bank is preparing to offer trust services in Canada when new legislation comes into effect, complementing our current U.S. capability through Harris.

Its founders established Bank of Montreal in 1817 to support the growth of trade and commerce. Since then, the Bank has built a reputation for soundness, integrity and innovation. In the process, it has grown to be one of the world's leading banks. Through its financial activities, the Bank contributes to economic growth in this nation and others in which it conducts business. Through charitable donations, educational grants, sponsorship of the arts and employee volunteers, the Bank sustains a 170-year tradition of participation in community activities.

Source of Funds

–as at October 31, 1987
($ in millions)



Personal Banking

Most personal transactions involve Canadians conducting their business in Canada. How this business is done reflects advances in technology and markets both in this country and abroad.

Customers also benefit from the competition coming from foreign-owned institutions, as well as that among Canadian banks, trust companies and investment dealers. The Bank's underlying strength derives from 1,175 branches which serve more than four million customers nationally, and from a complex and far-reaching infrastructure that processes data and disseminates information.

Deposits

The Bank's share of Canadian deposits among the chartered banks is higher than its proportion of branches nation-wide. Innovation has been necessary to maintain this strong position against other banks, trust and insurance companies and credit unions.

The highly successful Investment Savings Account (ISA) was a major development. Available in both Canadian and U.S. dollars, the ISA pays a savings rate of interest on deposits under $3,000; an investment rate on those between $3,000 and $10,000, and an even higher investment rate for those over $10,000.

The ISA allows savers to maximize interest earnings in one convenient account while retaining the accessibility of a regular savings account. The ISA augments the Investment Chequing Account, introduced earlier, in responding to consumer demand for integrated accounts which offer both high rates and convenience. The True Chequing Account continues to provide an inexpensive option to consumers who prefer a separate chequing account.

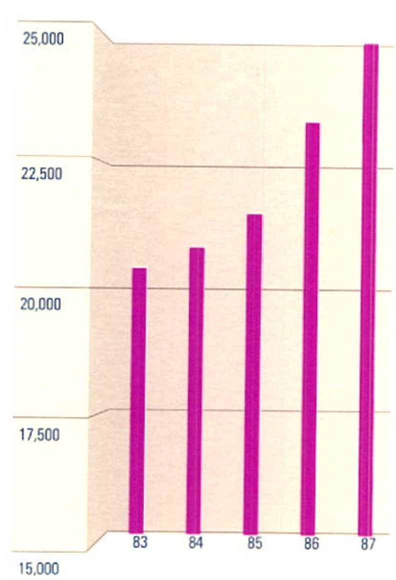
Loans

Personal loans are individually small compared with business loans, averaging about $650 per credit card loan, $9,000 per instalment loan and $55,000 per mortgage. But increasing numbers of Canadians are borrowing, and the total market is almost $200 billion.

Bank of Montreal continued to do well, led by strong performance in credit cards

Total Personal Deposits

–average balances, Parent Bank
($ in millions)



and mortgages. Other personal lending business has lagged behind somewhat, but the Bank expects to make considerable progress in this area, building on the leverage provided by a large branch network and its higher market share in personal deposits. Steps being taken in 1988 include:

- deployment in branches country-wide of 200 additional personal loans officers;
- expanded training of all personal lending staff through a comprehensive program introduced in late 1987;
- fine tuning of lending services, including innovations such as the Home Owner's Line of Credit, which allows customers to draw on the equity they have built up in their homes to secure a flexible, variable-rate, revolving line of credit at competitive interest rates; and
- heavy investment in technology to help credit officers evaluate loan applications more quickly and branch personnel to devote more time to customers. A computerized network in support of the loan approval process has already had considerable success in cutting turnaround time. About 75% of loan applications are now being processed with the support of this system, and this will be increased in 1988.

Payment and Transaction Services

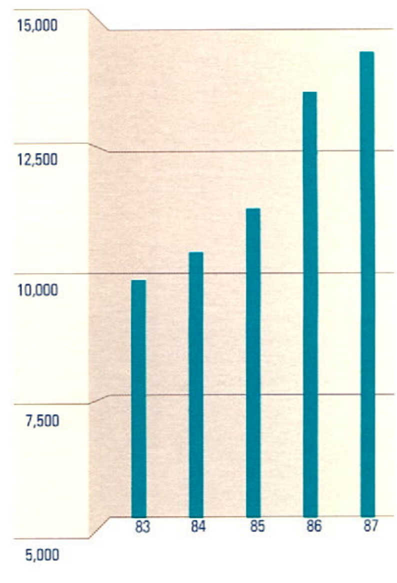
Revenues showed healthy growth as a result of increased volumes in foreign exchange, travellers' cheques and payments. The Bank also counts on account activity fees to help pay the costs of processing transactions and the massive investment in infrastructure – "bricks and mortar" as well as technology – which enables us to provide today's required level of customer service.

"Balance waivers" on the most popular deposit accounts provide consumers with the option of avoiding regular activity fees by holding specified minimum balances in their accounts.

Earnings from MasterCard came under pressure from intense pricing competition in 1987, as well as from public concern about the general level of credit card interest rates. The Bank's regular MasterCard continues to charge no annual fee, unlike competitors' cards, and the Bank has the largest share of the credit card business among the chartered banks.

Total Personal Loans

– average balances, Parent Bank
($ in millions)



An enhanced version of the Bank's Gold MasterCard was launched in September, aimed particularly at customers who travel frequently. Car rentals paid for with this card include free insurance. The existing Gold MasterCard has been upgraded to include these travel benefits in addition to the comprehensive package of banking services it already offers.

Bank-issued cards are also a key element in customer access to automated banking machines in Canada and abroad. The Bank's own Instabank machines continue to be heavily used. Interac®, the system of ABM networks shared by 16 financial institutions in Canada, is also operating successfully, and of its more than 3 million transactions monthly, more than 500,000 go through Instabanks. In addition, Bank customers accessed their Canadian accounts through the U.S. CIRRUS® network more than 250,000 times in 1987.

Mortgage Fund

The net assets of First Canadian Mortgage Fund (FCMF) increased by over 400% over the last twelve months, to $490 million. FCMF is a no-load mutual fund managed by the Bank and sold through its branches.

It is unique among Canadian mutual funds, carrying a triple-A rating from two bond rating agencies.

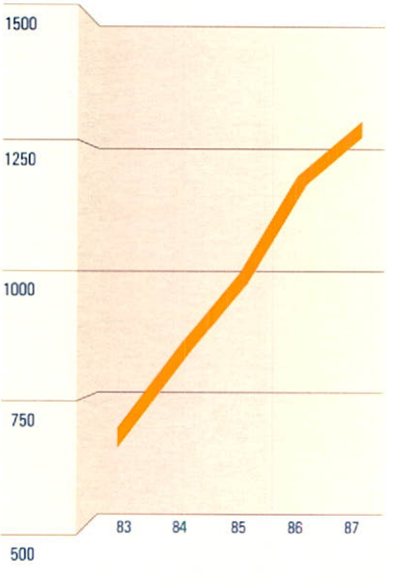
The fund invests only in single-family dwelling mortgages and is the top performing mortgage mutual fund in Canada.

Future Plans

Through Bank of Montreal Investment Management Limited, specialized portfolio management services and proprietary mutual funds will be available to personal customers. In addition, the Bank's acquisition of Nesbitt late in 1987 will allow the introduction of a range of retail brokerage services to Bank of Montreal customers during 1988.

Individual customers have never been more important to Bank of Montreal. Their business provides the solid foundation for activity in all major markets. To maintain its position in the Canadian market, the Bank will continue to make the substantial investment required in staff training, technology and premises.

MasterCard Outstandings
–as at October 31, Parent Bank
($ in millions)



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Bank of Montreal has led the Canadian banking industry in focusing on the needs of specific business sectors and in developing highly trained personnel to serve them. The range of companies from locally-based small businesses to large firms operating across Canada, and the changing demarcations among financial institutions, has created attractive marketing opportunities for the Bank.

Independent Business

Independent business is by far the largest employer in Canada. The Bank's Independent Business Program offers services tailored to small business while reducing the administrative time and paperwork burden such firms often face.

Independent business owners and professionals, including lawyers, accountants, doctors and dentists, often have overlapping personal and commercial banking needs. The Bank placed Executive Lenders in Commercial Banking Units (CBUs) to complement the activities of Commercial Account Managers and ensure that a full range of credit, payment, transaction and investment services is conveniently available.

Bank informational initiatives for business owners encompassed radio and television programs, newsletters, brochures and seminars.

- In April, the Bank launched a six-month radio program on 30 stations nation-wide entitled "Enterprise Canada", which featured profiles of successful enterprises.
- "Let's Talk Small Business", thirteen half-hour television programs which began airing in Ontario in December 1987, deals with the establishment and operation of a small business through interviews with industry specialists, government officials and successful entrepreneurs.
- The "Independent Business Review", a newsletter mailed six times per year to 18,000 independent businesses and distributed through CBUs, contains articles on industry trends, tax topics and human resource issues. A twenty-six week series based upon the Review began in the Financial Post newspaper in September.
- Ten "Problem Solvers" brochures, which together form a comprehensive guide to the financial aspects of operating a small business, continued to be in great demand.

Specialized Markets

The Automotive Dealership and Franchise markets are key growth areas for the Bank. Specific packages of credit and non-credit banking services have been developed, and Commercial Account Managers and support staff specially trained.

The Automotive Dealership Program again achieved exceptional growth in both commercial and personal loans. The Program includes operating loans, wholesale inventory financing, leasing credit and consumer point-of-sale loans (through the financing of dealership car sales). By the end of 1987, the Automotive Dealership Program's coast-to-coast network covered 75% of the market for automobile sales in Canada.

Franchises now account for approximately 45% of retail sales in Canada, and the market continues to expand. The Bank's Franchise Services group achieved its growth objectives for specialized financing and cash management services. "Let's Talk Franchising", the Bank's thirteen-week series of half-hour educational programs, was broadcast on CHCH television in Hamilton, Ontario. A follow-up series, also of thirteen weeks, will be aired in early 1988, and both series will be syndicated nationally. A video will be compiled from these shows and distributed throughout North America by the International Franchisors Association.

Mid-size and Canada-wide Business

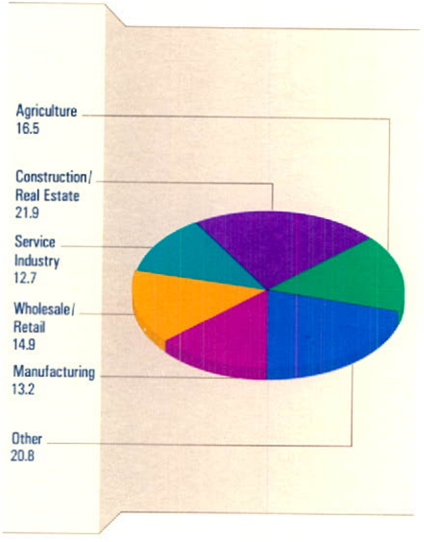
Larger Canadian companies look to the Bank for more than credit. They need treasury, cash management and trade finance services. With the restructuring of the financial services industry, many will now also expect such non-traditional services as the underwriting and distribution of their securities, investment management and trust services.

The Bank has the operational capability to meet these companies' demands. Bank of Montreal's strong branch network in Canada is supplemented by Nesbitt, by Harris, which has considerable trust and corporate banking strength, and by Treasury and Capital Markets operations in the world's major financial centres.

In September of this year, the FirstBank Cash Management Account™ was introduced to mid-sized business customers. Similar to the FirstBank Operating Account® introduced to the independent business market in 1986, the new account offers overdraft borrowing without the need for promissory notes, and automatic credit for deposited funds to reduce outstanding loan balances. It provides exact dollar borrowing, simplifies loan administration and improves customers' financial control and flexibility. A standard feature, the FirstBank Reporting Service, enables customers to check their daily account balances and transactions through their personal computers.

Commercial Banking Group Loans by Sector

– October 1987
(%)



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Agriculture

Canadian agriculture experienced another difficult year. By fiscal year-end, approximately 12% of the Bank's $1.4 billion agricultural loans were on a non-accrual basis. The grain and oilseed sector in particular continued to be adversely affected by weak world demand and oversupply encouraged by the subsidization policies of major producing countries. While subsidies to producers in certain countries will doubtless continue, there has been some progress in international negotiations towards reducing such market distortions.

Despite these difficulties, Canadian agriculture will continue to be an important market. The livestock sector, for example, has improved considerably over the last few years and is currently benefitting from lower feed costs.

The Bank's current agricultural lending products, including fixed-rate operating loans, fixed-rate farm mortgages, equipment loans and farm loan insurance, provide a wide range of options to meet producers' on-going credit needs. Work is also under way on the design of new services specific to agriculture.

The Bank's five Agricultural Advisory Panels across Canada, comprising representatives from the farming industry, advised on major trends in commodity prices and other industry developments, and provided feedback on our services and programs. Full-time Bank agrologists assisted account managers and customers in analyzing the impact of environmental factors and developing strategies for farming operations.

Customer Service

Service levels and profitability are closely related. As the Bank refines the technological systems which underpin its operations, both customer and Bank gain from efficiency and productivity improvements. The Account Management Support System, introduced in pilot form this year, allows account managers to transmit and receive electronically credit applications and approvals, inter-office communications, account histories and industry-related information. It reduces substantially the delays associated with document processing and results in faster turn-around on credit applications.

The steady improvement in credit skills and portfolio management procedures has resulted in a continued decline in loan losses in 1987. The emphasis in training this year was on customer service, and especially on recognition of client needs for treasury, cash management and trade finance products.

The basic services for commercial customers are in place, and programs aimed at specialized markets are gaining new and profitable business. Further automation of document processing and management reporting, as well as on-going Bank-wide efforts to enhance service, will continue. The Bank will also examine closely new opportunities resulting from regulatory changes and will enter those areas which best complement our current capabilities and promise attractive returns.

The Bank concentrated on key customer relationships and on non-credit areas. At the same time, productivity continued to receive major emphasis. A computerized Customer Profitability Model for Corporate and Government Banking Group now provides vital profit analyses to account managers.

In general many larger customers in North America and abroad continued to reduce bank borrowings in favour of other types of funding. North American corporations in particular replaced shorter-term debt with equity and/or long-term debt raised directly on financial markets. Profitable lending opportunities were further diminished as competing financial institutions sought to gain new footholds.

The Bank is able to meet these customers' changing requirements. With the purchase of Nesbitt, clients will benefit from the expertise of one of Canada's leading investment firms combined with the financial strength and distribution capacity of the Bank.

Bank of Montreal Investment Management Limited will offer portfolio management services to institutional and corporate clients. Securities lending services will also be offered to clients with custody accounts at the Bank. The planned trust company will eventually offer a full range of master trust and other fiduciary products. A Bank of Montreal project team has been working closely with experts from Harris Bankcorp, Inc.'s major operating subsidiary, Harris Trust and Savings Bank, to develop specific services, processing systems and controls, and to identify further Canadian business opportunities.

Canadian Activity

Non-bank financial institutions in Canada were a source of significant revenue, and they will continue to grow in importance as new institutions enter the market. The Bank processed transactions – cash management, funds transfer, clearing and securities services – for investment dealers, insurance and trust companies, and Schedule B banks, building on an extensive branch network, systems infrastructure, primary dealing in Canadian and U.S. government securities, and correspondent banking relationships worldwide.

Bank of Montreal has long been a leading banker to Canadian governments and Crown corporations, underwriting and distributing debt issues, handling securities, lending, dealing on the money and foreign exchange markets, and providing cash management and financial advisory services. Domestic bond activities, which included primary distribution of Government of Canada bonds as well as underwriting the issues of all ten provinces, were transferred late in the year to Nesbitt, which was already a leading participant in government bond underwritings. The Bank remains a major dealer in Canadian Treasury Bills and in the commercial paper of public sector borrowers. The Bank also participated in a number of Eurobond issues involving such borrowers.

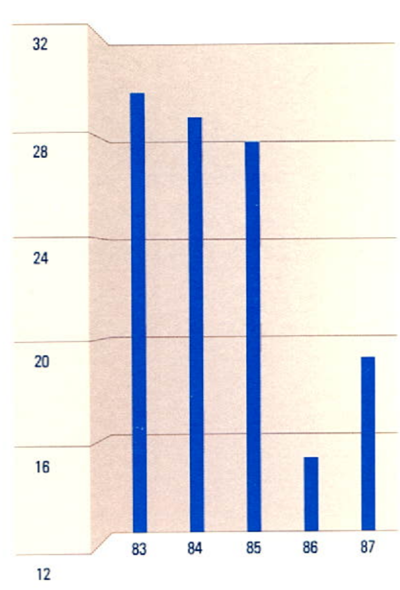
Cash management services, particularly those involving invoice processing and on-line account information including the status of cheques, were significantly enhanced for the public sector. The Bank has devoted considerable effort to the development of services in response to the declared objective of many public sector entities to improve the efficiency of their operations. These have been well received.

The Petroleum Industry

During the year the Bank managed a U.S.$290 million loan to Texas-based United Gas Pipe Line Company (UGPL). UGPL's 9,800-mile natural gas pipeline serves five U.S. Gulf Coast states. Our relationship with UGPL is shared by Harris, which provides cash and pension fund management services to UGPL.

This transaction is only the latest in the Bank's history of financing development of energy resources. Today the Bank is one of the world's leading petroleum bankers, serving all major international petroleum companies as well as specialized companies involved in production, refining, transportation and petrochemicals. In a business characterized by volatile prices, huge capital costs and long-term financing

Oil Prices
–average for the year
(West Texas Intermediate–
in $ US/barrel)



needs, its depth of experience and industry knowledge gives the Bank the expertise required to pursue profitable petroleum industry business inside and outside Canada.

Major International Markets

Bank of Montreal's corporate banking activities in the United States focus primarily on the commercial and industrial, energy and real estate sectors. All three were profitable despite the fact they were not especially buoyant in 1987. The Bank's results were achieved through careful selection of relationships and concentration on services for which it has a well-established reputation.

The Bank will continue a selective strategy. Foreign exchange activities, which have been highly successful in Canada, will continue to be expanded in the U.S. Harris will continue to target medium-size companies in the Mid-West and, more broadly, to market its corporate and trust services to larger clients throughout the United States.

In the United Kingdom, in addition to its treasury and capital markets activities, the Bank is a recognized leader in the development of mortgage-backed securities.

An important aspect of the Bank's program to manage its exposure to Third World loans involves adequate reservations against possible losses. Bank of Montreal has made specific country reservations and, since 1983, general reservations. This year, an additional reservation of $1,299 million was set aside for loans to 34 countries identified by the Superintendent of Financial Institutions, increasing reservations to more than 35%.

The performance of the Bank's portfolio of Third World loans was affected by the suspension in February of interest payments by Brazil on long and medium term debt. A conditional interim agreement, however, was reached in December between Brazil and its commercial bank creditors. Brazil has indicated it will be working closely with the international financial community and multilateral agencies to develop comprehensive, longer-term arrangements, including the resumption of interest payments. It will seek the assistance of the International Monetary Fund in formulating a program which ensures adequate economic growth. Despite its repayment difficulties, Brazil is an important market, and Banco de Montreal Investimento S.A. – Montrealbank (BAMI), scored continued success with financing, investment management, treasury and capital markets services.

Another initiative by the Bank was a proposal to the Brazilian Government in early 1987 to convert up to $100 million of loans into suitable equity investments. The proposal was intended to stimulate creative thinking about how to ease the country's burden of servicing its external debt while increasing the amount of investment capital for the Brazilian economy. By calendar year-end, Brazilian authorities announced they would proceed with a program of debt-equity conversions, and the Bank's proposal received government approval.

Mexico signed a refinancing agreement with its lenders in March and is responding to improved fiscal management. The year's higher oil prices had a positive effect on the country. An earthquake in Ecuador and the restriction by Peru of its debt repayments have had a lesser impact on the Bank. Ecuador is expected to resume interest payments in 1988.

The Bank established a Special Country Unit to manage country risk exposure through such innovative techniques as debt-equity conversions and swaps or sales of assets. The unit has already eliminated exposure to some countries and reduced it to others. It also explores profitable business opportunities which will not significantly increase country risk.

With relationship management as the cornerstone of the Bank's marketing efforts towards multinationals, governments and financial institutions, the skills of account managers are critical to our success. Account management received additional training during 1987, and such programs will continue to have a high priority.

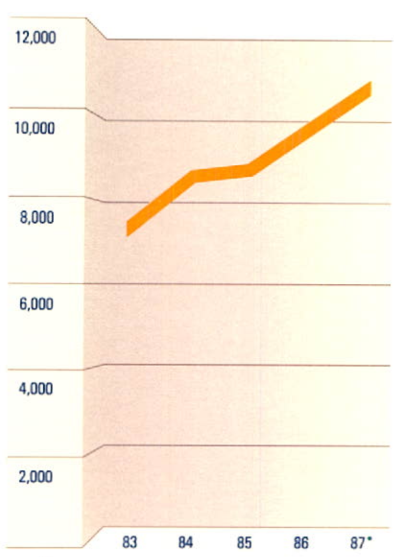
Harris Bankcorp, Inc., Bank of Montreal's wholly-owned subsidiary based in Chicago, continues to perform well. As in Canada, the banking industry in the United States operates amidst an evolving regulatory environment, shifting demand by business customers from traditional credit services to non-credit services and strong competition from other financial institutions.

Harris' affiliation with Bank of Montreal gave it the backing to compete for the business of the largest U.S. companies. With Harris' recognized leadership in cash management, trust and investment services, these new opportunities led to strong growth in fee-based revenues. Trust Department revenues and service charges on commercial accounts in particular rose substantially during the year.

During its third quarter, Harris set aside U.S. $50 million in reserves for possible losses on loans to less developed countries (LDCs). The reservation was taken in conjunction with the related move by Bank of Montreal. For the twelve months ended September 30, 1987, Harris' net income before the special provision was U.S. $67 million; after the special provision net income was U.S. $30 million. The action has given Harris a reserve ratio for LDC debt in excess of 35%, one of the strongest amongst American banks.

Harris' suburban bank affiliates demonstrated strong earnings while expanding operations. Under Illinois legislation, banks can have up to five branches, and these Harris subsidiaries took advantage to penetrate further the attractive personal and commercial banking markets in and around Chicago. Opportunities for expanding the affiliate network in the Chicago area are also being explored.

Harris Bankcorp, Inc.
Total Banking Assets
–as at December 31
(US $ in millions)



*Estimate

Harris also tripled the size of its branch in the Chicago Board of Trade Building. The branch, first opened in 1977, is designed to serve the needs of the trading members of the world's largest futures exchange, as well as other members of the Chicago financial community and the general public.

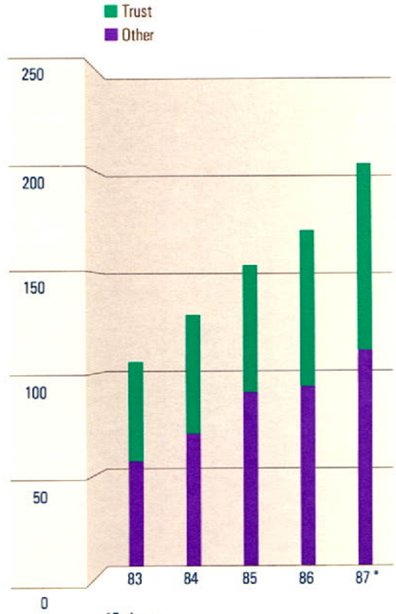
Harris' purchase during the year of the Commercial State Bank in Phoenix, Arizona complemented the already existing Harris Trust Company of Arizona. The acquisition will allow Harris to market its trust and investment services to high net worth individuals through the private banking facilities of the newly renamed Harris Trust Bank of Arizona.

In addition to providing enhanced opportunities at the upper end of Harris' business market, the Harris/Bank of Montreal relationship has resulted in important customer referrals for both institutions.

Joint efforts by the two banks continue to benefit Canadian and American companies with cash management needs across the border. Payroll disbursements, collection and concentration of daily sales receipts and cross-border funds transfers are facilitated by the strong operational capabilities of both banks in their respective domestic markets.

Harris Bankcorp, Inc.
Other Operating Income

–for year ending December 31
(US $ in millions)



*Estimate

On August 13th, Bank of Montreal and Nesbitt, Thomson Inc. jointly announced that the Bank would acquire the Canadian investment firm. Under the agreement, Bank of Montreal Securities Canada Limited, a newly created and wholly-owned Bank subsidiary, acquired all of Nesbitt's Class A Subordinate Voting Shares at a cost of approximately $270 million. In early 1988, Nesbitt will issue additional shares which will be sold to the Bank and to key Nesbitt employees, adding $45 million to its capital. As a result of these transactions, the Bank will effectively acquire 75% of the outstanding shares of Nesbitt at a cost of $292.5 million.

The acquisition boosts the Bank's competitive position under Canadian financial services legislation enacted last June. The new rules allow a Canadian financial institution to take a controlling interest in a Canadian investment dealer; foreign institutions will be given the same power in June 1988. This transaction furthers the Bank's goal of broadening the range of financial services which can be offered to meet its customers' needs.

Nesbitt, founded in 1912, is one of Canada's oldest and most respected investment dealers. Nesbitt's traditionally strong performance in retail distribution, institutional sales and research will add value for Bank shareholders as well as enhance service capability for our customers.

For Nesbitt customers, the Bank's size and capital base, technological infrastructure, coast-to-coast branch network and international operations complement the investment firm's experience and entrepreneurial skills. The 25% equity retained by Nesbitt employees will provide the incentive for the firm's management and staff to maintain the excellent performance they have already demonstrated.

Recognizing benefits to be gained by a closer integration of transaction processing functions, the Bank centralized their management during the year. This also led to a common reporting relationship for its Electronic Data Processing Systems and Domestic Operations Groups, under the Executive Vice-President, Operations.

Domestic Operations had itself been established in 1986 to improve the ability of Canadian branches to process the transactions of personal, commercial and other customers. One of its first priorities in 1987 was to improve the level of branch service to Commercial Banking customers. Domestic Operations tackled the problem through a number of steps, including consolidation of administration and document processing. As a result, area managers – who previously had responsibility for both customer service and transaction processing – can now dedicate their time more fully to improving service to customers.

The Electronic Data Processing Systems (EDPS) Group, in existence for more than a decade, supports all areas of the Bank with extensive computer and telecommunications networks and computer application programs.

Availability of on-line banking and automatic banking machine (ABM) systems remained high in 1987. This includes branch terminals, Instabanks and MoneyTrac® services. Systems were available to users 97.8% of the time for the year and processed 1.06 billion transactions, which was an increase of 4% over last year.

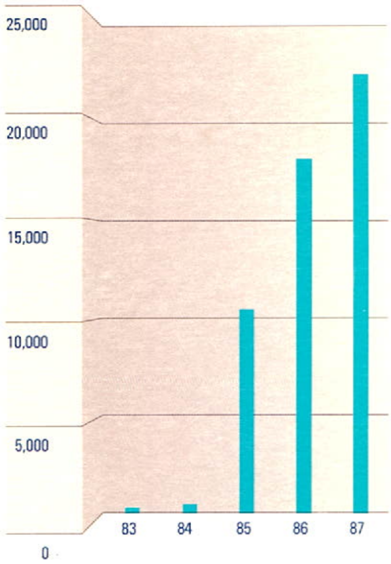
Bank of Montreal remained among the world leaders in applying communications technology to business. The expanded use of "T-1" technology in the Bank's Canadian network resulted in savings of 15% in 1987 over conventional facilities for data and voice communications.

The appropriate use of technology, supported by continuing major financial investments, will remain a cornerstone of service to the Bank's customers. Effective and efficient operations support is critical for their transactions to be processed to the standard they require and deserve.

As you would expect, the cost of maintaining this infrastructure is considerable. Nevertheless, in terms of convenience and efficiency the Bank believes that it represents good value to its customers. Indeed, in terms of its reliability, efficiency and convenience, the operation of the Canadian banking system compares favourably with those in other countries.

ABMs Available to Bank of Montreal Customers

– as at October 31



® Registered Trade Mark of Bank of Montreal

Risk Management and Control

The management and control of risk is a central function of banking. The Bank sets corporate limits at least as stringent as those required by regulation and industry practice on the levels of risks that it is willing to assume. The Risk Review Committee of the Board of Directors meets quarterly to review the Bank's policies and performance in this area.

Credit Risk

The bulk of the Bank's revenue and its largest single source of profits arise from loans.

The Bank adopted a new approach to credit risk management and control in 1982, which has been refined and improved since then. Excluding the impact of the special general provision relating to Third World debt, total loan losses as a percentage of eligible loans have fallen to 0.15%, the lowest level since 1978. Since this reflects some reversals, it should not be assumed that this level is indicative of future loss experience. The delinquency rates for consumer credit, encompassing personal loans, card services and residential mortgages, are now at their lowest point in the last six years.

Loan loss standards have been established for each operating group and incorporated into profit targets. These standards are an important factor in making credit decisions based on sound risk-reward considerations. The Bank ensures that newer types of off-balance sheet transactions are subject to the same process of credit control.

Management of troubled commercial accounts is centralized under the Special Accounts Management Unit. This unit is now involved at an earlier stage than before with troubled accounts, permitting the main operating units to concentrate on the acquisition and management of sound, profitable business. Troubled loans in the less developed countries are dealt with by another specialized unit.

Settlement risk, which arises from the possible failure of a customer with whom the Bank is trading securities or foreign exchange to fulfill his commitment as agreed after the Bank has fulfilled its commitment, was brought under improved operating procedures and controls. Lending and daylight overdraft limits were maintained at previous or reduced levels during 1987 despite the general upturn in economic activity. Other controls were introduced to limit exposure to individual institutions and companies, while flexibility to update these limits on an ongoing basis has been maintained.

Market Risk

Acknowledging the volatility of interest rates, foreign exchange rates and market conditions generally, the Bank maintained conservative limits on open positions.

Tight limits in all approved currencies were monitored daily for foreign exchange trading, where the Bank is very active globally.

Limits are also applied to interest rate term "gaps" for both balance sheet and off-balance sheet items.

The Bank's investment portfolio is mainly restricted to debt securities. As a result, the Bank was not affected by the sharp decline in equity prices during October.

With the acquisition of Nesbitt, Thomson Inc. in September, the Bank became more involved in the underwriting and distribution of securities, but overall inventory positions will continue to be subject to close scrutiny and managed with caution. During the stock market decline, Nesbitt maintained high liquidity levels, resulting in minimal losses.

Liquidity

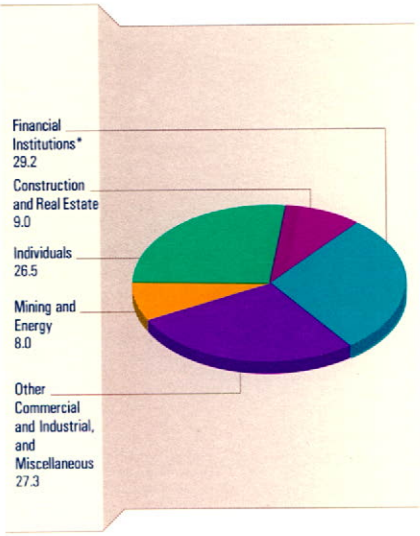
The long-standing Bank policy is to maintain liquid assets well in excess of those required by regulatory authorities. Liquid assets comprised 29% of total assets at the end of the year.

Operations Risk

Both the clerical process and electronic data processing within the Bank are subject to tight operations controls, which are continuously subject to independent review by the Corporate Audit Department. The level of errors and defalcations continues to be low.

Distribution of Loans Outstanding by Sector

–as at September 30, 1987
(%)



*Includes deposits with banks

The Bank's Employees

Employee morale and motivation are important to the Bank's success. Attitudes are measured by regular Management and Employee Opinion Surveys. Surveys in 1987 indicated that morale generally is at a satisfactory level and, reflecting our continuing efforts, trending upwards.

Bank training in 1987 focused on helping employees meet specific job requirements. For account managers, new courses included instruction in relationship selling skills and negotiation, and on the features of Capital Markets products. These complemented established programs in credit, sales and other Bank products. The Bank has also taken steps to upgrade management skills.

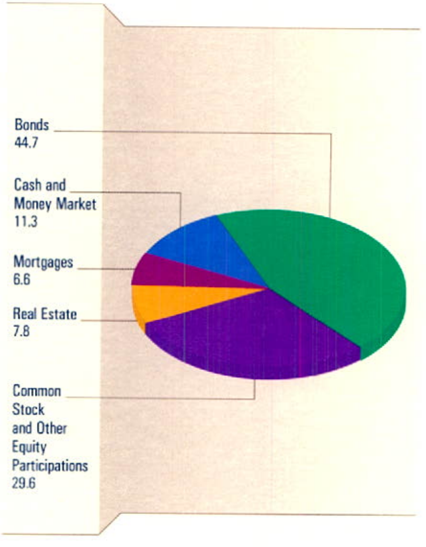
To complement these initiatives, future plans call for more centralized entry-level hiring and training. Previously, much of this was handled separately by each banking group.

Employee benefits have been further harmonized. As the process continues, employees will have equal access to more programs regardless of their classification as non-management, management or executive. The level of benefits is now largely a function of salary. Changes to the Pension Fund Society plan for employees, combined with the revisions to the Executive Pension Plan, have also contributed to harmonization of benefits for employees.

Revisions to its pension plans announced late in 1987 put the Bank in the forefront of industry in meeting the changes required by pension reform legislation.

Pension Fund Society

– as at October 31, 1987
(Market value of investment portfolio – %)



A noteworthy addition in 1988 will be a voluntary component to allow employees to arrange additional pension benefits to supplement amounts provided by the Bank. Other improvements are concurrently being made to the program.

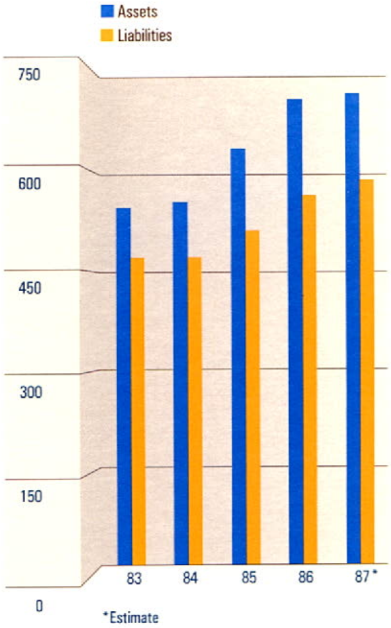
Other programs offered by the Bank continue to receive a positive response, including the Employee Assistance Program, which supports counselling for staff with family or health problems not covered under other plans.

Employees around the world contributed their own time, money and talents to a number of deserving causes in the communities where they live. For example, the employees in Southern Ontario, through their "Our People Fund" charity, raised some $875,000 in their 1988 campaign. Outside of the Bank, employees volunteered time to neighborhood organizations and community work.

The Bank is proud of its employees. They make a vital contribution to its success as well as to the communities in which they live.

Pension Fund Society

– as at October 31
(Assets at market value and actuarial liabilities on a statutory basis – $ in millions)



*Estimate

In keeping with its Commitment to People and its corporate responsibilities, the Bank contributed to charitable endeavours in Canada and in other countries where it has a significant presence.

Large donations went to hospitals, special care units such as the Ross Tilley Burn Centre in Toronto, foundations that coordinate medical research and associations that help the mentally and physically handicapped. The Bank believes that health care services in Canada are among the best in the world and plays its part to ensure that this care continues to be available.

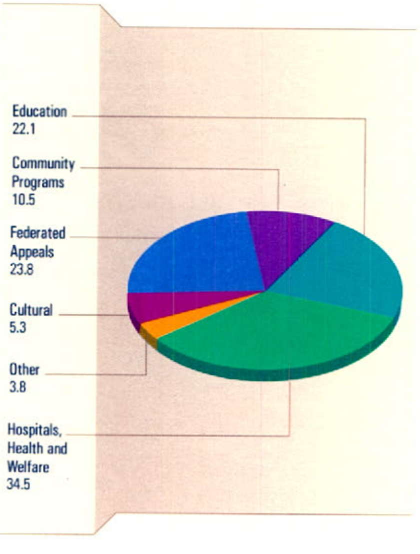
In November, 1987, Bank branches sold Project Sunshine Calendars, with the proceeds going to eight children's hospitals across the country. These calendars feature drawings by children who were patients in the hospitals. All of the illustrations include the sun as a symbol of hope.

The Bank has supported a number of Canadian cultural events and organizations. The Bank continued its support of the Montreal Symphony Orchestra (MSO) and in the fall of 1987 was the corporate sponsor of the MSO's 15-city tour of Europe. Led by the Orchestra's Music Director, Charles Dutoit, the MSO had an outstanding tour, bringing credit to Montreal, Canada and the Bank, as well as enhancing the considerable international reputation of the Orchestra. The Bank also contributed to the support of museums, art galleries and libraries. The Bank sponsored the Stratford Festival's popular production of "Cabaret", whose gala premiere was attended by many Bank customers, community leaders and other public dignitaries.

For the second year, the Bank sponsored all four North American events in the Nations' Cup equestrian series: at Spruce Meadows near Calgary, the Washington International Horse Show, the National Horse Show in New York and the Royal Agricultural Winter Fair in Toronto. The Nations' Cup is the most prestigious international team riding series, and the Bank's support is intended to raise the level of equestrian sport in Canada. For the first time, all four events were televised to Canadian audiences nationwide. This year saw the inauguration of the Bank of Montreal Trophy, to mark the long-standing, intense but

Allocation of Bank Donations

–Parent Bank, 1987
(%)



friendly competition between the Canadian and U.S. teams. The team compiling the best performance of the two during the four North American Nations' Cup events wins the trophy. The United States team narrowly won the trophy in its first year, as the competition reached a climax at the final event at the Royal Winter Fair.

Donations to groups and projects that strengthen the fabric of Canadian life ranged from the Duke of Edinburgh's Award in Canada, which recognizes the community work of youth between 14 and 25, to the Canadian Council of Christians and Jews, Junior Achievement, Boy Scouts and YM/YWCAs across the country. One of the Bank's most successful efforts is the EPOC program, created by former Bank Chairman Arnold Hart in 1969. This six-month training program for young school dropouts gives them the skills and attitudes to get and keep a job. Initially financed by the Bank, EPOC has garnered broad support and more than 70 firms now participate in the program. The Bank also helped various community centres, parks and projects such as the Governor General's Study Conference.

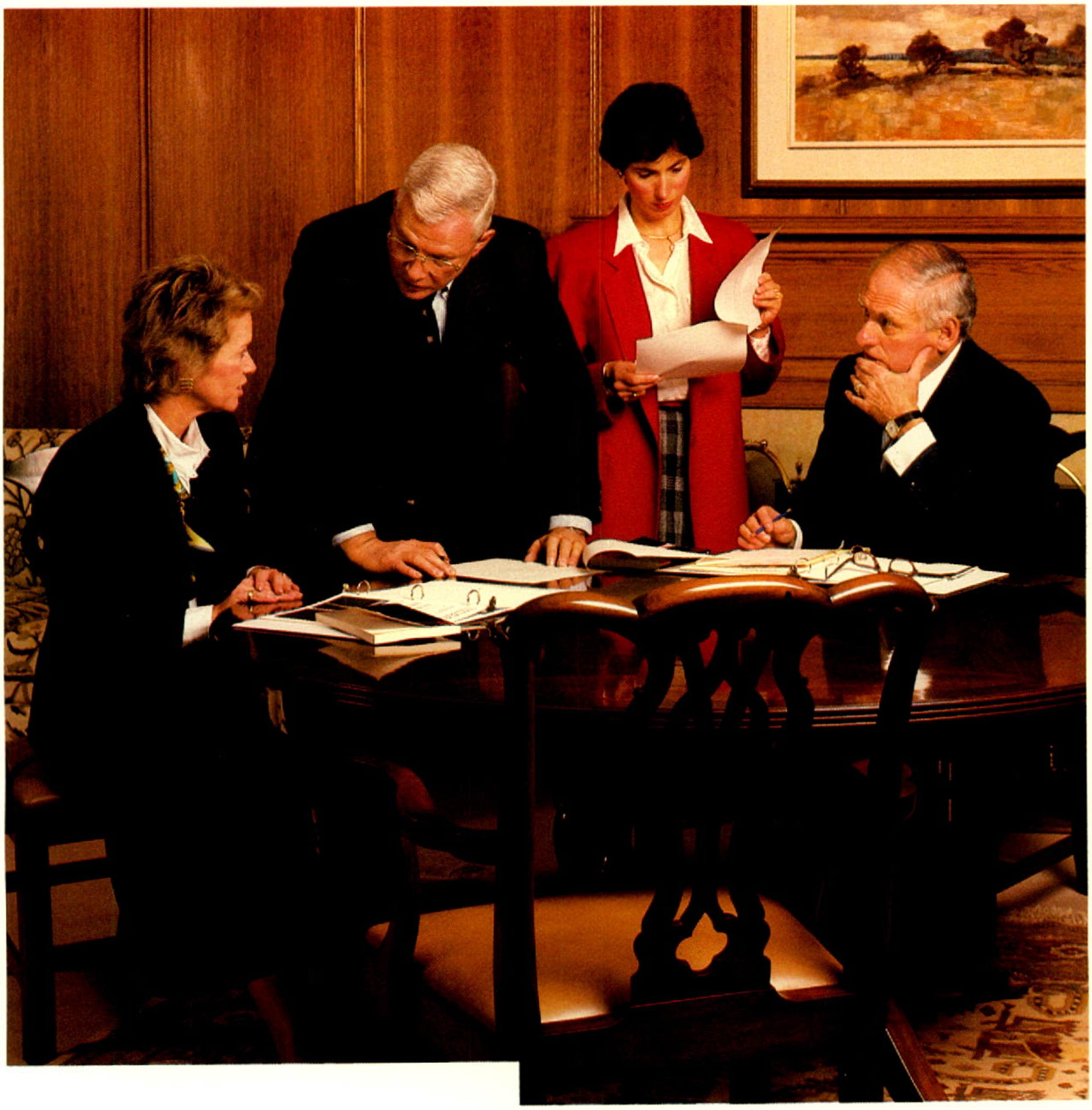
The Bank contributed to universities and academic foundations throughout North America. Bank of Montreal also funded chairs in business and finance at McGill University, the University of British Columbia and Queen's University. A major contribution to Acadia University in Wolfville, Nova Scotia, celebrating its 100-year relationship with the Bank, went toward two major programs: a lecture series to bring distinguished academics and business people to the University, and the Community in the Classroom series, providing special seminars for the local business community, students and faculty.

The Bank established, in 1987, a fellowship at Concordia University in Montreal named for the Hon. Pauline Vanier, the first woman to become director of a chartered bank. Recipients of the award will be qualified businesswomen who wish to pursue graduate business studies. In addition, a Matching Gift Program provided substantial financial support to universities which received personal donations from Bank employees.

Outside of these broad categories, the Bank supported other groups whose activities merit contributions. The Canadian Society for the Prevention of Cruelty to Animals, the Canada West Foundation, which promotes discussion on issues affecting Western Canada, and Big Brothers of Canada received support. The Bank responded as well to special needs. After tornados hit Edmonton last summer, it set up a special fund, donated additional money and quickly provided low-interest loans to the people affected by the natural disaster.

Chairman William D. Mulholland received the Prime Minister of Israel's Award in 1987 for his "contribution to improving economic conditions throughout the world."

The philosophy and the criteria for the Bank's donations are set out in a pamphlet entitled "Bank of Montreal Donations Policy." Copies may be obtained from the Bank's Secretary or its Public Affairs department.



In 1987, Bank of Montreal established a fellowship named for the Hon. Pauline Vanier, the first woman to become a director of a chartered bank when she joined the Bank's board twenty years ago. Each two-year award will enable a woman to undertake full-time business studies at Concordia University in Montreal. Details were worked out by Bank Senior Vice-President Elizabeth Wright, Chairman William D. Mulholland, Vice-President Lili de Grandpré and Senior Vice-President L. Richard O'Hagan.

Bank branches are located convenient to where our customers live and work in communities across Canada. At the opening of the new Chinatown branch in Toronto, manager Margaret Wong holds a "Lucky Money" jar for new customer Mrs. Isabel Lee. In keeping with a Chinese ceremonial tradition, all new customers in November were invited to draw from the "Lucky Money" jar. Mrs. Lee is hoping to pick one of the special pouches which would give her a one-ounce Maple Leaf gold coin.

Bank of Montreal's purchase of 75% of Nesbitt, Thomson, one of Canada's most respected investment firms, will deliver a broader range of services to the customers of 1,175 Bank branches. Close coordination between the Bank and Nesbitt began immediately. Joining Nesbitt President Brian Steck (2nd from left) in Bank of Montreal's Exchange Tower Branch are Bank Executive Vice-President Alan McNally, President Matthew Barrett and Executive Vice-President and Treasurer Jeffrey Chisholm.

Lori Finch, Commercial Account Officer with the Bank's Automotive Finance Centre in London, Ontario, discusses the Bank's M-Plan program with Jim Hayter Sr., of Jim Hayter Chevrolet/Oldsmobile in Goderich. The program helps dealers arrange financing for their customers, providing loan approvals in 20 minutes or less. It results in increased business for both the Bank and its auto dealer clients. The Bank's Automotive Finance Centres have attracted wide attention.

For one week every year, Rossland, in south-east British Columbia, commemorates the Gold Rush which led to the founding of the town. Bank of Montreal staff always join in the fun. This year they had something extra to celebrate – the Bank's 90th year serving the 4,000 people of Rossland. Pat St. Thomas greets 6 year-old Dawn Lukenbill, who dropped in to do her banking and enjoy the festivities.

As part of its ongoing commitment to provide Canadian business with useful information, the Bank produced a 13-week television series called *Let's Talk Franchising,* which was broadcast on CHCH-TV, Hamilton, Ontario. The programs were very well received, and a second series will be aired in 1988. Both will be syndicated nationally. Marvin Goldberg, Executive Vice-President, Legal Affairs, of Shoppers Drug Mart, is interviewed by series host Jennifer Nelson.

Jim Darlington, Manager, Agriculture, Central Division, and Les Frayne, Regional Agrologist, Kitchener CBU, inspect a combine at the International Plowing Match and Farm Machinery Show near Owen Sound, Ontario. The Bank welcomes agricultural customers from across Canada at its exhibit and also presents the Grand Champion Tractor Plowman Award each year. The five-day event draws more than 200,000 people.

Harris Bank has been a member of the Chicago Board of Trade (CBOT), the world's oldest and largest futures exchange, since 1928. The CBOT provides liquidity to the commodity and financial markets, and its members have never suffered a loss because of a default on a CBOT trade. Here, Bruce Osborne, a Harris Senior Vice-President (left), meets with Karsten Mahlmann, the CBOT's Chairman. Mr. Mahlmann is also a partner with Stotler & Co., who have been customers of Harris since 1962.

A recent financing by the Bank was 1987's U.S. $290 million package for LaSalle Energy Corporation's purchase of United Gas Pipe Line Company. UGPL is a major purchaser, transporter and marketer of natural gas. Its 9,800-mile transmission system extends from the producing areas of Texas and Louisiana across Mississippi and Alabama into northern Florida. Bank Senior Vice-President Thomas C. Wright (left) meets with UGPL Chairman and Chief Executive Officer Richard F. Nelson at the company's state-of-the-art control room in Houston, Texas.

Ian Millar, the world's top-ranked equestrian show jumper in 1987, was part of the Canadian Equestrian Team at the first Bank of Montreal Nations' Cup competition of the year held at Spruce Meadows, near Calgary. The Bank of Montreal Trophy, first awarded in 1987, goes to either the Canadian or United States team, based on success over the four North American Nations' Cup events sponsored by the Bank. The Nations' Cup series of 18 events overall comprises the world's most prestigious team jumping competitions.

Management Analysis of Operations

Table of Contents

Introduction

The purpose of this section is to provide an analysis of the major factors that affected the financial performance of the Bank in 1987.

Segmentation

For analytical purposes the Bank's results are segmented to separate the results of the Bank's U.S. subsidiary, Harris Bankcorp, Inc. ("Harris"). Bank of Montreal excluding the impact of Harris is referred to throughout this section as the "Parent Bank".

Harris was acquired on September 4, 1984 and therefore the 1984 results included two months of Harris' income and expenses. Subsequently, results are included for a full year. Because of the substantial impact of the Harris acquisition, year-over-year comparisons and longer term analyses show significant variances which are more readily understood by a separate review of the Parent Bank and Harris results.

On September 29, 1987, the Bank effectively acquired a 75% interest in Nesbitt, Thomson Inc. ("Nesbitt"), a major Canadian investment dealer. Accordingly, 1987 consolidated results include Bank of Montreal's share of Nesbitt's results from the date of acquisition, and the balance sheet at the end of October includes the assets and liabilities of Nesbitt. The assets and liabilities, and the results since acquisition, are not material in relation to the remainder of the Bank and are included as part of the Parent Bank for purposes of analysis in 1987.

The analysis which follows concentrates on the Bank's results before deducting the special provision for losses on trans-border claims ("special provision") which increased to approximately 35% the Bank's reservations for possible losses on all cross-border loans, to both public and private sector borrowers, in the 34 countries designated by the Superintendent of Financial Institutions. A discussion and explanation of the impact of the special provision on the Bank's results is provided in the section Loan Loss Experience and Provision for Loan Losses.

Terminology and Accounting Methods

In order to more fully understand the financial results of a bank, certain terminology and accounting methods need to be explained. In particular, clarification of the concept of the taxable equivalent adjustment and the method of accounting for loan losses will assist the reader in understanding the Management Analysis of Operations.

Taxable Equivalent Adjustment

The taxable equivalent adjustment is made to increase net interest income and income taxes to recognize the tax-exempt nature of interest income from small business development bonds, income debentures, term preferred shares and similar instruments. As a result of holding such tax-exempt instruments, both net interest income and the provision for income tax of the Bank are less than the amounts which would result if the income from these securities was taxable. The taxable equivalent adjustment increases interest income and taxes to such greater amounts to more clearly reflect the economic yield on these instruments. There is no effect on the Bank's net income. The amounts of these adjustments in the last five years are:

Year	$Millions
1983	155
1984	127
1985	175
1986	193
1987	138

Accounting for Loan Losses

Loan loss reservations comprises both specific and general reservations for possible losses on loans and are deducted from loan balances shown on the balance sheet. They are not included in determining the equity capital of the Bank. Loan loss reservations are intended to provide against the possibility that loan principal will not be repaid.

Loan loss experience is the current year's actual loss experience and comprises gross new reservations made during the year less any reversals during the year of outstanding reservations to determine "net new reservations", from which is deducted any principal recovered on loans previously written off. In accordance with guidelines issued by the Minister of Finance, loan loss experience does not include the special provision for losses on transborder claims.

Provision for loan losses is the amount deducted from income determined in accordance with an averaging formula mandated by the Minister of Finance. Essentially it is the average ratio of loan loss experience for the most recent five years to eligible loans for that same period, applied to total eligible loans at September 30th of the current year. For 1987, the definitions of loan loss experience and eligible loans reflect the guidelines issued by the Minister of Finance which were amended to accommodate the special provision.

Eligible loans, as defined by the Minister of Finance, basically includes all loans and securities (other than those guaranteed by the Government of Canada or a province) as well as customer acceptances, guarantees and letters of credit. However, in accordance with the guidelines issued by the Minister of Finance, eligible loans for 1987 do not include loans to public and private sector borrowers in the 34 countries designated by the Superintendent of Financial Institutions.

The amount charged to income in respect of loan losses is the provision for loan losses which may be either more or less than the amount of the actual loan loss experience for the year.

The difference between the loan loss experience and the provision for loan losses is charged or credited, as the case may be, directly to the capital funds of the Bank.

As a result of using the averaging formula, the reported results of Canadian chartered banks are not comparable over the short term to other international banks whose jurisdictions normally require an amount equivalent to the loan loss experience to be charged directly against earnings from operations.

The averaging formula tends to smooth the year-to-year changes in the amounts charged to income in respect of loan losses. As a result, the amount of the provision for loan losses charged to income in any year may differ quite significantly from the actual loan loss experience. To eliminate this effect, there is reference in various parts of the Management Analysis to income determined on the loan loss experience basis, which represents a restatement of net income for the year by substituting for the provision for loan losses in the income statement the actual loan loss experience for the year (and adjusting for any tax effect).

Summary

In 1987, Bank of Montreal reported consolidated net income (before the special provision) of $413 million, compared with $353 million in 1986, an increase of 17.0%. On a loan loss experience basis, consolidated net income (before the special provision) was $550 million, $239 million above the 1986 results, an increase of 76.8%.

Net interest income on a taxable equivalent basis for 1987 totaled $2,218 million, down $56 million from 1986. The decrease was primarily due to the Bank not receiving approximately $100 million of interest from Brazil and Ecuador, both of which suspended payments early in 1987. In addition, lower earnings from international money market trading and reduced asset volumes due to the successful efforts of the Bank in reducing the proportion of lower-yielding assets resulted in reduced net interest income. Offsetting these decreases were improvements in net interest income due to the strong performance of the Bank's Brazilian subsidiary and increased interest payments from non-accrual and previously written off loans. Despite lower net interest income, the improved asset mix resulted in the Bank maintaining the net interest spread at the 1986 level of 2.62%.

The provision for loan losses decreased in 1987 to $343 million from $521 million. The reduction arose from the combined effect of a $530 million reduction in loan loss experience and a decrease of $11.0 billion in eligible loans compared to 1986. The reduced loan loss experience reflects three major factors: first, continued improvement in the Bank's loan portfolio; second, a significant level of reversals of loan reservations made in earlier years, particularly those in the energy sector; and finally, loan loss reservations which apply to the loans to the 34 countries designated by the Superintendent of Financial Institutions were recorded as part of the special provision and are therefore not included in 1987 loan loss experience. The decrease in eligible loans was the result of the exclusion of transborder loans to the designated countries and the planned reduction in lower-yielding foreign currency loans during the year.

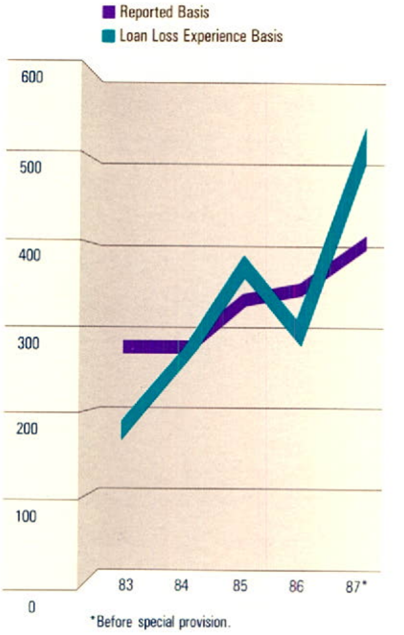
Net Income

($ in millions)	1983	1984	1985	1986	**1987***
Reported Basis	283	283	339	353	**413**
Loan Loss Experience Basis	185	289	391	311	**550**

*Before special provision.

Net Income

($ in millions)



*Before special provision.

Other operating income increased by $99 million or 12.1%. Growth was experienced in all categories, especially foreign exchange, activity fees, and trust income.

Non-interest expenses increased by $120 million or 6.2%. Although there were increases in all areas, the most significant rates of increase were in premises and equipment, in particular depreciation and computer expenses, and in government levies.

Average assets decreased by $2.2 billion primarily due to the deliberate reduction of lower-yielding assets and lower currency translation rates for the U.S. dollar.

Non-accrual loans net of specific and general reservations were approximately $1.4 billion, down 29.6% from 1986. The decrease is the net result of several significant events, including the placing of $1.2 billion of Brazilian loans on non-accrual status, reinstating certain petroleum sector loans to accrual status, and increasing reservations by the special provision of $1,299 million. Approximately one-half of the net non-accrual loan balance at October 31, 1987 is accounted for by Dome Petroleum Limited.

The consolidated return on average assets for the year based upon reported net income (before the special provision) was 0.49%, compared with 0.41% last year. On a loan loss experience basis (before the special provision), the return was 0.65%, up from the 0.36% recorded last year.

Special Provision for Losses on Transborder Claims

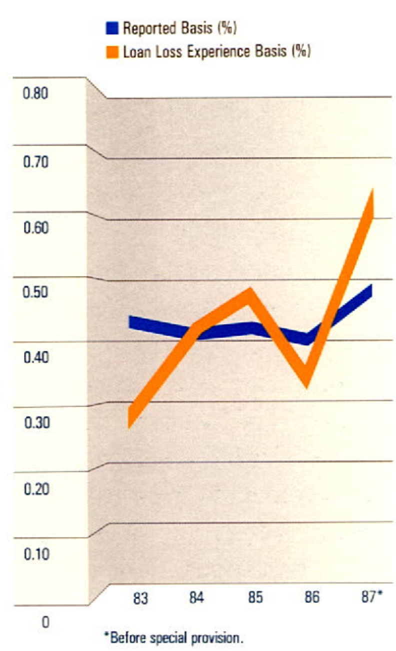
In accordance with regulatory directives, the total amount of designated country reservations established in 1987 together with a realized loss incurred on the disposal of some of these loans has been shown as a special provision for losses on transborder claims in the year rather than being averaged over five years. The total amount of this special provision was $1,299 million, $765 million after applicable income taxes. After this special provision, the Bank recorded a net loss for the year of $352 million on a reported basis and a net loss of $215 million on a loan loss experience basis.

Return on Average Assets

	1983	1984	1985	1986	**1987***
Reported Basis (%)	0.44	0.42	0.43	0.41	**0.49**
Loan Loss Experience Basis (%)	0.29	0.43	0.49	0.36	**0.65**

*Before special provision.

Return on Average Assets



*Before special provision.

Relative Contribution of Bank of Montreal and Harris Bankcorp, Inc.

As mentioned in the Introduction, the analysis which follows segments the consolidated results of the Bank between the Bank's U.S. subsidiary, Harris Bankcorp, Inc., and the remainder of the Bank, referred to as the "Parent Bank".

Harris Bankcorp, Inc.

In order to understand the consolidation of Harris and the Parent Bank, the accompanying table shows the summary income statement, average assets and return on average assets for the Parent Bank and Harris for 1987, and the adjustments required to reconcile to the results on a consolidated loan loss experience basis.

A major component of the combination adjustments is net interest income which reflects the imputed cost of funding the investment in Harris.

For 1987, on average, 82% of the cost of the Harris acquisition was deemed to have been funded by additional equity capital and 18% by interest-bearing funds. The interest cost imputed to the latter, with related tax adjustments, is set off against the earnings flow from Harris in determining its net contribution to the consolidated earnings of the Bank.

The remaining components of the combination adjustments mainly reflect the amortization of the amount by which the purchase price of the Harris acquisition exceeded its net asset value.

Parent Bank

As previously mentioned, the results of Nesbitt have been included as part of the Parent Bank. The acquisition of Nesbitt on September 29, 1987 added approximately $1.5 billion of assets to the Bank's balance sheet. However, as these assets were consolidated for only one month, the impact on the Bank's average assets was not material. Similarly, Nesbitt's contribution to consolidated net income in 1987 was immaterial as the results of only one month are consolidated with those of the Bank.

Relative Contribution of Parent Bank and Harris (Loan Loss Experience Basis*) 1987

($ in millions)	Parent Bank	Harris	Combination Adjustments	Bank of Montreal Consolidated
Income				
Net Interest Income**	1,786.1	451.7	(19.9)	2,217.9
Loan Loss Experience	9.0	65.9	–	74.9
	1,777.1	385.8	(19.9)	2,143.0
Other Operating Income	632.4	279.1	6.6	918.1
Non-Interest Expense	1,542.2	494.2	19.0	2,055.4
	867.3	170.7	(32.3)	1,005.7
Provision for Income Taxes**	387.2	80.8	(16.4)	451.6
Minority Interests	4.3	–	–	4.3
Net Income	475.8	89.9	(15.9)	549.8
Average Assets ($ in billions)	70.7	13.7	0.2	84.6
Return on Average Assets (percent)	0.67	0.66	–	0.65

*Before special provision.

**Taxable equivalent basis.

Net Interest Income and Spread

Net interest income is the difference between interest earned on loans and securities and interest paid on deposits and debentures. For the purpose of analysis it is adjusted to a taxable equivalent basis. Net interest spread is the net interest income adjusted to a taxable equivalent basis divided by the average of month-end total assets.

The Bank's consolidated taxable equivalent net interest income in 1987 amounted to $2,218 million, down $56 million from 1986. This was due to several factors. Principal among those were the foregone interest from Brazil and Ecuador, which amounted to approximately $100 million, and reduced earnings from international money market operations due to poor trading conditions. In addition, deliberate reductions in lower-yielding assets resulted in lower net interest income. These decreases were offset by the strong performance of the Bank's Brazilian subsidiary, which experienced substantially higher interest earnings, and the improved collections of interest on both non-accrual loans and other loans previously written off.

With the planned asset reductions taking place in lower-yielding loans and advances, the asset mix improved and the overall spread remained constant. This was the major factor enabling the Parent Bank to increase its net interest spread slightly from 2.51% in 1986 to 2.52% in 1987.

Net Interest Income – Taxable Equivalent Basis

($ in millions)	1983	1984	1985	1986	1987
Total Bank NII as reported	1,582	1,626	1,965	2,081	2,080
Taxable equivalent adjustment	155	127	175	193	138
NII taxable equivalent basis	1,737	1,753	2,140	2,274	2,218

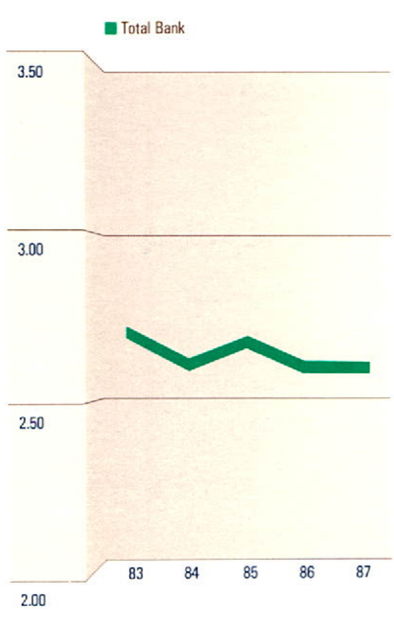
Net Interest Spread – Taxable Equivalent Basis

(As a % of average assets)	1983	1984	1985	1986	1987
Parent Bank	2.73	2.63	2.66	2.51	2.52
Harris		2.69*	3.25	3.55	3.31
Total Bank	2.73	2.63*	2.69	2.62	2.62

*The ratio for Harris has been restated to reflect net interest income for the full year. The Total Bank ratio reflects the inclusion of Harris for only the two months following acquisition.

Net Interest Spread – Taxable Equivalent Basis

(As a % of average assets)



Harris' net interest spread decreased from 3.55% in 1986 to 3.31%, due in part to reduced benefits of tax-exempt assets. Competitive pressures during 1987 had an adverse affect on Harris' spread. However, despite these effects Harris, in common with most U.S. based banks, consistently achieves higher spreads than are generally earned by Canadian chartered banks.

The interest rates which determine the yield on earning assets and the cost of the liabilities funding those assets do not always respond to changes in the market rate of interest simultaneously. To the extent that there are timing differences between changes in these interest rates and new market levels, net interest margins are affected. For example, if loans and securities are generally less sensitive to a rise in interest rates than the liabilities which fund those assets, margins will be reduced until the assets are repriced to the prevailing market rate. Similarly, when interest rates are falling in such an environment, the reverse is true and margins will temporarily increase.

The policy of the Bank is to minimize this risk by matching the terms of liabilities and assets within approved limits, so that net income will not be unduly sensitive to interest rate movements. Positions are reviewed regularly by the Bank's Funds Management Committee.

Loan Loss Experience and Provision for Loan Losses

Loan Loss Experience

The section of the financial statements captioned "Significant Accounting Policies and Practices" describes the Bank's accounting treatment when there is doubt as to the eventual collectibility of its loans. Loan loss experience represents the Bank's best estimate of the increase or decrease in the reservations which are prudently required to reflect the potential losses in the loan portfolio.

As described in the Introduction, loan loss experience for 1987 does not include the special provision in the amount (before income taxes) of $1,299 million. This treatment is in accordance with accounting guidelines issued by the Minister of Finance. However, prior to 1987, all such reservations remain included in loan loss experience thereby distorting somewhat year-over-year comparisons.

The accompanying table shows the history of the Bank's consolidated loan loss experience and provision for loan losses over the past 10 years. This shows that in only three of these years has loan loss experience exceeded 0.70% of eligible loans. The exceptions were:

(i) 1982 and 1983 – when the Bank made early recognition of losses resulting from depressed economic conditions, especially in Western Canada, which affected loans to the real estate, agricul-

Loan Loss Experience

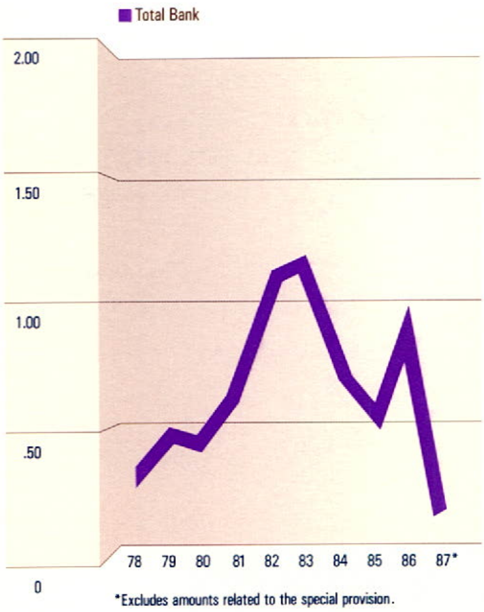
(As a % of eligible loans)	1978	1979	1980	1981	1982
Parent Bank	0.33	0.48	0.46	0.61	1.13
Harris					
Total Bank	0.33	0.48	0.46	0.61	1.13
	1983	1984	1985	1986	1987*
Parent Bank	1.19	0.77	0.59	1.03	0.02
Harris		0.34**	0.51	0.64	0.72
Total Bank	1.19	0.68**	0.58	0.98	0.15

*Excludes amounts related to the special provision.

**The ratio for Harris has been restated to reflect loss experience for the full year. The Total Bank ratio reflects the inclusion of Harris for only the two months following acquisition.

Loan Loss Experience

(As a % of eligible loans)



*Excludes amounts related to the special provision.

ture, mining and energy sectors; and (ii) 1986 – due to the precipitous decline in world oil prices.

Over the 10 years, the average has been 0.66%.

For Harris, the rise in loan loss experience as a percentage of eligible loans during the last three years is not indicative of a deteriorating loan portfolio, but rather the accumulation of prudential general reserves for possible loan losses.

In 1987, the Bank's consolidated loan loss experience was $75 million, a decrease of $530 million from the previous year.

The reduction from 1986 is the result of three significant factors. First, with oil prices ranging between U.S. $18 and U.S. $20 per barrel, the Bank increased by U.S. $1 a barrel to U.S. $16 per barrel the oil price upon which it based the valuation of its oil-related loan portfolio. On this basis, approximately $68 million of reservations made in previous years were not required and were reversed, thereby reducing 1987 loan loss experience. These reversals pertained to loans which had remained current throughout the period of depressed prices. Second, the amounts that the Bank would normally set aside against sovereign debt has, for 1987, been included in the special provision. Finally, the quality of the loan portfolio continues to improve. This, combined with improved economic conditions generally, has meant that certain reservations made in earlier years were not required and therefore were reversed.

The significant level of reversals of reservations made in earlier years and the

Loan Loss Experience and Provision for Loan Losses

($ in millions)	1978	1979	1980	1981	1982
Loan loss experience	70	127	154	268	550
Provision for loan losses	62	94	124	196	319
	1983	**1984**	**1985**	**1986**	**1987***
Loan loss experience	551	365	330	605	**75**
Provision for loan losses	361	375	428	521	**343**

*Excludes amounts related to the special provision.

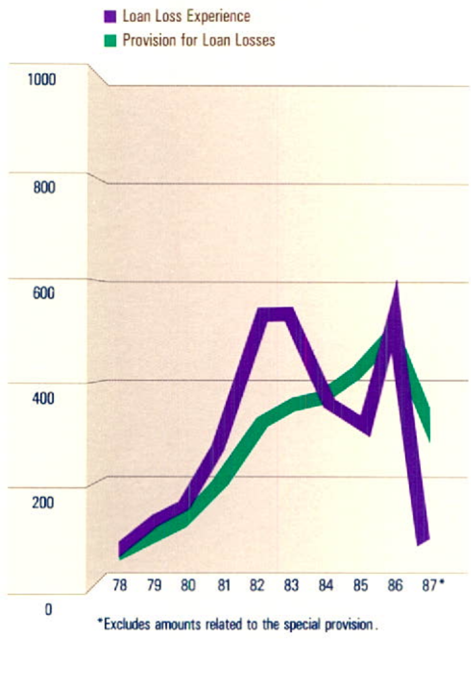
Eligible Loans

($ in millions)	1978	1979	1980	1981	1982
Parent Bank	21,282	26,378	33,241	44,576	48,598
Harris					
Total Bank	21,282	26,378	33,241	44,576	48,598
	1983	**1984**	**1985**	**1986**	**1987***
Parent Bank	46,160	46,772	49,154	53,278	**41,809**
Harris		7,229	7,827	8,668	**9,127**
Total Bank	46,160	54,001	56,981	61,946	**50,936**

*For 1987 only, excludes loans to the 34 designated countries.

Loan Loss Experience and Provision for Loan Losses

($ in millions)



*Excludes amounts related to the special provision.

exclusion of all reservations made against designated country loans has resulted in a 1987 loan loss experience which management believes to be exceptionally low. Therefore, caution should be exercised in attempting to extrapolate the loan loss experience of 1987 into succeeding years.

Special Provision for Losses on Transborder Claims

The Bank's reservations for possible losses on loans to the 34 countries designated by the Superintendent of Financial Institutions have been building over a number of years. In 1987, these reserves were increased by $1,299 million to reach approximately 35% of the aggregate indebtedness of the designated countries. The total of such reserves now amounts to approximately $2 billion.

The new level of reservations is consistent with recently revised guidelines issued by the Superintendent of Financial Institutions. Also, as directed by the Superintendent and mandated by the Minister of Finance, the total amount of reservations against the designated countries established in 1987 together with a loss incurred on the disposal of some of these loans have been accounted for as a special provision for losses on transborder claims. Net of applicable income taxes, this special provision amounted to $765 million and is shown as a separate item in the Consolidated Statement of Income.

For 1987 only, accounting guidelines require that the formula used to calculate the provision for loan losses charged to income excludes the gross amount of the special provision from loan loss experience, and excludes the aggregate indebtedness of the designated countries from eligible loans.

Provision for Loan Losses

As described in the Introduction, Canadian chartered banks are required to average their loan loss experience over five years. The effect of this formula is that the impact on net income of changes in loan loss experience is delayed.

For fiscal 1987, the provision for loan losses was $343 million, $177 million less than for 1986. The decrease was attributable to the lower loan loss experience described above and a lower level of eligible loans reflecting both the overall reduction in assets and the exclusion from eligible loans for 1987 of the aggregate amount of loans to the designated countries.

Other Operating Income

Other operating income consists of service charges, charge card income, most loan administration fees, income from foreign exchange, trust income and all other income which is not dividend or interest income.

In 1987, other operating income on a consolidated basis was $918 million, an increase of $99 million or 12.1% from last year. The 1987 increase for the Parent Bank was $62 million, with Harris accounting for the remainder. Growth occurred in all major categories.

For certain account services and transactions, the Bank charges a fee to recover the processing and administration costs incurred based on the type and frequency of the service performed. During 1987, volumes of transactions processed increased and service charge income for the Parent Bank accordingly rose by $37 million from the previous year. Similarly, foreign exchange revenue grew by $18 million or 22.3%, primarily because of the continuing success of Treasury's foreign exchange trading activities. Charge card income, which represents the merchant fee discount paid by retailers, has also increased mainly due to the increased volume of MasterCard transactions. These increases were partially offset by two factors. First, Canada Savings Bonds commissions were lower due to generally lower sales volume of the 1986 issue and second, there were lower Bankers' Acceptance fees.

Trust income at $123 million for 1987 continues to be a major factor for Harris, showing a 17.1% increase over 1986.

Harris also benefitted from strong growth in service charges and loan fees of 26.5% and 34.0% respectively.

Other Operating Income

($ in millions)	1983	1984	1985	1986	1987
Service charges	128	148	185	235	**283**
Charge card	66	78	130	154	**158**
Loan fees	93	87	114	134	**151**
Foreign exchange	46	50	77	92	**112**
Trust income	–	14	85	105	**123**
Non-recurring gains	–	43	–	–	**–**
Other	78	79	91	99	**91**
Total Bank	411	499	682	819	**918**

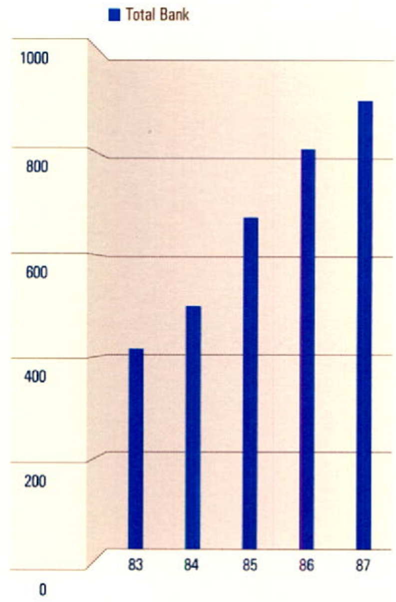
Other Operating Income

(As a % of average assets)	1983	1984	1985	1986	1987
Parent Bank	0.65	0.73	0.69	0.78	**0.89**
Harris		1.42*	1.80	1.89	**2.05**
Total Bank	0.65	0.75*	0.86	0.94	**1.09**

*The ratio for Harris has been restated to reflect other operating income for the full year. The Total Bank ratio reflects the inclusion of Harris for only the two months following acquisition.

Other Operating Income

($ in millions)



Non-Interest Expense

Non-interest expense consists of employee costs, premises and equipment costs and all other operating expenses. In total, these expenses amounted to $2,055 million in 1987, an increase of $120 million or 6.2% from last year.

For the Parent Bank, employee expenses, which account for just over half of the non-interest expense, were $839 million, $36 million or 4.5% higher than last year. This is mainly attributable to salary increases during the year as staff levels, excluding the addition of Nesbitt's employees, remain virtually unchanged from the previous year.

Parent Bank premises, equipment and computer costs increased from $307 million in 1986 to $336 million in 1987, an increase of 9.5%. The Parent Bank continues to invest significantly in enhancing its computer and telecommunications infrastructure, to improve its products and services, as well as its customer and management information. As a result of these enhancements, there was a 21.7% increase in computer and mechanical equipment expenses which principally comprise depreciation, maintenance and software licensing fees. These expenses

Non-Interest Expense

($ in millions)	1983	1984	1985	1986	1987
Salaries and staff benefits	727	777	996	1,060	**1,109**
Premises and equipment	183	213	261	269	**292**
Computer	74	75	104	121	**143**
Other expenses	265	319	426	485	**511**
Total Bank	1,249	1,384	1,787	1,935	**2,055**

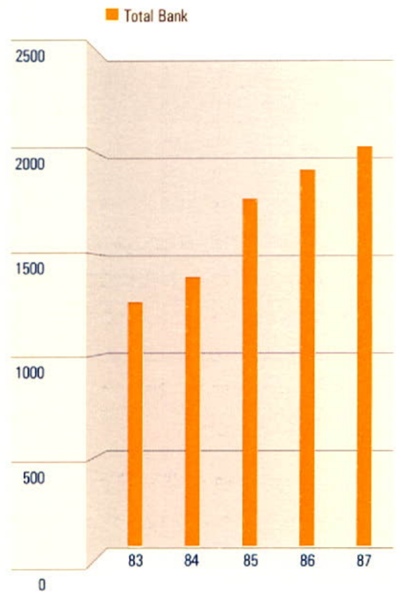
Non-Interest Expense

(As a % of average assets)	1983	1984	1985	1986	1987
Parent Bank	1.96	2.03	2.03	1.98	**2.18**
Harris		3.13*	3.36	3.56	**3.62**
Total Bank	1.96	2.07*	2.25	2.23	**2.43**

*The ratio for Harris has been restated to reflect non-interest expense for the full year. The Total Bank ratio reflects the inclusion of Harris for only the two months following acquisition.

Non-Interest Expense

($ in millions)



do not reflect all technology-related expenses, some of which are included in salaries and in premises and equipment.

The category of "Other expenses" contains such items as travel, advertising, communications, and federal and provincial capital taxes. For the Parent Bank, this category has increased by $25 million or 7.3% to $367 million. More than half of this increase is attributable to the federal capital tax introduced in 1986, increased provincial capital tax rates and higher deposit insurance premiums which in aggregate increased 24.1% to $75 million.

In total, Parent Bank non-interest expense increased from 1986 by 6.2%. The average rate of growth over the last 5 years has been approximately 6% and reflects the Parent Bank's commitment to contain increases in non-interest expenses. However, primarily as a result of the reduction of total assets, the Parent Bank's ratio of non-interest expense to average assets rose from 1.98% to 2.18%.

The increase in Harris' expenses was approximately $28 million. About half of this is due to employee expense increases attributable primarily to additional personnel, salary increases and higher payroll taxes. These increases were offset somewhat by the lower currency translation rate for the U.S. dollar compared to 1986.

The ratio of expenses to assets for Harris was 3.62%. This reflects Harris' continuing emphasis on activities (such as trust business) which generate non-interest revenue rather than interest income from earning assets.

Income and Capital Taxes

In 1987, the Bank's provision for income taxes was $182 million, an increase of $96 million from 1986. Expressed as a percentage of income before taxes and special provision, the tax charge was 30.4% in 1987.

This rate is less than the Canadian statutory marginal income tax rate of 48.9% applicable in 1987. One reason for this is the income derived from tax-exempt instruments, which were introduced as a matter of Government policy to aid small business and other groups. The yield on these instruments to the Bank is about one-half of that normally prevailing; the benefit of the non-taxable status is largely passed on to the borrowers. Adjusting for these items (by the "taxable equivalent adjustment" explained previously) restates the Bank's provision for income taxes to a level of 43.4% in 1987 (43.9% in 1986).

The aggregate tax rate is also affected by the rates of foreign tax applicable to the income earned by foreign subsidiaries of the Bank. The combined effective tax rate on these earnings is lower than the Canadian statutory marginal income tax rate.

Another element of taxation which is not included in the provision for income taxes is federal and provincial capital taxes, which are accounted for as other non-interest expenses. Generally, financial institutions pay a relatively high rate of capital tax. In 1987, the amount of these taxes levied upon the Bank was $49 million, an increase of 21.6% from 1986.

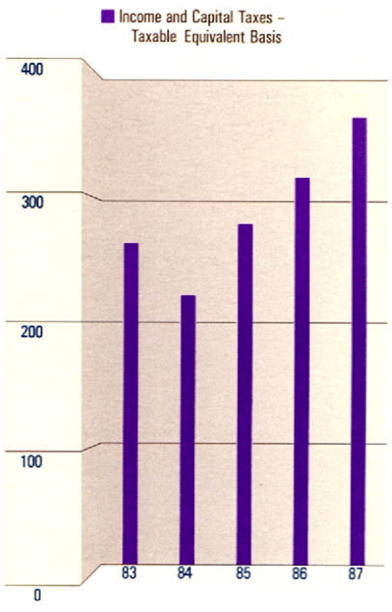
In addition to direct taxes on income and capital, Canadian chartered banks, unlike trust companies and other financial institutions with which the Bank competes, are required under the Bank Act to maintain interest-free reserves with the Bank of Canada. Maintenance of these reserves, which averaged $1.0 billion during 1987, represents a real cost to the Bank, as the funds deposited earn no income.

Income and Capital Taxes – Taxable Equivalent Basis

($ in millions)	1983	1984	1985	1986	**1987**
Provision for income taxes	96	79	88	87	**182**
Taxable equivalent adjustment	155	127	175	193	**138**
Capital taxes	15	17	19	40	**49**
Income and capital taxes on taxable equivalent basis	266	223	282	320	**369**

Income and Capital Taxes – Taxable Equivalent Basis

($ in millions)



Liquidity, Loans, Deposits and Average Assets

Liquidity

It is the policy of the Bank to maintain a relatively high proportion of its assets in liquid form in both Canadian and U.S. dollars. It holds these in the form of cash resources, deposits with banks, marketable securities and day, call and short loans. At October 31, 1987, liquid assets were 29.2% of total assets, compared with 28.0% a year earlier.

In Canadian dollars, the Bank maintained an average of $1.0 billion in non-interest bearing primary reserves, and an average of $1.0 billion in secondary reserves. Both of these reserves are required by the Bank of Canada. In U.S. dollars regulatory reserves averaged approximately $300 million.

The remainder of the Bank's liquidity, which averaged $21.5 billion, comprised short-term Government of Canada treasury bills; day, call and short loans, consisting largely of secured overnight advances to security dealers; deposits with major international banks and holdings of U.S. Government securities.

Loans

The Bank's loan portfolio at October 31, 1987, amounted to $52.6 billion net of reservations for losses of $2.6 billion, a decrease of $1.9 billion from 1986. The reduction reflects the reduced proportion of lower-yielding assets and the increase in reservations for losses, of which $1.3 billion was due to the special provision.

The Bank's policy is to maintain geographic diversity and to spread portfolio risk among major sectors of economic activity. As an illustration, the wide geographic diversification of the Bank's assets including the loan portfolio is shown in Note 5 to the financial statements.

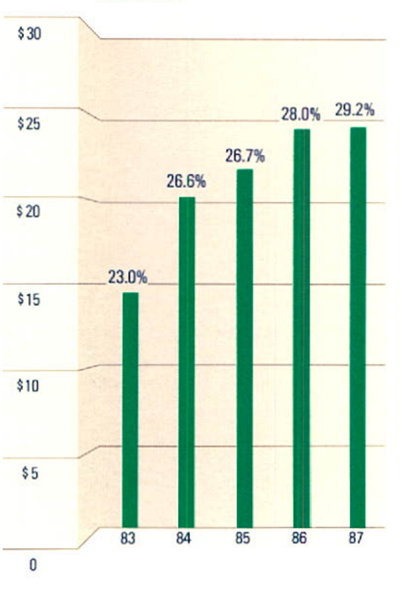
Parent Bank loans denominated in Canadian dollars increased by 7.1% or about $1.9 billion from 1986. Strong growth in residential mortgages was

Liquidity

($ in billions)	1983	1984	1985	1986	1987
Cash resources	1.4	2.0	2.4	2.2	**2.5**
Deposits with banks	6.9	11.3	10.3	12.3	**11.0**
Liquid securities	5.9	6.4	8.4	8.8	**10.0**
Day, call and short loans	0.3	0.7	0.9	1.1	**1.1**
Total	14.5	20.4	22.0	24.4	**24.6**
As a % of Total Assets	23.0	26.6	26.7	28.0	**29.2**

Liquidity

(Total dollars in billions with % of total assets)



experienced despite the Bank securitizing and selling approximately $430 million of its mortgage loans to the First Canadian Mortgage Fund, a mutual fund administered by Bank of Montreal Mortgage Corporation and eligible for Registered Retirement Savings Plans. Consumer loans also increased from a year ago.

Foreign currency loans in the Parent Bank declined by $4.5 billion or 21.8% compared to 1986. The reduction is explained by several factors. First, lower-yielding foreign currency loans were reduced through active sales of loan participations and management of customer relationships to attain profitability targets. Second, the reservations against the 34 designated countries of $1,299 million established in 1987 reduced these loan balances; such loans are virtually all denominated in foreign currencies, mainly U.S. dollars. Finally, the Canadian dollar equivalent of foreign currency loans have declined due to lower translation rates.

Included in foreign currency loans are all Harris' loan assets. In U.S. dollar terms Harris' loans grew by $812 million or 15.4%, primarily due to the increase in commercial loans.

Deposits

Total deposits at $72.1 billion were 3.7% lower at October 31, 1987. An increase in Canadian currency deposits of $2.5 billion or 7.5% was more than offset by a decrease in foreign currency deposits of $5.3 billion or 12.8%.

For the Parent Bank, the increase in Canadian dollar deposits of 7.5% occurred

Loans (Net of Reservations for Losses)

($ in billions)	1983	1984	1985	1986	**1987**
Parent Bank					
Canadian currency	23.1	23.1	25.1	26.6	**28.5**
Foreign currency	18.4	19.1	20.3	20.6	**16.1**
Harris		5.7	6.6	7.3	**8.0**
Total Bank	41.5	47.9	52.0	54.5	**52.6**

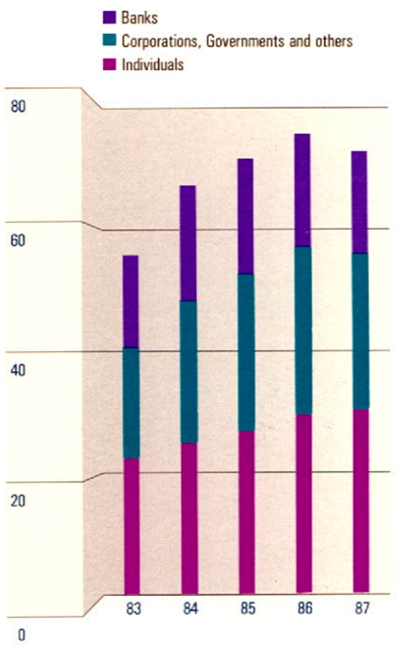
Deposits

($ in billions)	1983	1984	1985	1986	**1987**
Deposits by individuals	22.1	24.6	26.7	28.8	**30.0**
Deposits by corporations, governments and others	18.1	23.3	25.8	27.6	**25.4**
Deposits by banks	15.1	18.8	18.9	18.5	**16.7**
Total	55.3	66.7	71.4	74.9	**72.1**

Deposits

($ in billions)	1983	1984	1985	1986	**1987**
Demand	5.3	7.0	8.9	8.7	**8.6**
Notice	15.0	16.0	18.5	20.2	**22.5**
Term	35.0	43.7	44.0	46.0	**41.0**
Total	55.3	66.7	71.4	74.9	**72.1**

Deposits
($ in billions)



mainly in the category of notice deposits due to the success of the Investment Chequing Account and the Investment Savings Account. Personal deposits, including daily interest, investment savings and true savings accounts, chequable savings accounts and personal term deposits, are a stable source of funds which, at the end of 1987 represented 71.8% of Canadian dollar deposits.

Foreign currency deposits in the Parent Bank decreased $5.8 billion or 19.3%. A planned decrease in foreign loans and deposits with other banks resulted in reduced requirements for the term deposits used to fund such loans and securities.

For Harris, deposits in U.S. dollar terms increased by $848 million to reach $9.1 billion. The mix of deposits improved with an increase in low and medium-cost deposits while high-cost deposits decreased. In Canadian dollar equivalent terms, the value of Harris' deposits increased only $499 million as a result of the lower U.S. dollar exchange rate compared to a year ago.

It is the Bank's policy to match assets and liabilities in the more than 50 currencies in which the Bank's business is transacted. U.S. dollar loans are funded by an approximately equal amount of U.S. dollar deposits. Outside Canada, these deposits come primarily from commercial customers, banks, governments, international agencies and non-bank financial institutions.

Average Assets

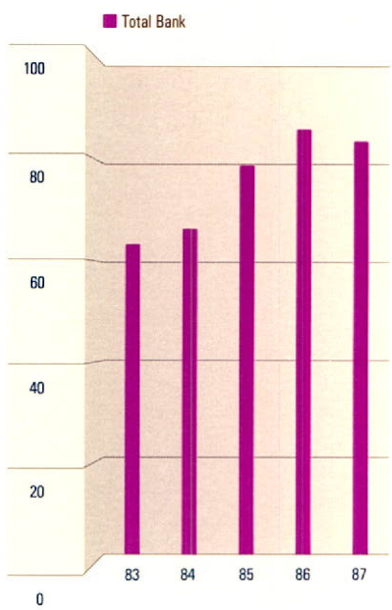
The average of the month-end assets decreased $2.2 billion (2.5%) from 1986 to $84.6 billion. The Parent Bank's average assets decreased by $2.7 billion (3.7%), while Harris' increased by $546 million or 4.2% from 1986. Aside from the currency translation effect, the decrease in average assets was mainly the result of the Bank's planned reduction in lower-yielding foreign currency assets including acceptances, deposits with banks and certain loans.

Average Assets

($ in billions)	1983	1984	1985	1986	1987
Parent Bank	63.7	65.0	67.8	73.7	70.9
Harris		10.9*	11.7	13.1	13.7
Total Bank	63.7	66.7*	79.5	86.8	84.6

*The average assets for Harris have been restated to reflect those for the full year. For the period from September 4, 1984 to October 31, 1984 the average assets were $1.7 billion which is reflected in the average assets of the Total Bank.

Average Assets
($ in billions)



Non-Accrual Loans Net of Reservations for Losses

Non-accrual loans are those loans and loan substitution securities which have been placed on a non-accrual accounting basis under circumstances outlined in the section of the financial statements entitled "Significant Accounting Policies and Practices". The category "non-performing loans" comprises all non-accrual loans plus those loans which have been renegotiated at a reduced interest rate.

Loan loss reservations comprise the aggregate specific and general reservations set aside against the possibility that loan principal will not be repaid.

During fiscal 1987, the Bank's level of total net non-accrual loans, that is net of reservations for losses, decreased by 29.6% to a level of $1.4 billion at year-end. The net reduction comprises an increase in gross non-accrual loans of some $500 million offset by an increase in reservations for losses of $1.1 billion.

Exposures to Brazil, Ecuador, Argentina as well as Dome Petroleum Limited account for approximately 60% of gross non-accrual loans.

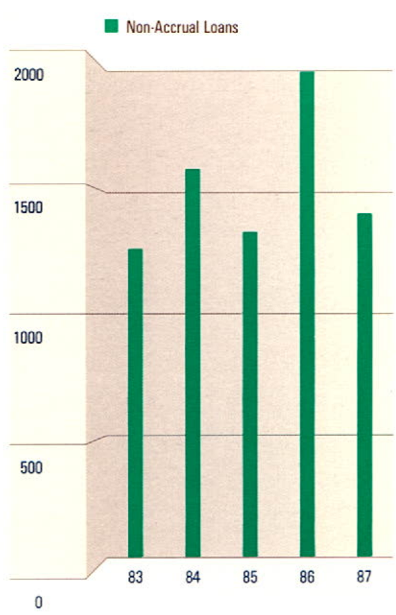
In the case of Brazil, on April 30, 1987, approximately $1.2 billion (which represents the Bank's total medium and long-term cross-border loans) were placed on non-accrual status, following the decision of the Brazilian government to suspend payments on all such loans. In December 1987, a conditional interim agreement was reached with Brazil under which

Non-Accrual Loans at Year End Net of Reservations for Losses

	1983	1984	1985	1986	1987
Non-accrual loans ($ in millions)	1,262	1,593	1,337	1,995	1,404
As a % of eligible loans	2.73	2.95	2.35	3.22	2.76
Interest income on Non-accrual loans ($ in millions)	114	122	127	120	112

Non-Accrual Loans at Year End Net of Reservations for Losses

($ in millions)



Brazil would resume interest payments beginning in January 1988. The agreement also provides for the payment of interest arrears to be funded in part by additional advances. Certain of these payments are conditional on Brazil reaching agreement with the Brazil Bank Advisory Committee on a medium-term financial arrangement.

In addition, on April 30, 1987, some $100 million of loans to Ecuadorian borrowers were placed on non-accrual status. Ecuador has been unable to service its debt to the Bank since an earthquake in March 1987 severely damaged the oil pipeline which was a principal source of export earnings.

All cross-border exposure to Argentina, amounting to approximately $400 million, was placed on non-accrual status at the end of April 1984. During 1987, Argentina has remained substantially current on its commitments and is not required by accounting regulations to be classified as non-accrual. However, in view of the continuing difficulties being experienced by the Argentine economy, the Bank considers it prudent to continue to treat all Argentine exposure on a non-accrual basis.

As at October 31, 1987, loans to Dome Petroleum Limited approximating $800 million were classified as non-accrual. All of the loans were secured. In November 1987, the Bank and Amoco Canada Petroleum Company Ltd., agreed in principle to the basis upon which the Bank will support Amoco's offer to purchase Dome. Conclusion of the acquisition on this basis, which requires approval by creditors, shareholders and the courts, will result in the Bank receiving cash and Amoco securities, the value of which will fully recover the principal amount of the Dome debt, removing the need for an existing reservation. The new Amoco obligations will be carried on an accrual basis.

Gross non-accrual loans were reduced by improvements in other sectors of the loan portfolio, notably petroleum, and by writing off non-accrual loans of earlier years; most of the latter had been fully provided against.

Loan loss reservations increased by $1.1 billion during the year to reach $2.6 billion at October 31, 1987. The increase is more than accounted for by the special provision of $1,299 million referred to earlier. This provision increased the general reservations on all cross-border loans to the 34 designated countries to just over $2 billion, or approximately 35% of total balances outstanding. Write-offs and reversals of reservations which were no longer required offset this large increase somewhat.

The Bank's credit review process is designed to ensure that recognition of potential losses takes place as early as practicable. An indicator of the continuing success of that process is the high yield which the Bank achieves on non-accrual loans. In 1987, the yield (representing cash receipts less interest reversals) on average net non-accrual loans was 5.9%.

Capital Funds

The capital shown on the Statement of Assets and Liabilities comprise funds invested by common and preferred shareholders and retained earnings. Reservations for loan losses are not included.

It is the Bank's policy to maintain adequate and appropriate levels of capital funds to support its asset volumes and to meet the requirements and guidelines of various regulatory authorities.

As at October 31, 1987, equity capital was $3.5 billion. Total capital funds which include equity capital and debentures were $4.7 billion.

The Bank's common shareholders' equity, which comprises common shares and retained earnings, amounted to $3.0 billion, a slight increase from 1986 despite the special provision recorded for 1987.

The Bank strengthened its common share capital during the year as follows:
(i) exchange for common shares of $95 million of Bank of Montreal Mortgage Corporation debentures on March 16;
(ii) conversion to common shares of $200 million Class A Convertible Preferred Shares Series I on March 27;
(iii) issuance of $300 million of common shares at a price of $33 per share, on October 1; and
(iv) issuance of $82 million of common shares through dividend reinvestment and stock purchase plans.

Preferred shares decreased to $450 million from $650 million due to the share conversion mentioned above.

Capital Funds

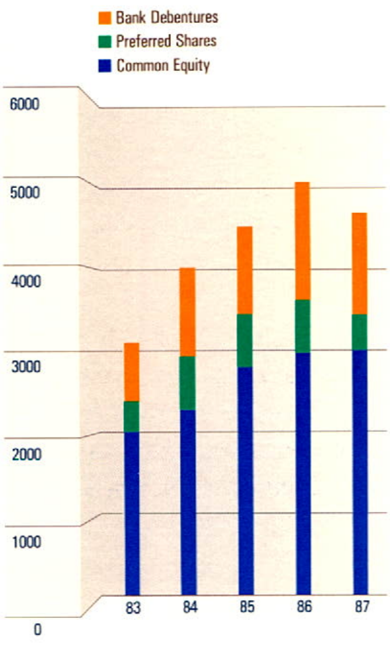
($ in millions)	1983	1984	1985	1986	**1987**
Common equity	2,013	2,296	2,802	2,995	**3,013**
Preferred shares	375	650	650	650	**450**
Equity capital	2,388	2,946	3,452	3,645	**3,463**
Bank debentures	728	1,065	1,100	1,462	**1,259**
Total capital funds	3,116	4,011	4,552	5,107	**4,722**

Capital Ratios

(percent)	1983	1984	1985	1986	**1987**
Ratio of equity capital to total assets	3.78	3.85	4.19	4.18	**4.11**
Ratio of total capital funds to total assets	4.93	5.24	5.52	5.86	**5.61**

Capital Funds

($ in millions)



Debt capital in the form of Bank debentures was reduced during fiscal 1987. The Bank called for redemption on December 22, 1986, U.S. $100 million (principal amount) of Series 5 floating rate debentures which were refunded in part from the proceeds of the Series 10 debentures issued in July 1986. Balances in Canadian dollar terms have also been reduced due to the impact of lower currency translation rates applied to the debentures denominated in U.S. dollars.

Subsequent to the fiscal year-end, the Bank called for redemption on December 1, 1987, its Series 7 debentures, which amounted to U.S. $150 million and carried a fixed interest rate of 16.25%. In addition, the Bank called for redemption on December 16, 1987, its Series 4 floating rate debentures which amounted to $125 million and carried an 8.9% interest rate as at October 31, 1987.

The Bank's ratio of equity capital and contingency reserves to total assets was 4.11% at October 31, 1987, virtually unchanged from the end of the previous fiscal year despite the special provision made during the year.

In the United States, the regulatory definition of capital is different in several respects from that used in Canada. The major difference is that the U.S. definition permits the inclusion of provisions for credit losses calculated under U.S. regulations. In Canada, loan loss reservations are entirely excluded. This difference in methodology results in a lower capital ratio calculated in accordance with Canadian practice than would be the case in the United States. During 1987, this difference has been magnified as the additional reservations against sovereign debt made by many U.S. banks had no significant impact on their primary capital ratio.

Annual Financial Statements

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Annual Financial Statements
Consolidated Statement of Assets and Liabilities

As at October 31
($ in thousands)

Bank of Montreal

Assets	1986	1987
Cash Resources		
Cash and deposits with Bank of Canada	$ 1,105,573	$ 1,654,237
Deposits with other banks	12,265,534	10,998,226
Cheques and other items in transit, net	1,142,854	887,318
	14,513,961	13,539,781
Securities Issued or Guaranteed by (note 1)		
Government of Canada	4,133,494	4,581,448
Provinces and municipal or school corporations	589,044	729,712
Other	5,802,286	5,738,108
	10,524,824	11,049,268
Loans (net of reservations for losses of $2,646,405; 1986–$1,585,584) (note 2)		
Day, call and short loans to investment dealers and brokers, secured	1,142,707	1,103,826
Banks	2,930,653	2,705,928
Mortgages	8,886,736	9,806,609
Other	41,510,461	38,941,867
	54,470,557	52,558,230
Other		
Customers' liability under acceptances	4,632,601	3,287,304
Land, buildings and equipment (note 3)	1,277,948	1,334,335
Other assets (note 4)	1,759,626	2,458,803
	7,670,175	7,080,442
Total Assets	$ 87,179,517	$ 84,227,721

Liabilities, Capital and Contingency Reserves	1986	1987
Deposits (note 6)		
Payable on demand	$ 8,729,485	$ 8,564,859
Payable after notice	20,131,834	22,514,371
Payable on a fixed date	46,015,077	41,004,980
	74,876,396	72,084,210
Other		
Acceptances	4,632,601	3,287,304
Liabilities of subsidiaries, other than deposits (note 7)	779,521	641,599
Other liabilities (note 8)	1,728,127	3,399,094
Minority interests	55,521	94,050
	7,195,770	7,422,047
Subordinated Debt		
Bank debentures (note 9)	1,462,482	1,258,978
Capital and Contingency Reserves (note 10)		
Appropriations for contingencies	459,464	–
Shareholders' equity		
Share capital (note 11)		
Preferred shares	650,079	450,000
Common shares	1,252,482	1,930,939
Retained earnings	1,282,844	1,081,547
	3,644,869	3,462,486
Total Liabilities, Capital and Contingency Reserves	$ 87,179,517	$ 84,227,721

William D. Mulholland
Chairman and
Chief Executive Officer

Matthew W. Barrett
President and
Chief Operating Officer

Consolidated Statement of Income

For the Year Ended October 31
($ in thousands except per share amounts)

Bank of Montreal

	1986	1987
Interest, Dividend and Fee Income		
Loans	$ 5,692,852	$ 5,422,512
Lease financing	46,490	48,326
Securities	868,165	855,575
Deposits with banks	921,979	774,998
	7,529,486	7,101,411
Interest Expense		
Deposits	5,263,337	4,844,881
Bank debentures	116,420	111,999
Liabilities other than deposits	68,685	64,983
	5,448,442	5,021,863
Net Interest Income	2,081,044	2,079,548
Provision for loan losses (note 12)	520,583	343,271
Net Interest Income After Provision for Loan Losses	1,560,461	1,736,277
Other operating income	818,856	918,085
Net Interest and Other Income	2,379,317	2,654,362
Non–Interest Expense		
Salaries	960,998	1,009,480
Pension and other staff benefits	98,581	99,837
Premises and equipment	390,504	434,941
Other expenses	485,402	511,171
	1,935,485	2,055,429
Income Before Provision for Income Taxes	443,832	598,933
Provision for income taxes (note 13)	86,500	182,006
Income Before Minority Interests	357,332	416,927
Minority interests	4,382	4,324
Net Income Before Special Provision	352,950	412,603
Special provision for losses on transborder claims (note 14)		765,000
Net Income (Loss) After Special Provision	$ 352,950	$ (352,397)
Net income (loss) per common share (note 15)		
–before special provision for losses on transborder claims	$ 3.70	$ 4.09
–after special provision for losses on transborder claims		$ (4.42)

Consolidated Statement of Appropriations for Contingencies

For the Year Ended October 31
($ in thousands)

Bank of Montreal

	1986	1987
Balance at Beginning of Year		
Tax allowable	$ 390,337	$ 317,620
Tax paid	66,764	141,844
	457,101	459,464
Changes During Year		
Loan loss experience for the year (note 12)	(604,682)	(74,866)
Provision for loan losses based on five year average loan loss experience	520,583	343,271
Tax effect on subsidiaries' portion of loan loss experience less provision for loan losses	6,462	4,934
Transfer from (to) retained earnings	80,000	(732,803)
	2,363	(459,464)
Balance at End of Year		
Tax allowable	317,620	-
Tax paid	141,844	-
	$ 459,464	$ -

Consolidated Statement of Changes in Shareholders' Equity

For the Year Ended October 31
($ in thousands)

Bank of Montreal

Class A Preferred Shares (note 11)	1986	1987
Balance at beginning of year	$ 650,079	$ 650,079
Conversion of Series 1 Shares to Common Shares	–	(200,079)
Balance at end of year	$ 650,079	$ 450,000

Common Shares (note 11)	Number of Shares	
Balance at October 31, 1985	77,425,769	$ 1,130,186
Shareholder Dividend Reinvestment and Share Purchase Plan	3,596,274	115,015
Stock Dividend Program	239,977	7,194
Exercise of Class A Preferred Shares – Series 2 Warrants	2,620	86
Conversion of Bank of Montreal Mortgage Corporation Exchangeable Debentures	26	1
Balance at October 31, 1986	81,264,666	1,252,482
Shareholder Dividend Reinvestment and Share Purchase Plan	2,387,101	76,073
Stock Dividend Program	202,365	6,412
Exercise of Class A Preferred Shares – Series 2 Warrants	3,225	107
Conversion of Class A Preferred Shares – Series 1	6,088,444	200,079
Conversion of Bank of Montreal Mortgage Corporation Exchangeable Debentures	3,044,953	95,486
Common Shares issued	9,100,000	300,300
Balance at October 31, 1987	102,090,754	$ 1,930,939

Retained Earnings	1986	1987
Balance at beginning of year	$ 1,215,111	$ 1,282,844
Net income (loss) after special provision	352,950	(352,397)
Dividends – Common shares	(157,605)	(184,133)
– Preferred shares	(57,404)	(45,007)
Unrealized gain (loss) on translation of net investment in foreign operations net of applicable tax	9,792	(58,972)
Transfer from (to) appropriations for contingencies	(80,000)	732,803
Income taxes related to the above transfer	–	(288,712)
Share issue expense (after tax)	–	(4,879)
Balance at end of year	$ 1,282,844	$ 1,081,547

The accounting policies and financial statement formats of Canadian banks are prescribed by the Bank Act and its regulations. The accounting policies followed by the Bank conform in all material respects with accounting principles generally accepted in Canada, except for the accounting for losses on loans, the treatment of gains and losses on the disposal of certain debt securities and the translation of foreign currencies.

The significant accounting policies followed by the Bank are described below:

Basis of Consolidation

These consolidated financial statements include the Bank and all its subsidiary corporations. The purchase method is used to account for all acquisitions. The difference between the cost of the investment and the fair value of the net assets acquired is deferred and amortized over a period not exceeding 25 years.

On September 29, 1987 the Bank effectively acquired 75% of the voting shares of Nesbitt, Thomson Inc. The assets and liabilities of Nesbitt, Thomson Inc. are included in the October 31, 1987 Consolidated Statement of Assets and Liabilities and the results of its operations from the date of acquisition are included in the Consolidated Statement of Income.

Investments in affiliated corporations in which the Bank owns 20% to 50% of voting shares are accounted for by the equity method, whereby the income of such corporations is recognized based on the Bank's proportionate share of the earnings.

Translation of Foreign Currencies

Assets and liabilities in foreign currencies are translated into Canadian dollars at year-end exchange rates. Revenues and expenses are translated at the average exchange rates prevailing during the year.

Realized and unrealized gains and losses on foreign currency assets and liabilities, other than those relating to net investments in foreign operations, are recorded in Other Operating Income.

Unrealized foreign currency translation gains and losses on investments in foreign branches, subsidiaries and associated corporations are recorded in retained earnings net of any offsetting losses and gains, after providing for applicable income taxes, on liabilities and foreign exchange contracts used to hedge the investments. Such gains and losses are recorded in income only when realized.

Securities

The Bank's securities are accounted for on either an investment or trading basis.

Investment account securities are securities purchased where the Bank's original intention is to hold the securities to maturity or until market conditions render alternative investments more attractive. Trading account securities are those securities purchased for resale over a short period of time.

Investment account securities are accounted for as follows:

- Equity securities, other than loan substitutes, are carried at cost. Gains and losses on the sale of these securities are included in income when realized.
- Debt securities, other than loan substitutes, are carried at amortized cost. Gains and losses on these securities are

Securities (cont'd)

deferred and amortized to income over five years, except for gains and losses on the sale of Treasury Bills and similar instruments which are included in income when realized.

- Any permanent impairment in the value of investment account securities, with the exception of loan substitutes, is recognized through a charge to income in the year of impairment.
- Loan substitutes are accorded the accounting treatment applicable to loans.

Trading account securities are carried at market value and adjustments to market value are reflected in income in the period in which they occur. Gains and losses on sale of trading securities are included in income when they occur.

Loans

Loans are stated net of any unearned income, unamortized discounts and reservations for losses.

Loan fees are recorded in income when received to the extent that they relate to expenses which have been incurred or services which have been provided by the Bank. Fees received for loan rescheduling and fees received in lieu of interest are deferred and amortized over the term of the loan.

Interest income is recorded on an accrual basis except on loans classified as non-accrual.

The accounting treatment for non-accrual loans, which complies in all respects with the regulations of the Superintendent of Financial Institutions, is as follows:

<table>
<tr><th></th><th>Personal Plan and Credit Card Loans</th><th>Sovereign Risk Loans</th><th>All Other Loans</th></tr>
<tr><td>Classification as non-accrual</td><td>Loans are classified as non-accrual when payments are contractually past due six months.</td><td colspan="2">Loans are classified as non-accrual when:
1. in the opinion of management there is significant doubt as to the ultimate collectibility of principal, in which case a specific reservation is established against the loan, or
2. payment of interest or principal is contractually past due 90 days and there is reasonable doubt as to ultimate collectibility, or
3. payment of interest or principal is contractually past due 180 days, or
4. in the opinion of management it is considered prudent or desirable to cease accruing interest, irrespective of the status of interest or principal payments.</td></tr>
<tr><td>Interest</td><td colspan="3">When the loan is classified as non-accrual, all accrued and unpaid interest is reversed and charged against income in the period in which the loan is classified as non-accrual. Interest is not capitalized if a loan is non-accrual nor is it capitalized to prevent placing a loan on a non-accrual basis.</td></tr>
</table>

	Personal Plan and Credit Card Loans	Sovereign Risk Loans	All Other Loans
Application of subsequent payments	Subsequent payments are applied first to interest, then to principal, unless directed otherwise by the borrower.	Subsequent payments are applied first to interest, then to principal, unless directed otherwise by the borrower.	Subsequent payments are recorded in income only if management has determined that the loans do not require reservations, otherwise they are recorded as a reduction of principal.
Establishment of reservation	Credit card loans are reviewed at least quarterly and fully reserved when they are six months in arrears. Personal plan loans are reviewed quarterly and fully reserved when they are one year in arrears.	Loans are reviewed at least quarterly. If there is significant doubt as to the ultimate collectibility of principal, a specific reservation is established at a level sufficient to provide for the estimated impairment of loan principal. The Bank also maintains general reservations against sovereign risk loans. The purpose of these general reservations is to permit management to provide from time to time against possible loan losses, when in its judgment circumstances are such as to give rise to concern, even though events may not have occurred which would justify the classification of individual loans as non-accrual. General reservations are prudential in nature and may be established on an allocated or unallocated basis.	Loans are reviewed at least quarterly. If there is significant doubt as to the ultimate collectibility of principal, a specific reservation is established at a level sufficient to provide for the estimated impairment of loan principal.
Write-offs	Credit card and personal plan loans are written off when they are fully reserved.	Loans are written off after all reasonable restructuring/collection activities have taken place and the possibility of further recovery is considered to be remote.	

Loan Losses
Actual loan loss experience comprises net new reservations for the year less recoveries against loans previously written off.

Reservations established during 1987 on claims where the ultimate risk is located in certain countries designated by the Superintendent of Financial Institutions are not eligible for inclusion in loan loss experience or provision for loan losses. For prior years such claims and the related reservations continue to be included in the five year averaging formula for provision for loan losses. The 1987 loan loss experience on such claims is included in a special provision as discussed in note 14.

The provision for loan losses charged to income is calculated using an averaging formula, prescribed by the Minister of Finance.

The difference between the actual loan loss experience and the five year average provision for loan losses is recorded in the appropriations for contingencies account.

Appropriations for Contingencies
The Bank is allowed to make appropriations for contingencies with respect to possible unspecified future losses through transfers from retained earnings. The maximum amount of the appropriations which is tax deductible is prescribed by the Minister of Finance.

Effective in 1987, banks may transfer tax allowable appropriations back to retained earnings.

Land, Buildings and Equipment
Land, buildings and equipment are stated at cost less an allowance for depreciation and amortization. Major Canadian properties are depreciated using the sinking fund method, while all other buildings and leasehold improvements are depreciated on a straight line basis over their estimated useful lives. Equipment is depreciated using the straight line method over its estimated useful life.

1 Securities

As at October 31 ($ in millions)	1986 Total	1987 Total	Term to Maturity: Within 1 Year	1 to 3 Years	3 to 5 Years	5 to 10 Years	Over 10 Years	No specific maturity
Investment Account								
Liquid securities								
Government of Canada Treasury Bills and Bonds	$ 4,026	$ 3,845	$3,794	$ 18	$ 33	$ –	$ –	$ –
Provincial government securities	575	642	640	–	–	–	2	–
Other Government Treasury Bills and Bonds	2,172	2,232	1,990	239	1	2	–	–
Other debt securities								
–Canadian issuers	397	338	205	–	132	–	1	–
–U.S. issuers	1,158	1,296	465	66	80	241	444	–
	8,328	8,353	7,094	323	246	243	447	–
Loan substitutes								
Term preferred shares	968	553	54	340	149	10	–	–
Floating rate income debentures	91	62	56	6	–	–	–	–
Fixed rate income debentures	74	–	–	–	–	–	–	–
Floating rate small business development bonds and small business bonds	205	115	50	62	3	–	–	–
	1,338	730	160	408	152	10	–	–
Investment securities								
Equity securities	134	120	–	41	–	–	–	79
Other debt securities –other issuers	288	252	144	4	19	4	81	–
	422	372	144	45	19	4	81	79
Trading Account	437	1,594	970	66	130	71	291	66
	$10,525	$11,049	$8,368	$842	$547	$328	$819	$145

As at October 31, 1987, the estimated market value of total securities is $11,140 million (1986 – $10,554 million). Investment securities of Harris Bankcorp, Inc. having a carrying value of $1,071 million (1986 – $843 million) were pledged, where permitted or required by law, to secure liabilities and public and trust deposits.

2 Non–Performing Loans

As at October 31

	1986			1987		
	(1) Domestic	International	Total	(1) **Domestic**	**International**	**Total**
($ in millions)						
Non-accrual loans	$ 1,582	$ 413	$ 1,995	**$ 1,185**	**$ 219**	**$ 1,404**
Renegotiated reduced rate loans (2)	–	–	–	**–**	**–**	**–**
Total non-performing loans (net of applicable reservations) (3)	$ 1,582	$ 413	$ 1,995	**$ 1,185**	**$ 219**	**$ 1,404**
Breakdown of total non-performing loans:						
Non-accrual consumer loans	$ 15	$ –	$ 15	**$ 14**	**$ –**	**$ 14**
Other non-performing loans	1,567	413	1,980	**1,171**	**219**	**1,390**
Total non-performing loans (net of applicable reservations) (3)	$ 1,582	$ 413	$ 1,995	**$ 1,185**	**$ 219**	**$ 1,404**
Average Non–Performing Loans (net of applicable reservations) (3)	$ 1,044	$ 546	$ 1,590	**$ 1,458**	**$ 436**	**$ 1,894**

Interest Recorded as Income on Non–Performing Loans (4)

For the year ended October 31

($ in thousands)						
Interest Income (5)						
Non-accrual loans	$ 35,594	$ 84,889	$ 120,483	**$ 82,258**	**$ 30,119**	**$112,377**
Renegotiated reduced rate loans	–	–	–	**–**	**–**	**–**
Interest income on non-performing loans	$ 35,594	$ 84,889	$ 120,483	**$ 82,258**	**$ 30,119**	**$112,377**

(1) The Domestic segment represents loans and interest booked in Canada regardless of currency or the residency of the customer. The International segment consists of loans and interest booked outside Canada, again regardless of currency or residency of the customer.

(2) Renegotiated reduced rate loans represent loans where, due to the weakened financial condition of the borrower, the rate of interest has been renegotiated to a rate less than the prevailing market. The financial information provided represents large exposures only, that is, where the balance outstanding is in excess of 1/10 of 1% of the Bank's capital.

(3) Includes both specific and general reservations.

(4) Interest income on non–performing loans is reported net of previously accrued interest which has been reversed in the current reporting year. Gross interest income received was $168,552 in 1987 (1986 – $140,024).

(5) The yield net of interest reversals on net non–performing loans in 1987 was 5.9% (1986 – 7.6%).

3 Land, Buildings and Equipment

As at October 31

($ in thousands)	1986 Net Book Value	1987 Cost	1987 Accumulated Depreciation	1987 Net Book Value
Land	$ 201,505	$ 201,444	$ –	$ 201,444
Buildings	633,068	793,068	154,061	639,007
Equipment	307,044	768,022	409,731	358,291
Leasehold improvements	136,331			135,593
	$ 1,277,948			$ 1,334,335

Depreciation of buildings and equipment and amortization of leasehold improvements amounted to $134,161 for the year ended October 31, 1987 (1986–$111,444).

4 Other Assets

As at October 31

($ in thousands)	1986	1987
Accrued interest income	$ 661,396	$ 602,757
Due from clients, dealers and other financial institutions	86,378	539,497
Deferred income taxes	367,218	504,827
Goodwill and other valuation intangibles	138,910	287,953
Other	505,724	523,769
	$ 1,759,626	$ 2,458,803

5 Geographic Distribution of Assets by Location of Ultimate Risk

(currencies in millions)	As at September 30, 1986 Cdn. $	U.S. $	Other Currencies	Total Cdn. $ Equiv.	As at September 30, 1987 Cdn. $	U.S. $	Other Currencies	Total Cdn. $ Equiv.
Canada	40,128	4,121	183 £ 103 D.M. 120 S.F. 32 Cdn. $ Equiv.	46,415	39,621	2,895	200 £ 65 D.M. 44 S.F. 33 Cdn. $ Equiv.	43,960
United States	300	16,892	73 £ 138 D.M. 43 S.F. 13 Cdn. $ Equiv.	24,030	207	16,153	46 £ 53 D.M. 47 S.F. 108 Cdn. $ Equiv.	21,673
Europe								
United Kingdom	254	1,083	423 £ 47 D.M. 55 S.F. 32 Cdn. $ Equiv.	2,715	208	1,302	380 £ 81 D.M. 45 S.F. 168 Cdn. $ Equiv.	2,988
France	127	580	22 £ 110 D.M. 45 S.F. 30 Cdn. $ Equiv.	1,120	155	588	28 £ 7 D.M. 25 S.F. 17 Cdn. $ Equiv.	1,029
Germany	41	448	2 £ 448 D.M. 28 S.F.	998	77	441	– £ 131 D.M. 10 S.F.	756
Other Europe	277	1,311	78 £ 349 D.M. 395 S.F. 148 Cdn. $ Equiv.	2,973	339	1,229	68 £ 332 D.M. 458 S.F. 28 Cdn. $ Equiv.	2,750
Latin America and Caribbean								
Brazil	211	875	4 D.M. 5,529 Cruz.	1,983	226	497	2 D.M. 31,147 Cruz.	1,729
Mexico	324	1,070	1 D.M.	1,810	366	897	1 D.M.	1,543
Other Latin America and Caribbean	98	1,026	– £ 7 D.M. 84 Cdn. $ Equiv.	1,609	106	780	1 £ – D.M. 68 Cdn. $ Equiv.	1,199

(currencies in millions)	As at September 30, 1986				As at September 30, 1987			
	Cdn. $	U.S. $	Other Currencies	Total Cdn. $ Equiv.	Cdn. $	U.S. $	Other Currencies	Total Cdn. $ Equiv.
Asia, Oceania and Australasia								
Japan	81	2,036	8 £ 218 D.M. 343 S.F. 715 Cdn. $ Equiv.	4,075	155	2,060	31 £ 149 D.M. 190 S.F. 442 Cdn. $ Equiv.	3,632
Other Asia, Oceania and Australasia	41	987	19 £ 19 D.M. 141 S.F. 487 Cdn. $ Equiv.	2,068	31	546	7 £ 21 D.M. 66 S.F. 376 Cdn. $ Equiv.	1,209
Africa and Middle East	1	113	2 £ 9 D.M. 8 S.F.	174	–	62	– £ 8 D.M. 5 S.F.	92
Total Assets	$41,883	$30,542	810 £ 1,453 D.M. 1,178 S.F. 5,529 Cruz. 1,541 Cdn. $ Equiv.	$89,970	$41,491	$27,450	761 £ 850 D.M. 890 S.F. 31,147 Cruz. 1,240 Cdn. $ Equiv.	$82,560

Each of the countries noted separately above represent an ultimate risk of one percent or more of the Bank's aggregate outstanding securities, deposits with other banks, customers' liability under acceptances and loans excluding mortgages.

Assets are shown net of reservations in source currencies and Canadian dollar equivalents. Canadian dollar equivalents are also noted for sundry foreign currency outstandings.

Conversion Table September 30	1986	1987
U.S. $	1.3876	1.3113
Pound Sterling (£)	2.0037	2.1309
Deutsche Mark (D.M.)	.6852	.7111
Swiss Franc (S.F.)	.8437	.8533
Cruzado (Cruz.)	.10019	.02729

6 Deposits

As at October 31

($ in thousands)	1986	1987
Deposits by Canada	$ 265,834	$ 975,719
Deposits by provinces	154,229	271,618
Deposits by banks	18,533,194	16,721,704
Deposits by individuals	28,773,845	30,041,276
Other deposits	27,149,294	24,073,893
	$ 74,876,396	$ 72,084,210

7 Liabilities of Subsidiaries, Other than Deposits

As at October 31

($ in thousands)	Interest Rate	Date Maturing	Redeemable at the Option of the Subsidiary beginning	1986	1987
Bank of Montreal Mortgage Corporation					
Series A debentures	–%	October, 1987	October, 1977	$ 1,195	$ –
Series B debentures (1)	–	February, 1989	February, 1979	1,325	–
Exchangeable debentures (2)	–	September, 1991	October, 1986	95,656	–
Bank of Montreal Realty Inc.					
Series 1 debentures	13.625	December, 2000	*	93,000	**86,000**
Notes	16.75	March, 1988	–	75,000	**75,000**
Notes	10.75	November, 1992	–	75,000	**75,000**
Notes	9.50	May, 1996	–	100,000	**100,000**
Mortgages	(3)	(3)	–	9,185	**8,987**
Term debt	(3)	(3)	–	70	**55**
Bank of Montreal Leasing Corporation					
Series I notes, secured	(4)	(4)	–	136,989	**112,836**
Short term notes, unsecured	(5)	(5)	–	150,200	**123,662**
Harris Bankcorp, Inc.					
Notes (6)	(3)	(3)	October, 1984	41,029	**38,478**
Empresa Técnica de Organizaçào e Participaçoes S.A.					
Mortgages (7)	(3)	(3)	–	872	**151**
Nesbitt, Thomson Inc.					
Promissory notes	13.00	April, 1995	March, 1988	–	**13,430**
Subordinated loans	(3)	(3)	October, 1987	–	**8,000**
				$779,521	**$641,599**

(1) Redeemed during 1987 fiscal year.
(2) Exchanged into common shares of the Bank as described in note 11.
(3) At varying rates of interest and varying terms to maturity to 1998.
(4) At varying rates of interest from 9.05% to 13.50% and varying terms to maturity to 1993.
(5) At varying rates of interest from 6.50% to 9.40% and varying terms to maturity.
(6) Denominated in U.S. $.
(7) Denominated in Brazilian cruzados

The aggregate sinking fund requirements and maturities as at October 31, 1987 are as follows:

($ in thousands)	
1988	$248,456
1989	81,942
1990	23,108
1991	15,424
1992	82,273
Thereafter	190,396
	$641,599

*The subsidiary has given notice of its intention to redeem all of the outstanding Series 1 debentures on December 15, 1987.

If effected, the transaction would cause a reduction of $56 million in debentures maturing after 1992, and a reduction of $6 million per year from 1989 to 1992 with a corresponding increase in debentures maturing in 1988.

8 Other Liabilities

As at October 31

($ in thousands)	1986	1987
Securities sold but not yet purchased	$ 232,907	$ **1,009,581**
Other short term indebtedness of subsidiaries	183,175	**931,260**
Accrued interest payable	860,441	**880,853**
Accounts payable and accrued expenses	412,624	**547,200**
Deferred fees	38,980	**30,200**
	$ 1,728,127	$ **3,399,094**

Included in Income from Loans is $27,095 (1986 – $25,736) of amortization of deferred fees.

9 Bank Debentures

As at October 31

($ in thousands)	Interest Rate	Date Maturing	Redeemable at the option of the Bank beginning	Denominated in U.S. $	1986	1987
Series A (1)	– %	April, 1992	April, 1986	–	$ 2,842	$ **–**
Series C	–	February, 1987	February, 1983	–	966	**–**
Series 3	6.33*	April, 1989	April, 1984	–	75,000	**75,000**
Series 4 (2)	8.905*	August, 1991	August, 1984	–	125,000	**125,000**
Series 5 (1)	–	December, 1990	December, 1985	100,000	139,080	**–**
Series 6	8.0625*	October, 1991	October, 1988	125,000	173,850	**164,438**
Series 7 (2)	16.25	December, 1991	December, 1987	150,000	208,620	**197,325**
Series 8	15.25	July, 1994	–	30,000	41,724	**39,465**
Series 9	8.00*	April, 1996	April, 1989	250,000	347,700	**328,875**
Series 10	7.1125*	July, 1998	July, 1991	250,000	347,700	**328,875**
					$ 1,462,482	$ **1,258,978**

*Floating rate debentures: interest rate stated is as at October 31, 1987. Minimum rates of interest on the floating rate notes are as follows:
Series 3 – No minimum rate
Series 4 – 7%
Series 6 – 5.25%
Series 9 – 5%
Series 10 – 6.05%

All debentures are direct unsecured obligations of the Bank and are subordinated in right of payment to the claims of depositors and certain other creditors. In accordance with the formula prescribed in the Bank Act, the Bank has the capacity, as of November 1, 1987, to issue an additional $472 million of debentures.

The aggregate sinking fund obligations and maturities of the Bank's debentures as at October 31, 1987 are as follows:

($ in thousands)	
1988	$ –
1989	75,000
1990	–
1991	299,304
1992	207,191
Thereafter	677,483
	$1,258,978

(1) Redeemed during 1987 fiscal year.

(2) The Bank has given notice of its intention to redeem all of the outstanding Series 4 Debentures on December 16, 1987 and all of the outstanding Series 7 Debentures on December 1, 1987. If effected, the transactions would cause a reduction of $125 million in debentures maturing in 1991 and $197 million in debentures maturing in 1992 with a corresponding increase in debentures maturing in 1988. Additionally, the Bank's debt issuing capacity would be increased to $794 million of debentures.

10 Changes in Capital and Contingency Reserves
For the year ended October 31

The following table provides a summary of the change in the Bank's Capital and Contingency Reserves.

($ in thousands)	1986	1987
Balance at beginning of year	$ 3,452,477	**$ 3,644,869**
Increases (decreases) due to:		
Net income (loss) after special provision	352,950	**(352,397)**
Unrealized gain (loss) on translation of net investment in foreign operations net of applicable tax	9,792	**(58,972)**
Increase of income taxes due to transfer to retained earnings from appropriations for contingencies	–	**(288,712)**
Excess (deficiency) of provision for loan losses charged to income over loan loss experience for the year	(84,099)	**268,405**
Tax effect on subsidiaries' portion of above excess (deficiency)	6,462	**4,934**
Shareholder Dividend Reinvestment and Share Purchase Plan	115,015	**76,073**
Stock Dividend Program	7,194	**6,412**
Exercise of Class A Preferred Shares Series 2 Warrants	86	**107**
Conversion of Bank of Montreal Mortgage Corporation Exchangeable Debentures	1	**95,486**
Common shares issued	–	**300,300**
Share issue expense (after tax)	–	**(4,879)**
	3,859,878	**3,691,626**
Deduct:		
Dividends – Common shares	(157,605)	**(184,133)**
– Preferred shares	(57,404)	**(45,007)**
Balance at end of year	$ 3,644,869	**$ 3,462,486**

11 Share Capital
As at October 31

Authorized

200,000,000 Common Shares without par value. The aggregate consideration for all common shares shall not exceed $5.5 billion.

50,000,000 Class A Preferred Shares without par value, issuable in series. The aggregate consideration for all Class A shares shall not exceed $1 billion.

12,500,000 Class B Preferred Shares without par value, issuable in series. The aggregate consideration for all Class B shares shall not exceed $250 million. These shares may be issued in foreign currencies.

Outstanding	1986		**1987**	
($ in thousands)	Number of Shares	Amount	**Number of Shares**	**Amount**
$2.85 Convertible Class A Preferred Shares Series 1 (1)				
Outstanding at end of year	5,799,400	$ 200,079	**–**	**$ –**
$2.50 Class A Preferred Shares Series 2; Convertible when tendered with Common Share Purchase Warrant (2)				
Outstanding at end of year	7,000,000	175,000	**7,000,000**	**175,000**
Class A Preferred Shares Series 3 (3)				
Outstanding at end of year	11,000,000	275,000	**11,000,000**	**275,000**
Common Shares				
Outstanding at beginning of year	77,425,769	1,130,186	**81,264,666**	**1,252,482**
Issued under the Shareholder Dividend Reinvestment and Share Purchase Plan and Stock Dividend Program	3,836,251	122,209	**2,589,466**	**82,485**
Issued on exercise of Class A Preferred Shares Series 2 Common Share Purchase Warrants	2,620	86	**3,225**	**107**
Issued on conversion of Class A Preferred Shares Series 1 (1)	–	–	**6,088,444**	**200,079**
Issued on conversion of Bank of Montreal Mortgage Corporation Exchangeable Debentures (4)	26	1	**3,044,953**	**95,486**
Issued through share offering (5)	–	–	**9,100,000**	**300,300**
Outstanding at end of year	81,264,666	1,252,482	**102,090,754**	**1,930,939**
Total Outstanding Share Capital		$ 1,902,561		**$ 2,380,939**

(1) Effective March 27, 1987, the Bank converted all of the then remaining Convertible Class A Preferred Shares Series 1 into common shares of the Bank at $32.78 per common share. This transaction was in accordance with the terms of the issue, where, if the Bank's common shares had traded at a weighted average price at or in excess of $36.60 for a period of 20 consecutive trading days, the Bank had the right to convert the convertible preferred shares into common shares at $32.78 per common share before May 26, 1991. Prior to the date of conversion the shares had an annual cumulative dividend of $2.85 per share and were convertible at the option of the holder at any time before May 26, 1991 into common shares of the Bank at a conversion price of $34.50 per common share.

(2) Class A Preferred Shares Series 2 have an annual cumulative dividend of $2.50 per share. Holders of the Series 2 Preferred Shares have received two common share purchase warrants entitling them to purchase one common share each at $33.00 until December 15, 1988. Holders of the warrants have the option to exercise either warrant by delivering one Series 2 Preferred Share plus $8.00 cash, equivalent to the difference between the exercise price and $25.00. The Series 2 Preferred Shares are redeemable from December 16, 1988 to December 15, 1989 at $25.75 per share, and thereafter at declining prices.

(3) Class A Preferred Shares Series 3 have an annual minimum cumulative dividend of $2.125 per share. After February 23, 1989 each Series 3 Preferred Share is entitled to a minimum quarterly dividend equal to the greater of $0.53125 per share or one quarter of 75% of the Bank's average prime rate (as defined) times $25.00. The Series 3 Preferred Shares are redeemable from February 1, 1989 to January 31, 1990 at $26.00 per share, and thereafter at declining prices.

(4) On March 16, 1987 the Bank exchanged all of the then outstanding 11.75% Exchangeable Debentures of Bank of Montreal Mortgage Corporation, due September 8, 1991, for common shares of the Bank at $31.35 per common share. This transaction was in accordance with the terms of the debentures, where, if prior to September 8, 1991 the Bank's common shares had traded at a weighted average price at or in excess of $34.65 for a period of 20 consecutive trading days, the Bank had the right to exchange the debentures for common shares of the Bank at $31.35 per common share. Prior to the date of exchange, the holders of the exchangeable debentures (see note 7) of Bank of Montreal Mortgage Corporation due September 8, 1991 had the right to exchange the debentures for common shares of the Bank at a price of $33.00 per common share.

(5) On October 1, 1987, the Bank issued for cash 9,100,000 new common shares at $33.00 per share.

As at October 31, 1987, Common Shares were reserved for possible issuance in respect of the following:	Number of Shares
Shareholder Dividend Reinvestment and Share Purchase Plan and Stock Dividend Program	1,334,035
Exercise of Common Share Purchase Warrants attached to Class A Preferred Shares Series 2	13,693,884
	15,027,919

12 Loan Losses

For the year ended October 31

($ in thousands)

The provision for loan losses of $343,271 (1986–$520,583) in the Consolidated Statement of Income is based on the five year averaging formula prescribed by the Minister of Finance. Actual loan loss experience of $74,866 (1986–$604,682) is charged to Appropriations for Contingencies.

Reservations established during 1987 on claims where the ultimate risk is located in certain countries designated by the Superintendent of Financial Institutions are not eligible for inclusion in loan loss experience or provision for loan losses. For prior years such claims and the related reservations continue to be included in the five year averaging formula for provision for loan losses. The 1987 loan loss experience on such claims is included in a special provision as discussed in note 14.

13 Income Taxes

For the year ended October 31

The provision for income taxes recorded in the Consolidated Statement of Income represents taxes applicable to income before the special provision for losses on transborder claims. The credit for income taxes related to the special provision amounted to $534 million.

The income taxes recorded in retained earnings represent the income tax effect of the transfer from appropriations for contingencies, as well as gains and losses on liabilities and forward exchange contracts used to hedge the investments in foreign branches, subsidiaries and associated corporations. These items are recorded directly in retained earnings.

		1986		1987
($ in thousands)				
The total income taxes for the year excluding those related to the special provision are reported in the consolidated financial statements as follows:				
Statement of Income	$	86,500	$	**182,006**
Statement of Retained Earnings				
Transfer from appropriations for contingencies		–		**288,712**
Unrealized foreign currency translation gains and losses		(10,132)		**32,630**
Other		–		**(4,315)**
Total	$	76,368	$	**499,033**
The current and deferred income taxes are as follows:				
Current income taxes	$	75,342	$	**74,554**
Deferred income taxes		1,026		**424,479**
Total	$	76,368	$	**499,033**

Deferred taxes result from timing differences in the recognition of revenues and expenses for tax and financial statement purposes. The sources of these differences and the tax effect of each are as follows:

		1986		1987
Provision for loan losses	$	(6,337)	$	**110,765**
Transfer from appropriations for contingencies		–		**288,712**
Other		7,363		**25,002**
	$	1,026	$	**424,479**

The provision for income taxes before the special provision recorded in the Consolidated Statement of Income is lower than the amount that would be computed by applying the combined Canadian Federal and Provincial statutory income tax rate. This is because a portion of interest and dividend income is exempt from tax and because income is taxed at other than the combined Canadian Federal and Provincial statutory income tax rate.

	1986	1987
Combined Canadian Federal and Provincial statutory income tax rate	49.6%	**48.9%**
Increase (decrease) in rate resulting from:		
Tax-exempt income from Canadian securities, primarily income debentures, preferred shares and small business development bonds	(11.5)	**(5.0)**
Lower income tax rate applicable to income of foreign subsidiaries	(21.3)	**(15.6)**
Other	2.7	**2.1**
Effective income tax rate before the special provision	19.5%	**30.4%**

14 Special Provision For Losses On Transborder Claims

For the year ended October 31

During 1987 the Bank established additional general reservations of $1,299 million for losses on claims for which the ultimate risk resides in certain countries designated by the Superintendent of Financial Institutions. These additional reservations were recorded in income as a special provision of $765 million net of applicable income taxes of $534 million. The credit for income taxes related to this provision has been established based on the estimated applicable rate for the year and jurisdiction in which the Bank expects to realize the deduction.

Additions to reservations for losses on claims other than those referred to above have been charged to appropriations for contingencies and included in the five-year averaging formula prescribed by the Minister of Finance for the calculation of provision for loan losses.

15 Net Income per Common Share

For the year ended October 31

Net income per common share has been calculated using the daily average of common shares outstanding. For the year ended October 31, 1987 this average was 89,910,855 (1986–79,981,715).

Fully diluted net income per common share before special provision for losses on transborder claims was $4.01 (1986–$3.59) and has been calculated as if: (a) all outstanding Class A Convertible Preferred Shares Series 1 had been converted into common shares at the beginning of the year, (b) all outstanding Class A Preferred Shares Series 2 had been converted into common shares at the beginning of the year with the exercise of a warrant, (c) all the remaining Series 2 warrants had been exercised for common shares, (d) the 1987 common share issue occurred at the beginning of the year and (e) assets at the current rate of leverage had been generated from the foregoing conversions, upon which after tax earnings of $65.7 million (1986–$27.3 million) have been imputed using the current rate of return on average assets (before the special provision) of 0.49% (1986–0.41%).

Fully diluted net income per common share after special provision for losses on transborder claims is the same as reported for the basic net income per common share after the special provision because any adjustments are anti-dilutive.

16 Commitments and Contingencies

As at October 31

In the normal course of business, there are various outstanding commitments and contingent liabilities such as commitments to extend credit, foreign exchange contracts and financial futures contracts which properly are not reflected in the financial statements. These also include letters of credit and guarantees, the amounts of which are disclosed below. In the opinion of management, there are no material commitments or contingencies which represent unusual risk and no material losses are anticipated as a result of these transactions.

($ in thousands)	1986	1987
Guarantees	$ 1,571,296	$ **1,296,635**
Letters of credit	3,131,158	**2,666,101**
	$ 4,702,454	$ **3,962,736**

17 Pension Funds

For the year ended October 31

($ in thousands)

The Pension Fund Society of the Bank of Montreal is the Bank's principal pension plan in Canada, while a number of smaller plans provide pensions to executives and to other employees in Canada and in other parts of the world.

These plans are generally non-contributory, with the Bank responsible for contributions to adequately fund the plans. The Bank has established the Pension Advisory Committee of the Board of Directors to provide guidance and report on plan affairs to the Bank's Board of Directors.

In the Pension Fund Society of the Bank of Montreal the Bank uses the accrued benefit actuarial method and best estimate assumptions in valuing pension obligations. Pension plan assets are valued at market values. As at October 31, 1987, pension plan assets are estimated to be $722,500 and contractual pension plan obligations are estimated to be $557,000. Experience gains/losses and amounts arising as a result of changes in assumptions and plan initiation or amendments are amortized over the expected remaining service life of the employee group.

Total pension expense which was $10,425 in 1987, (1986 – $14,826) includes straight line amortization of experience gains/losses and amounts arising as a result of assumptions and plan changes, current service cost, interest revenue/expense on plan assets and pension obligations and Bank contributions to the Canada and Quebec Pension Plans.

18 Lease Commitments

As at October 31

Annual contractual rental commitments of more than $25,000 on leased buildings and equipment are as follows:

($ in thousands)	Annual Commitments
1988	$ 82,231
1989	71,480
1990	62,673
1991	51,919
1992	43,085
Thereafter	510,284
	$ 821,672

19 Legal Proceedings

As at October 31

Management considers that the aggregate liability which may result from various legal proceedings outstanding against the Bank and its subsidiaries will not be material.

20 Domestic / International Segmented Financial Data

For the year ended October 31

Domestic operations represents the Bank's business booked in Canada as transacted in a variety of currencies regardless of the residency of the customer. International operations represents business booked outside of Canada, again regardless of currency or residency of the customer. However, transactions on international money markets are deemed to be international even if booked in Canada.

In order to segment domestic and international results, it is necessary to make certain allocations. The capital funds of the Bank are allocated based upon relative average assets. Any remaining excess or shortfall of assets in comparison with liabilities and capital funds is considered as supplied to or funded by the other segment at the marginal cost of funds. Corporate expenses are allocated based upon the relative amounts of non-interest expenses of each segment.

	Domestic		International		Total	
	1986	**1987**	1986	**1987**	1986	**1987**
($ in millions)						
Net interest income	$ 1,220	**$ 1,331**	$ 861	**$ 748**	$ 2,081	**$ 2,079**
Provision for loan losses	265	**150**	256	**193**	521	**343**
	955	**1,181**	605	**555**	1,560	**1,736**
Other income	503	**560**	316	**358**	819	**918**
	1,458	**1,741**	921	**913**	2,379	**2,654**
Non-interest expense	1,279	**1,356**	656	**699**	1,935	**2,055**
	179	**385**	265	**214**	444	**599**
Income taxes	38	**158**	49	**24**	87	**182**
	141	**227**	216	**190**	357	**417**
Minority interests	4	**4**	–	**–**	4	**4**
Net income before special provision	137	**223**	216	**190**	353	**413**
Special provision for losses (net of income taxes)				**765**		**765**
Net income (loss) after special provision	$ 137	**$ 223**	$ 216	**$ (575)**	$ 353	**$ (352)**
Average total assets	$ 45,239	**$ 46,361**	$ 41,522	**$ 38,223**	$ 86,761	**$ 84,584**
Return on average total assets						
–before special provision	0.30%	**0.48%**	0.52%	**0.50 %**	0.41%	**0.49 %**
–after special provision		**0.48%**		**(1.50)%**		**(0.42)%**

The only foreign country from which more than 10% of the Bank's consolidated interest income was derived was the United States, where interest income was Cdn. $1,502 in 1987 (1986–Cdn. $1,671).

The special provision for losses on transborder claims has been allocated to the international segment.

21 Acquisition of Nesbitt, Thomson Inc.

On September 29, 1987 the Bank effectively acquired 75% of the voting shares of Nesbitt, Thomson Inc. for cash.

The acquisition, which was accounted for using the purchase method, is summarized as follows:

($ in millions)	
Net assets acquired:	
Tangible assets	
Cash and securities	$ 1,084
Land, buildings and equipment	26
Other assets	
– Due from dealers, clients and financial institutions	286
– Other	54
	1,450
Less liabilities assumed	
Deposits	226
Liabilities of subsidiaries, other than deposits	21
Other liabilities	
– Securities sold but not yet purchased	379
– Other	658
	1,284
Net assets	166
Less minority interest	40
Net assets acquired by the Bank	126
Excess of purchase price over net assets acquired	172
Total cost of investment	$ 298

The Consolidated Statement of Income includes the results of operations of Nesbitt, Thomson Inc. from the date of acquisition. The excess of purchase price over net assets acquired is being amortized over 15 years.

Statement of Management's Responsibility for Financial Data

The consolidated statements of Bank of Montreal have been prepared by, and are the responsibility of, the Bank's management. The presentation and information provided therein have been prepared in accordance with the provisions of the Bank Act and related regulations and rules issued by the Superintendent of Financial Institutions, which correspond to generally accepted accounting principles except as noted within the annual financial statements. The financial statements necessarily include amounts based on informed judgements and estimates of the expected effects of current events and transactions with appropriate consideration to materiality. The financial information presented elsewhere in the Annual Report is consistent with that in the financial statements.

In meeting its responsibility for the reliability of financial data, management relies on comprehensive internal accounting, operating and system controls. The Bank's overall controls include an organizational structure providing for effective segregation of responsibilities, delegation of authority and personal accountability, written communication of policies and procedures of corporate conduct throughout the Bank, and careful selection and training of personnel; the regular updating and application of written accounting and administrative policies and procedures necessary to ensure adequate internal control over transactions, assets and records; as well as a continued program of extensive internal audit covering all aspects of the Bank's operations. These controls are designed to provide reasonable assurance that financial records are reliable for preparing financial statements and maintaining accountability for assets, and that assets are safeguarded against unauthorized use or disposition.

The Board of Directors oversees management's responsibilities for financial statements through the Audit Committee, which is composed solely of directors who are not officers or employees of the Bank.

The Shareholders' Auditors and the Bank's Chief Auditor have full and free access to the Audit Committee to discuss audit, financial reporting and related matters.

William D. Mulholland
Chairman and
Chief Executive Officer

Matthew W. Barrett
President and
Chief Operating Officer

Keith O. Dorricott
Executive Vice-President and
Chief Financial Officer

November 24, 1987

Auditors' Report

To the Shareholders of Bank of Montreal

We have examined the consolidated statement of assets and liabilities of Bank of Montreal as at October 31, 1987 and the consolidated statements of income, appropriations for contingencies and changes in shareholders' equity for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of Bank of Montreal as at October 31, 1987 and the results of its operations for the year then ended in accordance with prescribed accounting principles applied, except for the method of accounting for the special provision for losses on transborder claims as explained in note 14 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Peat Marwick

Peat Marwick
Chartered Accountants

Touche Ross & Co

Touche Ross & Co.
Chartered Accountants

Toronto, November 24, 1987

Capital Stock

At October 31, 1987, the Bank had three types of shares outstanding: Class A Preferred Shares Series 2, Class A Preferred Shares Series 3 and common shares. The Class A Preferred Shares Series 2 pay cumulative preferred dividends at an annual rate of $2.50 per share. The Class A Preferred Shares Series 3 pay cumulative preferred dividends at an annual rate of $2.125 until February 23, 1989; thereafter, the quarterly dividend shall be the greater of $0.53125 per share or an amount determined by applying one quarter of 75% of the Bank's average Prime Rate for stated periods to $25. In relation to the issue of the Class A Preferred Shares Series 2, the Bank issued common share purchase warrants entitling the holders to purchase common shares at $33 per share up to December 15, 1988.

Listing of Stock

The common shares of the Bank are listed on the Montreal, Toronto, Winnipeg, Alberta, Vancouver and London (England) stock exchanges. The shares list under the following stock symbols on Canadian exchanges: "BMO" for the common stock, "BMOX" for the Class A Preferred Shares Series 2 and "BMOC" for the Class A Preferred Shares Series 3.

Stock Prices

The following table sets forth the high and low closing prices on the Toronto Stock Exchange of the common shares of the Bank for the periods indicated:

Year	High	Low	Volume
1983	33.625	24.75	12,373,774
1984	28.375	21.375	16,740,700
1985	31.50	23.25	21,758,400
1986	35.25	27.25	27,963,425
1987 Jan.-Oct. 31	39.25	25.50	35,129,860

Transfer Agent and Registrar

The principal transfer agent for both the common and preferred shares of the Bank is The Royal Trust Company at its principal offices in Halifax, Montreal, Toronto, Winnipeg, Regina, Calgary and Vancouver. The Royal Trust Company also acts as registrar for these shares.

Dividends

Dividends paid on the common shares of the Bank over the past five years are shown in the following table:

Year Ended Oct. 31	1983	1984	1985	1986	1987
Dividends paid per common share	$1.96	$1.96	$1.96	$1.96	$2.00

Dividend Options

Shareholders of Bank of Montreal may choose from several dividend options including:

- Shareholder Dividend Reinvestment and Share Purchase Plan
- Stock Dividend Program
- Electronic Funds Transfer Service

Shareholder Dividend Reinvestment and Share Purchase Plan

The Shareholder Dividend Reinvestment and Share Purchase Plan provides a means for holders of record of common shares or Class A Preferred Shares Series 2 or Series 3, resident in Canada, to reinvest cash dividends in new common shares of the Bank at a purchase price of 95% of the average market price, without the payment of any commissions or service charges. Shareholders may also purchase additional common shares of the Bank at 100% of the average market price by making optional cash payments of up to $40,000 per annum, whether or not dividends on shares are being reinvested.

Stock Dividend Program

The Stock Dividend Program provides a means for holders of record of at least 100 common shares or 100 Class A Preferred Shares Series 2 or Series 3 to acquire common shares of the Bank at 95% of the average market price by electing that dividends be paid by the issue of common shares of the Bank having a value substantially equivalent to the cash dividend otherwise payable.

Electronic Funds Transfer Service

Shareholders not wishing to participate in the Shareholder Dividend Reinvestment and Share Purchase Plan or the Stock Dividend Program may choose to have dividends deposited directly to an account in any financial institution which provides electronic funds transfer facilities.

Details of the dividend options and enrollment forms may be obtained by contacting The Royal Trust Company, Corporate Trust Division, 630 Dorchester Boulevard West, Montreal, Quebec H3B 1S6.

Restraints on Bank Shares under the 1980 Bank Act

The Bank Act contains restrictions on the ownership of shares of the Bank. These restrictions limit ownership of shares by all non-residents to a maximum of 25% of any class of shares. These restrictions also do not allow any person or group of associated persons to own more than 10% of any class of shares and prohibit ownership of the Bank's shares by Canadian or foreign governments.

Distribution of Shareholders

The following table indicates the distribution of common shareholders by country of residence at October 31, 1987:

	Shareholders
Canada	98.3%
United States	0.8
Other	0.9
	100.0%

Copies of Annual Report

Additional copies of this Annual Report may be obtained by contacting the Bank's Public Affairs Department, P.O. Box 6002, Place d'Armes, Montreal, Quebec H2Y 3S8, or 1 First Canadian Place, Toronto, Ontario M5X 1A1.

For other shareholder information, please write to the Secretary of the Bank, P.O. Box 6002, Place d'Armes, Montreal, Quebec H2Y 3S8.

International Advisory Council

The International Advisory Council advises the Bank and its Senior Executive on political, economic and social trends which impact its current or future operations.

Sir Peter B. Baxendell (United Kingdom)
Chairman of the Hawker Siddeley Group plc., retired Managing Director of the Royal Dutch/Shell Group, and retired Chairman of Shell U.K. and of Shell Canada Limited.

Viscount Étienne Davignon (Belgium)
Managing Director of the Société Générale de Belgique, former Vice-President of the Commission of the European Communities and former President of the International Energy Agency.

Francis Gautier (France)
Vice-Chairman and Chief Executive Officer of the BSN Group of companies.

Sydney Gruson (United States)
Senior Advisor to Rothschild Inc., retired Vice-Chairman and Director of The New York Times Company.

John H. Hale (United Kingdom)
Director of Bank of Montreal and Pearson plc., retired Managing Director of Pearson plc., and former Executive Vice-President of Alcan Aluminium.

Walther Leisler Kiep (Federal Republic of Germany)
Managing Partner of Gradmann & Holler, Director of Bank of Montreal, Chairman of the Atlantik-Brücke, former member of the Bundestag and currently member of the Executive Committee and Federal Treasurer of the CDU.

Hon. Allan J. MacEachen, P.C. (Council Chairman)
Leader of the Opposition, Senate of Canada, former Deputy Prime Minister, Secretary of State for External Affairs and Minister of Finance.

José E. Mindlin (Brazil)
Chairman, President and a founder of Metal Leve S.A., and member of the Advisory Board of Banco de Montreal Investimento S.A.

William D. Mulholland (ex-officio)
Chairman and Chief Executive Officer, Bank of Montreal.

Sir Eric James Neal (Australia)
Chief Commissioner of the City of Sydney, Deputy Chairman, Westpac Banking Corporation, Director and retired Managing Director of Boral Limited.

Hon. Charles H. Percy (United States)
President of Charles Percy & Associates, Inc., former United States Senator from Illinois and Chairman of the Senate Foreign Relations Committee.

Peter von Siemens (Federal Republic of Germany)
Member of the Managing Board, Senior Vice-President, Head of Business Administration for the Corporate Research and Technology Department, Siemens AG.

Hon. Jesús Silva-Herzog (Mexico)
Former Secretary of Finance and Public Credit, United Mexican States.

Jack H. Warren (Canada)
Principal Trade Policy Advisor, Government of Quebec, Chairman, Bank of Montreal Bahamas Ltd., retired Vice-Chairman and Director of Bank of Montreal.

Members were saddened by the loss of their colleague Ichiro Hattori, President of Seiko Instruments and Electronics Ltd. and Seiko Epson Corp. of Tokyo, who passed away during the year.

Directors of Bank of Montreal

W.D. Mulholland, LL.D. (1)
Chairman of the Board

Grant L. Reuber, O.C. (1)
Deputy Chairman

Stanley M. Davison (4)
Vice-Chairman

Matthew W. Barrett (1)
President

Charles F. Baird, LL.D. (1,2,5)
Bethesda, Maryland
Company Director

Ralph M. Barford (1,2,5)
Toronto
President
Valleydene Corporation Limited

Peter J.G. Bentley, O.C. (6)
Vancouver
Chairman and Chief Executive Officer
Canfor Corporation

Claire P. Bertrand (4)
Montreal
Company Director

Robert A. Boyd, O.C. (3)
Montreal
Vice-President
Gendron Lefebvre Inc.

Fred S. Burbidge, O.C. (1,2,5)
Montreal
Company Director

Pierre Côté, C.M. (1,2,3)
Quebec
Chairman
Celanese Canada Inc.

C. William Daniel, O.C. (1,5)
Toronto
Company Director and Consultant

Graham R. Dawson (4)
Vancouver
President
G.R. Dawson Holdings Limited

Louis A. Desrochers, O.C. (1,2)
Edmonton
Partner
Messrs. McCuaig Desrochers

John H. Devlin (4)
Toronto
Company Director

John F. Fraser (1)
Winnipeg
President and Chief Executive Officer
Federal Industries Ltd.

Thomas M. Galt (5)
Toronto
Chairman and Chief Executive Officer
Sun Life Assurance Company of Canada

J. Peter Gordon, O.C. (1,2,5)
Toronto
Director
Stelco Inc.

John H. Hale
London, England
Director
Pearson plc.

Donald S. Harvie, O.C. (6)
Calgary
Chairman
Devonian Foundation

Richard M. Ivey, O.C. (3)
London, Ont.
Chairman
Allpak Limited

Betty Kennedy, O.C., LL.D. (1,4)
Toronto
Broadcast Journalist

Walther Leisler Kiep
Stuttgart, FRG
Managing General Partner
Gradmann & Holler

Merv Leitch, Q.C. (3)
Calgary
Partner
Macleod Dixon

The Right Hon. The Earl of Lindsay
London, England
Member
House of Lords

J. Blair MacAulay (6)
Toronto
Partner
Fraser & Beatty

Ronald N. Mannix (6)
Calgary
Chairman
Manalta Coal Ltd.

Eric H. Molson (5)
Montreal
Deputy Chairman
The Molson Companies Limited

Jerry E.A. Nickerson (4)
North Sydney, N.S.
Chairman
H.B. Nickerson & Sons Ltd.

Jeremy H. Reitman (3)
Montreal
President
Reitmans (Canada) Limited

William M. Sobey (4)
Stellarton, N.S.
Honorary Chairman
Sobeys Stores Limited

Mary Alice Stuart (6)
Toronto
Chairman and Chief Executive Officer
CJRT-FM Inc.

James C. Thackray
Toronto
Director
Bell Canada

Lorne C. Webster (1,3)
Montreal
Chairman and Chief Executive Officer
Prenor Group Ltd.

B. Kenneth West
Chicago
Chairman and Chief Executive Officer
Harris Bankcorp, Inc.

Charles N.W. Woodward
Vancouver
Chairman and Chief Executive Officer
Woodward's Limited

1 Member of the Executive Committee

2 Member of the Management Compensation Sub-Committee of the Executive Committee

3 Member of the Audit Committee

4 Member of the Donations Committee

5 Member of the Risk Review Committee

6 Member of the Pension Advisory Committee

Executive Officers

W.D. Mulholland
Chairman and
Chief Executive Officer

G.L. Reuber
Deputy Chairman

S.M. Davison
Vice-Chairman

M.W. Barrett
President and
Chief Operating Officer

J.S. Chisholm
Executive Vice-
President and
Treasurer

A.G. McNally
Executive Vice-
President
Personal Banking

F.A. Comper
Executive Vice-
President
Operations

K.E. Palmer
Executive Vice-
President
Commercial Banking

M.R.P. Rayfield
Executive Vice-
President
Corporate and
Government Banking

G.E. Neal
Executive Vice-
President
Capital Markets

C.G. Stratton
Executive Vice-
President
Special Accounts

G.W. Hopkins
Executive Vice-
President
Electronic Data
Processing Systems

• • •

D. Munford
Executive Vice-
President
Credit Policy

J.D. Gibson
Executive Vice-
President
Human Resources and
Corporate Affairs

K.O. Dorricott, F.C.A.
Executive Vice-
President and Chief
Financial Officer

W.B. Bateman
Executive Vice-
President and
Chairman,
Commercial Lending
Committee

P.G. Bourgeau
Secretary

C. McGregor
Vice-President and
Chief Accountant

S. Zargham, F.C.A. (U.K.)
Senior Vice-President and
Chief Auditor

Legal deposit, 4th quarter (1987), Bibliothèque nationale du Québec.

Design:
Rushton, Green and Grossutti Inc.

Photography:
Sidney Tabak
V. Tony Hauser
The Davidson Bénard Group

Colour Separation:
Empress Graphics Inc.

Typography:
Cooper & Beatty

Printing:
Haughton Graphics Limited

Paper:
Text and photo pages:
Graphic Papers;
a division of Rolland inc.

Cover:
Whyte-Hooke Papers;
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