BMO Financial Group

Q3 2008 CONFERENCE CALL

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Assumptions about the level of asset sales, expected asset sale prices and risk of default of the underlying assets of the structured investment vehicles were material factors we considered when establishing our expectations regarding the structured investment vehicles discussed in the Q3 Report to Shareholders including the amount to be drawn under the BMO liquidity facilities. Key assumptions included that assets would continue to be sold with a view to reducing the size of the structured investment vehicles, under various asset price scenarios.

Assumptions about the level of defaults and losses on defaults were material factors we considered when establishing our expectation of the future performance of the transactions that Apex Trust has entered into. Key assumptions included that the level of defaults and losses on defaults would be consistent with historical experience. Material factors which were taken into account when establishing our expectations of the future risk of credit losses in Apex Trust as discussed in the Q3 Report to Shareholders included industry diversification in the portfolio, initial credit quality by portfolio and the first-loss protection incorporated into the structure.

In establishing our expectations regarding the run-rate costs of our credit card loyalty rewards program discussed in the Q3 Report to Shareholders, we took into account the terms of the agreement that was entered into with Loyalty Management Group Canada Inc. in the quarter.

In establishing our expectations regarding the timing of completion of the integration of the Wisconsin acquisitions and associated costs discussed in the Q3 Report to Shareholders, we assumed that the integration would be completed in accordance with the current project plan and in line with current cost estimates.

In establishing our fourth quarter expectations for specific provisions for credit losses and for gross impaired loans, we assumed that the credit environment would remain consistent with current conditions, and that our credit exposures would perform in a manner consistent with the expectations we have developed through the ongoing assessment of our exposures.

Assumptions about the performance of the Canadian and U.S. economies in 2008 and how it would affect our businesses were material factors we considered when setting our strategic priorities and objectives, and when determining our financial targets, including provisions for credit losses and our expectations about achieving those targets and our outlook for our businesses. Key assumptions were that the Canadian economy would expand at a moderate pace in 2008 while the U.S. economy expands modestly, and that inflation would remain low in North America. We also assumed that interest rates in 2008 would decline slightly in Canada and the United States, and that the Canadian dollar would trade at parity to the U.S. dollar at the end of 2008. In determining our expectations for economic growth, both broadly and in the financial services sector, we primarily consider historical economic data provided by the Canadian and U.S. governments and their agencies. In the first quarter, we anticipated that there would be weaker economic growth in Canada and that the United States would slip into a mild recession in the first half of 2008. We also updated our views that quarter to expect lower interest rates and a somewhat weaker Canadian dollar than when we established our 2008 financial targets. Although the United States avoided a technical recession in the first half of the year, we anticipate further weakness in its economy and as such our views remain largely unchanged from the first quarter. Tax laws in the countries in which we operate, primarily Canada and the United States, are material factors we consider when determining our sustainable effective tax rate.

PRESENTATION

Operator

Please be advised that this conference call is being recorded. Good afternoon and welcome to the BMO Financial Group's third-quarter 2008 conference call for August 26. Your host for today is Viki Lazaris, Senior Vice President of Investor Relations. Ms. Lazaris, please go ahead.

Viki Lazaris *- BMO Financial Group - IR Contact*

Good afternoon, everyone. Thanks for joining us today. Presenting today are Bill Downe, BMO's Chief Executive Officer; Russ Robertson, Chief Financial Officer; and Tom Flynn, our Chief Risk Officer. The following members of the management team are also here this afternoon -- Tom Milroy from BMO Capital Markets; Gilles Ouellette from the Private Client Group; Frank Techar, head of P&C Canada; Ellen Costello from P&C US; and Barry Gilmour, head of Technology and Operations.

The call is scheduled for one hour. After the presentation, the management team will be available to answer questions from prequalified analysts. To give everyone an opportunity to participate, we ask that you please ask one question, then requeue.

At this time, I would like to caution our listeners by stating the following on behalf of those speaking today. Forward-looking statements may be made during this call, and there are risks that actual results could differ materially from forecasts, projections or conclusions in the forward-looking statements. Certain material factors and assumptions were applied in drawing the conclusions or making the forecasts or projections in these forward-looking statements. You can find additional information about such material factors and assumptions and the material factors that could cause actual results to so differ in our caution regarding forward-looking statements set forth in our news release or on the Investor Relations Web site.

With that said, I will hand things over to Bill.

Bill Downe *- BMO Financial Group - President, CEO*

Thank you, Viki, and good afternoon, everyone. As noted, my comments may include forward-looking statements.

Turning first to our financial results, net income for the third quarter was $521 million compared to $660 million in 2007. On a year-to-date basis, we've earned $1.4 billion. Earnings per share fully diluted were $0.98 compared to $1.28 a year ago. Cash EPS was $1 compared to $1.30. You should note that, year over year, the increase in PCLs amounted to approximately $0.50 a share.

In the quarter, our Tier 1 capital ratio strengthened from 9.4% to 9.9%, and return on equity was 13.5% on a higher capital base. While our core businesses have reported good, in some cases very good results, the deterioration in the US housing markets has required higher provisions for credit losses and our overall results have been negatively impacted. Looking at our results on a business-by-business basis, there is clear evidence that we are making good progress in delivering against our stated strategies.

Before I speak to the core businesses, I want to make a few comments on credit. Our US portfolio, including our securitization conduit, is being carefully supervised, given the economic environment in the US and more specifically the US housing industry. Two credits that were removed from the conduit early in the year are in the Bank's workout group, and we took an additional provision against them in Q3. We are managing this situation actively and are confident that this provision is appropriate. As in previous credit cycles, we believe we will maximize recoveries through an aggressive workout process.

Tom Flynn will talk in specific detail about our credit exposures and take you through the provisions as well as giving you an update on the off-balance sheet entities.

Moving now to core businesses, our Canadian retail strategy continues to deliver good results. P&C Canada recorded one of its best quarters ever with net income of $343 million. This was up over the second quarter of 2008 and was attributable to good revenue growth across the business -- strong personal loan growth at 19% year over year, market share increasing 87 basis points over Q3 2007, and I'd note it has improved in seven consecutive quarters. Commercial banking loans increased 9% over a year ago, and market share also improved 69 basis points over Q3 2007, and it as well has improved in six of the seven last quarters.

Customer loyalty continues to improve in both our personal and commercial businesses, our customer base is growing and we are strengthening customer relationships. Our results in P&C Canada are a clear indication that our customer and growth strategy is working. We are going to keep doing what we are doing, and we expect this business will continue to provide improved returns.

P&C US is holding its own in a challenging environment with net income growing 12% year over year. In particular, net interest margins are showing early signs of stabilization, and this is an encouraging sign, given margin pressures in recent quarters. Volumes, spreads and fees all improved over the second quarter. Half of the revenue growth was due to the Wisconsin acquisitions, and this was in line with our expectations. The results included $3 million in integration costs from Wisconsin. We expect these to increase to $16 million to $18 million in the fourth quarter, when we will have completed the bulk of the integration process.

Harris has been able to capture a significant share of refinancing volume from high-quality borrowers who are taking advantage of a decline in mortgage rates in the last two quarters and wanted to establish a new banking relationship. Clearly, provisions for credit losses are elevated, but Harris continues to compare very favorably with other US regional banks. Our P&C business is not immune to larger market forces, but anchored in the Midwest, it's solid, is growing and it's running well.

The Private Client Group delivered the second straight quarter of record net income at $110 million. This was an increase of $8 million or 8.4% year over year, despite challenging market conditions. Revenue growth covered a number of our fee-based businesses, including full-service investing and higher trust and investment revenues in North American private banking. Obviously, we are pleased by the excellent results in Wealth Management, and we expect it to continue to perform well.

I'd now like to address our expenses in broad terms because I don't want there to be any uncertainty about our discipline. We're balancing our spending on long-term growth opportunities while recognizing the importance and visibility of shorter-term profitability. We're going to maintain a prudent level of strategic spending to support continued market share growth while mindful of the current environment.

And we see a bigger picture. Our spending on the retail network has been an investment in stronger competitive positioning and includes growing and upgrading our branch network, increasing specialized sales forces, bolstering call centers and becoming more visible in our communities through more visible advertising and promotion.

From the results I've just discussed, it's clearly working. We're profitably building market share and building our retail business, and I think we are hitting our stride. So we will continue to invest in building the business because it's generating good returns for BMO and its shareholders.

The level of spending has been tempered by prevailing economic conditions, and it will be adjusted as conditions change. Russ is going to provide more specific details about Q3 expenses.

Coming back to the operating groups, in BMO Capital Markets, results are up year over year with net income of $259 million, an improvement over Q3 2007. We had good revenue growth, attributable in part to strong trading and driven by a positive yield curve. We expect the yield curve to remain positive while other areas of the business continue to be impacted by current market conditions, notably lower M&A.

With considerable uncertainty remaining in the marketplace, we continue to refocus capital markets, absorbing $28 million in severance-related expenses to achieve further expense reductions. We have reviewed our US credit commitments to focus on those clients where there is an opportunity to develop multi-product relationships and as a result, have designated 20% as non-core. These will not be renewed on expiry.

As well, derisking the business continues, as evidenced by the reduction in the core credit book, in the SIVs, in securitization and continued risk reduction in the commodity business.

Looking now at the economic outlook, we expect the US economy will slow further in the second half. Although the US is not technically in a recession, falling house prices, rising unemployment, tightening credit standards and high gasoline and grocery bills are all expected to depress consumer spending.

In particular, house prices will continue to decrease until the large inventory of unsold houses is absorbed. The Chicago housing market does continue to perform better than other regions in the country. The Case-Shiller data for June show the year-over-year median house price decline was 9.5% in Chicago, and that compares to the nationwide 20-city index decline of 15.9%. That said, the benefit of tax rebate checques was largely spent in Q2 and is unlikely to provide lift beyond Q3. As a result, there is considerable concern over consumers' financial health.

In Canada, the economic outlook for the balance of 2008 is for an annual growth rate of 1%, and that would be the slowest growth rate since 1992. Regionally, the West is still doing well but slowing as commodity prices have declined, and Ontario and Quebec have lost good jobs and are in recession. Canada's residential real estate market is cooling.

The period of the liquidity that we've been experiencing does not have a historic parallel. However, the economic cycle does have defined characteristics, and we are seeing indicators that suggest that the cycle is progressing much like others have before. For example, with housing starts in the US at a 17-year low, it's clear that, at some point, the supply-demand balance is going to come back into line.

In short, these times are challenging, and we can reasonably expect them to remain challenging for the near future. I can tell you, however, that BMO Financial Group is managing effectively through this period and ready to capture significant gains when more normal times resume.

With that, I'll turn it over to Russ to walk through the financials.

Russ Robertson ***- BMO Financial Group - CFO***

Thanks, Bill, and good afternoon. As some my comments are forward-looking, please note the caution regarding forward-looking statements on Slide 1.

On Slide 3 and as Bill mentioned, you can see the reported third quarter earnings were $521 million or $0.98 per share, compared to $1.28 last year. On a cash basis, earnings were $1 per share.

I'd like to spend my time today discussing some of the key drivers of earnings this quarter. Tom will comment specifically on provisions for credit losses. On Slide 4, you will see that revenue was $2.7 billion, up about 5% quarter over quarter. Quarter over quarter, there was volume growth across most products in P&C Canada as well as higher card revenue. Results also benefited by two additional calendar days this quarter. P&C US results were up as well, with volume growth, spread stabilization, increased fees and the addition of the Wisconsin-based bank acquisitions. Private Client Group's revenue growth came mainly from the brokerage businesses and North American private banking.

Revenue in BMO Capital Markets grew due to significantly higher trading revenues and strong performance for our interest-rate-sensitive businesses.

Year-over-year revenues increased 7.5% on a reported basis. Net interest income was $1.3 billion in Q3, up over both comparative quarters.

Looking more specifically at the margins on Slide 5, total bank margin was up 11 basis points from Q2. The main driver of the increase was higher trading spreads in BMO Capital Markets.

On a group basis, margins were down year over year by 5 basis points in P&C Canada but were up quarter over quarter by 2 basis points. The decrease year over year was due to lower mortgage refinancing fees, higher funding costs, and competitive pricing pressures, partially offset by improving product mix. The quarter-over-quarter increase was driven by a more favorable product mix and higher financing fees, partially offset by higher funding costs.

Margins in P&C US were up 18 basis points quarter over quarter with early signs of spread stabilization in loans and deposits in part due to pricing initiatives. The main driver of the 26-basis point year-over-year decline was the 22 basis point impact of a portfolio transfer.

The increase in BMO Capital Markets is attributable to better spreads in trading and corporate lending. Looking forward, we will continue to focus on shifting our mix to higher spread products but expect downward assure on margins.

Turning to Slide 7, non-interest revenue was impacted by capital markets environment charges amounting to $134 million pretax, $96 million after-tax, or $0.19 per share, compared with the prior quarter benefit of $42 million pretax or $0.06 per share. Two items account for the majority of the quarter-over-quarter change -- first a charge of $58 million pretax for mark-to-marketed valuations on counterparty credit exposures on derivative contracts, largely a result of widening corporate counter-party credit spreads relative to BMO. The prior quarter had a benefit of $128 million pretax, largely as a result of BMO credit spreads widening relative to our government counterparties.

Second, a net charge of $15 million pretax related to our APEX restructuring and valuations changes during the quarter. The prior quarter had a recovery of $85 million. This quarter included a gain of $40 million due to the reversal of a portion of charges previously recorded on our $815 million of APEX exposure. Another party to the restructuring holds a $600 million exposure to APEX through a total return swap with BMO. We had a loss of $55 million related to this total return swap transaction. This total return swap is in the trading portfolio and subject to mark-to-market accounting.

Also included the capital markets charges were the following -- a recovery of $25 million pretax for other trading and structured credit-related positions; last quarter, we had a charge of $93 million; a $28 million pretax charge for asset-backed commercial paper held that is subject to the Montreal Accord, this is due to an increase in the discount rate used for valuation; a $3 million charge for our capital notes investment in SIVs; and a charge of $55 million pretax for other-than-temporary impairments and valuation adjustments on preferred shares held in our trading portfolio. These charges above are reflected in the noninterest revenues, specifically $61 million in securities gains and losses other than trading, $76 million in trading revenue and a recovery of $3 million in Other NIR.

Turning to Slide 8, expenses were up 7.4% from a year ago and increased in each of the operating groups. Excluding the severance charge in BMO Capital Markets, expenses were up 5.7% from the prior year. As Bill noted earlier, the largest increase year over year has been the continued investment in our businesses of approximately $70 million. Over half of this increase relates to acquisitions and sales force expansion. The balance relates to initiatives, marketing and promotion.

Professional fees were also up year over year, due in part due regulatory initiatives. Other increases included BMO Capital Markets' severance costs and higher capital taxes, as the prior year was unusually low. These increases were offset by lower performance-based compensation, mostly in BMO Capital Markets, and the effects of the weaker US dollar. The quarter-over-quarter increase was 6%. Consistent with year over year, the increase reflects continued investment in our businesses, higher capital taxes and severance. There were also two additional days in the current quarter and higher performance-based compensation in line with increased revenues. These increases were reduced by a Visa litigation reserve and an increase in foreign pension expense booked in the second quarter.

Our effective tax rate for the quarter was a recovery of 12.2%. The decrease in the rate from last quarter is mainly due to $95 million of recoveries of prior years' income taxes and the higher proportion of income from lower tax-rate jurisdictions. We've revised our ongoing sustainable effective tax rate estimate to range from 17% to 21%, down from 19% to 23%.

On Slide 10, you will see that our capital ratio was 9.9% for the quarter, up 48 basis points from Q2 with risk-weighted assets of $182.3 billion under Basel II. 27 of the basis points increase is driven by higher Tier 1 balances, including a preferred share issuance. The remainder of the increase is a result of lower risk-weighted assets, including a $2 billion drop in market risk assets.

To wrap up, I should say that, as we have reported cash earnings of $1 per share, I would like to provide some thoughts on what our sustainable earnings may be, based on present market and credit conditions. I think I would adjust that dollar for the general allowance, which is $0.06 a share, the severance of $0.04 a share and adjust downward for the income tax drawdown that we took of $0.19 a share. Then I think I would significantly reduce the level of provision for credit losses that we had in the current period to a more normal level in this present environment. That would give me a sustainable earnings per share of $1.20 to $1.30 in my view.

With that, I will turn things over to Tom.

Tom Flynn ***- BMO Financial Group - Chief Risk Officer***

Thank you, Russ. Before I begin, I will draw your attention to the caution regarding forward-looking statements.

I want to start with three overarching points about the quarter from a risk prospective. First, Q3 credit losses are elevated by provisions on two large accounts. These two accounts have attributes that make them not representative of the portfolio as a whole. Second, the weak state of the US housing market has continued to put pressure on portfolios that are related to that sector. Third, our Canadian portfolios and our non-housing-related US portfolios continue to perform in a satisfactory manner. I will speak at some length to give you a better understanding about each of these three points.

Starting on Slide 3 with impaired loans, you can see that impaired loan formations during the quarter totaled $434 million, down from the prior two quarters. The decrease in the quarter largely reflects the impact on formations in quarters one and two from two accounts. These two accounts increased our aggregate Q1 and Q2 formations by approximately $600 million. The majority of Q3 formations came from manufacturing and US commercial real estate sectors and from one account in the oil and gas sector. Gross impaired loans decreased slightly from last quarter but remain higher than the first quarter, due to the weaker environment.

Slide 4 shows segmented geographic and industry information for impaired loans. The majority of impaired loans are US-based at the end of Q3. Accounts related to commercial real estate represent 58% of US impaired loans. This includes a commercial real estate-related loan classified in financial institutions. Within the commercial real estate category, exposure is largely concentrated in the residential subsector.

Turning to Slide 5, our total provision for credit losses was $484 million in the quarter. This included a $50 million increase in the general allowance. The increase in the general allowance is based on our assessment of the weaker outlook for the economy and, in particular, the US housing market.

The Q3 specific provision was $434 million. $247 million of this was from the two commercial accounts that I mentioned earlier. Both of these accounts were originated in our US securitization conduit. If you exclude these two accounts, the specific provision for the quarter would have been $187 million, and this included an amount of $27 million for one account in the oil and gas sector.

The table on Slide 5 provides additional segmented geographic and business line information on the provision. You'll see that the Canadian portfolios have performed well with both consumer and commercial provisions being relatively flat. US consumer and commercial provisions are up, both due largely to the US housing market. Corporate loan provisions are up from the prior quarters. The two accounts that I have referred to represent about 80% of the provision.

Clearly, the provision for the two accounts is large for the quarter. The two accounts had characteristics that made them more susceptible to loss, given the current state of the US housing market. Due to the unusual size of these provisions, I will give you additional color on them.

The first account was a related to a company that, until recently, had a successful long-term record of buying and remediating distressed US residential mortgages. The funding provided was largely used to finance a warehouse portfolio of such mortgages. When the account was transferred from our US conduit, it had approximately $460 million in outstandings. Collateral for the account largely consisted of approximately 4000 residential mortgages spread across much of the United States.

The size of the provision reflects the continued weakness in the housing market also some specific factors. The first of these is that the values for the type of distressed mortgages, including foreclosed mortgages that are included in the portfolio, have been more negatively impacted than the overall housing market. In addition, some of the collateral was in states that have been harder hit by the downturn.

To arrive at the provision on this account during a time when markets were deteriorating rapidly, we undertook a series of appraisals to update portfolio information. This review led to the additional provision of $151 million and the write-off of $105 million this quarter. With this provision, the net unreserved balance is approximately $210 million.

The second account funded an underlying portfolio of approximately 250 loan facilities. These facilities were used to fund housing development projects located largely in Minnesota and to a lesser degree in South Carolina. These loans were originated and serviced by a third-party company. The loan had a gross value of approximately $150 million when it was transferred. We have taken a provision this quarter of $90 million and a total of $125 million against this account. The net unreserved exposure is under $25 million.

The size of the provision taken here reflects the weak state of the US housing development market but, again, also a number of specific factors. These include that the portfolio was concentrated outside major urban areas, which has negatively impacted values as these markets have been hit harder by the downturn. Secondly, issues associated with the way the facility was put together and its operations increased our exposure to loss. Lastly, the need to replace the original servicer and work through complex documentation that included multiple liens added complexity and risk.

So, to conclude on these two accounts, both of the accounts had characteristics that made them particularly vulnerable to the housing downturn. We believe that the provision we have taken will cover off the exposure that we have to the two accounts.

Moving now to Slide 6, you can see a further segmentation of the Q3-specific provision. As with formations, provisions are driven by the US portfolio with approximately 70% of US-specific provisions resulting from the two loans that I have already covered in detail. The consumer and within that credit card business continues to be the largest component of the Canadian provisions.

The credit card business tends to be fairly predictable over time. With respect to cards, we have noticed a decline in delinquencies over the last quarter, demonstrating the success of efforts to rebalance our origination channels and also improvements made in our collection areas.

To sum up our view on the quarter from a credit perspective, first, the portfolios associated with the US housing market are feeling the effects of the economic environment as reflected in higher provisions. Second, our Canadian portfolios continue to perform well, as do US portfolios that are not tied to the US housing market. Finally, provisions in the current quarter were above where we had expected them to be, primarily due to the larger than expected provisions taken against two accounts that had attributes that made them particularly exposed to the US housing market.

Slide 7 provides details on our US loan book, which is well diversified across portfolios. The consumer portfolio represents less than 10% of BMO's loan book. The residential mortgage and indirect auto portfolios have seen a pickup in loss rates, but they remain relatively modest both in absolute terms and relative to other US banks. For example, mortgage and indirect auto portfolio average charge-offs in quarters 2 end 3 were each under a third of Q2 peer averages.

In common with other banks, we have seen more weakness in our US home equity portfolio in the last two quarters. Losses have increased here but again they remain below industry average.

You can also see from the information provided on the bottom left of the slide that the higher-risk parts of our mortgage and home equity portfolios are relatively small. The US commercial and corporate portfolios are well diversified and generally performing well. The commercial real estate portion of the portfolio is approximately $4.7 billion, and within this, approximately $1.7 billion is developer related.

Slide 8 provides an update on our US securitization conduit, which was formed in 1997. The ratings continue to be strong at A1 and P1 by Moody's and S&P, respectively. Assets in the conduit are well diversified across 99 different securitization transactions, each of which has a diversified pool of underlying assets. The average transaction size here is $93 million. There are ten transactions larger than $200 million, and none of these is real estate related. Only one of these is above $365 million. These ten transactions are made up of eight different asset types, including equipment leases, consumer loans and credit card receivables.

The asset quality is fine. 97% of the assets are internally rated investment grade equivalent, even when no value is given to the monoline wraps that some transactions have. 61% are externally rated with these ratings being single-A or better.

Earlier in the year, we transferred a third account from our US securitization conduit. This conduit funded a number of real estate projects which are diversified across much of the United States. The July 31 outstanding here was approximately $160 million, down from $225 million when the account was moved out of the conduit. The assets continue to perform, and we are expecting full repayment on this loan.

For the conduit as a whole, commercial real estate-related commitments currently represent approximately 13% of total commitments. Given the environment, there can be no certainties with respect to performance. That said, a review of the conduit's portfolio has not identified other immediate concerns.

On Slide 8, I will direct you to the large trading and underwriting gains and losses on a few dates. These were driven by the type of valuation adjustments that Russ referred to earlier.

Slide 9 provides an update on some topical capital market-related issues. As you can see, progress continues to be made, and our exposures are manageable. We have only modest exposure to US subprime mortgages, monolines and hedge funds. As Russ mentioned, Apex has been successfully restructured. We remain comfortable with the credit exposure here, given the credit quality of the underlying companies and the first loss protection that is in place.

The SIVs are being managed in line with our plans. We're comparable with our senior position, given the credit quality of the assets and the size of the subordinate capital notes. The amount that we have funded has increased in the quarter. As we told your last quarter, we intend to slow the pace of asset sales in the SIV to preserve the value of the subordinate capital that supports our senior funding.

Last quarter, the size of the Links facility was approximately $8.8 billion. That amount is down to $7.9 billion at July 31. The amount that we have actually funded at the end of Q3 was approximately $3 billion for Links and $4 billion in total. We expect an increase of approximately $1 billion in the funded amount during the fourth quarter.

Our expectation for the total size of the facility that will be funded has not changed since the facility was first put in place and continues to be below $6 billion for Links and EUR500 million for Parkland. With that, we will open the call for questions.

QUESTION AND ANSWER

Operator

Thank you. We will now take questions from the telephone lines. The first question will be from Andre Hardy, RBC Capital Markets.

Andre Hardy *- RBC Capital Markets - Analyst*

I have two quick ones on APEX, please. First of all, this total return swap, can you address the quality of counterparty and what kind of collateral agreement there may be?

The second one is I understand you are marking this on a -- your mid-term notes, I mean, you are marking on the discounted cash flow basis. What would lead you to mark this on a liquidation basis? I understand this is probably not going to get liquidated, since there's no funding risk anymore. But under what scenario would you have to make that assumption?

Bill Downe – ***BMO Financial Group – President and CEO***

We'll let Tom Milroy take that question, Andre.

Tom Milroy *- BMO Financial Group - CEO of BMO Capital Markets*

Andre, I'll answer the first part. The counterparty is one of undoubted credit quality and does not have to post any cash collateral. So we are quite happy with the position.

Andre Hardy *- RBC Capital Markets - Analyst*

What has no risk out there?

Tom Milroy *- BMO Financial Group - CEO of BMO Capital Markets*

I'm sorry? I'm not sure I understood your second comment.

Andre Hardy *- RBC Capital Markets - Analyst*

I'm sorry. How can credit quality be that strong that you have no doubt?

Tom Milroy *- BMO Financial Group - CEO of BMO Capital Markets*

We think it is very high credit quality, so we are comfortable with the position.

Andre Hardy *- RBC Capital Markets - Analyst*

Okay. On the second question?

Russ Robertson *- BMO Financial Group - CFO*

It's Russ Robertson. Can you just repeat the second part of the question, please?

Andre Hardy *- RBC Capital Markets - Analyst*

Yes. Given that the margin facility related to APEX is being drawn, I suspect that if you had to assume that APEX were dissolved, the mark to market would be a lot more severe than what you're marketing it at, which is based on a DCF methodology. My question is, what would lead to a change in the accounting treatment for your holdings in mid-term notes of APEX?

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

The accounting is based on the expectation that the facility will be in place through the life of APEX and the structure will remain in place. We are, therefore, accounting for it based on the underlying credit quality of the portfolio, which we believe to be high and also to be supported by the first loss protection that is in place. So with that expectation staying in place, that will continue to be the accounting. Really, we wouldn't revert to any other type of the accounting for it.

Andre Hardy *- RBC Capital Markets - Analyst*

Is there a check such that, if market value remains below a certain level for an extended period, you'd have to change your accounting?

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

No.

Operator

Jim Bantis, Credit Suisse.

Jim Bantis ***- Credit Suisse - Analyst***

One question for Russ -- you were kind enough to give us a core earnings guidance of $1.20 to $1.30. I just want to put that -- just maybe dig into one of your assumptions regarding loan loss provisions. I put in the context of some of the commentary that Tom had regarding the US and Bill's rather pessimistic view in terms of the Canadian economy and some of the issues that it's facing. So maybe you could just elaborate in terms of what you think the level of loan losses is expected to being in the coming couple of quarters, given the environment that you've suggested this EPS range could be earned.

Bill Downe ***- BMO Financial Group - President, CEO***

Jim, I might suggest that Tom speak specifically to that, since he's got the closest view of the credit portfolio.

Jim Bantis ***- Credit Suisse - Analyst***

Great, thank you.

Tom Flynn ***- BMO Financial Group - Chief Risk Officer***

Sure, I'll go ahead. This quarter, as you know, the specific provision was $434 million. If you exclude the two large credits that we think have characteristics that are fairly unique, the provision was $187 million, which is up from the last two quarters, not up dramatically, but it is up.

We think the environment is weakening, both in Canada and in the US. The US housing market weakened noticeably through the last quarter and isn't showing signs of bottoming. So we think there is upward pressure that we will feel on the level of $187 million. Exactly how much pressure there is over the next quarter will depend on how the economy plays out, what the housing market does, and how the US consumer holds up.

Jim Bantis ***- Credit Suisse - Analyst***

Tom, I know you still continue to book expected losses in terms of the segments, and then everything else is booked into the corporate. But with the elevation of loan losses and impairments, if we were to apply some of these increases towards the segments, would a majority of it still be coming from the wholesale operations out of BMO Capital Markets, or would some of this start to filter through Harris Bank?

Tom Flynn ***- BMO Financial Group - Chief Risk Officer***

We thought this would be a bit of the challenging issue for people this quarter, so on Slide 5 of my presentation, we've provided some additional segmented disclosure. What you can see there is the trend in provisions for, really, each of the lines of business. You can see that there has been some pressure in the US consumer portfolio and the US commercial portfolio, which is part of P&C US. The pressure that you are seeing there is very connected to what's going on in the US housing sector.

The commercial side is driven principally by home equity loans. The consumer side is driven largely by developers, and then down below, you can see the BMO Capital Markets provision of $310 million in the quarter. In that, we've got the $247 million for the two large credits, $27 million for one company in the oil and gas sector. If you include those, I think you are down to something like $30 million, $35 million. That would include some pressure from developers and also just general portfolio activity.

Operator

Brad Smith, Blackmont Capital.

Brad Smith *- Blackmont Capital - Analyst*

Thanks very much. I just had a quick question with respect to the gross loans and acceptances details on Page 31. I'm just noting there that the bulk of the increase of roughly $3 billion sequentially during the quarter relates to financial institutions which are now just over $20 billion of gross loan exposure. I was just wondering if I might get some sense for what would have caused that rather substantial increase during the particular third-quarter, and maybe some just general comments about what sort of exposures are actually included in that line item.

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

Sure, it's Tom Flynn. Virtually all of the increase in the quarter relates to the funding that I referred to earlier or for Links and Parkland, so the funding activity that we have for the two SIVs shows up in the financial institutions line.

More generally, the balance is very highly diversified across really all segments of the US and Canadian and even European financial institution space. We don't have many large exposures, and we've got exposure that's diversified across all of subsectors within financial institutions.

Brad Smith *- Blackmont Capital - Analyst*

Then I guess just following on that, if I look at the provisioning in the quarter on Page 30, your year-to-date provision is $194 million for that line item in your gross loan portfolio, I take it. That's up about $155 million, so I take it that's what the provision for that space was during the third quarter. Is there something there that is causing you to want to ramp up your allowance relative to that financial institutions line?

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

This is a bit of a funny situation. One loan that was funded out of our conduit that funds the distressed mortgages is classified in our accounts in the Financial Institution category. So when we showed the slide on impaired formations in the provision, you could see that a large part of the provision was coming from the Financial Institution category. There is a footnote that notes that the loan relates to the distressed mortgages. So really, almost all of the provision that you see in that category on Slide 30 of the supp pack relates to the one of the two larger loans that I've talked about in detail. It's not broadly related to issues in the Financial Institution portfolio.

Brad Smith *- Blackmont Capital - Analyst*

Okay, and then just a final question, switching gears to the domestic private client segment, where I'm seeing some pretty strong revenue growth both sequentially and year over year, but I'm not seeing any assets under admin or asset under management growth to match that. What is it that's driving that rather strong revenue growth? It's north of 6%, almost 7%, I think, sequentially.

GillesOuellette - *BMO Financial Group – President and CEO, Private Client Group*

Well, the business in the last six or seven years, as you know, has changed quite a bit. Today, we're considerably less dependent on the transaction side of the business. In the Private Client Group as a whole, only about 25% of the revenues is related to the day-to-day activities in the market.

What's happened is that, in this period of time, the markets have held up and we've been able to grow our revenues. The markets have slowed down considerably, but as long as the levels hold up, revenues are going to continue.

Brad Smith *- Blackmont Capital - Analyst*

I would presume that the bulk of the revenues in that segment are either transaction-related commissions or asset-based fees. If the AUA isn't going up and the AUM isn't going up, I'm just trying to figure out how the revenue is going up.

GillesOuellette - ***BMO Financial Group – President and CEO, Private Client Group***

The transaction revenue has slowed down but the assets have held up. A lot of it has to do with the mix of the different businesses. Some of the assets, or the areas where the assets haven't grown, has been in the transaction side. The other thing that's happened, too, year over year is the spread revenue has increased quite a bit. Some of our clients have gone to cash, and that has increased the spread revenues.

Operator

Michael Goldberg, Desjardins Securities.

Michael Goldberg *- Desjardins Securities - Analyst*

I have a few questions. First of all, I don't mean to be cheeky, but how does an oil and gas company get into trouble in the current environment? And how is it that BMO found itself lending to them?

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

It's Tom Flynn. The provision that we took was for a company that was US-based that had some issues with its natural gas trading operation and had a fairly high-profile bankruptcy in the last quarter. So it is counter-intuitive, given the price of commodities, that this company had an issue with its trading activities. We took that provision against an exposure of about $65 million.

Michael Goldberg *- Desjardins Securities - Analyst*

Okay. Secondly, in the stress testing that you do, could you give me some idea of the impact that you get by taking US employment down by 1.5% and house prices down a further 5% to 10% on average on credit quality?

Bill Downe *- BMO Financial Group - President, CEO*

Michael, this is Bill. I don't want to be cheeky, but we'd probably have to run that for you and give you some kind of a sense. I don't think we get all that one right out of the air.

Michael Goldberg *- Desjardins Securities - Analyst*

Sure, okay, you can get back to me. Finally, I notice that you have again updated your Level Three exposures. Can you just run through quickly some of the key items that account for changes from the second quarter?

Russ Robertson *- BMO Financial Group - CFO*

It's Russ, Michael, yes. There's no different -- no new instruments in our Level Three, and it does include the APEX notes, which have moved from trading to available for sale, the Montreal Accord assets-backed commercial paper and CDO portfolios. There has been an increase in the amounts, but the increase is fully hedged.

Michael Goldberg *- Desjardins Securities - Analyst*

There has been an increase in what did you say?

Russ Robertson *- BMO Financial Group - CFO*

Well, the types of instruments, the three I mentioned, Apex, and Montreal Accord and CDO portfolios, the nature of the type of assets that are in the Level Three, that has not changed, but there has been an increase in the CDO portfolio. Just to let you know, that increase is totally hedged.

Michael Goldberg *- Desjardins Securities - Analyst*

With what?

Russ Robertson *- BMO Financial Group - CFO*

I'm not certain. Can I get back to you on that?

Michael Goldberg *- Desjardins Securities - Analyst*

Sure. Thank you.

Operator

Mario Mendonca, Genuity Capital Markets.

Mario Mendonca *- Genuity Capital Markets - Analyst*

Good afternoon. I have a question. First, it's more of a point of clarification on Andre's questions about Apex and Sitka. The $600 million total return swap, this counterparty, why would this counterparty have their exposure through a total return swap and not just put up the cash the way BMO has or put up a facility the way BMO has?

Tom Milroy *- BMO Financial Group - CEO of BMO Capital Markets*

It's Tom Milroy, Mario. Going into the restructuring, they held it already in a total return swap. So coming out of it, they held it in the same form.

Mario Mendonca *- Genuity Capital Markets - Analyst*

But BMO has put up the money, and this company has their exposure in the form of a total return swap. Is that fair?

Tom Milroy *- BMO Financial Group - CEO of BMO Capital Markets*

That's right.

Mario Mendonca *- Genuity Capital Markets - Analyst*

Now, why is that BMO would have a mark-to-market loss of $55 million? Presumably, the side, that other counterparty would have a gain of $55 million. I guess I'm getting at -- is if BMO has put up $600 million, then written a total return swap, the loss on the total return swap should have been offset by the gain on the asset that BMO put up. Ultimately, what I'm saying is, if BMO is not putting up the $600 million really, the risk, then why does BMO have a loss at all?

Russ Robertson *- BMO Financial Group - CFO*

It's Russ. The terms of the underlying and the terms of the total return swap aren't exactly the same, and that gives rise to this one-time loss. But I will add, just for some additional information, that there will be a $10 million swing in the value for each 50 basis points of shift in spreads.

Mario Mendonca *- Genuity Capital Markets - Analyst*

Can you verify that? 50 basis point shift in what spreads are you referring to?

Russ Robertson *- BMO Financial Group - CFO*

Well, in the valuation of the underlying and the swap -- if there's a 50 basis points movement, then there will be $10 million gain or loss, to give you some idea of the sensitivity.

Mario Mendonca *- Genuity Capital Markets - Analyst*

I'll get off this quickly. It just seems to me that BMO now seems like they are on the hook for the $600 million. Is that a fair statement? Like BMO has got $815 million and another $600 million?

Russ Robertson *- BMO Financial Group - CFO*

No. The counter party is on the hook for the $600 million and any diminution in value.

Mario Mendonca *- Genuity Capital Markets - Analyst*

Okay. The actual question I want to ask really related to the SIVs. Last quarter, you said the liquidity provided was about $427 million. It's now up to about $4 billion. That's the liquidity you've provided. I think that's correct, isn't it, that you added about $4 billion of liquidity in one quarter?

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

A little less, but that's not far off.

Mario Mendonca *- Genuity Capital Markets - Analyst*

Okay, it was $427 million, so something under $4 billion but a lot, essentially, in this quarter? You are adding another $1 billion next quarter is what you're suggesting, getting you to $5 billion. The assets in the facility, liquidity -- sorry, the assets right now in the SIVs are about, what is it, $9.8 billion, roughly? Down only about $1.4 billion from last quarter? I think what I'm getting at is that the assets in the SIVs are declining slowly, only $1.4 billion this quarter, but the liquidity is ramping up really quickly. Ultimately, what I'm getting at is at some point, BMO is going to be providing over 50% of the funding for that SIV, and it could happen as early as next quarter. Does that have any accounting applications for BMO, if BMO is, in fact, providing more than 50% of the funding for the SIV?

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

It's Tom Flynn. No, it does not have accounting applications. That's because there is significant capital that is subordinate to us and bears the risk of the expected loss in the structure. The funding is up in the quarter, and it's up by more than the change in the total level of assets might suggest because the quarter was relatively heavy, from an asset maturity perspective. And we did sell some assets in the SIVs during the quarter but they didn't meet the maturing notes. So, pursuant to the terms of our facility, we provided the funding.

The total amount that we expect to fund hasn't increased from the total amount that we talked about at the time the facility was first put in place. The amount of funding is expected to ramp up, and it will peak roughly a year from now.

Mario Mendonca *- Genuity Capital Markets - Analyst*

I'll stop very soon just because this surprised me at how much funding was provided in one quarter. The capital notes -- what's left in the capital notes, market value, not the book value? I think you told us it was something like $147 million? It was a small number, from what I recall.

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

It is a small number. Let me just look for it here.

Mario Mendonca *- Genuity Capital Markets - Analyst*

I think what I'm getting at is, if the capital notes are -- if that's a really small number and -- because it sounds like it, because essentially the stuff is going away -- how is it that there is a sort of an equity owner? Why doesn't BMO essentially become the owner?

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

It doesn't become the owner because people, in the case of Links, own subordinate capital notes that have a book value that's approximately $1.3 billion. The market value of those securities moves around with the market value of the underlying assets, but it doesn't change the reality that they own the assets. Those assets are at risk first before our senior funding facility, given the structure.

Mario Mendonca *- Genuity Capital Markets - Analyst*

So you don't envision any way that this could possibly come on BMO's books? Obviously, you know where I am going with this.

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

We don't expect so. The way we look at this really is we've got a portfolio that is 75% plus rated double-A. We think the quality will prove up over time, and against a portfolio of that quality, we've got book value of subordinate capital of $1.3 billion. So losses on the underlying assets would have to be multiples of losses experienced on assets of that quality in order for the subordinate capital to be consumed. With that, we should be okay from a risk perspective, and we are not expecting a change in the accounting.

Mario Mendonca ***- Genuity Capital Markets - Analyst***

Thank you for indulging me.

Operator

Ian de Verteuil, BMO Capital Markets.

Ian de Verteuil ***- BMO Capital Markets - Analyst***

Tom, the gross loans on the balance sheet, Page 31 of your supp pack, you provided breakdown by category. The financial institutions line has always intrigued me because it's your single biggest exposure, and it's grown more markedly than anything else. So I just want to find out a bit more about it. So, of that $4.5 billion, we know that $3 billion is Links, we know that $0.5 billion was a financial institution that really was residential but was US real estate in some manner. So I'm down to, I don't know, $17 billion or something like that. What can you tell me about that $17 billion portfolio? What can you tell us about it to make us feel that it's not more sort of structures or more real estate-related stuff?

Tom Flynn ***- BMO Financial Group - Chief Risk Officer***

Yes, I guess the first thing I would say is that if you look at the losses that have been produced in that portfolio over time, they have been modest. I talked about the diversified nature of the portfolio earlier. I don't have a detailed segmentation by asset type, but the portfolio is very highly diversified across the different subsectors that make up the financial services industry. The ratings of the companies that are in that category are strong.

Ian de Verteuil ***- BMO Capital Markets - Analyst***

Are there any more structured like loans, so loans to structures like SIVs or conduits that show up in this Financial Institutions line?

Tom Flynn ***- BMO Financial Group - Chief Risk Officer***

Loans to SIVs or conduits -- the answer, I am almost certain, would be no. We aren't out there lending to other people's SIVs or conduits.

Ian de Verteuil ***- BMO Capital Markets - Analyst***

So the doubling in this loan book over two years -- are you lending to small regional banks in the United States over $100,000 each?

Tom Flynn ***- BMO Financial Group - Chief Risk Officer***

We have checked on that number, and the lending to small US regional banks is de minimis. It would be under a couple hundred million dollars, so we are not in that business.

Ian de Verteuil ***- BMO Capital Markets - Analyst***

How about to large commercial banks in the US, then?

Tom Flynn ***- BMO Financial Group - Chief Risk Officer***

A similar answer -- maybe we can take it off-line and try to give you more detail, but it really is highly diversified, covers the different sectors that are part of financial services and over time has produced modest levels of a both impaired loans and loss.

Ian de Verteuil ***- BMO Capital Markets - Analyst***

Thanks, I'll follow up off-line.

Operator

Robert Sedran, National Bank Financial.

Robert Sedran ***- National Bank Financial - Analyst***

Tom, you touched on this a little in your prepared remarks, but can you provide any more detail on the differences between the performing asset that was taken from Fairway and the two on which the provisions have been taken? If you expect it to be repaid, why was it taken out of Fairway in the first place?

Tom Flynn ***- BMO Financial Group - Chief Risk Officer***

I'm not sure I have a whole lot to add. You have seen that the loan has been reduced from approximately $225 million down to about $160 million. So the loan is in a mode of paying out. The loan funds, development projects -- they are spread across much of the US portion of the portfolio is retail related, and we have been managing this account in what we call our special asset group, which is our workout group. Clearly, there was a level of risk attached to the loan, given that we took it out of the conduit. But given what has developed over the last quarter, although always there is risk, we're expecting that it will pay out.

I might add one point to that. This does differentiate this loan from the one of the two loans that we took a provision on that was developer related. The developers that are being funded through that third loan largely make up the 100 largest developers in the US, and so we're dealing with companies that are generally good what they do, well-established and have more resources to complete projects in a tougher environment than some of the people that we were dealing with in that other loan hat.

Operator

Sumit Malhotra, Merrill Lynch.

Sumit Malhotra ***- Merrill Lynch - Analyst***

In the capital market segment, it looks like your average loans and acceptances are down about 3% quarter over quarter. Can you talk about the 20% reduction in non-core relationships in that segment, how much of that this is related to? Is that 20% number a static one, or do you see this increasing going forward? Basically, I'm trying to get a view on what's the appetite of the Bank in the mid market commercial corporate space in the US right now.

Tom Milroy ***- BMO Financial Group - CEO of BMO Capital Markets***

It's Tom Milroy. I'll just respond to both of those. The first one, the reduction in the average loans and acceptances really had more to do with the reduction in our repo book because the steps that we have taken to reduce the US loan portfolio haven't actually come through at this stage. We have identified the loans. We have put them into a non-relationship portfolio, and we are working them down.

The change in our appetite really relates to what type of business we want to do. We looked at our entire portfolio, and this subset really comprises those loans where we felt we didn't have the opportunity to make a decent return by selling additional products. It was more on that basis. So I would say that we continue to have an appetite to be a provider of lending capital into the US middle market space, but where we can sell more products and ensure that we get a reasonable return from the relationship.

Sumit Malhotra *- Merrill Lynch - Analyst*

If we move onto something else here, $4 billion in liquidity provided to the SIVs -- your commentary suggests we are up to $5 billion by the end of Q4. If I just look at this, funding is not expected to exceed 70%, that would put your total at just over $6 billion. Given how difficult it seems for this entity to fund itself right now, and it's certainly not the only one, the $6 billion number doesn't sound that far away. Can you just remind me what was the original rationale behind the commentary of the not to exceed 70%? And is that still valid in your view?

Tom Flynn *- BMO Financial Group - Chief Risk Officer*

It's Tom Flynn. First of all, the number is still valid. The funding picked up fairly dramatically in the current quarter. The increase over the next year will be more gradual and will peak in around a year. The 70% number reflects the net impact of the need to fund the maturing debt in the SIV, offset by asset maturities that occur with the SIVs asset portfolio and ongoing asset sales. So we see this situation really as playing out as we expected. We were not expecting the market to come back for SIV paper directly. We are funding it in line with our initial expectations and continuing with asset sales, although at a slower pace, given the illiquidity in the market and the resulting lower prices.

Sumit Malhotra *- Merrill Lynch - Analyst*

I guess I'll wrap up here, Tom. My counter would be, in Q2, it seemed like when the world felt a lot better about the problems we have in April and May, you were able to sell a decent amount. We didn't have to see that much on the liquidity side this quarter. Credit markets get a little bit tighter, and the funding picks up. My concern would be if this kind of environment continues, you may have to exceed that 70%. Again, $5 billion at the end of Q4 doesn't seem that far away. I don't know if you want to comment on that, but I'll certainly leave it there. Thanks.

Bill Downe *- BMO Financial Group - President, CEO*

Thanks very much. This is Bill Downe. We are at the last question that was in the queue. I might have one last reflection on the topic, and that is that, as Tom said, the variables are maturing assets and the sale of assets. When we looked at the paper maturity, when we put the line in-place, we didn't anticipate any difference. There's no expectation of rollovers as paper matures. The line is necessary to balance that. When we put the line in-place, it was in the area, as I recall, of around $11 billion. So the progress that we've made continues to be, I would say, a steady pace. We did reflect, as I recall, that we would slow down the pace in periods when spreads were a little bit wider and the asset realizations were below what we thought was a fair market value. Those will rise and fall as we go through quarters, based on what's going on in the external market. It doesn't change our view as to what the draws will be over the next 12 months. The draws will be determined by, as I said, the variables of maturities, asset sales and the run-off of the book.

I want to finish up with a quick comment with respect to the economy because I know, in the questions, I have a sense that there was a concern about pessimism. I would just like to be real clear about this. We are very vigilant with respect to the economy. I wouldn't put it in the category of pessimism. I think I referenced the kinds of pressures that we're experiencing.

One of the observations about the US housing market is that it is good news that housing starts are at the low level where they are, and at some point, people are going to come out of rental housing and move back into purchased housing. Clearly, the one big blockage in the market is the GSEs that are pending restructuring. When they are restructured, I think the US housing market will become a much more orderly place.

So I'll just finish up with that because I didn't want to leave the impression that we think that we are on the edge of a precipice. But we are vigilant, and we do recognize that further deterioration obviously will translate into loan books.

With that, I just want to thank you. I know that this afternoon has been very busy because you've had two calls, and I'll turn it back to Viki.

Viki Lazaris *- BMO Financial Group - SVP Investor Relations*

Thanks again for joining us today. If there's further questions, the IR team will be at their desks and on the phone and be happy to take your questions. I know we have a few follow-ups for some of you. Thanks again and have a great day.