HARRIS PREFERRED CAPITAL CORP
Form 10-K
March 24, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

2003
FORM 10-K

ANNUAL REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003

COMMISSION FILE NUMBER 1-13805

HARRIS PREFERRED CAPITAL CORPORATION
(Exact name of registrant as specified in its charter)

MARYLAND (State or other jurisdiction of incorporation or organization)	# 36-4183096 (I.R.S. Employer Identification No.)
111 WEST MONROE STREET, CHICAGO, ILLINOIS (Address of principal executive offices)	60603 (Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE:
(312) 461-2121

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGIS
7 3/8% Noncumulative Exchangeable Preferred Stock, Series A, par value $1.00 per share	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form

10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether this registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [ ] No [X]

The number of shares of Common Stock, $1.00 par value, outstanding on March 24, 2004 was 1,000. No common equity is held by non-affiliates.

HARRIS PREFERRED CAPITAL CORPORATION

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PART I

Forward-Looking Information

Forward-looking statements contained in this Annual Report on Form 10-K ("Report") of Harris Preferred Capital Corporation (the "Company") may include certain forward-looking information, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including (without limitation) statements with respect to the Company's expectations, intentions, beliefs or strategies regarding the future. Forward-looking statements include the Company's statements regarding tax treatment as a real estate investment trust, liquidity, provision for loan losses, capital resources and investment activities. In addition, in those and other portions of this document, the words "anticipate," "believe," "estimate," "expect," "intend" and other similar expressions, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. It is important to note that the Company's actual results could differ materially from those described herein as anticipated, believed, estimated or expected. Among the factors that could cause the results to differ materially are the risks discussed in the "Risk Factors" section included in the Company's Registration Statement on Form S-11 (File No. 333-40257), with respect to the Preferred Shares declared effective by the Securities and Exchange Commission on February 5, 1998. The Company assumes no obligation to update any such forward-looking statements.

ITEM 1. BUSINESS

General

Harris Preferred Capital Corporation is a Maryland corporation incorporated on September 24, 1997, pursuant to the Maryland General Corporation Law. The Company's principal business objective is to acquire, hold, finance and manage qualifying real estate investment trust ("REIT") assets (the "Mortgage Assets"), consisting of a limited recourse note or notes (the "Notes") issued by Harris Trust and Savings Bank (the "Bank") secured by real estate mortgage assets (the "Securing Mortgage Loans") and other obligations secured by real property, as well as certain other qualifying REIT assets. The Company's assets are held in a Maryland real estate investment trust subsidiary, Harris Preferred Capital Trust. The Company has elected to be treated as a REIT under the Internal Revenue Code of 1986 (the "Code"), and will generally not be subject to federal income tax if it distributes 90% of its adjusted REIT ordinary taxable income and meets all of the qualifications necessary to be a REIT. All of the shares of the Company's common stock, par value $1.00 per share (the "Common Stock"), are owned by Harris Capital Holdings, Inc. ("HCH"), a wholly-owned subsidiary of the Bank. The Company was formed by the Bank to provide investors with the opportunity to invest in residential mortgages and other real estate assets and to provide the Bank with a cost-effective means of raising capital for federal regulatory purposes.

On February 11, 1998, the Company, through a public offering (the "Offering"), issued 10,000,000 shares of its 7 3/8% Noncumulative Exchangeable Preferred Stock, Series A (the "Preferred Shares"), $1.00 par value. The Offering raised $250 million less $7.9 million of underwriting fees. The Preferred Shares are traded on the New York Stock Exchange under the symbol "HBC Pr A". Holders of Preferred Shares are entitled to receive, if declared by the Company's Board of Directors, noncumulative dividends at a rate of 7 3/8% per annum of the $25 per share liquidation preference (an amount equivalent to $1.8438 per share per annum). Dividends on the Preferred Shares, if authorized and declared, are payable quarterly in arrears on March 30, June 30, September 30 and December 30 of each year. The Preferred Shares may be redeemed for cash at the option of the Company, in whole or in part, at any time and from time to

time, at the principal amount thereof, plus the quarterly accrued and unpaid dividends, if any, thereon. The Company may not redeem the Preferred Shares without prior approval from the Board of Governors of the Federal Reserve System or the appropriate successor federal regulatory agency.

Each Preferred Share will be automatically exchanged for one newly issued Bank Preferred Share in the event (i) the Bank becomes less than "adequately capitalized" under regulations established pursuant to the

Federal Deposit Insurance Corporation Improvement Act of 1991, as amended, (ii) the Bank is placed into conservatorship or receivership, (iii) the Board of Governors directs such exchange in writing because, in its sole discretion and even if the Bank is not less than "adequately capitalized," the Board of Governors anticipates that the Bank may become less than adequately capitalized in the near term, or (iv) the Board of Governors in its sole discretion directs in writing an exchange in the event that the Bank has a Tier 1 risk-based capital ratio of less than 5%. In the event of an exchange, the Bank Preferred Shares would constitute a new series of preferred shares of the Bank, would have the same dividend rights, liquidation preference, redemption options and other attributes as the Preferred Shares, except that the Bank Preferred Shares would not be listed on the New York Stock Exchange and would rank pari passu in terms of cash dividend payments and liquidation preference with any outstanding shares of preferred stock of the Bank.

Concurrent with the issuance of the Preferred Shares, the Bank contributed additional capital of $241 million, net of acquisition costs, to the Company. The Company and the Bank undertook the Offering for two principal reasons: (i) the qualification of the Preferred Shares as Tier 1 capital of the Bank for U.S. banking regulatory purposes under relevant regulatory capital guidelines, as a result of the treatment of the Preferred Shares as a minority interest in a consolidated subsidiary of the Bank, and (ii) lack of federal income tax on the Company's earnings used to pay the dividends on the Preferred Shares, as a result of the Company's qualification as a REIT. On December 30, 1998, the Bank contributed the common stock of the Company to HCH, a newly-formed and wholly-owned subsidiary of the Bank. The Bank is an indirect wholly-owned U.S. subsidiary of Bank of Montreal. The Bank is required to maintain direct or indirect ownership of at least 80% of the outstanding Common Stock of the Company for as long as any Preferred Shares are outstanding.

The Company used the Offering proceeds and the additional capital contributed by the Bank to purchase $356 million of notes (the "Notes") from the Bank and $135 million of mortgage-backed securities at their estimated fair value. The Notes are obligations issued by the Bank that are recourse only to the underlying mortgage loans (the "Securing Mortgage Loans") and were acquired pursuant to the terms of a loan agreement with the Bank. The principal amount of the Notes equals approximately 80% of the principal amounts of the Securing Mortgage Loans.

Business

The Company was formed for the purpose of raising capital for the Bank. One of the Company's principal business objectives is to acquire, hold, finance and manage Mortgage Assets. These Mortgage Assets generate interest income for distribution to stockholders. A portion of the Mortgage Assets of the Company consists of Notes issued by the Bank that are recourse only to Securing Mortgage Loans that are secured by real property. The Notes mature on October 1, 2027 and pay interest at 6.4% per annum. Payments of interest are made to the Company from payments made on the Securing Mortgage Loans. Pursuant to an agreement between the Company and the Bank, the Company, through the Bank as agent,

receives all scheduled payments made on the Securing Mortgage Loans, retains a portion of any such payments equal to the amount due on the Notes and remits the balance, if any, to the Bank. The Company also retains approximately 80% of any prepayments of principal in respect of the Securing Mortgage Loans and applies such amounts as a prepayment on the Notes. The Company has a security interest in the real property securing the Securing Mortgage Loans and will be entitled to enforce payment on the loans in its own name if a mortgagor should default. In the event of such default, the Company would have the same rights as the original mortgagee to foreclose the mortgaged property and satisfy the obligations of the Bank out of the proceeds.

The Company may from time to time acquire fixed-rate or variable-rate mortgage-backed securities representing interests in pools of mortgage loans. The Bank may have originated a portion of any such mortgage-backed securities by exchanging pools of mortgage loans for the mortgage-backed securities. The mortgage loans underlying the mortgage-backed securities will be secured by single-family residential properties located throughout the United States. The Company intends to acquire only investment grade mortgage-backed securities issued by agencies of the federal government or government sponsored agencies, such as the Federal Home Loan Mortgage Corporation ("FHLMC"), the Federal National Mortgage Association ("Fannie Mae") and the Government National Mortgage Association ("GNMA"). The

Company does not intend to acquire any interest-only, principal-only or similar speculative mortgage-backed securities.

The Bank may from time to time acquire or originate both conforming and nonconforming residential mortgage loans. Conventional conforming residential mortgage loans comply with the requirements for inclusion in a loan guarantee program sponsored by either FHLMC or Fannie Mae. Nonconforming residential mortgage loans are residential mortgage loans that do not qualify in one or more respects for purchase by Fannie Mae or FHLMC under their standard programs. The nonconforming residential mortgage loans that the Company purchases will be nonconforming because they have original principal balances which exceed the limits for FHLMC or Fannie Mae under their standard programs. The Company believes that all residential mortgage loans will meet the requirements for sale to national private mortgage conduit programs or other investors in the secondary mortgage market. As of December 31, 2003 and 2002 and for each of the years then ended, the Company did not directly hold any residential mortgage loans.

The Company may from time to time acquire commercial mortgage loans secured by industrial and warehouse properties, recreational facilities, office buildings, retail space and shopping malls, hotels and motels, hospitals, nursing homes or senior living centers. The Company's current policy is not to acquire any interest in a commercial mortgage loan if commercial mortgage loans would constitute more than 5% of the Company's Mortgage Assets at the time of its acquisition. Unlike residential mortgage loans, commercial mortgage loans generally lack standardized terms. Commercial real estate properties themselves tend to be unique and are more difficult to value than residential real estate properties. Commercial mortgage loans may also not be fully amortizing, meaning that they may have a significant principal balance or "balloon" payment due on maturity. Moreover, commercial properties, particularly industrial and warehouse properties, are generally subject to relatively greater environmental risks than non-commercial properties, generally giving rise to increased costs of compliance with environmental laws and regulations. There is no requirement regarding the percentage of any commercial real estate property that must be leased at the time the Bank acquires a commercial mortgage loan secured by such commercial real estate property, and there is no requirement that commercial mortgage loans have third party guarantees. The credit quality of a commercial

mortgage loan may depend on, among other factors, the existence and structure of underlying leases, the physical condition of the property (including whether any maintenance has been deferred), the creditworthiness of tenants, the historical and anticipated level of vacancies and rents on the property and on other comparable properties located in the same region, potential or existing environmental risks, the availability of credit to refinance the commercial mortgage loan at or prior to maturity and the local and regional economic climate in general. Foreclosures of defaulted commercial mortgage loans are generally subject to a number of complicated factors, including environmental considerations, which are generally not present in foreclosures of residential mortgage loans. As of December 31, 2003 and 2002 and for each of the years then ended, the Company did not hold any commercial mortgage loans.

The Company may invest in assets eligible to be held by REITs other than those described above. In addition to commercial mortgage loans and mortgage loans secured by multi-family properties, such assets could include cash, cash equivalents and securities, including shares or interests in other REITs and partnership interests. At December 31, 2003, the Company held $11.5 million of short-term money market assets and $230 million of U.S. Treasury securities. At December 31, 2002, the Company held $20 million of short-term money market assets and $80 million of U.S. Treasury securities.

The Company intends to continue to acquire Mortgage Assets from the Bank and/or affiliates of the Bank on terms that are comparable to those that could be obtained by the Company if such Mortgage Assets were purchased from unrelated third parties. The Company may also from time to time acquire Mortgage Assets from unrelated third parties.

The Company intends to maintain a substantial portion of its portfolio in Bank-secured obligations and mortgage-backed securities. The Company may, however, invest in other assets eligible to be held by a REIT. The Company's current policy and the Servicing Agreement (defined below) prohibit the acquisition of any Mortgage Asset constituting an interest in a mortgage loan (other than an interest resulting from the acquisition of mortgage-backed securities), which mortgage loan (i) is delinquent (more than 30 days past

due) in the payment of principal or interest at the time of proposed acquisition; (ii) is or was at any time during the preceding 12 months (a) on nonaccrual status or (b) renegotiated due to financial deterioration of the borrower; or (iii) has been, more than once during the preceding 12 months, more than 30 days past due in payment of principal or interest. Loans that are on "nonaccrual status" are generally loans that are past due 90 days or more in principal or interest. The Company maintains a policy of disposing of any mortgage loan which (i) falls into nonaccrual status, (ii) has to be renegotiated due to the financial deterioration of the borrower, or (iii) is more than 30 days past due in the payment of principal or interest more than once in any 12 month period. The Company may choose, at any time subsequent to its acquisition of any Mortgage Assets, to require the Bank (as part of the Servicing Agreement) to dispose of the mortgage loans for any of these reasons or for any other reason.

The Bank services the Securing Mortgage Loans and the other mortgage loans purchased by the Company on behalf of, and as agent for, the Company and is entitled to receive fees in connection with the servicing thereof pursuant to the servicing agreement (the "Servicing Agreement"). The Bank receives a fee equal to 0.25% per annum on the principal balances of the loans serviced. Payment of such fees is subordinate to payments of dividends on the Preferred Shares. The Servicing Agreement requires the Bank to service the loans in a manner generally consistent with accepted secondary market practices, with any

servicing guidelines promulgated by the Company and, in the case of residential mortgage loans, with Fannie Mae and FHLMC guidelines and procedures. The Servicing Agreement requires the Bank to service the loans solely with a view toward the interest of the Company and without regard to the interest of the Bank or any of its affiliates. The Bank will collect and remit principal and interest payments, administer mortgage escrow accounts, submit and pursue insurance claims and initiate and supervise foreclosure proceedings on the loans it services. The Bank may, with the approval of a majority of the Company's Board of Directors, as well as a majority of the Company's Independent Directors, subcontract all or a portion of its obligations under the Servicing Agreement to unrelated third parties. An "Independent Director" is a director who is not a current officer or employee of the Company or a current director, officer or employee of the Bank or of its affiliates. The Bank will not, in connection with the subcontracting of any of its obligations under the Servicing Agreement, be discharged or relieved in any respect from its obligations under the Servicing Agreement. The Company may terminate the Servicing Agreement upon the occurrence of such events as they relate to the Bank's proper and timely performance of its duties and obligations under the Servicing Agreement. As long as any Preferred Shares remain outstanding, the Company may not terminate, or elect to renew, the Servicing Agreement without the approval of a majority of the Company's Independent Directors.

The Company entered into an advisory agreement with the Bank (the "Advisory Agreement") pursuant to which the Bank administers the day-to-day operations of the Company. The Bank is responsible for (i) monitoring the credit quality of Mortgage Assets held by the Company, (ii) advising the Company with respect to the reinvestment of income from and payments on, and with respect to the acquisition, management, financing and disposition of the Mortgage Assets held by the Company, and (iii) monitoring the Company's compliance with the requirements necessary to qualify as a REIT, and other financial and tax-related matters. The Bank may from time to time subcontract all or a portion of its obligations under the Advisory Agreement to one or more of its affiliates. The Bank may, with the approval of a majority of the Company's Board of Directors, as well as a majority of the Company's Independent Directors, subcontract all or a portion of its obligations under the Advisory Agreement to unrelated third parties. The Bank will not, in connection with the subcontracting of any of its obligations under the Advisory Agreement, be discharged or relieved in any respect from its obligations under the Advisory Agreement. The Advisory Agreement is renewed annually. The Company may terminate the Advisory Agreement at any time upon 60 days' prior written notice. As long as any Preferred Shares remain outstanding, any decision by the Company either to renew the Advisory Agreement or to terminate the Advisory Agreement must be approved by a majority of the Board of Directors, as well as by a majority of the Company's Independent Directors.

The Advisory Agreement in effect in 2003 and 2002 entitled the Bank to receive advisory fees of $56,000 and $43,000, respectively. In 2004, advisory fees of $115,000 have been approved.

The Company may from time to time purchase additional Mortgage Assets out of proceeds received in connection with the repayment or disposition of Mortgage Assets, the issuance of additional shares of

Preferred Stock or additional capital contributions with respect to the Common Stock. The Company may also issue additional series of Preferred Stock. However, the Company may not issue additional shares of Preferred Stock senior to the Series A Preferred Shares either in the payment of dividends or in the distribution of assets on liquidation without the consent of holders of at least 67% of the outstanding shares of Preferred Stock at that time or without approval of a majority of the Company's Independent Directors. The Company does

not currently intend to issue any additional shares of Preferred Stock unless it simultaneously receives additional capital contributions from HCH or other affiliates sufficient to support the issuance of such additional shares of Preferred Stock.

Although the Company does not currently intend to incur any indebtedness in connection with the acquisition and holding of Mortgage Assets, the Company may do so at any time (although indebtedness in excess of 25% of the Company's total stockholders' equity may not be incurred without the approval of a majority of the Company's Independent Directors). To the extent the Company were to change its policy with respect to the incurrence of indebtedness, the Company would be subject to risks associated with leverage, including, without limitation, changes in interest rates and prepayment risk.

Employees

As of December 31, 2003, the Company had no paid employees. All officers of the Company were employed by the Bank.

Environmental Matters

In the event that the Company is forced to foreclose on a defaulted Securing Mortgage Loan to recover its investment in such loan, the Company may be subject to environmental liabilities in connection with the underlying real property, which could exceed the value of the real property. Although the Company intends to exercise due diligence to discover potential environmental liabilities prior to the acquisition of any property through foreclosure, hazardous substances or wastes, contaminants, pollutants or sources thereof (as defined by state and federal laws and regulations) may be discovered on properties during the Company's ownership or after a sale thereof to a third party. If such hazardous substances are discovered on a property which the Company has acquired through foreclosure or otherwise, the Company may be required to remove those substances and clean up the property. There can be no assurance that in such a case the Company would not incur full recourse liability for the entire costs of any removal and clean-up, that the cost of such removal and clean-up would not exceed the value of the property or that the Company could recoup any of such costs from any third party. The Company may also be liable to tenants and other users of neighboring properties. In addition, the Company may find it difficult or impossible to sell the property prior to or following any such clean-up. The Company has not foreclosed on any Securing Mortgage Loans.

Qualification as a REIT

The Company elected to be taxed as a REIT commencing with its taxable year ended December 31, 1998 and intends to comply with the provisions of the Code with respect thereto. The Company will not be subject to Federal income tax to the extent it distributes 90% (95% for years prior to January 1, 2001) of its adjusted REIT ordinary taxable income to stockholders and as long as certain assets, income and stock ownership tests are met. For 2003 as well as 2002, the Company met all Code requirements for a REIT, including the asset, income, stock ownership and distribution tests. Cash distributions in the amount of $1.8438 per Preferred Share were paid in 2003 and 2002. A cash dividend on common stock of $2 million was declared on December 2, 2003 to the stockholder of record on December 15, 2003 and paid on December 31, 2003. A cash dividend on common stock of $3.090 million was declared on December 4, 2002 to the stockholder of record on December 15, 2002 and paid on December 27, 2002. In addition, on September 12, 2003 and 2002, the Company paid a cash dividend of $530 thousand and $130 thousand, respectively, on the outstanding common shares to the stockholder of record on September 3, 2003 and September 4, 2002, respectively. These dividends completed the 2002 and 2001 REIT tax compliance requirements.

ITEM 2. PROPERTIES

None as of December 31, 2003.

ITEM 3. LEGAL PROCEEDINGS

The Company is not currently involved in any material litigation nor, to the Company's knowledge is any material litigation currently threatened against the Company other than routine litigation arising in the ordinary course of business. See Note 8 to Financial Statements on page 30.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of 2003.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

HCH presently owns all 1,000 shares of the common stock of the Company, which are not listed or traded on any securities exchange. On December 2, 2003, the Company declared $2 million in cash dividends on common stock, which were paid in December 2003. On December 4, 2002, the Company declared $3.090 million in cash dividends on common stock, which were paid in December 2002. In addition, on September 12, 2003 and 2002, the Company paid a cash dividend of $530 thousand and $130 thousand, respectively, on the outstanding common shares to the stockholder of record on September 3, 2003, and September 4, 2002, respectively. These dividends completed the 2002 and 2001 REIT tax compliance requirements regarding income distributions.

The Preferred Shares are traded on the New York Stock Exchange under the symbol "HBC Pr A". During 2003 and 2002, the Company declared and paid cash dividends to preferred stockholders of approximately $18.4 million in each year. Although the Company declared cash dividends on the Preferred Shares for 2003 and 2002, no assurances can be made as to the declaration of, or if declared, the amount of, future distributions since such distributions are subject to the Company's financial condition and capital needs; the impact of legislation and regulations as then in effect or as may be proposed; economic conditions; and such other factors as the Board of Directors may deem relevant. Notwithstanding the foregoing, to remain qualified as a REIT, the Company must distribute annually at least 90% of its ordinary taxable income to preferred and /or common stockholders.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial data for the Company and should be read in conjunction with the Consolidated Financial Statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this Report.

FOR THE YEARS ENDED DECEMBER 31

	2003	2002	2001	2000	1999
	(IN THOUSANDS, EXCEPT PER SHARE DATA)				
Statement of Operations Data:					
Interest income	$ 17,678	$ 19,934	$ 28,715	$ 32,312	$ 31,58
Noninterest income	4,158	2,677	4,796	257	-
Operating expenses:					
Loan servicing fee	70	131	243	373	51
Advisory fees	56	43	35	57	5
General and administrative	362	314	300	290	30
Total operating expenses	488	488	578	720	86
Net income	21,348	22,123	32,933	31,849	30,72
Preferred stock dividends	18,438	18,438	18,438	18,438	18,43
Net income available to common stockholder	$ 2,910	$ 3,685	$ 14,495	$ 13,411	$ 12,28
Basic and diluted net income per common share	$ 2,910	$ 3,685	$ 14,495	$ 13,411	$ 12,28
Distributions per preferred share	$ 1.8438	$ 1.8438	$ 1.8438	$ 1.8438	$ 1.843
Balance Sheet Data (end of period):					
Total assets	$494,318	$502,042	$489,342	$489,939	$473,98
Total liabilities	$ 84	$ 96	$ 100	$ 115	$ 9
Total stockholders' equity	$494,234	$501,946	$489,242	$489,824	$473,89
Cash Flows Data:					
Operating activities	$ 18,046	$ 19,440	$ 28,736	$ 31,638	$ 30,82
Investing activities	$ 3,120	$ 2,440	$ 4,035	$ (419)	$ 10,29
Financing activities	$(20,968)	$(21,658)	$(33,084)	$(31,662)	$(40,47

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Consolidated Financial Statements and notes thereto appearing later in this Report.

SUMMARY

YEAR ENDED DECEMBER 31, 2003 COMPARED TO DECEMBER 31, 2002

The Company's net income for 2003 was $21.3 million. This represented a 3.5% decrease from 2002 net income of $22.1 million. Earnings decreased primarily because of reduced interest income on earning assets, partially offset by increased gains on securities sales from $2.7 million in 2002 to $4.2 million in 2003.

Interest income on the Notes for 2003 totaled $1.5 million and yielded 6.4% on $24 million of average principal outstanding compared to $2.8 million and a 6.4% yield on $43 million average principal outstanding for 2002. The decrease in income was attributable to a reduction in the Note balance because of

customer

payoffs in the Securing Mortgage Loans. The average outstanding balance of the Securing Mortgage Loans was $29 million for 2003 and $53 million for 2002. Interest income on securities available-for-sale for 2003 was $14.9 million, resulting in a yield of 4.6% on an average balance of $326 million compared to interest income of $15.1 million with a yield of 4.9% on an average balance of $309 million for 2002. The decrease in interest income on securities available-for-sale was primarily attributable to a reduction in yield, partially offset by growth in the investment portfolio. As securities matured or were sold, proceeds were invested in lower yielding securities as market interest rates declined. Gains from investment securities sales were $4.2 million in 2003 and $2.7 million in 2002. There were no Company borrowings during either year.

Operating expenses for both of the years ended December 31, 2003 and 2002 totaled $488 thousand. Loan servicing expenses for 2003 totaled $70 thousand, a decrease of $61 thousand or 47% from 2002. This decrease was attributed to the reduction in the principal balance of the Notes. Advisory fees for the year ended December 31, 2003 were $56 thousand compared to $43 thousand for the same period a year ago, due to higher internal processing, record-keeping and overhead costs. General and administrative expenses for the same period totaled $362 thousand, an increase of $48 thousand or 15% from 2002, due to increased compliance and governance costs.

On December 30, 2003, the Company paid a cash dividend of $0.46094 per share on the outstanding Preferred Shares to the stockholders of record on December 15, 2003 as declared on December 2, 2003. On December 30, 2002, the Company paid a cash dividend of $0.46094 per share on the outstanding Preferred Shares to the stockholders of record on December 15, 2002 as declared on December 4, 2002. On a year-to-date basis, the Company declared and paid $18.4 million of dividends to holders of Preferred Shares for 2003 and 2002, respectively. A cash dividend on common stock of $2.0 million was declared on December 2, 2003 to the stockholder of record on December 15, 2003 and paid on December 31, 2003. A cash dividend on common stock of $3.090 million was declared on December 4, 2002 to the stockholder of record on December 15, 2002 and paid on December 27, 2002. In addition, on September 12, 2003 and September 12, 2002, the Company paid a cash dividend of $530 thousand and $130 thousand, respectively, on the outstanding common shares to the stockholder of record on September 3, 2003 and September 4, 2002, respectively. These common share dividends completed the Company's 2002 and 2001 REIT tax compliance requirements.

At December 31, 2003 and 2002, there were no Securing Mortgage Loans on nonaccrual status and there was no allowance for loan losses.

YEAR ENDED DECEMBER 31, 2002 COMPARED TO DECEMBER 31, 2001

The Company's net income for 2002 was $22.1 million. This represented a $10.8 million or 33% decrease from 2001 net income of $32.9 million. Earnings decreased primarily because of reduced interest income on earnings assets. In addition, gains on securities sales declined from $4.8 million in 2001 to $2.7 million in 2002.

Interest income on the Notes for 2002 totaled $2.8 million and yielded 6.4% on $43 million of average principal outstanding compared to interest income of $5.2 million and a 6.4% yield on $81 million average principal outstanding for 2001. The decrease in income was attributable to a reduction in the Note balance because of principal paydowns by customers in the Securing Mortgage Loans. The average outstanding balance of the Securing Mortgage Loans was $53 million for

2002 and $99 million for 2001. Interest income on securities available-for-sale for 2002 was $15.1 million, resulting in a yield of 4.9% on an average balance of $309 million compared to $21.9 million with a yield of 6.1% on an average balance of $363 million for 2001. The decrease in interest income on securities available-for-sale was primarily attributable to a reduction in yield. As securities matured or were sold, proceeds have been invested in lower yielding securities as a result of declining interest rates. Gains from investment securities sales were $2.7 million in 2002 and $4.8 million in 2001.

There were no Company borrowings during either year.

Operating expenses for the year ended December 31, 2002 totaled $488 thousand; a decrease of $90 thousand from the year ended December 31, 2001. Loan servicing expenses for 2002 totaled $131 thousand, a decrease of $112 thousand or 46% from 2001. This decrease was attributed to the reduction in the

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principal balance of the Notes because servicing costs vary directly with their balances. Advisory fees for the year ended December 31, 2002 were $43 thousand compared to $35 thousand for the same period a year ago. General and administrative expenses for the same period totaled $314 thousand, an increase of $14 thousand or 5% from 2001, as a result of additional reporting and compliance costs.

On December 30, 2002, the Company paid a cash dividend of $0.46094 per share on the outstanding Preferred Shares to the stockholders of record on December 15, 2002 as declared on December 4, 2002. On December 30, 2001, the Company paid a cash dividend of $0.46094 per share on the outstanding Preferred Shares to the stockholders of record on December 15, 2001 as declared on December 4, 2001. On a year-to-date basis, the Company declared and paid $18.4 million of dividends to holders of Preferred Shares for both 2002 and 2001. A cash dividend on common stock of $3.090 million was declared on December 4, 2002 to the stockholder of record on December 15, 2002 and paid on December 27, 2002. A cash dividend on common stock of $14.3 million was declared on December 4, 2001 to the stockholder of record on December 15, 2001 and paid on December 31, 2001. In addition, on September 12, 2002 and September 12, 2001, the Company paid a cash dividend of $130 thousand and $346 thousand, respectively, on the outstanding common shares to the stockholder of record on September 4, 2002 and 2001, respectively. These dividends completed the Company's 2001 and 2000 REIT tax compliance requirements.

At December 31, 2002 and 2001, there were no Securing Mortgage Loans on nonaccrual status and there was no allowance for loan losses.

QUARTER ENDED DECEMBER 31, 2003 COMPARED TO QUARTER ENDED DECEMBER 31, 2002

The Company's net income for the fourth quarter of 2003 was $4.6 million compared to $4.7 million in the fourth quarter of 2002. Earnings decreased primarily because of reduced interest income on earning assets offset by gains on sales of securities.

Fourth quarter 2003 interest income on the Notes totaled $282 thousand and yielded 6.4% on $18 million of average principal outstanding compared to interest income of $550 thousand and a 6.4% yield on $34 million average principal outstanding for the fourth quarter of 2002. The decrease in income was attributable to a reduction in the Note balance because of principal paydowns by customers in the Securing Mortgage Loans. The average outstanding balance of the Securing Mortgage Loans for the fourth quarter of 2003 and 2002 was $22 million and $42 million, respectively. Interest income on securities available-for-sale for the current quarter was $3.1 million resulting in a yield of 4.6% on an

average balance of $265 million, compared to interest income of $3.9 million with a yield of 4.1% on an average balance of $379 million for the same period a year ago. The decrease in interest income is primarily attributable to the reduction in the investment portfolio of mortgage-backed securities, partially offset by the increased investment in U.S. Treasury securities.

There were no Company borrowings during the fourth quarter of 2003 or 2002.

Fourth quarter 2003 operating expenses totaled $179 thousand, an increase of $4 thousand from the fourth quarter of 2002. Loan servicing expenses totaled $13 thousand, a decrease of $13 thousand or 50% from the prior year's fourth quarter, attributed to the reduction in the principal balance of the Notes. Advisory fees for the fourth quarter of 2003 were $26 thousand compared to $8 thousand in the prior year's fourth quarter, due to increased costs for processing, recordkeeping and administration. General and administrative expenses totaled $140 thousand in the current quarter, essentially unchanged from fourth quarter 2002.

ALLOWANCE FOR LOAN LOSSES

The Company does not currently maintain an allowance for loan losses due to the over-collateralization of the Securing Mortgage Loans and the prior and expected credit performance of the collateral pool.

CONCENTRATIONS OF CREDIT RISK

A majority of the collateral underlying the Securing Mortgage Loans is located in Illinois and Arizona. The financial viability of customers in these states is, in part, dependent on the states' economies. The

collateral may be subject to a greater risk of default than other comparable loans in the event of adverse economic, political or business developments or natural hazards that may affect such region and the ability of property owners in such region to make payments of principal and interest on the underlying mortgages. The Company's maximum risk of accounting loss, should all customers in Illinois and Arizona fail to perform according to contract terms and all collateral prove to be worthless, was approximately $12 million and $2 million, respectively at December 31, 2003 and $21 million and $6 million, respectively, at December 31, 2002.

INTEREST RATE RISK

The Company's income consists primarily of interest payments on the Mortgage Assets it holds. If there is a decline in interest rates during a period of time when the Company must reinvest payments of interest and principal with respect to its Mortgage Assets, the Company may find it difficult to purchase additional Mortgage Assets that generate sufficient income to support payment of dividends on the Preferred Shares. Because the rate at which dividends, if, when and as authorized and declared, are payable on the Preferred Shares is fixed, there can be no assurance that an interest rate environment in which there is a decline in interest rates would not adversely affect the Company's ability to pay dividends on the Preferred Shares.

COMPETITION

The Company does not engage in the business of originating mortgage loans. While the Company will acquire additional Mortgage Assets, it anticipates that such Mortgage Assets will be acquired from the Bank and affiliates of the Bank. Accordingly, the Company does not expect to compete with mortgage conduit programs, investment banking firms, savings and loan associations, banks, thrift

and loan associations, finance companies, mortgage bankers or insurance companies in acquiring its Mortgage Assets.

LIQUIDITY RISK MANAGEMENT

The objective of liquidity management is to ensure the availability of sufficient cash flows to meet all of the Company's financial commitments. In managing liquidity, the Company takes into account various legal limitations placed on a REIT.

The Company's principal liquidity needs are to maintain the current portfolio size through the acquisition of additional Notes or other qualifying assets and to pay dividends to its stockholders after satisfying obligations to creditors. The acquisition of additional Notes or other qualifying assets is funded with the proceeds obtained from repayment of principal balances by individual mortgages or maturities of securities held for sale on a reinvested basis. The payment of dividends on the Preferred Shares will be made from legally available funds, principally arising from operating activities of the Company. The Company's cash flows from operating activities principally consist of the collection of interest on the Notes and mortgage-backed securities. The Company does not have and does not anticipate having any material capital expenditures.

In order to remain qualified as a REIT, the Company must distribute annually at least 90% of its adjusted REIT ordinary taxable income, as provided for under the Code, to its common and preferred stockholders. The Company currently expects to distribute dividends annually equal to 90% or more of its adjusted REIT ordinary taxable income.

The Company anticipates that cash and cash equivalents on hand and the cash flow from the Notes and mortgage-backed securities will provide adequate liquidity for its operating, investing and financing needs including the capacity to continue preferred dividend payments on an uninterrupted basis.

As presented in the accompanying Statement of Cash Flows, the primary sources of funds in addition to $18.0 million provided from operations during 2003 were $14.5 million provided by principal payments received on the Notes and $743.0 million from the maturities and sales of securities available-for-sale. In 2002, the primary sources of funds other than $19.4 million provided from operations were $24.9 million provided by principal payments received on the Notes and $822.3 million from the maturities of securities

available-for-sale. The primary uses of funds for 2003 were $765.4 million in purchases of securities available-for-sale and $18.4 and $2.5 million in preferred stock dividends and common stock dividends paid, respectively. In 2002, the primary uses of funds were $848.2 million in purchases of securities available-for-sale and $18.4 and $3.2 million in preferred stock dividends and common stock dividends paid, respectively.

ACCOUNTING PRONOUNCEMENTS

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," on January 1, 2003. The Statement requires that a liability for costs associated with exit or disposal activities is recognized when the liability is incurred, as defined in Concepts Statement 6. It nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The adoption of the Statement was not material to the

Company's financial position or results of operations.

The Company adopted the disclosure requirements of Financial Accounting Standards Board ("FASB") Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), on December 31, 2002. The recognition and measurement provisions of FIN 45 were adopted on January 1, 2003. The adoption of FIN 45 was not material to the Company's financial position or results of operations.

In December 2003, the FASB issued FASB Interpretation No. 46 (Revised), "Consolidation of Variable Interest Entities" ("FIN 46R"). FIN 46R replaces FIN 46, which was issued in January 2003. FIN 46R addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and whether it should consolidate the entity. An entity is subject to FIN 46R and is called a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that has a majority interest in the expected losses or the expected residual returns or both. The Company does not have an interest in a VIE and is not subject to the provisions of FIN 46R.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The Statement clarifies accounting for derivative instruments, including embedded derivatives, and accounting for hedging activities. The Company adopted the Statement on July 1, 2003. The adoption of the Statement did not have a material effect on the Company's financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." The Statement applies to issuers of financial instruments and establishes standards for the classification and measurement of freestanding financial instruments having characteristics of both liabilities and equity. The Company adopted the Statement on July 1, 2003. The adoption of the Statement did not have a material effect on the Company's financial position or results of operations.

In December 2003, the FASB issued SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits" to improve financial statement disclosures for defined benefit plans. The Statement requires additional disclosures, primarily for plan assets and cash flow requirements. The Company adopted the disclosure requirements of SFAS No. 132 on December 31, 2003. The adoption of the Statement did not have a material effect on the Company's financial position or results of operations.

OTHER MATTERS

As of December 31, 2003, the Company believes that it is in full compliance with the REIT tax rules, and expects to qualify as a REIT under the provisions of the Code. The Company expects to meet all REIT

requirements regarding the ownership of its stock and anticipates meeting the annual distribution requirements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

As of December 31, 2003, the Company had $17 million invested in Notes, a decrease of $14 million from December 31, 2002. The decline was attributable to customer payoffs in the Securing Mortgage Loans. At December 31, 2003, the Company held $234 million in mortgage-backed securities compared to $365 million at December 31, 2002. At December 31, 2003, the Company held $230 million in U.S. Treasuries compared to $80 million at December 31, 2002. At December 31, 2003, the Company held an investment of $11.5 million in securities purchased from the Bank under agreement to resell compared to $20 million at December 31, 2002. The Company is subject to exposure for fluctuations in interest rates. Adverse changes in interest rates could impact negatively the value of mortgage-backed securities, as well as the levels of interest income to be derived from these assets.

The Company's investments held in mortgage-backed securities are secured by adjustable and fixed interest rate residential mortgage loans. The yield to maturity on each security depends on, among other things, the price at which each such security is purchased, the rate and timing of principal payments (including prepayments, repurchases, defaults and liquidations), the pass-through rate and interest rate fluctuations. Changes in interest rates could impact prepayment rates as well as default rates, which in turn would impact the value and yield to maturity of the Company's mortgage-backed securities.

The Company currently has no outstanding borrowings.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Refer to the Index to Consolidated Financial Statements on page 20 for the required information.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There have been no disagreements with accountants on any matter of accounting principles, practices or financial statement disclosure.

On January 27, 2004, the Audit Committee of Harris Preferred Capital Corporation ("HPCC") dismissed PricewaterhouseCoopers LLP ("PwC") as its independent accountants effective upon completion of audit services related to HPCC's December 31, 2003 financial statements.

ITEM 9A. CONTROLS AND PROCEDURES

As of December 31, 2003, Paul R. Skubic, the Chairman of the Board, Chief Executive Officer and President of the Company, and Janine Mulhall, the Chief Financial Officer of the Company, evaluated the effectiveness of the disclosure controls and procedures of the Company and concluded that these disclosure controls and procedures are effective to ensure that material information required to be included in this Report has been made known to them in a timely fashion. There was no change in the Company's internal controls over financial reporting identified in connection with such evaluations that occurred during the quarter ended December 31, 2003 that has materially affected or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

The Company's Board of Directors consists of five members. The Company does not anticipate that it will require any additional employees because it has

retained the Bank to perform certain functions pursuant to the Advisory Agreement described above. Each officer of the Company currently is also an officer of the

Bank and/or affiliates of the Bank. The Company maintains corporate records and audited financial statements that are separate from those of the Bank or any of the Bank's affiliates. None of the officers, directors or employees of the Company will have a direct or indirect pecuniary interest in any Mortgage Asset to be acquired or disposed of by the Company or in any transaction in which the Company has an interest or will engage in acquiring, holding and managing Mortgage Assets.

Pursuant to terms of the Preferred Shares, the Company's Independent Directors will consider the interests of the holders of both the Preferred Shares and the Common Stock in determining whether any proposed action requiring their approval is in the best interests of the Company.

The persons who are directors and executive officers of the Company are as follows:

NAME	AGE	POSITION AND OFFICES HELD
Paul R. Skubic..	55	Chairman of the Board, Preside
Janine Mulhall..	42	Chief Financial Officer
Frank M. Novosel......................................	57	Treasurer, Director
Teresa L. Patton......................................	56	Vice President of Operations
Margaret M. Sulkin....................................	45	Assistant Treasurer
Delbert J. Wacker.....................................	72	Director
David J. Blockowicz...................................	61	Director
Forrest M. Schneider..................................	56	Director

The following is a summary of the experience of the executive officers and directors of the Company:

Mr. Skubic has been Vice President and Controller of the Bank and Chief Accounting Officer for Harris Bankcorp, Inc., and the Bank since 1990. Prior to joining Harris Bankcorp, Inc., Mr. Skubic was employed by Arthur Andersen & Co. He is a certified public accountant.

Ms. Mulhall, has been Senior Vice President and Chief Financial Officer of Harris Bankcorp, Inc. since July 2003. From November 1995 to that time she held several positions in the Finance area of Harris Bankcorp's parent company, Bank of Montreal, including most recently Vice President and Chief Accountant. From 1984 to 1995, Ms. Mulhall was with KPMG LLP in Toronto. She is a Canadian Chartered Accountant.

Mr. Novosel has been a Vice President in the Treasury Group of the Bank since 1995. Previously, he served as Treasurer of Harris Bankcorp, Inc., managing financial planning. Mr. Novosel is a Chartered Financial Analyst and a member of the Investment Analysts' Society of Chicago.

Ms. Patton has been a Vice President in Residential Mortgages at the Bank for 16 years and is currently the Director of Secondary Marketing. Prior to this position she was the Manager of Sales and Delivery for the Residential Mortgage Division. She currently serves on the Bank's Asset/Liability Committee, and has

been employed by the Bank for over 26 years holding positions in Consumer and Commercial Banking.

Ms. Sulkin has been a Vice President in the Taxation Department of the Bank since 1992. Ms. Sulkin has been employed by the Bank since 1984. Prior to joining the Bank, she was employed by KPMG LLP. She is a certified public accountant.

Mr. Wacker retired as a partner from Arthur Andersen & Co. in 1987 after 34 years. From July 1988 to November 1990, he was Vice President -- Treasurer, Parkside Medical Services, a subsidiary of Lutheran General Health System. From November 1990 to September 1993, he completed various financial consulting projects for Lutheran General.

Mr. Blockowicz is a certified public accountant and is a partner with Blockowicz & Del Guidicie LLC. Prior to forming his firm, Mr. Blockowicz was a partner with Arthur Andersen & Co. through 1990.

Mr. Schneider is President and Chief Executive Officer of Lane Industries, Inc. Mr. Schneider is a director of Lane Industries and director of General Binding Corporation. He has been employed by Lane

Industries since 1976. He is a graduate of the University of Illinois where he received his B.S. and masters degree in finance.

INDEPENDENT DIRECTORS

The terms of the Preferred Shares require that, as long as any Preferred Shares are outstanding, certain actions by the Company be approved by a majority of the Company's Independent Directors. Delbert J. Wacker, David J. Blockowicz and Forrest M. Schneider are the Company's Independent Directors.

If at any time the Company fails to declare and pay a quarterly dividend payment on the Preferred Shares, the number of directors then constituting the Board of Directors of the Company will be increased by two at the Company's next annual meeting and the holders of Preferred Shares, voting together with the holders of any other outstanding series of Preferred Stock as a single class, will be entitled to elect two additional directors to serve on the Company's Board of Directors. Any member of the Board of Directors elected by holders of the Company's Preferred Shares will be deemed to be an Independent Director for purposes of the actions requiring the approval of a majority of the Independent Directors.

AUDIT COMMITTEE

The Board of Directors of the Company has established an audit committee with an approved Audit Committee Charter, which will review the engagement of independent accountants and review their independence. The audit committee will also review the adequacy of the Company's internal accounting controls. The audit committee is comprised of Delbert J. Wacker, David J. Blockowicz and Forrest M. Schneider. The Company's Board of Directors has determined that each member of the audit committee is an audit committee financial expert as defined in rules of the Securities and Exchange Commission. Each audit committee member is independent as defined in rules of the New York Stock Exchange.

COMPENSATION OF DIRECTORS AND OFFICERS

The Company pays the Independent Directors of the Company fees for their services as directors. The Independent Directors receive annual compensation of

$10,000 plus a fee of $750 for each attendance (in person or by telephone) at each meeting of the Board of Directors or the Audit Committee.

The Company has adopted a code of ethics for its senior officers, which is filed as Exhibit 14 hereto.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based on a review of reports filed with respect to the year ended December 31, 2003, the Company believes that all ownership reports were filed on a timely basis.

ITEM 11. EXECUTIVE COMPENSATION

The Company will not pay any compensation to its officers or employees or to directors who are not Independent Directors.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

(A) SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

No person owns of record or is known by the Company to own beneficially more than 5% of the outstanding 7 3/8% Noncumulative Exchangeable Preferred Stock, Series A.

(B) SECURITY OWNERSHIP OF MANAGEMENT

The following table shows the ownership of 7 3/8% Noncumulative Exchangeable Preferred Stock, Series A, by the only officers or directors who own any such shares.

TITLE OF CLASS	NAME OF BENEFICIAL OWNER	AMOUNT OF BENEFICIAL OWNERSHIP	P O
Preferred Stock..................................	Paul R. Skubic	300 Shares	
Preferred Stock..................................	Forrest Schneider	2200 Shares	

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

(A) TRANSACTIONS WITH MANAGEMENT AND OTHERS

The Bank, through its wholly-owned subsidiary, HCH, indirectly owns 100% of the common stock of the Company.

A substantial portion of the assets of the Company initially consisted of Notes issued by the Bank. The Notes mature on October 1, 2027 and pay interest at 6.4% per annum. During 2003, the Company received repayments on the Notes of $15 million compared to 2002 repayments of $25 million. In years ended December 31, 2003, 2002 and 2001, the Bank paid interest on the Notes in the amount of $1.5 million, $2.8 million and $5.2 million, respectively, to the Company.

The Company purchases U.S. Treasury and Federal agency securities from the Bank under agreements to resell identical securities. At December 31, 2003, the Company held $11.5 million of such assets and had earned $1.3

million of interest from the Bank during 2003. At December 31, 2002, the Company held $20 million of such assets and earned $2.1 million of interest for 2002. The Company receives rates on these assets comparable to the rates that the Bank offers to unrelated counterparties under similar circumstances.

The Bank and the Company have entered into a Servicing Agreement and an Advisory Agreement, the terms of which are described in further detail on page 5 of this Report. In 2003, the Bank received payments of $70 thousand and $56 thousand, respectively, compared to $131 thousand and $43 thousand for 2002, under the terms of these agreements.

(B) CERTAIN BUSINESS RELATIONSHIPS

Paul R. Skubic, Chairman of the Board of the Company, and all of its executive officers, Janine Mulhall, Frank M. Novosel, Teresa L. Patton and Margaret M. Sulkin, are also officers of the Bank.

(C) INDEBTEDNESS OF MANAGEMENT

None.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

AUDIT FEES

For both of the years ended December 31, 2003 and 2002, the Company's principal accountant billed $72 thousand for the audit of the Company's annual financial statements and review of financial statements included in Form 10-Q filings.

AUDIT-RELATED FEES

There were no fees billed for services reasonably related to the performance of the audit or review of our financial statements outside of those fees disclosed above under "Audit Fees" for years ended December 31, 2003 and 2002.

TAX FEES AND ALL OTHER FEES

There were no tax fees or other fees billed by the Company's principal accountants other than those disclosed above for years ended December 31, 2003 and 2002.

PRE-APPROVAL POLICIES AND PROCEDURES

Prior to engaging accountants to perform a particular service, this Board of Directors obtains an estimate for the service to be performed. All of the services described above were approved by the Board of Directors in accordance with its procedures.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Documents filed with Report:

(1) Financial Statements (See page 20 for a listing of all financial statements included in Item 8)

(2) Financial Statement Schedules

All schedules normally required by Form 10-K are omitted since they are either not applicable or because the required information is shown in the financial statements or notes thereto.

(3) Exhibits:

*3(a)(I)	Articles of Incorporation of the Company
*3(a)(ii)	Form of Articles of Amendment and Restatement of the Company establishing the Series A Preferred Shares
*3(b)	Bylaws of the Company
*4	Specimen of certificate representing Series A Preferred Shares
*10(a)	Form of Servicing Agreement between the Company and the Bank
*10(b)	Form of Advisory Agreement between the Company and the Bank
*10(c)	Form of Bank Loan Agreement between the Company and the Bank
*10(d)	Form of Mortgage Loan Assignment Agreement between the Company and the Bank
14	Code of Ethics for Senior Officers
21	Subsidiaries
24	Power of attorney
31.1	Certification of Janine Mulhall pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Paul R. Skubic pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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* Incorporated by reference to the exhibit of the same number filed with the Company's Registration Statement on Form S-11 (Securities and Exchange Commission file number 333-40257)

(b) No reports on Form 8-K were filed.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Harris Preferred Capital Corporation has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on the 24th day of March 2004.

/s/ PAUL R. SKUBIC

Paul R. Skubic
Chairman of the Board and President

/s/ JANINE MULHALL

Janine Mulhall
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by Paul R. Skubic, Chairman of the Board and President of the Company, as attorney-in-fact for the following Directors on behalf of Harris Preferred Capital Corporation of the 24th day of March 2004.

David J. Blockowicz
Frank M. Novosel
Forrest M. Schneider
Delbert J. Wacker

Paul R. Skubic
Attorney-In-Fact
Supplemental Information

No proxy statement will be sent to security holders in 2004.

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INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

The following consolidated financial statements are included in Item 8 of this Annual Report on Form 10-K:

HARRIS PREFERRED CAPITAL CORPORATION

Consolidated Financial Statements

Report of Independent Auditors

Consolidated Balance Sheets

Consolidated Statements of Operations and Comprehensive Income

Consolidated Statements of Changes in Stockholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

HARRIS TRUST AND SAVINGS BANK

Financial Review

Consolidated Financial Statements

Joint Independent Auditors

Report of Independent Auditors

Consolidated Statements of Condition

Consolidated Statements of Income

Consolidated Statements of Comprehensive Income

Consolidated Statements of Changes in Stockholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

All other schedules are omitted since the required information is not present or is not present in amounts sufficient to require submission of the schedule or because the information required is included in the consolidated financial statements and notes hereof.

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REPORT OF INDEPENDENT AUDITORS

To the Stockholders and Board of Directors
of Harris Preferred Capital Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and comprehensive income, of changes in stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Harris Preferred Capital Corporation (the "Company") and its subsidiary at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP

February 23, 2004
Chicago, Illinois

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HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31	
	2003	2002
	(IN THOUSANDS, EXCEPT SHARE DATA)	
ASSETS		
Cash on deposit with Harris Trust and Savings Bank..........	$ 926	$ 728
Securities purchased from Harris Trust and Savings Bank under agreement to resell..................................	11,500	20,000
Notes receivable from Harris Trust and Savings Bank.........	16,547	31,078
Securities available-for-sale:		
Mortgage-backed..	233,857	365,383

U.S. Treasury	229,995	79,976
Securing mortgage collections due from Harris Trust and Savings Bank	414	2,930
Other assets	1,079	1,947
TOTAL ASSETS	$494,318	$502,042
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accrued expenses	$ 84	$ 96
Commitments and contingencies	--	--
STOCKHOLDERS' EQUITY		
7 3/8% Noncumulative Exchangeable Preferred Stock, Series A ($1 par value); liquidation value of $250,000,000 and 20,000,000 shares authorized, 10,000,000 shares issued and outstanding	250,000	250,000
Common stock ($1 par value); 1,000 shares authorized, issued and outstanding	1	1
Additional paid-in capital	240,733	240,733
Earnings in excess of distributions	1,230	850
Accumulated other comprehensive income -- net unrealized gains/(losses) on available-for-sale securities	2,270	10,362
TOTAL STOCKHOLDERS' EQUITY	494,234	501,946
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$494,318	$502,042

The accompanying notes are an integral part of these financial statements.

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HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME

	FOR THE YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS, EXCEPT SHARE DATA)		
INTEREST INCOME:			
Securities purchased from Harris Trust and Savings Bank under agreement to resell	$ 1,266	$ 2,063	$ 1,566
Notes receivable from Harris Trust and Savings Bank	1,508	2,776	5,208
Securities available-for-sale:			
Mortgage-backed	14,791	14,693	20,828
U.S. Treasury	113	402	1,113
Total interest income	17,678	19,934	28,715
NON-INTEREST INCOME:			
Gain on sale of securities	4,158	2,677	4,796
	4,158	2,677	4,796
OPERATING EXPENSES:			
Loan servicing fees paid to Harris Trust and Savings			

Bank	70	131	243
Advisory fees paid to Harris Trust and Savings Bank	56	43	35
General and administrative	362	314	300
Total operating expenses	488	488	578
Net income	21,348	22,123	32,933
Preferred dividends	18,438	18,438	18,438
NET INCOME AVAILABLE TO COMMON STOCKHOLDER	$ 2,910	$ 3,685	$ 14,495
Basic and diluted earnings per common share	$2,910.00	$3,685.00	$14,495.00
Net income	$ 21,348	$ 22,123	$ 32,933
Other comprehensive income/(loss) -- net unrealized gains/(losses) on available-for-sale securities	(8,092)	12,239	(431)
Comprehensive income	$ 13,256	$ 34,362	$ 32,502

The accompanying notes are an integral part of these financial statements.

HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

	PREFERRED STOCK	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	EARNINGS IN EXCESS OF DISTRIBUTIONS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)
			(IN THOUSANDS EXCEPT PER SHARE DATA)		
BALANCE AT DECEMBER 31, 2000	$250,000	$ 1	$ 240,733	$ 536	$(1,446)
Net income	--	--	--	32,933	--
Other comprehensive loss	--	--	--	--	(431)
Dividends declared on common stock ($14,646.00 per share)	--	--	--	(14,646)	--
Dividends declared on preferred stock ($1.8438 per share)	--	--	--	(18,438)	--
BALANCE AT DECEMBER 31, 2001	$250,000	$ 1	$ 240,733	$ 385	$(1,877)
Net income	--	--	--	22,123	--
Other comprehensive income	--	--	--	--	12,239
Dividends declared on common stock ($3,220.00 per share)	--	--	--	(3,220)	--
Dividends declared on					

preferred stock ($1.8438 per share)...............	--	--	--	(18,438)	--
BALANCE AT DECEMBER 31, 2002.......................	$250,000	$ 1	$ 240,733	$ 850	$10,362
Net income..................	--	--	--	21,348	--
Other comprehensive loss....	--	--	--	(8,092)	(8,092)
Dividends declared on common stock ($2,530.00 per share)..................	--	--	--	(2,530)	--
Dividends declared on preferred stock ($1.8438 per share)...............	--	--	--	(18,438)	--
BALANCE AT DECEMBER 31, 2003.......................	$250,000	$ 1	$ 240,733	$ 1,230	$ 2,270

The accompanying notes are an integral part of these financial statements.

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HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

	FOR THE YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS)		
OPERATING ACTIVITIES:			
Net income..	$ 21,348	$ 22,123	$ 32,933
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on sale of securities........................	(4,158)	(2,677)	(4,796)
Net decrease (increase) in other assets............	868	(2)	614
Net decrease in accrued expenses...................	(12)	(4)	(15)
Net cash provided by operating activities.......	18,046	19,440	28,736
INVESTING ACTIVITIES:			
Net decrease (increase) in securities purchased from Harris Trust and Savings Bank under agreement to resell...	8,500	1,000	(18,000)
Repayments of notes receivable from Harris Trust and Savings Bank..	14,531	24,884	46,998
Decrease (increase) in securing mortgage collections due from Harris Trust and Savings Bank..................	2,516	2,423	(2,567)
Purchases of securities available-for-sale.............	(765,405)	(848,215)	(897,270)
Proceeds from maturities and sales of securities available-for-sale..................................	742,978	822,348	874,874
Net cash provided by investing activities.......	3,120	2,440	4,035
FINANCING ACTIVITIES:			

Cash dividends paid on preferred stock	(18,438)	(18,438)	(18,438)
Cash dividends paid on common stock	(2,530)	(3,220)	(14,646)
Net cash used by financing activities	(20,968)	(21,658)	(33,084)
Net increase (decrease) in cash on deposit with Harris Trust and Savings Bank	198	222	(313)
Cash on deposit with Harris Trust and Savings Bank at beginning of period	728	506	819
Cash on deposit with Harris Trust and Savings Bank at end of period	$ 926	$ 728	$ 506

The accompanying notes are an integral part of these financial statements.

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HARRIS PREFERRED CAPITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

Harris Preferred Capital Corporation (the "Company") is a Maryland corporation whose principal business objective is to acquire, hold, finance and manage qualifying real estate investment trust ("REIT") assets (the "Mortgage Assets"), consisting of a limited recourse note or notes (the "Notes") issued by Harris Trust and Savings Bank (the "Bank") secured by real estate mortgage assets (the "Securing Mortgage Loans") and other obligations secured by real property, as well as certain other qualifying REIT assets. The Company holds certain assets through a Maryland real estate investment trust subsidiary, Harris Preferred Capital Trust. The Company has elected to be a REIT under sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the "Code"), and will generally not be subject to Federal income tax to the extent that it meets all of the REIT requirements in Code Sections 856-860. All of the 1,000 shares of the Company's common stock, par value $1.00 per share (the "Common Stock"), are owned by Harris Capital Holdings, Inc. ("HCH"), a wholly-owned subsidiary of the Bank. On December 30, 1998, the Bank transferred its ownership of the common stock of the Company to HCH. The Bank is required to maintain direct or indirect ownership of at least 80% of the outstanding Common Stock of the Company for as long as any 7 3/8% Noncumulative Exchangeable Preferred Stock, Series A (the "Preferred Shares"), $1.00 par value, is outstanding. The Company was formed by the Bank to provide investors with the opportunity to invest in residential mortgages and other real estate assets and to provide the Bank with a cost-effective means of raising capital for federal regulatory purposes.

On February 11, 1998, the Company completed an initial public offering (the "Offering") of 10,000,000 shares of the Company's Preferred Shares, receiving proceeds of $242,125,000, net of underwriting fees. The Preferred Shares are traded on the New York Stock Exchange. Concurrent with the issuance of the Preferred Shares, the Bank contributed additional capital of $250 million to the Company.

The Company used the proceeds raised from the initial public offering of the Preferred Shares and the additional capital contributed by the Bank to purchase $356 million of Notes from the Bank and $135 million of mortgage-backed securities at their estimated fair value.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on deposit with the Bank.

ALLOWANCE FOR POSSIBLE LOAN LOSSES

The allowance for possible loan losses is maintained at a level considered adequate to provide for potential loan losses. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. Known losses of principal on impaired loans are charged off. The provision for loan losses is based on past loss experience, management's evaluation of the loan portfolio securing the Mortgage Assets under current economic conditions and management's estimate of anticipated, but as yet not specifically identified, loan losses. Such estimates are reviewed periodically and adjustments, if necessary, are recorded during the periods in which they become known. At December 31, 2003 and 2002, no allowance for possible loan losses was recorded under this policy.

INCOME TAXES

The Company has elected to be taxed as a REIT commencing with its taxable year ended December 31, 1998 and intends to comply with the provisions of the Code with respect thereto. The Company does not expect to be subject to Federal income tax because assets, income distribution and stock ownership tests in Code Sections 856-860 are met. Accordingly, no provision for income taxes is included in the accompanying financial statements.

The REIT Modernization Act, which took effect on January 1, 2001, modified certain provisions of the Code, with respect to the taxation of REITs. A key provision of this tax law change reduced the required level of distributions by a REIT from 95% to 90% of ordinary taxable income starting in calendar year 2001.

SECURITIES

The Company classifies all securities as available-for-sale, even if the Company has no current plans to divest. Available-for-sale securities are reported at fair value with unrealized gains and losses included as a separate component of stockholders' equity.

Interest income on securities, including amortization of discount or premium, is included in earnings. Realized gains and losses, as a result of securities sales, are included in securities gains, with the cost of securities sold determined on the specific identification basis.

The Company purchases U.S. Treasury and Federal agency securities from the Bank under agreements to resell identical securities. The amounts advanced under these agreements represent short-term loans and are reflected as securities purchased under agreement to resell in the balance sheet. Securities purchased under agreement to resell totaled $11.5 million at December 31, 2003 compared to $20 million at December 31, 2002. The securities underlying the agreements are book-entry securities. Securities are transferred by appropriate entry into the Company's account with the Bank under a written custodial agreement with the Bank that explicitly recognizes the Company's interest in these securities.

The Company's investment securities are exposed to various risks such as interest rate, market and credit. Due to the level of risk associated with

certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect the carrying value of investments in securities available-for-sale currently reported in the balance sheet.

NEW ACCOUNTING PRONOUNCEMENTS

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," on January 1, 2003. The Statement requires that a liability for costs associated with exit or disposal activities is recognized when the liability is incurred, as defined in Concepts Statement 6. It nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The adoption of the Statement was not material to the Company's financial position or results of operations.

The Company adopted the disclosure requirements of Financial Accounting Standards Board ("FASB") Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), on December 31, 2002. The recognition and measurement provisions of FIN 45 were adopted on January 1, 2003. The adoption of FIN 45 was not material to the Company's financial position or results of operations.

In December 2003, the FASB issued FASB Interpretation No. 46 (Revised), "Consolidation of Variable Interest Entities" ("FIN 46R"). FIN 46R replaces FIN 46, which was issued in January 2003. FIN 46R addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and whether it should consolidate the entity. An entity is subject to FIN 46R and is called a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that has a majority interest in the expected losses or the expected residual returns or both. The Company does not have an interest in a VIE and is not subject to the provisions of FIN 46R.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The Statement clarifies accounting for derivative instruments, including embedded derivatives, and accounting for hedging activities. The Company adopted the Statement on July 1, 2003. The adoption of the Statement did not have a material effect on the Company's financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." The Statement applies to issuers of financial instruments and establishes standards for the classification and measurement of freestanding financial instruments having characteristics of both liabilities and equity. The Company adopted the Statement on July 1, 2003. The adoption of the Statement did not have a material effect on the Company's financial position or results of operations.

In December 2003, the FASB issued SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits" to improve

financial statement disclosures for defined benefit plans. The Statement requires additional disclosures, primarily for plan assets and cash flow requirements. The Company adopted the disclosure requirements of SFAS No. 132 on December 31, 2003. The adoption of the Statement did not have a material effect on the Company's financial position or results of operations.

MANAGEMENT'S ESTIMATES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. NOTES RECEIVABLE FROM THE BANK

On February 11, 1998, proceeds received from the Offering were used in part to purchase $356 million of Notes at a rate of 6.4%. The Notes are secured by mortgage loans originated by the Bank. The principal amount of the Notes equals approximately 80% of the aggregate outstanding principal amount of the Mortgage Loans. During 2003, the Company received repayments on the Notes of $14.5 million compared to 2002 repayment of $25 million. For years ended December 31, 2003, 2002 and 2001, the Bank paid interest on the Notes in the amount of $1.5 million, $2.8 million and $5.2 million, respectively, to the Company.

The Notes are recourse only to the Securing Mortgage Loans that are secured by real property. The Notes mature on October 1, 2027. Payments of principal and interest on the Notes are recorded monthly from payments received on the Securing Mortgage Loans. The Company has a security interest in the real property securing the underlying mortgage loans and is entitled to enforce payment on the Securing Mortgage Loans in its own name if a mortgagor should default. In the event of default, the Company has the same rights as the original mortgagee to foreclose the mortgaged property and satisfy the obligations of the Bank out of the proceeds. The Securing Mortgage Loans are serviced by the Bank, as agent of the Company.

The Company intends that each mortgage loan securing the Notes will represent a first lien position and will be originated in the ordinary course of the Bank's real estate lending activities based on the underwriting standards generally applied (at the time of origination) for the Bank's own account. The Company also intends that all Mortgage Assets held by the Company will meet market standards, and servicing guidelines promulgated by the Company, and Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("FHLMC") guidelines and procedures.

The balance of Securing Mortgage Loans at December 31, 2003 and 2002 was $21 million and $39 million, respectively. The weighted average interest rate on those loans at December 31, 2003 and 2002 was 5.996% and 6.930%, respectively.

None of the Securing Mortgage Loans collateralizing the Notes were on nonaccrual status at December 31, 2003 or 2002.

A majority of the collateral securing the underlying mortgage loans is located in Illinois and Arizona. The financial viability of customers in these states is, in part, dependent on those states' economies. The Company's maximum risk of accounting loss, should all customers in Illinois and Arizona fail to perform according to contract terms and all collateral prove to be worthless, was approximately $12 million and $2 million, respectively, at December 31, 2003

and $21 million and $6 million, respectively, as of December 31, 2002.

4. SECURITIES

	DECEMBER 31, 2002				DECE	
	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE	AMORTIZED COST	UNREAL GAIN
				(IN THOUSANDS)		
AVAILABLE-FOR-SALE SECURITIES						
Mortgage-backed............	$231,587	$2,665	395	$233,857	$355,018	$10,3
U.S. Treasury..............	$229,995	$ --		$229,995	$ 79,979	$
Total Securities...........	$461,582	$2,665	$395	$463,852	$434,997	$10,3

Mortgage-backed securities include Government National Mortgage Association ("GNMA") Platinum Certificates. The contractual maturities of the mortgage-backed securities exceed ten years. Expected maturities can differ from contractual maturities since borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The U.S. Treasury Bills held at December 31, 2003 mature within the next month.

5. COMMON AND PREFERRED STOCK

On February 11, 1998, the Company issued 10,000,000 Preferred Shares, Series A, at a price of $25 per share pursuant to its Registration Statement on Form S-11. Proceeds from this issuance, net of underwriting fees, totaled $242,125,000. The liquidation value of each Preferred Share is $25 plus any authorized, declared and unpaid dividends. The Preferred Shares are redeemable at any time at the option of the Company, in whole or in part, at the liquidation preference thereof, plus the quarterly accrued and unpaid dividends, if any, to the date of redemption. The Company may not redeem the Preferred Shares without prior approval from the Board of Governors of the Federal Reserve System or the appropriate successor federal regulatory agency. Except under certain limited circumstances, as defined, the holders of the Preferred Shares have no voting rights. The Preferred Shares are automatically exchangeable for a new series of preferred stock of the Bank upon the occurrence of certain events.

Holders of Preferred Shares are entitled to receive, if declared by the Board of Directors of the Company, noncumulative dividends at a rate of 7 3/8% per annum of the $25 per share liquidation preference (an amount equivalent to $1.84375 per share per annum). Dividends on the Preferred Shares, if authorized and declared, are payable quarterly in arrears on March 30, June 30, September 30, and December 30 each year. Dividends paid to the holders of the Preferred Shares for the years ended December 31, 2003 and 2002 were $18,438,000 in both years. The allocations of the distributions declared and paid for income tax purposes for December 31, 2003 and 2002 were 92% of ordinary income and 8% of capital gain and 90% of ordinary income and 10% of short term capital gain, respectively.

On December 30, 1998, the Bank contributed the Common Stock of the Company to HCH. The Bank is required to maintain direct or indirect ownership of at least 80% of the outstanding Common Stock of the Company for as long as any Preferred Shares are outstanding. Dividends on Common Stock are paid if and when authorized and declared by the Board of Directors out of funds legally available

after all preferred dividends have been paid. A Common Stock dividend of $2,000 per common share was declared on December 2, 2003, to the stockholder of record on December 15, 2003 and paid on December 31, 2003. The allocations of the distribution declared and paid for income tax purposes were 92% of ordinary income and 8% of capital gain. A Common Stock dividend of $3,090 per common share was declared on December 4, 2002, to the stockholder of record on December 15, 2002 and paid on December 27, 2002. The allocations of

the distribution declared and paid for income tax purposes were 90% of ordinary income and 10% of capital gain. In addition, on September 12, 2003 and September 12, 2002, the Company paid a cash dividend of $530 thousand and $130 thousand, respectively, on the outstanding common shares to the stockholder of record on September 3, 2003 and September 4, 2002, respectively. These dividends completed the 2002 and 2001 REIT tax compliance requirements.

6. TRANSACTIONS WITH AFFILIATES

The Company entered into an advisory agreement (the "Advisory Agreement") with the Bank pursuant to which the Bank administers the day-to-day operations of the Company. The Bank is responsible for (i) monitoring the credit quality of Mortgage Assets held by the Company; (ii) advising the Company with respect to the reinvestment of income from and payments on, and with respect to, the acquisition, management, financing, and disposition of the Mortgage Assets held by the Company; and (iii) monitoring the Company's compliance with the requirements necessary to qualify as a REIT.

The Advisory Agreement in effect in 2003, 2002 and 2001 entitled the Bank to receive advisory fees of $56,000, $43,000, and $35,000, respectively. For 2004, advisory fees of $115,000 have been approved by the Board of Directors.

The Securing Mortgage Loans are serviced by the Bank pursuant to the terms of a servicing agreement (the "Servicing Agreement"). The Bank receives a fee equal to 0.25% per annum on the principal balances of the loans serviced. The Servicing Agreement requires the Bank to service the mortgage loans in a manner generally consistent with accepted secondary market practices, and servicing guidelines promulgated by the Company and with Fannie Mae and FHLMC guidelines and procedures. In 2003, 2002 and 2001, the Bank received payments of $70 thousand, $131 thousand and $243 thousand, respectively.

The Company purchases U.S. Treasury and Federal agency securities from the Bank under agreements to resell identical securities. At December 31, 2003, the Company held $11.5 million of such assets and had earned $1.2 million of interest from the Bank during 2003. At December 31, 2002, the Company held $20 million of such assets and earned $2.1 million of interest for 2002. At December 31, 2001, the Company held $21 million of such assets and earned $1.6 million of interest for 2001. The Company receives rates on these assets comparable to the rates that the Bank offers to unrelated counterparties under similar circumstances.

7. OPERATING SEGMENT

The Company's operations consist of monitoring and evaluating the investments in Mortgage Assets. Accordingly, the Company operates in only one segment. The Company has no external customers and transacts most of its business with the Bank.

8. COMMITMENTS AND CONTINGENCIES

Legal proceedings in which the Company is a defendant may arise in the normal course of business. At December 31, 2003 and 2002, there was no pending

litigation against the Company.

9. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following table sets forth selected quarterly financial data for the Company:

	YEAR ENDED DECEMBER 31, 2003				YEAR ENDED DECEMBER 31,		
	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER	FIRST QUARTER	SECOND QUARTER	THIRD QUARTE
	(IN THOUSANDS EXCEPT PER SHARE DATA)						
Total interest income..............	$ 5,293	$4,779	$ 3,856	$ 3,750	$ 5,945	$ 4,686	$ 4,4
Total noninterest income (loss).......	2,463	--	687	1,008	--	2,695	(
Total operating expenses............	130	99	80	179	126	101	
Net income............	7,626	4,680	4,463	4,569	5,819	7,280	4,3
Preferred dividends...	4,609	4,609	4,609	4,611	4,609	4,609	4,6
Net income (loss) available to common stockholder.........	3,017	71	(146)	(32)	1,210	2,671	(2
Basic and diluted income (loss) per common share........	$3,017.00	$71.00	$(146.00)	$(32.00)	$1,210.00	$2,671.00	$(253.

FINANCIAL STATEMENTS OF HARRIS TRUST AND SAVINGS BANK

The following unaudited financial information and audited financial statements for Harris Trust and Savings Bank are included because the Preferred Shares are automatically exchangeable for a new series of preferred stock of the Bank upon the occurrence of certain events.

HARRIS TRUST AND SAVINGS BANK

CERTAIN INFORMATION REGARDING HARRIS TRUST AND SAVINGS BANK

Harris Trust and Savings Bank ("the Bank") is an Illinois banking operation located at 111 West Monroe Street, Chicago, Illinois 60603. The Bank is a wholly-owned subsidiary of Harris Bankcorp, Inc., a multibank holding company incorporated under the laws of the State of Delaware and headquartered in Chicago and registered under the Bank Holding Company Act of 1956, as amended. Harris Bankcorp, Inc. is a wholly-owned subsidiary of Harris Financial Corp. ("HFC") (formerly known as Bankmont Financial Corp.). Harris Bankcorp, Inc. also owns 27 other banks, 26 in the counties surrounding Chicago and one with locations in Arizona, Florida and Washington. HFC is a wholly-owned subsidiary

of Bank of Montreal. At December 31, 2003, Harris Bankcorp's assets amounted to $30.61 billion, with the Bank representing approximately 65 percent of that total.

The Bank, an Illinois state-chartered bank, has its principal office, 59 domestic branch offices and 107 automated teller machines located in the Chicago area. The Bank also has offices in Atlanta, Detroit, Los Angeles and San Francisco; a foreign branch office in Nassau; and an Edge Act subsidiary, Harris Bank International Corporation ("HBIC"), engaged in international banking and finance in New York. At December 31, 2003, the Bank had total assets of $19.92 billion, total deposits of $12.74 billion, total loans of $9.57 billion and equity capital of $1.60 billion.

The Bank provides a broad range of banking and financial services to individuals and corporations domestically and abroad, including corporate banking, personal financial services, personal trust services and investment services. The Bank also offers (i) demand and time deposit accounts; (ii) various types of loans (including term, real estate, revolving credit facilities and lines of credit); (iii) sales and purchases of foreign currencies; (iv) interest rate management products (including swaps, forward rate agreements and interest rate guarantees); (v) cash management services; (vi) underwriting of municipal bonds; (vii) financial consulting; and (viii) a wide variety of personal trust and trust-related services.

Competitors of the Bank include commercial banks, savings and loan associations, consumer and commercial finance companies, credit unions and other financial services companies. Based on legislation passed in 1986 that allows Illinois banks to be acquired by banks or holding companies in states with a reciprocal law in effect, together with the Federal Interstate Banking Efficiency Act of 1994 that allows for both interstate banking and interstate branching in certain circumstances, the Bank believes that the level of competition will increase in the future.

The Bank is subject to regulation by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. As a state-chartered bank, it is also regulated by the Illinois Office of Banks and Real Estate. These regulatory bodies examine the Bank and supervise numerous aspects of its business. The Federal Reserve System regulates money and credit conditions and interest rates in order to influence general economic conditions, primarily through open market operations in U.S. Government securities, varying the discount rate on bank borrowings, setting reserve requirements against financial institution deposits and prescribing minimum capital requirements for member banks. These policies have a significant influence on overall growth and distribution of bank loans, investments and deposits, and affect interest rates charged on loans and earned on investments or paid for time, savings and other deposits. Board of Governors monetary policies have had a significant effect on the operating results of commercial banks in the past and this is expected to continue.

Although primarily focusing on U.S. domestic customers, identifiable foreign assets accounted for 3 percent of the Bank's total consolidated assets at December 31, 2003 and foreign net income was approximately 8 percent of the Bank's consolidated net income for the year then ended. Foreign net income is generated from three primary sources: (i) lending to foreign banks and other financial institutions; (ii) time deposits held in foreign banks; and (iii) foreign exchange trading profits of approximately $5.1 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

2003 COMPARED TO 2002

Summary

The Bank's 2003 net income was $117.9 million, down $54.0 million from 2002. Declines in gains from sales of portfolio securities, a higher provision for loan losses and increased pension costs more than offset increased noninterest revenue excluding security sales. Return on average common equity ("ROE") for 2003 was 7.43 percent and 11.02 percent in 2002. Return on average assets ("ROA") was 0.61 percent in 2003 and 0.95 percent in 2002.

Earnings before amortization of goodwill and other valuation intangibles ("cash earnings") were $124.0 million in 2003, a 30 percent decrease compared to 2002. Cash return on average common stockholder's equity ("cash ROE") represents net income applicable to common stock plus after-tax amortization expense of goodwill and other valuation intangibles, divided by average common stockholder's equity less average intangible assets. Cash ROE was 8.76 percent in 2003 compared to 12.85 percent in 2002.

For 2003, net interest income on a fully taxable equivalent basis of $447.9 million was down 4 percent from 2002. Net interest margin declined from 2.99 percent to 2.70 percent in 2003, reflecting the impact of lower yields in the investment securities portfolio. Average earning assets increased $1.01 billion or 6 percent to $16.59 billion in the current year, attributable to an increase of $990 million in investment securities.

Noninterest income increased $2.2 million to $514.7 million for 2003. Gains on sales of mortgage loans increased $8.9 million and fees from providing service to related corporate entities rose $28.5 million. Net gains from sales of investment securities decreased $35.3 million.

Total noninterest expenses were $690.7 million, up $34.4 million or 5 percent from 2002. Income taxes were $39.3 million, down $28.0 million from 2002, reflecting lower pretax income in 2003.

The provision for loan losses was $103.6 million in 2003 compared to $71.2 million in 2002. Net loan charge-offs during the current year were $75.8 million compared to $91.6 million in 2002 reflecting lower write-offs in the commercial loan portfolio.

Nonperforming assets totaled $172 million or 1.79 percent of total loans at both December 31, 2003 and December 31, 2002. At December 31, 2003, the allowance for possible loan losses was $235 million or 2.45 percent of total loans outstanding compared to $207 million or 2.15 percent of loans at the end of 2002. As a result, the ratio of the allowance for possible loan losses to nonperforming assets increased from a multiple of 1.2 at December 31, 2002 to 1.4 at December 31, 2003.

At December 31, 2003, the Bank's equity capital amounted to $1.60 billion, up slightly from $1.58 billion at December 31, 2002. Unrealized securities gains, net of tax, were $31.0 million at December 31, 2003 compared to $73.0 million at December 31, 2002. In February 1998, Harris Preferred Capital Corporation, a subsidiary of the Bank, issued $250 million of noncumulative preferred stock in a public offering (see Note 18 to Financial Statements). The preferred stock qualifies as Tier 1 capital for U.S. banking regulatory purposes.

The Bank's regulatory capital leverage ratio was 8.52 percent compared to 8.64 percent one year earlier. Regulators require most banking institutions to maintain capital leverage ratios of not less than 4.0 percent. At December 31, 2003, the Bank's Tier 1 and total risk-based capital ratios were 10.20 percent

and 12.25 percent, respectively, compared to respective ratios of 10.19 percent and 12.50 percent at December 31, 2002. The 2003 year-end risk-based capital ratios substantially exceeded minimum required regulatory ratios of 4.0 percent and 8.0 percent, respectively.

2002 COMPARED TO 2001

Summary

The Bank's 2002 net income was $171.8 million, up $89.6 million from 2001. Earnings comparability for 2002 and 2001 was affected by a third quarter 2001 special provision for loan losses of $121 million and a special pretax charge of $3.2 million in fourth quarter 2001 relating to impairments in the value of certain equity investments. Excluding the effect of these special charges, earnings grew 6 percent over the prior year. This increase was attributable to continued strong business growth in consumer, mortgage and small business loans and retail deposits, and a reduction in the provision for loan losses and increased earnings from treasury activities. Return on average common equity ("ROE") for 2002 was 11.02 percent and 10.41 percent in 2001 excluding the special charges described above. Return on average assets ("ROA") was 0.95 percent in 2002 and 0.80 percent in 2001 excluding the special charges described above.

Earnings before amortization of goodwill and other valuation intangibles ("cash earnings") were $177.9 million in 2002, a 1 percent increase compared to 2001, excluding the special charges described above. Cash return on average common stockholder's equity ("cash ROE") represents net income applicable to common stock plus after-tax amortization expense of goodwill and other valuation intangibles, divided by average common stockholder's equity less average intangible assets. Cash ROE was 12.85 percent in 2002 compared to 13.13 percent in 2001, excluding the special charges.

For 2002, net interest income on a fully taxable equivalent basis of $465.2 million was down 5 percent from 2001. Net interest margin rose from 2.80 percent to 2.99 percent in 2002, reflecting the impact of a declining rate environment during the past year. Average earning assets declined $1.85 billion or 11 percent to $15.58 billion in 2002, attributable to a decrease of $1.17 billion in investment securities and $799 million in average loans.

Noninterest income increased $55.3 million to $512.5 million for 2002. Excluding the special $3.2 million writedown of equity securities in 2001, noninterest income increased 11 percent from 2001. Net gains from portfolio securities increased $25.9 million, service charge fees increased $19.8 million and trading profits decreased $9.3 million. Inter-corporate service charges increased $13.2 million. Trust and investment management fees decreased $6.0 million.

Total noninterest expenses were $656.4 million, up $24.1 million or 4 percent from 2001. Income taxes were $67.3 million, up $57.1 million from 2001, reflecting substantially higher pretax income in 2002.

The provision for loan losses was $71.2 million in 2002 compared to $203.5 million in 2001. Third quarter 2001 results included a $121 million special provision for loan losses. Net loan charge-offs during the current year were $91.6 million compared to $95.1 million in 2001 reflecting higher recoveries in the commercial loan portfolio.

Nonperforming assets at December 31, 2002 totaled $172 million, or 1.79 percent of total loans compared to $205 million or 2.05 percent a year earlier.

At December 31, 2002, the allowance for possible loan losses was $207 million or 2.15 percent of total loans outstanding compared to $227 million or 2.28 percent of loans at the end of 2001. As a result, the ratio of the allowance for possible loan losses to nonperforming assets increased slightly from a multiple of 1.1 at December 31, 2001 to 1.2 at December 31, 2002.

At December 31, 2002, the Bank's equity capital amounted to $1.58 billion, up slightly from $1.56 billion at December 31, 2001. Unrealized securities gains, net of tax, were $73.0 million at December 31, 2002 compared to $20.1 million at December 31, 2001. In February 1998, Harris Preferred Capital Corporation, a subsidiary of the Bank, issued $250 million of noncumulative preferred stock in a public offering (see Note 18 to Financial Statements). The preferred stock qualifies as Tier 1 capital for U.S. banking regulatory purposes.

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The Bank's regulatory capital leverage ratio was 8.64 percent compared to 8.23 percent one year earlier. Regulators require most banking institutions to maintain capital leverage ratios of not less than 4.0 percent. At December 31, 2002, the Bank's Tier 1 and total risk-based capital ratios were 10.19 percent and 12.50 percent, respectively, compared to respective ratios of 9.80 percent and 12.26 percent at December 31, 2001. The 2002 year-end risk-based capital ratios substantially exceeded minimum required regulatory ratios of 4.0 percent and 8.0 percent, respectively.

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JOINT INDEPENDENT AUDITORS

The Board of Directors of Harris Trust and Savings Bank engaged the firms of KPMG LLP and PricewaterhouseCoopers LLP to serve as joint auditors for each of the years in the three year period ended December 31, 2003.

The Bank's ultimate parent company, Bank of Montreal ("BMO"), has elected to appoint two firms of independent public auditors to be auditors of BMO and all significant subsidiaries. The Bank's independent public auditors reflect the appointments made by BMO.

INDEPENDENT AUDITORS' REPORT

To the Stockholder and Board
of Directors of Harris Trust and Savings Bank

We have audited the accompanying consolidated statements of condition of Harris Trust and Savings Bank and Subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, comprehensive income, changes in stockholder's equity and cash flows for each of the years in the three year period ended December 31, 2003. These consolidated financial statements are the responsibility of Harris Trust and Savings Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall

financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Harris Trust and Savings Bank and Subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to Financial Statements, Harris Trust and Savings Bank and Subsidiaries adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002.

/S/ KPMG LLP /S/ PRICEWATERHOUSECOOPERS LLP

Chicago, Illinois
January 23, 2004

FINANCIAL STATEMENTS
HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CONDITION

	DECEMBER 31	
	2003	2002
	(IN THOUSANDS EXCEPT SHARE DATA)	
ASSETS		
Cash and demand balances due from banks	$ 823,615	$ 1,057,254
Money market assets:		
Interest-bearing deposits at banks	424,459	417,206
Federal funds sold	409,425	237,950
Securities available-for-sale (including $4.07 billion and $4.39 billion of securities pledged as collateral for repurchase agreements at December 31, 2003 and December 31, 2002, respectively)	6,624,280	5,781,360
Trading account assets	59,467	42,423
Loans	9,573,452	9,607,887
Allowance for possible loan losses	(234,798)	(206,999)
Net loans	9,338,654	9,400,888
Premises and equipment	302,975	298,414
Customers' liability on acceptances	44,234	16,168
Bank-owned insurance	1,035,239	994,185
Loans held for sale	168,904	149,311
Goodwill and other valuation intangibles	165,978	174,397
Other assets	522,260	457,462
TOTAL ASSETS	$19,919,490	$19,027,018
LIABILITIES		
Deposits in domestic offices -- noninterest-bearing	$ 4,231,540	$ 3,414,159
-- interest-bearing	7,844,596	6,408,171

Deposits in foreign offices -- noninterest-bearing	49,016	31,383
-- interest-bearing	616,889	1,184,571
Total deposits	12,742,041	11,038,284
Federal funds purchased	1,190,839	872,096
Securities sold under agreement to repurchase	3,452,567	4,188,688
Short-term borrowings	10,841	300,694
Short-term senior notes	--	200,000
Acceptances outstanding	44,234	16,168
Accrued interest, taxes and other expenses	171,422	153,148
Other liabilities	230,917	200,286
Minority interest -- preferred stock of subsidiary	250,000	250,000
Preferred stock issued to Harris Bankcorp, Inc.	5,000	5,000
Long-term notes -- subordinated	225,000	225,000
TOTAL LIABILITIES	18,322,861	17,449,364
STOCKHOLDER'S EQUITY		
Common stock ($10 par value); 10,000,000 shares authorized, issued and outstanding	100,000	100,000
Surplus	634,944	626,640
Retained earnings	860,674	803,249
Accumulated other comprehensive income	1,011	47,765
TOTAL STOCKHOLDER'S EQUITY	1,596,629	1,577,654
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	$19,919,490	$19,027,018

The accompanying notes to the financial statements are an integral part of these statements.

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	FOR THE YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS EXCEPT SHARE DATA)		
INTEREST INCOME			
Loans	$470,500	$512,946	$ 726,403
Money market assets:			
Deposits at banks	3,061	2,066	3,537
Federal funds sold and securities purchased under agreement to resell	3,655	7,938	13,672
Trading account	1,672	2,031	3,277
Securities available-for-sale:			
U.S. Treasury and federal agency	163,593	195,336	340,398
State and municipal	302	24	99
Other	2,178	2,243	2,128
Total interest income	644,961	722,584	1,089,514
INTEREST EXPENSE			

Deposits	125,102	162,267	339,445
Short-term borrowings	50,458	64,262	212,635
Senior notes	3,722	12,144	33,997
Minority interest -- dividends on preferred stock of subsidiary	18,438	18,438	18,438
Long-term notes	10,452	11,257	13,929
Total interest expense	208,172	268,368	618,444
NET INTEREST INCOME	436,789	454,216	471,070
Provision for loan losses	103,604	71,220	203,508
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	333,185	382,996	267,562
NONINTEREST INCOME			
Trust and investment management fees	84,586	82,829	88,846
Money market and bond trading	9,343	9,347	17,016
Foreign exchange	5,076	7,155	8,833
Service fees and charges	112,683	118,635	98,823
Securities gains	25,953	61,272	35,397
Bank-owned insurance	43,712	50,713	47,226
Foreign fees	26,349	24,399	21,305
Syndication fees	14,168	6,289	6,584
Other	192,856	151,869	133,155
Total noninterest income	514,726	512,508	457,185
NONINTEREST EXPENSES			
Salaries and other compensation	321,170	310,116	293,247
Pension, profit sharing and other employee benefits	76,572	61,279	51,328
Net occupancy	41,964	41,727	34,473
Equipment	54,586	53,531	53,329
Marketing	31,217	29,165	34,310
Communication and delivery	22,963	22,593	19,992
Expert services	26,733	28,328	25,600
Contract programming	28,930	29,105	31,479
Other	76,337	70,369	64,731
	680,472	646,213	608,489
Amortization of intangibles	10,267	10,151	23,752
Total noninterest expenses	690,739	656,364	632,241
Income before income taxes	157,172	239,140	92,506
Applicable income taxes	39,301	67,306	10,234
NET INCOME	$117,871	$171,834	$ 82,272
BASIC EARNINGS PER COMMON SHARE (based on 10,000,000 average shares outstanding)			
NET INCOME	$ 11.79	$ 17.18	$ 8.23

The accompanying notes to the financial statements are an integral part of these statements.

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS
OF COMPREHENSIVE INCOME

	FOR THE YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS)		
NET INCOME	$117,871	$171,834	$ 82,272
Other comprehensive (loss) income:			
Cash flow hedges:			
Cumulative effect of accounting change	--	--	(7,976)
Net unrealized gain on derivative instruments, net of tax expense of $21 in 2003, zero in 2002, and $4,684 in 2001	35	--	7,976
Minimum pension liability adjustment net of tax benefit of $3,161 in 2003, $16,618 in 2002, and zero in 2001	(4,792)	(25,194)	--
Unrealized (losses) gains on available-for-sale securities:			
Unrealized holding (losses) gains arising during period, net of tax (benefit) expense of ($18,194) in 2003, $58,702 in 2002 and $34,589 in 2001	(26,140)	90,296	52,388
Less reclassification adjustment for gains included in net income, net of tax expense of $10,096 in 2003, $23,835 in 2002 and $13,769 in 2001	(15,857)	(37,437)	(21,627)
Other comprehensive (loss) income	(46,754)	27,665	30,761
Comprehensive income	$ 71,117	$199,499	$113,033

The accompanying notes to the financial statements are an integral part of these statements.

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY

	COMMON STOCK	SURPLUS	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL STOCKHOLDE EQUITY
	(IN THOUSANDS EXCEPT PER SHARE DATA)				
BALANCE AT DECEMBER 31, 2000	$100,000	$613,365	$821,719	$(10,661)	$1,524,42
Contribution to capital surplus	--	4,523	--	--	4,52
Tax benefit from stock option exercise	--	2,698	--	--	2,69
Net income	--	--	82,272	--	82,27
Dividends -- ($8.40 per common share)	--	--	(84,000)	--	(84,00

Other comprehensive income........	--	--	--	30,761	30,76
BALANCE AT DECEMBER 31, 2001........	100,000	620,586	819,991	20,100	1,560,67
Contribution to capital surplus...	--	5,591	--	--	5,59
Tax benefit from stock option exercise......................	--	463	--	--	46
Net income.......................	--	--	171,834	--	171,83
Dividends -- ($18.80 per common share)........................	--	--	(188,000)	--	(188,00
Dividends -- ($0.115 per preferred share)........................	--	--	(576)	--	(57
Other comprehensive income........	--	--	--	27,665	27,66
BALANCE AT DECEMBER 31, 2002........	100,000	626,640	803,249	47,765	1,577,65
Contribution to capital surplus...	--	6,086	--	--	6,08
Tax benefit from stock option exercise......................	--	2,218	--	--	2,21
Net income.......................	--	--	117,871	--	117,87
Dividends -- ($6.00 per common share)........................	--	--	(60,000)	--	(60,00
Dividends -- ($0.089 per preferred share)........................	--	--	(446)	--	(44
Other comprehensive loss..........	--	--	--	(46,754)	(46,75
BALANCE AT DECEMBER 31, 2003........	$100,000	$634,944	$860,674	$ 1,011	$1,596,62

The accompanying notes to the financial statements are an integral part of these statements.

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	FOR THE YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS)		
OPERATING ACTIVITIES:			
Net Income..	$ 117,871	$ 171,834	$ 82,272
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses......................	103,604	71,220	203,508
Depreciation and amortization, including intangibles................................	67,207	61,892	71,054
Deferred tax expense (benefit)..................	9,487	6,035	(24,783)
Gain on sales of securities....................	(25,953)	(61,272)	(35,397)
Increase in bank-owned insurance................	(43,054)	(47,105)	(47,162)
Trading account net cash purchases..............	(14,712)	(21,486)	(25,351)
Decrease in interest receivable.................	4,839	19,811	70,082
Increase (decrease) in interest payable..........	7,331	(22,155)	(18,506)
(Increase) decrease in loans held for sale.......	(19,593)	(27,723)	120,683
Other, net.......................................	74,257	14,234	9,850

Net cash provided by operating activities........	281,284	165,285	406,250
INVESTING ACTIVITIES:			
Net increase in interest-bearing deposits at banks..	(7,253)	(221,483)	(54,375)
Net (increase) decrease in Federal funds sold and securities purchased under agreement to resell.......................................	(171,475)	341,800	(88,675)
Proceeds from sales of securities available-for-sale...........................	1,539,979	2,678,763	1,898,048
Proceeds from maturities of securities available-for-sale...........................	4,526,559	7,453,346	7,707,315
Purchases of securities available-for-sale.......	(7,031,858)	(9,992,242)	(8,740,451)
Net (increase) decrease in loans................	(53,809)	246,595	697,425
Proceeds from sale of bank premises.............	--	--	32,276
Purchases of premises and equipment.............	(53,744)	(56,753)	(64,985)
Other, net......................................	152	5,145	--
Net cash (used) provided by investing activities..................................	(1,251,449)	455,171	1,386,578
FINANCING ACTIVITIES:			
Net increase (decrease) in deposits.............	1,703,757	(152,576)	(1,302,517)
Net (decrease) increase in Federal funds purchased and securities sold under agreement to repurchase................................	(417,378)	637,433	(185,528)
Net decrease in other short-term borrowings......	(289,853)	(404,005)	(785,031)
Proceeds from issuance of senior notes...........	2,590,000	750,000	2,308,500
Repayment of senior notes.......................	(2,790,000)	(1,410,000)	(1,838,000)
Proceeds from the issuance of preferred stock of subsidiary..................................	--	--	5,000
Cash dividends paid on common stock.............	(60,000)	(188,000)	(84,000)
Net cash provided (used) by financing activities................................	736,526	(767,148)	(1,881,576)
Net decrease in cash and demand balances due from banks..	(233,639)	(146,692)	(88,748)
Cash and demand balances due from banks at January 1....................................	1,057,254	1,203,946	1,292,694
Cash and demand balances due from banks at December 31..................................	$ 823,615	$ 1,057,254	$ 1,203,946
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest....................................	$ 200,841	$ 290,524	$ 636,949
Income taxes................................	$ 21,263	$ 67,056	$ 69,310

The accompanying notes to the financial statements are an integral part of these statements.

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION AND NATURE OF OPERATIONS

Harris Trust and Savings Bank is a wholly-owned subsidiary of Harris Bankcorp, Inc. ("Bankcorp"), a Delaware corporation which is a wholly-owned subsidiary of Harris Financial Corp. ("HFC") (formerly known as Bankmont Financial Corp.), a Delaware corporation which is a wholly-owned subsidiary of Bank of Montreal ("BMO"). Throughout these Notes to Financial Statements, the term "Bank" refers to Harris Trust and Savings Bank and subsidiaries.

The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiaries. Significant intercompany accounts and transactions have been eliminated. Certain reclassifications were made to conform prior years' financial statements to the current year's presentation. See Note 23 to the Financial Statements for additional information on business combinations and Note 24 for additional information on related party transactions.

The Bank provides banking, trust and other services domestically and internationally through the main banking facility, 6 active nonbank subsidiaries and an Edge Act subsidiary, Harris Bank International Corporation ("HBIC"), in New York. The Bank provides a variety of financial services to commercial and industrial companies, financial institutions, governmental units, not-for-profit organizations and individuals throughout the U.S., primarily the Midwest, and abroad. Services rendered and products sold to customers include demand and time deposit accounts and certificates; various types of loans; sales and purchases of foreign currencies; interest rate management products; cash management services; underwriting of municipal bonds; and financial consulting.

BASIS OF ACCOUNTING

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and conform to practices within the banking industry.

FOREIGN CURRENCY AND FOREIGN EXCHANGE CONTRACTS

Assets and liabilities denominated in foreign currencies have been translated into United States dollars at respective year-end rates of exchange. Monthly translation gains or losses are computed at rates prevailing at month-end. There were no material translation gains or losses during any of the years presented. Foreign exchange trading positions including spot, forwards, option contracts and swaps are revalued monthly using prevailing market rates. Exchange adjustments are included with noninterest income in the Consolidated Statements of Income.

DERIVATIVE FINANCIAL INSTRUMENTS

The Bank uses various interest rate, foreign exchange, equity and commodity derivative contracts in the management of its risk strategy or as part of its dealer and trading activities. Interest rate contracts may include futures, forwards, forward rate agreements, option contracts, caps, floors, collars and swaps. Foreign exchange contracts may include spot, forwards, futures, option contracts and swaps. Equity contracts and commodity contracts may include option contracts and swaps.

All derivative instruments are recognized at fair value in the Consolidated Statements of Condition. All derivative instruments are designated either as hedges or as held for trading or non-hedging purposes.

Derivative instruments that are used in the management of the Bank's risk strategy may qualify for hedge accounting if the derivatives are designated as hedges and applicable hedge criteria are met. On the date that the Bank enters into a derivative contract, it designates the derivative as a hedge of the fair

value of a recognized asset or liability or an unrecognized firm commitment, a hedge of a forecasted transaction or the

variability of cash flows that are to be received or paid in connection with a recognized asset or liability, a foreign currency fair value or cash flow hedge. Changes in the fair value of a derivative that is highly effective (as defined) and qualifies as a fair value hedge, along with changes in the fair value of the underlying hedged item, are recorded in current period earnings. Changes in the fair value of a derivative that is highly effective (as defined) and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income only until earnings are recognized from the underlying hedged item. Net gains or losses resulting from hedge ineffectiveness are recorded in current period earnings. Changes in the fair value of a derivative that is highly effective (as defined) and qualifies as a foreign currency hedge are recorded in either current period earnings or other comprehensive income depending on whether the hedging relationship meets the criteria for a fair value or cash flow hedge.

The Bank formally documents all hedging relationships at inception of hedge transactions. The process includes documenting the risk management objective and strategy for undertaking the hedge transaction and identifying the specific derivative instrument and the specific underlying asset, liability, firm commitment or forecasted transaction. The Bank formally assesses, both at inception and on an ongoing quarterly basis, whether the derivative hedging instruments have been highly effective in offsetting changes in the fair value or cash flows of the hedged items and whether the derivatives are expected to remain highly effective in future periods.

Hedge accounting is discontinued prospectively when the Bank determines that the hedge is no longer highly effective, the derivative instrument expires or is sold, terminated or exercised, it is no longer probable that the forecasted transaction will occur, the hedged firm commitment no longer meets the definition of a firm commitment, or the designation of the derivative as a hedging instrument is no longer appropriate.

When hedge accounting is discontinued because a fair value hedge is no longer highly effective, the derivative instrument will continue to be recorded on the balance sheet at fair value but the underlying hedged item will no longer be adjusted for changes in fair value. When hedge accounting is discontinued because the hedged item in a fair value hedge no longer meets the definition of a firm commitment, the derivative instrument will continue to be recorded on the balance sheet at fair value and any asset or liability that was recorded to recognize the firm commitment will be removed from the balance sheet and recognized as a gain or loss in current period earnings. When hedge accounting is discontinued because it is no longer probable that the forecasted transaction in a cash flow hedge will occur, the gain or loss on the derivative that was in accumulated other comprehensive income will be recognized immediately in earnings and the derivative instrument will be marked to market through earnings. When hedge accounting is discontinued and the derivative remains outstanding, the derivative may be redesignated as a hedging instrument as long as the applicable hedge criteria are met under the terms of the new contract.

Derivative instruments that are entered into for risk management purposes and do not otherwise qualify for hedge accounting are marked to market and the resulting unrealized gains and losses are recognized in noninterest income in the period of change.

Derivative instruments that are used as part of the Bank's dealer and trading activities are marked to market and the resulting unrealized gains and losses are recognized in noninterest income in the period of change.

IMPACT OF NEW ACCOUNTING STANDARDS

The Bank adopted Statement of Financial Accounting Standards ("SFAS") No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," on January 1, 2003. The Statement requires that a liability for costs associated with exit or disposal activities be recognized when the liability is incurred, as defined in Concepts Statement 6. It nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The adoption of the Statement was not material to the Bank's financial position or results of operations.

The Bank adopted the disclosure requirements of Financial Accounting Standards Board ("FASB") Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), on December 31, 2002. The recognition and measurement provisions of FIN 45 were adopted on January 1, 2003. The disclosures are included in Note 11 to the Financial Statements. The adoption of FIN 45 was not material to the Bank's financial position or results of operations.

In December 2003, the FASB issued FASB Interpretation No. 46 (Revised), "Consolidation of Variable Interest Entities" ("FIN 46R"). FIN 46R replaces FIN 46, which was issued in January 2003. FIN 46R addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and whether it should consolidate the entity. An entity is subject to FIN 46R and is called a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that has a majority interest in the expected losses or the expected residual returns or both. The Bank does not have an interest in a VIE and is not subject to the provisions of FIN 46R.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The Statement clarifies accounting for derivative instruments, including embedded derivatives, and accounting for hedging activities. The Bank adopted the Statement on July 1, 2003. The adoption of the Statement did not have a material effect on the Bank's financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." The Statement applies to issuers of financial instruments and establishes standards for the classification and measurement of freestanding financial instruments having characteristics of both liabilities and equity. The Bank adopted the Statement on July 1, 2003. The adoption of the Statement did not have a material effect on the Bank's financial position or results of operations.

In December 2003, the FASB issued SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits" to improve financial statement disclosures for defined benefit plans. The Statement requires additional disclosures, primarily for plan assets and cash flow requirements. The Bank adopted the disclosure requirements of SFAS No. 132 on December 31, 2003.

SECURITIES

The Bank classifies securities as either trading account assets or available-for-sale. Trading account assets include securities acquired as part of trading activities and are typically purchased with the expectation of near-term profit. These assets consist primarily of municipal bonds and U.S. government securities. All other securities are classified as available-for-sale, even if the Bank has no current plans to divest.

Trading account assets are reported at fair value with unrealized gains and losses included in trading account income, which also includes realized gains and losses from closing such positions. Available-for-sale securities are reported at fair value with unrealized gains and losses included, on an after-tax basis, in a separate component of stockholder's equity. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses, as a result of securities sales, are included in securities gains, with the cost of securities sold determined on the specific identification basis.

LOANS, LOAN FEES AND COMMITMENT FEES

Loans not held for sale are recorded at the principal amount outstanding, net of unearned income, deferred fees and origination costs. For fair value hedges that are highly effective, loans designated as the underlying hedged items are recorded net of changes in fair value attributable to the hedged risks. Origination

fees collected on commercial loans, loan commitments, mortgage loans and standby letters of credit, that are not held for sale, are generally deferred and amortized over the life of the related facility. Other loan-related fees that are not the equivalent of yield adjustments are recognized as income when received or earned. At December 31, 2003 and 2002, the Bank's Consolidated Statements of Condition included approximately $12 million and $15 million, respectively, of deferred loan-related fees net of deferred origination costs.

In conjunction with its mortgage and commercial banking activities, the Bank will originate loans with the intention of selling them in the secondary market. These loans are classified as available-for-sale and are included in "Other Assets" on the Bank's Consolidated Statements of Condition. The loans are carried at the lower of allocated cost or current market value, on a portfolio basis. Deferred origination fees and costs associated with these loans are not amortized and are included as part of the basis of the loan at time of sale. Realized gains and unrealized losses are included with other noninterest income.

The Bank engages in the servicing of mortgage loans and acquires mortgage servicing rights by purchasing or originating mortgage loans and then selling those loans with servicing rights retained. The rights to service mortgage loans for others are recognized as separate assets by allocating the total cost of the mortgage loans to the mortgage servicing rights and the loans (without the mortgage servicing rights) based on their relative fair values. The capitalized mortgage servicing rights are amortized in proportion to and over the period of estimated net servicing income. The capitalized mortgage servicing rights are periodically evaluated for impairment based on the fair value of those rights. Fair values are estimated using discounted cash flow analyses. The risk characteristics of the underlying loans used to stratify capitalized mortgage servicing rights for purposes of measuring impairment are market interest rates, loan type and repricing interval.

Commercial and real estate loans are placed on nonaccrual status when the collection of interest is doubtful or when principal or interest is 90 days past due, unless the credit is adequately collateralized and the loan is in process of collection. When a loan is placed on nonaccrual status, all interest accrued but not yet collected which is deemed uncollectible is charged against interest income in the current year. Interest on nonaccrual loans is recognized as income only when cash is received and the Bank expects to collect the entire principal balance of the loan. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Interest income on restructured loans is accrued according to the most recently agreed upon contractual terms.

Commercial and real estate loans are charged off when, in management's opinion, the loan is deemed uncollectible. Consumer installment loans are charged off when 120 days past due. Consumer revolving loans are charged off when 180 days past due. Accrued interest on these loans is recorded to interest income. Such loans are not normally placed on nonaccrual status.

Commercial loan commitments and letters of credit are executory contracts and are not reflected on the Bank's Consolidated Statements of Condition. Fees collected are generally deferred and recognized over the life of the facility.

Impaired loans (primarily commercial credits) are measured based on the present value of expected future cash flows (discounted at the loan's effective interest rate) or, alternatively, at the loan's observable market price or the fair value of supporting collateral. Impaired loans are defined as those where it is probable that amounts due for principal or interest according to contractual terms will not be collected. Both nonaccrual and certain restructured loans meet this definition. Large groups of smaller-balance, homogeneous loans, primarily residential real estate and consumer installment loans, are excluded from this definition of impairment. The Bank determines loan impairment when assessing the adequacy of the allowance for possible loan losses.

ALLOWANCE FOR POSSIBLE LOAN LOSSES

The allowance for possible loan losses is maintained at a level considered adequate to provide for estimated loan losses. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. Known losses of principal on impaired loans are charged off. The provision for loan losses is based on past loss experience, management's evaluation of the loan portfolio under current economic

conditions and management's estimate of losses inherent in the portfolio. Such estimates are reviewed periodically and adjustments, if necessary, are recorded during the periods in which they become known.

PREMISES AND EQUIPMENT

Premises and equipment are stated at cost less accumulated depreciation and amortization. Interest costs associated with long-term construction projects are capitalized and then amortized over the life of the related asset after the project is completed. For financial reporting purposes, the provision for depreciation and amortization is computed on the straight-line basis over the estimated useful lives of the assets. Estimated useful lives ranges from 3 years to 39 years.

BANK-OWNED INSURANCE

The Bank has purchased life insurance coverage for certain officers. The

one-time premiums paid for the policies, which coincide with the initial cash surrender value, are recorded as assets on the Consolidated Statements of Condition. Increases or decreases in cash surrender value (other than proceeds from death benefits) are recorded as other income or other expense. Proceeds from death benefits first reduce the cash surrender value attributable to the individual policy and any additional proceeds are recorded as other income.

GOODWILL AND OTHER INTANGIBLE ASSETS

The Bank records goodwill and other intangible assets in connection with the acquisition of assets from unrelated parties or the acquisition of new subsidiaries. Goodwill that originated prior to July 1, 2001 was amortized on a straight-line basis through 2001 year-end but discontinued effective January 1, 2002 in connection with the adoption of SFAS No. 142. Goodwill arising subsequent to July 1, 2001 is not amortized. Goodwill is periodically assessed for impairment, at least annually. Intangible assets with finite lives are amortized on either an accelerated or straight-line basis depending on the character of the acquired asset. Original lives range from 3 to 15 years. Intangible assets subject to amortization are reviewed for impairment when events or future assessments of profitability indicate that the carrying value may not be recoverable. Intangible assets with indefinite useful lives are not amortized and are reviewed for impairment annually or more frequently if events indicate impairment.

OTHER ASSETS

Property or other assets received in satisfaction of debt are included in "Other Assets" on the Bank's Consolidated Statements of Condition and are recorded at the lower of remaining cost or fair value. Fair values for other real estate owned generally are reduced by estimated costs to sell. Losses arising from subsequent write-downs to fair value are charged directly to expense.

Loans intended to be sold in the secondary market are classified as available-for-sale and are included in "Loans held for sale" on the Consolidated Statements of Condition. The loans are carried at lower of allocated cost or current market value, on a portfolio basis. The Bank has qualifying mortgage loan commitments that are intended to be sold in the secondary market. These loan commitments are derivatives and are accounted for at fair value.

RETIREMENT AND OTHER POSTEMPLOYMENT BENEFITS

The Bank has noncontributory defined benefit pension plans covering virtually all its employees. For its primary plan, the policy of the Bank is to, at a minimum, fund annually an amount necessary to satisfy the requirements under the Employee Retirement Income Security Act ("ERISA"), without regard to prior years' contributions in excess of the minimum. The Bank generally contributes the maximum allowable under the U.S. Internal Revenue Code.

Postemployment benefits provided to former or inactive employees after employment but before retirement are accrued if they meet the conditions for accrual of compensated absences. Otherwise, postemployment benefits are recorded when expenses are incurred.

INCOME TAXES

Deferred tax assets and liabilities, as determined by the temporary differences between financial reporting and tax bases of assets and liabilities, are computed using enacted tax rates and laws. The effect on deferred tax assets

and liabilities of a change in tax rates or law is recognized as income or expense in the period including the enactment date.

The Bank is included in the consolidated Federal income tax return of HFC. Income tax return liabilities or benefits for all the consolidated entities are not materially different than they would have been if computed on a separate return basis.

MANAGEMENT'S ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The areas requiring significant management judgment include provision and allowance for possible loan losses, income taxes, pension cost, postemployment benefits, valuation of intangible assets, fair values and temporary vs. other-than-temporary impairment.

RECLASSIFICATIONS

Certain reclassifications were made to conform prior years' financial statements to the current year's presentation.

2. SECURITIES

The amortized cost and estimated fair value of securities available-for-sale were as follows:

	DECEMBER 31, 2003				DECEM	
	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE	AMORTIZED COST	UNREALIZ GAINS
				(IN THOUSANDS)		
U.S. Treasury.........	$2,820,111	$35,934	$4,306	$2,851,739	$2,562,541	$ 92,62
Federal agency........	2,790,603	3,844	155	2,794,292	2,677,716	16,31
Mortgage-backed.......	915,825	3,115	1,032	917,908	392,106	12,10
State and municipal...	28,592	364	--	28,956	627	-
Other.................	31,260	125	--	31,385	27,287	3
Total securities......	$6,586,391	$43,382	$5,493	$6,624,280	$5,660,277	$121,08

The following table summarizes, for available-for-sale securities with unrealized losses as of December 31, 2003, the amount of the unrealized loss and the related fair value of the securities with unrealized losses. The unrealized losses have been further segregated by investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months. Management believes that all of the unrealized losses are temporary.

	LENGTH OF CONTINUOUS UNREALIZED LOSS			
	LESS THAN 12 MONTHS		12 MONTHS OR LONGER	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
	(IN THOUSANDS)			
U.S. Treasury	$ 608,118	$(4,306)	$ --	$ --
Federal agency	180,994	(155)	--	--
Mortgage-backed	639,820	(1,032)	--	--
State and municipal	--	--	--	--
Other	--	--	--	--
Temporarily impaired securities-available-for-sale	$1,428,932	$(5,493)	$ --	$ --

At December 31, 2003 and 2002, available-for-sale and trading account securities having a carrying amount of $4.07 billion and $4.39 billion, respectively, were pledged as collateral for certain liabilities, securities sold under agreement to repurchase, public and trust deposits, trading account activities and for other purposes where permitted or required by law. The Bank maintains effective control over the securities sold under agreement to repurchase and accounts for the transactions as secured borrowings.

The amortized cost and estimated fair value of available-for-sale securities at December 31, 2003, by contractual maturity, are shown below. Expected maturities can differ from contractual maturities since borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	DECEMBER 31, 2003	
	AMORTIZED COST	FAIR VALUE
	(IN THOUSANDS)	
Maturities:		
Within 1 year	$2,653,123	$2,659,767
1 to 5 years	3,414,543	3,446,204
5 to 10 years	205,710	201,948
Over 10 years	281,755	284,976
Other securities without stated maturity	31,260	31,385
Total securities	$6,586,391	$6,624,280

In 2003, 2002 and 2001, proceeds from the sale of securities available-for-sale amounted to $1.54 billion, $2.68 billion and $1.90 billion, respectively. Gross gains of $26.5 million and gross losses of $0.5 million were realized on these sales in 2003, gross gains of $63.0 million and gross losses of $1.7 million were realized on these sales in 2002 and gross gains of $35.4 million and no gross losses were realized on these sales in 2001. Net unrealized holding gains on trading securities increased during 2003 from an unrealized

gain of $0.9 million at December 31, 2002 to an unrealized gain of $1.1 million at December 31, 2003. The increase of $0.2 million has been included in 2003 earnings.

3. LOANS

The following table summarizes loan balances by category:

	DECEMBER 31	
	2003	2002
	(IN THOUSANDS)	
Domestic loans:		
Commercial, financial, agricultural, brokers and dealers	$5,043,936	$5,641,852
Real estate construction	289,364	241,278
Real estate mortgages	3,260,731	2,854,919
Installment	930,644	740,414
Foreign loans:		
Banks and other financial institutions	29,223	100,488
Other, primarily commercial and industrial	19,554	28,936
Total loans	9,573,452	9,607,887
Less allowance for possible loan losses	234,798	206,999
Loans, net of allowance for possible loan losses	$9,338,654	$9,400,888

Nonaccrual loans, restructured loans and other nonperforming assets are summarized below:

	YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS)		
Nonaccrual loans	$171,226	$169,588	$202,320
Restructured loans	--	--	2,309
Total nonperforming loans	171,226	169,588	204,629
Other assets received in satisfaction of debt	450	1,975	140
Total nonperforming assets	$171,676	$171,563	$204,769
Gross amount of interest income that would have been recorded if year-end nonperforming loans had been accruing interest at their original terms	$ 12,380	$ 8,496	$ 14,306
Interest income actually recognized	--	--	--
Interest shortfall	$ 12,380	$ 8,496	$ 14,306

90-day past due loans, still accruing interest (all domestic)	$ 14,865	$ 12,478	$ 13,129

At December 31, 2003 and 2002, the Bank had no aggregate public and private sector outstandings to any single country experiencing a liquidity problem which exceeded one percent of the Bank's consolidated assets. At December 31, 2003 and 2002 commercial loans with a carrying value of $4.78 billion and $3.74 billion, respectively, were pledged to secure potential borrowings with the Federal Reserve.

MORTGAGE SERVICING RIGHTS

The carrying amount of mortgage servicing rights was $16.3 million and $12.9 million at December 31, 2003 and 2002, respectively. The fair value of those rights equaled or exceeded the carrying amount at both December 31, 2003 and December 31, 2002. Mortgage servicing rights, included in other assets, of $11.2 million and $4.5 million were capitalized during 2003 and 2002, respectively. Amortization expense associated with the mortgage servicing rights was $7.7 million and $5.9 million in 2003 and 2002, respectively. There were no direct write-downs in 2003 or 2002. During 2003, impairment of mortgage servicing rights totaling $0.1 million was recorded in a valuation allowance to reflect the excess of carrying value over estimated fair value.

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4. ALLOWANCE FOR POSSIBLE LOAN LOSSES

The changes in the allowance for possible loan losses are as follows:

	YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS)		
Balance, beginning of year	$206,999	$ 227,374	$118,951
Charge-offs	(88,244)	(106,650)	(98,814)
Recoveries	12,439	15,055	3,729
Net charge-offs	(75,805)	(91,595)	(95,085)
Provisions charged to operations	103,604	71,220	203,508
Balance, end of year	$234,798	$ 206,999	$227,374

Details on impaired loans and related allowance are as follows:

	IMPAIRED LOANS FOR WHICH THERE IS A RELATED ALLOWANCE	IMPAIRED LOANS FOR WHICH THERE IS NO RELATED ALLOWANCE	TOTAL IMPAIR LOANS
	(IN THOUSANDS)		

December 31, 2003			
Balance	$144,064	$27,162	$171,2
Related allowance	76,913	--	76,9
Balance, net of allowance	$ 67,151	$27,162	$ 94,3
December 31, 2002			
Balance	$156,306	$13,282	$169,5
Related allowance	76,538	--	76,5
Balance, net of allowance	$ 79,768	$13,282	$ 93,0

	YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS)		
Average impaired loans	$181,900	$191,493	$153,920
Total interest income on impaired loans recorded on a cash basis	$ --	$ --	$ --

5. PREMISES AND EQUIPMENT

Premises and equipment are stated at cost less accumulated depreciation and amortization. A summary of these accounts is set forth below:

	DECEMBER 31	
	2003	2002
	(IN THOUSANDS)	
Land	$ 22,855	$ 23,183
Premises	209,877	203,089
Equipment	410,674	385,907
Leasehold improvements	47,175	41,331
Total	690,581	653,510
Accumulated depreciation and amortization	387,606	355,096
Premises and equipment	$302,975	$298,414

Depreciation and amortization expense was $49.4 million in 2003, $46.3 million in 2002 and $48.3 million in 2001.

On December 17, 2001, the Bank closed on the sale of its fifteen story operations center containing approximately 415,000 gross square feet located at 311 West Monroe Street, Chicago, Illinois, and leased back

approximately 259,000 rentable square feet. The lease ends on December 31, 2011. The Bank has rights of first offering to lease additional space and options to extend to December 31, 2026. The remainder of the building was occupied by third-party tenants. The sale resulted in a realized gain of $1 million and a deferred gain of $14.0 million and $15.7 million as of December 31, 2003 and 2002, respectively.

In addition, the Bank owns or leases premises at other locations to conduct branch banking activities.

6. GOODWILL AND OTHER INTANGIBLE ASSETS

The Bank adopted SFAS No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002. Under this standard, goodwill and other intangible assets that have indefinite useful lives are not subject to amortization while intangible assets with finite lives are amortized. Goodwill is periodically assessed for impairment, at least annually. Upon adoption of SFAS No. 142, the Bank had no goodwill.

The Bank adopted SFAS No. 147, "Acquisitions of Certain Financial Institutions -- an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9," on October 1, 2002. Under this standard, most acquisitions of financial institutions are removed from the scope of SFAS No. 72 and Interpretation 9 and are accounted for in accordance with SFAS No. 141, "Business Combinations," and SFAS No. 142. As such, unidentifiable intangible assets recognized and amortized in accordance with SFAS No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions," represent goodwill that will be accounted for under SFAS No. 142. At adoption date, the Bank had an unidentifiable intangible asset that, in accordance with SFAS No. 72, was excluded from the scope of SFAS No. 142 and continued to be amortized through third quarter 2002. Upon adoption of the Statement, the unidentifiable intangible asset was reclassified to goodwill and no longer amortized starting in fourth quarter 2002. Under the transitional requirements of the Statement, the first three quarters of 2002 were restated to reflect the reversal of previously amortized goodwill in those quarters. The earnings impact for each of these three quarters was $2.35 million pretax ($1.4 million after tax).

The Bank's goodwill was subject to the annual impairment test in the fourth quarter of 2003. The fair value of the reporting unit was estimated using a valuation technique based on multiples of book value. The test did not identify potential impairment and no impairment loss was recognized in 2003.

For the years ended December 31, 2003, 2002 and 2001, the Bank's net income and earnings per share on a proforma basis adjusted to exclude the amortization of goodwill are included in the following table:

	YEARS ENDED DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS EXCEPT SHARE DATA)		
Net income	$117,871	$171,834	$82,272
Plus goodwill amortization	--	--	5,639
Adjusted net income	$117,871	$171,834	$87,911

Earnings per common share:			
Net income applicable to common stock	$ 11.79	$ 17.18	$ 8.23
Plus goodwill amortization	--	--	0.56
Adjusted net income applicable to common stock	$ 11.79	$ 17.18	$ 8.79

The carrying value of the Bank's goodwill was $89.3 million at December 31, 2003 and 2002.

Besides goodwill, the Bank did not have any intangible assets not subject to amortization as of December 31, 2003 and 2002.

As of December 31, 2003, the gross carrying amount and accumulated amortization of the Bank's amortizable intangible assets are included in the following table:

	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARR VALUE
		(IN THOUSANDS)	
Branch network	$145,000	$(72,500)	$72,50
Other	5,724	(1,569)	4,15
Total finite life intangibles	$150,724	$(74,069)	$76,65

Total amortization expense for the Bank's intangible assets was $10.3 million and $10.2 million in 2003 and 2002, respectively.

Estimated intangible asset amortization expense for the years ending December 31, 2004, 2005, 2006, 2007 and 2008 is $10.4 million per year.

7. DEPOSITS

The following table summarizes deposit balances by category:

	DECEMBER 31		INCREASE (DECREASE 2003 VS. 2002	
	2003	2002	AMOUNT	%
		(DOLLARS IN THOUSANDS)		
Demand deposits	$ 4,231,540	$ 3,414,159	$ 817,381	2
Interest-bearing checking deposits	146,441	116,564	29,877	2
Money market accounts	2,094,733	1,855,870	238,863	1
Statement savings accounts	1,799,684	1,607,760	191,924	1
Savings certificates	1,477,743	1,797,894	(320,151)	(1
Other time deposits	2,325,995	1,030,083	1,295,912	12
Deposits in foreign offices	665,905	1,215,954	(550,049)	(4

Total deposits..............................	$12,742,041	$11,038,284	$1,703,757	1
	===========	===========	==========	

Certificates of deposit in denominations exceeding $100,000 issued by domestic offices totaled $2.8 billion at December 31, 2003. Total interest expense on domestic office certificates of deposit of $100,000 or more amounted to approximately $51 million, at both December 31, 2003 and December 31, 2002. Virtually all time deposits in foreign offices were in denominations exceeding $100,000.

The remaining maturity of certificates of deposit as of December 31, 2003 is as follows:

Certificates of Deposit

	(IN MILLIONS)
Maturities:	
2004..	$2,115
2005..	198
2006..	45
2007..	623
2008..	1,011
Thereafter..	429

Total...	$4,421
	======

8. SECURITIES PURCHASED UNDER AGREEMENT TO RESELL AND SECURITIES SOLD UNDER AGREEMENT TO REPURCHASE

At various times the Bank enters into purchases of U.S. Treasury and Federal agency securities under agreements to resell identical securities. The amounts advanced under these agreements represent short-term loans and are reflected as receivables in the Consolidated Statements of Condition. There were no securities purchased under agreement to resell outstanding at December 31, 2003 and December 31, 2002. The

securities underlying the agreements are book-entry securities. Securities are transferred by appropriate entry into the Bank's account with Bank of New York through the Federal Reserve Bank of New York under a written custodial agreement with Bank of New York that explicitly recognizes the Bank's interest in these securities.

The Bank also enters into sales of U.S. Treasury and Federal agency securities under agreements to repurchase identical securities. The amounts received under these agreements represent short-term borrowings and are reflected as liabilities in the Consolidated Statements of Condition. Securities sold under agreement to repurchase totaled $3.45 billion and $4.19 billion at December 31, 2003 and 2002, respectively. Securities sold under agreement to repurchase are transferred via book-entry to the counterparty, if transacted with a financial institution or a broker-dealer, or are delivered to customer safekeeping accounts. The Bank monitors the market value of these securities and adjusts the level of collateral for repurchase agreements, as appropriate. The Bank maintains effective control over the securities sold under agreement to

repurchase and accounts for the transactions as secured borrowings.

Securities Purchased Under Agreement to Resell

	2003	2002
	(DOLLARS IN THOUSANDS)	
Amount outstanding at end of year	$ --	$ --
Highest amount outstanding as of any month-end during the year	$350,375	$405,063
Daily average amount outstanding during the year	$ 65,847	$ 7,598
Daily average annualized rate of interest	0.53%	1.62%
Average rate of interest on amount outstanding at end of year	--	--

Securities Sold Under Agreement to Repurchase

	2003	2002
	(DOLLARS IN THOUSANDS)	
Amount outstanding at end of year	$3,452,567	$4,188,688
Highest amount outstanding as of any month-end during the year	$4,821,309	$4,188,688
Daily average amount outstanding during the year	$4,164,402	$3,125,430
Daily average annualized rate of interest	1.04%	1.52%
Average rate of interest on amount outstanding at end of year	0.91%	1.19%

9. SENIOR NOTES AND LONG-TERM NOTES

The following table summarizes the Bank's long-term notes:

	DECEMBER 31	
	2003	2002
	(IN THOUSANDS)	
Floating rate subordinated note to Bankcorp due March 31, 2005	$ 50,000	$ 50,000
Floating rate subordinated note to Bankcorp due December 1, 2006	50,000	50,000
Fixed rate 6 1/2% subordinated note to Bankcorp due December 27, 2007	60,000	60,000
Fixed rate 7 5/8% subordinated note to Bankcorp due June 27, 2008	15,000	15,000
Fixed rate 7 1/8% subordinated note to Bankcorp due June 30, 2009	50,000	50,000
Total	$225,000	$225,000

All of the Bank notes are unsecured obligations, ranking on a parity with all unsecured and subordinated indebtedness of the Bank and are not subject to redemption prior to maturity at the election of the debtholders. The interest rate on the floating rate notes reprices semiannually and floats at 50 basis points above 180 day London Interbank Offering Rate ("LIBOR"). At year-end 2003, 180 day LIBOR was 1.22 percent.

Scheduled principal payments on long-term notes are as follows: 2004 -- $0.0 million; 2005 -- $50.0 million; 2006 -- $50.0 million; 2007 -- $60.0 million; 2008 -- $15.0 million; thereafter -- $50.0 million.

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The Bank offers to institutional investors from time to time, unsecured short-term and medium-term bank notes in an aggregate principal amount of up to $1.5 billion outstanding at any time. The term of each note could range from 14 days to 15 years. These senior notes are subordinated to deposits and rank pari passu with all other unsecured senior indebtedness of the Bank. As of December 31, 2003, there were no senior short-term notes outstanding. As of December 31, 2002, $200 million of senior short-term notes were outstanding with original maturities of 64 days (remaining maturities of 22 days) and stated interest rates of 1.33 percent.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

Generally accepted accounting principles require the disclosure of estimated fair values for both on and off-balance-sheet financial instruments. The Bank's fair values are based on quoted market prices when available. For financial instruments not actively traded, such as certain loans, deposits, off-balance-sheet transactions and long-term borrowings, fair values have been estimated using various valuation methods and assumptions. Although management used its best judgment in estimating these values, there are inherent limitations in any estimation methodology. In addition, accounting pronouncements require that fair values be estimated on an item-by-item basis, thereby ignoring the impact a large sale would have on a thin market and intangible values imbedded in established lines of business. Therefore, the fair value estimates presented herein are not necessarily indicative of the amounts the Bank could realize in an actual transaction. The fair value estimation methodologies employed by the Bank were as follows:

The carrying amounts for cash and demand balances due from banks along with short-term money market assets and liabilities reported on the Bank's Consolidated Statements of Condition were considered to be the best estimates of fair value for these financial instruments. Fair values of trading account assets and available-for-sale securities were based on quoted market prices.

A variety of methods were used to estimate the fair value of loans. Changes in estimated fair value of loans reflect changes in credit risk and general interest rates which have occurred since the loans were originated. Fair values of floating rate loans, including commercial, broker dealer, financial institution, construction, charge card, consumer and home equity, were assumed to be the same as carrying value since the loans' interest rates automatically reprice to market. Fair values of residential mortgages were based on current prices for securities backed by similar loans. For long-term fixed rate loans, including consumer installment and commercial mortgage loans, fair values were estimated based on the present value of future cash flows with current market rates as discount rates. Additionally, management considered appraisal values of collateral when nonperforming loans were secured by real estate.

The fair values of customers' liability on acceptances and acceptances

outstanding approximate carrying value due to the short-term nature of these assets and liabilities and the generally negligible credit losses associated with them.

The fair values of accrued interest receivable and payable approximate carrying values due to the short-term nature of these assets and liabilities.

The fair values of bank-owned insurance investments approximate carrying value, because upon liquidation of these investments the Bank would receive the cash surrender value which equals carrying value.

The fair values of demand deposits, savings accounts, interest-bearing checking deposits and money market accounts were the amounts payable on demand at the reporting date, or the carrying amounts. The fair value of time deposits was estimated using a discounted cash flow calculation with current market rates offered by the Bank as discount rates.

The fair value of senior notes approximates carrying value because the average maturity on these notes is less than one year.

The fair value of minority interest -- preferred stock of subsidiary (Harris Preferred Capital Corporation) approximates carrying value as the preferred stock has a liquidation preference that equals book value.

The fair value of long-term notes was determined using a discounted cash flow calculation with current rates available to the Bank for similar debt as discount rates.

The fair values of credit facilities approximates their carrying value (i.e. deferred income) of estimated cost that would be incurred to induce third parties to assume these commitments.

The estimated fair values of the Bank's financial instruments at December 31, 2003 and 2002 are presented in the following table. See Note 11 to Financial Statements for additional information regarding fair values of off-balance-sheet financial instruments.

	DECEMBER 31			
	2003		2002	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
	(IN THOUSANDS)			
ASSETS				
Cash and demand balances due from banks	$ 823,615	$ 823,615	$ 1,057,254	$ 1,057,254
Money market assets:				
Interest-bearing deposits at banks	424,459	424,459	417,206	417,206
Federal funds sold and securities purchased under agreement to resell	409,425	409,425	237,950	237,950
Securities available-for-sale	6,624,280	6,624,280	5,781,360	5,781,360
Trading account assets	59,467	59,467	42,423	42,423
Loans, net of unearned income and				

allowance for possible loan losses.....	9,338,654	9,364,083	9,400,888	9,455,610
Customers' liability on acceptances......	44,234	44,234	16,168	16,168
Accrued interest receivable.............	71,811	71,811	76,649	76,649
Loans held for sale.....................	168,904	168,904	149,311	149,311
Bank-owned insurance....................	1,035,239	1,035,239	994,185	994,185
Total on-balance-sheet financial assets...........................	$19,000,088	$19,025,517	$18,173,394	$18,228,116
LIABILITIES				
Deposits:				
Demand deposits........................	$ 8,301,415	$ 8,301,415	$ 6,988,180	$ 6,988,180
Time deposits..........................	4,440,626	4,455,398	4,050,104	4,080,992
Federal funds purchased.................	1,190,839	1,190,839	872,096	872,096
Securities sold under agreement to repurchase............................	3,452,567	3,452,567	4,188,688	4,188,688
Short-term borrowings...................	10,841	10,841	300,694	300,694
Acceptances outstanding.................	44,234	44,234	16,168	16,168
Accrued interest payable................	23,251	23,251	15,920	15,920
Short-term notes -- senior..............	--	--	200,000	200,000
Minority interest -- preferred stock of subsidiary............................	250,000	250,000	250,000	250,000
Preferred stock issued to Harris Bankcorp, Inc..........................	5,000	5,000	5,000	5,000
Long-term notes -- subordinated.........	225,000	243,571	225,000	237,173
Total on-balance-sheet financial liabilities......................	$17,943,773	$17,977,116	$17,111,850	$17,154,911
OFF-BALANCE-SHEET CREDIT FACILITIES (POSITIVE POSITIONS/(OBLIGATIONS))				
Loan commitments........................	$ (11,239)	$ (11,239)	$ (13,957)	$ (13,957)
Standby letters of credit...............	(1,126)	(1,126)	(854)	(854)
Commercial letters of credit............	--	--	(44)	(44)
Total off-balance-sheet credit facilities.......................	$ (12,365)	$ (12,365)	$ (14,855)	$ (14,855)

11. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Bank utilizes various financial instruments with off-balance-sheet risk in the normal course of business to meet its customers' financing and risk management needs. The Bank's major categories of financial

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instruments with off-balance-sheet risk include credit facilities, financial guarantees and various securities-related activities.

Credit Facilities

Credit facilities with off-balance-sheet risk include commitments to extend credit and commercial letters of credit.

Commitments to extend credit are contractual agreements to lend to a customer as long as contract terms have been met. They generally require payment of a fee and have fixed expiration dates. The Bank's commitments serve both business and individual customer needs, and include commercial loan commitments, home equity lines, commercial real estate loan commitments and mortgage loan

commitments. The maximum potential amount of undiscounted future payments the Bank could be required to make is represented by the total contractual amount of commitments, which was $8.3 billion and $8.0 billion at December 31, 2003 and 2002, respectively. Since only a portion of commitments will ultimately be drawn down, the Bank does not expect to provide funds for the total contractual amount. Risks associated with certain commitments are reduced by participations to third parties, which at December 31, 2003, totaled $944 million and at December 31, 2002, totaled $667 million.

Commercial letters of credit are commitments to make payments on behalf of customers when letter of credit terms have been met. Maximum risk of accounting loss is represented by total commercial letters of credit outstanding of $46 million at December 31, 2003 and $41 million at December 31, 2002.

Credit risks associated with all of these facilities are mitigated by reviewing customers' creditworthiness on a case-by-case basis, obtaining collateral, limiting loans to individual borrowers, setting restrictions on long-duration maturities and establishing stringent covenant terms outlining performance expectations which, if not met, may cause the Bank to terminate the contract. Credit risks are further mitigated by monitoring and maintaining portfolios that are well-diversified.

Collateral is required to support certain of these credit facilities when they are drawn down and may include equity and debt securities, commodities, inventories, receivables, certificates of deposit, savings instruments, fixed assets, real estate, life insurance policies and memberships on national or regional stock and commodity exchanges. Requirements are based upon the risk inherent in the credit and are more stringent for firms and individuals with greater default risks. The Bank monitors collateral values and appropriately perfects its security interest. Periodic evaluations of collateral adequacy are performed by Bank personnel.

The fair value of credit facilities (i.e. deferred income) is approximately equal to their carrying value of $12.4 million at December 31, 2003 and $14.9 million at December 31, 2002.

Financial Guarantees

Financial guarantees with off-balance-sheet risk include standby letters of credit, loans sold with recourse and written put options.

Standby letters of credit are unconditional commitments that guarantee the obligation of a customer to a third party should that customer default. They are issued to support financial and performance-related obligations including brokers' margin maintenance, industrial revenue bond repayment, debt repayment, construction contract performance and trade agreement performance. The Bank's maximum risk of accounting loss for these items is represented by the total commitments outstanding of $2.76 billion at December 31, 2003 and $2.66 billion at December 31, 2002. Risks associated with standby letters of credit are reduced by participations to third parties which totaled $948 million at December 31, 2003 and $881 million at December 31, 2002. In most cases, these commitments expire within three years without being drawn upon.

The Bank has sold mortgage loans with limited recourse. The recourse provisions require the Bank to reimburse the buyer, based on pre-determined rates, upon the occurrence of certain credit-related events. The maximum amount payable under the recourse provisions is $7.0 million at December 31, 2003. The carrying amount of the recourse liability is $1.3 million at December 31, 2003.

Written put options are contracts that provide the buyer the right (but not the obligation) to sell a financial instrument at a specified price, either within a specified period of time or on a certain date. The Bank writes put options, providing the buyer the right to require the Bank to buy the specified assets per the contract terms. The maximum amount payable for the written put options is equal to their notional amount of $864.7 million at December 31, 2003. The fair value of the related derivative liability is $4.3 million at December 31, 2003.

Securities Activities

The Bank's securities activities that have off-balance-sheet risk include municipal bond underwriting and short selling of securities.

Through its municipal bond underwriting activities, the Bank commits to buy and offer for resale newly issued bonds. The Bank is exposed to market risk because it may be unable to resell its inventory of bonds profitably as a result of unfavorable market conditions. In syndicate arrangements, the Bank is obligated to fulfill syndicate members' commitments should they default. The syndicates of which the Bank was a member had underwriting commitments totaling $47 million at December 31, 2003 and $37 million at December 31, 2002.

Security short selling, defined as selling of securities not yet owned, exposes the Bank to off-balance-sheet market risk because the Bank may be required to buy securities at higher prevailing market prices to cover its short positions. The Bank had no short position at December 31, 2003 or 2002.

12. DERIVATIVE FINANCIAL INSTRUMENTS

The Bank utilizes various derivative financial instruments in the normal course of business to a) meet its customers' financing and risk management needs, b) reduce its own risk exposure, and c) produce fee income and trading profits. Fair values of derivative financial instruments are based on market prices of comparable instruments, pricing models using year-end rates and counterparty credit ratings.

All derivative instruments are recognized at fair value in the Consolidated Statements of Condition. All derivative instruments are designated either as hedges or held for trading or non-hedging purposes.

The Bank uses various interest rate, foreign exchange, equity, and commodity derivative contracts as part of its dealer and trading activities or in the management of its risk strategy. Interest rate contracts may include futures, forwards, forward rate agreements, option contracts, caps, floors, collars and swaps. Foreign exchange contracts may include spot, futures, forwards, option contracts and swaps. Equity contracts and commodity contracts may include options and swaps. The Bank enters into derivative contracts with BMO to facilitate a more efficient use of combined resources and to better serve customers. See Note 24 for additional information on related party transactions.

At December 31, 2003, the Bank recorded, for dealer and trading activities and for risk management activities that do not otherwise qualify for hedge accounting, the fair value of derivative instrument assets of $112.3 million in other assets and derivative instrument liabilities of $92.7 million in other liabilities. At December 31, 2002, the Bank recorded the fair value of derivative instrument assets of $147.2 million in other assets and derivative instrument liabilities of $151.9 million in other liabilities. These amounts reflect the netting of certain derivative instrument assets and liabilities when the conditions in FASB Interpretation ("FIN") No. 39, "Offsetting of Amounts Related to Certain Contracts," have been met.

Dealer and Trading Activity

Interest Rate Contracts

As dealer, the Bank serves customers seeking to manage interest rate risk by entering into contracts as counterparty to their (customer) transactions. In its trading activities, the Bank uses interest rate contracts to profit from expected future market movements.

These contracts may create exposure to both credit and market risk. Replacement risk, the primary component of credit risk, is the risk of loss should a counterparty default following unfavorable market movements and is measured as the Bank's cost of replacing contracts at current market rates. The Bank manages credit risk by establishing credit limits for customers and products through an independent corporate-wide credit review process and by continually monitoring exposure against those limits to ensure they are not exceeded. Credit risk is, in many cases, further mitigated by the existence of netting agreements that provide for netting of contractual receivables and payables in the event of default or bankruptcy. Netting agreements apply to situations where the Bank is engaged in more than one outstanding derivative transaction with the same counterparty and also has a legally enforceable master netting agreement with that counterparty.

Market risk is the potential for loss arising from potential adverse changes in underlying market factors, including interest and foreign exchange rates. The Bank manages market risk through the imposition of integrated value-at-risk limits and an active, independent monitoring process.

Value-at-risk methodology is used for measuring the market risk of the Bank's trading positions. This statistical methodology uses recent market volatility to estimate the maximum daily trading loss that the Bank would expect to incur, on average, 99 percent of the time. The model also measures the effect of correlation among the various trading instruments to determine how much risk is eliminated by offsetting positions.

Futures and forward contracts are agreements in which the Bank is obligated to make or take delivery, at a specified future date, of a specified instrument, at a specified price or yield. Futures contracts are exchange traded and, because of exchange requirements that gains and losses be settled daily, create negligible exposure to credit risk.

Forward rate agreements are arrangements between two parties to exchange amounts, at a specified future date, based on the difference between an agreed upon interest rate and reference rate applied to a notional principal amount. These agreements enable purchasers and sellers to fix interest costs and returns.

Options are contracts that provide the buyer the right (but not the obligation) to purchase or sell a financial instrument, at a specified price, either within a specified period of time or on a certain date. Interest rate guarantees (caps, floors and collars) are agreements between two parties that, in general, establish for the purchaser a maximum level of interest expense or a minimum level of interest revenue based on a notional principal amount for a specified term. Options and interest rate guarantees written create exposure to market risk. As a writer of interest rate options and guarantees, the Bank receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option or interest rate guarantee. Options and interest rate guarantees purchased create exposure to credit risk and, to the extent of the premium paid or unrealized gain recognized, market risk.

Interest rate swaps are contracts involving the exchange of interest payments based on a notional amount for a specified period. Most of the Bank's activity in swaps is as intermediary in the exchange of interest payments between customers, although the Bank also uses swaps to manage its own interest rate exposure (see discussion of risk management activity).

Foreign Exchange Contracts

The Bank is a dealer in foreign exchange ("FX") contracts. FX contracts may create exposure to market and credit risk, including replacement risk and settlement risk. Credit risk is managed by establishing limits for customers through an independent corporate-wide credit approval process and continually monitoring exposure against those limits. In addition, both settlement and replacement risk are reduced through netting

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by novation, agreements with counterparties to offset certain related obligations. Market risk is managed through establishing exposure limits by currency and monitoring actual exposure against those limits, entering into offsetting positions, and closely monitoring price behavior.

The Bank and BMO combine their U.S. FX revenues. Under this arrangement, FX net profit is shared by the Bank and BMO in accordance with a specific formula set forth in the agreement. This agreement expires on April 2, 2004, but may be extended at that time. Either party may terminate the arrangement at its option. FX revenues are reported net of expenses. Net gains (losses) from dealer/trading foreign exchange contracts, for the years ended December 31, 2003 and December 31, 2002, totaled $5.1 million and $7.2 million, respectively, of net profit under the aforementioned agreement with BMO.

At December 31, 2003, approximately 95 percent of the Bank's gross notional positions in foreign currency contracts are represented by seven currencies: Eurodollar, Canadian dollars, British pounds, Australian dollar, Swedish krona, Japanese yen and the Mexican peso.

Foreign exchange contracts include spot, futures, forwards, options and swaps that enable customers to manage their foreign exchange risk. Spot, future and forward contracts are agreements to exchange currencies at a future date, at a specified rate of exchange. Foreign exchange option contracts give the buyer the right and the seller an obligation (if the buyer asserts his right) to exchange currencies during a specified period (or on a certain date in the case of "European" options) at a specified exchange rate. Cross currency swap contracts are agreements to exchange principal denominated in two different currencies at the spot rate and to repay the principal at a specified future date and exchange rate.

Equity Contracts

The Bank enters into equity contracts that enable customers to manage the risk associated with equity price fluctuations. Equity contracts include options and swaps.

Commodity Contracts

The Bank enters into commodity contracts that enable customers to manage the risk associated with commodity price fluctuations. Commodity contracts include options and swaps.

Risk Management Activity

In addition to its dealer and trading activities, the Bank uses interest rate contracts, primarily swaps, and foreign exchange contracts to reduce the level of financial risk inherent in mismatches between the interest rate sensitivities and foreign currency exchange rate fluctuations of certain assets and liabilities. For non-trading risks, market risk is controlled by actively managing the asset and liability mix, either directly through the balance sheet or with off-balance sheet derivative instruments. Measures also focus on interest rate exposure gaps and sensitivity to rate changes.

The Bank has an interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that may be caused by interest rate volatility. The Bank manages interest rate sensitivity by modifying the repricing or maturity characteristics of certain fixed rate assets so that net interest margin is not adversely affected, on a material basis, by movements in interest rates. As a result of interest rate fluctuations, fixed rate assets will appreciate or depreciate in market value. The effect of the unrealized appreciation or depreciation will generally be offset by the gains or losses on the derivative instruments.

The Bank has a foreign currency risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that may be caused by foreign currency exchange rate fluctuations. Certain assets and liabilities are denominated in foreign currency, creating exposure to changes in exchange rates. The Bank uses cross currency interest rate swaps and foreign exchange forward contracts to hedge the risk.

Risk management activities include the following derivative transactions that qualify for hedge accounting.

Fair Value Hedges

The Bank uses interest rate swaps to alter the character of 1) revenue earned on certain long-term, fixed rate loans and available-for-sale securities and 2) interest paid on certain long-term, fixed rate deposits. Interest rate swaps convert the loans, securities and deposits from fixed rate to variable rate. Interest rate swap contracts generally involve the exchange of fixed and variable rate interest payments between two parties, based on a common notional amount and maturity date.

For fair value hedges, as of December 31, 2003 the Bank recorded the fair value of derivative instrument assets and liabilities of $10.7 million and $23.9 million, respectively, in other assets and other liabilities. For fair value hedges, as of December 31, 2002 the Bank recorded the fair value of derivative instrument liabilities of $14.9 million in other liabilities. Net losses recorded for the year-to-date periods ended December 31, 2003 and December 31, 2002 representing the ineffective portion of the fair value hedges were not material to the consolidated financial statements of the Bank. Gains or losses resulting from hedge ineffectiveness are recorded in noninterest income.

Cash Flow Hedges

The Bank uses interest rate swaps to reduce the variability associated with future interest payments on floating-rate, prime-based loans. Interest rate swaps convert the expected cash flows on the loans from variable to fixed. Changes in the fair value of the swaps are recorded in other comprehensive income.

For cash flow hedges, as of December 31, 2003 the fair value of the derivative instrument asset was recorded in other assets and was not material to

the consolidated financial statements of the Bank. No hedge ineffectiveness was recorded to earnings for the year ended December 31, 2003. The unrealized gain (loss) in accumulated other comprehensive income related to the interest rate swap is reclassified to earnings in the same period that the interest on the floating-rate loans affects earnings. The amount expected to be reclassified to earnings over the next twelve months is not expected to be material to the consolidated financial statements of the Bank. There were no cash flow hedges in 2002.

Risk management activities also include the following derivative transactions that do not otherwise qualify for hedge accounting.

Foreign exchange contracts are used to stabilize any currency exchange rate fluctuation for certain senior notes and certain loans. The derivative instruments, primarily cross currency interest rate swaps and to a lesser extent forward contracts, do not qualify for hedge accounting and are accounted for at fair value.

The Bank has qualifying mortgage loan commitments that are intended to be sold in the secondary market. These loan commitments are derivatives and are accounted for at fair value. The Bank enters into forward sales of mortgage-backed securities to minimize its exposure to interest rate volatility. These forward sales of mortgage-backed securities are also derivatives and are accounted for at fair value.

13. CONCENTRATIONS OF CREDIT RISK IN FINANCIAL INSTRUMENTS

The Bank had one major concentration of credit risk arising from financial instruments at December 31, 2003 and 2002. This concentration was the Midwest geographic area. This concentration exceeded 10 percent of the Bank's total credit exposure, which is the total potential accounting loss should all customers fail to perform according to contract terms and all collateral prove to be worthless.

Midwestern Geographic Area

A majority of the Bank's customers are located in the Midwestern region of the United States, defined here to include Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri, Ohio and Wisconsin. The Bank provides credit to these customers through a broad array of banking and trade financing products including

commercial loans, commercial loan commitments, commercial real estate loans, consumer installment loans, mortgage loans, home equity loans and lines, standby and commercial letters of credit and banker's acceptances. The financial viability of customers in the Midwest is, in part, dependent on the region's economy. Corporate customers headquartered in the region and serving a national or international market are not included in this concentration because their business is broad-based and not dependent on the region's economy. The Bank's maximum risk of accounting loss, should all customers making up the Midwestern concentration fail to perform according to contract terms and all collateral prove to be worthless, was approximately $14.0 billion or 50 percent of the Bank's total credit exposure at December 31, 2003 and $13.4 billion or 50 percent of the Bank's total credit exposure at December 31, 2002.

The Bank manages this exposure by continually reviewing local market conditions and customers, adjusting individual and industry exposure limits within the region and by obtaining or closely monitoring collateral values. See Note 11 to Financial Statements for information on collateral supporting credit

facilities.

14. EMPLOYEE BENEFIT PLANS

The Bank has noncontributory defined benefit pension plans covering virtually all its employees as of December 31, 2003. Most of the employees participating in retirement plans were included in one primary plan ("primary plan") during the three-year period ended December 31, 2003. The plan is a multiple-employer plan covering the Bank's employees as well as persons employed by certain affiliated entities.

Certain employees participating in the primary plan are also covered by a supplemental unfunded retirement plan. The purpose of this plan is to extend full retirement benefits to individuals without regard to statutory limitations for qualified funded plans.

Effective January 1, 2002, the plan's benefit formula for new employees was changed to an account-based formula from a final average pay formula. The account-based benefit formula is based upon eligible pay, age and length of service. Prior to January 1, 2002, the plan's benefit formula was a final average pay formula, based upon length of service and an employee's highest qualifying compensation during five consecutive years of active employment less an estimated Social Security benefit. For employees who were employed as of December 31, 2001 and leave the Corporation on or after January 1, 2002, benefits are calculated two ways: under the account-based formula for service beginning January 1, 2002 and under the final average pay formula for all service. This group of employees will receive the greater benefit.

The policy for this plan is to have the participating entities, at a minimum, fund annually an amount necessary to satisfy the requirements under ERISA, without regard to prior years' contributions in excess of the minimum. The Bank generally contributes the maximum allowable under the U.S. Internal Revenue Code. For 2003, 2002 and 2001, cumulative contributions were less than the amounts recorded as primary plan pension expense for financial reporting purposes. For 2004, the estimated pension contribution is $13.9 million. The total consolidated pension expense of the Bank, including the supplemental unfunded retirement plan (excluding settlement losses and curtailment gains), for 2003, 2002, and 2001 was $22.2 million, $11.7 million and $7.1 million, respectively. The qualified pension accumulated benefit obligation for 2003, 2002, and 2001 was $263.6 million, $233.3 million and $200.3 million, respectively.

In addition to pension benefits, the Bank provides medical care benefits for retirees (and their dependents) who have attained age 55 and have at least 10 years of service. The Bank also provides medical care benefits for disabled employees and widows of former employees (and their dependents). The Bank provides these medical care benefits through a self-insured plan. Under the terms of the plan, the Bank contributes to the cost of coverage based on employees' length of service. Cost sharing with plan participants is accomplished through deductibles, coinsurance and out-of-pocket limits. Funding for the plan largely comes from the general assets of the Bank supplemented by contributions to a trust fund created under Internal Revenue Code Section 401(h).

FASB Staff Position No. 106-1, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, permitted employers either to recognize the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act) immediately as of the

December 8, 2003, enactment date or to defer recognition until FASB issues further guidance. Specific authoritative guidance on the accounting is pending and guidance, when issued, could require the sponsor to change previously reported information. The deferral was elected by the Bank for 2003 and accordingly, measures of the accumulated postretirement benefit obligation or net periodic postretirement benefit cost in the financial statements or accompanying notes do not reflect the effects of the Act.

Settlement losses amounting to $2.6 million for the supplemental unfunded retirement plan were recognized in 2003.

The following tables set forth the change in benefit obligation and plan assets for the pension and postretirement medical care benefit plans for the Bank:

	PENSION BENEFITS			POSTRETIREMENT MEDICAL BE		
	2003**	2002**	2001**	2003**	2002**	2
			(IN THOUSANDS)			
CHANGE IN BENEFIT OBLIGATION*						
Benefit obligation at beginning of year...........................	$ 311,566	$ 248,377	$224,002	$ 44,361	$ 38,389	$
Service cost......................	13,867	10,871	8,812	1,569	1,259	
Interest cost.....................	19,239	18,451	16,419	2,917	2,799	
Plan Amendments...................	--	1,585	4,033	--	--	
Acquisitions/transfers............	--	--	94	--	--	
Curtailment (gain) or loss........	--	--	--	--	--	
Benefits paid (net of participant contributions)..................	(42,600)	(19,065)	(13,035)	(2,227)	(2,863)	
Actuarial (gain) or loss..........	38,863	51,347	8,052	7,549	4,777	
Benefit obligation at end of year...........................	$ 340,935	$ 311,566	$248,377	$ 54,169	$ 44,361	$
CHANGE IN PLAN ASSETS						
Fair value of plan assets at beginning of year..............	$ 210,844	$ 236,956	$246,912	$ 24,406	$ 25,962	$
Actual return on plan assets......	38,180	(14,316)	(1,361)	7,001	(3,579)	
Acquisitions/transfers............	--	--	1,192	--	--	
Employer contribution.............	8,861	7,269	3,248	--	2,023	
Benefits paid.....................	(42,600)	(19,065)	(13,035)	--	--	
Fair value of plan assets at end of year***.....................	$ 215,285	$ 210,844	$236,956	$ 31,407	$ 24,406	$
Funded Status.....................	$(125,650)	$(100,722)	$(11,421)	$(22,762)	$(19,955)	$(
Contributions made between measurement date (September 30) and end of year................	--	--	--	--	--	
Unrecognized actuarial (gain) or loss...........................	131,102	117,006	29,580	7,506	5,079	
Unrecognized transition (asset) or obligation......................	--	--	(85)	15,641	17,392	
Unrecognized prior service cost...	2,836	2,556	691	1,015	1,184	
Net amount at year-end............	$ 8,288	$ 18,840	$ 18,765	$ 1,400	$ 3,700	$

AMOUNTS RECOGNIZED IN THE

STATEMENT OF CONDITION CONSIST OF:						
Prepaid benefit cost..............	$ --	$ --	$ 18,765	$ 1,400	$ 3,700	$
Accrued benefit liability.........	(44,313)	(25,528)	--	--	--	
Intangible asset..................	2,836	2,556	--	--	--	
Accumulated other comprehensive income (gross of tax)...........	49,765	41,812	--	--	--	
Net amount recognized at year-end........................	$ 8,288	$ 18,840	$ 18,765	$ 1,400	$ 3,700	$
Other comprehensive income attributable to change in additional minimum liability (gross of tax)..................	$ 7,953	$ 41,812	$ --	$ --	$ --	$

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	PENSION BENEFITS			POSTRETIREMENT MEDICAL BE		
	2003**	2002**	2001**	2003**	2002**	2
			(IN THOUSANDS)			
COMPONENTS OF NET PERIODIC BENEFIT COST						
Service cost......................	$ 13,867	$ 10,871	$ 8,812	$ 1,569	$ 1,259	$
Interest cost.....................	19,239	18,451	16,419	2,917	2,799	
Expected return on plan assets....	(17,591)	(21,778)	(20,066)	(1,953)	(2,077)	
Amortization of prior service cost...........................	(279)	(280)	(745)	169	169	
Amortization of transition (asset) or obligation..................	--	(85)	(313)	1,751	1,751	
Amortization of actuarial (gain) or loss........................	4,638	--	(75)	--	(233)	
Net periodic benefit cost.........	$ 19,874	$ 7,179	$ 4,032	$ 4,453	$ 3,668	$

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* Benefit obligation is projected for Pension Benefits and accumulated for Postretirement Medical Benefits.

** Plan assets and obligation measured as of September 30.

*** The actual allocation of plan assets by category are as follows:

	2003	2002	2001
Pension:			
Equity securities...	73%	67%	69%
Fixed income securities...................................	27%	33%	31%
Postretirement Medical:			

Equity securities	73%	66%	69%
Fixed income securities	27%	34%	31%

Investment objectives include the achievement of a total account return (net of fees) which meets or exceeds over a long time horizon the expected return on plan assets, the inflation rate as measured by the Consumer Price Index, and the median performance in a comparable manager universe. The return on asset assumption is based upon management's review of the current rate environment, historical trend analysis and the mix of asset categories represented in the Plan's portfolio. The performance benchmark includes the asset classes of equities and fixed income securities. Plan asset and liability studies are presented to the Investment Committee periodically. The current portfolio target allocation is as follows:

U.S. large capitalization equities	35%
U.S. small capitalization equities	10%
International equities	15%
Emerging market equities	5%
Market bonds	25%
High yield bonds	10%
	100%

	PENSION BENEFITS			POSTRETIREMENT MEDICAL BENEFITS		
	2003	2002	2001	2003	2002	2001
WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31						
Discount rate*	6.00%	6.75%	7.50%	6.00%	6.75%	7.50%
Expected return on plan assets	8.00%	9.00%	9.00%	8.00%	8.00%	8.00%
Rate of compensation increase	4.50%	5.50%	5.50%	N/A	N/A	N/A

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* Discount rates are used to determine service costs for the subsequent year.

For measurement purposes, a 10 percent annual rate of increase for pre 65 and a 12 percent annual rate of increase for post 65 in the per capita cost of covered health care benefits was assumed for 2003. The rate will

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be graded down to 5.0 percent for pre 65 and 5.5 percent for post 65 in 2013 and 2012, respectively, and remain level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1-PERCENTAGE	1-PERCENTAGE

	POINT INCREASE	POINT DECREASE
	(IN THOUSANDS)	
Effect on total of service and interest cost components.....	$ 892	$ (694)
Effect on postretirement benefit obligation.................	$8,389	$(6,753)

The following table sets forth the status of the supplemental unfunded retirement plan:

	SUPPLEMENTAL UNFUNDED RETIREMENT BENEFITS		
	2003	2002	2001
	(IN THOUSANDS)		
CHANGE IN BENEFIT OBLIGATION			
Benefit obligation at beginning of year....................	$ 25,544	$ 23,750	$ 19,258
Service cost...	1,132	2,273	1,320
Interest cost..	1,075	1,398	1,049
Settlement (gain) or loss..................................	1,546	--	--
Plan amendments/merger.....................................	--	--	(3,990)
Benefits paid (net of participant contributions)...........	(180)	(239)	(385)
Settlement payments..	(10,872)	--	--
Actuarial (gain) or loss...................................	(4,294)	(1,638)	6,498
Benefit obligation at end of year..........................	$ 13,951	$ 25,544	$ 23,750
CHANGE IN PLAN ASSETS			
Fair value of plan assets at beginning of year.............	$ --	$ --	$ --
Actual return on plan assets...............................	--	--	--
Employer contribution......................................	11,052	239	385
Benefits paid..	(11,052)	(239)	(385)
Fair value of plan assets at end of year...................	$ --	$ --	$ --
Funded Status..	$(13,951)	$(25,544)	$(23,750)
Contributions made between measurement date (September 30) and end of year...	916	--	45
Unrecognized actuarial (gain) or loss......................	3,325	8,020	10,274
Unrecognized transition (asset) or obligation..............	--	12	25
Unrecognized prior service cost............................	(2,978)	(2,880)	(2,711)
Prepaid (accrued) benefit cost.............................	$(12,688)	$(20,392)	$(16,117)
COMPONENTS OF NET PERIODIC BENEFIT COST			
Service cost...	$ 1,132	$ 2,273	$ 1,320
Interest cost..	1,075	1,398	1,049
Expected return on plan assets.............................	--	--	--
Amortization of prior service cost.........................	97	170	415
Amortization of transition (asset) or obligation...........	13	10	99
Recognized actuarial (gain) or loss........................	53	664	208
Net periodic benefit cost..................................	$ 2,370	$ 4,515	$ 3,091
Additional (gain) or loss recognized due to:			
Settlement...	$ 2,597	$ --	$ --
WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31:			

Discount rate..	5.25%	5.50%	6.00%
Rate of compensation increase............................	4.50%	5.70%	5.70%

The Bank has a defined contribution plan that is available to virtually all employees. Effective January 1, 2002, the Bank amended the plan to enhance the 401(k) matching contribution and discontinue the profit sharing contribution. The matching contribution is based on the amount of eligible employee contributions. The profit sharing contribution was based on the annual financial performance of the Bank relative to predefined targets. The Bank's total expense for this plan was $9.4 million, $9.3 million and $7.8 million in 2003, 2002 and 2001, respectively.

15. STOCK OPTIONS

The Bank has two primary stock-based compensation plans, an options program and a performance incentive plan. The option plans are accounted for under the fair value based method of accounting and are described below.

Harris Bankcorp Stock Option Program

The Harris Bankcorp Stock Option Program was established under the Bank of Montreal Stock Option Plan for certain designated executives and other employees of the Bank and affiliated companies in order to provide incentive to attain long-term strategic goals and to attract and retain services of key employees.

The Bank has two types of option plans. The Fixed Stock Option Plan consists of standard stock options with a ten-year term which are exercisable only during the second five years of their term, assuming cumulative performance goals are met. The Performance Based Option Plan consists of standard and performance conditioned stock options with a ten-year term and a four-year vesting period, which are exercisable twenty-five percent per annum. The standard options may be exercised at any time once vested. The performance-conditioned options may be exercised provided the BMO shares trade at fifty percent over the price of the stock at date of grant for twenty consecutive days, after the vesting date. The stock options are exercisable for BMO common stock equal to the market price on the date of grant. The compensation expense related to this program totaled $5.8 million, $5.6 million and $4.5 million in 2003, 2002 and 2001, respectively.

The following table summarizes the stock option activity for 2003, 2002 and 2001 and provides details of stock options outstanding at December 31, 2003:

	2003		2002		
OPTIONS	SHARES	WTD. AVG. EXERCISE PRICE	SHARES	WTD. AVG. EXERCISE PRICE	SHARES
Outstanding at beginning of year...............	3,994,491	$33.32	3,609,059	$34.30	2,702,246
Granted..................	--	--	425,300	26.18	1,160,300
Exercised................	(470,448)	34.25	(76,115)	30.44	(133,307)
Forfeited, cancelled.....	--	--	--	--	(90,700)
Transferred..............	(101,859)	26.18	36,247	13.15	(29,480)
Expired..................	--	--	--	--	--

Outstanding at end of year..................	3,422,184	33.40	3,994,491	33.32	3,609,059
	=========		==========		==========
Options exercisable at year-end..............	2,432,304	$35.70	1,552,213	$35.51	810,731
Weighted-average fair value of options granted during the year..................		N/A		$ 5.27	

N/A -- There were no stock options granted during fiscal 2003.

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RANGE OF EXERCISE PRICES	OPTIONS OUTSTANDING: NUMBER OUTSTANDING DECEMBER 31, 2003	WTD. AVG. REMAINING CONTRACTUAL LIFE	WTD. AVG. EXERCISE PRICE	OPTIONS EXERC: NUMBER EXERCISABLE DECEMBER 31, 2003
$22-30	1,629,894	7.77 years	$23.66	790,553
34-42	1,072,397	5.37	37.27	1,072,397
46-54	719,893	6.46	49.70	569,354
	---------			---------
22-54	3,422,184	6.74	33.40	2,432,304
	=========			=========

The fair value of the stock options granted has been estimated using the Rolle-Geske Model with the following assumptions:

	2003	2002	2001
Risk-free interest rate....................................	N/A	4.80%	5.50%
Expected life, in years....................................	N/A	7.0	7.0
Expected volatility..	N/A	23.44%	23.29%
Compound annual dividend growth............................	N/A	8.39%	9.21%
Estimated fair value per option (US $)......................	N/A	$ 5.27	$ 3.55

N/A -- There were no stock options granted during fiscal 2003.

Mid-Term Incentive Plan

The Bank maintains the Mid-Term Incentive Plan which was established in January 2000. The plan is intended to enhance the Bank's ability to attract and retain high quality employees and to provide a strong incentive to employees to achieve BMO's governing objective of maximizing value for its shareholders.

During 2003 the Bank was party to an agreement made between BMO and a third

party to assume the obligation related to the 2003 Mid-Term Inventive Plan. The Bank's share of the payment was $14.5 million. A similar agreement was entered into in 2002 related to the 2002 Mid-Term Incentive Plan for a payment of $8.0 million. These amounts will be recorded as compensation expense over the three year performance cycle of the plan on a straight-line basis. Any future payments required under these plans will be the responsibility of the third party.

Payouts under the plan to participants depend on the achievement of specific performance criteria that are set at the grant date. The right to receive distributions under the plan vest and are paid out after three years based on various factors including the BMO share price. Compensation expense for this plan totaled $20.5 million, $10.6 million and $6.8 million in 2003, 2002 and 2001, respectively.

16. LEASE EXPENSE AND OBLIGATIONS

Rental expense for all operating leases was $16.6 million in 2003, $15.9 million in 2002 and $13.6 million in 2001. These amounts include real estate taxes, maintenance and other rental-related operating costs of $6.2 million, $6.6 million and $2.9 million for 2003, 2002 and 2001, respectively, paid under net lease arrangements. Lease commitments are primarily for office space.

Minimum rental commitments as of December 31, 2003 for all noncancelable operating leases are as follows:

	(IN THOUSANDS)
2004	$10,000
2005	9,251
2006	8,965
2007	7,725
2008	6,086
2009 and thereafter	16,885
Total minimum future rentals	$58,912

Occupancy expenses for 2003, 2002 and 2001 have been reduced by $17 million, $17 million and $15 million, respectively, for rental income from leased premises.

17. INCOME TAXES

The 2003, 2002 and 2001 applicable income tax expense (benefit) were as follows:

		FEDERAL	STATE	TOTAL
		(IN THOUSANDS)		
2003:	Current	$ 31,116	$(1,302)	$ 29,814
	Deferred	8,374	1,113	9,487
	Total	$ 39,490	$ (189)	$ 39,301

2002: Current	$ 58,791	$ 2,480	$ 61,271
Deferred	5,247	788	6,035
Total	$ 64,038	$ 3,268	$ 67,306
2001: Current	$ 38,271	$(3,254)	$ 35,017
Deferred	(23,860)	(923)	(24,783)
Total	$ 14,411	$(4,177)	$ 10,234

Deferred tax assets (liabilities) are comprised of the following at December 31, 2003, 2002 and 2001:

	DECEMBER 31		
	2003	2002	2001
	(IN THOUSANDS)		
Deferred tax assets:			
Allowance for possible loan losses	$ 91,977	$ 83,194	$ 95,253
Deferred expense and prepaid income	13,155	13,554	13,037
Deferred employee compensation	19,110	16,605	7,865
Other assets	882	16,697	11,641
Gross deferred tax assets	125,124	130,050	127,796
Deferred tax liabilities:			
Depreciable assets	(40,650)	(43,608)	(31,197)
Other liabilities	(18,684)	(11,165)	(15,386)
Gross deferred tax liabilities	(59,334)	(54,773)	(46,583)
Deferred tax assets	65,790	75,277	81,213
The tax effect of fair value adjustments on available-for-sale securities, minimum pension liabilities and hedging transactions recorded directly to stockholder's equity	(76)	(31,507)	(13,258)
Net deferred tax assets	$ 65,714	$ 43,770	$ 67,955

At December 31, 2003 and 2002, the respective deferred tax assets of $65.8 million and $75.3 million included $59.3 million and $67.7 million for Federal taxes and $6.5 million and $7.6 million for state taxes, respectively. Management believes that the realization of the recognized net deferred tax asset is more likely than not based on existing carryback ability and expectations as to future taxable income.

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Total income tax expense of $39.3 million for 2003, $67.3 million for 2002 and $10.2 million for 2001 reflects effective tax rates of 25.0 percent, 28.2 percent, and 11.1 percent, respectively. The reconciliation between actual tax expense and the amount determined by applying the federal statutory rate of 35

percent to income before income taxes were as follows:

	YEARS ENDED DECEMBER 31					
	2003		2002		2001	
	AMOUNT	PERCENT OF PRETAX INCOME	AMOUNT	PERCENT OF PRETAX INCOME	AMOUNT	PERCE PRE INC
	(DOLLARS IN THOUSANDS)					
Computed tax expense..........	$ 55,010	35.0%	$ 83,699	35.0%	$ 32,377	35
Increase (reduction) in income tax expense due to:						
Tax-exempt income from loans and investments net of municipal interest expense disallowance.............	(563)	(0.4)	(567)	(0.2)	(891)	(1
Bank-owned insurance.........	(15,253)	(9.7)	(17,709)	(7.4)	(16,507)	(17
Equity ownership in securitization trust......	--	--	--	--	(278)	(0
State income taxes...........	(123)	(0.1)	2,124	0.9	(2,715)	(2
Other, net...................	230	0.2	(241)	(0.1)	(1,752)	(1
Actual tax expense............	$ 39,301	25.0%	$ 67,306	28.2%	$ 10,234	11

The tax expense from net gains on security sales amounted to $10.1 million, $23.8 million, and $13.8 million in 2003, 2002 and 2001, respectively.

18. REGULATORY CAPITAL

The Bank, as a state-member bank, must adhere to the capital adequacy guidelines of the Federal Reserve Board ("the Board"), which are not significantly different than those published by other U.S. banking regulators. The guidelines specify minimum ratios for Tier 1 capital to risk-weighted assets of 4 percent and total regulatory capital to risk-weighted assets of 8 percent.

Risk-based capital guidelines define total capital to consist primarily of Tier 1 (core) and Tier 2 (supplementary) capital. In general, Tier 1 capital is comprised of stockholder's equity, including certain types of preferred stock, less goodwill and certain other intangibles. Core capital must comprise at least 50 percent of total capital. Tier 2 capital basically includes subordinated debt (less a discount factor during the five years prior to maturity), other types of preferred stock and the allowance for possible loan losses. The portion of the allowance for possible loan losses includable in Tier 2 capital is limited to 1.25 percent of risk-weighted assets.

The Board also requires an additional measure of capital adequacy, the Tier 1 leverage ratio, which is evaluated in conjunction with risk-based capital ratios. The Tier 1 leverage ratio is computed by dividing period-end Tier 1 capital by adjusted quarterly average assets. The Board established a minimum ratio of 3 percent applicable only to the strongest banking organizations having, among other things, excellent asset quality, high liquidity, good earnings and no undue interest rate risk exposure. Other institutions are expected to maintain a minimum ratio of 4 percent.

The Federal Deposit Insurance Corporation Improvement Act of 1991 contains

prompt corrective action provisions that established five capital categories for all Federal Deposit Insurance Corporation ("FDIC")-insured institutions ranging from "well capitalized" to "critically undercapitalized." Classification within a category is based primarily on the three capital adequacy measures. An institution is considered "well capitalized" if its capital level significantly exceeds the required minimum levels, "adequately capitalized" if it meets the minimum levels, "undercapitalized" if it fails to meet the minimum levels, "significantly undercapitalized" if it is significantly below the minimum levels and "critically undercapitalized" if it has a ratio of tangible equity to total assets of 2 percent or less.

Noncompliance with minimum capital requirements may result in regulatory corrective actions that could have a material effect on the Bank's financial statements. Depending on the level of noncompliance, regulatory corrective actions may include the following: requiring a plan for restoring the institution to an acceptable capital category, restricting or prohibiting certain activities and appointing a receiver or conservator for the institution.

As of December 31, 2003, the most recent notification from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. Management is not aware of any conditions or events since December 31, 2003 that have changed the capital category of the Bank.

At December 31, 2003 the Bank had $255 million of minority interest in preferred stock of subsidiaries including $250 million noncumulative, exchangeable Series A preferred stock with dividends payable at the rate of 7 3/8% per annum. The Bank also had a total of $5 million of preferred stock with cumulative dividends payable at the rate of LIBOR plus 100 basis points adjusted as of the first business day of the calendar quarter that the record date falls. During both 2003 and 2002, $19 million of dividends were paid on the preferred stock. All issues of preferred stock qualify as Tier 1 capital for the Bank under U.S. banking regulatory guidelines.

The following table summarizes the Bank's risk-based capital ratios and Tier 1 leverage ratio for the past two years as well as the minimum amounts and ratios as per capital adequacy guidelines and FDIC prompt corrective action provisions.

	ACTUAL		FOR CAPITAL ADEQUACY PURPOSES		TO BE WELL CAPITALI UNDER PROMPT CORRECT ACTION PROVISIONS	
	CAPITAL AMOUNT	CAPITAL RATIO	CAPITAL AMOUNT	CAPITAL RATIO	CAPITAL AMOUNT	CAPI RAT
			(IN THOUSANDS)			
As of December 31, 2003:						
Total Capital to Risk-Weighted Assets.......	$1,980,042	12.25%	$ $1,293,089	$ 8.00%	$ $1,616,361	$ 10
Tier 1 Capital to Risk-Weighted Assets.......	$1,649,198	10.20%	$ $ 646,744	$ 4.00%	$ $ 970,116	$ 6
Tier 1 Capital to Average Assets................	$1,649,198	8.52%	$ $ 774,271	$ 4.00%	$ $ 967,839	$ 5
As of December 31, 2002:						
Total Capital to Risk-Weighted Assets.......	$1,928,809	12.50%	$ $1,234,438	$ 8.00%	$ $1,543,047	$ 10

Tier 1 Capital to Risk-Weighted Assets.......	$1,572,465	10.19%	$	$ 617,258	$ 4.00%	$	$ 925,887	$ 6
Tier 1 Capital to Average Assets................	$1,572,465	8.64%	$	$ 727,993	$ 4.00%	$	$ 909,991	$ 5

19. INVESTMENTS IN SUBSIDIARIES AND STATUTORY RESTRICTIONS

Harris Trust and Savings Bank's investment in the combined net assets of its wholly-owned subsidiaries was $792 million and $787 million at December 31, 2003 and 2002, respectively.

Provisions of both Illinois and Federal banking laws place restrictions upon the amount of dividends that can be paid to Bankcorp by its bank subsidiaries. Illinois law requires that no dividends may be paid in an amount greater than the net profits then on hand, reduced by certain loan losses (as defined). In addition to these restrictions, Federal Reserve member banking subsidiaries require prior approval of Federal banking authorities if dividends declared by a subsidiary bank, in any calendar year, will exceed its net profits (as defined in the applicable statute) for that year, combined with its retained net profits, as so defined, for the preceding two years. Based on these and certain other prescribed regulatory limitations, the Bank could have declared, without regulatory approval, $100 million of dividends at December 31, 2003. Actual dividends paid, however, would be subject to prudent capital maintenance. Cash dividends paid to Bankcorp by the Bank amounted to $60 million and $188 million in 2003 and 2002, respectively.

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The Bank is required by the Federal Reserve Act to maintain reserves against certain of its deposits. Reserves are held either in the form of vault cash or balances maintained with the Federal Reserve Bank. Required reserves are essentially a function of daily average deposit balances and statutory reserve ratios prescribed by type of deposit. During 2003 and 2002, daily average reserve balances of $279 million and $266 million, respectively, were required for the Bank. At year-end 2003 and 2002, balances on deposit at the Federal Reserve Bank totaled $164 million and $211 million, respectively.

20. CONTINGENT LIABILITIES

Harris Trust and Savings Bank and certain subsidiaries are defendants in various legal proceedings arising in the normal course of business. In the opinion of management, based on the advice of legal counsel, the ultimate resolution of these matters will not have a material adverse effect on the Bank's financial position or results of operations.

21. OTHER COMPREHENSIVE INCOME

The following table summarizes the components of other comprehensive income (loss) shown in stockholder's equity:

	UNREALIZED GAINS ON AVAILABLE-FOR-SALE SECURITIES	MINIMUM PENSION LIABILITY ADJUSTMENT	UNREALIZED GAIN ON DERIVATIVE INSTRUMENTS	T ACCU O COMPR IN
	(IN THOUSANDS)			

Balance at December 31, 2001.............	$20,100	$ --	$--	$2
Balance at December 31, 2002.............	$72,959	$(25,194)	$--	$4
Balance at December 31, 2003.............	$30,962	$(29,986)	$35	$

22. FOREIGN ACTIVITIES (BY DOMICILE OF CUSTOMER)

Income and expenses identifiable with foreign and domestic operations are summarized in the table below:

	FOREIGN	DOMESTIC	CONSOLIDATED
		(IN THOUSANDS)	
2003			
Total operating income..................................	$ 17,790	$ 1,141,897	$ 1,159,687
Total expenses..	1,594	1,000,921	1,002,515
Income before taxes.....................................	16,196	140,976	157,172
Applicable income taxes.................................	6,437	32,864	39,301
Net income..	$ 9,759	$ 108,112	$ 117,871
Identifiable assets at year-end.........................	$523,206	$19,396,284	$19,919,490
2002			
Total operating income..................................	$ 18,305	$ 1,216,787	$ 1,235,092
Total expenses..	2,978	992,974	995,952
Income before taxes.....................................	15,327	223,813	239,140
Applicable income taxes.................................	6,092	61,214	67,306
Net income..	$ 9,235	$ 162,599	$ 171,834
Identifiable assets at year-end.........................	$559,259	$18,467,759	$19,027,018
2001			
Total operating income..................................	$ 22,701	$ 1,523,998	$ 1,546,699
Total expenses..	9,302	1,444,891	1,454,193
Income before taxes.....................................	13,399	79,107	92,506
Applicable income taxes.................................	5,325	4,909	10,234
Net income..	$ 8,074	$ 74,198	$ 82,272
Identifiable assets at year-end.........................	$228,741	$19,507,430	$19,736,171

Determination of rates for foreign funds generated or used are based on the actual external costs of specific interest-bearing sources or uses of funds for the periods. Internal allocations for certain unidentifiable income and expenses were distributed to foreign operations based on the percentage of identifiable foreign income to total income. As of December 31, 2003, 2002 and 2001,

identifiable foreign assets accounted for 3 percent, 3 percent and 1 percent, respectively, of total consolidated assets.

23. BUSINESS COMBINATIONS/INTANGIBLES

At December 31, 2003 and 2002, intangible assets, including goodwill resulting from business combinations, amounted to $166 million and $174 million, respectively. Amortization of these intangibles amounted to $10.3 million in 2003, $10.2 million in 2002 and $23.8 million in 2001. The decrease in the 2002 amortization is primarily due to the Bank's adoption of SFAS No. 147, "Acquisitions of Certain Financial Institutions-an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9," on October 1, 2002 (see Note 6).

24. RELATED PARTY TRANSACTIONS

During 2003, 2002 and 2001, the Bank engaged in various transactions with BMO and its subsidiaries. These transactions included the payment and receipt of service fees and occupancy expenses; purchasing and selling Federal funds; repurchase and reverse repurchase agreements; short-term borrowings; interest rate and foreign exchange rate contracts. The purpose of these transactions was to facilitate a more efficient use of combined resources and to better serve customers. Fees for these services were determined in accordance with applicable banking regulations. During 2003, 2002 and 2001, the Bank received from BMO approximately

$17.3 million, $20.8 million and $24.9 million, respectively, primarily for trust services, data processing and other operations support provided by the Bank. The Bank made payments to BMO of approximately $32.0 million, $27.3 million and $32.1 million in 2003, 2002 and 2001, respectively.

At December 31, 2003, derivative contracts with BMO represent $49.4 million and $102.1 million of unrealized gains and unrealized losses, respectively. At December 31, 2002, derivative contracts with BMO represented $20.3 million and $136.7 million of unrealized gains and unrealized losses, respectively.

The Bank and BMO combine their U.S. foreign exchange activities. Under this arrangement, the Bank and BMO share FX net profit in accordance with a specific formula set forth in the agreement. This agreement expires in April 2004 but may be extended at that time. Either party may terminate the arrangement at its option. FX revenues are reported net of expenses. 2003, 2002 and 2001 foreign exchange revenues included $5.1 million, $7.2 million and $8.8 million of net profit, respectively, under this agreement.

On July 3, 2003, the Bank issued a $1.0 billion certificate of deposit ("CD") to a subsidiary of BMO, BMO (Barbados) Limited. The certificate matures June 30, 2008 and bears a 2.84 percent fixed rate of interest, payable quarterly. On August 28, 2003, the Bank issued a $427.7 million CD to BMO (Barbados) Limited. The certificate matures March 31, 2009 and bears a 4.30 percent fixed rate of interest, payable semi-annually. On September 22, 2003, the Bank issued a $570 million CD to BMO (Barbados) Limited. The certificate matures September 24, 2007 and bears a 3.28 percent fixed rate of interest, payable quarterly. Interest expense recognized on these CD's in 2003 was $25.4 million.