BMO Financial Group

Q3 2013 CONFERENCE CALL

CORPORATE PARTICIPANTS

Sharon Haward-Laird
SVP and Head of IR

Bill Downe
President and CEO

Tom Flynn
EVP and CFO

Surjit Rajpal
EVP and Chief Risk Officer

Frank Techar
President and CEO
P&C Banking Canada

Mark Furlong
President and CEO
P&C Banking U.S.

CONFERENCE CALL PARTICIPANTS

Robert Sedran
CIBC World Markets

Peter Routledge
National Bank Financial

John Reucassel
BMO Capital Markets

Andre Hardy
RBC Capital Markets

Steve Theriault
BofA Merrill Lynch

Sumit Malhotra
Macquarie Securities

Michael Goldberg
Desjardins Securities

Gabriel Dechaine
Credit Suisse

Brad Smith
Stonecap Securities Inc.

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Effective the first quarter of 2013, our regulatory capital, risk-weighted assets and regulatory capital ratios have been calculated pursuant to the Capital Adequacy Requirement (CAR) Guideline released by the Office of the Superintendent of Financial Institutions (OSFI) in December 2012 to implement the Basel III Accord in Canada. When calculating the pro-forma impact of Basel III on our regulatory capital (including capital deductions and qualifying and grandfathered ineligible capital), risk-weighted assets and regulatory capital ratios in prior periods, we assumed that our interpretation of OSFI's draft implementation guideline of rules and amendments announced by the Basel Committee on Banking Supervision (BCBS), and our models used to assess those requirements, were consistent with the final requirements that would be promulgated by OSFI. We have not recalculated our pro-forma Basel III regulatory capital, risk-weighted assets or capital ratios based on the CAR Guideline and references to Basel III pro-forma items refer to these items as previously estimated.

Assumptions about the level of default and losses on default were material factors we considered when establishing our expectations regarding the future performance of the transactions into which our credit protection vehicle has entered. Among the key assumptions were that the level of default and losses on default will be consistent with historical experience. Material factors that were taken into account when establishing our expectations regarding the future risk of credit losses in our credit protection vehicle and risk of loss to Bank of Montreal included industry diversification in the portfolio, initial credit quality by portfolio, the first-loss protection incorporated into the structure and the hedges into which Bank of Montreal has entered.

Assumptions about the performance of the Canadian and U.S. economies, as well as overall market conditions and their combined effect on our business, are material factors we consider when determining our strategic priorities, objectives and expectations for our business. In determining our expectations for economic growth, both broadly and in the financial services sector, we primarily consider historical economic data provided by the Canadian and U.S. governments and their agencies. See the Economic Review and Outlook section of Bank of Montreal's Third Quarter 2013 Report to Shareholders.

Non-GAAP Measures

Bank of Montreal uses both GAAP and non-GAAP measures to assess performance. Readers are cautioned that earnings and other measures adjusted to a basis other than GAAP do not have standardized meanings under GAAP and are unlikely to be comparable to similar measures used by other companies. Reconciliations of GAAP to non-GAAP measures as well as the rationale for their use can be found in Bank of Montreal's Third Quarter 2013 Report to Shareholders and Bank of Montreal's 2012 Management's Discussion and Analysis, all of which are available on our website at www.bmo.com/investorrelations.

Examples of non-GAAP amounts or measures include: efficiency and leverage ratios; revenue and other measures presented on a taxable equivalent basis (teb); amounts presented net of applicable taxes; adjusted net income, revenues, provision for credit losses, specific provision for credit losses, expenses, earnings per share, effective tax rate, ROE, efficiency ratio and other adjusted measures which exclude the impact of certain items such as credit-related items on the acquired M&I performing loans, run-off structured credit activities, M&I integration costs, amortization of acquisition-related intangibles, decrease (increase) in collective allowance for credit losses and restructuring costs.

Bank of Montreal provides supplemental information on combined business segments to facilitate comparisons to peers.

PRESENTATION

Operator

Please be advised that this conference call is being recorded. Good afternoon, and welcome to the BMO Financial Group Q3, 2013 earnings release and conference call for August 27, 2013. Your host for today is Ms. Sharon Haward-Laird, SVP and Head of Investor Relations. Please go ahead.

Sharon Haward-Laird ***- Bank of Montreal - SVP and Head of IR***

Thank you operator, good afternoon everyone and thanks for joining us today. Our agenda for today's investor presentation is as follows. We will begin the call with remarks from Bill Downe, BMO's CEO; followed by presentations from Tom Flynn, the Bank's Chief Financial Officer; and Surjit Rajpal, our Chief Risk Officer.

After their presentations, we will have a short question-and-answer period where we will take questions from pre-qualified analysts. Please note that due to a peer bank hosting their quarterly call at 2.30 today, we will be ending our call promptly at 2.25. Accordingly, I would ask everyone to please keep their questions to one or two questions and then re-queue.

Also with us this afternoon to take questions are BMO's business unit heads, Tom Milroy from BMO Capital Markets; Giles Ouellette from the Private Client Group; Frank Techar, Head of P&C Canada; and Mark Furlong, Head of P&C US.

On behalf of those speaking today I note that forward-looking statements may be made during this call. Actual results could differ materially from forecasts, projections or conclusions in these statements. Information about material factors that could cause results to differ and the material assumptions underlying these forward-looking statements can be found in our annual MD&A and our third-quarter report to shareholders.

With that said, I'll now turn things over to Bill.

Bill Downe - BMO Financial Group - President and CEO

Thank you, Sharon. And welcome to all of you on the call.

BMO’s third quarter results confirm the strength of the bank’s performance to date in 2013 and reflect the benefits of our disciplined growth strategy, which is well diversified by geography and business mix. There was good year over year growth in revenues and earnings as well as loans and deposits.

Our Canadian retail businesses were particularly strong in the quarter with both P&C Canada and traditional wealth earnings reaching new highs.

In U.S. Personal and Commercial banking, we continue to see growth in total loans driven by momentum in core commercial & industrial lending -- our large commercial businesses are doing well on both sides of the border. And good earnings performance from our capital markets business continued.

These operating results are underpinned by the successful execution of well-established strategies across all our businesses.

Our strong capital and liquidity, a prudent approach to risk management and an improving North American economy, led by the U.S., give us confidence we’re well positioned.

Third quarter results confirm this confidence. Both reported and adjusted net income were 1.1 billion or 1.68 per share.

On an adjusted basis, EPS[1] was 13% ahead of last year and pre-provision pre-tax earnings[1] were up 7%. Operating leverage[1] was just under 1% and ROE[1] improved to 15.6%.

1 – on a reported basis: EPS was 18% ahead of last year and pre-provision pre-tax earnings were up 8%; Operating leverage was 2.2% and ROE improved to 15.6%

We continue to make fundamental changes to business models across the organization to adapt our current and longer term view of how financial services will be purchased and consumed. Accordingly, expense growth in the quarter includes operating investment in our businesses to position them for continued growth.

Credit performance in the quarter was good -- provision for credit losses was down significantly in acquired and legacy portfolios. Surjit will comment on credit later in the call.

Our Basel III Common Equity Tier 1 ratio remains strong at 9.6% at the end of the third quarter.

Under our normal course issuer bid, we repurchased another 4 million shares in Q3 and we expect to continue to be active in Q4. As we said last quarter, purchasing shares at the current level is an attractive use of the excess capital we're generating and clearly benefits shareholders.

Turning to the operating groups:

P&C Canada's adjusted net income[1] for Q3 was strong at 500 million, up 8% year over year.

We've been clear about our focus on deepening customer relationships and maintaining industry-leading loyalty to drive financial performance.

This quarter's results reinforce our confidence in the strategy. There was strong growth in loans and commercial deposits again in Q3 -- contributing to higher net income in the quarter.

We're doing the right things to generate sustainable revenue growth -- with a focus on adding high quality earning assets including secured mortgages and auto loans.

In addition, there's good momentum in mutual funds -- the strongest growth we've seen since 2010.

Similarly, building on BMO's advantaged market share position, the Commercial banking team continues to deliver with loans up 12% from last year and 3% quarter-over-quarter.

Commercial deposits increased 15% -- another strong quarter of growth which is having a positive impact on margins.

We've taken deliberate actions to increase deposit accounts and balances across all commercial segments we serve. As a result of this focus, our commercial customers are increasingly rewarding us with more of their business.

U.S. P&C adjusted net income[1] was 160 million U.S. -- 4% ahead of last year. Year-to-date adjusted earnings[1] of 520 million U.S. were up 7%.

Total loans continued to grow driven by the core commercial and industrial portfolio.

We're increasing connections between personal bankers and wealth management, with success in identifying and attracting new business opportunities within the two segments, where customers get the best from teams that share account coverage.

It's an approach that has allowed us to effectively increase share of wallet and the size of our customer base without increasing the cost of supporting the banking relationship.

This kind of optimization will enhance the earnings power of the combined personal, commercial and wealth businesses in the U.S.

Private Client Group posted strong third quarter adjusted net income[1] of 225 million with traditional wealth earnings[1] of 131 million -- both records.

Strong year-over-year growth of 37% in traditional wealth businesses was mainly due to broad growth in client assets, higher transaction volumes and good productivity.

1 – on a reported basis: P&C Canada's net income was $497MM, up 9% Y/Y; P&C US net income was $147MM, 7% ahead of last year. YTD earnings of $482MM, up 10%; PCG net income of $218 with traditional wealth earnings of $125MM.

Assets under management grew 11% from a year ago.

We continue to attract new clients, increase market share and drive strong financial performance from our focus on customers and investing judiciously in the business.

We've had a sustained focus on client experience and we've been rewarded by the marketplace and our clients.

BMO Nesbitt Burns recently received the highest client loyalty score for investment advisors in the 2013 Full Service Brokerage Report from Ipsos Reid[2].

This recognition reflects the energy and commitment from our investment advisors to help clients have control of their financial lives, make better decisions with better information and have confidence in the choices they make.

Other accolades for being a market leader in wealth include: Best Private Bank in Canada and the Midwest by World Finance; top bank owned online brokerage by the Globe and Mail and more recently from Ipsos Reid, number one in client satisfaction amongst all online brokerages in Canada; and our Global Asset Management business was ranked among the Best U.S. Mutual Families of 2012 by Barron's. Clearly, we've built a very strong wealth franchise and have attractive prospects for growth.

BMO Capital Markets delivered Q3 adjusted net income[1] of 281 million with ROE of 19%.

Results were highlighted by year over year revenue growth of 8% driven by good performance from our diversified businesses.

Our commitment to focusing on clients and our strong market positions are recognized by a number of awards this quarter.

BMO Capital Markets was selected as a 2013 Greenwich Quality and Share Leader in Canadian equities.

Before wrapping up, a few words on the business outlook in our core markets going forward.

We believe the North American economic environment will provide good opportunities for growth in each of our businesses.

The Canadian economy continues to grow modestly although exports are expected to pick up as U.S. demand improves, while business investment should strengthen.

In the U.S., GDP growth is expected to increase meaningfully in 2014, reducing the unemployment rate below 7% next year. Business investment has picked up recently and is expected to grow nicely in the year ahead.

To conclude, we're making progress against our strategic agenda and the areas we're focused on.

Domestic retail delivered strong revenue, earnings and volume growth. Wealth management and capital markets continue to deliver good earnings growth providing diversification.

And, as I touched on earlier, we're building on BMO's advantaged market share in commercial banking with sustained volume growth in both Canada and the U.S.

Our distinct brand and large North American platform are differentiators and position us well.

And with that, Tom I'll turn it over to you.

Tom Flynn - BMO Financial Group - EVP and CFO

Thanks Bill and good afternoon everyone.

1 – on a reported basis: BMO CM net income of $280MM with ROE of 19.0

2 - BMO Nesbitt Burns received the highest net promoter score (tied with Scotia McLeod) for its advisors in the 2013 Full Service Brokerage Report from Ipsos Reid. Net promoter score is a measure of client loyalty calculated based on clients' response to a question on how likely they are to recommend their advisor

We'll move now to slide 8. Q3 results were good with adjusted net income[1] of approximately 1.1 billion, up 12%. These results represent particularly good contributions from P&C Canada and PCG. Bill has already gone through the high level results shown on the page, so I'll move into the details.

Before doing so I do note that Items removed for adjusted net income were similar in character to prior quarters, and totaled just 1 million in the quarter. Slide 30 provides the details.

Moving to slide 9, Q3 adjusted revenue[1] was 3.9 billion, up 6% year-over-year, and 4% from Q2.

Adjusted net interest income[1] was down 1% year-over-year, with good volume growth offset by lower margins. Adjusted net interest income[1] was up 4% from Q2 due to more days and good volume growth.

Adjusted non-interest revenue[1] was up 14% year-over-year, with growth across most NIR categories. We had a significant increase in Insurance revenues and good increases in trading, mutual fund revenues and securities commissions and fees.

Adjusted non-interest revenue[1] was up 3% from last quarter, reflecting good performance in P&C Canada and PCG. Most NIR categories increased, including Insurance, mutual funds and credit cards. Non-interest trading revenues were lower, despite higher overall trading revenues.

The stronger U.S. dollar increased adjusted revenue[1] growth by less than 1%.

Turning to slide 10, Q3 adjusted expenses[1] of 2.5 billion were up 5% year-over-year, largely reflecting higher employee costs due to investment in front-line roles, higher revenue-based costs, as well as higher severance and technology costs.

Adjusted expenses[1] were up 2% from Q2 largely due to three more days in the current quarter and higher employee-related costs.

The stronger U.S. dollar increased adjusted expense[1] growth by less than 1%.

As shown on slide 11, capital ratios are in good shape.

The Basel III Common Equity Tier 1 ratio remains strong at 9.6%, down 10 basis points from last quarter, with higher RWA and the impact of 4 million shares being repurchased in the quarter, largely offset by higher capital.

The increase in RWA was primarily due to model methodology and calibration changes and the impact of foreign exchange on our US dollar denominated RWA. The RWA increase from new loan originations was offset by paydowns of higher risk weighted loans and positive credit migration.

Moving to slide 12. In Q3, P&C Canada adjusted net income[1] was strong at 500 million, up 8% year-over-year and 16% from last quarter. Revenue growth of 4% was driven by higher balance and fee volumes partially offset by lower NIM.

NIM was relatively stable quarter-over-quarter, down 1 basis point primarily due to changes in mix as loan and deposit spreads were essentially unchanged.

Loan growth continued to be strong in the quarter, with total loans up 10% from last year and 3% from Q2. Commercial loans were up 12% year-over-year.

Deposits were up 8% year-over-year and 3% from Q2. Our commercial deposit strategy is continuing to work effectively, with balances up 15% year-over-year and 5% from last quarter.

Provisions were lower year-over-year due to lower consumer provisions.

Expenses were up 4% year-over-year, reflecting investment in the business including increases in front-line roles. Compared to last quarter, expenses were up from three more days and the similar drivers.

1 – on a reported basis: Net income of approximately $1.1B, up 17%; Revenue was $4.1B, up 4% Y/Y and 3% from Q2; Net interest income was down 3% Y/Y, up 2% from Q2; Non-interest revenue was up 15% Y/Y, up 3% from last quarter; Expenses of $2.5B were up 2% Y/Y, down 1% Q/Q; P&C Canada's net income was $497MM, up 9% Y/Y and 16% Q/Q

Moving to slide 13, P&C US adjusted net income[1] was US160 million, up 4% year-over-year and down 3% from Q2.

Revenue of US705 million was lower than a year ago largely due to the benefits of loan growth being more than offset by lower margins.

NIM was down by 16 basis points quarter-over-quarter due to competitive loan pricing, in particular in one portfolio, lower deposit spreads given the low-rate environment, and growth in lower spread assets. This decline is bigger than we expect looking forward.

Expenses were down year-over-year due to synergy-related savings net of select investments being made in the business.

Total loans were up both year-over-year and quarter-over-quarter. Core C&I loan growth continued to be strong with balances up 4% from Q2.

Turning to slide 14. BMO Capital Markets adjusted net income[1] was 281 million, up 13% year-over-year, and 2% from last quarter.

Revenue increased 8% year-over-year driven by good performance across our diversified businesses, as increases in trading revenue and equity underwriting more than offset a decline in M&A and interest-rate-sensitive businesses.

Expenses were up year-over-year and from Q2 largely reflecting higher employee costs.
ROE was good at 19.0%.

Turning to slide 15. Private Client Group adjusted net income[1] was strong at 225 million.

Traditional wealth businesses had record results with net income[1] up 37% year-over-year and 16% from Q2. Year-over-year revenue growth of 12% was driven by growth in client assets, increased transaction volumes and the benefit of acquisitions. In the graph in the bottom left corner you can see the positive trend in the traditional wealth business over time.

In insurance there was a 42 million after-tax benefit from the rise in interest rates in the quarter -- relative to interest rate declines that have affected financial results over a number of quarters looking back. The underlying Insurance business has also performed well contributing to higher earnings.

Q3 income excluding the impact of rates on Insurance is consistent with our view of a normal run-rate for PCG with good prospects to grow off that base over time.

Assets under management were up 11% year-over-year due to growth in new client assets and market appreciation.

Turning now to slide 16. The Corporate segment had a net loss[1] of 11 million on a reported basis and 35 million on an adjusted basis, in-line with last quarter.

Adjusted revenues were down year-over-year and from Q2 primarily due to a higher group TEB offset.

Adjusted recoveries of credit losses were up year-over-year and from Q2 largely reflecting higher recoveries on the purchased credit impaired loan portfolio. As a reminder we record all acquired loan accounting items in the Corporate segment.

Adjusted expenses increased from last year and Q2, primarily due to higher technology costs.

To conclude, we had good results in the quarter and feel good about how our businesses are positioned looking ahead.
And with that, I will turn it over to Surjit.

1 – on a reported basis: P&C net income was US$147MM, up 7% Y/Y, down 3% Q/Q; BMO CM net income was $280MM, up 12% Y/Y and 2% Q/Q; PCG net income was $218MM, Traditional wealth income up 37% Y/Y and 17% Q/Q; Corporate segment was net loss of $11MM compared to a net income of $13MM last quarter.

Surjit Rajpal - BMO Financial Group - EVP and Chief Risk Officer

Thank you Tom and good afternoon everyone.

I am pleased with our performance from a risk perspective this quarter. An improving US economic environment and greater loan sale activity contributed to our US credit results. Our Canadian portfolio also registered improved credit performance.

Referring to slide 19, specific provisions excluding the purchased portfolio were 153 million, or 24 basis points and 28 basis points year-to-date. This is a reduction of 64 million compared to last quarter, with the majority of the decrease due to lower new provisions and higher recoveries and reversals in our P&C businesses in both Canada and the U.S.

Provisions for the purchased performing portfolio were 44 million, down 21 million quarter-over-quarter. The decrease was due to the improved economic environment, as well as some loan sales.

The recovery on the purchased credit impaired portfolio was 140 million, an increase of 33 million, reflecting higher loan sales this quarter. Our value maximization strategy has resulted in a year-to-date recovery of 306 million on top of the 509 million recovery last year. Reduction of our purchased credit impaired portfolio has been a key component of our US strategy and as we leverage our work-out capabilities, the strong results continue to be recorded in our Corporate Services group. The portfolio is now down to 29% of its original size.

Our total provision for credit losses this quarter reflects a 20 million dollar change in the Collective Allowance, which includes our assessment of potential loan losses related to the Alberta floods.

Moving to the next slide, impaired formations were largely flat quarter-over-quarter. Formations in the purchased performing portfolio decreased to 211 million this quarter, the fifth consecutive quarterly decrease.

Gross impaired loans have been steadily declining since the end of 2012. GIL decreased by 7% this quarter as a result of higher loan sales in the U.S. and the resolution of a number of larger impaired loans in the Canadian commercial portfolio. GIL as a percentage of Gross loans and Acceptances, including purchased portfolios, are now down to less than 1%.

To conclude, as I mentioned earlier, I am pleased with the credit results for this quarter and remain optimistic about our future credit performance given improving conditions in the US and the stable Canadian environment.

I will now turn it over to the operator for the question and answer portion of today's presentation.

QUESTION AND ANSWER

Operator

Thank you. We will now take questions from the telephone lines.

(Operator Instructions)

Robert Sedran from CIBC.

Robert Sedran ***- CIBC World Markets - Analyst***

Good afternoon. Surjit, can you give us an update on the evolution of these purchased credit impaired numbers, please. Appreciating that there's a lot of caveats, but your guess is certainly better than mine. I think last quarter you suggested that H2 could look like H1. After Q3 I think H2 already looks like H1.

Surjit Rajpal - BMO Financial Group - EVP and Chief Risk Officer

Well, I am obviously a little reluctant to be very definitive about what happens to the purchased credit impaired portfolio, given it's a combination of a work-out process that we go through and loan sales. And in quarters in which we have some loan sales, you do see better numbers. So I would suggest that if you want to look forward, you've got to bear in mind the portfolio's already down to 29% of its size, so it's a much smaller factor. Having said that, I would expect the next quarter to be good because we are trying to take advantage of the improving market. And through resolutions and loan sales, that would see the results to be good but not at the level that you've seen for the last two quarters.

Robert Sedran ***- CIBC World Markets - Analyst***

Okay, thank you. As a follow-up on the similar theme in Canada, we keep hearing about the Canadian consumer being a problem. And then you've taken provisioning levels down and your peers are doing the same, or at least have been doing the same. How much of this is good performance today? And how much is this you feeling optimistic about the next 12 to 18 months when it comes to consumer? Considering that the loan book is more heavily secured than it was in past cycles, should the trough be lower than past cycles? Have we got this wrong in the market?

Surjit Rajpal - BMO Financial Group - EVP and Chief Risk Officer

On the consumer side I think you'd better differentiate between the two markets. In Canada, we did actually -- the allowance that we had increased in our consumer area because of the Alberta floods. I think the consumer area in Canada is performing quite well for now and I would expect that to continue. I don't know how to answer your question on the trough. If the market were to change, obviously then the market does change and if it's driven by high consumer debt levels, things could be very different. I'm cautious. All I can tell you is that in terms of our provisioning from a collective allowance standpoint, we feel comfortable that the numbers that we have there more than adequately protect us, and are appropriate for the level of risk that we see going forward.

Robert Sedran ***- CIBC World Markets - Analyst***

Thank you.

Operator

Peter Routledge, National Bank Financial.

Peter Routledge ***- National Bank Financial - Analyst***

Frank, very strong quarter. I notice expenses, I'm sure you want to talk about revenue too, but I notice the expenses were in line. They've been pretty good, really for the last couple years now. How much expense control is left related to the restructuring? Will you get more of a lift from restructuring in the quarters ahead? Or do we pretty much see all of that now? Then, what's your outlook on your efficiency ratio for 2014?

Frank Techar - BMO Financial Group - President & CEO - P&C Banking Canada

Sorry, Peter, you were talking about the Canadian business?

Peter Routledge ***- National Bank Financial - Analyst***

Yes, P&C Canada, I'm sorry.

Frank Techar - BMO Financial Group - President & CEO - P&C Banking Canada

Okay. Well, first of all, since you've given me the opportunity, I am going to barge in and make a couple of comments about the quarter, because I may not have an opportunity to do it. This was a really good, strong, clean quarter for P&C Canada. The best thing about it was the fact that the improvement was broad-based across a number of different elements. I won't repeat -- Tom and Bill mentioned the very strong loan growth that we've seen, very strong mutual fund growth that we've seen. These are really big numbers for us, especially in this competitive environment. And we think we can continue the growth just the way we've seen over the last couple of quarters.

In addition to that, the margin compression has moderated a bit and that's on the back of stronger deposit growth, which you all know we've been working on very hard. And the numbers came through nicely this quarter. And so my expectation about margin going forward is similar to what I said a few quarters ago, which is moderating moving forward 1 to 2 basis points as we go into fiscal 2014. And we also saw non-interest revenue very broadly strong across many product categories, our deposit products, our card products, mutual fund products. The lift we've seen in the results for this quarter are broad-based across many elements of the business, which gives me confidence that moving forward with strength in many areas, there's no reason why we can't continue. So with strong growth, moderating margin declines, better non-interest revenue growth, I'm expecting our revenue growth to continue to improve over the coming quarters.

Relative to expenses, we are building a stronger Bank and we're building one that's going to win and last. We are continuing to invest modestly in the business, particularly on two fronts. One is improving our channels, both our branches and our online and mobile capabilities, but also improving some of our core processes. And right now in-flight, we've got work going on our commercial lending platform and our credit card platform. We do have a little, as you characterized it, restructuring going on in the business.

Specifically, our expenses were up 27 million sequentially and that increase occurred in a couple of areas. Days, as you might imagine, we had some volume-driven costs and this investment in the business. So going forward, I'd expect to see a little bit of seasonal growth in Q4, but I'm really not expecting year over year expense growth to be higher than we saw this quarter. I'm expecting it to be lower as we go into 2014. I think our investment in the business can be offset with some of the productivity initiatives we've got ongoing and I wouldn't expect it to be this high as we move forward.

Peter Routledge ***- National Bank Financial - Analyst***

A follow-up for Bill. It may be unfair of me to ask a dividend question without first saying you bought back 4 million shares. I guess the question isn't so much why the Board elected not to raise the dividend. Was it more of a tradeoff decision, you like the price of your shares throughout the quarter so you elect to buy back maybe a bit more shares, and you hold off on dividend for a later date? Or is there other consideration?

Bill Downe - BMO Financial Group - President and CEO

Well, thanks for not asking an unfair question, Peter. (laughter) I don't think there's a change in direction. I would be consistent with my previous comments that we believe that returning capital to shareholders is a good thing to do, particularly when you have very strong capital ratios. And that increasing the dividend over time, consistent with earnings increases, is the pattern that we want to stick with and that's dividend increases one or two times a year. I think your point about the way in which capital is returned to the shareholders, it is the case that we bought back 4 million shares and if you just look at the value of the repurchase plus the dividend, about 60% returned to the shareholders and about 40% retained as retained earnings to support the growth of the businesses. And I think you're right, we do believe that the share price is attractive and that a good mix between share backs and dividend increases will be well-received by all shareholders.

Peter Routledge ***- National Bank Financial - Analyst***

Thanks.

Operator

John Reucassel, BMO Capital Markets.

John Reucassel ***- BMO Capital Markets - Analyst***

Some clarifications from Surjit. Surjit, you said the purchased credit impaired loan portfolio, it's down 29% or it's down 71% from original?

Surjit Rajpal - BMO Financial Group - EVP and Chief Risk Officer

It's down 71% to 29%.

John Reucassel ***- BMO Capital Markets - Analyst***

Got it, okay. The collective allowance was on the Canadian portfolio, and sorry if I missed it. Is this Alberta flooding or where is the collective allowance?

Surjit Rajpal - BMO Financial Group - EVP and Chief Risk Officer

The collective allowance increased, a large portion of it was because of the Alberta floods.

John Reucassel ***- BMO Capital Markets - Analyst***

Okay.

Surjit Rajpal - BMO Financial Group - EVP and Chief Risk Officer

The increase that you saw is actually more towards that than any other single factor.

John Reucassel ***- BMO Capital Markets - Analyst***

Okay. A question for Mark, on the US. Looks like margins came down a little more than you would have thought. I think that's what Tom mentioned in the comments. So could you talk a little bit about the product or what portfolio that was in? What the market looks like now and an update where we are?

Mark Furlong - BMO Financial Group - President & CEO - P&C Banking U.S.

Sure. So this is not a typical quarter for our net interest margin. We had one portfolio in our commercial business that repriced. It's a 20-year business with a strong credit class of commercial customers, and we think we're being competitive on price, and just being strategic with the portfolio. So that's one piece of it. If you look at the margin, over the course of the year we've also grown some lower spread assets like indirect auto. And we took some opportunity in the quarter to add some assets at relatively decent spreads, with strong credit characteristics that just happened to be available. And that's really just a result of our strong liquidity position that allowed us to do it.

And then as we add new lending assets, particularly in commercial, they have lower spreads than the current portfolio. But we think they're good relationships that will build for a long period of time, and we have full relationships because we continue to grow DDA well with them. In some cases, just the normal renewals. The credit risk profile of a customer has improved, particularly as the economy's improved. So some of those renewals will be at lower spreads than historical portfolios. You take it all together and that's where we're at.

I think going forward we'd say that for the next couple quarters, until we see some of the lift in the short end of the yield curve, that we probably still have 5 basis points or so per quarter of margin contraction. And then maybe another 2 or 3 if we decide to deploy a little bit of excess liquidity and we find the assets we like. Depending on what it is, they would clearly have to be, if they're going to be a little lower spread, clearly have to be superior credit quality. And that's certainly what we've done so far.

I think maybe the end of that question that you had was, is it competitive out there? Yes, I think it's still pretty competitive out there. There's certainly some asset-hungry banks, but we don't lead with price. In that portfolio I mentioned that we repriced, we didn't lose a single customer. And I think that was what, from our perspective, was most in terms of building relationships. Did I get everything you asked?

John Reucassel ***- BMO Capital Markets - Analyst***

Yes, that's great. Thanks, Mark.

Operator

Andre Hardy, RBC Capital Markets.

Andre Hardy ***- RBC Capital Markets - Analyst***

The question is probably for Tom Flynn. One of the drivers of margin pressure has obviously been low medium-term interest rates and those have risen in recent months. So when you look at the outlook for margins, how many more quarters do you foresee interest rates having a negative impact on margins at the current interest rate level? And by how much has the time horizon of margin pressure shrunk as a result of the recent increase in interest rates?

Tom Flynn - BMO Financial Group - EVP and CFO

Frank and Mark have talked about their outlooks broadly. So Frank talked about heading into next year 1 to 2 basis points a quarter of pressure likely. Mark, around 5 maybe, with a little bit more for deploying some excess liquidity. So those are the overall group numbers. Underneath that, the part that relates to lower rates is fading.

And so in Canada, we are pretty much, given how we've been positioned through the negative spread compression, coming from low rates. As we move into next year that should be pretty much behind us. And in the US, the tail is longer, given the different rate environment and also how we're positioned. And the low rate impact is likely the last until we're pretty much through all of next year. But that's baked into the number that Mark mentioned earlier.

Andre Hardy ***- RBC Capital Markets - Analyst***

That's very helpful. Thank you.

Operator

Steve Theriault, Bank of America Merrill Lynch.

Steve Theriault ***- BofA Merrill Lynch - Analyst***

First, just to follow up on John's question, back to Mark, can you size how much -- you talked about one big portfolio in commercial that was long-standing, I think that was up for renewal. Can you isolate how much that actually impacted the NIM this quarter? Is it material in and of itself?

Mark Furlong - BMO Financial Group - President & CEO - P&C Banking U.S.

I think when you look like at 54 billion, 55 billion loan portfolio, that in itself isn't material. But it was enough to have an effect in the quarter and it happened early. So we got pretty much all of it in the quarter, which is why we have some confidence that we're not going to see that kind of an impact in the fourth quarter, and the first quarter related to that. It's pretty much past us. If it's not, it's fractions of a basis point kind of a thing.

Steve Theriault ***- BofA Merrill Lynch - Analyst***

Okay. I want to ask a quick question on capital, probably for Tom Flynn. Your market risk's been pretty stable, but I noted market risk jumped, looks like almost 50% in the quarter. Clearly there's something unusual going on there. Does that have anything to do with the model and methodology changes you mentioned earlier or is that something else going on there?

Tom Flynn - BMO Financial Group - EVP and CFO

It is connected to the reference that we made to the model changes. So there are two things driving the market risk change in the quarter, most of the change relates to translating our activities into risk-weighted assets in a more conservative way and that drove the majority of the increase. And then in addition, the VAR was up somewhat in the quarter and that drove about 20% of the increase.

Steve Theriault ***- BofA Merrill Lynch - Analyst***

The VAR drove about 20% of the total increase?

Tom Flynn - BMO Financial Group - EVP and CFO

No, of the increase in market risk RWA, around 20% of that is attributable to an increase in VAR during the quarter.

Steve Theriault ***- BofA Merrill Lynch - Analyst***

I may follow up. If I might, one more quick one. Maybe for Tom or Surjit. We're getting better clarity on leverage rules and some banks are providing, more so outside of Canada, but some banks are providing better clarity here. It's challenging for us on the outside looking in. Can you tell us where you think you are on leverage, based on the most recent known set of parameters? Are we at the point where you can give us a reasonable number?

Surjit Rajpal - BMO Financial Group - EVP and Chief Risk Officer

Not based on the parameters. The parameters haven't been set. The parameters are based on the fact that you expect the total debt to get paid off over a five- to seven-year period, and the senior debt to be paid off in five to seven years. And there's another trigger for overall debt as well. We on the basis of the new Fed definition, I can't give you something precise yet, because the definition is in itself not precise.

But we do track leverage finance numbers and leverage loan numbers based on what we believe to be the parameters that are more granular from our standpoint, where the leverage is higher than for the industry in the normal course. A large number of the financially-sponsored transactions that we have do get captured under that particular portfolio. So we do have it. The number is not large. It is, and I want to go by memory over here, would be around CAD3.5 billion, CAD4 billion. In that range.

Tom Flynn - BMO Financial Group - EVP and CFO

And then on the leverage ratio, which has also been topical, the rules are not fully developed and there's still work being done around calibrations, so we don't think it's appropriate to disclose a number. But based on everything we know about the rules as they're currently contemplated and our position, we don't expect the leverage ratio to be a constraint for us.

Steve Theriault ***- BofA Merrill Lynch - Analyst***

Thanks for the color everyone.

Operator

Sumit Malhotra, Macquarie Capital Markets.

Sumit Malhotra ***- Macquarie Securities - Analyst***

First question is for Frank Techar, and specifically thinking about loan growth in your segment. You might actually be the wrong bank to ask because your loan growth has been pretty consistent and pretty strong over the last number of quarters, specifically in the residential mortgage book, but going back to the question on the uptick in rates, even from the low point in your posted mortgage rates I think you've moved up roughly 80 basis points. When I see resi mortgage balances up about 4.5% this quarter, do you attribute some of that to customers perhaps acting ahead of a perceived further move in mortgage rates? And how do you think that increase in rates is going to impact the level of loan growth going forward?

Frank Techar - BMO Financial Group - President & CEO - P&C Banking Canada

Sumit, I think a couple of things. One is seasonality definitely plays a role. So I know our growth over the last two quarters has been strong. Part of that's because of the time of year. I do think there's been a little bit of bring-forward with respect to the perception that rates are going up. So there might have been a little bit of a flush of activity as a result of that. It's very hard to put your finger on, though. It's more anecdotal than anything.

And my expectation is that overall market growth moving forward is likely to slow a bit. I think in particular if rates do move up a bit more, we're going to see a little bit more slowing. From my perspective, we've been able to grow faster than the market as it is now and our objective is to grow faster under that scenario as well. But I would say there's a bit of a bias for a slowdown, no doubt, in particular staring at the possibility of rates going up.

Sumit Malhotra ***- Macquarie Securities - Analyst***

Let me just balance that because that's an interesting statement, given your loan growth has been pretty much the best in the sector. Even with this uptick in rates, your commentary on net interest margin outlook hasn't really changed. Frankly, I know you've been somewhat -- you want to be cautious on the guidance there or the target there. I think last quarter you told us you're expecting things to moderate to 1 to 2 basis points in decline. Even with this significant uptick we've seen in posted rates, that hasn't changed. If loan growth starts to slow, is it reasonable to expect at some point you're going to see the offset happen in the form of margin maybe being even better than you talked about?

Frank Techar - BMO Financial Group - President & CEO - P&C Banking Canada

Yes, I think that would happen. In particular, if our deposit growth continued as strong as it would be, and that relationship between loan growth and deposit growth changes, we'd see slower growth in our mortgage book, we'd see even more improvement in our net interest margin.

Sumit Malhotra ***- Macquarie Securities - Analyst***

My last question is for Bill Downe on -- going back to the leverage ratio. If I start with what we heard over the last number of years on the Basel III common equity Tier 1. Basel told us they wanted 7%, or more correctly…they told the banks they wanted 7%. OSFI came in with an 8% mark and the banks have told us they want to manage with a buffer on top of that. I know there's different ratios or different calculations that are out there, but the leverage ratio I've heard or I've read about from Basel is 3%. Is it reasonable to expect, Bill, that there's going to be a buffer from OSFI on top of the 3% And then a buffer from the banks on top of that? Can you give us a little bit of help with that calculation?

Bill Downe - BMO Financial Group - President and CEO

Well, I think your question, Sumit, you've almost answered yourself, in that any time there's a threshold established, it's prudent to put some distance between you and the threshold so that you maintain flexibility. I think Tom's answer with respect to BMO, and I think that's the most important thing is -- and use the same thought process as you used up to your question. When we thought about what the appropriate level of common equity, CET-1 would be, we incorporated a lot of different inputs, public pronouncements. But we moved very quickly, particularly through the period immediately after making a significant acquisition, to the level that we thought would give us maximum flexibility. And we're happy to be ahead of the curve. We didn't need to go as fast as we did, but we think it was worthwhile to have done. And then, I think Tom's answer really is the correct one, that with respect to our own position, we're comfortable that our view of the world is a good one and that it is similarly prudent.

Sumit Malhotra ***- Macquarie Securities - Analyst***

That's very helpful. Thanks for your time.

Operator

Michael Goldberg, Desjardins Securities.

Michael Goldberg ***- Desjardins Securities - Analyst***

Thank you. You said you don't expect that leverage will be a constraint, but if Basel III leverage were to become a binding constraint and you wanted to optimize your capital, what would be your priorities in terms of the assets that you'd want to curtail and what impact would you see from that? And overall, more broadly speaking, what impact do you see of a tight leverage requirement on bond and money markets?

Tom Flynn - BMO Financial Group - EVP and CFO

It's Tom. I'll take a first crack at that. From our perspective, I will repeat that based on what we know now, we don't believe the leverage ratio will be a constraint. And so this is not something that we are significantly focused on at the moment. We're obviously watching what's going on internationally. But from what we've seen to date, we don't believe this will be a constraint for us.

For a bank that had to adjust to a new constraint, I think the basic economics would be looking at your lowest-yielding assets and particularly those that don't have a customer connection, and doing the math to see if you are ahead of the game or not after looking at the yield on those assets against the cost of the capital you would need to hold if you wanted to keep them on your books. There has been, I think, some talk in the market, and this might be what you're referring to, for banks potentially to be less active in the repo markets as a result of a binding leverage constraint. Repo assets are among the lowest spread assets on the balance sheet, so it does make sense that if banks were looking to pare back they would look hard at those portfolios. So we see that as an area that people might look. But I'd say in the North American markets it's far too early to conclude that there's potential for a meaningful decrease in the market liquidity as a result of balance sheet adjustments coming from banks.

Michael Goldberg ***- Desjardins Securities - Analyst***

And what impact do you expect in terms of backup lines on commercial paper if -- with the inclusion of those lines in the -- I'm talking about the commitment fees. With the inclusion of those lines in the determination of leverage, do you expect that that would push up commitment fees?

Tom Flynn - BMO Financial Group - EVP and CFO

Well, I guess to the extent that the cost of doing business in that product category increased, I think there would likely be an impact to the pricing in the market, and so there's the potential for that going forward. People do look at those lines as part of overall corporate relationships, so the product doesn't exist in isolation, and is viewed as part of an overall client relationship. But in general, where the cost of business goes up for this and other industries, I think there's some attempt made to mitigate that through changes in the way business is done and changes in the pricing approaches that you take to the market.

Michael Goldberg ***- Desjardins Securities - Analyst***

And again, just to follow up, I know this is hypothetical, but if the impact is in the repo market, then what impact does that have on the bond and money markets? And do you think that -- I'll ask -- do you think that this has been well thought through?

Tom Flynn - BMO Financial Group - EVP and CFO

I think that is a very interesting question. But a tough question to deal with in the time that we have, just given the remaining time in the call. So if we could, maybe happy to follow up offline and continue the discussion which is an interesting one.

Michael Goldberg ***- Desjardins Securities - Analyst***

Okay. Thank you.

Operator

Gabriel Dechaine, Credit Suisse.

Gabriel Dechaine ***- Credit Suisse - Analyst***

First question is on the capital management. Given your strong core Tier 1 ratio, given what I estimate to be a B-3 leverage ratio of about 4%, I think you've got one of the most flexible capital positions out there. Is there any reason why when your current NCIB expires you wouldn't be able to go to, or wouldn't want to ask OSFI to bump up the size of your buyback from, say, 2% to 4% of your shares outstanding?

Next question's for Frank. Two-pronged, I guess. Could you confirm there wasn't a big spike in prepayment income that might have benefited your NIM this quarter in Canadian P&C? And also, if you can outline any -- do you have any big strategies in place to take advantage of some anticipated disruption in the credit card market in Canada in 2014? Any expenses associated with that would be helpful as well. Thanks.

Bill Downe - BMO Financial Group - President and CEO

Gabriel, before Frank answers the second question, I'll just go back to my response on the dividend and the return of capital to shareholders. You can work with the mix but I think thinking about the rate at which we're returning capital, all other things being equal, is one that we're very comfortable with, the combination of the dividend and the buyback.

Gabriel Dechaine ***- Credit Suisse - Analyst***

Do you think in theory that OSFI would have any objections to a more aggressive buyback plan, I guess.

Bill Downe - BMO Financial Group - President and CEO

You should ask them, I think.

Gabriel Dechaine ***- Credit Suisse - Analyst***

They're not returning my calls. (Laughter)

Bill Downe - BMO Financial Group - President and CEO

Well, we’ll continue to return your calls. I'll turn it over to Frank.

Frank Techar - BMO Financial Group - President & CEO - P&C Banking Canada

Gabriel, no large prepayment levels in this quarter. As I said earlier, it was just a really clean quarter, both on the net interest earnings and the non-interest revenue side. And relative to the credit card market, we, along with everyone else I think, are expecting some disruption in the market over the next little while. We view this as an opportunity. We're going to aggressively defend our own customer base and we're going to compete aggressively for those customers that are questioning their current products. So we do plan on spending heavily on marketing our credit card products next year. I'm happy that some of our competitors have been so open about how much they intend to spend, but I'm not going to be.

Gabriel Dechaine ***- Credit Suisse - Analyst***

Okay. So more or less than them, or what? I'm on a roll here. Okay. Thanks.

Operator

Brad Smith, Stonecap Securities.

Brad Smith ***- Stonecap Securities Inc. - Analyst***

I had a question. Just trying to reconcile a couple of things here. First of all, we continue to refer to the strengthening US economy. And I believe that some of the deposit deterioration that I've seen in the call reports has been attributed to the runoff of some low margin deposit CD accounts in the US. So what I'm trying to reconcile is how the growth rates in loans, deposits and the progression in net interest margins could be as low as it is in the US relative to the Canadian experience, when that's where the economy is strengthening and the low margin deposit business is rolling off. I'll give you some examples. The loans and acceptances are up 10% in Canada, 2.5% in the US. Deposits are up 8% in Canada, 1% in the US, segment anyway, on a constant dollar basis. Can you shed some light on that? I think really my question is, do you think you need to do another acquisition to kick start the growth down there? Or is there some sort of turnover or event that you see in the near term that's going to do that?

Mark Furlong - BMO Financial Group - President & CEO - P&C Banking U.S.

This is Mark Furlong. At least let me start and give you some thoughts. So the US consumer is de-levered. We've seen that in credit card. It's down from over 1 trillion. It's down to 850 million in the US. You go back, it's probably four or five years of consistent de-leveraging across the entire US consumer. We see that a little bit as well in our mortgage, in our home equity book. And that's really a result of low rates that allowed mortgage loans and the home equity loan to get refinanced into one loan. Now, the counter to that, particularly in the markets we're in is that there had been little price appreciation that was occurring across a lot of our footprint, particularly Chicago and some of the core Midwest markets.

So now we have Chicago coming on with its eighth straight year over year increase in house prices, and so continues to show some good local movement. Still, locally in Chicago, we're 28% below the peak of pricing in September of '06. So there is a great amount of momentum that's building up there. You could see it in increases in median home price, you could see it in increases in home sales. You can see a consumer that is beginning to have a little more capacity to grow.

In our personal book, particularly on the deposit side, we've taken the opportunity to bring down the price of CDs as close to market as we can. And in some cases that has caused some account consolidation and has caused some to run off, which is fine because we've brought that down quite a bit. We've also taken some opportunities in our accounts to do product alignment, so both organizations pre-merger had grandfathered accounts. And we have slowly stepped through a process of aligning those so that we could do more streamlined marketing that focused on the product set that was really the long-term, go-forward product set.

That included things like eliminating zero-balance checking and replacing it with some other products we thought would be effective. The long and short of all that is we continue to have really good increase in checking balances. We continue to add core relationships. We do get some checking account consolidation, for example, which we think seems real normal, relative to maybe an inefficient use of checking accounts that now has become much more efficient. Obviously having less accounts on the system related -- that were inefficient and had low balances is good for us from an expense standpoint. We think we've designed some products that are really good for the consumer as well, too.

So I guess that's a way of tying in what's going on with the consumer, what's going on with our business. You've clearly seen from the business side that we have had very robust growth on the C&I side. In fact, you haven't yet seen it in commercial real estate but we've added over $1.7 billion of new commitments. We've shown a little growth this quarter. I feel confident that we're going to show growth next quarter. And you're going to see the utilization of those C&I lines that, because they have such big cash equity positions unlike pre-recession, the utilization is a little bit slower. But the investor base is incredibly high-quality and known to us really well and we'll begin to see that growth. I think we're going to continue to see some pretty good expansion on the balance sheet side in the US business and feel pretty confident about the long-term growth profile where we're at.

Brad Smith ***- Stonecap Securities Inc. - Analyst***

Great. Thanks. Just one last question. In terms of loans and deposits, is your market share growing, Mark?

Mark Furlong - BMO Financial Group - President & CEO - P&C Banking U.S.

Well, our core customer market share is growing. What we did was, in the merger, we've taken the opportunity to eliminate a lot of wholesale brokered accounts that were unrelated to a core customer. So, using Milwaukee as an example, we grew the base 3.5 billion -- I'm sorry, we grew the base 1.5 billion last year. But you can't see it because we eliminated 3.5 billion of brokered CDs. It looks like a 2 billion drop. In fact, it's a 1.5 billion core customer increase in deposits. Do we feel good about it? Yes. That's the core relationship again, so we feel like we're doing it. In Chicago, we've continued to grow that deposit base very robustly and I know that's not uncommon in headquarter cities to see that growth. But we continue to grow and it is directly tied to the strong C&I growth and the building commercial real estate growth.

Brad Smith ***- Stonecap Securities Inc. - Analyst***

Thanks very much.

Operator

Thank you. That concludes the question-and-answer session. I would like to return the meeting to Ms. Haward-Laird.

Sharon Haward-Laird ***- Bank of Montreal - SVP and Head of IR***

Thank you. Thank you for joining us today and I'm sorry if we didn't get to any of the questions on the call, but we'd be happy to answer your questions in Investor Relations afterwards. Have a good afternoon everyone.