BMO Financial Group

Q3 2014 CONFERENCE CALL

CORPORATE PARTICIPANTS

Sharon Haward-Laird
Head, IR

Bill Downe
Chief Executive Officer

Frank Techar
Chief Operating Officer

Tom Flynn
Chief Financial Officer

Surjit Rajpal
Chief Risk Officer

Cam Fowler
Group Head
Canadian P&C

Tom Milroy
Group Head,
BMO Capital Markets

Mark Furlong
Group Head
US P&C

Gilles Ouellette
Group Head
Wealth Management

CONFERENCE CALL PARTICIPANTS

Robert Sedran
CIBC World Markets

Sumit Malhotra
Scotiabank

John Aiken
Barclays Capital

Darko Mihelic
RBC Capital Markets

Steve Theriault
BofA Merrill Lynch

Mario Mendonca
TD Securities

Peter Routledge
National Bank Financial

Gabriel Dechaine
Canaccord Genuity

Doug Young
Desjardins Securities

Meny Grauman
Cormark Securities

Derek DeVries
UBS

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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 2014 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 2014 Report to Shareholders and Bank of Montreal's 2013 Annual Report, 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, non-interest 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 purchased performing loan portfolio, run-off structured credit activities, acquisition integration costs, amortization of acquisition-related intangibles assets, 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's Q3 2014 earnings release conference call for August 26, 2014. Your host for today is Ms. Sharon Haward-Laird, Head Investor Relations.

Ms. Haward-Laird, please go ahead.

Sharon Haward-Laird - *BMO Financial Group - Head, IR*

Thank you. 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 the bank's Chief Financial Officer, Tom Flynn and our Chief Risk Officer, Surjit Rajpal.

After their presentations we will have a short question and answer period where we will take questions from pre-qualified analysts. To give everyone an opportunity to participate, please keep it to one question and then re-queue.

Also with us this afternoon are Frank Techar, Chief Operating Officer, Cam Fowler from Canadian P&C, Mark Furlong from U.S. P&C, Tom Milroy from BMO Capital Markets and Gilles Ouellette from Wealth Management.

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.

I would also remind listeners that the Bank uses non-GAAP financial measures to arrive at adjusted results to assess and measure performance by business and the overall Bank. Management assesses performance on a reported and adjusted basis and considers both to be useful in assessing underlying business performance.

Bill and Tom will be referring to adjusted results in their remarks unless otherwise noted. Additional information on adjusting items, the Bank's reported results and factors and assumptions related to forward-looking information can be found in our annual report and our third quarter report to shareholders.

And now, I will hand things over to Bill.

Bill Downe - *BMO Financial Group - CEO*

Thank you, Sharon, and good afternoon everyone.

BMO delivered very good results in the third quarter confirming continued momentum across our businesses. Net income[1] was up 4% from strong results a year ago.

Personal and Commercial banking in Canada had continuing strong performance with operating leverage above 2%. Year-to-date earnings[1] were up 10%.

Net income and pre-provision, pre-tax earnings in U.S. Personal and Commercial banking was encouraging, with improved revenue trends despite the continued low interest rate environment.

Traditional wealth posted net income[1] growth of 27% reflecting good organic growth in client assets and the acquired F&C business.

1 – on a reported basis: BMO net income was flat Y/Y; P&C Canada YTD earnings up 10%; Traditional Wealth posted net income growth of 15%

And, there were very good results in BMO Capital Markets driven by strong revenue growth in Investment and Corporate Banking.

Wealth Management and BMO Capital Markets provide valuable diversification to our business mix.

After slowing early this year due to the harsh winter, the North American economy has rebounded.

In Canada, consumer spending has improved and is expected to grow moderately while business investment is expected to strengthen in response to firmer exports, supporting commercial credit growth.

In the U.S., consumer and business spending also strengthened from a year ago. Economic conditions have historically been much stronger in prior recoveries but they've gradually improved over the last 5 years. Against this backdrop, BMO's operating groups have delivered very good performance with earnings per share up 8% year-to-date.

I'll now touch on a few highlights from our third quarter.

Net income[1] was $1.2 billion or $1.73 per share. Revenue[1] grew 10% to $4.2 billion and ROE[1] was 15%. Loans were up 9% and deposits increased 11% from a year ago. Credit performance in the quarter continued to be good. Surjit will provide more detail later in the call.

BMO's Common Equity Tier 1 ratio was 9.6% which includes the anticipated impact of the F&C acquisition.

Turning to the operating groups:

Canadian P&C net income[1] was up 8% reaching a new high at $528 million. Revenue growth has been 6% or better for the last three quarters. And, efficiency[1] has improved 100 basis points this year. Online, mobile and digital capabilities are another way we face the market. We know these are areas of strength for us; the customer experience is simple and personal; designed for people, by people.

We've invested steadily and this has ensured continued innovation in customer-friendly technology and a strong foothold for us in the mobile space. During the quarter, in mobile banking, we activated the ability for customers to move money between their Canadian and U.S. dollar accounts at Bank of Montreal. And, our mobile apps continue to be popular and exceptionally well received in the market. Active users are up 25% and volumes for financial transactions increased over 30% from the previous quarter.

U.S. P&C net income[1] increased to US$158 million in source currency supported by year-over-year revenue growth and disciplined expense management. In commercial banking, we continued to deliver robust loan growth with core C&I loans up 18% in the quarter. Broad-based growth was especially strong in our northern footprint, including Minneapolis, St. Paul and across Wisconsin, Illinois and Indiana. BMO Harris Bank's footprint benefits from an urban and affluent customer base where we've been most successful over time.

In partnership with U.S. Wealth Management, BMO Harris Premier Services now has over 100 banker-advisor teams in place to provide clients with a more cohesive experience. We've successfully migrated 35,000 customers to Premier Services, more than doubling the number of our mass affluent banking clients that now have an assigned advisor. Deposit and loan sales with these customers have increased from the prior year by 20% and 55%, respectively.

BMO Capital Markets reported strong results with net income[1] of $306 million. Revenue was up 15% reflecting good growth across the business, led by strong performance in Investment and Corporate Banking. We've seen clear progress in the U.S. business with year-to-date earnings up 25% and efficiency has improved.

Wealth Management posted net income[1] of $212 million. There was continued momentum in traditional wealth with good organic revenue and earnings growth. Assets under management and administration increased to over $750 billion with F&C adding approximately $150 billion in AUM.

In the quarter, *Global Banking and Finance Review* named BMO -- Best Wealth Management firm in Canada. This recognition reflects the strength of our value proposition and ongoing commitment to clients.

1 – on a reported basis: BMO net income was $1.1B or $1.67 per share; Revenue grew 5% to $4.2B; ROE was 14.4%; Canadian P&C net income was up 8% to $526MM; efficiency improved 90bps this year; U.S. P&C net income increased to US$147MM; Wealth management net income $190

To conclude, strong operating group performance continued this quarter resulting in $1.2 billion in earnings.

Our success in growing both sides of the balance sheet is directly attributable to a strategy that emphasizes the delivery of an industry-leading customer experience, a brand promise that recognizes that money is personal, and a bank should be too.

We're directing our energy and capital in areas that will continue to move the Bank forward with our customers including how we go to market and interact with customers across all of our channels including branches, online and mobile. How we leverage data and enhance analytics to serve customers better as well as meeting regulatory expectations. And, our continued drive to improve efficiency.

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

Tom Flynn - *BMO Financial Group - CFO*

Thanks Bill and good afternoon everyone.

I'll now go through our results starting on slide 8. Q3 was a very good quarter with EPS[1] of $1.73 and net income[1] of $1.2 billion, both up 4% from a strong Q3 last year. Q3 of last year had very low credit losses and a benefit in our insurance business from rising long-term rates versus a rate charge in the current quarter. Excluding the rate impacts and net credit related items, underlying earnings growth was in the double-digits.

Our operating groups continued to perform well this quarter, with strong results in Canadian P&C, BMO Capital Markets, and traditional wealth and improved results in U.S. P&C.

Adjusting items are similar in character to prior quarters and this quarter includes F&C acquisition integration costs of $7 million after-tax, which are reported in the Wealth Management segment.

Revenue was up 10% from last year to $4.2 billion driven mainly by good organic growth, and also by the addition of F&C and the stronger U.S. dollar.

Net interest income[1] was up 4% year-over-year driven by volume growth, purchased performing loan revenue, and the impact of the stronger U.S. dollar, partially offset by lower net interest margin. Net interest income[1] was up 2% sequentially in large part due to 3 more days in the current quarter.

BMO's overall net interest margin excluding trading was stable quarter-over-quarter.

Non-interest revenue[1] was up 16% from last year with increases across most categories. Insurance income was lower year-over-year due to the impact of long-term rates.

Q3 expenses[1] were $2.7 billion, up 11% from last year. The increase reflects higher employee-related expenses, the impact of F&C, higher technology and support costs related to a changing business and regulatory environment, and the stronger U.S. dollar.

Expenses[1] were up 5% from Q2 primarily due to the impact of F&C and 3 more days in the current quarter. Looking forward, as can be the case, we expect Q4 expenses to reflect some seasonal quarter-over-quarter expense growth.

The effective tax rate[1] was 15.6%, down from Q3 last year and relatively in line with the prior quarter. The rate was 24.0% on a TEB basis, relatively in-line with our longer term trends.

Moving to slide 9, our Common Equity Tier 1 Ratio was 9.6%, down approximately 10 basis points from Q2. The F&C acquisition reduced the ratio by approximately 75 basis points, as expected. This was offset by a 25 basis points benefit from growth in retained earnings and approximately 35 basis points from lower RWA split essentially equally between improvements in book quality, reductions in book size and changes in methodology. Some of the reductions in book

1 – on a reported basis: BMO EPS of $1.67 up 1% and net income of $1.1B relatively flat; Revenue up 5% to $4.2B; Net interest income was down 3% Y/Y, up 2% Q/Q; Non-interest revenue up 16% from last year; Q3 expenses were $2.8B 9% from last year and 6% from Q2; effective tax rate was 15.3%

quality and book size were the result of work we did in the quarter to free up capital capacity given the closing of the F&C acquisition.

Moving now to our operating group performance starting on slide 10, as Bill mentioned, Canadian Personal and Commercial Banking continued to perform very well. Net income[1] was $528 million, up 8% year-over-year, with 6% revenue growth and good operating leverage.

Balance sheet growth was strong with total loans up 7% and deposits up 9%. Personal loan growth was 7%, and deposit growth was strong at 10%. Commercial loans were up 9% and deposits were up 7%.

NIM was up 1 basis point from last quarter.

Expenses were up 4% year-over-year due to continued investment in the business net of a focus on productivity. Quarter-over-quarter expenses were up 5% in part due to the impact of three more days in the current quarter.

Operating leverage was 2.1%, above 2% for the fourth consecutive quarter and the efficiency ratio improved to 49.7%.

Moving to U.S. P&C on slide 11, net income[1] was US$158 million, up 1% from the prior year and 4% from Q2. Revenue of $707 million was up 1% from last year driven by loan growth, net of lower NIM and mortgage revenue. Loans were up 8% year-over-year with continued strong growth in core C&I balances of 18%. Revenue was up 2% quarter-over-quarter from three more days and commercial loan growth, partially offset by lower commercial lending fees. The net interest margin declined 3 basis points, which was in-line with expectations, due to changes in mix, including loans growing faster than deposits, and lower loan spreads.

Expenses remain well managed and were modestly higher year-over-year and quarter-over-quarter.

The growth in U.S. P&C this quarter is consistent with our expectations for the business.

Turning to slide 12, BMO Capital Markets had another strong quarter with net income[1] of $306 million, up 14% year-over-year and relatively unchanged from Q2. Revenue growth was good at 15%, with contribution across most businesses, particularly I&CB. Expenses were up 13% from last year due to higher employee-related expenses and costs due to a changing business and regulatory environment. ROE remains strong at 22.4% in the quarter.

Moving on to slide 13, Wealth Management net income[1] of $212 million was down 4% from the prior year. Strong performance in traditional wealth continued with net income up 27%. Approximately 60% of the increase was due to the contribution of F&C.

As I mentioned earlier, Insurance results were impacted by the movement in long-term interest rates with a negative impact of $22 million after-tax in the current quarter relative to a benefit of $42 million after-tax in the prior year, a year-over-year negative swing of $64 million. There was continued growth in the underlying Insurance businesses.

Expenses[1] were up 24% year-over-year mainly due to the impact of the F&C acquisition and higher revenue-based costs from organic operations.

The acquisition of F&C added approximately 10% to Wealth Management's revenues, expenses and net income in the quarter.

Assets under management and administration were up 48%, or 19% excluding F&C, driven by market appreciation, the stronger U.S. dollar and growth in new client assets.

Turning now to slide 14. The Corporate segment had a net loss[1] of $55 million compared to a net loss[1] of $21 million in the third quarter of last year and was relatively flat quarter-over-quarter. The year-over-year decline was primarily due to lower credit recoveries.

To wrap up, our results this quarter demonstrate continued momentum and good performance across our businesses and we feel good about how we are positioned looking ahead.

1 – on a reported basis: Canadian P&C net income was $526MM up 8% Y/Y; U.S. P&C net income was US$147MM up 2% Y/Y from the prior year and 4% from Q2; BMO CM net income of $306MM up 14% Y/Y and flat to Q2; Wealth Management net income of $190MM down 12% from prior year; Expenses were up 27% Y/Y; Corporate net loss of $55MM compared to a net income of $3MM in the third quarter of last year

With that, I will turn it over to Surjit.

Surjit Rajpal - *BMO Financial Group - Chief Risk Officer*

Thank you Tom and good afternoon everyone.

We had another good quarter from a risk perspective. Starting on slide 17, specific PCLs were $130 million, a decrease of $32 million dollars from the prior quarter. The decrease was largely due to impaired loan sales in the U.S.

In P&C Canada, both consumer and commercial losses were flat quarter-over-quarter. In P&C US, commercial losses were down compared to the previous quarter, while consumer losses increased by $10 million. The increase in consumer losses was mainly due to methodology changes, absent which, consumer losses would have also decreased.

The recovery in the Corporate portfolio increased by $28 million due to impaired loan sales.

Moving to the next slide, formations were $457 million, down $52 million from the prior quarter, with the reduction coming from commercial portfolios in both Canada and the U.S.

Gross impaired loans also decreased this quarter to below $2.0 billion. U.S. loan sales and a reduction in commercial formations in Canada accounted for this decrease.

In summary, we had solid credit performance, reflective of good underlying trends and the success we had in selling impaired loans.

Looking to the next quarter, I expect continued good credit performance with less benefit though from loan sales. I will now turn it over to the operator for the question and answer portion of today's presentation.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Our first question is from Rob Sedran from CIBC World Markets. Please go ahead.

Robert Sedran - *CIBC World Markets - Analyst*

Hi, good afternoon. Tom, you went a fair bit of the way in explaining the drop in risk-weighted assets. Although I guess all else equal, the currency probably would have inflated that number, so the decline is even larger. When I look at a smaller decline in average earning assets, is that the similar phenomenon at play in terms of optimizing the balance sheet in shrinking some of the less productive assets? And is there a lasting revenue impact from some of that activity?

Tom Flynn - Bank of Montreal - CFO

Thanks for the question. A few things. I'll address the last part of it first. We're not expecting any lasting revenue impact from the things that we did during the course of the quarter. There was a connection between the change in risk-weighted assets and the change in the balance sheet that you see quarter-over-quarter, as you have mentioned. The currency quarter-over-quarter actually reduced the RWA a little bit. It was not significant, but it was about $500 million from a lower spot rate on the currency quarter-over-quarter. And then the big driver related to the three items that I alluded to in my comments, book quality improved, our book size improved as it's used to calculated risk-weighted assets, and we had one methodology change, and so those were the largest drivers. And the last thing I'd add is that market risk itself was down about $1 billion as well.

Robert Sedran - *CIBC World Markets - Analyst*

Now, I'm not sure if it was you or Bill, but in your comments you linked the closing of the F&C acquisition with some of the activities to improve the ratio. So that mitigating impact, were they explicitly linked? And I know this is a tough question to answer, but is there something magical about 9.5 or what level you decided to take this to that was linked to that acquisition?

Tom Flynn - Bank of Montreal - CFO

I'd say we wish we could predict the ratio with that much precision. There's a degree of inherent movement in the ratio quarter-to-quarter and a lot of moving pieces. We weren't targeting a number with that degree of precision, but we absolutely did look at some of our positions and the way that we had capital allocated out in areas, given the reduction to the ratio that F&C produced and gave some of our activities a bit of a scrub to free up capital capacity to accommodate the acquisition of F&C.

I'll give you a little flavor for that. We did look at unused commitments and authorizations, places where we had capital available for clients but they were not using it, and shaved those lines and authorizations a bit in a way that had no client impact and freed up some capital. And we sold some legacy securitization positions, no big impact on the P&L, but it did free up some capital.

And during the quarter we purchased some mortgage insurance, which is helpful both from a capital and a liquidity perspective. We did go through and did some additional work this quarter given the impact of the close of the acquisition, and that came through and helped the ratio as it settled in at the end of the quarter.

Robert Sedran - *CIBC World Markets - Analyst*

Sounds like a busy summer, thanks.

Operator

Our next question is from Sumit Malhotra from Scotiabank.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks, good afternoon. Maybe to start by following up on the last topic of conversation. Last quarter I think it was mentioned, Bill, that 9.5% was a level the bank wanted to get back to before thinking about, what I'll call more than normal course capital deployment, things like share purchases and other levers.

I think you got there at least faster than I expected. Wanted to get an update from you as to whether you feel you're where you need to be from a capital perspective to perhaps think about restarting share repurchases or other areas. Or is there a buffer you would like to have before that begins?

Bill Downe - *Bank of Montreal - CEO, BMO Financial Group*

Thanks for the question, Sumit. I think what we talked about in the last call is, if my recollection is correct, as the comfortable range being between 9.5% and 10%, and that's all other things being equal. And by that I mean there still is evolving discussion globally around where Basel III and other capital regimes will come to rest. But I think that range still seems to us to be the appropriate range.

I do think that our track record of thinking in advance about acquisitions, having the ability to build up excess capital in anticipation and then quickly recover stands on record. The acquisition of M&I, we approached that transaction with very strong capital to begin with and rebuilt capital faster than many had anticipated. And in the case of F&C, I think we did the same kind of discipline. And as Rob observed, it was a busy summer, but we really had anticipated the impact of the transaction pretty clearly.

I think that as I said in the last call, it gates at this point on organic growth because the best application for retained earnings and additional capital is to support growth of the balance sheet and the businesses. And as we look across all four business groups, we're really at a time where if the economy does expand, the businesses are all well positioned. And, I think they will absorb much of the capital that we generate, and that would be the first choice.

As we've said, we're judicious in using share buybacks when we don't have an identified expectation of either robust organic growth or something that really might complement one of the businesses.

And then we have a dividend policy that really commits to return earnings to the shareholders in the form of dividends as revenue grows. So, I think it's all part of a pretty well articulated framework for thinking about this and being in the range of 9.5% to 10% is a good place to be in order to have flexibility in all those areas.

Sumit Malhotra - *Scotiabank - Analyst*

Thank you for that answer. And maybe to end off back to Tom for a moment, on a similar topic, it certainly seems like with the differing banks on a quarterly basis there can be ups and downs as far as model refinements and balance sheet optimization are concerned from a capital perspective. BMO has had some benefits in this regard, a couple times as of late, and I wanted to just hear from you as to whether you think there are further opportunities to contain or manage down the RWA level through either divestitures or refinements to the process, or do you think it's more of a normal course situation from where you stand now? Thanks.

Tom Flynn - Bank of Montreal - CFO

I would view it as more of a normal course situation looking forward. We came out this quarter with a ratio that was a little ahead of expectations, we're pleased with that. It does reflect some work over the summer and looking forward, I would expect the same kind of trends that we have shown over a longer period of time versus what we saw this quarter.

Sumit Malhotra - *Scotiabank - Analyst*

And if I say 15 to 20 basis points in normal course accretion on a quarterly basis, that's consistent with the range you would envision?

Tom Flynn - Bank of Montreal - CFO

That would be consistent. 15ish to maybe 20 is how I would put it.

Sumit Malhotra - *Scotiabank - Analyst*

Thank you, sir.

Operator

Our following question is from John Aiken from Barclays.

John Aiken - *Barclays Capital - Analyst*

Good afternoon. Was just hoping that you could give us an update on F&C and where things stand right now in terms of the integration and how the discussions have been ongoing with the strategic partners.

And just a point of clarification, in Tom's commentary, when we talked about the 10% that comes from total Wealth Management, not just what you classify as the traditional Wealth Management?

Gilles Ouellette - Bank of Montreal - Group Head, Wealth Management

Thanks, John. The F&C acquisition closed three months ago, and after the first quarter, it's really going well. But we've hit all our numbers on the financials. The employees seem to be pretty happy with the transaction. We certainly haven't lost anybody from the investment management team. The clients, with the exception of the one strategic partner, who declared in February before we closed the transaction that they were going to be leaving at the end of the calendar year, all the clients seem to be happy. And we've been building the book pretty well in the first quarter. We're pretty pleased with the net inflows in the first quarter.

I think as mentioned, when we first did the transaction, that the real value creation here was going to be from us being able to sell the F&C products to the North American client base and at the same time, selling the North American product to the European client base, and that's well in motion.

We've had the training sessions with all of the North American relationship managers with respect to the F&C products. And at the same time, we've had all of the training sessions with the F&C relationship managers with respect to the North American products, and the pipeline is building. We're pretty happy with what's happening and as I say, after -- this quarter it's pretty early, but certainly seems to be hitting on every cylinder. And you're right, with respect to the 10% that Tom was mentioning, that's for the whole Wealth Management business.

It's obviously growing this business to a much larger part of BMO. In terms of with F&C, going forward we're now looking at a sustainable quarterly number somewhere between $235 million to $245 million. And if we can keep growing it organically, I'd say the 18% to 19% and 20% which we've been doing for the last couple years, those numbers grow pretty quickly.

John Aiken - *Barclays Capital - Analyst*

Great, thank you.

Operator

Thank you. Our next question is from Darko Mihelic from RBC Capital Markets.

Darko Mihelic - *RBC Capital Markets - Analyst*

Hi, thank you. My first question is with respect to the growth in the Canadian P&C non-interest revenue. I wonder if you can highlight what it was that gave you a $43 million quarter-over-quarter bump. Was there any items in there, and what specifically helped to grow that quick?

And then the second question relates to card revenues, and if you can provide some sort of a breakdown between what is annual fee and what is interchange related, that would be very helpful. Thank you.

Cam Fowler - Bank of Montreal - Group Head, Canadian P&C

Darko, it's Cam Fowler. Thanks for the questions, I'll start with the NIR. The increase in NIR is driven by what I would characterize as a broad-based set of numbers. We've got growth in retail products and investment products, card products and the commercial business all contributing there.

You asked if there was anything beyond that. There is a small security gain in there, but on balance the vast majority of that activity is underlying core growth that I think is sustainable.

On the card side, can I just double check your question? Was your question a distinction between interchange versus fees?

Darko Mihelic - *RBC Capital Markets - Analyst*

Yes, please.

Cam Fowler - Bank of Montreal - Group Head, Canadian P&C

Yes, I think the way that I would characterize the activity in our cards business is that we are pleased with what we're seeing across the board. Originations have been the priority; as you know, we're focused on the premium business here, and those originations have been very, very strong at multiples of past years.

Balance growth is coming on. We have seen fee growth in the business. I don't think I can give you a specific number on the difference between the fee growth and the interchange, but I think both are at or above where we would expect them to be right now.

Darko Mihelic - *RBC Capital Markets - Analyst*

Okay, thank you.

Operator

Our following question is from Steve Theriault from Bank of America Merrill Lynch.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Thanks very much. Question for one or both Tom Milroy or Tom Flynn, just wanted to delve into the teb offset for a second, so it was relatively large again this quarter. I suspect that's at least a driver of why equity trading was so strong this quarter.

Last quarter you mentioned, Tom, several large client-related transactions. Is that what we're seeing again here in Q3? Can you tell us much about the nature? And having seen these for a couple of quarters, I'm wondering if they're becoming less one-off or more regular?

Tom Milroy - Bank of Montreal - Group Head, BMO Capital Markets

Thanks, Steve. It's Tom Milroy. There's two buckets of activity that impact the teb, and the first one is securities that we hold related to client transactions. And those revenues I would view as being recurring, and so it's a recurring revenue stream.

Then the second ones are the ones we talked about last quarter, which were our client-related transactions that are periodic in nature and therefore, not as predictable. The former is historically well over 50% of the teb revenue. And you're right, in this quarter, in the equity derivatives line, we benefited from some of that in that case.

Steve Theriault - *BofA Merrill Lynch - Analyst*

But there's no particular ramping of the latter category, it just so happens we've seen a couple quarters?

Tom Milroy - Bank of Montreal - Group Head, BMO Capital Markets

Exactly, and it comes and goes. So you can have a quarter with nothing and then a quarter with a couple of transactions.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Okay, thanks for that.

Operator

Our following question is from Mario Mendonca from TD Securities.

Mario Mendonca - *TD Securities - Analyst*

Gilles, if we could go back to F&C for a moment. You referred to what's already been essentially announced, like a preannounced loss of one particular strategic partner, and I want to make sure I understand what you're referring to here. Are you referring to the loss of assets in October 2014 of about GBP15 billion, is that what you were referring to?

Gilles Ouellette - Bank of Montreal - Group Head, Wealth Management

I'm referring to that client, because that is the one client. We don't expect it in October, we expect it more like December. So, it's not going to impact the numbers this year, but it will next year. But having said that, I think we've mentioned in the past that the revenues off the strategic partners are considerably less than what we are getting off the rest of the business. So, it's not going to have the same kind of proportionate impact on the revenues that we will have on the AUM.

We've had discussions with the other strategic partners, and I think there are some opportunities here to build the business with the other ones. I think the circumstances around this one were quite unique. I think there are some other things going on in our Friends Life that brought this about. It certainly wasn't performance because the whole unit was performing, from an investment point of view, it's performing extremely well.

Mario Mendonca - *TD Securities - Analyst*

I think you addressed the second part of my question, which was essentially is there anything else going on in strategic partners beyond this GBP15 billion that you would say is at risk, or would you say you've got that mostly under control?

Gilles Ouellette - Bank of Montreal - Group Head, Wealth Management

Well, we've had extensive conversations with them, and we can't say it's under control, but we think that we have a good relationship with them. And the dialogue has been more about building the relationship rather than ending it. I think they are quite intrigued with a number of other products that we have, and particularly the products that we're bringing from North America; not only in active management, but also in the passive products.

Mario Mendonca - *TD Securities - Analyst*

Okay, and then just finally, and this is more of a housekeeping question. Were there any interest recoveries in the U.S. business that may have affected the margin this quarter, or was it not material?

Mark Furlong - Bank of Montreal - Group Head, US P&C

Yes, this is Mark Furlong. We did have some interest recoveries. We have them every quarter, and we had maybe a couple million more this quarter than last, but we have some every quarter.

Mario Mendonca - *TD Securities - Analyst*

What would it have done to the margin this quarter in terms of what would it have added to the margin, the NIM that you disclosed?

Mark Furlong - Bank of Montreal - Group Head, US P&C

I don't think I have that handy, but it's a couple million more than last quarter. Not 10 million, but just a couple.

Mario Mendonca - *TD Securities - Analyst*

Thank you.

Operator

Our next question is from Peter Routledge from National Bank Financial.

Peter Routledge - *National Bank Financial - Analyst*

I guess a question for Mark. Just on the U.S. business, I noticed your adjusted operating leverage went positive for the first time in several quarters. And I think the question behind that is looking at your adjusted net income, kind of flat in the Supp Pack over the last couple years. When will we get liftoff in this business, where we see 10% year-over-year earnings growth, consistently positive operating leverage?

Mark Furlong - Bank of Montreal - Group Head, US P&C

Good question. As you know, we've wound down a run-off portfolio on the commercial side and that is getting pretty small now. We're winding down through the rest of 2015 and we went through a little margin compression due to some competition. And while we'll continue to see a little bit of compression over the course of the next year or so, nothing like what we've faced this year.

But I guess what I'd say is we have positive operating leverage this quarter. I think next quarter you'll see some of the same on a year-over-year basis. We have good commercial growth and good business banking growth this quarter. And I think the performance in the quarter was pretty good, and I expect we'll continue to see that. The revenue trends were encouraging, and I think that's going to continue to be a big positive for us.

The other side, we're investing in the business and we are into our mortgage and home equity platform and our credit cards. That will have a positive impact on revenues, as will treasury products and services, and then trying to manage expenses as diligently as possible in a regulatory environment in the U.S. that keeps us pretty active.

I think 10% year-over-year, we're not quite there yet, but some number of quarters out in front of us, I think we'll be able to see that on a consistent basis. And clearly, being able to produce positive operating leverage is one of the goals we have.

Peter Routledge - *National Bank Financial - Analyst*

You said the commercial portfolio, you're running down the rest of 2015, or did you mean the rest of 2014?

Mark Furlong - Bank of Montreal - Group Head, US P&C

No, we're down to a relatively small number. But we still have to run it off the rest of 2015. It won't be gone until the end of 2015. But it has a lot smaller effect in 2015 than it did in 2014, so I don't expect we'll talk that much about it next year at all.

Peter Routledge - *National Bank Financial - Analyst*

So, the drag is less. On the non-interest revenue, US dollars it seemed down a little bit more than I would have thought, 126 versus 134. Is there anything unusual in that?

Mark Furlong - Bank of Montreal - Group Head, US P&C

No, the big thing in there is just lower mortgage volumes in the U.S., because you know the $1.8 trillion of mortgages done in 2013 and the estimate for 2014, I realize it doesn't perfectly line up the months, but it's close enough, it was about $1 trillion, down 45% and margins are down on that business too. That's really what we're faced with.

But that has a marginal impact on net income, but it does have an impact on revenues. But that business, we had pretty good growth in production this quarter, and I'm optimistic about what production will look like the next couple quarters based how low the fixed rate financing is in the U.S. I think we'll see some pick-up in that over time, but that's really what -- that's really the big decline in fee income.

Peter Routledge - *National Bank Financial - Analyst*

And then one last one, average current loans and acceptances, growth rate seemed a little slow, were there some loan sales that depressed that this quarter?

Mark Furlong - Bank of Montreal - Group Head, US P&C

There was a little bit that came out of there, but it had a modest impact on it. But what I'd say is what's really in the United States is still on the consumer side, the ability to grow mortgages and home equity loans is still slower. And so I think if you looked at the trends in those portfolios since the peak in 2007, you'd find most banks our size and a little smaller. Of course, the big ones, you'd find that those portfolios haven't started to grow yet.

Now, that being said, certainly with home prices improving in the United States, we've seen a pick-up in home equity lending, and I think that's a big positive. And I expect that some number of quarters down the road we will begin to see that portfolio grow. Utilization of lines on home equity is also down, but some of that's a combination of stronger selling of home equity products, and so the line utilization will pick up over time. I think we'll continue to see some growth there.

The biggest growth in the consumer portfolios in the U.S., as you know, are auto loans, which our portfolio's grown and student loans, which is most of that is handled by the U.S. government. That's not really on most banks' balance sheet. That's really the slow part of what's going on in the consumer side. A little bit of sales, but by and large, the business side of our business is growing pretty strong and grew right through the end of the quarter, so feel pretty optimistic looking forward.

Peter Routledge - *National Bank Financial - Analyst*

Okay, thank you.

Operator

Our following question is from Gabriel Dechaine from Canaccord Genuity.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Good afternoon. Just curious about interchange regulation, if there's a cap implemented on interchange, how would that affect the growth strategy for some of your premium cards, specifically one like the World Elite, the 2% travel cash back card?

Cam Fowler - Bank of Montreal - Group Head, Canadian P&C

Gabriel, it's Cam Fowler here. Thanks for the question. Probably not appropriate to be commenting exactly on the interchange points now. Obviously, we don't have a say in the setting of this.

We are paying quite close attention and as you point out, we are pretty heavily focused on this business and specifically within the business, the premium segment. I think the key point here to keep in mind for the business that we have is, the business is growing very well, particularly in the World Elite.

It will be impacted by an interchange cap, I think that's fair to say. But we are coming to this from a relatively smaller base than the vast majority of our peers, so I don't anticipate this to be a material impact on us. And it will certainly not slow down in any way our commitment to this space and the value of these customers to the franchise.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Or the value proposition I guess, wouldn't be impacted?

Cam Fowler - Bank of Montreal - Group Head, Canadian P&C

Well, I think it's true that issuers in this regard have lots of levers they can consider in terms of economics of the business, as do other participants in the ecosystem, and that one will just play out over time. But we see this to be such an important product to us and our aspiration for primary customers that we've been pretty thoughtful about the whole thing.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Just to go back to Wealth for a minute, and then going through various adjustments here; if I exclude the insurance business, I focus just on what you call Traditional Wealth, back out the F&C contribution to revenues, it looks like organic revenue growth in Traditional Wealth was about 11%. It's a good number, but it falls quite a bit short of the 19% growth in AUM. What's the driver behind that divergence? Is it you've got a bunch of assets at the end of the quarter or some fee adjustments Gilles?

Gilles Ouellette - Bank of Montreal - Group Head, Wealth Management

Actually, the major issue here is that our NIM in the Wealth side year-over-year has been down 29 basis points. So, the NIR growth, fees, commissions, et cetera, were up 15%, but the NIE growth was around 1%, and that's from the interest rates, right? So, now that's stabilized because comparing it to the previous quarter, it's only down about 2%. But it does look pretty bad year-over-year, but the NIR makes up for it.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

That's helpful, thanks. And if I could sneak another one in there for Bill or Tom on the capital, I was a bit surprised to see you reintroduce the 2% drip discount in the quarter. Was that a one quarter thing, now that you're at the low end of your target range for Core Tier 1?

Tom Flynn - Bank of Montreal - CFO

It's Tom. We put the discount on during the last quarter and took it off for the dividend declared today. So, it was just a one quarter discount, and we decided to take it off given the strength of the ratio in the quarter.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay, thanks. I'll requeue.

Operator

Our next question is from Doug Young from Desjardins.

Doug Young - *Desjardins Securities - Analyst*

Hi, good afternoon. One key question, I know there's some give and takes on the EPS this quarter between the M&I, PCI and PPL, and then I think you had lower security gains and the hit on the insurance side. And I'm just also wondering, with all of the adjustments you made to lower your risk-weighted assets, if there was any gains that came through related to sales of the securitized portfolio or buying bulk insurance, if there was any gains that I'm missing in there.

Tom Flynn - Bank of Montreal - CFO

No, there were no gains that resulted from the activities that you're asking about. And overall in the quarter, as you probably saw, security gains were quite low relative to our normal run rate.

Doug Young - *Desjardins Securities - Analyst*

Yes, okay. But there's nothing else unusual,? Okay.

And then just on the Wealth Management quickly, and I know there's a lot bouncing around on the efficiency ratio, but I did see the efficiency ratio increasing. And I'm just wondering, is that now a new normal efficiency ratio level for the Wealth business overall? Or is there, or should we be anticipating that to come down back towards where it historically has run? And is that an impact of the business mix impact because of the F&C acquisition?

Gilles Ouellette - Bank of Montreal - Group Head, Wealth Management

No, the F&C acquisition didn't have much to do with it. That ratio is roughly in line with the overall Wealth Management ratio. Obviously, this quarter was impacted by the interest rates, or the loss as a result of interest rates. The number was about 70.7. We think that we can be tracking to around 70. But when we project out a couple years, what with the revenue growth that we're expecting, we think that number is going to go down below the 70 number.

But given the business mix, we think that probably the number that we can realistically shoot for is probably around 67 to 68. A lot of it has to do with mix, and some of the businesses we run have a high efficiency ratio. It's just the nature of the business.

Doug Young - *Desjardins Securities - Analyst*

And so just a point of clarification on an earlier question, and sorry I missed this. You talked about $235 million to $245 million with F&C on the Wealth side. Can you just clarify, is that your target in terms of where you think you can take earnings, or?

Gilles Ouellette - Bank of Montreal - Group Head, Wealth Management

No, no, that's what we're running currently.

Doug Young - *Desjardins Securities - Analyst*

Okay, that's fine, thank you.

Operator

Our next question is from Meny Grauman from Cormark Securities.

Meny Grauman - *Cormark Securities - Analyst*

Good afternoon. A question about your ETF business. I'm hearing that there's growing pricing pressure in that business, and I was wondering what the competitive landscape is and specifically, what is going on with fees in this business?

Gilles Ouellette - Bank of Montreal - Group Head, Wealth Management

Thank you for the question. The ETF business, I think how I would describe it, the MERs of ETF is quite a bit lower than mutual funds, and equities are higher than fixed income. Although there's been some competitive pressure, the reason that MERs have come down a little bit in that business in the last couple of years is because there's been a trend more towards fixed income ETFs. And we've been leading the trend. So our MERs will come down a little bit, but they have stabilized now.

On the other hand, when you have specialty ETFs, like covered call ETFs that we've had a lot of success with; the MERs in that business are quite a bit higher. So, it depends a lot on the products that you're launching. I think in the last, as I say, the last couple years, because of the launch of the fixed income ETFs, the MERs have come down.

Just as a matter of interest. BMO is now in the top 10 globally in fixed income ETFs. So, we more or less like to take credit for introducing these to the Canadian marketplace, and they have been extremely well received. And volume is picking up and with that, the contribution is also picking up.

Meny Grauman - *Cormark Securities - Analyst*

Thanks, and then just a quick question on F&C. You noted selling F&C products to new customers, in particular, bringing other products to North America. I'm wondering, how long does this sales process typically take? Or more clearly, when do you expect to see real progress in terms of that initiative?

Gilles Ouellette - Bank of Montreal - Group Head, Wealth Management

One of the reasons that we were so interested in F&C was because we'd had a lot of success selling the Pyrford international money management or asset management to the North American market. I think in the last three years, the assets of Pyrford have tripled, and a lot of it had to do with our North American distribution. So, we felt pretty comfortable.

Now, it did take us a couple years to gain some traction in North America because we had to train the sales force, et cetera. With this, with F&C, we started training the sales force right out of the gate, and it's not so much about how long is it going to take us. We're really into the institutional timing for these. And the buying cycle, as you know, in this business is a little bit longer. So, I would expect that we're going to start seeing some benefit from this in the latter part of this calendar year.

Meny Grauman - *Cormark Securities - Analyst*

Great, thank you.

Operator

Our following question is from Derek Devries from UBS.

Derek Devries - *UBS - Analyst*

Thanks, and good afternoon, everyone. I want to go back to an earlier comment you made about the U.S. personal and commercial banking business. And you were talking about the pressures on NIM, and you said that going forward, you'd expect to see less competition on the asset side of the balance sheet.

First, how many more quarters should we roll forward that guidance for 2 to 4 basis points of NIM pressure? And then second, why would you think in a higher interest rate environment we would see less pressure competitively on the asset side? I would have thought it would be more.

Mark Furlong - Bank of Montreal - Group Head, U.S. P&C

Okay, this is Mark Furlong again. So, I probably said something like less competition; what I should have said is the intensity of the competition is a little different today than it was a year ago. But so I still think we'll see some competition, but all the conditions precedent to having an increase in interest rates would tell you there's some expansion going on that is a lot more substantive than it is today. And if that's the case, that sounds like a lot more growth and a lot more opportunity.

And clearly, as you have seen from the writings of the performance of the U.S. banks, there's a narrower group of banks that are having relatively robust growth in loans and so therefore, there's a lot more competition. As that expands in the US, that growth, then naturally there will be more sources that aren't necessarily there today.

I think going forward we'll see stronger growth in the U.S., and that will give everybody a chance to participate in that, and hopefully that maybe neutralizes some of the silliness that goes on from time to time in loan pricing.

In terms of looking forward from a margin compression, the risk of compression, I think that maybe it would be best if I for at least the fourth quarter said, I don't know the range has really changed much, at least right now for what the risk of that is. The positive side is that as we get loan growth, it's coming out on the business side in spreads that are less than the loan growth that we got three or four years ago. So that, as opposed to robust repricing, is naturally bringing spreads down.

We'll grow net interest income because we're adding good relationships and cross-selling into that relationship, albeit they are going to come on at spreads that are below historical spreads. I see that as the positive to the equation, and we'll continue to grow deposits through the cycle. I'm sure there's some excess liquidity that will move out, but that's just natural in a rising rate environment.

And then I think the last piece, so I make sure I give you a complete answer, is I think that when we get to the fourth quarter, I'll be able to give a little broader outlook on what happens to the spreads, what happens with margins in 2015.

Derek DeVries - *UBS - Analyst*

Okay, that was very complete. I appreciate your response.

Operator

Thank you. Our next question is from Mario Mendonca from TD Securities.

Mario Mendonca - *TD Securities - Analyst*

Question for Cam. Can we go back to response to Darko about the growth in non-interest revenue? My inclination is to try to tie that growth into something else that's happening. And would it be fair to say that that growth is connected to the growth we're seeing in loans, deposits, investment income -- or in AUM? It would be helpful if you could try to marry that with something that we also see throughout your disclosure.

Cam Fowler - Bank of Montreal - Group Head, Canadian P&C

Thanks for the question, Mario. It's Cam here. I think what you're asking is where is it coming from, and I would go back to the fundamentals of what's going on in the business.

The objective we have is sustained organic growth at the head of the market right now and for the past few quarters, I think we've been able to do that. The balance sheet is what's driving it, and you can see that in most categories we're up ahead of the market, which is exactly where we would like to be. But we are benefiting on the retail side on products, investments are kicking in.

The card products are contributing as is the commercial business. I think there's more opportunity on the card side in the future, but it's very broad-based. And I would link it to the sales performance and the distribution disciplines that we have going on in the Canadian business on both sides of the balance sheet.

Mario Mendonca - ***TD Securities - Analyst***

Okay, that's helpful, and another, more of a philosophical question. When you were referring to interchange, and I'm not going to ask about numbers here, when you were referring to interchange, you said we don't have a say in the interchange fee. And that's virtually identical to what Royal Bank said on their call, they said we don't have control of the interchange.

And what confuses me about both of those statements is that the banks are providing a service and getting paid for that service. So, why wouldn't the bank have a say in what it gets paid? And both banks offered the same explanation, in both cases I was confused. Why wouldn't the bank have a say in what it gets paid?

Cam Fowler - Bank of Montreal - Group Head, Canadian P&C

That's quite a philosophical question you're asking, and I'm not in a position to answer it. We have a well-structured and secure payment system in the country that's been in place for a long time, many decades. And it's the networks who make this call, and that's the way it is. We participate to the extent that we're asked and we're invited for our opinions, but we are one player in a complicated ecosystem. That's all I have to say on that.

Mario Mendonca - ***TD Securities - Analyst***

So, if Visa and MasterCard announced we are going to get paid zero, how do the banks react to that? It just seems odd that a bank doesn't have a say over what it gets paid for providing a service.

Cam Fowler - Bank of Montreal - Group Head, Canadian P&C

I can understand where you're coming from. I didn't set the rules. How we would respond is the way that I suspect most organizations respond in competitive situations, which is to assess your options and see how you think you could do best in the market.

Mario Mendonca - ***TD Securities - Analyst***

Thanks.

Operator

Thank you. This concludes the Q & A session. I would now like to turn the meeting back over to Ms. Haward-Laird.

Sharon Haward-Laird - ***Bank of Montreal - Head, IR***

Thank you everyone. We're happy to take any further calls in Investor Relations with any follow-up questions, and have a great afternoon. Thank you.