BMO Financial Group

Q4 2017 CONFERENCE CALL

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PRESENTATION

Jill Homenuk - ***Bank of Montreal - Head of 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 Darryl White, BMO's CEO; followed by presentations from Tom Flynn, the bank's Chief Financial Officer; and Surjit Rajpal, our Chief Risk Officer. Following the formal remarks, the group head for each of our businesses will provide comments on their outlook for 2018.

We have with us today Cam Fowler from Canadian P&C and Dave Casper from U.S. P&C. Pat Cronin is here for BMO Capital Markets and Joanna Rotenberg is representing BMO Wealth Management. After the group head presentation, we will have a short question-and-answer period where we will take questions from prequalified analysts.

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.

Darryl and Tom will be referring to adjusted results in their remarks, unless otherwise noted as reported. 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 MD&A and our fourth quarter earnings release.

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

Darryl White - ***Bank of Montreal - CEO***
Thank you, Jill, and good afternoon, everyone.

Earlier today, we announced earnings for the fourth quarter of $1.3 billion, concluding a record year with net income of over $5.5 billion and earnings per share of $8.16, up a strong 10% and 9%, respectively, from last year. These results demonstrate the continued benefit of our diversified and competitively advantaged businesses and our ability to anticipate and adapt to a rapidly changing environment.

Our operating groups contributed to good revenue growth for the year of 6%, driven by continued customer, loan and deposit growth in a generally constructive environment.

Expenses continue to be well-managed, increasing 4% from last year as we balanced improved operating efficiency with investing for future growth. Operating leverage for the year was 1.9%, in-line with our medium-term target of 2% and building nicely on the 2.1% we achieved last year.

The balance sheet remained strong and well-diversified. Loan losses have increased in-line with loan growth and the PCL ratio remained stable at 23 basis points.

We have a strong capital position with a CET1 ratio of 11.4%, providing good flexibility to continue to grow the business and to return capital to shareholders. During the year, we repurchased 5 million shares under the NCIB and earlier today, we announced an increase to our quarterly dividend of $0.03 per common share or 6%, reflecting strong fundamentals across the bank. This will bring our annual dividend to $3.72.

Each of our operating groups demonstrated good performance for the year and is well positioned for continued growth. In Canadian Personal and Commercial Banking, we had good underlying earnings growth of 6% and that's excluding the Moneris gain in the first quarter, with improved efficiency, lower loan losses and improving margins in the second half of the year. Balance growth is well diversified and we remain committed to building a leading customer experience, delivering the innovative products and services that our customers want. For example, customers can now go paperless with the introduction of e-form and e-signature capabilities, making it easier and faster to bank with BMO.

U.S. Personal and Commercial Banking had solid performance with momentum in commercial lending and growth in personal deposits and customers. We benefited from improved deposit margins and are making key investments in the business that will drive future growth.

BMO Capital Markets earnings were up 5% this year despite the impact of the tax change in our Canadian equity business. This was driven by particularly strong results in the U.S. where earnings were up approximately 50% in each of the last 2 years.

In BMO Wealth Management, we had a very strong year in both Traditional Wealth and Insurance with earnings up 18%, even with the impact of elevated claims in our reinsurance business this quarter. Performance reflects growth in assets under management from improved equity markets and from net new client assets as well as good loan growth and deposit growth. Initiatives to improve efficiency across the business led to strong positive operating leverage of over 5%.

Our U.S. segment overall, which now contributes to 25% of total bank earnings, has delivered compound annual income growth of 13% over the last 2 years, delivering strong operating leverage and improving its efficiency ratio by over 6% since the end of 2015.

The bank remains committed to our medium-term objectives: EPS growth of 7% to 10%, operating leverage of 2% or more, capital that exceeds our regulatory expectations and an ROE of 15% or more, based on our view that return on equity will improve over time from the actions underway and as interest rates rise from currently low levels.

We also remain committed to our strategy, which is firmly rooted in the customer. It's built on a solid foundation that positions us well to accelerate growth. And as we look forward, we have a focused agenda, and I'd like to highlight four specific areas we're putting a lot of energy into right now.

First, we're accelerating our growth in our U.S. segment. We have a long and well-established U.S. presence dating back to the bank's earliest roots, which accelerated in the 1980s, and now has a leading position and reputation driven by our deep commitment to customer relationships, by our highly qualified bankers. We've built through strong organic growth and targeted acquisitions in commercial banking and capital markets while we reinforced our wealth business on core private banking and asset management. We expect a constructive environment going forward and continued strong performance as we drive more revenue in U.S. Capital Markets, continue to build on the strength of commercial banking, accelerate our growth and profitability in personal banking and grow core personal wealth and asset management clients and revenue.

Second, we're accelerating the transformation of our business through a pragmatic approach to technology investment and deployment. We're now leveraging our multi-year investment in foundational architecture and data integration to enrich customer experience, simplify processes and speed up delivery, driving both revenue growth and expense savings. We've seen steadily increasing digital adoption leading to customers who are more loyal and do more business with us. Similarly, good momentum in digital sales is bringing new customers to BMO and expanding existing relationships. Customers are enjoying the convenience of technology-enabled Smart Branches and enhanced ABM functionality as we deliver a more personalized experience at a lower cost.

Third, we are maintaining our focus on efficiency improvements. As I mentioned earlier, we achieved a strong operating leverage of 1.9% this year and 2.1% last year, which combined, improved the efficiency ratio by 240 basis points since the end of 2015. We have made good progress and I expect it to continue.

Fourth, I'd like to highlight with pride that we believe our employees, our culture and our values are a competitive advantage. We have consistently high, industry-leading employee engagement. Across the organization, employees are empowered to create and embrace change, allowing us to adapt more quickly in an evolving environment. A diverse workforce, an inclusive workplace and a commitment to gender equality helps ensure employees and customers feel valued, respected and heard, which in turn leads to stronger business performance.

We're honoured to have earned external recognition for this commitment. Just last week, BMO was named one of the 2017 Most Admired Corporate Cultures in Canada by Waterstone Human Capital. And earlier this year, we were recognized as one of the Best Workplaces in Canada by the Great Place To Work Institute. Earlier this year, we achieved best-in-class ranking of 19th out of 6,000 public companies in the 2017 Thomson Reuters Diversity & Inclusion Index, and we are one of only 9 organizations in the world to receive the Catalyst Award twice.

Later in the call, you will hear from each of the leaders on their outlook for the year ahead. From my perspective, we enter the year from a position of strength, and we have all the elements in place to take advantage of the opportunities in the current environment and over the long term.

With that, I'll turn it over to Tom to talk about the fourth quarter.

Thomas E. Flynn - ***Bank of Montreal - CFO***
Okay. Thank you, Darryl.

I'll start my comments on Slide 9 and will focus on the Q4 results. Q4 reported EPS was $1.81 and net income was $1.2 billion. Adjusted EPS was $1.94 and adjusted net income was $1.3 billion. Reported and adjusted results this quarter include elevated reinsurance claims of $112 million, which reduced net income growth by approximately 8% and reduced EPS by $0.17. The high level of claims reflect the extraordinary circumstance of having 3 major hurricanes and earthquakes in the quarter.

Adjusting items in the quarter include a restructuring charge of $59 million pre-tax or $41 million after-tax. The charge reflects our work to accelerate the use of technology to enhance customer experience and to drive operational efficiencies. Adjusting items for the quarter are shown on Slide 25.

Adjusted net revenue of $5.1 billion was down 2% from last year. Revenue was flat, excluding the impact of the weaker U.S. dollar. Elevated reinsurance claims and the gain on the sale of an equity investment in the prior year together had a 3% impact on revenue growth. Net interest income increased 2% year-over-year. Net non-interest revenue was down 6%, mainly due to the items mentioned a minute ago.

Expenses were well-managed as we continue to focus on improving efficiency while investing in our business and technology. Adjusted expenses were essentially unchanged from last year, or up 2% excluding the impact of the weaker U.S. dollar.

Adjusted operating leverage was negative for the quarter and flat excluding the impact of the reinsurance claims.

The adjusted effective tax rate was 19.3% compared with 21% a year ago, primarily due to higher tax exempt income from securities. The adjusted effective tax rate on a teb basis was 27.2%, up 1 point from a year ago.

Moving to Slide 10. The Common Equity Tier 1 ratio was strong at 11.4%, up 20 basis points from last quarter. As shown on the slide, the ratio benefited from capital growth from retained earnings and pension impacts, net of higher source currency risk-weighted assets and the impact of share buybacks.

Moving now to our operating groups and starting on Slide 11. Canadian P&C showed continued positive trends with adjusted net income of $625 million, up 6% from a year ago. Results continue to benefit from our advantaged commercial business and good deposit growth. Revenue growth was also good at 5%, driven by higher balances across most products, higher net interest margin and increased noninterest revenue.

Total loans were up 4%. Personal loans, including mortgages were up 3%. Mortgage growth of 3% reflects our decision to scale back participation in third-party mortgages given their return profile. We continue to focus on growing in our own channels where mortgages were up 5% from last year. Commercial loans were up 7%. Total deposit growth was 6% with personal deposits up 5%, including 11% growth in chequing account balances and 7% commercial deposit growth.

NIM increased 5 basis points from last quarter, primarily due to higher deposit spreads and also some benefit from interest recoveries. Expenses were well-managed, up 3%. And operating leverage at 1.7% was the best in the year, and the efficiency ratio was 48.4%. Provision for credit losses were higher compared to last year due to higher commercial provisions.

Moving to U.S. P&C on Slide 12. Adjusted net income was $291 million. The comments that follow speak to the U.S. dollar performance.

Adjusted net income of $231 million was up 2% from last year. Revenue was up 3%, driven by deposit revenue and commercial loan volumes. Average loan balances increased 1%. Excluding the indirect auto loan portfolio, average loans were up 5% from the prior year. Commercial loan growth was 8%. Net interest margin decreased 3 basis points from Q3 due to loans growing faster than deposits, partially offset by improved deposit spreads. Expenses were up 3% year-over-year. Credit provisions were modestly higher compared to last year and down from the third quarter.

Turning to Slide 13. BMO Capital Markets adjusted net income was $326 million, down from a record quarter a year ago. Our Capital Markets U.S. business continues to perform very well with net income up 5% from the prior year and 34% from the prior quarter in U.S. dollars. As Darryl mentioned, U.S. growth has been excellent and is up approximately 50% in each of the last 2 years in Capital Markets. Revenue of $1.1 billion was down 4%. Investment and Corporate Banking revenue was lower from a strong quarter last year and trading revenue was largely unchanged. Expenses were up 3% from last year. Provisions for credit losses were higher due to net recoveries in the prior year.

Moving now to Slide 14. Wealth Management adjusted net income was $186 million. As mentioned, the results this quarter include elevated reinsurance claims of $112 million. Our reinsurance business is well diversified and treaties are written with a high attachment point, which means losses from an uninsured event must reach significant levels before we have meaningful claims. This is clearly an unusually high claims quarter given we had 3 large hurricanes during the quarter and earthquakes. We expect claims of this type of magnitude to occur infrequently with our last significant claims year being 2011. Earnings in Traditional Wealth were lower versus last year as business growth was more than offset by a gain on sale of an equity investment last year. The Insurance business had a net loss in the quarter as reinsurance claims more than offset benefits from favorable market movements and the impact of investment portfolio related changes. Adjusted expenses increased 2%, reflecting continued very good expense management.

Turning now to Slide 15 for Corporate Services. The adjusted net loss was $119 million compared to a net loss of $188 million a year ago. Results were better mainly due to lower expenses, in part due to a real estate gain from the sale of an office building and higher revenue excluding teb, partially offset by lower credit recoveries.

Lastly, I'd like to comment on the adoption of IFRS 9. As you know, IFRS 9 becomes effective for us in Q1 of next fiscal year and introduces an expected credit loss methodology. The implementation of this standard is not expected to have a significant impact on shareholders' equity or capital. As noted in our disclosure, we expect an increase in shareholders' equity on adoption of approximately $65 million after-tax.

To conclude, the fourth quarter capped off a strong year with earnings up 10%, operating leverage in line with our 2% target and a strong capital position. We're confident of continued momentum as we head into 2018.

And with that, I will hand it over to Surjit.

Surjit S. Rajpal - ***Bank of Montreal - Chief Risk Officer***
Thank you, Tom, and good afternoon, everyone.

Starting on Slide 17. Specific provisions were $208 million or 22 basis points, flat to the prior quarter. For the year, specific PCL of 23 basis points were unchanged from the prior year. Provisions in Canadian P&C were $134 million this quarter, up $9 million from the prior quarter due to an increase in commercial losses with no industry concentration. U.S. P&C provisions decreased $13 million to $66 million. PCLs were down due to a sale of legacy consumer loans and normal variability in the commercial portfolio. In Capital Markets, PCLs were a modest $4 million this quarter, up from a small recovery last quarter.

On Slide 18. Formations were $527 million are in line with the average formations over the past 2 years. Gross impaired loans increased $65 million to $2.174 billion, with the majority of the increase as a result of FX. The GIL rate was 57 basis points.

Turning to the Canadian residential mortgage portfolio on Slide 19, uninsured LTVs remain stable and delinquency levels were unchanged. On originations, LTVs were also stable as were credit scores and amortization periods. We continue to be very comfortable with this exposure.

As Tom mentioned in his remarks, the IFRS 9 expected credit loss methodology became effective on November 1st. We estimate a reduction in our allowances of $100 million from the new methodology. Our allowances continue to provide robust loss coverage.

In summary, we had another good quarter from a credit perspective. And given the strong economic outlook, we expect losses over the coming year to remain in the low to mid-20 basis points.

I will now turn the call over to Cam.

Cameron Fowler - ***Bank of Montreal - President of North American Personal & Business Banking***
Thank you, Surjit.

2017 was a very positive year for Canadian P&C. We continued to deliver strong financial performance, including positive operating leverage in 7 of the last 8 quarters and record net income. And we made strong progress against our strategic agenda, most notably through investments in digital initiatives and the continued evolution of our physical network and advice-based sales force. And we're well positioned to deliver growth in 2018. Our priorities remain the same and my confidence is grounded in 3 key areas.

First, is on digital. We're focused on building simple personalized experiences for our customers. And we've made great progress in architecture, digital process and customer facing capabilities to this end, including our recent launch of the BMO skill for Amazon Alexa. 2018 will be another important year as we drive towards our objective of greater than 70% digital adoption, greater than 30% digital sales penetration and continued double-digit mobile transaction growth.

Secondly, we have a strong commercial business and it will continue to be an engine for growth. We're focused on diversification by sector and geography and we're seeing positive results that we expect will continue. For example, we have double-digit growth in technology, health care and transportation. And in the GTA, where we are undersized relative to our portfolio, we're seeing double-digit growth in key customer segments. We'll build upon this momentum in 2018 by increasing our commercial account management capacity by 10% to 15% in this market.

Lastly, we continue to focus on reducing structural costs through a pragmatic and disciplined approach to enable reinvestment back into our business, most notably in advisory-based sales, new formats, digital and marketing.

In summary, I'm proud of the results we delivered in '17, and I'm excited about the accelerated performance in 2018.

I'll pass it now to Dave.

Dave Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***

Thanks, Cam.

U.S. P&C delivered good results in 2017. We have a clear strategy and are executing on it. And this will continue into 2018 with good revenue growth and positive operating leverage.

Our well-diversified commercial business continues to build on a strong track record as we opportunistically expand our geographic footprint and grow our specialized national businesses. Our pipeline is strong and the confidence of our client base is improving, leading to what I expect will be another year of mid- to high single-digit year-over-year commercial loan growth.

Our personal business is also gaining momentum. In 2017, we opened a record number of new accounts and delivered personal deposit growth of 5%. In our mortgage business, we redefined our sales model, streamlined processes and optimized our pricing to ensure that we remain competitive.

Across all of our businesses, we're making the necessary investments to improve our customer experience with a focus on revenue growth, including investing in our online banking platform and Smart Branch technology in our retail business, and making significant improvements to our already industry-leading treasury management product offering in our commercial business. At the same time, we remain focused on expense management.

The improving interest rate environment and the potential for favourable corporate tax legislation gives me additional confidence in our long-term success. Overall, I'm very proud of the results we delivered in 2017, and our entire team is poised to build on that momentum in 2018.

And with that, I'll pass it to Pat.

Pat Cronin – *Bank of Montreal - Group Head of BMO Capital Markets Corp.*
Thank you, Dave.

After a strong performance for Capital Markets in 2017, the solid NIAT growth, despite the impacts that Darryl mentioned in his opening comments, we feel really well- positioned in 2018 to build on our position of strength and momentum with a diversified and client-focused business model and a prudent approach to risk management.

In Canada, we have dominant market share positions across all products and segments that we operate in, and we intend to competitively protect that position. As such, we expect this business to continue to perform well going forward, despite the full year impact of the federal budget changes and higher funding costs.

The U.S. continues to be our largest current and future growth driver. And we expect to further leverage our strong U.S. capabilities, product breadth and capital position to further differentiate ourselves in the marketplace with our clients. We also expect to drive more U.S. net income through a deeper partnership with our strong U.S. commercial partners. And so for all of these reasons, we expect our U.S. platform to continue to see strong net income growth next year.

We will continue to grow our corporate lending books in Canada and the U.S. with an overall growth rate roughly consistent with our experience over the past few years to drive greater depth and breadth in our client relationships.

We expect to continue to invest in our control environment to ensure that it remains robust with good risk and capital control, which we think is a great foundation for the growth that we just mentioned. We continue to see upside from increasing our focus on expense management, which will lead to positive operating leverage next year.

We're proud of our strong results in 2017. We have real momentum going into 2018. We expect constructive markets, given current economic forecasts. And consequently, we're confident in our outlook for the year ahead.

And with that, I'll now turn it over to Joanna.

Joanna Rotenberg - *Bank of Montreal – Co-Head of BMO Wealth Management*
Thank you, Pat.

In 2017, Wealth had a strong year. We had adjusted net income after-tax over $1 billion and we represented 18% year-over-year growth. We had strong and record deposit and loan revenue growth, nearly 400 points of productivity improvement, strong operating leverage and we had improved client experience measures across just about every business.

Going into 2018, we expect a similar or even better rate of net income growth. And our goal is to double our business over the next 5 years.

Our personal wealth business will deliver this by positioning our model to serve clients exceptionally in high-growth segments where BMO has got a competitive advantage, like business owners. Expanding our digital wealth capabilities and digitization to deliver a great client experience as well as productivity gains, and working across our businesses and our borders to deliver the best of BMO to every client.

Our Global Asset Management business has streamlined its structure and will grow by focusing on globally relevant world-class and consultant-credible products, focusing distribution in target markets, segments and channels where we have an advantage, and shaping our operating platform to profitably scale up our business.

In U.S. Wealth, we have a strong foundation for growth, having seen through exiting non-core businesses, streamlining our operations and enhancing our leadership and go-to-market model. Our underlying efficiency ratio is now over 400 points better than 2 years prior. So we're well positioned for strong top and bottom line growth.

And finally, Insurance. Absent any significant movements in loan rates or unusual items, we would expect to deliver approximately $70 million in quarterly after-tax earnings, and that would reflect continued growth in our underlying businesses.

So in summary, we had a strong year in 2017, and we feel very confident going into 2018.

Back over to you, Darryl.

Darryl White - ***Bank of Montreal - CEO***
Thanks, Joanna.

So I think that we've heard a consistent theme from each of our business leaders. As a team, we are united in our confidence in the bank and in our opportunities for growth going forward. And I would add that we intend to deliver it sustainably, creating value for shareholders and acting in the long-term interest of our customers to earn and maintain the trust that our business with them is built on.

So with that, operator, we will move to take questions from the phone.

QUESTION AND ANSWER

Meny Grauman - ***Cormark Securities***
I wanted to ask about commercial deposit growth. It's contracting, so I want to know what's driving that and what's the outlook going forward.

And then as a follow-on, how do you fix that trend? And does it have an impact on margins?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
Meny, this is Dave. I'm assuming you're talking about the U.S.?

Meny Grauman - ***Cormark Securities***
In the U.S.

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
A couple of things. The growth in deposits, or in this case, the lack of growth in commercial deposits is actually in just one area. These are low value, very high-rate sensitive deposits that we have expected for at least a year that they would ultimately go. Most of those have gone already. It does not have any meaningful impact at all on our earnings. And our core growth in both our retail and our commercial deposits are up. Our retail deposits are up. Our core retail is up about 5% or 6% and our commercial core deposits are up close to that same amount. So to just kind of pull it back, I want to remind you, the way we're set up in the U.S. -- just as we're overweight on the loans to commercial, probably 65% or 70%, to 30% retail, we're also in a very good way very overweight on the deposit side to retail. And the retail has continued to grow.

So let me just stop for a second and make sure that I've answered your question. But the big point is, the decline we saw in that one area was expected. It was planned and these are low value, high volatile deposits. Does that help?

Meny Grauman - ***Cormark Securities***
Yes. So just to clarify, you're saying going forward, you don't expect any further declines in that deposit bucket?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking Banking***
The declines that we had to date were a little bit less than we expected. But if there are further declines, I would expect them to be very modest and offset by core deposit growth.

Meny Grauman - ***Cormark Securities***
Okay. And so you're not making any changes to where you're focusing on collecting deposits or how you're collecting deposits. Is that correct?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
No. Our focus has always been on core deposits, and these are deposits that we get from our commercial clients where we're providing all the operating services.

On the retail side, we continue to grow that. As you recall, we have just under 600 branches in the United States. We have a really strong deposit gathering capability on the retail side. And our focus has remained the same and we expect to continue to grow them.

Stephen Theriault - ***Eight Capital***
If I could start with Cam. Cam, just to expand on your outlook. The margins have been very strong, up 10 basis points in the back half of the year. Can you touch on your outlook there for '18?

And then Tom mentioned in his comments a bit of a scale back in third-party mortgages. I may have missed it there. Can you talk about what that means for mortgage growth next year in terms of your outlook?

And maybe it makes sense there to fold in your expectations for growth incorporating the B-20 that's coming into effect the beginning of the year.

Cameron Fowler - ***Bank of Montreal - President of North American Personal & Business Banking***
Okay. Thanks, Steve. On the first one on NIM, just a reminder, there's 2 things driving the 5 points. One is spread. The other is an interest gain. They're about half-and-half. So it's 5 points. Going forward, it's stable-to-up for us next year. And to me, that means probably between 2 and 3, to 2 and 4 points to the positive through the course of '18.

Question #2 on third-party. There's nothing particularly new there, just that the economics are getting tricky to rationalize from an ROE perspective, given the other places we could be deploying capital. We are just as focused on the market though as we ever have been. This is, to us, a primary customer game, and we like our proprietary channels best. We made that decision 8 or 9 years ago when we went out of the broker market. So from our proprietary channels, we'd expect to be at market, which, this year has been 5% or 6%. And '18, I expect will be maybe a little more modest at 4%, 5%. And we'll be right in there, I would expect, in our proprietary growth.

On the final question, B-20 and impact. I think what I would say is change is coming January 1. We are prepared for it. I would expect that the impact on our originations would be between 5% and 10%. That is factored into the forecasts that I gave you in terms of expected growth.

Stephen Theriault - ***Eight Capital***
Okay. And then if I could do one more for, probably, for Tom, or for Joanna on the reinsurance losses this quarter. The disclosure is fairly limited. I find that whenever we go through these cycles, where there's a lot of pain in a short period of time, we think about returns through the cycle. And the last bit of pain was in 2011 with the issues in Japan and in New Zealand. Can you talk about what the returns maybe have been since then? Or how you think of through the cycle returns? It seemed like we've had Katrina 10 years ago. We had Japan 5 years ago. And now we have these issues. Is this a 5-year cycle in terms of how you think of this business? Anything that helps us there in terms of why this business makes good sense and why it's a good return business for you guys would be helpful.

Joanna Rotenberg - ***Bank of Montreal – Co-Head of BMO Wealth Management***
Sure. I'm happy to answer. This is Joanna. And great questions. Let me start off by saying, we do believe it's a good business. And it does provide a good return on capital.

For your purposes, I would think about the through cycle return on capital as being between 15% to 20%. I'd say it could go as high as 25% in years where we don't have claims. And I would say one of the reasons we like it is because of that return. Another is because of the diversification it offers us. We're highly diversified globally, and I would say that includes worldwide coverage; very limited in Canada, very uncorrelated to bank returns, as you can imagine based on the portfolio. And we have a good mix of both property catastrophe as well as more of a specialty book. So it's well diversified and a good return on capital.

As you point out, this is a highly unusual year and I think Tom had referenced that before. We expect, based on our modeling, that even a single event like one of the earthquakes that we had of that magnitude would be more like a 1 in 10-year event based on our risk model and when you put them together, it's more approaching 1 in 80. So this is a highly unusual series of events to have them at this level of attachment point. And I would just remind you, as Tom said, we do reinsure at high attachment points. What that practically means is, you won't see any claims typically in an event like a Sandy. It's probably a great example where it was something approaching $20 billion, and we had no claims out of that. And as you point out rightly, our last major claim of consequence would've been with the New Zealand and Asian earthquake. I'd also remind you, our losses are capped as we do have a good prudent cap and so we do have good tight oversight over the risk limits there. And because of the annual nature of this business, we do believe should conditions change, it's really an annual renewal of our treaty. So we feel good that we have good flexibility in the business as well.

Stephen Theriault - ***Eight Capital***
And when you think about the business in terms of just the insurance business and you gave us an outlook of $70 million normalized earnings per quarter. And not necessarily relative to that, but when we think of the business over the last few years, has the reinsurance business been 10% of the earnings, 20% of the earnings? Could you ballpark that for us?

Joanna Rotenberg - ***Bank of Montreal – Co-Head of BMO Wealth Management***
Sure. It's about 20% of our earnings and what I would say, as we look at the underlying growth of the insurance business as well as Wealth Management, I would expect it to grow about in-line with Wealth Management more broadly. So no significant swings.

Nick Stogdill - ***Crédit Suisse***
If I could go back to Dave on the U.S. P&C business. I just wanted to get your updated outlook on the personal loan balances for 2018 – they're still relatively flattish here sequentially. I know last year was impacted, or the year-over-year growth was impacted by the sale of the indirect auto portfolio. So maybe just some updates on initiatives you have for the personal side of the business going forward.

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
So the personal business has already started to make some pretty significant improvements in the fourth quarter, both in our mortgage business, and our indirect auto business has started to pick up again. And I would expect overall in that year-over-year, we would have modest growth, but definitely a growth in the 2% to 3%, I would think, in that range. We have some good things going. We looked at the overall business and as you may recall, I think we had mentioned it before, we have made a purchase, a one-time purchase of about $2 billion in the mortgage business that we made very early in this quarter. So we should have some good growth and good momentum.

Nick Stogdill - ***Crédit Suisse***
And for that mortgage purchase, that's just a one-off? There's nothing more strategic to it? And we shouldn't really expect that to be a recurring type of activity going forward?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
No. I would not expect it to be recurring. I would expect though that our mortgage business will continue to grow as we expand, but that would not be something we'd do on a recurring basis likely.

Gabriel Dechaine - ***National Bank Financial***
I've got a question about the U.S. for Dave. And then I've got a question on the strategy, a bigger picture one.

First on the U.S. though, the auto book. We've seen the sale of a part of that portfolio but even adjusted for that, the book keeps shrinking. So what's the strategy for consumer lending in the U.S.? And how important is this business to have?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
Well, let me first take the auto book. The auto book, we sold a couple of billion dollars in the first quarter. But after doing that, the book has really, I think, in the fourth quarter it's been pretty steady, and we would expect some modest growth in the auto book.

The retail lending business is an important part of the overall business for the bank. We want us to be able to support our customers whether they're in a loan, whether it's a mortgage or home equity loan. So it's an important business. The deposit gathering business is even more important for us because we have such a good market, particularly in the Midwest. So we're seeing some growth, some momentum and I would expect that will continue into 2018.

Thomas E. Flynn - ***Bank of Montreal - CFO***
Gabriel, it's Tom. I just might add one thing. We do have the mortgage purchase in Q1 that Dave talked about. And in some ways, that's a one-time thing. In other ways, it's not really. And as we've looked at the U.S. marketplace, we've spent a little bit of time looking at where consumer credit has originated, and the share of consumer credit originated outside of the traditional banking system has grown somewhat over time. And we do think it makes sense for us to increase our participation in that part of the market. So the transaction in the first quarter is a larger-than-average example of that. But it wouldn't be surprising or unreasonable to expect some other similar arrangements as we go through next year, either in the form off low-type arrangements or discrete portfolio transactions. And those types of things won't take away from the focus on growing the core business, but they do reflect our desire to participate in consumer credit broadly. A bit of a share shift that is occurring and also the strong balance sheet that we've got.

Gabriel Dechaine - ***National Bank Financial***
Sorry, what was the transaction in Q1?

Thomas E. Flynn - ***Bank of Montreal - CFO***
It's about a $2 billion U.S. prime mortgage purchase.

Gabriel Dechaine - ***National Bank Financial***
And that's coming in the current quarter.

Thomas E. Flynn - ***Bank of Montreal - CFO***
Correct. Current quarter being Q1 '18.

Gabriel Dechaine - ***National Bank Financial***
And were you talking about outside of the -- National Bank, my employer, and Credigy has had a relationship with LendingClub? Is it something along those lines?

Thomas E. Flynn - ***Bank of Montreal - CFO***
I wouldn't say necessarily exactly like that, but in partnership with organizations that are originating consumer credit that fits in our risk return bucket.

Gabriel Dechaine - ***National Bank Financial***
Okay. And then my big picture strategy question for Darryl. So the priority you listed out for the strategy #3, was on the focus on efficiency. BMO has got the highest efficiency ratio in the sector. So where do you want to be 5 years from now? And what are you going to do to get there?

Darryl White - ***Bank of Montreal - CEO***
Well, thanks for the question, Gabriel. If you look forward, the first thing I'd do is very quickly look back, and I look at the fact that over the last 2 years, we have chipped away at that efficiency ratio by 240 basis points. We had positive operating leverage averaging over the course of those 2 years of 2% in each case. And when I look at the environment, I look at the opportunity to grow on the revenue side, and I'd point out that the capital position we're starting from as we sit here today is also in a class of its own. And then on the flip side, I also look at the initiatives that we're undertaking with respect to cost.

So I think that what you can expect is we're going to continue the trend that you've seen over the last 2 years for the next 5 years. And by the way, I should point out, I'm glad you asked the question, that we focused very intently here on maintaining the balance. In the past year, while we have improved our operating leverage by 2%, we've, at the same time, increased our spend in the technology portfolio by 13%. So to do both of those things at the same time as we continue to reinvest in the technology, in the client businesses, grow our capital at the same time, increasing our dividend at the same time and reduce our efficiency, that's been the trend. And I would expect that to continue to be the trend.

Gabriel Dechaine - *National Bank Financial*
You do have a strong capital position. And every 2 or 3 years, there's a cycle where you have a lot of capital, do a deal - an attractively valued one, usually - and then kind of roll with that as well. I guess that's the root of my question. Are we in an internal focus or external focus on the strategy?

Darryl White - *Bank of Montreal - CEO*
Are you asking me if we're going to do another M&A deal soon?

Gabriel Dechaine - *National Bank Financial*
Might as well, yes.

Darryl White - *Bank of Montreal - CEO*
Thank you for the question. The condition when you think through the factors that I just summarized a moment ago suggests that we're in a reasonably good position to continue to consolidate. We think we've become pretty good at it, I must say. We've got a reasonable bit of practice at it. We've got some execution on the core architecture side that has been improving each of the steps along the way. If you go back to the Harris Bank in the 1980s, you look at the M&I deal in 2010, you look at the GE Transportation Finance. Each time you do one of these, you get a little bit better and a little bit more efficient at it. And at the same time, we've got a pretty good muscle memory at this point in time on regulatory risk and compliance.

So all those things suggest - combined with the capital ratio - that we would be in a position to continue the trend that you've seen in the past. But, I've been pretty consistent on this question with most investors, that it does not necessarily drive a compulsion to transact. Our first and foremost growth opportunities are organic. We see lots of opportunities to grow organically. And opportunistically, if we see something that is attractive on the M&A side, we'll move forward, but we're going to be pretty picky.

Sumit Malhotra - *Scotiabank*
Let me pick it up on the efficiency front as well. I'll start with Tom. The restructuring charge that you announced in the quarter is $59 million pre-tax. It's a lot lower than what you had enacted in 2015 and 2016, which I think was in and around $340 million. So with this one being at this level, was it very targeted in terms of what the bank was accomplishing here? And can I direct that to the sequential or quarter-over-quarter change I saw in the headcount or FTE level?

Thomas E. Flynn - *Bank of Montreal - CFO*
So a couple of things. Thanks for the question. The charge is smaller for sure than others we've had over the last few years. More than anything, it just reflects us identifying opportunities to accelerate our agenda, improve our financial performance and not wanting to wait on capitalizing on those for some potential future larger activity and wanting to move forward. So we thought the plans that we had contemplated through the charge made sense and we wanted to execute on them. The FTE in the quarter is down pretty meaningfully, as you've alluded to. A little bit of that would tie into the charge, but some of the benefits or most of the benefits will roll in over the first 2 quarters of next year. So the majority would be future versus past oriented. And I'd point out in the FTE quarter-over-quarter, there's a little bit of a dynamic related to the timing of summer student hirings. So 250 million or 300 million of the lower FTE count in the quarter relates to that dynamic.

Sumit Malhotra - *Scotiabank*
But as you said there and part of your answer, we will see some of the benefit of the charge reflected in efficiency in the near term?

Thomas E. Flynn - *Bank of Montreal - CFO*
You will. You'll see some benefit reflected in the near term. And probably more importantly, given the size of the charge, as Darryl talked about off the top and in response to questions, we are very much focused on continuing to invest in the business including in technology to drive customer benefits and efficiency benefits, and we're focused on continuing to improve the operating leverage. We've moved the operating leverage by 2% in each of the last 2 years. We're focused on doing that again next year while investing in technology and that really does mean, given the level of investment, that you need to be reengineering parts of the operation in order to produce those outcomes. And I should correct myself. I think in reference to the FTE, I said 250 million summer students. And that would be somewhat larger than

our summer student budget and approximately 250 FTE or 300 reflects the summer student dynamic.

Sumit Malhotra - ***Scotiabank***
Let me wrap up with Darryl. Obviously, I think a lot of us look at the numbers here and the prospect of ROE expansion and we come back to that efficiency number. You talked about some of the plans you have in place. I wanted to ask you this. Your efficiency has gotten better in the last 2 years. The industry has as well. When we look at BMO's peer efficiency being at the high-end of the group, do you think there are structural reasons that is going to remain the case? Or have there been investment decisions? For example, the U.S. Capital Markets buildout that you're quite familiar with. I don't want to answer too much of this here but obviously, you've been at the forefront of things like ETFs and robo that have helped drive operating leverage in a big way in Wealth. So in aggregate efficiency, are there structural reasons that this bank has to be at the high-end? Or do you feel that's not necessarily the case?

Darryl White - ***Bank of Montreal - CEO***
Sumit, I think it's a good question and thank you for it. We've said before, and I would maintain the view that part of the gap is related to structural differences. If you look at the business mix, we skew bigger, as you know, on Capital Markets and on Wealth and in particular some of the areas in Wealth that you just pointed to, which attract a higher efficiency ratio. We like those businesses and we think that over time, they'll deliver disproportionately high growth rates. And if you continue down the path of thinking about mix, we also skew having a larger U.S. business overall than some of our peers, which is a jurisdiction that in general has a higher efficiency ratio than Canada. So, I would say that about half of the gap - if you want to think about a gap - half of the gap is explained structurally and half of the gap is one that we think about a lot, in places where we have work to do and that's where we're applying a lot of our energy. Does that help?

Sumit Malhotra - ***Scotiabank***
It does. And I'll wrap up just by asking, when you were answering the last question, you mentioned I think you said best-in-class capital position. Does some of that capital need to be allocated to a larger level of restructuring to drive efficiency? Or do you feel with some of these charges you've taken, enough has been done on the restructuring front?

Darryl White - ***Bank of Montreal - CEO***
Well, I think about restructuring, and assume it is continuous improvement. So we're in a process right now of thinking about how, as Tom said, is how we engineer the organization. Through that work, we saw some things that we could do in the near term to accelerate some of the performance. And that's what we've done in terms of the restructuring. I don't so much think about the capital position as it relates to our ability to affect change. We've got capital to put into play to grow our client servicing tools as well as the assets that we put forth to our clients as we go forward. So we're going to continue to work on efficiency in various ways. I think the capital position we've got is an advantage because we've got degrees of freedom and we've got flexibility. But I would offer that we'd be continuing to focus on efficiency whether or not the capital was at that level.

Mario Mendonca - ***TD Securities***
If we could go back to the U.S. for a moment. Dave, you said that the loss of those commercial deposits would not be meaningful to the bank from an earnings perspective. So it does sort of lead to the next question. What was their purpose? Why were they there then if they weren't making much of a contribution to the bank?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
So the deposits I was talking about and the ones you're referencing are deposits largely from some of our financial institutions. It really became prevalent in 2008 and 2009 as the rate environment in the U.S. was so low, large clients kept their money with the bank. And it was there. We've seen it. The issue with it and the reason why I say it really wasn't of value to us is, it could go at any time. Rates could go up, but it can move and they're there, they're non-interest-bearing deposits. But we really couldn't invest them in anything long-term just given the nature. So as the rates moved up, we expected them to go, and they moved slower than actually we thought but that's the issue. Does that help clarify?

Mario Mendonca - ***TD Securities***
Just one sort of follow-up. I guess, it sort of begs the question, why did you keep them if they weren't contributing to the bank's profitability? Was there some relationship that maybe they were improving?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
Well, these are clients of the bank. And to the extent that we weren't paying any interest on them, they were there, they were supporting very short-term loan growth -- we're not in the business of really asking our clients to move their money. Some did during that period of time. And we thought - even though it wasn't really that

advantageous to us - this is not the right thing to do. We weren't trying to attract deposits from non-customers, but our customers we kept. We didn't encourage, but we didn't kick them out.

Mario Mendonca - ***TD Securities***
Is there any risk of losing some of these, you called them, operating services? Or is there any revenue attached to these services you provide these clients now that they've pulled their money out?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
Well, first of all, they didn't pull out their money in total. They pulled out deposits or they moved their deposits to institutions that would pay interest on them that we wouldn't. The core operating services that we provide on the deposit side - so check clearing, payment services for our commercial business - those services we continue to grow and those are paid for either through fees or often times through deposits.

Mario Mendonca - ***TD Securities***
Okay. A somewhat related question then. You made reference to loans growing faster than deposits and how that was negatively impacting the margin in the business. That throws me off a little bit because the bank is running with a fair bit larger balance of deposits relative to loans. The deposit gap is fairly large. So when loans are growing, I would've thought that, that would just substitute for the securities that were held, in which case it would benefit the margin, not hurt the margin. So where am I missing the margin explanation?

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
So I think you're probably referring to our NIM.

Mario Mendonca - ***TD Securities***
I am. Yes.

David R. Casper - ***President & CEO of BMO Harris Bank N.A. and Group Head of Commercial Banking***
So the way the NIM works, and this quarter is a good example, we had good net interest income from those deposits and from the loans. And part of that was the rate increase, that grew. What was growing in the denominator, and this is the way we compute the NIM, the denominator is just the loans. So if loans grow faster then you're going to have, by definition, you're going to have a lower NIM. So it's a bit of a trade-off. The good news is our loans in the quarter grew almost 6% quarter-over-quarter. So that's the good news, but you don't get it in NIM when you still have to add that into the denominator. So that's the issue. We can take you through the calculations, if you want, offline, but it's pretty standard in the business and the way we run it.

Mario Mendonca - ***TD Securities***
Yes. And the other thing that throws me off is, there are a number of U.S. regional banks and some money centres that with all their excess deposits, whenever their loans are growing quickly, it actually augments their margins. So it's a different dynamic from what I'm used to for a bank that's deposit rich.

Thomas E. Flynn - ***Bank of Montreal - CFO***
Yes. And I think that's maybe the thing that's different, Mario. It's Tom. Over a period of time, we're deposit rich. We had excess deposits. With the Transportation Finance acquisition, we essentially consumed those excess deposits.

Mario Mendonca - ***TD Securities***
Okay. So it's probably no longer appropriate to refer to BMO as deposit rich bank in the U.S.

Thomas E. Flynn - ***Bank of Montreal - CFO***
Yes. That's exactly right. We have a great deposit business and we have a great lending business. And the 2 are pretty much in balance right now.

Mario Mendonca - *TD Securities*
Okay. That explains it. And then finally, and this is something that I've always sort of struggled with for all the banks. The balance sheet does appear to be shrinking over the last couple of years. You can see it in non-trading securities, repos, and deposits with banks. Across the board, it looks like the balance sheet is shrinking, and I don't mean loans. So is this just opportunistic client activity? What would cause the balance sheet to shrink like that?

Thomas E. Flynn - *Bank of Montreal - CFO*
Are you talking about the overall balance sheet?

Mario Mendonca - *TD Securities*
I am. The entire balance sheet.

Thomas E. Flynn - *Bank of Montreal - CFO*
There's some currency there. The loan balances are growing, but the U.S. dollar is weaker at the end of this year than it was at the end of last year. It's a $0.05 or $0.06 impact. So I think most of what you're seeing is currency at the 2 year-ends. There's nothing from a capital perspective that we're doing that would have an impact.

Mario Mendonca - *TD Securities*
No conscious effort to shrink the balance sheet then from your perspective?

Thomas E. Flynn - *Bank of Montreal - CFO*
That's right.

Mike Rizvanovic - *Macquarie*
Just a quick follow-up for Cam on your 5% to 10% guidance. What's your baseline? The comment you made on origination activity declining. Is that relative to all of 2017?

Cameron Fowler - *Bank of Montreal - President of North American Personal & Business Banking*
Regarding B20, is that what you mean?

Mike Rizvanovic - *Macquarie*
Yes.

Cameron Fowler - *Bank of Montreal - President of North American Personal & Business Banking*
Yes. We just looked back on all of '17 and tested what we thought the origination impact would be.

Mike Rizvanovic - *Macquarie*
Okay. So that's basically incorporating the recent trend. What confused me a little bit is that when I look at the last 5 months or so, Canada-wide, it looks like the resale dollar volume is down about close to 10% already. So I'm just wondering, is that 5% to 10% comment building in, some return to stability in the Toronto market or is it not capturing recent trends?

Cameron Fowler - *Bank of Montreal - President of North American Personal & Business Banking*
I think this is a very difficult question to answer because there are a lot of moving parts in the Canadian housing market. And so when we looked at it, we said, here is what we think, all things equal based on the past 12 months, we also gave some thought to what we have going on in the Canadian market outside of Toronto and Vancouver, and we came up with the 5% to 10% range. I think it's tricky to get sharper than that. But I did keep that decrease in origination in mind when I estimated our 4% to 5% proprietary growth.

Darryl White - ***Bank of Montreal - CEO***

I'm going to close the call by thanking our 45,000 employees at BMO for their contributions to our success to supporting our customers; to living our values; and especially at this time of year, to giving back to our communities. And to everyone joining the call today, we wish you the best for the holiday season and a successful 2018. Thanks for joining today.