Q3 2019 Conference Call

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PRESENTATION

Jill Homenuk – Bank of Montreal – Head of Investor, Media & Government Relations

Thank you. Good morning, 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 Pat Cronin, our Chief Risk Officer. We have with us today Cam Fowler from Canadian P&C, and Dave Casper from U.S. P&C. Dan Barclay is here for BMO Capital Markets and Joanna Rotenberg is here for BMO Wealth Management.

After the presentation, we will have a question-and-answer period where we will take questions from prequalified analysts. To give everyone an opportunity to participate, please keep it to one question. Darryl will then close the call with concluding remarks.

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 2018 annual report and our third quarter of 2019 report to shareholders.

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

Darryl White – Bank of Montreal – CEO

Thank you, Jill, and good morning, everyone. Thank you for joining us this morning. Today, we announced earnings for the third quarter of $1.6 billion and earnings per share of $2.38. We delivered another quarter of strong operating performance that reflects the diversification and resilience of our businesses.

Our core North American Personal and Commercial Banking businesses continue to have strong momentum, with pre-provision, pre-tax earnings up 9% from last year and good operating leverage. In both Canada and the U.S., we're growing loans and deposits at above market rate and expanding our customer base. Balance growth is well diversified and driving good revenue performance.

Capital Markets continues to perform well with record Investment and Corporate Banking revenue this quarter and strong momentum in our U.S. business.

Wealth results were impacted by lower insurance revenue. In Q4 of last year, we said we were reviewing ways to lower variability in our reinsurance business. In light of the environment in the reinsurance sector, performance is no longer meeting our risk return expectations and so we've made the strategic decision to exit the majority of this business.

We absorbed an increase in provisions for credit losses this quarter as we continue to prudently build allowances for performing loans. At the same time, as Pat will explain, overall credit quality in our portfolio remains strong.

As we guided last quarter, expense growth moderated this quarter and we expect that to continue in Q4. Improving the bank's efficiency is a top priority. This quarter the ratio improved to below 60%, driven by steady improvement in Personal and Commercial Banking and we are doing more to build on that momentum.

On a year-to-date basis, earnings per share were up 5% or 7% excluding the impact of the severance charge in Capital Markets last quarter. Our capital position remained strong with our CET1 ratio increasing to 11.4%, supporting strong organic growth.

Turning to Slide 5, our U.S. platform, which is now contributing over a third of the bank's earnings, continues to deliver strong results with good growth in each of our businesses. Year-to-date, earnings were up 24% and efficiency is improving at an accelerated rate. We're growing our Mid-west footprint, where we recently took over the #1 position as the largest bank in Chicago by assets, a testament to the strength of our teams in differentiating BMO in a highly competitive market. At the same time, we continue to accelerate organic growth outside our core footprint. For example, we recently expanded our presence in Texas, opening a new commercial office in Fort Worth. We have a long and successful history serving customers in the second largest U.S. state, including our Capital Markets office in Houston and our Transportation Finance team in Irving. We've also added Wealth Management capabilities to our rapidly growing Dallas office.

In Personal and Business Banking, we're attracting new customers through our competitive digital capabilities. Just six months after launching our new mobile banking service, customers can open an account in minutes, and we've already gained market-leading ranking for our mobile app in the United States in line with the largest U.S. banks and our leading Canadian app. We're reaching customers across the country having now opened accounts in all 50 states with two-thirds of new balances coming from outside our branch footprint.

In U.S. Capital Markets, momentum continues to build. We had strong M&A activity this quarter that included advising on three cross-border transactions and three deals completed in close partnership with commercial banking. With strategic investments we've made in our U.S. platform, together with the strength of our Canadian business, we expect continued good performance and strong operating leverage for the overall Capital Markets business going forward.

We're continuing to grow our bank by executing on strategies that leverage BMO's unique strengths, including our collaborative approach to building customer relationships and loyalty, guided by our purpose to boldly grow the good in business and life, in partnership with our customers. For example, this quarter we launched a holistic health care banking program supported by BMO professionals with a deep understanding of practitioners' needs. This integrated team provides trusted banking and wealth management advice through every stage of our customer's journey from starting of practice, to growing and innovating, to succession planning, and to retirement.

Our integrated approach recognizes the unique and evolving needs of our small business customers across industries. In agriculture, for example, we're proud to be the #1 partner for Canadian farmers, where our scale and deep understanding of the industry enables our bankers to build long-term relationships as trusted advisors helping our clients navigate trade and climate challenges, including offering relief programs where needed.

Looking ahead, our diversification and earnings strength positions us well for uncertainties in the environment. The core of the bank, our flagship Personal and Commercial businesses on both sides of the border, account for two-thirds of the bank's income and continue to demonstrate good earnings power. We're gaining share and we’re not wavering from our disciplined risk and underwriting principles.

We have a strong foundation and we're executing on agile and sustainable business strategies designed to deliver good performance even in a more challenging revenue environment.

Operating leverage improved from last quarter and we expect that to continue. Our management team remains firmly committed to achieving our efficiency target of 58% by 2021. We're making strategic choices in each business to drive the profitability and the operating strength of the bank over the long term, such as the actions we've taken in Capital Markets and Wealth to align resources with the market dynamics and revenue environment.

Holding true to our purpose, we'll shape our success and that of our customers, employees and communities.

And now I'll turn it over to Tom to talk about the third quarter financial results.

Tom Flynn – Bank of Montreal – CFO

Thank you, Darryl, and good morning, everyone.

My comments will start on Slide 8. Q3 reported EPS was $2.34 and net income was $1.6 billion. Adjusted EPS was $2.38 and adjusted net income was $1.6 billion, both up 1%. Operating results this quarter reflect good performance in our P&C and Capital Markets businesses and positive operating leverage. Adjusting items are similar in character to past quarters and are shown on Slide 24.

Net revenue of $5.8 billion was up 5%, or 4%, excluding the impact of the stronger U.S. dollar, reflecting good performance in our P&C businesses and BMO Capital Markets, partially offset by a lower contribution from the Insurance business. Expenses increased 4%, or 3%, excluding the impact of the stronger U.S. dollar, largely reflecting higher employee-related expenses and technology costs. Operating leverage for the quarter was positive 0.5% at the all bank level.

Looking forward, we're on track to deliver positive operating leverage again in the fourth quarter. As we said on our second quarter earnings call, we expect expense growth for the second half of the year to be half the rate of the first half of the year, and we're on track to deliver that.

Moving to Slide 9 for capital. The Common Equity Tier 1 ratio was 11.4%. The ratio was up 10 basis points from the prior quarter, driven by retained earnings growth and lower deductions, partially offset by higher risk-weighted assets. The higher risk-weighted assets were driven by commercial and corporate loan growth across our businesses, net of lower market risk RWA.

Moving now to our operating groups and starting on Slide 10. Canadian P&C net income was $649 million, up 1% from last year, with strong pre-provision, pre-tax earnings growth of 8%. Revenue growth was 6%, driven by higher balances, increased non-interest revenue and higher margins.

Total loans were up 6% with commercial loans up a strong 16%. Mortgage growth through proprietary channels, including amortizing HELOCs, was 4%. Deposit growth continued to be very good with personal balances up 12% and commercial up 9%.

NIM was up 4 basis points from last quarter reflecting improved lending spreads, including the benefit of a widening Prime-to-BA and favourable product mix changes. Expense growth was 4%, reflecting investment in the business. Operating leverage was good at 1.9% and efficiency improved to 47.3%. The provision for credit losses was $204 million and includes a provision on performing loans of $30 million.

Moving to U.S. P&C on Slide 11 and my comments here will speak to U.S. dollar performance. Net income for the quarter was $285 million, down 1% from last year, and pre-provision pre-tax earnings growth was strong at 9%. Revenue growth was good at 5%, reflecting higher loan and deposit balances, net of lower net interest margin. Average loan growth was 13%, with commercial loans up 16% and higher personal loans. Deposit growth continues to be good, up 14%, marking the fourth consecutive quarter of double-digit growth in both personal and commercial deposits.

Net interest margin was down 15 basis points from last quarter due to higher deposit costs, including changes in mix, loan spread compression and the impact of loans growing faster than deposits. Expenses were well-managed and up just 2%. Operating leverage was strong at 2.8% and the efficiency ratio improved to 57.9%. Provisions for credit losses were $73 million and include a $28 million provision for credit losses on performing loans.

Moving now to Slide 12. BMO Capital Markets net income was good at $318 million, up 5% from last year. The U.S. business continued to perform very well, delivering net income of U.S. $83 million and contributing 34% of Capital Markets earnings. Revenue growth was strong at 9%, with Investment and Corporate Banking revenue up 15% and Trading Products up 4%. Expenses increased 13%, with the KGS acquisition accounting for almost half of that increase. The stronger U.S. dollar contributed approximately 1% to each of revenue and expense growth. Provisions for credit losses were $10 million compared to $7 million in the prior year.

Moving to Slide 13. Wealth Management net income was $257 million. Traditional Wealth net income of $233 million was up 10% from last year with higher revenue, primarily due to the impact of a legal provision in the prior year and higher deposit and loan revenue. Average loan growth was strong at 16% and deposits grew 5% as we continue to diversify our product mix. Insurance net income was $24 million, down from $89 million in the prior year and below the level of a typical quarter, largely due to lower reinsurance results and the impact of lower interest rates.

On reinsurance, as Darryl mentioned, we have made the decision to wind down our Property and Casualty reinsurance business. This decision reflects returns in the business coming in at a level below our expectations and a higher level of variability in results, partially due to weather-related claims. Expenses were well managed and up 1% from last year.

Turning now to Slide 14 for Corporate Services. The net loss was $21 million, and $34 million better than the net loss a year ago. Results were above trend and include items that had a positive impact on revenue and expenses in the current quarter, including a gain on the sale of an office building.

To conclude, the third quarter results demonstrate the benefits of our diversified business mix, good operating discipline and a positive trend on expenses as expected. We're focused on executing our strategy and continuing to generate positive operating leverage as we head into the fourth quarter and into next year.

And with that, I'll hand it over to Pat.

Pat Cronin – Bank of Montreal – CRO

Thank you, Tom, and good morning, everyone.

Starting on Slide 16, the total provision for credit losses was $306 million or 28 basis points, which is up from 16 basis points last quarter. As you may recall, last quarter's PCL included a $40 million recovery on a U.S. commercial loan. Adjusting for that significant recovery, the quarter-over-quarter increase was driven by 3 main factors: first, higher Canadian consumer losses, realized almost entirely as a result of implementation issues with a new consumer collections platform; second, a single large loss in our Canadian commercial portfolio; and third, a higher provision this quarter for performing loans. I'll discuss each of these further in my subsequent comments.

Looking at the PCL for impaired loans, our provision in this quarter was $243 million or 22 basis points, an increase of $93 million from the prior quarter. Adjusting for the $40 million recovery I referenced earlier, the balance of the increase this quarter was in Canadian P&C and came from two principal sources.

First, consumer PCL increased $26 million to $133 million. This increase was primarily due to elevated delinquencies which were driven by implementation issues associated with our new collection system. With these implementation issues largely behind us, we expect Canadian consumer losses to normalize over the next few quarters.

The second factor driving the overall increase this quarter was in the Canadian commercial business, where we had a $41 million impaired provision, an increase of $26 million from the prior quarter. This increase was mostly due to loss provisioning on one account.

Apart from these two factors in Canadian P&C, the PCL on impaired loan results in the other businesses were good this quarter.

U.S. consumer provisions at $8 million were up from their very low level last quarter, but still remain at the lower end of the recent historical range. U.S. commercial PCL on impaired loans was $53 million compared to $16 million last quarter. Adjusting for last quarter's $40 million recovery, commercial PCL was actually lower this quarter than in Q2.

PCL on impaired loans for Capital Markets was also lower this quarter at $7 million compared to a $12 million provision in Q2.

Now turning to the performing loan provision and the third of the three factors I referred to at the outset of my remarks, PCL on performing loans was $63 million, an increase of $37 million from last quarter. This increase was due to a combination of balance growth, a modestly softer economic outlook and, to a lesser extent, credit migration. We view this increase as a prudent adjustment to our performing loan provision and not a reflection of concern with credit quality in any of our lending portfolios.

Turning to Slide 17, formations decreased $62 million this quarter, with notable decreases in Canadian consumer as well as in commercial loans. While there were formations in the oil and gas sector, as with last quarter, we provisioned appropriately based on our expectation of relatively low ultimate losses on these formations. The ratio of gross impaired loans to total loans was 55 basis points this quarter, up 2 basis points compared to the prior quarter and well within recent historical levels.

In summary, we are not seeing any concerning systemic, thematic or sectoral trends in any of our credit books, which remain of strong and consistent credit quality. While this quarter's loss rate is at the high-end of recent guidance, based on the nature of this quarter's increases and our current economic outlook, we still expect to see losses in the low-to-mid-20 basis points going forward.

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

QUESTIONS AND ANSWERS

Meny Grauman – Cormark Securities Inc., Research Division – MD & Head of Institutional Equity Research

Hi, good morning. We hear a lot about trade uncertainty these days and what that’s causing to the overall business environment given your position both in Canada and the U.S. Can you comment on what you're seeing there on a ground level in terms of the impact that trade is having on your customers and specifically if you could talk about the ag business? Are you seeing any signs of trouble there, if you could comment on that from a credit perspective, in particular?

Darryl White – Bank of Montreal – CEO

Meny, it's Darryl. Thanks for the question. Maybe I'll start, and with respect to the ag business, Pat might have a comment on the credit question that you asked. In general, I would say it's hard to ignore the fact that the trade tensions are creating, first of all, volatility in the markets, as you know well, but also some suppression of growth. If we look at it across all industries, if we look at across the U.S., our estimate is that, including the developments of late last week, we would see something in the order of a half a percentage point of U.S. GDP impact as a result of the trade protectionist measures, in aggregate. That's coming off of a fairly healthy level, and unemployment, as we know, is still extraordinarily low by any historical standards and we've got inflation around 2%. So it's not a catastrophe, but it is definitely a slowing environment from the perspective of GDP growth. Our customer base in Canada and the U.S. continues to spend and continues to expand, I would say, a little more prudently than perhaps they might have six or twelve months ago. So slowing environment as a result of the trade measures for sure. As far as credit is concerned, we do feel it in some portfolios more than others. The good news is, you referenced ag in particular, the ag portfolio in the U.S. in particular, is under some stress, partly related to trade. It's well covered by land values. So you don't see provisions necessarily, but there is some stress in that small portfolio for us. Would you add much to that, Pat?

Pat Cronin – Bank of Montreal – CRO

No. We are certainly seeing the signs of stress in the U.S. ag portfolio. That has persisted actually for the better part of the last couple of years. So exacerbated probably mildly by some of the recent tariff issues. But it's been going on for a while. I would contrast that quite strongly though with Canada where we're seeing very little impact from these issues and, in fact, which is the bulk of our portfolio. Roughly about 83% of the ag book sits in Canada. And at the moment, anyway, the level of impairment in that portfolio is virtually nil. Maybe Dave or Cam, if they want to make a broader comment on other sectors.

Dave Casper – Bank of Montreal – President & CEO, BMO Harris Bank N.A. and Group Head, Commercial Banking

I think you covered it well.

Meny Grauman – Cormark Securities Inc., Research Division – MD & Head of Institutional Equity Research

Just as a follow-up there, just in terms of your expectations for loan growth specifically or commercial loan growth on both sides of the border. It doesn't look like there is any impact given the kind of numbers you're putting up. Would you expect that growth to slow materially over the next few quarters?

Dave Casper – Bank of Montreal – President & CEO, BMO Harris Bank N.A. and Group Head, Commercial Banking

I would say, I would expect it to moderate to some extent, not necessarily due to any of the factors that we've discussed as far as trade. It's just that we've experienced good strong loan growth, and I think over time it will moderate, that would be the general view.

Cam Fowler – Bank of Montreal – President of North American Personal & Business Banking

It's Cam, I'll follow up on Dave's as well. In Canada, we're in the 16% zone on the commercial book as you can see. The pipeline is more or less where it has been in the last three or four quarters. I talked about diversification of that growth on this call. It's five industries that are around that number and it's five regions of the country that are double digits. So I do agree with Dave there will be some moderation, but I wouldn't expect there to be too much in the near term.

Gabriel Dechaine – National Bank Financial, Inc., Research Division – Analyst

Good morning, just a question for Pat and to clarify the issue with the Canadian consumer PCL. You've implemented a new system. There were some delays in tracking or taking action on collections and that sort of may be created a backlog in here in your system and therefore, a spike in PCL. So just kind of, is that correct? And walk me through how this normalization trend is expected to develop.

Pat Cronin – Bank of Montreal – CRO

Sure. So your description is accurate. And yes, there were just some implementation issues with the platform that we have largely sorted our way through. I think your best indication of any future impact really comes from early-stage delinquencies. So you don't see it but last quarter we had a fairly large spike in early-stage as you would expect as we fell behind on collections. That flowed through this quarter into the higher PCLs that you're seeing. When I look at early-stage delinquencies now across all of the consumer portfolio, we're seeing early-stage delinquencies down in every single product category, and actually in terms of delinquency rates, pretty much back down to where they have been historically. And so on that basis, that's why we're making a statement that we expect it to normalize. We're not seeing any of the same issues in those early-stage delinquency numbers that we saw last quarter. So we think the issue is largely behind us. So from here on in it will really depend on how the economy changes more than anything else.

Gabriel Dechaine – National Bank Financial, Inc., Research Division – Analyst

Okay. And then just another one on the margin for the U.S. business. Big drop there sequentially. Is there any timing issue there? Your loans go down immediately and the deposits, you need to reprice it over time. And then, is there any need or appetite to take some other action? I know you've done it in the past where you've disposed of some low-margin loan books because they just weren't making enough spread for you. Is there anything of that nature, really?

Dave Casper – Bank of Montreal – President & CEO, BMO Harris Bank N.A. and Group Head, Commercial Banking

So let met take the first: the drop this quarter was probably three things in all, you touched on them and all of them had a pretty similar impact. We did have this quarter stronger loan growth and deposit growth. So, in the quarter, that did make some of the difference. We also had rising deposit cost. As we continue to grow our customer base, more and more of our deposits are coming from our interest-bearing deposits. So that has an impact as well. And loan spreads to some extent, and this will maybe get to your last question, have come down a little bit. But I would say that is not due to any particular real strong diminution. It's more, we do have a higher credit quality today; we have, most of our growth is coming from businesses where we have lower loss given default. So that's had some impact. But I would not say there's any drastic action at all. We continue to grow our loans to good customers and also deposits. So that's probably the summary.

Gabriel Dechaine – National Bank Financial, Inc., Research Division – Analyst

So it’s three of them?

Tom Flynn – Bank of Montreal – CFO

It's Tom. Maybe I'll jump in on the trajectory and add the total bank perspective. So on the U.S. P&C business, with the cuts that we've seen from the Fed and the potential for ongoing very strong commercial loan growth, although a little moderated, it’s likely to be some pressure in Q4 on the margin. The cut itself would be in the zone of 5 bps and there could be another 2 to 3 depending on the loan growth level and how strong it is in relation to deposits. So that's U.S. P&C for Q4. The Canadian story is different. And in Canada, we had a nice increase in margin in the current quarter. We think that will sustain for the fourth quarter. So Canadian margin should be flat to flattish in the fourth quarter. And looking out to next year for the Canadian business, we think the margin will be again flattish. If the Bank of Canada moves, there's maybe a little bit of pressure but nothing significant from what we're seeing here today. And on the U.S. side, if the Fed moves again, there's a potential for some incremental pressure. And so at the total bank level, if you roll that up, Q4 with a little bit of pressure in the U.S., NIM is likely down ex-trading in the zone of 1 to 3 bps and out to next year – with Canada stable and a bit of pressure in the U.S. – there's the potential for another 1 to 2. So big picture, Canada is pretty stable; U.S., with the strong loan growth and the Fed cutting, a bit of pressure, but not a really significant impact at the all bank level.

John Aiken – Barclays Bank – Director & Senior Analyst

Good morning. Tom, I wanted to just get a little bit of more information on the reinsurance. What was the recurring level of earnings if you were to go over a longer period of time, three to five years? And with exiting the business, do you expect to see a material release of capital?

Joana Rotenberg – Bank of Montreal – Group Head, BMO Wealth Management

Thanks for your question. So we, as you described and you saw, we did take a step to exit our business. Part of it was because of the consistency of earnings. And I would say, over time, it did move around by a few million dollars. I would say, overall, one of the reasons we've exited is because over the past two years in particular, because of some of the larger scale of events we've seen both in 2017 and 2018, it did give a lot of volatility to the business. And so we have seen pricing improve but not at the level we expected. And we are expecting and have continued concerns there with climate change, we're just going to see more frequent and higher claims, and so we didn't feel like there was a good symmetry between risk and reward. What I would describe is going forward it won't have a material impact on our insurance earnings partly because of the volatility we've seen in the business. What I would say though is I do expect it to lower the volatility of our business and, even more importantly, improve the ROE for wealth.

John Aiken – Barclays Bank – Director & Senior Analyst

Great, thanks for the colour.

Doug Young – Desjardins Securities – Diversified Financials and Insurance Analyst

Good morning. Just maybe going back to Pat. The $63 million PCL build on performing loans, hoping maybe you can just flush that out a little bit? And I know it bounced around in the last few quarters. Just trying to get an idea of what, for a normal quarter, if there was such a thing, what is a normal performing loan PCL build? Is it 2 basis points, 3 basis points? And then just lastly on credit, you talked about one large Canadian account that you provisioned for. Was this something that was impaired in the quarter? Or was this something that was previously impaired and the provision was just updated?

Pat Cronin – Bank of Montreal – CRO

Sure. I'll start with your second question first. It was something that was impaired in the quarter where we took a provision on. And it was in the services sector, in the healthcare subsector. So I think you can see that in the disclosure. In terms of the performing provision, unfortunately, I don't think there is such a thing really as a normal quarter and I think you've seen that from all the banks over the course of the quarters. I can tell you a tip, in any given quarter, it's going to be driven first by loan growth as you would imagine. And we had some of that this quarter. I would say, that accounted for may be something like a third of that number that you're seeing. Then it's going to depend on your forecasted view of economic conditions out over the next 12 to 24 months. And for us, when we looked at the current data that we saw during the quarter and particularly some softening in variables like corporate profit growth rates and some modest adjustments to GDP, that added about another, probably call it about a third to a half of the increase in the total provision. And then you're going to get credit migration in the portfolio as well. And that credit migration can go up and down. It is somewhat asymmetric though because positive credit migration within Stage 1 gives you a little bit of a benefit to PCL, but negative migration from Stage 1 to Stage 2, when you trip over from 12 months to lifetime, gives quite a bit of an incremental bump to PCL. So even negative credit migration doesn't necessarily mean there's a lot of weakness in the portfolio. Sometimes it just results from that asymmetry to how things are moving around. And for us, that migration this quarter was about a quarter of the $63 million. And so, I can tell you going forward, as Dave said and Cam would agree, we do expect to see continued loan growth. So to the extent that continues, you should expect to see a provision for that. And then I can tell you that our best guess for the outlook for the economic condition in the next 24 months is our current forecast. And so, unless that changes on the basis of new data that's coming in over the course of the subsequent quarters, that likely won't change. But again to the extent that things get better or worse, we will move our economic forecast in light of the updated data.

Sumit Malhotra – Scotiabank Global Banking and Markets, Research Division – MD of Canadian Financial Services

Just to pick up on that, when you mentioned at the end of your prepared remarks that 20 to 25 basis points is still a reasonable level for the PCL ratio for the bank. Is that inclusive of 2020? And are you looking only at the impaired portfolio? Or is that the total provision rate?

Pat Cronin – Bank of Montreal – CRO

No, that would be the total provision rate. And I think we've been guiding to that number for a while now, and I can give you a sense of why I'm thinking that way. If you look at the consumer portfolio, like I said, when we look at early-stage delinquencies, both overall and regionally, we're seeing things returning pretty much to normal. And so that was the origin of my earlier comment about why we think consumer PCLs will normalize over the course of the next couple of quarters, because we're just not seeing it in the early-stage delinquency numbers. On the wholesale side, we're seeing formation rates pretty much normal. You'll see them at 15 bps this quarter. That's pretty much exactly where they've been on average over the last few years. Our gross impaired loan rate at 55 bps; it's a little bit higher than what you saw last quarter and a year ago by a couple of basis points, but still, again, well within the normal range. The weighted average probability of default of the book is essentially flat to last quarter and almost flat to last year. And when I look across the diversification of the book, all of that tells me that we're not seeing signs of stress that would cause that PCL rate to rise dramatically, other than the general upward trend from what we have highlighted as particularly low levels of loss rates in the last couple of years. And so that general trend I think will take us into the mid-20s. But based on what we're seeing in the credit quality of the book, both consumer and wholesale, we're not seeing anything that would dramatically cause us to deviate from that number.

Sumit Malhotra – Scotiabank Global Banking and Markets, Research Division – MD of Canadian Financial Services

And candidly, I think you touched a bit on this in some of the remarks earlier, when you think about PCL ratios for the bank going forward to where they are now, it's fair to say, one of the larger swing factors is, I would think, you're not expecting as much in the way of recoveries. And just to be clear, when you talk about where provisions are going, do you embed any changes in the Stage 1 and 2 provision? Or do you assume that to be zero unless model refinements are already being forecast?

Pat Cronin – Bank of Montreal – CRO

Yes. The provision that we have right now reflects our best estimate of how the future is going to look for the performing provision. And then as you said, we don't really bake in recoveries into our forward-look on PCLs. They do happen from time-to-time and it's not wildly unusual. As I said, last quarter, we worked recoveries pretty hard, and pretty consistently. So they're going to come in the future. I don't know when and how much, but we certainly wouldn't bake them into our forward-look.

Sumit Malhotra – Scotiabank Global Banking and Markets, Research Division – MD of Canadian Financial Services

Last question is for Tom on capital. Just want to have the numbers right here. Tom, some of your counterparts have mentioned some adjustments that are coming into start 2020 with IFRS 16 and some of the other parameter updates. Do you have an estimate for the impact to BMO? And was there any pension liability hit for capital this quarter? It didn't look like it based on your number.

Tom Flynn – Bank of Montreal – CFO

Quick answer. So the Q1 impact from the IFRS 16 change and the change in some of the parameters is 15 to 20 basis points. And on the pension side, there was no meaningful impact in the current quarter. Our approach to managing the pension risk looks to match the assets to the liabilities. It's not perfect, but it's a pretty good match. And we also have a pension asset. And so in the current quarter, that asset reduced and that's a deduction from capital. So that's actually a positive. And with that, the net impact from pension was de minimis in the quarter.

Sumit Malhotra – Scotiabank Global Banking and Markets, Research Division – MD of Canadian Financial Services

At this level of capital, do you anticipate once again becoming active on your NCIB?

Tom Flynn – Bank of Montreal – CFO

Well, I'll stick to our normal story on that. We have felt very good about the loan growth that we've had in the business and the customer growth that comes with that. The commercial growth, in particular in Canada and the U.S. has been above market and we feel good about how the business is growing. So that's our first and best use of capital. And if the ratio builds from the current level and moves above 11.50, we would expect to be active. So our normal guidance is for the ratio to grow by 10 to 15 basis points. We said last quarter that would be around the lower end of that range with strong growth. That's what played out this quarter. We've got the Q1 change coming as you asked about in your question. So a bit of a long answer, but I'd expect activity with the ratio moving up from the current level and we need to get through the Q1 adjustments that we've got coming.

Robert Sedran – CIBC World Markets – MD & Head of Research

Hi, good morning. I'd like to try to combine, Tom, your outlook on the margin with some of Dave's discussion on loan growth to get a sense for revenues. It sounds like you are still expecting a fairly robust top line as much as we try to forecast what the margins are going to do, I guess we are really trying to get to is revenues, so the pre-provision earnings that we saw of around, I believe it was 9% in the U.S., is that a reasonable assumption even in this margin world, or should we expect that to slow?

Dave Casper – Bank of Montreal – President & CEO, BMO Harris Bank N.A. and Group Head, Commercial Banking

So let me start. It's a tough question to answer. Here's what I know. We will continue to grow our customer base probably faster than the market. It's still very good opportunities for us that will lead to higher revenue, higher loan growth and higher deposit growth. The tougher part is just what happens with rate? So it's really hard for me to predict and what I can predict over the long term, we'll continue to grow our U.S. business on both the personal and commercial side. We've got really strong momentum. And despite a lot of noise in the U.S. economy, our clients are generally still pretty positive and I'm pretty positive about the long-term aspects of this business.

Robert Sedran – CIBC World Markets – MD & Head of Research

So just to try to push a little bit further. I mean, so you're still expecting reasonable growth rates and with the margin contraction you had this quarter, you still put up some pretty strong top line, even with the rate move. So a pretty robust top line would still be the working assumption. I understand it's not guidance, but that's what you're looking for?

Dave Casper – Bank of Montreal – President & CEO, BMO Harris Bank N.A. and Group Head, Commercial Banking

Well, I think I pretty much said what I would say. I think it's, again, I think the rates will have some impact. I just don't know what they will be. But we're going to continue to grow customers, we're going to continue to grow deposits, loans, and we'll see what happens. The 9% this quarter of PPPT was strong and that's a good number for us. I don't know what it's going to be next quarter.

Darryl White – Bank of Montreal – CEO

And Rob, it's Darryl. Let me see if I can come in on this. I think you've raised an important question and I thought you framed it well in the sense that we think about the revenue growth of the business and when we think about the overall returns of the business. The NIM is part of that equation, of course, it's part of that equation. When we look at our U.S. businesses, plural, I talked about them earlier, up 24% on earnings year-to-date, 14% in the quarter. The P&C business that you're quizzing Dave about just now, when we look at a compressing margin against an expanding customer base and top line growth, we also look at the fact that it does now have a double-digit ROE and an efficiency ratio that is accretive to the rest of the bank's efficiency ratio. So, when I put all that together, that's an attractive package for the growth of the bank overall. And Tom talked earlier about the total bank NIM, and when we look at total bank NIM and we don't get completely myopic into the margin in one of our business segments at 167 basis points, we think it's quite competitive with respect to other investment opportunity. So, when we put that into the mix, we like the trajectory. We can't control the rate environment as Dave said, but our strategy is unchanged, and we keep pumping with our customer base.

Robert Sedran – CIBC World Markets – MD & Head of Research

Ok, that may have been an unanswerable question, so I appreciate the attempt. Thanks, guys.

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

Good morning. Darryl, you've emphasized the importance of continuing to manage expenses lower in this environment. And I'm just observing a sort of different approach to this across banks in Canada and the U.S., some taking very aggressive approaches, big restructuring charges and others sort of doing it at the margin. When you think about BMO in 2020 and 2021, how do you think BMO behaves – a little more aggressively with perhaps some restructuring initiatives, meaningful restructure initiatives, or perhaps just let attrition take care of expenses? How do you envision BMO playing?

Darryl White – Bank of Montreal – CEO

Yes. It's a good question. So, in order to answer that question, I'll take you back a bit. We talked a couple of years ago about working our efficiency ratio down and delivering it through operating leverage. The most important outcome is the forecast that we've given holding ourselves accountable to the 58% in 2021. And if you see the trajectory, we're on our way there. We're below 60% for the first time in a very long time this quarter. And we're getting there by moderating our expense growth. Tom told you last quarter that we would start to moderate our expense growth. In this quarter, we've done that. We're telling you today we're going to moderate that even further in the fourth quarter. I think you're going to see us do that considerably. And then as we go out beyond that, we're working on our business plans. We're thinking about how we're going to manage through the course of 2020 and 2021. I think it would be very prudent to assume that we're going to have, we and others are going to have, a reasonable but lower revenue growth environment to work within. And in that context, we'll make our decisions on how aggressive we'll be with respect to restructuring, I would say, as we launch into the first couple of quarters of 2020. So stay tuned on that. Decisions aren't yet made, but it will be in the context of our assessment of the overall revenue environment and our ability to reach the commitment that we've made to 58%.

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

So at this point, it would not be appropriate for me to rule it out, like a meaningful restructuring charge?

Darryl White – Bank of Montreal – CEO

Yes. I've said before, I think in a couple of your competitors' conferences, in fact, that you shouldn't necessarily rule it out. But there will be a day that will come where we'll say that story is behind us.

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

I understand. And then maybe for Pat, looking back at other credit cycles and I'm not suggesting that what we're seeing today is a credit cycle, in fact, there appears to be normalization. Looking back at other cycles, PCL has got as high as 80, 90, 100 basis points plus. As I start to model out a credit cycle today or what it might look today, would it be your view that our credit cycle today could, in fact, be a lot less meaningful in terms of how high the PCL ratio gets than it has been in the past because of things like mix or perhaps just underwriting standards, is that conceivable? Or is that wishful thinking on my part?

Darryl White – Bank of Montreal – CEO

Pat?

Pat Cronin – Bank of Montreal – CRO

Sorry, I don't think that's wishful thinking at all. I do think the mix issue is an important one. I look at some of the more particularly volatile sectors like CRE and I think about what our mix looks like in the CRE sector now, relative to what it looked like going into the last cycle, and we start to decompose sectors like that. We actually feel much better about where we are now versus, say, the last cycle. And the diversification of the book has only gotten better since the last cycle, if you think about how we've diversified into the U.S., how we've diversified into multiple other sectors that weren't there in 2008. And I think diversification is a pretty powerful benefit when it comes to a change in the cycle. But I think I'm kind of with you with respect to the cycle. I'm not calling for a recession either, nor are we institutionally. When I look at forecast for GDP rates, for unemployment, for housing starts, for interest rates, all of that to us for 2020 looks pretty stable relative to 2019. And so while I think things will be softer relative to some really strong performance in '17 and '18, it doesn't feel recessionary. But if we do end up in that cycle, I think you're right. I think the mix of our businesses and the diversification profile is much better than what it was in 2008, and I think that will serve us well.

Scott Chan – Canaccord Genuity Limited, Research Division – Director of Research of Financials & Financial Services Analyst

Good morning. Maybe going back, Tom, to the U.S. NIM question. I think you commented that the initial Fed cut impacted U.S. NIM by 5 bps. And if that kind of continues three or four times, say, up until fiscal 2020, is that kind of a nice barometer to use on potential future impacts just on that isolated item?

Tom Flynn – Bank of Montreal – CFO

So I guess two things. You heard correctly on the approximate impact of the first cut. And then, I would say, the answer to the second question about, thinking about the impact of future cuts would be no. So typically as rates move down, we'd expect less sensitivity in the margin to cuts and we saw that same dynamic playing out as rates moved up. Initially, our deposit spreads widened significantly as rates started to move and that impact diminished in the last couple of cuts. And so we'd expect higher sensitivity in the first couple of cuts than in cuts that would follow. So direction would be similar but the impact would become muted as the Fed move is added up.

Scott Chan – Canaccord Genuity Limited, Research Division – Director of Research of Financials & Financial Services Analyst

Okay, thank you very much.

Darko Mihelic – RBC Dominion Securities, Research Division – Financials Analyst

Hi, thank you, just a quick question on the corporate. It looks like you had office building sale and some higher securities gains. Just to help with the modeling, I wonder if you can give us an idea of the size of that, or maybe what corporate should really be losing every quarter?

Tom Flynn – Bank of Montreal – CFO

So corporate had better than average performance in the quarter for the reasons I mentioned in my remarks and you played back. The way I would look at corporate is our average loss over the last six quarters is about $60 million. And that's as good a number as any to work with. And the numbers move around quarter-to-quarter and we saw the benefit of that in the current quarter. But for modeling purposes, we think taking the last six quarters is a reasonable approach. And again, the number is $62 million for the last six quarters.

Darko Mihelic – RBC Dominion Securities, Research Division – Financials Analyst

That’s helpful, thanks very much.

Darryl White – Bank of Montreal – CEO

Thank you, operator.

As I said earlier, we continue to have strong operating performance in our businesses with good PPPT growth for the quarter and for the year-to-date. While credit losses increased from very low levels as we prudently added allowances for performing loans, as Pat explained, credit quality in our portfolio remains very high.

Now, going back to the beginning of fiscal 2018, we discussed with you two clear objectives: one, growing our U.S. business at a faster rate than the rest of the bank; and two, improving the overall bank's efficiency performance. Now, almost two years later, our update on each of these objectives remains very positive. We've increased the share of the bank's earnings from our U.S. operations from roughly 25% then to roughly 35% today. And as we said earlier, our U.S. segment’s earnings are up 24% year-to-date. And we've done this by prudently taking share in our core businesses and consistently delivering double-digit PPPT growth in the United States.

On efficiency, in fiscal 2017, our adjusted efficiency ratio was 62.7%. In the quarter that we announced today, we broke through 60% and delivered 59.9% efficiency. Going forward, as Tom said, we have a clear focus on managing expense growth, which moderated this quarter and will further moderate in Q4. We committed at our Investor Day last fall to 58% efficiency by 2021 and we are focused on delivering that outcome for our shareholders. So we feel good about our momentum on both of these objectives and we'll continue to have a sharp focus on them going forward regardless of the environment we're operating in. Overall, we're executing on our strategies and they position the bank for sustainable performance going forward.

So thank you all for your time today and we look forward to speaking to you again on the Q4 call in December.