Q3 2021 Conference Call

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PRESENTATION

Christine Viau - *Bank of Montreal - Head of Investor Relations*

Thank you, and good morning. Welcome to BMO's third quarter 2021 results presentation. We will begin the call with remarks from Darryl White, BMO's CEO; followed by Tayfun Tuzun, our Chief Financial Officer; and Pat Cronin, our Chief Risk Officer. Also present to take questions today are Ernie Johannson from Canadian P&C; Dave Casper, from U.S. P&C; Dan Barclay from BMO Capital Markets; and Joanna Rotenberg from BMO Wealth Management.

As noted on Slide 2, forward-looking statements may be made during this call, which involve assumptions that have inherent risks and uncertainties. Actual results could differ materially from these statements. I would also remind listeners that the bank uses non-GAAP financial measures to arrive at adjusted results. Management measures performance on a reported and adjusted basis and considers both to be useful in assessing underlying business performance. Darryl and Tayfun will be referring to adjusted results in their remarks, unless otherwise noted as reported.

And now, I'll turn the call over to Darryl.

Darryl White - *Bank of Montreal - CEO*

Thank you, Christine, and good morning, everyone. Operating momentum across our diversified businesses and the execution of our purpose-driven strategy continue to drive strong and consistent financial performance. Today, we announced net income of $2.3 billion and earnings per share of $3.44, up from $3.13 last quarter. The key drivers of our very strong performance reflect the execution of our purpose-driven strategy and are consistent over time.

Number one, an advantaged and diversified business mix, well positioned for growth through a focus on customer loyalty and consistent investment in digital capabilities, product innovation and customer-facing employees delivering leading financial advice. Number two, targeted actions to improve efficiency and returns and drive long-term profitability. Number three, differentiated risk management and capital allocation, driving consistent credit performance and increasing flexibility for capital deployment. And number four, a steadfast commitment to support the financial well-being of our customers and communities through the economic recovery and beyond.

Our consistent financial performance allows us to continue to build on our long-standing commitment to support a sustainable future, a thriving economy and an inclusive society. And we're acting with purpose and urgency.

This quarter, we announced a 10-year, $12 billion financing commitment towards breaking down barriers to affordable housing in Canada and supporting the aspiration that all Canadians have a home they can afford that meets their needs. In support of mental health, we've extended our Lifeworks Wellness Assistance Program to Canadian Business Banking clients across Canada at no additional cost. We're focused on removing barriers to economic inclusion, with a new dedicated segment in the U.S. providing access to safe and affordable financial products and services for communities historically underserved by financial institutions, including the ‘Bank On’ certified BMO Harris Smart account.

We're also continuing to advance our significant body of work to address the impact of climate change. This quarter, BMO Capital Markets announced the creation of a dedicated Energy Transition Group to provide knowledge, tools and support to clients in their pursuit of energy transition opportunities. Our commitments to building a sustainable future were again recognized in the Corporate Knights’ ranking of Canada's Best 50 Corporate Citizens. Ranked first among Canadian banks, we received top quartile scores in clean investment, board gender diversity, executive diversity as well as clean revenue.

Turning now to our financial performance. On a year-to-date basis, we delivered adjusted pre-provision pretax earnings of $8.5 billion, an increase of 21% from last year, with revenue up 10% and strong operating leverage of 7.3%. We continue to be disciplined in our approach to expense management to drive efficiency improvements. At the same time, we're making targeted investments to position our business for growth, including in marketing, sales force and technology. Even with those investments, year-to-date expenses are up just 3%, and have declined 1% after excluding higher performance-based costs.

At our Investor Day in 2018, we set an efficiency ratio target of 58% or better by 2021. We reached that goal a year early, and we've made further progress this year with year-to-date efficiency of 56.2%. We remain focused on delivering positive operating leverage going forward, including the benefit from strategic actions we've taken to optimize capital and resource allocation.

Our credit quality remains very strong, with low impaired provisions again this quarter. Return on equity this quarter was 17.6% and is also above target, and our capital position continues to strengthen with a CET1 ratio of 13.4%, positioning us well for growth and the eventual relaxing of constraints on returning capital to shareholders.

The economy and our customers have shown remarkable resilience to an evolving landscape of pandemic-related restrictions. With those now lifting and vaccination rates continuing to climb, the Canadian and U.S. economies remain poised for the strongest growth in decades. Despite uncertainty around the emergence of variants of the virus and ongoing supply chain and labour issues, GDP in Canada is expected to grow 6% this year and 4.5% in 2022, and in the U.S. 6% this year and 4% in 2022.

We're already seeing consumer activity increasing with pent-up demand and savings driving higher credit card spend. Small businesses are coming back, and commercial lending is beginning to grow, as Tayfun will discuss. We're embracing the future as a digital-first bank with a strong technology foundation built to navigate change and lead in loyalty, profitability and efficiency improvement. Digital isn't just a channel at BMO. It's the way we operate every part of the business, with leading cloud, data and AI capabilities, user-friendly tools and common platforms for better, faster service.

Engaging in productive partnerships is accelerating our digital transformation. This quarter, we selected AWS as our strategic cloud provider to further modernize banking platforms and build digital financial service applications. In addition, in the U.S. we're expanding our relationship with financial technology leader FIS, with a major multiyear modernization program that accelerates mobile digital solutions, supporting continued growth across U.S. markets. We're also working with Lively, an industry-leading Health Savings Account solutions provider in the U.S., to bring a modern and personalized HSA experience to customers, providing them with financial tools to tackle rising health care costs.

We continue to deploy a series of market-leading capabilities and offers, while shifting service transactions to digital, allowing our employees to focus on advice and sales. With the balance sheet approaching $1 trillion, we're continuing to build an integrated scale advantage across our North American platform.

Which brings me to our U.S. segment, which continues to be a driver of earnings growth, contributing 39% of total bank earnings year-to-date. Pre-provision pretax earnings were up 34% year-to-date, with an efficiency ratio of 55.2%. We're a leader in the Midwest and growing nationally, with over 50% of revenue coming from outside our Midwest footprint. Our integrated approach brings the full value and scale of BMO to our North American customers. As the fastest-growing part of the bank with an accretive efficiency and comparable ROE, the opportunities to continue to expand share and grow are significant.

On a year-to-date basis, each of our businesses delivered strong PPPT growth and positive operating leverage. Our flagship Canadian P&C business is delivering peer-leading performance. Year-to-date, PPPT growth of 14% was supported by continued strong consumer balance growth across mortgages, chequing and saving products and diversified commercial lending growth. We continue to strengthen core digital experience capabilities and drive top-tier digital sales, helping more customers make real financial progress.

In U.S. P&C, PPPT was up 18% year-to-date. We've shown strong growth in commercial deposits and core retail checking balances and are continuing to see momentum in commercial pipelines and expect lending to accelerate as the economy expands and supply chain issues ease. This quarter, we added new commercial banking offices in Denver and Orlando, expanding our operations in areas with strong demographic and economic indicators, and we're continuing to add clients and deepen relationships.

In BMO Wealth Management, we had a very strong quarter. PPPT growth was 36% year-to-date. We're delivering best-in-class experience, with mutual fund sales year-to-date more than 4x all of last year and leading ETF flows. We're investing in key areas of competitive strength in private wealth, Canadian asset management and digital investing. This quarter, BMO InvestorLine introduced enhancements that elevate and personalize our clients' digital trading experience, and we began offering commission-free trading for more than 80 ETFs, further enabling self-directed investors to build well-diversified portfolios.

BMO Capital Markets is an important source of diversified earnings to the overall bank and had another strong quarter, delivering year-to-date PPPT growth of 36%. Investment and Corporate Banking had a second consecutive quarter of record revenue in a robust M&A environment and year-to-date was ranked #1 in the Canadian equity capital markets league tables. Global Markets continued to perform very well in normalizing market conditions. The deliberate actions and investments we've made in the business over the past few years have strengthened and repositioned us for sustained performance.

To conclude, we believe our commitment to support a sustainable future, a thriving economy and an inclusive society and our financial performance are inextricably linked. Supporting our customers, our communities and our employees is how BMO will continue to drive long-term shareholder value.

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

Tayfun Tuzun - *Bank of Montreal - CFO*

Thank you, Darryl. Good morning, and thank you for joining us. I will start my comments on Slide 11. Third quarter reported EPS was $3.41 and net income was $2.3 billion. Adjusted EPS was $3.44, and adjusted net income was $2.3 billion, up from $1.3 billion last year, driven by a strong revenue growth, improved efficiency and lower provisions. Sequentially, earnings increased 9%. Third quarter adjusted return on equity was very strong at 17.6%, up from 9.6% in the prior year, and the efficiency ratio improved to 55.7%. Our strong performance has enabled us to continue to invest for future growth this quarter, while maintaining positive operating leverage.

Adjusting items this quarter included expenses of $18 million after-tax from the impact of divestitures, offset by a partial reversal of restructuring charges recorded in the fourth quarter of 2019 related to severance of $18 million after-tax. Adjusting items are shown on Slide 34.

Net revenue was $6.6 billion, up 10% from last year, with good growth across each of our operating groups. Expenses increased 8% from last year, mainly reflecting higher performance-based compensation. Efficiency improved to 55.7%, and operating leverage was positive 2.1%. This quarter, we had a total recovery of credit losses of $70 million, which included a $71 million provision for credit losses on impaired loans and a $141 million recovery in the provision for performing loans. Pat will speak to these in his remarks.

Moving to the balance sheet on Slide 12. Average loans were down 3% year-over-year and flat excluding the impact of the weaker U.S. dollar. Business and government loans declined due to lower utilization rates and the continued wind-down of the non-Canadian energy portfolio, while consumer loans increased due to strong mortgage growth in Canadian P&C. As a more recent indicator of accelerating loan growth, period-end loan balances are showing momentum and were up 3% compared to last quarter. Average customer deposits were up 5% year-over-year and up 1% on a linked-quarter basis, reflecting the highly liquid corporate and consumer balance sheets. Looking ahead, as the economic recovery takes place, we expect loan growth to accelerate, averaging in the mid-single digits in both our P&C businesses.

Moving to Slide 13 for capital. Our capital position continued to strengthen this quarter. The common equity Tier 1 ratio was 13.4%, up 40 basis points from 13% in the second quarter, predominantly reflecting the impact of very strong internal capital generation. Source currency risk-weighted assets were modestly higher quarter-over-quarter, as business growth and an increase in market risk, driven by the unwinding of OSFI's temporary reduction in the stress VaR multiplier, were largely offset by positive asset quality changes. We expect our regulatory capital ratios to continue to grow given the constraints on capital management actions.

Turning to Slide 14. Net interest income was relatively flat from last year and up 7% on an ex trading basis, driven by earning asset growth and higher NIM. Total bank net interest margin ex trading was up 2 basis points from the prior quarter, reflecting the impact of interest rate risk hedging, investment and funding activities in treasury. On a sequential basis, margin was down modestly in both P&C businesses. In Canada, the decline was due to lower loan and deposit margins, while in the U.S. the impact of lower deposit margins was partially offset by the benefit of accelerated PPP revenue from loan forgiveness.

Moving to our interest rate sensitivity on Slide 15. As shown on the slide, a 100 basis point rate shock is expected to benefit net interest income by over $360 million over the next 12 months, 2/3 driven by short rate impacts. The impact of a 25 basis point increase in short-term rates would add over $100 million to revenue over the next 12 months. The higher second year benefit to rising rates would be primarily driven by reinvestment of capital and deposits at higher yields. These sensitivities assume no benefit to rising rates from surge deposits, and the benefit to revenue would be significantly higher if we retain these deposits.

Turning to Slide 16. Non-interest revenue net of CCPB was up 6% from the prior quarter and up 3% on an ex trading basis, primarily driven by higher gains on investments in our operating groups and in Corporate Services, partially offset by lower securities commissions and fees. Year-over-year non-interest revenue increased 24%, reflecting a rebound in markets and customer activity, including higher gains on investments, underwriting and advisory fees, mutual fund revenue and card revenue. Although we may see quarter-to-quarter volatility in some of our non-interest revenue lines, we are very pleased with the underlying strength and future growth capacity across all fee-generating businesses.

Moving to Slide 17. Expenses were up 2% quarter-over-quarter, primarily driven by performance-based compensation, more days in the current quarter and the impact of higher head count in client-facing sales roles. Expenses were up 8% year-over-year, reflecting higher performance-based compensation, technology-related costs and advertising spend. On a year-to-date basis and excluding the impact of increased variable compensation reflecting stronger performance, expenses declined 1.3%.

While we achieved a sub-56% efficiency ratio this quarter, we have continued to invest in our company to modernize our technology and to grow our revenue-generating capabilities, including sales capacity. As we look ahead, we see very good growth opportunities in all our businesses and are confident that, while opportunistically investing for growth, we will achieve positive operating leverage as a result of strategic actions to optimize efficiency and highly focused expense management.

Moving to the operating groups and starting on Slide 18. Canadian P&C net income was $815 million, up from $319 million last year, reflecting pre-provision pretax earnings growth of 19%. Revenue was strong and up 14% from the prior year, with good growth in both net interest income and non-interest revenue. Non-interest revenue increased across most categories, including gains on investments in our commercial business and card-related revenue reflecting higher customer activity. Expenses were up 9%, reflecting investment in the business, including client-facing and sales roles, marketing and technology spend.

Operating leverage was 5.4%, and efficiency ratio was 46.7%. Average loans were up 5% from last year and up 3% from the prior quarter, reflecting continued strength in residential lending and 2% growth in commercial loans. Deposits were up 7% year-over-year, reflecting continued strong growth in core retail accounts, offset by lower term deposits. The provision for credit losses was $94 million.

Moving to U.S. P&C on Slide 19. My comments here will speak to the U.S. dollar performance. Net income of $453 million compared to $199 million in the prior year. Strong results reflect 12% growth in pre-provision pretax earnings and positive operating leverage of 4.8%. Revenue was up 7% from last year, reflecting growth in both net interest income and non-interest revenue. Expenses were well managed, up 2% from last year, and efficiency improved to 50.3%. On the balance sheet, although average commercial loans were down 1% year-over-year, excluding the impact of PPP loans, period-end loan balances were up 3% from the prior quarter, which is likely a signal for stronger loan growth in coming quarters. Average deposits increased 5% year-over-year. There was a total recovery of credit losses of $49 million.

Moving to Slide 20. Wealth Management had very strong results with net income of $406 million, up 16% from the prior year. Traditional Wealth net income was $333 million, up 19%, reflecting higher revenue due to growth in client assets, including stronger global markets. Insurance net income was $73 million, up 5% from the prior year. Expenses were up 10% from last year due to higher revenue-based costs and investments in the business. Assets under management and assets under administration both increased from the prior year due to stronger global markets.

Turning to Slide 21. BMO Capital Markets had another strong quarter, with net income of $564 million, up 30% from the prior year. Investment and Corporate Banking had record performance, with revenue up 29%, driven by higher underwriting revenue and gains on investments. Global Markets revenue declined reflecting a moderating market environment. The results demonstrate the benefits of diversification in growing revenues. Expenses were up 12%, driven by higher performance-based costs. Operating leverage was negative 9% this quarter, but positive 11% year-to-date. There was a total recovery of credit losses of $94 million.

Turning now to Slide 22 for Corporate Services. The net loss was $52 million compared to a net loss of $117 million last year.

To conclude, we have operating momentum across our businesses, a strong balance sheet and capital position and are opportunistically investing in our businesses to capture market share and deliver continued long-term growth in an improving economic environment. I am confident in our ability to scale resource allocation for future growth while maintaining positive operating leverage, which will be a key success factor.

And with that, I will turn it over to Pat.

Pat Cronin - *Bank of Montreal - CRO*

Thank you, Tayfun, and good morning, everyone. We were pleased with our risk performance this quarter. We saw continued positive momentum across many of our key risk metrics and a fourth consecutive quarter of improvement in our credit risk profile, reflecting the steady economic improvement we've seen throughout this fiscal year and the strong risk management disciplines across the bank.

Starting on Slide 24. The total provision for credit losses was a release of $70 million or negative 6 basis points, down from $60 million or 5 basis points last quarter. Impaired provisions for the quarter were $71 million or 6 basis points, down from $155 million or 13 basis points in the second quarter and well below pre-COVID levels. Similar to last quarter, the strong impaired loan performance is due to very low formations. We are very pleased with these results, but do expect impaired provisions to return to more normal levels over time.

We recognized a release on the provision for performing loans of $141 million this quarter, which was mainly the result of an improving economic outlook and positive credit migration. Given the relatively strong consensus economic outlook and our specific forecast for impaired losses in the year ahead, we remain comfortable that our $2.7 billion of performing loan allowances provides more than adequate provisioning against loan losses in the coming year.

Turning to the impaired loan credit performance in the operating groups. We saw unusually low loss provisions across most business segments. In Canadian P&C, consumer impaired loan losses were $86 million, down 4 basis points from the prior quarter. And in U.S. P&C, the consumer business had a net recovery on impaired loans of $2 million. This strong credit performance across our consumer businesses was driven by low delinquency rates and insolvencies as well as strong recoveries, particularly in auto lending.

In our commercial and corporate businesses, we saw excellent credit performance. In Canadian commercial, we reported impaired loan provisions of $15 million, down significantly from $54 million last quarter. Our U.S. commercial business had a net recovery on impaired loans of $7 million. The decline in provisions was driven by very low formations and a low loss rate on those formations. Our Capital Markets business also had excellent credit performance this quarter, with a net recovery of $19 million. This performance was also driven by very low formations and, additionally good recoveries on prior reservations, particularly in oil and gas.

On Slide 26, impaired formations at $390 million continue to be very low relative to prior quarters. Gross impaired loans declined by $570 million to 51 basis points and are now consistent with pre-COVID levels. In the appendix, we provide an overview of those sectors where we have seen COVID-related impacts on credit quality. These segments make up less than 5% of our portfolio and have had quite modest impaired loan losses to date. In addition, we are seeing early signs of credit improvement in these segments, with net positive credit migration this quarter in almost all of the sectors highlighted. And as you can see on Slide 28, there were no trading loss days this quarter.

In terms of the outlook, we remain cautiously optimistic given the solid credit performance we've seen in the last 4 quarters. While uncertainty remains in terms of the future path of the pandemic and variants of concern, assuming economic strength continues in line with consensus estimates, we would expect further releases from our performing provision in the coming quarters. We expect impaired loan losses to normalize from the very low levels of this quarter and expect the impaired loss rate to be in the low 20s in terms of basis points over the next year or so. However, given the strength of current conditions, we may see the next quarter or 2 with impaired losses below that level.

I will now turn the call back to the operator for the question-and-answer portion of this call.

QUESTIONS AND ANSWERS

Ebrahim Poonawala - *BofA Securities*
I guess, Tayfun, if you could just start with the net interest margin. I get the consolidated margin still went up sequentially, but talk to us in terms of your expectation both in Canada and U.S. P&C. If we don't get a major lift in interest rates, where the margins are headed for both these segments? And if you have the contribution from the PPP fees to U.S. NII for the third quarter.

Tayfun Tuzun - *Bank of Montreal - CFO*

Sure. Thanks for the question, Ebrahim. First, let me say that I think the treasury team has done a great job over the past 4 to 6 quarters in navigating these challenging times, and our margin actually continues to show a very healthy picture with the expansion of 2 basis points this quarter ex trading margins. As I look at the -- in the environment, clearly, there are some puts and takes. The yield curve has flattened. The level of rates is low. But despite that, we've been able to manage the interest rate sensitivities very appropriately. I think the impact of excess liquidity has been neutral so far this year. So, as we look forward into the next 3, 4, 5 quarters, as loan growth picks up and we start consuming excess liquidity, that should be a tailwind that should help us against the continued headwinds related with the yield curve.

But in general, I don't expect any cliffs. I think we will continue to manage our NIM with a target of stability. There may be some quarterly fluctuations. PPP is one of those. We benefited, as you remember, 2 basis points from PPP in the second quarter, probably another 2 basis points or so in the third quarter. And as PPP loans have accelerated their exit through the forgiveness process, you may see a little bit of a dip in the fourth quarter in the U.S., but they will pick up again -- in the first half of next year because now you're getting into the second wave of PPP loans that were originated in 2021. So gives and takes, in general, we expect relative stability with some continued headwinds as normal in this environment. I will turn it over to Dave and Ernie to make comments about NIM in their business with respect to deposit and loan spreads.

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

It's Dave. I couldn't add much to what you said, Tayfun. You're right, we'll have a little bit of a headwind in the U.S. P&C in the fourth quarter, pick it back up in the next year. And I agree with everything you said.

Ernie Johannson - *Bank of Montreal - Group Head, N.A. Personal & Business Banking*

Yes. It's Ernie. I have nothing to add. Just again, the focus is on how we're growing loans, and the loan growth over deposit will have that impact on our NIM. So, nothing further to add. Thanks.

Ebrahim Poonawala - *BofA Securities*

If I could just follow up on that, and maybe this is for Dave. Tayfun, you mentioned the 3% period-end loan growth ex PPP. Dave, if you could just give us some color around intra-quarter. Like we heard from a lot of U.S. banks talking about loan balances inflecting in June, July. Is that consistent with what you saw? And is that momentum building? Or have you seen a slowdown because of the uptick in Delta and some of the additional supply chain disruptions we've seen in the last few weeks?

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

I think your comment is mostly for the U.S., but I would say, in most cases, they apply to Canada as well. So, we were 3% up point-over-point ex PPP. And that was generally throughout the quarter. And that's despite all the things you mentioned. Despite the really significant supply chain issues and labour issues, we're still up 3% point-over-point, both in Canada and the U.S. That's despite, frankly, what I thought would have been better by now, which is still 10 points difference in our utilization between pre-COVID and today. And that comes in all of our working capital businesses, whether it's asset-based lending or our floor plan financing or trucks and trailers. So, all that's still to come, and we were still up 3% point-over-point.

Through all the headwinds, this team has done really well. And I'll tell you what it really is beyond anything we've talked about before. Client acquisition throughout the pandemic has been very strong in Canada and the U.S. Our teams have been in front of customers, whether it's face to face, which is starting in some cases certainly, but on Teams all the time. And client acquisition has been remarkably consistent and strong with really good pipeline. I'd say we're at the front end of that and feeling real good about it.

Scott Chan - *Canaccord Genuity Corp.*

Maybe going back to Tayfun on the interest rate sensitivity on Slide 15. Can you remind us why you have more leverage on an increase in short-term rates on the U.S. side relative to Canada? And is there anything on the Canadian side where you can reposition to get better exposure on that?

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. It's really related to -- that's a great question. It's really related to deposit composition in the U.S. And the betas in the U.S. tend to be a little bit higher. So that's driving the difference between Canada and the U.S. And we will continue -- we actually have -- given the fact that we are now expecting better loan growth into '22, both in Canada and the U.S., as we exit the excess liquidity, we are very focused on growing the transactional deposit balances in Canada to support that loan growth, which could potentially slightly change the sensitivity, maybe a little bit more closer to the U.S. rates. But nonetheless, in the U.S., you always have the impact of higher competition for deposits that I think will preserve somewhat of a difference between the 2 countries.

Meny Grauman - *Scotiabank Global Banking*

Darryl, operating leverage of 7.3% year-to-date, and I guess the question is, can you have too much of a good thing? Meaning we know all banks are focused on fintech threats. Technology needs continue to only grow. And as you look at that operating leverage, what gives you confidence that you're not missing an opportunity to accelerate investment in the business and still put up good operating leverage, but definitely scope to have even great operating leverage below that 7.3% year-to-date level?

Darryl White - *Bank of Montreal - CEO*

Yes. Meny, thanks for the question. As you know, we began our journey on operating leverage a couple of years ago. So, it's not a result of anything we did in any particular quarter this year, but it's the acceleration of a lot of actions that we've been taking for some time. You're right, 7.3% year-to-date, over 2% for the quarter. We're proud of those numbers, and we are -- you're hearing us here recommit to positive operating leverage as we go forward. I would remind you that I've said before, within the quarters that have gone by, we've got lots of expense items that go up, and we've got lots of them that go down. What you see, of course, is the net. And that's a function of how we're repositioning the NIX spend within the bank, and we're making real investments in those places that are going up.

If you look at the quarter in question, we had expenses that are a little higher than they have been in the previous quarters. Some of that -- in fact, a good deal of it is performance-based comp, but also, we accelerated some investments in marketing, in frontline sales force, in technology, so that we could hit 2022 running as it were. And with all that, despite all that, we still delivered the 2% operating leverage. So, I think we're on the right track. We don't feel, Meny, like there are places around -- opportunities that are good opportunities that are starved. We're feeding those opportunities where we think they can deliver long-term value. And at the same time, we're able to deliver the shareholders operating leverage. We think there's more to come from what you've seen so far.

Meny Grauman - *Scotiabank Global Banking*

And just a clarification in terms of reiterating the outlook for positive operating leverage, but can that change on a quarter-to-quarter basis? Meaning as you look to Q4, could we have a negative operating leverage quarter given how strong the year-to-date has been?

Darryl White - *Bank of Montreal - CEO*

Yes. So, look, as you know, we don't give specific guidance on any particular quarter, but I'm reiterating the view that we'll have positive operating leverage on the horizon going forward. Could we have any particular quarter, whether it's Q4 or otherwise, where it's not positive? I suppose, but we won't commit to anything other than positive over the course of the coming quarters at this point in time.

Gabriel Dechaine - *National Bank Financial, Inc.*

Sticking with Darryl there. Your bank, based on my numbers, consensus, the lowest, if not the lowest dividend payout ratio in the group. I'm wondering what we should expect if and when OSFI removes the restrictions currently in place. Are we going to go to modest or moderate dividend increases, like more of same as steady pace? Or could we see some larger catch-up type increases, or if and when, of course, this caveat around that statement?

Darryl White - *Bank of Montreal - CEO*

Yes. Thanks for the question, Gabe. I think what you should look for is, I said at our annual meeting, we've taken our dividend record pretty seriously for the better part of 200 years. So we're going to continue that, first and foremost. The payout ratio that we respected and targeted pre-COVID is one that I think we'll target as we get to that day that you're talking about when we have restrictions lifted. So the priority really for us in terms of the excess capital is we will look to getting our payout ratio back to where it was probably fairly quickly, if I had to guess. Then we'll look at other means of returning capital through dividend increases over the course of the ensuing quarters. And then, of course, even with that, as you will have calculated, there'll be lots left over for other things as well, including buybacks. That's kind of the order of priority for us.

John Aiken - *Barclays Bank PLC*

Just looking at the reported AUM growth sequentially in the quarter, there was a comment in the report to shareholders talking about the Bank of Canada provincial bond purchase program, the ending of that having a -- being a bit of a headwind. Can you give us a sense of what the size of that was in terms of the AUM and what the revenue contribution was?

Joanna Rotenberg - *Bank of Montreal - Group Head, BMO Wealth Management*

This is Joanna. I would say, overall, de minimis, while it impacted our AUM, the provincial bond purchase program in winding down has very minimal impact on our financials.

Mario Mendonca - *TD Securities*

Darryl, can we go back to the expense question for a moment? A few years ago -- well, actually not a few years -- in 2020, it was a fairly big gap between BMO's efficiency ratio and that of the average of the big 6. Now that gap has been essentially eliminated now. And the reason why that's interesting to me is BMO's efficiency ratio has been higher -- had been higher than the group's for as long as I can remember, like a decade or more. And then in the last couple of years, over the last 18 months or so, that gap has vanished. Now I suspect a lot of it relates to the actions that management has taken, a lot relates to the environment. So what I'm getting at here is, as you look forward, do you now expect BMO to be sort of in line with the group efficiency ratio? Have those structural reasons for the difference in BMO's efficiency ratio that we've discussed in the past, have those gone away? Is BMO now -- is it appropriate to think of BMO as an average efficiency ratio bank and not one that would be 500 or 600 basis points higher as we've seen in the past?

Darryl White - *Bank of Montreal - CEO*

Thanks, Mario. Firstly, thank you for acknowledging the progress. We take it very seriously. I don't say that facetiously. It's very important to us. We committed to it in the timeline that you talked about. And we believe we're delivering on it, in fact, ahead of target. Your question is a good one. How do we think about it and where do we go from here? Look, we have made progress on this particular metric more than the average of our peers, maybe more than any of our peers. You can calculate that. But -- I will say I don't think we're done yet. Because if you look at where we are, we would still have some catch up to do relative to the average of our peers, and we still think there's opportunity to do that.

How? More of what we've been doing. We had a hard look, as you know, at every expense line item in the place and realized that there were places we could do things better. We could do things with partners better than we were doing them ourselves. And we took a pretty hard look at the portfolio as well. So, you saw some of the portfolio shifts over the last couple of years. Those weren't driven by social issues. They weren't driven by an appetite for a particular geography necessarily. They were driven by returns, and they were driven by our views on our ability to drive efficiency.

And some of the returns from those decisions, and I would highlight, in particular, the exit of the GAM businesses outside of Canada, the returns, as far as efficiency gains are concerned, we published the pro formas on those before. They're not in our numbers yet. So they come next year as well. I think we've got more room to go from where we are. And what's our destination? Ultimately, we told all of you that we would get to 58% in 2021. We did that a year earlier. Here we are around 56% year-to-date. And I don't see why we can't take another point or two off that as we drive into the next couple of years.

Mario Mendonca - *TD Securities*

I'll interpret that to mean it's unlikely that we'll see that big gap emerge again, that this is real, this is more permanent than -- it's a permanent improvement then.

Darryl White - *Bank of Montreal - CEO*

Having a gap, Mario, to our peer group on efficiency, and ROE I would point out as well now that we're through 17% on the ROE, is not part of our business plan.

Mario Mendonca - *TD Securities*

Got it. Let me go to another related or sort of unrelated question. It relates to the treasury business. And I'm focused specifically on securities gains. The numbers have been very high over the last few quarters. Just to remind you, it's been over $100 million in this quarter, nearly $200 million in securities gains. Looking back a few quarters, that's a pretty big number. Can we talk about what's driving the material securities gains? Is it just the change in interest rates? Or what asset classes and what segments are we seeing these big securities gains, or both?

Tayfun Tuzun - *Bank of Montreal - CFO*

Mario, I'll take that. This is Tayfun. So, despite the fact that in our disclosures those are characterized as securities gains, there is clearly more than just the investment portfolio. And these gains, especially the last 3, 4 quarters, have really not been related to our investment portfolio, and they are very much related to valuation increases in investments that we make in our businesses in this type of an environment. That line item will always -- even pre-COVID, it showed positive results. They are very much parts of our business with our clients and pieces of broader relationships, both in the commercial business as well as in the Capital Markets business. And this quarter, that line item does not have any significant securities gains as defined by the investment portfolio at all. These are all business-related investments. And I will turn it over to Dave and Dan for their comments related to their business with their clients.

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

Thanks, Tayfun. It's Dave. So, the business that would have attracted some of the investment gains, and it's been consistent in P&C Canada for a long time, these are small investments we make with our clients largely supporting growth. We've been doing this for a long time. This year, it's been good gains. Some are real realizations, but many of them are just mark-to-market. But it's been a business we've had. This has been a pretty good year, but we've had these on and off for many years. Dan?

Dan Barclay - *Group Head, BMO Capital Markets*

Yes. And consistent with what Dave said, our portfolio is very similar. Most of this is in the investments we've made alongside our clients as they've had mark-to-market gains. It's nothing in terms of an individual security or an individual business. It's actually across the portfolio.

Mario Mendonca - TD Securities

And the mark-to-market gains are what? Because rates have declined? Is that the logic or is there something else to it?

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

No increase in the valuation of the investment.

Dan Barclay - *Group Head, BMO Capital Markets*

Yes. I would say it's more tied to equity than to interest rates.

Paul Holden - *CIBC Capital Markets*

Just want to follow up with respect to your outlook for commercial loan growth. So, I appreciate you're expecting it to accelerate to roughly mid-single digits. Just wondering how the excess deposits and liquidity situation sort of factors into that equation. Is it a matter of if these excess deposits burn off, then maybe we can get to a higher rate? What we're really just trying to understand to what extent it is dampening loan growth potential?

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

Yes, it's Dave. Well, it definitely is having an impact, certainly, in capital expenditures. As a lot of our clients are growing their CapEx, where they have cash, they're using those. So that would have an impact, and that will continue. But I think overriding that is there really is a strong demand. We talked about the utilization that hasn't even come back yet. But business demand has gone up. It will be -- I expect the loan growth, as I said -- I think I said at the beginning of this year, while we were in the midst of COVID, that I thought year-over-year we would have -- or at the end of the fourth quarter, we'd have mid-single-digit growth. I think that's actually going to be better and probably go out longer into next year. So, I think it's really strong. It will be impacted by clients drawing down on their cash, but many of our clients are already starting to borrow more.

Paul Holden - *CIBC Capital Markets*

Okay. And the second question is on the Capital Markets business. I think everyone is kind of trying to figure out what normal might look like, not just for BMO, but obviously for the banks more broadly. You've been putting up very strong results for the last year plus. So any help with kind of what you would view as sort of a normalized run rate given the investments you've made in the business in the last couple of years would be helpful.

Dan Barclay - *Group Head, BMO Capital Markets*

Yes, it's Dan here. I think, first off, it's been very satisfying to see the investments that we've made and the repositioning that we've done pay off. And I think that's driving a very -- a large chunk of the outperformance. In particular, if you think about the investments we made in the U.S. over the last 10 years and bringing those to fruition, we're really seeing those now operate at scale and deliver the results that we expected.

When we look forward, we're continuing to make investments where we can get to client acquisition, product expansion, the ability to grab more market share, particularly in the U.S., some places in Canada, all with the goal of creating more sustainable revenues and more diversity across our line. Obviously, we have exposure to market behaviours, and I wouldn't say we can predict that with intense accuracy over the long term. But what I can say is that we're going to continue to deliver positive operating results, positive operating leverage as we look forward and continue to drive sustainable performance in the business.

Paul Holden - *CIBC Capital Markets*

Okay. So, there's no revenue or PPPT sort of forecast that you'd want to share with us in terms of what you view as a normalized run rate?

Dan Barclay - *Group Head, BMO Capital Markets*

I think, at this stage, we're watching that. We obviously have pieces of the business where we've made investments and we're making gains, and then we have others where we have exposure to market normalizing. At this stage, I wouldn't push forward a PPPT target per se. We have got to a new normal and a new baseline as we look forward. And we're going to continue to benefit from -- if you think about volatility to the marketplace, that's an asset for us. It also serves as a diversity to the rest of the bank. So we're really strong. The rest of the bank is working through it. And when the rest of the bank starts to really grow, we'll moderate a little bit.

Darko Mihelic - *RBC Capital Markets*

I'm looking at your supplemental, Page 11, the very first line item. I'm interested in a couple of things here. First and foremost, how much of that $264 million is coming from the $9.95 BMO InvestorLine sort of a direct brokerage? Second question related to that is, what's your early read on the situation now that you've had a competitor go to zero? What would be your intention? And then the third and last question with respect to that line item is I keep seeing these commercials saying that the fees are -- the low fees are making a difference. What about also the full service part of your business, which is relatively big? Are you seeing any pressures there to also lower fees?

Joanna Rotenberg - *Bank of Montreal - Group Head, BMO Wealth Management*

This is Joanna. Thanks for your question. Starting from the beginning, overall, we're really satisfied with our Wealth results overall. I think they represent very strong diversified operating performance, and that includes across our businesses and across our categories. To comment specifically about the online brokerage revenue, again, very happy with our brokerage results. They continue to deliver strong client growth. We've seen about2.5x pre-pandemic rates of client growth, and we want to see that. And we're seeing it, by the way, across both our self-directed business as well as our digital advice business, which is an important and growing part of our business.

We are, of course, always monitoring and changing our offering to make sure we deliver the best experience for our clients and value to them. And for us, that includes actions that we've taken, which includes the zero trading commissions on our most popular ETFs, which has been very well received. I would say, from a line item perspective, just getting into the trading commission revenues, we don't specifically disclose trading commission revenues, but it's not a material part of our revenues. I would say online brokerage fees represents today in terms of wealth net revenues about 2% or a little bit less. That's less than 1% of bank revenues. So not a material line item to us. But we're going to continue to evolve and enhance our platform.

And one of the areas that we are focused on is growing our digital advice business. It's an important and growing category overall. And today, between adviceDirect as well as SmartFolio, we represent 1/3 of that category, and we intend to grow that area. As it relates to the full-service brokerage, we've seen strong growth there, strong growth both in terms of the full-service brokerage business. Yields have naturally, together with the rest of the category, moved around a little bit, but have generally held, in particular in recent quarters as equity markets have strengthened. We've seen great growth in that business, and that would include both on a stand-alone basis as well as in connection to the broader BMO offering, and that would include partnerships, including commercial, as well as working together across our banking portfolio. So continue to see strong client demand there for full-service brokerage and the advice we're delivering and expect that to continue.

Darko Mihelic - *RBC Capital Markets*

Maybe just a quick follow-up to that. Is it important -- or maybe ask it a different way. If another competitor were to go to zero, would that be the move that sort of pushes you towards absolutely following? Or is there some other consideration?

Joanna Rotenberg - *Bank of Montreal - Group Head, BMO Wealth Management*

I would say we're always going to be evaluating our offering. And that includes, obviously, evaluating what are our customers looking for, how do they value different parts of our platform and, of course, the competitive activity and external activity will influence that. I wouldn't say those are hard and fast rules, and we continue to grow our business, and we'll continue to expand our offering. This is a business we want to support.

Lemar Persaud - *Cormark Securities Inc.*

I just want to follow up on the answer to Mario's question on the business investment gains. It sounds like you're suggesting some normalization in that moving forward. Did I interpret that correctly? Or can they remain elevated for the next couple of years? And anything you guys can give us in terms of outlook for that and to help us along with our modeling would be very helpful.

Tayfun Tuzun - *Bank of Montreal - CFO*

Sure. Lemar, I'll take this. This is Tayfun. So, when you look at this year, for example, we had $102 million in Q1, $111 million in Q2, $198 million in Q3. There is going to be some volatility because sometimes you receive the financials related to these entities in certain periods, which are going to cause an uptick. But overall, I think, in this environment, you should continue to expect these numbers to remain healthy. Will they always be near $200 million? We will not predict that, or I wouldn't suggest that you model it. But on average, this year, we clearly have been above $100 million. Unfortunately, it's a little bit difficult to predict exactly on a quarterly basis how these numbers will move around.

Lemar Persaud - *Cormark Securities Inc.*

Okay. And then my next question is on the domestic retail business. I think one of the things that we're seeing with COVID is how important cards growth is to overall profitability, not just for BMO, across the group. And given that the growth is perhaps a bit tougher to come by than I had expected in a post-pandemic recovery, I'm wondering if you could comment on the competitive landscape for cards first. And then second, with the rise of Buy Now, Pay Later and increased competition, can you talk about the outlook for cards post pandemic both in terms of balances and also in profitability?

Ernie Johannson - *Bank of Montreal - Group Head, N.A. Personal & Business Banking*

Thanks. It's Ernie. I appreciate the question. A couple of comments just overall as I frame up cards in the perspective of the P&C Canada business, which had a very strong performance and momentum this quarter and consistent with what we've been delivering over the past little while. Cards have been part of that story, part of that growth story, and it will continue to be part of that story going forward. We've seen good performance this quarter coming out of our cards business. We're seeing consumer spend return, as you can imagine. And we're seeing it pretty broad-based, with the exception of travel category.

So just to give you a perspective, spend this year is up about 20% over last year. And I always frame it against '19 because we want to kind of get a better look at it, and it's 8% higher than Q3 of '19. So we're seeing the card business return. That's a function of, for us, obviously, the breadth and offering of our product suite and also the fact that we're seeing some good performance coming out of our recent launch of our Visa Eclipse product. So the combination of good programs for our customers and offerings broad-based in rewards, so, for example, CashBack has been doing extremely well for us or Eclipse cards have been, that's a recognition of where Canadian consumers are looking to find value in their credit card.

As I think about the competitive landscape, I always measure that against our performance, and we've had consistent growth year-over-year, quarter-over-quarter on our cards franchise. Again, a recognition of the strength of the portfolio and the marketing and the actions that we've been taking. Buy Now, Pay Later is an interesting opportunity both on the cards franchise as well as our lending. And obviously, we keep a good track of, we haven't seen it really pick up in terms of a share gain yet.

But obviously, over time, that will manifest. And we'll be participating in some way, shape or form in that market as we go forward. So I would say, overall, we're going to continue to see cards -- credit cards being an important component of the payment ecosystem in Canada, one that we participate well in. And given our dual network capability now and our breadth and suite of products, we're well positioned for growth even through the pandemic and, more importantly, coming out of pandemic. Overall, pretty confident on our future in cards.

Christine Viau - *Bank of Montreal - Head of Investor Relations*

Sorry. I think we're just going to have to hold that off for now and just go to one last question before we wrap the call.

Nigel D'Souza - *Veritas Investment Research Corp.*

I actually had a follow-up on your security gains as well in the quarter. And I was wondering if those gains were at all related to debt for equity swaps on workouts that were undertaken during the pandemic. Is it the revaluation of the equity portion of those debt for equity swaps that were undertaken over the last 12 to 18 months? Or is this something completely unrelated that's driving those gains?

Dan Barclay - *Bank of Montreal - Group Head, BMO Capital Markets*

It's Dan here. Maybe I'll take that from the Capital Markets piece. There is a very small amount in that. The majority was in our equity investments. I think there's a future where some of those debt for equity swaps will see bigger gains in the future for that.

Nigel D'Souza - *Veritas Investment Research Corp.*

Okay. And if I could just quickly just finish on the potential impact of the Delta variant and how that could impact your outlook for growth or credit on the credit side. Has there been any change on your adverse scenario inputs or any potential management overlay that you might apply depending on how the Delta variant plays out? And on the growth side, you mentioned supply chain issues with the Delta variant impacting Asia. Do you see any of that supply chain issue persisting and perhaps impacting your commercial growth outlook?

Pat Cronin - *Bank of Montreal - CRO*

Thanks for the question, Nigel. It's Pat. I'll take the credit part of it. We made no changes to the weighting of our adverse scenario, nor the severity. You might recall, in Q2, we did actually increase the severity of our adverse case, and we left that unchanged for this quarter. If you look at our total performing provision releases so far, we've released about 21% of what we added during fiscal '20. So we think that's a pretty good balance between the momentum that we're seeing in the economy and the really strong credit performance we're seeing and, obviously, the uncertainty around Delta or other variants that might emerge. So we think we're in a fairly cautious position should the adverse scenario play out. But if our base case scenario plays out, we obviously think we've got lots of releases still to come.

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

And just quickly, it's Dave, on the growth side. I would say that certainly has had an impact. But in our comments, we've taken that into consideration. We -- while we've had significant inventory slowdowns in some markets, that's factored in, and I still think that we've got good growth coming ahead.

Darryl White - *Bank of Montreal - CEO*

Thank you, all of you for your questions this morning. I'm going to take us home. I'm going to conclude with 4 key summary themes that have been consistent for us for the past several quarters. First, our results for the first 3 quarters, our strong ROE, EPS growth and operating leverage are all above our midterm targets. Second, we delivered on our expense and efficiency commitments, and we have strategies in place to do more. Third, credit quality remains a differentiator, and we believe it will continue to be even as our balance sheet begins to grow again as it is.

And number four, with our business mix, which we think is advantaged, it's primed for ensuring that the economic recovery and the strong momentum we have in our businesses are going to be connected to our highly confident view that our purpose-driven strategy will deliver consistent financial performance. And while we do that, we will do our part in enabling an inclusive recovery for our customers and our communities.

Thank you all for participating in today's call, and we look forward to speaking to you again in December.
