BMO Financial Group

Q3 2023 Conference Call

CORPORATE PARTICIPANTS

Christine Viau
Head of Investor Relations

Darryl White
CEO

Tayfun Tuzun
CFO

Piyush Agrawal
CRO

Ernie Johannson
Group Head, N.A. Personal and Business Banking

Nadim Hirji
Group Head, BMO Commercial Banking

Dan Barclay
Group Head, BMO Capital Markets

Deland Kamanga
Group Head, BMO Wealth Management

Darrel Hackett
U.S. CEO

CONFERENCE CALL PARTICIPANTS

Doug Young Desjardins Securities

Gabriel Dechaine National Bank Financial

Paul Holden CIBC Capital Markets

Meny Grauman Scotiabank Global Banking and Markets

Lemar Persaud Cormark Securities

Ebrahim Poonawala Bank of America Securities

Joo Ho Kim Credit Suisse

Nigel D'Souza Veritas Investment Research

Non-GAAP Measures and Other Financial Measures

Results and measures in this document are presented on a GAAP basis. Unless otherwise indicated, all amounts are in Canadian dollars and have been derived from our audited annual consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS). References to GAAP mean IFRS. We use a number of financial measures to assess our performance, as well as the performance of our operating segments, including amounts, measures and ratios that are presented on a non-GAAP basis. We believe that these non-GAAP amounts, measures and ratios, read together with our GAAP results, provide readers with a better understanding of how management assesses results.

Management considers both reported and adjusted results and measures to be useful in assessing underlying ongoing business performance. Adjusted results and measures remove certain specified items from revenue, non-interest expense and income taxes. Adjusted results and measures presented in this document are non-GAAP. Presenting results on both a reported basis and an adjusted basis permits readers to assess the impact of certain items on results for the periods presented, and to better assess results excluding those items that may not be reflective of ongoing business performance. As such, the presentation may facilitate readers' analysis of trends. Except as otherwise noted, management's discussion of changes in reported results in this document applies equally to changes in the corresponding adjusted results.

Non-GAAP amounts, measures and ratios do not have standardized meanings under GAAP. They are unlikely to be comparable to similar measures presented by other companies and should not be viewed in isolation from, or as a substitute for, GAAP result.

Examples of non-GAAP amounts, measures or ratios include: efficiency and leverage ratios calculated using revenue presented net of CCPB; revenue and other measures presented on a taxable equivalent basis (teb); pre-provision pre-tax income; amounts presented net of applicable taxes; adjusted net income, revenues, non-interest expenses, earnings per share, effective tax rate, ROE, efficiency ratio, and other adjusted measures which exclude the impact of certain items such as acquisition and integration costs, amortization of acquisition-related intangible assets, impact of divestitures, restructuring costs and management of fair value changes on the purchase of Bank of the West. Bank of Montreal provides supplemental information on combined operating segments to facilitate comparisons to peers.

Certain information contained in BMO's Management's Discussion and Analysis dated August 29, 2023 for the fiscal quarter ended July 31, 2023 ("Third Quarter 2023 MD&A") is incorporated by reference into this document. Quantitative reconciliations of non-GAAP and other financial measures to the most directly comparable financial measures in BMO's financial statements for the period ended July 31, 2023, an explanation of how non-GAAP and other financial measures provide useful information to investors and any additional purposes for which management uses such measures, can be found in the Non-GAAP and Other Financial Measures section of the Third Quarter 2023 MD&A. Further information regarding the composition of our non-GAAP and other financial measures is provided in the "Glossary of Financial Terms" section of the Third Quarter 2023 MD&A. The Third Quarter 2023 MD&A is available on SEDAR+ at http://www.sedarplus.ca and on our website at www.bmo.com/investorrelations.

PRESENTATION

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

We will begin the call today with remarks from Darryl White, BMO's Chief Executive Officer, followed by Tayfun Tuzun, our Chief Financial Officer and Piyush Agrawal, our Chief Risk Officer. Also present to take questions are Ernie Johannson, Head of BMO North American Personal and Business Banking, Nadim Hirji, Head of BMO Commercial Banking, Dan Barclay, Head of BMO Capital Markets, Deland Kamanga, Head of BMO Wealth Management and Darrel Hackett, BMO U.S. CEO.

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 with that, I'll turn the call over to Darryl.

Darryl White – *Bank of Montreal – CEO*

Thank you, Christine, and good morning, everyone. I'd like to start this morning by acknowledging the ongoing devastating wildfires impacting British Columbia and the Northwest Territories. We're committed to doing our part to help make sure the families, businesses and communities get the support they need, including financial relief options for those affected.

Also, today, I'd like to welcome Darrel Hackett, our U.S. CEO, to his first investor call. Darrel has been with BMO since 2004, most recently as President of BMO Wealth Management, U.S. His track record of dedication to our clients' success, extensive community leadership and commitment to eliminating barriers to inclusion will be a key contributor to the ongoing success of BMO U.S.

Turning to the quarter, our performance continues to reflect the strength, diversification and active management of our businesses in an evolving environment. This quarter, we reported earnings per share of $2.78, impacted by one-time items that we will discuss. Pre-provision pre-tax earnings were up 6% from last year and all-bank revenue was up 22%, driven by record results in Canadian Personal and Commercial Banking, supported by double-digit deposit growth, and good contribution from the Bank of the West.

Credit performance is normalizing in line with our expectations with higher provisions this quarter compared with historically low levels. Our balance sheet remains strong, reflecting our long-standing track record of superior risk management.

We further strengthened our capital position with a CET1 ratio of 12.3%, an increase from Q2 despite the impact of the closing of the AIR MILES transaction. For the year-to-date, return on equity was 12.6% and return on tangible common equity was 15.8%.

As we discussed last quarter, we're taking action to adjust to market forces that are creating near-term headwinds for the industry and negative operating leverage for us this year. We have a proven track record of disciplined expense management while making targeted investments where we have the best opportunities to support our customers and deliver sustainable growth. Our approach has delivered positive operating leverage in each of the last five years and continuous improvement in our efficiency. Our results this quarter included severance costs in each of our businesses related to workforce reductions representing approximately 2.5% of our total FTE, which is complementary and incremental to our ongoing Bank of the West integration program. We're undertaking these changes to enable us to accelerate our efficiency initiatives and align investment with customer and market opportunities. We expect the impact of these initiatives, combined with the expense synergies still to come from the Bank of the West, to result in a return to positive operating leverage for fiscal 2024.

Our U.S. segment has consistently contributed to the bank's earnings growth and efficiency improvement. This quarter, for the first time, pre-provision pre-tax earnings in the U.S. exceeded US$1 billion, double where we were four years ago. We have a differentiated position in the U.S. market, ranking in the top 10 of diversified banks while benefiting from the strength of BMO's trillion-dollar North American balance sheet.

And we're positioned to accelerate our long-term growth strategy as we complete the acquisition of the Bank of the West. Conversion is on track for the upcoming Labour Day weekend. We're bringing the best of both companies together for our employees and ensuring a smooth [transition] for our customers who will benefit from the greater convenience, speed and product options of a broader company with deeper resources. Employees and customers are embracing our entry into the market, and we're already seeing a strong response to our offers and campaigns having opened thousands of new accounts, and that's before the full rollout of product capabilities and marketing post conversion next weekend. In addition, we've added hundreds of active clients in our trading businesses and continue to complete one-client transactions between commercial and Capital Markets. We know that brand recognition is one of the most powerful factors in attracting new customers, and our brand campaign reinforces the scale and the strength of BMO. While BMO may be new to parts of California, we're letting customers know we're not new to banking, and we're here to stay.

We're confident in the power of our integrated North American franchise and our strategy to help clients make real financial progress.

Canadian P&C delivered another quarter of strong performance with Personal and Business Banking breaking through $2 billion in revenues for the first time and continuing to grow market share. Leading customer acquisition and strong customer onboarding has been a key contributor to our growth. Our new to Canada segment, for example, is up 40% over last year. We're focused on meeting customers where they are, including our branch inside Calgary's Gateway Newcomer Centre, where our teams provide specialized guidance and resources.

In addition, this quarter, we closed the acquisition of AIR MILES, Canada's longest standing and most recognized loyalty program with 10 million active customers representing half of Canadian households. We're leveraging BMO's strength in innovation and digital to expand and enhance the program and are already seeing early success in attracting new collectors and partners.

In U.S. P&C, we grew revenue 51%, reflecting the addition of the Bank of the West. While loan demand has been muted across the industry, we're continuing to add customers and deepen relationships. This quarter, we launched BMO V-PAYO, an integrated payable solution, expanding a product capability within Bank of the West to all U.S. clients. It's a great example of working together as one unified bank and building our position as a leader in B2B payments.

We're committed to actively fostering a culture that gives people space to innovate. BMO was the only financial institution named among the top 30 companies on Fast Company's Best Workplaces for Innovators list, and we were recently recognized by J.D. Power, ranking first in customer satisfaction with online banking in Canada. These are a testament to how BMO's digital-first strategy and industry-leading experiences are exceeding our customers' evolving expectations.

In BMO Wealth Management, we continue to deliver results and extend our leadership in the ETF market. This quarter, we further expanded our innovative suite of active exchange-traded funds to provide investors with more choice and portfolio customization.

BMO Capital Markets had a solid performance, including good revenue contribution in the U.S. even as client activity remained below historical trends. We have key momentum in key areas, ranking in the top 10 in global and North American M&A and adding products and capabilities in our U.S. rates business, examples of how we're continuing to provide value-added expertise and products in support of our clients' needs.

Our Purpose, to boldly grow the good in business and life, guides all we do. This quarter, we were included in Corporate Knights' listings of Canada's Best 50 Corporate Citizens with top-quartile scores in board, gender diversity and executive racial diversity, the only Canadian bank named to the list. In addition, we received a top-quartile Sustainable Revenue score, reflecting our commitment to sustainable financing and responsible investing.

As we look ahead, we're all aware of the macro headwinds facing the industry. These external forces are influencing the environment we're all operating in, and I believe they could persist for some time to come. Against that backdrop, what sets BMO apart is the strength of our team and the emphasis that we've placed on dynamically managing our business to control the forces that we can control. We're taking action to reduce our cost base while making investments to drive high performance for the long term, including realizing the synergies from Bank of the West. I'm confident that our unique and differentiated North American growth strategy sets us apart on both sides of the border. We have the scale across our Canadian and U.S. franchises to continue to support our customers, advance our digital strategy and make meaningful differences in the communities that we serve. I'll now turn it over to Tayfun.

Tayfun Tuzun – *Bank of Montreal – CFO*

Thank you, Darryl. Good morning and thank you for joining us. My comments will start on slide 9.

Third quarter reported EPS was $1.97, and net income was $1.5 billion. Adjusting items are shown on slide 38 and include acquisition-related impacts for integration costs and amortization of intangibles, which decreased net income by $370 million and $85 million, respectively, as well as a $131 million after-tax charge related to tax measures enacted by the Canadian government that amended the HST definition for financial services.

The remainder of my comments will focus on adjusted results. Adjusted EPS was $2.78 and net income was $2 billion, down 4% from last year. Our results this quarter were impacted by severance costs and legal provisions, which reduced net income by $245 million and earnings per share by $0.34 on a combined basis. Revenue increased 22% with good organic growth in each of our operating groups and the benefit of acquisitions. Expenses increased 33%, primarily due to the impact from acquisitions. PPPT of $3.1 billion was up 6%, driven by strong growth in our Canadian P&C business, contributions from our Bank of the West acquisition and higher results in BMO Capital Markets. Total PCL was $492 million, including a $159 million provision for performing loans compared with a total provision of $136 million in the prior year. Piyush will speak to these in his remarks.

Turning to slide 10, the acquisition of Bank of the West contributed $167 million to net income, $1.1 billion to revenue and $749 million to expenses. We are pleased with the Bank of the West second quarter post-closing results as their contribution remains in line with our expectations. We are highly focused on successfully executing our systems conversion and brand unification this weekend, which will complete the full integration of Bank of the West within our U.S. segment. As we have shared with you since the announcement, our confidence level in achieving the cost synergies remains very high. To date, we have been tracking ahead of our expectations on cost synergies and with the benefit of additional analysis over the last two quarters since we closed the transaction, we believe there is potentially more upside, including third-party expenses and technology costs. We plan to give you a final post-conversion update when we report our fourth quarter earnings on all relevant metrics.

Moving to the balance sheet on slide 11, average loan growth was 22% year-over-year or 21% on a constant currency basis, including Bank of the West, and good growth across our businesses. Sequentially, period-end loans were down 1% or flat on a constant currency basis. Consumer loans were higher, driven by mortgage growth in Canadian P&C while business and government loans were lower as growth in BMO Capital Markets in Canadian P&C was offset by lower commercial loans in U.S. P&C. We expect loan demand in the U.S. will remain muted through the end of the year, continuing the trends that we have seen during the last two quarters, while modest growth is expected to continue in Canada.

Average customer deposits increased 22% year-over-year from Bank of the West and higher balances in Canadian P&C and BMO Capital Markets. Sequentially, period-end deposit balances were stable and up 1% on a constant currency basis, with strong growth in term deposits in Canada, offset by declines in our U.S. P&C and Wealth Management businesses.

Turning to slide 12, the continued strong deposit growth in Canada is the result of continued success in customer acquisition, new products and digital investments across our retail and commercial businesses and we have seen signs of term migrations starting to slow. In the U.S., trends have stabilized and going forward, our enhanced digital platform, combined with a larger retail branch network and our advanced treasury management capabilities addressing the needs of our commercial clients, especially post conversion, should help us grow our deposit base.

Turning to slide 13, on an ex-trading basis, net interest income was up 25% and net interest margin was up seven basis points from the prior year, driven by Bank of the West and strong balance growth and margin expansion in the underlying businesses. Year-over-year growth was partially offset by the impact of higher low-yielding asset balances for liquidity purposes. Net interest margin was up two basis points from last quarter, driven by higher margins in Canadian P&C, partially offset by lower margins in U.S. P&C and Wealth businesses. In Canadian P&C, NIM increased by seven basis points, driven by wider deposit margins as well as higher loan margins and favourable change in our loan and deposit mix. In U.S. P&C, NIM was reduced by 16 basis points sequentially, driven by lower deposit balances and margins as well as lower loan margins.

We continue to expect relative stability in our overall margin as the benefit of reinvestment of equity and non-maturity deposits at higher yields offsets pressures from higher deposit costs. Although we may see some NIM tightening in Canada over the next couple of quarters based on strong pricing competition in loans and deposits, in the U.S., we expect a more stable outlook.

Moving to slide 14, expenses increased 33% from last year, mainly due to Bank of the West and higher severance costs. Sequentially, expenses were down 1%, excluding the impact of severance costs, three more days in the current quarter and the addition of two months of results from the acquired AIR MILES business. As we predicted earlier in the year, the expense trends are improving based on our decision to curb expense growth earlier in the year and reinforced by the dynamic expense management actions we have taken this quarter to moderate growth and meet our commitment to positive operating leverage and improved efficiency.

This quarter, we incurred severance costs to accelerate operational efficiencies across the bank while we continue to align resources to areas that will support long-term customer growth. We expect this to drive expense savings of approximately $200 million in fiscal 2024 and run rate savings of approximately $250 million by early 2025. In addition, we have identified further actions to optimize real estate, technology and procurement costs. Next quarter, we will record an impairment charge of approximately $45 million for real estate reduction opportunities that will generate future savings. The estimated cumulative run rate benefits from the severance costs and these additional actions are estimated to exceed $400 million at an annualized basis. Combined with the targeted cost synergies at Bank of the West, we expect these will result in positive operating leverage in 2024 and help us continue to invest in our businesses while keeping our expense growth at acceptable levels. We expect our expense trends to start reflecting these benefits starting in the first quarter of 2024 once the conversion related activities this quarter are behind us.

Turning to slide 15, our capital position remained strong with a Common Equity Tier 1 ratio of 12.3%, up 10 basis points from the prior quarter. Internal capital generation, shares issued under the dividend reinvestment plan and lower source currency RWA primarily reflecting change in assets were mostly offset by the AIR MILES acquisition and the impact from acquisition integration costs and tax-related charge in the current quarter.

Moving to the operating groups and starting on slide 16, Canadian P&C delivered net income of $923 million, down 4% from the prior year. Pre-provision pre-tax earnings grew 10% year-over-year, offset by higher provisions for credit losses. Record revenue of $2.8 billion in the quarter was up 10%, driven by 10% growth in net interest income, reflecting both strong balance growth and higher margins as well as 11% growth in noninterest revenue due to higher card fees as well as the acquisition of AIR MILES. Expenses were up 10% versus prior year, reflecting the impact of severance costs and inclusion of AIR MILES. Loans were up 7% year-over-year, with 8% growth in residential mortgage lending and 7% in commercial loans and were up 1% from the prior quarter. Deposits increased 12% year-over-year and 3% sequentially across both retail and commercial businesses with strong growth in term deposits.

Moving to U.S. P&C on slide 17, my comments here will speak to the U.S. dollar performance. Net income was $489 million up 10%, mainly due to the contribution from Bank of the West. Pre-provision pre-tax earnings growth of 22% was partially offset by higher provisions for credit losses. Revenue was up 51% year-over-year, driven by Bank of the West. Sequentially, revenue was down 3% due to lower deposit margins and lower loan balances. Expenses increased 82% year-over-year primarily due to the impact of Bank of the West and up 4% quarter-over-quarter, primarily due to severance and higher advertising costs as we prepare to roll out our unified brand across our U.S. markets. Loans were up 53% from the prior year driven by the Bank of the West and declined 1% quarter-over-quarter primarily in commercial. Deposits increased 41% year-over-year and declined 3% sequentially.

Moving to slide 18, BMO Wealth Management net income was $304 million, down from $325 million last year. Wealth and Asset Management net income was $223 million, compared with $264 million in the prior year. Contributions from Bank of the West and growth in new client assets were more than offset by lower net interest income and higher expenses. Insurance net income was $81 million compared with $61 million in the prior year driven by favorable market movements in the current quarter. Expenses were up 15%, mainly due to the impact of Bank of the West, investments made in the business last year and severance costs in the quarter.

Moving to slide 19, BMO Capital Markets net income was $316 million, up 18% year-over-year. Revenue in Global Markets was up 7%, reflecting higher trading activity. Improved client activity in Investment and Corporate Banking and the prior-year markdowns on loan underwriting commitments resulted in a 35% increase in revenues year-over-year. Expenses were up 17%, driven by higher performance-based compensation and legal provisions.

Turning now to slide 20, Corporate Services net loss was $159 million compared with $187 million in the prior quarter and net income of $7 million in the prior year. To conclude, we acted with pace this quarter to accelerate operational efficiencies that are necessary to align our operating performance with our long-term commitment to positive operating leverage, and we will continue to exercise disciplined expense management going forward while remaining focused on our long-term growth strategies. The strength of our North American franchise supported by the underlying diversification of our businesses will continue to create a significant differentiation for BMO as the banking industry continues to evolve. I will now turn it over to Piyush.

Piyush Agrawal – *Bank of Montreal – CRO*

Thank you, Tayfun, and good morning, everyone. Our risk performance continues to reflect strong risk management discipline across the bank against a backdrop of significant monetary tightening and other macroeconomic headwinds.

Starting on slide 22, the total provision for credit losses was $492 million or 30 basis points. Impaired provisions for the quarter were $333 million or 21 basis points, up five basis points from prior quarter, consistent with the expected normalization in loss rates.

Moving to slide 23, performing provision for credit losses of $159 million for this quarter primarily reflected portfolio credit migration, which is a natural outcome of the higher interest rate environment. Over the last five quarters, we have added consistency to our allowance to reflect risks in the economy. Our $3.4 billion of performing loan allowance provides good coverage of over 3.4x on trailing four-quarter impaired losses.

Turning to the impaired loan credit performance in the operating groups, Canadian retail impaired loan losses were $174 million or 33 basis points, up one basis point from last quarter. For residential real estate secured lending, we continue to view the risk from higher rates as modest given our high credit quality borrower base and low LTVs. Delinquency rates and losses remain low and based on data over the last couple of quarters, customers renewing are able to absorb the impact of the higher interest rates. In U.S. retail, impaired loan losses were $55 million or 41 basis points, up 9 basis points from second quarter, primarily due to unsecured credit losses.

Turning to our Corporate and Commercial businesses, Canadian commercial impaired loan provisions were $35 million or 13 basis points, up 9 basis points from very low loss levels in Q2. U.S. commercial impaired losses were $64 million or 16 basis points, up 10 basis points from prior quarter, driven by a large provision in the retail trade sector. Our Capital Markets businesses continue to experience low impaired loan results with a loss of $1 million this quarter. On slide 24, bank-wide impaired formations of $917 million increased $74 million from second quarter. Gross impaired loans was $2.8 billion, up $186 million from prior quarter. The gross impaired loan ratio of 44 basis points remains below pre-pandemic levels.

On slide 26, we provide an overview of our commercial real estate portfolio. The portfolio is well-diversified across geographies and property types. Throughout market cycles, we have maintained consistent and disciplined underwriting standards and client selection. The office subsegment, which represents 1% of our overall loan portfolio, is monitored closely and is diversified across urban and suburban areas with no concentration in any particular city. As expected, we have seen negative migration in this portfolio, though impairment and losses remain low. Overall, we are comfortable with our commercial real estate portfolio given the careful client selection, strong credit structures and credit quality. As we look ahead, we continue to monitor closely the macro environment. If the economic outlook unfolds in line with consensus estimates, we expect impaired loss rates to remain within low to mid-20 basis points consistent with this quarter's performance.

Given the quality of our portfolio, high allowance coverage and strong risk management capabilities, we remain well positioned to manage current and emerging risks. I will now turn the call back to the operator for the Q&A portion of the call. Thank you.

QUESTIONS AND ANSWERS

Ebrahim Poonawala – *Bank of America Securities*

I guess maybe Tayfun, first question, just unpacking what you said on the net interest margin if I heard you correctly, CAD NIM could see tightening, U.S. expect more stabilization, that's opposite of what I would have thought. I would have expected the U.S. pressure to continue on deposit pricing, some promotions that you might run for systems integration with Bank of the West. And in Canada, the back book repricing should serve as a tailwind to the NIM going forward. So clearly, I'm missing something, if you can elaborate on what the dynamics are, both on the asset and the deposit side driving that NIM outlook.

Tayfun Tuzun – *Bank of Montreal – CFO*

Sure. I will make some comments and then also turn it over to Ernie and Nadim for what they're seeing in the U.S. and Canada. I'll start at the enterprise level, Ebrahim. We actually feel very good about how we are positioned today. Our NIM expanded a couple of basis points. We are guiding for more stability in the foreseeable future. And I like where the rates are today, clearly, we are benefiting from higher longer rates. And we are, I think, pretty well positioned to deal with whatever the monetary authorities do in Canada and the U.S. So at an enterprise level, I think our NIM positioning looks very good in the current environment.

Coming down to Canada and the U.S.; in Canada, this quarter, we have seen deposit spread widening, some loan spread widening. And I think our business managed their spreads very well during the quarter. But at the same time, we are aware of rising pricing competition, both on deposits as well as loans, especially as the quarter came to an end. And we're cognizant of how that may impact our NIM going into the next couple of quarters, thus the comment about some tightening in Canada. In Canada, obviously, we also have benefited from good deposit growth relative to loan growth during the quarter. That's always very helpful. In the U.S., the pricing competition continues clearly. There's no let down yet, and we're not necessarily anticipating a significant change, I think, in general, migration towards term deposits will continue.

We are though switching to a more growth mode, both in our personal deposits as well as commercial deposits, which will be helpful, which will support some of that stabilization. We are also expecting better loan spreads in the U.S., which also is helpful. And then overall, the corporate interest rate risk management related support

that is provided by the rollover impact of our non-maturity deposits is helping the U.S. P&C business. I think both of these expectations are in line with what we are seeing in the markets as well as our overall risk management approach. With that, any comments, Ernie and Nadim.

Nadim Hirji – *Group Head, BMO Commercial Banking*

Sure. I would just say it characterized that loan volumes are down, of course, both sides of the border, but there is a divergence. In Canada, we're still seeing better loan volume demand and more opportunities for deposit growth, but the competitor sets are different as well. The Canadian banks are still fighting for market share. They're still fighting on structures. And we're not seeing as much pricing discipline in Canada. On the other hand, the U.S. with the specialty regional banks tightening up on capital and liquidity, we are seeing structures now tightening. We are seeing banks taking lower holds, and that is leading to stabilization in our margins and spreads within the loan book. So that's why we're seeing a bit of a divergence.

Ernie Johannson – *Group Head, N.A. Personal and Business Banking*

And then on the deposit side, let me just make some comments about U.S. first then Canada. In the U.S., we're seeing some actual good performance relative to peers on our retail book. That's a function of both the legacy BMO side, as you like to say, as well as the Bank of the West platform. We're seeing some good success in terms of stabilizing the retail deposit in the Bank of the West market and offering out promotions, et cetera and capabilities that are being well received by our colleagues there and our customer base. As we think about that, coupled with that digital deposit taking, I'm really confident in our U.S. growth strategy around deposits to continue to be at peer or above peers in the marketplace.

And then if I switch gears and go to Canada, we are in top tier market share growth consistently in deposits in the retail side of the Canadian business. That's driven by our leading acquisition. We have record new customer acquisition in Canada. That strong digital sales capability, branch conversations that are focused on full relationships. We are seeing that shift a bit to term. But as Tayfun mentioned, it's slowing down; we're watching it and it's plateauing. And we'll continue to see that happen over the next little while. But overall, really confident in our ability to continue to drive growth in the deposit side going forward.

Ebrahim Poonawala – *Bank of America Securities*

Got it. And just very quickly, Tayfun, on capital. Remind us the impact from FRTB, Basel floor factor increases in 1Q '24 to the CET1 and separately, if the U.S. Basel Endgame NPR were to pass as is, it seems like the burden on foreign bank IHC is going to be quite meaningful, both in capital markets and otherwise. How impactful is that to BMO's U.S. operations?

Tayfun Tuzun – *Bank of Montreal – CFO*

Thanks for the question, Ebrahim. In terms of the impact of FRTB, we think that the impact will be very, very modest into Q1. The work still continues, and we have some additional details that we need to finalize, but we are not expecting a big impact into Q1. Darrel, would you like to comment on the U.S. side, the regulatory developments in the U.S. side?

Darryl White – *CEO*

Yes. I'm just going to clarify for people. When Tayfun said, Darrel, he's referring to Darrel Hackett's first call here. And so it's a great question, Ebrahim, for him to take as far as the overall environment is concerned in the U.S.

Darrel Hackett – *U.S. CEO*

Yes. Thank you for the hand off here, and hello, everybody. In terms of Basel III Endgame, first, it's really important to remember that we've operated in the U.S. as a significant entity for nearly 40 years. And we've effectively begun our journey to being a Category III U.S. bank nearly two years ago when we announced the acquisition of Bank of the West. Earlier this year, with the approval and close of Bank of the West, we became a U.S. entity with more than $400 billion in assets, making us a top 10 U.S. bank. So given this, we are uniquely well positioned among our peers and we've already been maintaining strong capital ratios in our U.S. regulated entities. So, while the Basel III Endgame proposals are still in early stages, we feel very well prepared for what's to come, and we expect the current proposals to only have a modest impact on our current journey.

Meny Grauman – *Scotiabank Global Banking and Markets*

Tayfun, I think you were clear in terms of your commentary on expenses coming from Bank of the West. But I'm curious -- I apologize if I missed it, but if you could just talk about the outlook for revenue synergies, specifically in the context of a tougher U.S. operating environment. I think it's clear that what's emerging. I'm wondering if there's any impact there on your ability to deliver on the revenue synergies that you've guided to?

Tayfun Tuzun – *Bank of Montreal – CFO*

Good question. Look, I mean, we acknowledge the environment. It impacts all banks that are operating in the U.S. But overall, our expectations remain intact, and although the timing may change a little bit, we are still of the opinion that our financial expectations remain well grounded. We have an important weekend coming up with conversion as I said, we are also doing more work on potentially identifying additional expense saving opportunities. We plan to update you with all these metrics once we get to the end of Q4. But broadly, our expectation is that we are still in the same range in terms of our expectations. That is not necessarily denying the current environment, but I think our expectations and optimism remains the same.

Darryl White – *CEO*

It's Darryl, Meny, just to complement that, I agree with all that. I think the thesis is holding completely. In fact, as days go by, we're getting increasingly encouraged by the thesis on the customer side, and you asked about revenue synergies; well Tayfun is right, we will give you all an update at the end of the conversion quarter, which is the one that's coming. In the meantime, we can tell you that the acceleration on new accounts, new customers, the crossover between the commercial business and the capital markets business, we talked to you about that last quarter, continues to increase at a healthy rate. And we've even observed early days, even before our pretty substantial marketing push, which will begin in about 10 days from now, a real activation at the branch level with the digital platforms as well. I don't know, Ernie, would you complement that with some specificity.

Ernie Johannson – *Group Head, N.A. Personal and Business Banking*

Yes, definitely. As Darryl pointed out, we have not launched all the capabilities of tools, financial planning, et cetera, in the market yet, nor our big brand campaign or major offers that we're going to introduce over the next couple of weeks. Having said that, the performance of our branch network, just being allowed to be able to have different offers and campaigns, we're already seeing a lift overall about 20% overall in terms of performance. And that's a function of them reaching out to customers and having great conversations. So, the colleagues are ready and the customers are extremely open to these conversations and receptive to what we have to offer. And we haven't brought the full product, as we mentioned earlier, to them.

As well, our digital capabilities are performing. We've taken the Bank of the West digital capabilities out of the market and put BMO's in, and they're actually performing at parity, which says even without the brand advertising, we were able to deliver the same sorts of lift. So these are all promising indicators of the future ahead after we get through the next weekend.

Gabriel Dechaine – *National Bank Financial*

I want to continue on that line of questioning. And just -- I'll use my words, you can tell me if I have it right or not. But the sense I'm getting is maybe there's some revenue shortfall versus expectation related to the Bank of the West acquisition because the margins, maybe the loan book and deposit book are both smaller, but you still sound pretty confident in your accretion targets, and I'm reading into the expense management commentary that you might find some additional cost savings to keep you on track. Is that a fair interpretation?

Tayfun Tuzun – *Bank of Montreal – CFO*

Well, first of all, I don't think that we're stepping back from our overall revenue synergy expectations. I don't think that we're necessarily changing that. Ernie mentioned some of the more promising signs of how we are getting there. Again, as I said, once we finalize our expense saving targets, which we expect to be higher than what we shared with you before, we will also update the accretion numbers. But as I said, overall, we believe we are still largely intact with our expectations that we shared with you earlier in the year.

Gabriel Dechaine – *National Bank Financial*

Okay. Piyush, the comment you made, the customers renewing at higher rates in the mortgage book. Are they absorbing it or adapting well. Can you quantify that? I mean, I know what the adjectives mean, but what does that mean from your perspective?

Piyush Agrawal – *CRO*

Sure. I think the Canadian residential secured book remains high quality because, again, the customer base has an average FICO of 790. When you've got about 10% renewals a year and if I go back to the last four quarters of data, we've had significant success in those renewals. They are at about a 10% to 20% increase as they come up for renewal, and all of them have successfully renewed and the performance has been stellar. In addition, I'll give you the fact that -- for those that are even not due today, we've got programs underway to reach out to customers. We reached out about 40% of the customers, and we are getting very good positive feedback. So voluntarily, customers have come up and either topped up payments if they're in negative amortization or increased their payments as they're going forward. So even though the back book, the big maturities are '25, '26, the early success you see from anecdotal the data of four quarters, and our expectations because of the strength of the Canadian customer in the secured portfolio, gives us a very high level of confidence.

Doug Young – *Desjardins Securities*

Just maybe to drill down on the U.S. commercial loan book. Obviously down sequentially. It seems and you can correct me if I'm wrong, but maybe it's down a little bit more than what we would have seen some of your peers. I'm just trying to understand a little bit more, and I understand the economic side of it, is there any particular part of the book that's contracting more or where you're seeing less retention, just hoping to get a little bit more colour. And then maybe just kind of weaving that into the NIM discussion, is the loan balance movement have a positive negative impact on your NIM and your NIM outlook?

Nadim Hirji – *Group Head, BMO Commercial Banking*

So in terms of segments, I would say that when you look at segments that are more reliant on M&A activity, we're seeing more softer loan growth in those areas versus our general diversified businesses; private equity, of course, has slowed down. Real estate has, of course, slowed down quite drastically. So those would be the segments that would have the biggest effects. But what we're looking at right now is demand starting to increase. We're seeing pipelines increasing as we move into Q4. So I expect that we'll see better growth in the U.S. franchise as we go into fiscal '24. But we can't deny the macroeconomic background that we're under. When we look at deploying our capital, we are laser-focused on not just volume growth, but rather how do we optimize return for our shareholders. How do we go after sole bank relationships or left lead where we get the treasury and payment services revenue, the cash management fee revenue and how do we also get share of wallet and make sure that we're getting the trading products and one client referrals to our Wealth and Capital Markets colleagues.

So we're not going after volume, we're going after quality because it’s these relationships, both existing and new, that add the most significant shareholder value. And when the commercial banking demand does come back, we are on both sides of the boarder extremely well positioned to meet or probably beat what the market will be at that time, especially when we see the M&A activity increasing. And when you think about M&A activity, if I look at our mid-market M&A group pipeline right now, it's probably the biggest pipeline that I've seen in two to maybe three years. We're definitely starting to see the turn coming. But as always, when it comes to Q4, we'll update you on growth numbers at that time.

Darryl White – *CEO*

I'm going to complement that, Doug, it's Darryl speaking. When I look at the quarter-over-quarter sequential commercial growth that you referred to in the U.S., on the surface, you might come to the conclusion that it's a little bit below market, but I'm not fussed by it, and I'll tell you why. Some of that is -- and by the way, when I say a little bit, like a very little bit, some of that is explained by mix, which Nadim was just into. And some of it is actually explained by the fact that we have July in our quarter and the U.S. banks don't. And I think when you adjust for those two things, you will see that we're pretty much right on market is my hypothesis.

And more importantly, the point Nadim made just now when the sun comes out on the industry and it will one day, we've shown time and time again that when it does we can perform better than market in commercial banking with the fourth largest book on the continent, and we expect that we'll be able to do that again. And the great news about that is that we will also simultaneously have the flow-through of the efficiency of the program that we announced today as well as the full flow-through of the efficiency of the Bank of the West synergies, and when you put all of those things together for us, that's what to me gets me excited because it's a pretty differentiated outcome for our bank.

Tayfun Tuzun – *Bank of Montreal – CFO*

And on your NIM question, Doug. In quarters when deposit growth exceeds loan growth, we see a positive impact of that on our NIM. This past quarter in Q3, our loan growth exceeded deposit growth. So therefore, that had a negative impact on our NIM. Next quarter, we are predicting a stable loan environment and potentially a better deposit environment which should be marginally helpful for our NIM in Q4.

Paul Holden – *CIBC Capital Markets*

A quick question on capital management. Just wondering the thought process behind the DRIP discount and when that might come off given you are seeing a build in the CET, or you should be seeing a build in the CET1, I think, on an organic basis, given the slow loan growth environment. And then obviously, with the operating efficiency improvements expected that will also help organic capital generation. And then you've provided some pretty neutral/positive outlook for FRTB and Basel III impacts.

Tayfun Tuzun – *Bank of Montreal – CFO*

It's a good question. We will be finalizing our FRTB analysis over this quarter, which will give us more clarity. As I said, we are pretty confident that it will have a modest impact on our capital. Look, I mean, when we started the year, we said that the assessment on DRIP is a quarterly process that management and the Board will go through together. We are maintaining our 12-plus-percent CET1 ratio targets across the bank. And depending upon what we see in the environment with respect to RWA growth and the regulatory decisions that are still coming in, in the U.S., obviously, we've seen it, which as Darrel said, does not impact us much. The more clarity we have on the environment, both macro as well as regulatory, the closer we will get to a decision on DRIP.

Paul Holden – *CIBC Capital Markets*

Got it. And then I guess my follow-up on that point would be can you give us a sense of what your operating target range is for the CET1. We've heard some other banks sort of talk about maybe getting up to 12.5-plus-percent. Are you sort of thinking the same thing over time?

Tayfun Tuzun – *Bank of Montreal – CFO*

I think a reasonable range is between 12% and 12.5% and in the current environment, as I said before, the target level capital is impacted by multiple factors including the environment and the regulatory regime and the peers. So, we will be very sensitive to all of those three. I think that the range is still 12% to 12.5% under the current OSFI regime and potentially closer to that 12.5% point.

Lemar Persaud – *Cormark Securities*

Maybe for Tayfun. Should we think about the severance charges as being a one quarter phenomenon? Or is there further charges coming down the pipeline?

Tayfun Tuzun – *Bank of Montreal – CFO*

It is a one quarter phenomenon, and that's the reason why we noted the severance this quarter. We expect continued focus on expense savings as our commitment to positive operating leverage remains firm, but the severance charge is this quarter.

Lemar Persaud – *Cormark Securities*

Okay. Perfect. And then could you remind us what the conditions are for -- to adjust for legal provisions? I guess, you guys called out higher legal expenses as one of the reasons for elevated expenses. But just looking at your adjustments, we have seen legal provisions that are adjusted for. So I guess, how do you draw the line in the sand for what you adjust for and what you leave in your core expense numbers?

Tayfun Tuzun – *Bank of Montreal – CFO*

We tend not to adjust for legal provisions. In our normal business, we always have legal proceedings, and we believe that if there is a reason for us to take reserves, that they should be included in our financials on a non-adjusted basis as part of the operating performance.

Darryl White – *CEO*

You might ask then, Lemar, why did we call it out this quarter, I think, really is your question because you're right, normally, we don't adjust. And the reason we've called it out this quarter is because it's unusually high. We don't expect that level in the normal course. We wanted you all to know that.

Lemar Persaud – *Cormark Securities*

Okay. And that's linked to the severance. Is that what it's related to?

Darryl White – *CEO*

No, it's not linked to the severance. It's separate from the severance.

Tayfun Tuzun – *Bank of Montreal – CFO*

And it does include the off-channel communication settlements that is very public, obviously.

Nigel D'Souza – *Veritas Investment Research*

I just want to drill down a little bit more on the trends you're seeing on the deposit side in your U.S. business. Any colour on what you're seeing for noninterest-bearing deposits? How much of that remains in terms of deposit mix, what you're seeing on insured deposits and if there's a difference in flows for deposits for the Bank of the West franchise versus the BMO U.S. franchise?

Ernie Johannson – *Group Head, N.A. Personal and Business Banking*

Yes, I'll take that one. So, what we're seeing in terms of the U.S., we're still seeing the pre-pandemic or the through the pandemic surge deposits still existing to some degree in the franchise. They're slowly running off. We would anticipate that to take place probably in the first half of next year to be fully out. They're still elevated in our chequing and our savings accounts. We are seeing again that migration to term, which is expected as we continue to be in a market where the rates are attractive to our customer base. As well on the Bank of the West side, as I mentioned, we're seeing stability in terms of our ability to retain deposits and are now seeing growth. That's a function of our introduction of better pricing optimization of the portfolio itself and expect that to move forward.

And then on our digital deposit taking, we're seeing strong outcomes as well in terms of what we're seeing being driven through the digital channels across the 50 States. So overall, I'd say those are the trends. We believe that there's lots of opportunity in the franchise itself of Bank of the West, given the market itself is very attractive. And so as we go through our campaign season, et cetera, we anticipate to be able to grow at market in those particular markets. I'm not sure Nadim, if you have any other thoughts.

Nadim Hirji – *Group Head, BMO Commercial Banking*

So, it would be very similar, but I would say if you're asking trends, the shift mix that we've seen going from noninterest to interest-bearing has slowed down and is stabilizing. I don't think it's going to shift back anytime soon, but I do think that it has stabilized in terms of the shift mix.

Darryl White – *CEO*

Just the last point on this, you're also asking that whether there's a juxtaposition between the Bank of the West franchise and the legacy BMO franchise, I would say we're pretty much at the point where that's converging because you'll see that as we go through Q4, we have our conversion weekend literally coming ahead of us. And the franchise value starts to integrate and blend together almost completely. So, the benefit that we bring with the scale and the capabilities, and the technology is infiltrated into the Bank of the West system. And as time has gone on, we've seen a convergence of the performance on deposits, and that's what we would expect to see on a blended basis going forward.

Nigel D'Souza – *Veritas Investment Research*

Great. And just a quick follow-up for Piyush on the credit loss outlook. I think you've signaled for PCL to be somewhere in the low 20 basis point range. That actually puts you above - and that's impaired - but that puts you above the run rate for PCLs in 2019. So just wondering if you could comment on, are you seeing interest rates weigh on the commercial side or the retail side? And do you expect those provisions to remain elevated and any pathway for when that could fall below 20 basis points?

Piyush Agrawal – *Bank of Montreal – CRO*

I think on the impaired piece, I think that's the one you're referring to. The guidance we're giving is consistent low 20s to mid-20s. Of course, interest rate is a big part of the environment. It's a very natural evolution for our borrowing customers to adjust their performance to a 500 basis point increase in a very short period of time, that's what you're seeing coming through. I would say, if you take that for the next quarter and you sort of average it out for the entire year, we are well below 20 on an average basis. But again, within the realm of normalization that I think all of you and all of us have been expecting for the industry. I don't have anything else to sort of add over there. I think the Bank of the West portfolio performs very well, converging, as we've used term with the BMO U.S. portfolio. And the trends are similar, weaker in unsecured a little bit, but strong secured portfolio and then risk rating changes on the wholesale portfolio. So overall, the position of strength from where we are starting and a very strong risk appetite.

Joo Ho Kim – *Credit Suisse*

On expenses, there are a lot of moving pieces. I'm just trying to get a sense of how you see your efficiency ratio evolving in 2024? And I'm trying to get a better idea of if there's a pathway to get back to the mid-50s in efficiency ratio that year or if that's more of a story beyond 2024?

Tayfun Tuzun – *Bank of Montreal – CFO*

Just as we signaled earlier in this year, we significantly curtailed expense growth at the beginning of this year and predicted that our year-over-year expense growth would start coming down and our quarter-over-quarter expense growth would start reflecting that. And that happened this quarter – that has happened over the past couple of quarters. As we look forward now, we are truly still committing to positive operating leverage both with the contribution that's coming from Bank of the West as well as from our own operations. We will update our expectations for '24 when we get to the end of Q4. But the primary driver of our actions clearly is that firm commitment to positive operating leverage. The efficiency ratio is going to be an outcome of that. We would expect improvement in our efficiency ratio. And we hope that we will be able to update you with that when we get to the end of next quarter.

Darryl White – *CEO*

I want to thank everybody for their questions and leave you with the following thought. Guided by the Purpose-driven strategy that I've talked about and the winning culture that I've talked about, I think you can take away that we are proactively addressing the period of volatility that we're in to deliver consistent and sustained performance. We're doing that by dynamically managing our business to continue strengthening the already robust foundation and invest in our businesses for growth.

And with the full integration of the Bank of the West ahead of us, the strength and the size and the stability of our balance sheet and our superior risk and liquidity capital management are built really to outperform in any environment. And with that, I want to thank everybody for participating, and we look forward, of course, to speaking to all of you through the fall and again formally in December. Thank you.