BMO Financial Group

Q4 2016 CONFERENCE CALL

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* Effective November 1, 2016 Frank Techar is appointment Vice-Chair, BMO Financial Group, and Darryl White is appointed COO, BMO Financial Group

PRESENTATION

Jill Homenuk - ***Bank of Montreal - Head of Investor Relations***

Thank you. Good afternoon, everyone, and thanks for joining us today. Our agenda for today's investor presentation is as follows. We will begin the call with remarks from Bill Downe, BMO's CEO; followed by presentations from Tom Flynn, the Bank's Chief Financial Officer; and Surjit Rajpal, our Chief Risk Officer.

Following the formal remarks, a Group Head for each of our businesses will provide comments on our outlook for 2017. We have with us today Cam Fowler, from Canadian P&C and Dave Casper from U.S. P&C. Darryl White is here for BMO Capital Markets, as Darryl concluded the quarter as Group Head. Pat Cronin will join the call in Q1. Joanna Rotenberg is representing BMO Wealth Management, as Gilles Ouellette could not be with us today due to a prior commitment. Going forward, Gilles and Joanna will alternate participation in these calls. Frank Techar is also with us this afternoon.

After the Group Head presentations, we will have a short question-and-answer period where we will take questions from pre-qualified analysts. To give everyone an opportunity to participate, please keep it to one or two questions and then reque.

On behalf of those speaking today, I note that forward-looking statements may be made during this call. Actual results could differ materially from forecasts, projections or conclusions in these statements. I would also remind listeners that the Bank uses non-GAAP financial measures to arrive at adjusted results to assess and measure performance by business and the overall Bank. Management assesses performance on a reported and adjusted basis and considers both to be useful in assessing underlying business performance.

Bill and Tom will be referring to adjusted results in their remarks unless otherwise noted as reported. Additional information on adjusting items, the Bank's reported results and factors and assumptions related to forward-looking information can be found in our annual MD&A and our fourth-quarter earnings release. With that said, I will hand things over to Bill.

Bill Downe - ***Bank of Montreal - CEO***

Thank you, Jill, and welcome to everyone joining us this afternoon. Today we announced earnings for the fourth quarter of $1.4 billion, up 10% from last year. These results conclude a year in which we achieved record earnings of $5 billion and earnings per share of $7.52, both up 7% from a year ago.

There was good growth in Canadian banking, U.S. banking and Capital Markets. And as I'll discuss in a moment, this performance is driven by consistent execution of our strategy.

2016 was our third year of revenue growth above 8%, reflecting a well-diversified business mix that extends across key geographies and customer segments we've identified as being critical for continued growth.

Over the last six quarters we made real and sustained progress on expense management. Expense growth for the year was 2% in constant currency and excluding the impact of acquisitions and divestitures.

Consistent with our expectations, provisions for credit losses increased from low levels a year ago. Despite continuing weakness in commodity prices and slower economic growth in certain regions, loan losses remain below the long-term historical average and the balance sheet remains strong.

We're well-capitalized with a CET1 ratio of 10.1%, and this is after completing the acquisition of BMO Transportation Finance this year. Earlier today we announced an increase to our quarterly dividend of $0.02 per common share, bringing our annual dividend to $3.52, an increase of 5% from last year.

Moving to slide 5, in 2016 we had good momentum across our operating groups. In each of our businesses we continued to deepen relationships, supporting our customers in a changing environment.

In Canadian Personal & Commercial banking we had well-diversified balance growth across commercial and personal lending and deposit products. Revenue and earnings grew by 5%, with positive operating leverage of 1.4%.

U.S. Personal & Commercial banking had a strong year, with net income up 28%, or 22% in source currency, including the benefit of BMO Transportation Finance, together with strong organic deposit and commercial loan growth.

BMO Capital Markets had a record year with revenue consistently exceeding $1 billion per quarter and earnings growth of 23%. Performance was good across trading products, investment & corporate banking and in our U.S. segment, consistent with clear strategic direction and strong leadership of the group.

Effective November 1, we appointed Darryl White Chief Operating Officer for the Bank. He has a deep understanding of the banking industry, risk management and global markets and has spent his entire career working directly with customers, gaining invaluable perspective. Darryl is bringing that perspective and financial industry knowledge in providing strategic leadership to the Bank's personal, commercial and wealth businesses. Pat Cronin, who worked closely with Darryl on both the strategy and operations of the capital markets business as Chief Operating Officer, is well-positioned to build on this momentum as the new Group Head.

Turning to wealth management, lower results reflect weaker equity markets in the first half of the year, as well as the net impact of sales of non-strategic investments in the current and prior years. Underlying that, there was solid growth across a number of the businesses.

Recent changes to the leadership team in wealth recognize diverse and unique growth opportunities in all areas. Gilles Ouellette was appointed Group Head of BMO Asset Management, and Vice Chair of International, and is focused on leveraging the global scale of the institutional business that has been built over a number of years. Joanna Rotenberg was appointed Group Head BMO Wealth Management with an expanded mandate to deliver integrated investment, private banking, insurance and financial planning solutions to retail clients.

Looking at the Bank's performance for the year against our medium-term objectives, earnings per share growth of 7%, operating leverage of 2.1% and a CET1 ratio of 10.1%, were in-line with our targets. While ROE has averaged 14.2% over the past five years, returning to our target of 15% will take time to achieve, given the regulatory capital levels under which we operate. But we remain confident that actions underway to improve efficiency and grow earnings across our businesses, as well as the upside of rising interest rates, will contribute to the achievement of these objectives in the medium term.

To meet the evolving needs of our customers, we've made significant progress in executing on our technology and innovation agenda. We've delivered new digital capabilities to our customers and continue to re-engineer our technology architecture to be more customer-centric, faster and cost effective.

In Canada, approximately 40% of service transactions are now completed through digital channels, up 28% year-over-year. Digital retail banking sales continued to grow and now represent the equivalent of 115 branches. We simplified our own processes to work more efficiently and have advanced productivity through the divestiture of non-strategic or underperforming assets.

At the same time, we continue to expand and invest in our North American platform both organically and through targeted acquisitions. We continue to leverage and expand our capital markets client base in the U.S. BMO Transportation Finance is performing well. Overall, 25% of our earnings come from our U.S. segment. And in his new role as Vice Chair, Frank Techar will focus on further leveraging opportunities to accelerate growth in this core market.

Each of these advancements is aligned with achieving industry-leading customer loyalty and delivering great customer experience. We're proud to have been named one of the Top 25 Brands in Canada for 2017 by Canadian Business. Based solely on customer feedback, this recognition belongs in large part to our employees, as ambassadors of the BMO brand.

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

Tom Flynn - *Bank of Montreal - CFO*

Thanks, Bill. I'll start my comments on slide 9 and will focus throughout on the Q4 results. Reported EPS for the quarter was $2.02, up 10% and net income was $1.3 billion, up 11%. On an adjusted basis, EPS was $2.10, up 11% and net income was $1.4 billion. As Bill said, our performance reflects the consistent execution of our strategy and the benefits of our well-diversified business mix. Adjusting items are similar to past quarters and are shown on slide 26.

Net revenue was up 10% from last year. Looking now at its components, net interest income was up 8%, benefiting from the addition of BMO Transportation Finance and organic volume growth. Non-interest revenue was up 12%, primarily due to good capital markets revenues.

Expenses were up 7% from last year, reflecting the impact of some seasonality and more specifically, the BMO Transportation Finance business acquisition, higher employee-related expenses and increased technology costs, partially offset by the impact of divestitures. Adjusted operating leverage was good at 2.9%, or 2.8% on a reported basis. Also on a net revenue basis, the adjusted efficiency ratio improved 160 basis points to 62.6%, and improved 170 basis points to 63.9% on a reported basis.

The adjusted effective tax rate was 21.2%, up from 18.9% a year ago and was 26.3% on a TEB basis, up from 24.7%.

Moving to slide 10. The common equity Tier 1 ratio is 10.1%, up from 10% last quarter. The increase reflects higher capital from retained earnings growth, partially offset by higher risk-weighted assets.

As detailed on the slide, risk-weighted assets were up $5 billion in the quarter. The increase was driven by the impact of FX and business growth, partially offset by changes in book quality and models, and higher Basel I capital floor risk-weighted assets.

The sale of Moneris U.S. was announced in November and is expected to close in the first quarter. And also in Q1, we completed the sale of a portion of our U.S. Personal & Commercial indirect auto portfolio. The combination of these two transactions will produce a net after-tax gain in the first quarter of approximately $130 million and increase the CET1 ratio by a little over 10 basis points.

Moving now to our operating groups and starting on slide 10, Canadian P&C had net income of $592 million, up 5% from last year. Revenue growth was 5%, reflecting higher balances across most products and increased non-interest revenue. Total loans were up 6% and deposit volume was good, at 8%. NIM was down 2 basis points from last quarter, primarily due to above-trend interest recoveries and pre-payments in Q3.

Expense growth was 4%, reflecting continued investments in the business, net of our ongoing focus on expense management. On an adjusted basis, operating leverage was positive 1.2% and the efficiency ratio was 48.9%. Credit provisions were up compared to last year.

Moving on to U.S. P&C on slide 12, adjusted net income was $299 million, up 35% from last year. The comments that follow speak to the U.S. dollar performance.

Adjusted net income of US$226 million was up 34% from a year ago. The acquired BMO Transportation Finance business represented approximately 14% of U.S. P&C's revenues and adjusted expenses in the quarter, similar to Q3.

Revenue was up 25% year-over-year, largely due to the acquisition and higher loan and deposit volumes. Average loan growth was 18%, with organic commercial loan growth of 17%, partially offset by lower personal loans, including the ongoing planned reduction of the indirect auto portfolio. Q1 2017 results will include the sale of the portion of our indirect auto portfolio that I mentioned earlier and a related charge of approximately US$25 million after-tax for the segment. Net interest margin increased 1 basis point from Q3.

Expenses were up 15% year-over-year, primarily due to the acquired BMO Transportation Finance business. On an adjusted basis, operating leverage was very strong at almost 10% and the efficiency ratio improved over 500 basis points to 60.3%.

Credit provisions were up from last year, primarily due to a consumer loan sale benefit in the prior year and the impact of the acquisition.

Moving now to slide 13. BMO Capital Markets had strong net income of $396 million. Revenue was $1.2 billion, up 27%. Trading products revenue growth reflects higher trading revenue, primarily from improved client activity. Investment & corporate banking growth reflects strong M&A advisory activity and higher revenue from equity and debt underwriting and corporate lending.

Expense growth of 6% largely reflects higher employee costs given the strong performance. Operating leverage was very strong and the efficiency ratio was 55.6%. Provisions for credit losses were down from last year due to recoveries in the energy sector.

Moving now to slide 14, wealth management adjusted net income was $302 million, up 11% from the prior year. Both traditional wealth and insurance earnings were higher, largely due to business growth and improved market conditions. From a year-over-year growth perspective, a gain on the sale of an equity investment in the current quarter was offset by a gain on sale net of a legal provision in the prior year. Expenses declined 2% year-over-year, mainly due to divestitures and the impact of the weaker British pound, partially offset by continued investment in the business.

Turning to slide 15 for corporate services, the adjusted net loss was $194 million compared to an adjusted net loss of $33 million a year ago. Results declined due to lower revenue, driven by a recovery under a legal settlement in the prior year, above-trend expenses and lower credit recoveries.

To conclude, the strong results in the quarter capped off a record year and demonstrate the benefits of our diversified business mix and good operating disciplines. And with that, I'll hand it over to Surjit.

Surjit Rajpal - ***Bank of Montreal - Chief Risk Officer***

Thank you, Tom, and good afternoon, everyone. Starting on slide 17, our PCLs were $174 million, down from the prior quarter, primarily due to improving oil and gas performance. PCLs in the Canadian P&C business decreased by $29 million, largely as a result of lower oil and gas losses in commercial.

U.S. P&C consumer provisions continued below trend. Commercial losses were flat quarter over quarter but up year-over-year with the addition of the Transportation Finance business. Capital markets had a $8 million recovery this quarter because of an oil and gas reversal, coupled with significantly lower new oil and gas provisions.

On slide 18, formations are down by $19 million across a broad range of industries. Gross impaired loans are flat at 62 basis points. Overall, the Bank experienced lower oil and gas losses, benefiting from oil prices as well as mitigating actions taken by our clients.

On slide 19, the composition of the Alberta consumer portfolio was unchanged. Though losses in this portfolio decreased quarter-over-quarter, provisions for the year have increased. Delinquencies also increased, reflecting the rise in Alberta unemployment; however consumer delinquencies in other regions largely offset this increase.

Turning to slide 21, our Canadian residential mortgage portfolio continues to perform well. It will take time for the impact of recent housing policy changes to fully materialize; however our underwriting practices are prudent and position us well.

In summary, the Bank's credit performance this quarter was strong. Looking back, our 2016 performance was strong, with PCLs of $815 million or 23 basis points, compared to cycle of 19 basis points in the prior two years. For Fiscal 2017, given the expectation of improved growth in the North American economies, I expect losses to average in the mid-20s with variability between quarters. I'll now turn the call back to Bill.

Bill Downe - ***Bank of Montreal - CEO***

Thanks, Surjit. In a moment each of our Group Heads will provide an outlook for their businesses, but first let me comment on the year ahead. We are operating in an ever-changing environment. We're confident in North American economy which is projected to grow at a moderate but slightly faster pace in the next 12 months. GDP growth is expected to improve to just under 2% in Canada and over 2% in the U.S. on higher oil prices, firmer U.S. consumer demand and physical expansion in both countries. And I do think this is a conservative estimate.

We continue to monitor the rate environment and are closely watching the evolving geopolitical landscape and how it may affect our businesses and our customers. We've demonstrated we understand the current environment and the opportunities it presents. We have a clear plan, aligned with our vision and anchored in our five strategic priorities. It's working. We're well-positioned to drive growth with a diversified portfolio of businesses, a strong North American and global footprint.

The leadership team is heading into the next fiscal year with confidence. We're leveraging the benefit of 200 years of experience and capitalizing on good momentum across the Company to define a great customer experience and deliver sustainable growth through time. Now I'll turn it over to Cam Fowler to comment on Canadian personal and commercial.

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

Thank you, Bill. This was a good year for Canadian P&C, both financially and from a customer capability perspective. Financially we delivered consistent revenue growth, balance sheet growth and operating leverage throughout the year, resulting in record net income of $2.2 billion.

On the customer capability side, our technology architecture continues to mature, allowing us to introduce products more quickly, as evidenced by our new mobile account-opening app and our in-branch digital capabilities for our customers. Looking to 2017, I expect similar operating performance to 2016 with a continued focus on expense control to mitigate potential headwinds, and a continued focus on disciplined risk management.

Our priorities remain the same and my confidence is grounded in three areas. First, we have a great commercial business and our lending growth has been strong this year, up 10% year-on-year and broad based across geographies and sectors. We've made investments in this business and we'll continue to see benefits through next year.

Second, our retail deposit growth has been building over time. In particular, we focused on expanding our primary customer relationships which has resulted in strong chequing growth, up 11% for the year which is our second straight year of double-digit growth.

Finally, we've done a good job of keeping our expense growth in-line with revenue performance, as well as streamlined processes and create capacity to invest in the business. We've had five consecutive quarters of positive operating leverage and finished the year at 1.2%. With that, I'll turn it over to Dave.

Dave Casper - ***Bank of Montreal - Group Head, U.S. P&C***

Thanks, Cam. U.S. Personal & Commercial Banking had a transformational year in 2016. Our adjusted net income growth was 22%. Our efficiency ratio improved by over 300 basis points and our net interest margin increased by 16 basis points.

In fiscal year 2016 we closed a very strategic acquisition, BMO Transportation Finance. This business has met our high expectations and it was and will continue to be a significant contributor to our performance over time.

Equally important to our Transportation Finance acquisition, we had strong organic growth in loans, personal and commercial deposits and revenues, particularly as the year progressed. This was highlighted by quarter-over-quarter organic growth of 6% for revenue, 17% for pre-provision pre-tax, and 15.5% for net income growth. As we look forward, we continue to build on the strength of our franchise as we grow our business and maintain disciplined expense control.

Our commercial business is both diversified and high performing. We continue to add strong commercial relationships that benefit from our long term approach to helping companies grow the value of their business. Our personal business is scaling up and improving efficiency by focusing on operations, optimizing sales, productivity and improving returns.

For these reasons, as well as the prospect of higher rates in the new year, which will be a benefit given our significant commercial and personal deposit base, I am confident that we will continue our growth in 2017. With that, I'll hand it over to Darryl.

Darryl White - ***Bank of Montreal - Group Head, BMO Capital Markets***

Thank you, Dave. After a strong performance in 2016, with 23% NIAT growth and really strong operating leverage, looking ahead to 2017, we are well-positioned to build on with our balanced, diversified and client-focused business model and a disciplined approach to risk management. We continue to concentrate on our growth strategy, with the U.S. as our largest market opportunity for growth, where we continue to leverage the platform we've built and our ability to differentiate by strategically deploying our coverage model and our balance sheet in a progressively improving economy.

In Canada we have a strong market position across all products and sectors. We intend to competitively protect our position and expect this business to continue to perform well going forward. We'll also continue to focus on expense management and maintaining our enhanced control environment.

We are facing a headwind pertaining to the federal budget changes in Canada. We expect to counterbalance much of this headwind through ongoing organic growth of our businesses in Canada, continuing our growth rate in the U.S. and some targeted new products and initiatives.

So we had a strong result in 2016. And assuming that markets continue to be constructive, we feel confident we can maintain our momentum. At this point I'll turn it over to Joanna.

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

Thanks, Darryl. In wealth management our net income increased by 5% year-over-year in the second half of the year. This is through a combination of good underlying growth, disciplined expense management and better market conditions versus the first half of 2016. We increasingly benefit from well-diversified income across our full range of businesses which positions us well.

In the context of possible future regulatory changes, we believe we're comparatively advantaged through our continued focus on three areas. First, we continue to invest in market-leading product innovations and wealth planning solutions tailored to clients' evolving needs, as we did with SmartFolio and ETFs.

Second, we are continuing to improve our productivity through digitization, process transformation and expense discipline. And finally, we're increasing collaboration both across our wealth businesses, as well as across the Bank, to deliver an exceptional client experience. And this is an area where we are already seeing great progress.

So to close, we had great momentum coming out of 2016 and we're well-positioned in 2017 to continue that momentum, assuming constructive markets continue. I'll now turn it over to the operator for questions.

QUESTION AND ANSWER

Meny Grauman - ***Cormark Securities - Analyst***

Hi, good afternoon. A question about capital ratios. Wanted to know, regarding the episode in October when you had to amend your regulatory ratios, what lessons did you learn from that mistake? Are there any management lessons or any insights that you got from that episode?

Tom Flynn - ***Bank of Montreal - CFO***

It's Tom, I'll take that question. At the time that we issued the release, we concluded a review of our Basel I calculation, which we instigated as a result of our own processes, determining that it made sense to do that review. And for us, and I don't think our experience is that different from the Canadian industry overall, the Basel I capital floor had not been operative, in that it didn't determine the capital ratios, for a long period of time, back to 2008.

I think the lesson is just when you've got something that is operating, is in the background but isn't driving numbers that are transparent, to make sure you are as focused on it as you are on other things. And our own processes determined that we should do the review. We found a few items that were misclassified through that, corrected the record through the disclosure. And as you've seen this quarter, have moved on and posted a ratio that's higher at the end of the quarter than it was at the end of last quarter as amended.

Meny Grauman - ***Cormark Securities - Analyst***

And then if I could ask a follow-up more detailed question on that issue. If I look on slide 39 of the supp-pack, you show the Basel I capital floor. It looks like it starts to kick-in in Q4 2015 and then it subsequently continues to rise quarter-after-quarter. I'm wondering if you can give us -- I don't know if the word is guidance, but some indication of where you see that number going, and if it's possible to give a sense of how you expect that to develop going forward.

Tom Flynn - ***Bank of Montreal - CFO***

Well, I'll answer your question but I'll start with what we think the outcome of that movement will be. Over time, we've guided to an expectation that the common equity ratio would go up by, on average, about 10 to 15 basis points per quarter. And it can move around, as you know, in any quarter, but that's a rule of thumb that we’ve said people should take guidance from.

And that would continue to be our guidance. We expect the ratio to move up through time. We think it will move up in the zone of the 10 to 15 basis points. That reflects an assumption about good, ongoing earnings performance and good growth in the balance sheet, which we have had through the course of this year. And it would reflect assumptions about the performance of the Basel I floor as part of the overall RWA picture. And so that's -- I think that's the key takeaway in terms of the impact.

Looking specifically at that line and your question, we have had growth through the course of this year. A good portion of that relates to changes that have reduced our Basel III RWA more than our Basel I. And those changes relate to improvements in book quality and changes in models and methodologies. Those changes, again, reduce the BIII RWA, but not BI, which results in the BI floor growing.

Going forward, I wouldn't expect the same kind of growth in that line over the next year that you saw in the past year. And any number in the supp-pack can be hard to predict quarter-over-quarter. I'd expect some growth but relatively gradual compared to what you saw over the last year.

Meny Grauman - ***Cormark Securities - Analyst***

Thank you.

Steve Theriault - ***Dundee Capital Partners - Analyst***

Thanks very much, good afternoon, everyone. Starting with the U.S. business, we can see the transportation PCLs building over the last few quarters. Will we notice a material seasoning effect over the course of the next year with the PCLs from the BMO Transportation book now that you've had it for a year? Maybe that's for Surjit. And for Dave, you'll have had it in the numbers now a full year, how fast do you expect to grow that business over 2017, or beyond?

Surjit Rajpal - ***Bank of Montreal - Chief Risk Officer***

Steve, this is Surjit, I'll answer the question about the PCLs and then Dave can talk about the growth that he expects in the portfolio. The PCLs that we're experiencing are in line with what we expected when we bought the business.

This is a business that is a high-risk-return business which has its own cycles. And I do expect that the losses over the next few quarters will moderate a little bit. They are higher than they were when we purchased the business.

What we are finding is that in this business right now, the spot prices are stabilizing. There was some over-capacity as a result of a very large number of truck sales that have happened in the past, which is slowly abating, or I should say, stabilizing. The improved economic outlook should help a fair bit as well.

So a combination of these factors I would think down the road -- it's hard to predict, but let's say some time middle of next year, they will stabilize. And this will continue to remain a very attractive risk-return business for the Bank. In terms of growth, I'll hand it over to David. David, over to you.

Dave Casper - ***Bank of Montreal - Group Head, U.S. P&C***

Thanks, Surjit. Just to remind you, this is the leading North American truck and trailer financing business. It does give us a very good input into what's going on in the economy.

I would say last year, we had overall in the U.S. business in the commercial business of which this is part of it, we had solid growth of probably 15% or 16% and the transportation finance business would have been less than that. I would expect that it will be less again going into 2017, probably with a little bit of a pick-up in the second half of the year as the economy picks up. Hopefully that helps.

Steve Theriault - ***Dundee Capital Partners - Analyst***

If you wrapped it together and think about having GE for a full year and the strong business you've had in commercial, do you think you can still do double-digit loan growth in 2017?

Dave Casper - ***Bank of Montreal - Group Head, U.S. P&C***

I would say that last year I thought we would be in the modest 10% or 11% and we exceeded that significantly. I would not expect us to be that high again this year. I would guide you more towards 10% which would still be above the market as we continue to grow further.

Steve Theriault - ***Dundee Capital Partners - Analyst***

Okay. And then if I could ask one question for Tom, and thanks for that, on the corporate line. The drag from corporate was clearly a lot higher this quarter. Would you still say that $100 million run-rate is reasonable looking ahead? And part of that, part of the Q4 decline if you will, was expenses. So wondering if there was any changes in how expenses are being allocated into that division or if it's really some one-off noise this quarter?

Tom Flynn - ***Bank of Montreal - CFO***

Sure. If you look at corporate over the last six quarters, the average income is about negative $100 million, so the number that you cited. And that's a pretty good number to think about for the sector, smoothed through time. And I say smoothed only because the numbers can move around a bit in corporate.

We saw that this quarter. There was, what I'd call, some seasonality in the numbers, some higher year-end spend related to IT, advertising, performance compensation given the strong finish to the year, and to projects. So those things push up the number on the expense side for the quarter, but I wouldn't extrapolate off of that number.

And the only other thing I'd add is that in Q1 of each year we do have higher expenses associated with stock-based compensation for employees who are eligible to retire. That expense is typically about $90 million pre-tax. Close to a third of that is in corporate, so the Q1 expense number in corporate is a little higher than the run rate because of that. But overall, I think takeaway that in the zone of a loss of $100 million to a little bit higher is a good way to think about it.

Steve Theriault - ***Dundee Capital Partners - Analyst***

And Tom, that $130 million net gain for next quarter, given the size, will you note that as an adjusting item?

Tom Flynn - ***Bank of Montreal - CFO***

We will be transparent around it, so that analysts and investors can do what they think makes sense. We actually haven't decided if we're going to adjust or not at this point.

Steve Theriault - ***Dundee Capital Partners - Analyst***

Okay, thanks very much.

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

Good afternoon. First, more of a clean-up question. I want to understand what was happening in the domestic retail business, specifically in net or non-interest income. The number was a fair bit higher than I would have expected. Is there anything in particular you could highlight?

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

It's Cam Fowler speaking, I'll take that one. We are up about 6.5% on the year. It's pretty broad-based growth in that number. It's across retail products and commercial and investments.

There is, on the commercial side, one gain in there, but ex the gain we're still very strong mid-single-digits. So my answer to the specific question is there is a gain but it's fairly core, and that there's momentum that I would expect to have us deliver similar results going forward on the NIR side.

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

Could you tell us what that gain relates to and quantify it, please?

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

It is a gain in the capital partners business. From a quantification perspective, I would say it is 20%, 25%, a number like that.

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

Sorry, 25% of what?

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

Of the NIR pick up.

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

Oh, I see. A different question, and maybe this is best for Darryl White. When we were learning about the budget and specifically the total return swaps, there was a time there, at least I thought, that it was perhaps more important to BMO than its peers. Could you give us an idea of what it means to EPS? Is it still like a 2% or 3% drag, or would it be lower than that, given all of the offsetting initiatives you have in place?

Darryl White - ***Bank of Montreal - Group Head, BMO Capital Markets***

Yes, sure. Perhaps I can help you with that. I think there were a few questions in your question, but relative to the peers, our assessment is that it's not outsized relative to the peers and if it is, it's barely outsized relative to the peers, in terms of the pack.

You do refer to 2% to 3%. That is something that I think we were on the record on many quarters ago. As we look at it today, on a mitigated basis, I think you should expect it to be less than that.

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

So in the 1% to 2%?

Darryl White - ***Bank of Montreal - Group Head, BMO Capital Markets***

Less than that. Less than the 2% to 3%. 1% to 2% feels better that 2% to 3%.

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

I understand. That's all I've got, thank you.

Robert Sedran - ***CIBC World Markets - Analyst***

Hi, good afternoon. I guess I'll stick with Darryl.

When I look at either slide 13 and see the investment & corporate banking revenue, or just the underwriting revenue flat out, obviously a very strong quarter for that part of BMO Capital Markets. It would be helpful if you can give us a little bit more color around which product, and maybe even more importantly, which geography was driving some of that strength. And how you feel about that as a number as you think about 2017. I hate to ask the run rate question, but I feel like I need a little help this time.

Darryl White - ***Bank of Montreal - Group Head, BMO Capital Markets***

I think that I can help, Rob, and thanks for the question. It's always nice to get a question about good numbers.

I think the place to help you the most is to guide you to page 11 of the supp-pack. You quite rightly noticed the underwriting revenues had a nice lift. And I should point out it's underwriting and advisory. The reason that's important is because the answer that you're looking for is that the majority of the pick-up is in fact in advisory.

If you look at the lift for example, from Q3 to Q4, where we increased fees by $81 million, the majority of it, in fact more than all of it, I'll be a little more specific, more than all of it was in the advisory business, so the M&A business.

As far as the geography is concerned, the lion's share of that lift itself was in fact in the U.S. So it's very consistent with our strategy and what we've been trying to do for some time now. That market, in the mid-market in particular, in the U.S., was active in the quarter. And we were more active than the market itself so we saw a nice lift there. So it's a little bit confusing to just focus on the underwriting part of it, but underwriting and advisory, my guidance to you would be focus on advisory and focus on U.S. and you get pretty close to the answer and we're quite proud of it in terms of how it fits with the strategy.

Going forward, it's difficult obviously to forecast the business, Rob, in any particular quarter. What I can tell you is that we like the trajectory of the business as we look at it going forward. We had a particularly strong quarter in the investment & corporate banking business, as you pointed out in the slides.

And we had a good one in the trading products business as well, but not our best of the year in the trading products business. So on balance, you'll see where it comes out going forward. But I think that the momentum continues to be quite positive in both businesses.

Robert Sedran - ***CIBC World Markets - Analyst***

Thanks for that. I guess it's fair to say the underwriting business, though, has a little bit more of a cadence to it. There's more of a run-rate feel to it, where the advisory business is a little lumpier. Is that, at least, the right way to think about it from a run-rate perspective? Like the advisory business is going to come in bigger tickets and it's going to come and go a little bit?

Darryl White - ***Bank of Montreal - Group Head, BMO Capital Markets***

I think that's not a bad way to think about it. Sometimes there are transactions that are lumpy in nature. Although I wouldn't want you to think from that comment that there's one transaction that drove the answer to my question a moment ago. It's a collection of transactions across a collection of client activities. But net-net you are right, you can see the advisory part of the business move around a little bit more actively from quarter to quarter.

Robert Sedran - ***CIBC World Markets - Analyst***

Okay thanks for that, that's quite helpful.

Gabriel Dechaine - ***Canaccord Genuity - Analyst***

Good afternoon. Just want to clarify, did you quantify the gain from the sale of Moneris U.S. and what the capital impact could be? I know you talked about a gain earlier, but it was muffled on the call so I didn't quite get it.

Tom Flynn - ***Bank of Montreal - CFO***

Well hopefully that was your phone and not our communication on the muffled part.

Gabriel Dechaine - ***Canaccord Genuity - Analyst***

Maybe it was.

Tom Flynn - ***Bank of Montreal - CFO***

We talked about having two items in Q1. One is the gain on the sale of Moneris, and the second is a loss on the sale of a portion of our U.S. indirect auto portfolio. They will net to approximately $130 million after tax. And the Moneris gain itself is approximately $170 million.

Gabriel Dechaine - ***Canaccord Genuity - Analyst***

Okay, perfect, thanks. I want to get back to this Basel I floor issue. The way I see it, it's a total balance sheet perspective. And to the extent that the internal models spit out a certain RWA, they have to be in a certain bandwidth versus what they would have been under the standardized approach. And you went below that threshold and that's caused these RWA -- the Basel I floor to kick in additional RWAs. Does that mean that in the future, as your balance sheet grows, the RWA intensity of your asset growth is going to be more than it was in prior years?

Tom Flynn - ***Bank of Montreal - CFO***

It's Tom. I would say not necessarily. We won't have the same benefit from credit quality improvements and models and methodologies that flows through the advanced Basel III AIRB RWA. But offsetting that to some degree will be an ability to manage the growth of low-risk assets that attract high Basel I RWA.

So net-net I'm not sure there's a big benefit or a big increase in the risk-weighted asset growth. Although the benefit that we have had over the last few years from positive migration in the portfolio and models and methodology won't translate directly into better overall RWA.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. Is this somewhat of a reversal of the benefit you received last year from transitioning your U.S. book?

Tom Flynn - *Bank of Montreal - CFO*

There is a connection to the transition of the U.S. book. We transitioned that book over the last roughly two years, phased in over time. It did produce a meaningful benefit to the U.S. RWA, i.e. they went down. And so to a degree this is capping that benefit, yes.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. And then my last question is for you, Tom, and for Dave. Dave sounded pretty excited about the outlook for the U.S. segment. That's great and the rate outlook, I imagine, is a big part of that.

Can you give me a sense of what's built into your business plan for 2017 in terms of rate increases? What do you expect margins to do as a result? And then, Tom, more broadly if you can quantify or update some of the guidance or sensitivity you gave a couple years ago on the Bank's rate sensitivity. I was looking at the Canadian five-year and there’s going to be a beneficial impact on your consolidated margins, right?

Tom Flynn - *Bank of Montreal - CFO*

Yes, sure, its Tom. I'll start and then Dave can add. So we do have a positive sensitivity to higher U.S. rates and then generally to higher rates, as you know. There's a sensitivity to the short rate and then a sensitivity to long rates that flows in through time, because we basically have what's like a bond ladder that matures over five to six years. So there's a positive rate sensitivity.

A 100 basis points parallel shift in both the Canadian and the U.S. curve would be, subject to a lot of assumptions about market competitive dynamics and consumer behaviour, in the zone of $175 million of revenue. And 75-100 of that would be a sensitivity, again subject to the assumptions about behaviour off of the U.S. short rate for a 100 basis point move. So that's the sensitivity.

In terms of the overall margin outlook for the Bank, obviously many, many assumptions go into that. We see upside in the U.S. related to higher rates, the potential for higher rates to begin to phase-in from the long-term rate move that we've seen, although that takes some time. And then on the flip side, we'll have some higher funding costs coming from the adoption at the beginning of next year of what's called the net stable funding ratio. And potentially from the introduction of bail-in debt later in this year.

So net-net, we think at the total Bank level, the margin's likely to be in the zone of flattish. So that's the overall picture and I'll let Dave add anything he wants on the U.S. P&C business.

Dave Casper - *Bank of Montreal - Group Head, U.S. P&C*

The one thing that you would look at in the U.S. P&C business, you'd see our NIM. And I think we've guided in the past, absent any rate increase, like 2 to 3 basis points per quarter. And that's largely as the loan book grows and as spreads narrow. There's other things in there but those would be the two factors.

And that guidance would continue with the likelihood of a rate increase that could more than offset that decline. And the other modest positive to what Tom said before, when we do reduce our indirect auto loan book, that is a lower-priced book -- lower-priced assets. So to the extent that we replace those assets with better margins, that would have a marginal positive impact as well.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay, perfect. So 2 to 3 basis points down per quarter absent rate hikes, that's what you're saying?

Dave Casper - *Bank of Montreal - Group Head, U.S. P&C*

That's correct, and the rate hike could offset that.

Gabriel Dechaine - ***Canaccord Genuity - Analyst***

Okay no time for a stress-test question for Surjit. I'll wait until next year, maybe.

Sumit Malhotra - ***Scotiabank - Analyst***

Thanks, good afternoon. First is a, I'll call it a geography question for Tom Flynn, and just going back to the synthetic total return swaps. I'll ask you directly first, is the TEB adjustment line the best way, in your opinion, that we should measure the contribution the Bank is getting from this business? And if so, you've been running the last few quarters around, if I average it, about $130 million a quarter. Should we expect that line to trend materially lower as this business runs off after April?

Tom Flynn - ***Bank of Montreal - CFO***

I would say that's a good place to look to see the impact of the budget change. There are other things in that line, and so it's not at all only related to the business that's impacted by the budget change. But you will see the difference in that line as we go through the year, yes.

Sumit Malhotra - ***Scotiabank - Analyst***

It doesn't look like it's changed too much so far. From Q1 levels certainly it's down, but last three have been flat. Is it reasonable to think there's a more accelerated decline in this line as we approach the end of April?

Tom Flynn - ***Bank of Montreal - CFO***

I would say the line should probably hold up fairly well until that point, and then it will come down as we approach that date. The decline will be more oriented around the change in the regulation versus sooner.

Sumit Malhotra - ***Scotiabank - Analyst***

Fair enough, thank you.

Darryl White - ***Bank of Montreal - Group Head, BMO Capital Markets***

It's Darryl. Just to help you, Tom is exactly right. We have seen, I would say, some clients take trades off, but they're not material. We haven't really seen any material changes in the book, in fact, since Q1 of 2016.

Sumit Malhotra - ***Scotiabank - Analyst***

That's helpful. So we'll look for that later next year. And then my actual question is for Cam Fowler and it's going to be around your mortgage business. I'll preface it by saying that I know BMO is a lot less exposed proportionately to Canadian resi-real estate than the rest of the sector, but would be interested your thoughts. Your mortgage growth in Canada this year, if I average it, was just a shade under 6%, so pretty reasonable and comparable numbers to what we've had the last few years.

As I know Surjit said, it's early days with the new mortgage insurance rules, but if I take that and the 35 basis point or so increase in five-year rates, when we're hopefully all here a year from now, is your mortgage growth, in your view, likely to be about the same? Or higher or lower than that number, taking those two factors into account if you could break them apart, please?

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

I would agree with the point that said it's pretty early days to understand what the impact of the changes is going to be. And it's even difficult for me to say what I think my growth is going to be. I would just say from a competitive perspective, we intend to stay competitive in the market.

We feel B.C. through GVA coming off a touch, as have others. But to your first point, we are undersized in particular in Toronto, where we've been making investments and positioning ourselves to do well in the market. So the rest of Canada we've also been well-positioned with our proprietary sales force which is, I think, stronger than it was before. Could the market slow a little bit in 2017? Yes, I expect it would. But from a relative basis, I would like us and would expect us to remain quite competitive in 2017.

Sumit Malhotra - *Scotiabank - Analyst*

Is a rate move even a factor at all or just not big enough to matter for your clients yet in terms of the activity you've seen?

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

It's not something we're feeling yet.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks for your time.

Peter Routledge - *National Bank Financial - Analyst*

Hi, there. I'm going to ask a capital question, but I'll come at it a little differently. As I'm sure you're aware of the ongoing Basel deliberations on risk weightings under Basel III or IV. I was wondering if risk ratings on your balance sheet generally go up as a result of Basel III or IV deliberations, might the Basel I floor just go away? Which would imply you have less sensitivity to regulatory change coming out of Basel?

Tom Flynn - *Bank of Montreal - CFO*

It's Tom, I'll take a crack at that and Surjit can add if he wants. I would say the underlying logic of the Basel I floor that we're living with now and any standardized risk weights that come out of, let's call it Basel IV, would be similar.

So the fact that we are now operating with the Basel I floor has the potential to mute the impact for us of the Basel IV reforms on the standardized side relative to a bank that isn't subject to the floor. And I'd say has the potential to, because obviously the details matter and we haven't seen those details.

Peter Routledge - *National Bank Financial - Analyst*

Conceptually that's not inaccurate.

Tom Flynn - *Bank of Montreal - CFO*

I think that's fair.

Peter Routledge - *National Bank Financial - Analyst*

And then on the discount on the DRIP. What's your expected take-up rate and how long do you expect to have it in force?

Tom Flynn - *Bank of Montreal - CFO*

Typically when we have the DRIP on the take-up rate is in the zone of 30%. We'll likely keep it on for the next few quarters. Exactly how long depends on how things play out, but I would have it on for at least the next couple of quarters.

Peter Routledge - ***National Bank Financial - Analyst***

Great. Thank you very much.

Darko Mihelic - ***RBC Capital Markets - Analyst***

Hi, thank you. I'm looking at the U.S. business. And now that I can step back and look at it for the whole year and strip out transportation finance expenses, it looks like expenses are actually down year-over-year in the U.S. business. Can you talk to what it was that you've done?

I do see some aggressive FTE reductions in the last couple of quarters. But more to the point, Dave, I wonder if you can talk about what the expectation for expense growth is next year in your business.

Dave Casper - ***Bank of Montreal - Group Head, U.S. P&C***

You're right. They really are essentially flat year-over-year if you take out the transportation finance business. We've done a number of things, but probably first and foremost, we have watched our growth throughout the year and we have managed it in a number of ways, probably more in our personal business where, just as you would expect in any of the U.S. businesses, as fewer and fewer people are using the branches day to day, we have less space so we can have fewer people.

And so we have had then -- it was part of our cost savings as part of the reduction in forces earlier in the year. Our technology spend has actually increased, but overall we've managed to keep it flat. A number of different things, nothing that we think would hurt our expectations to continue to grow aggressively in the future. Does that help in terms of your question?

Darko Mihelic - ***RBC Capital Markets - Analyst***

Yes, it's just not normal to see zero expense growth in a business. Typically, you have some sort of inflation-plus factor when you look forward, at least I've seen that in most businesses. So it's just curious that -- it just seems like this is a one-year phenomenon. Am I getting from you that next year we should see a return to expense growth?

Dave Casper - ***Bank of Montreal - Group Head, U.S. P&C***

We would expect, and we have in our plans that we would have expense growth in next year, less than our revenue growth, and managed, and we expect to stay disciplined. But I think you'd see in many of the U.S. banks, that they've done a pretty good job of managing expenses.

Darko Mihelic - ***RBC Capital Markets - Analyst***

And Dave, are there any tax structures in place in the U.S. that would get in the way of a -- I mean, if there were a reduction in corporate tax rates in the U.S., would we just take your U.S. tax rate and reduce it concomitantly? Or is there something I should be thinking about with respect to a tax structure?

Tom Flynn - ***Bank of Montreal - CFO***

It's Tom, Darko. The benefit of any reduction would flow through pretty much directly into the tax line that you see in the U.S. segment.

Darko Mihelic - ***RBC Capital Markets - Analyst***

Okay, thanks for that. And one quick last question. There were some benefits in the insurance business on a go-forward basis. Should we expect similar benefits on a quarterly basis? Or was the macro effect of higher rates, is that like a one and done deal in the insurance business?

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

Thanks for your question, this is Joanna. We did, as part of the quarter, certainly see a pick-up in long-term interest rates in insurance due to the decrease in the fair value of our policy benefit liability. So I would say this would be a pretty big swing versus our quarterly run rate. I would expect a moderation of that going forward. But certainly given the rate environment, I think we expect it to be somewhat of a tailwind.

Darko Mihelic - ***RBC Capital Markets - Analyst***

And could you size the management actions in the quarter for us?

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

For the quarter, they were lower than usual. I think overall, we continue to see it, on a year-over-year basis, a little lower. Tom, maybe you want to add?

Tom Flynn - ***Bank of Montreal - CFO***

Yes, the management actions really weren't significant in the quarter. They were a bit of help but in the zone of $5 million. The bigger thing taking the insurance income above the average run rate was just the benefit from rates. And I'd think about $60 million to $65 million as a typical quarter for the insurance business, absent any movement from actions or rates or actuarial assumptions.

Darko Mihelic - ***RBC Capital Markets - Analyst***

Okay, that's great. Thank you very much.

Operator

Thank you. There are no further questions registered at this time. I'd like to turn the meeting back over to Mr. Downe.

Bill Downe - ***Bank of Montreal - CEO***

Well, thank you, operator. Since this is our last call of the year, I'll take a moment to say thank you to everyone on the phone for your engagement and the interest you show in the performance of our Bank. And wish you all the very best for the holidays and look forward to talking to you in the new year. Thanks very much.