BMO Financial Group

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We caution that the foregoing list is not exhaustive of all possible factors. Other factors and risks could adversely affect our results. For more information, please refer to the discussion in the Risks That May Affect Future Results section, and the sections related to credit and counterparty, market, insurance, liquidity and funding, operational, legal and regulatory, business, strategic, environmental and social, and reputation risk, in the Enterprise-Wide Risk Management section that begins on page 69 of BMO's 2019 Annual Report, all of which outline certain key factors and risks that may affect our future results. Investors and others should carefully consider these factors and risks, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. We do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by the organization or on its behalf, except as required by law. The forward-looking information contained in this document is presented for the purpose of assisting our shareholders in understanding our financial position as at and for the periods ended on the dates presented, as well as our strategic priorities and objectives, and may not be appropriate for other purposes.

Material economic assumptions underlying the forward-looking statements contained in this document are set out in the Economic Developments and Outlook section on page 18 of BMO's 2019 Annual Report. Assumptions about the performance of the Canadian and U.S. economies, as well as overall market conditions and their combined effect on our business, are material factors we consider when determining our strategic priorities, objectives and expectations for our business. In determining our expectations for economic growth, both broadly and in the financial services sector, we primarily consider historical economic data provided by governments, historical relationships between economic and financial variables, and the risks to the domestic and global economy.

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Examples of non-GAAP amounts or measures include: efficiency and leverage ratios; revenue and other measures presented on a taxable equivalent basis (teb); amounts presented net of applicable taxes; results and measures that exclude the impact of Canadian/U.S. dollar exchange rate movements (i.e. constant currency basis or CCY), adjusted net income, revenues, non-interest expenses, earnings per share, effective tax rate, ROE, efficiency ratio, pre-provision pre-tax earnings, and other adjusted measures which exclude the impact of certain items such as, acquisition integration costs, amortization of acquisition-related intangible assets, reinsurance adjustment, restructuring costs, revaluation of U.S. net deferred tax asset as a result of U.S. tax reform and the remeasurement of an employee benefit liability as a result of an amendment to the benefits plan.

Bank of Montreal provides supplemental information on combined business segments to facilitate comparisons to peers.

PRESENTATION

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Thanks again for joining me this morning. For your opening question, I got the sense that you felt that we were entering 2020 with momentum. Maybe you can give us a bit of colour around that, and how does the macro environment factor into that momentum that you're seeing going into 2020 for Bank of Montreal?

Darryl White – Bank of Montreal – CEO

That's a good place to start, I guess. I would qualify what you've just asked, Darko, with – relative momentum – because I think you framed it quite well. We've got the macro environment, I just caught the tail end of the last discussion, and we've got how our business performs within that macro environment. And I think it's important to talk about both, though.

The macro environment, we saw the shift begin really. It's actually interesting. As I'm sitting here, I'm having almost a déjà vu as you and I talked almost 365 days ago, coming out of what felt like a capital markets calamity in the last 3 months of calendar 2018, and the conversation that was omnipresent then was all about that and what was really going on. And then, of course, we had what felt like a couple of months of calm.

Through the course of the balance of 2019, that's when we saw really two things happening on the macro environment, which I think colours to a great degree where we are today and where we're going on your question. The first of those was the rate cuts that we saw, three consecutive rate cuts at the Fed and the flattening of the yield curve. We're still today in an environment where we're living with a yield curve that has a little bit of perceptible shape in the U.S. I think this morning, between 2s and 10s, we're around 35 basis points. And in Canada, almost none.

The second factor on the macro side is what we've all talked about, which is a slowing macroeconomic environment in North America – with us, remember, about 85% to 90% of our activity is in North America. So, when I talk about it, I sort of think about that slowing environment and the lower rates and the flatter yield curve. But when I step back from it, Darko, I look at that slowing environment, I say, well, where are we slowing to? Are we still growing? We're definitely still growing. I mean, I think the U.S. economy this year will probably – nobody's got a perfect crystal ball – but if I had to cuff it, I'd say it'll probably be between 1.5% and 2% growth in 2020. Compare that to last year, we don't know the number yet, but let's say we land around 2.5%. And so that is a slowing down, but there's still growth in that economy, and it is an election year. And that probably translates back to Canada with a similar range.

So with that as a backdrop, when I talk about momentum, I look at the decisions that we've made and the businesses where we traffic. And I'm at the point now where I can say in every single one of our businesses, I believe with a stable environment, the one that I've just described, even though it's growing a little bit slower, we've got relative momentum that is quite impressive. And I say that when I look at our Canadian businesses, our P&C business in Canada, our P&C business in the U.S., our wealth management business and our capital markets business, where, if you look at our fourth quarter, in all four of our businesses, we had positive operating leverage. And we think we stacked up very well on almost any financial metric as we published our fourth quarter. And it's that momentum that we bring into 2020 against the backdrop that I just described, which, of course, is the backdrop that we're all living with.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Given that, I mean, when we look at last year's numbers, about, let's just say, 5% EPS growth, about 14% ROE. You're targeting 7% to 10% EPS and a higher ROE, and 2% operating leverage – which sounds like you're really emphatic that there's momentum on the operating leverage – but what about the other targets, are they achievable in 2020?

Darryl White – Bank of Montreal – CEO

Let's talk about the EPS. I think what we said at the end of the quarter is that we're not changing our view on our mid-term target on EPS. Ours is a 7%-plus. And at the same time, we said that 2020 is likely to be more challenging in order to get there. And that's just math, right? If you look at the way, in the year that I just described, in 2019, our revenue growth was 6%. And that revenue growth at 6% was pretty good relative to the peers, I think the peer average of Canadians was 5%, and we were 6%. Later on, everything I just said carrying into 2020, absent inorganic growth, we've been pretty clear and declared that our expense growth, we think, for the first time in a very long time at the Bank of Montreal will be 2% or better.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Better being lower?

Darryl White – Bank of Montreal – CEO

Exactly. 2% or lower. So if you think you're going to get to 7% EPS growth, you have to have a view that you've got an 8%, or a 9%, or a 10% on revenue, and that's not going to happen. I don't think it's going to happen for us or for others, absent something unusual going on in the environment.

I can tell you I'm very confident in the 2% or better on the expenses. Revenues, we'll have to see because all of these environmental issues that we just talked about, you and I, will play out over the course of the year. But I think signing up for 7% EPS growth is very aspirational. Somebody would have to have a very aspirational view, and I think you and others have validated that in the work that you've done on revenues in order to get there.

Having said that, we might get close, it depends on what happens over the course of the year. What we do when we look at our mid-term targets is we have a look at what we think of the year, we do the analysis that I just took you through, and we began this work, actually in our case, almost a year ago to look out at the environment and say, what would our reasonable response be, and our reasonable response was a pretty definitive change in the shape of the curve on the cost structure. We, at the end of the second quarter last year, told all of you that the second half would have a growth rate in our expenses that would be approximately half of the growth rate of the first half of the year. Doesn't roll off the tongue really well, but I think you could follow. And it's exactly what it was. In our fourth quarter, we were less than 2% on our NIX, and that's because we had this view going forward. That, we know we can deliver. We can deliver that through 2020, we'll see where the revenues come out.

And the second thing you do is you say, well, are you going to, therefore, throw out what you call your medium-term growth targets and sign up for something less aspirational. And we said we're absolutely not going to do that. If I look back over the last three to five years, we have hit our EPS growth target four out of the five years. We've averaged over 7% in the three-year horizon and the five-year horizon. So we set aggressive numbers, but we think of them in that two-, three-, five-year horizon, and we're comfortable signing up for that based on our history and our view of the future, just not necessarily in the next ten months.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

One of the things that helped you last year with the revenue growth was strong loan growth, actually, both sides of the border, but why don't we pick on the U.S. first? You had very strong loan growth in the U.S., and the question that I often get is, how do you get such strong loan growth without either competing on price or on credit quality? In commercial in particular, given the strength of what we saw last year. So maybe you can touch on the highlights of what you're doing in the U.S.

Darryl White – Bank of Montreal – CEO

For people who don't follow us closely, Darko's question – our loan growth in the U.S. last year in commercial in our P&C business was low double digits. It was [14%], which was clearly industry leading. What I would do is kind of take you back to industry structure and strategy, which I've talked about before. Very different in the U.S. relative to Canada. To set up the commercial story for us, you always have to remember where we are from a relative perspective. We're the #2 commercial lender in Canada. Maybe I'll come back to that after we go through the U.S.

In the U.S., we're a top 10 commercial lender. In Canada, there are maybe 10 or 12 good competitors. In the U.S., there are hundreds, and we're top 10 among the hundreds, and the top 3, or 4, or 5, sort of looks like Canada – they're fighting for a tenth of a basis point every day in terms of share growth. And after that, it gets to competitors who have 1% and 2% and 3% market share, or fractions of that, as you get to hundreds of participants into the U.S. marketplace. And BMO is in the top 10. When you put, by the way, our U.S. and Canada together, we think we're the sixth largest commercial lender on the continent.

That's my way of starting by telling you we're really good at this. Some people around our place say we've been at this for 200 years. We've been at this for decades at least, and certainly since 1984 in the U.S. when we bought the Harris Bank, so this isn't a social experiment for us. When we decided a couple of years ago that we wanted to drive more operating leverage out of our U.S. business, bring our efficiency ratio of our U.S. business down to the enterprise number, which, by the way, the U.S. P&C number is now below the enterprise number, it was because we were going to make investments in people, create capacity with the technology, with the balance sheet and with the client relationships. And we started to grow that business faster than the market by taking advantage of that industry structure, which, frankly, has a lot of competitors who are half our size, a quarter of our size, a tenth of our size, who just don't have the ability to compete in the way that we do.

And so, it's a share gain. I look really carefully at spreads, and while spreads for the overall market in C&I – which you can see, they're all quite well documented, published in the U.S. – came down through the course of 2019, ours came down too, but they did not come down faster than the market. We were participating in the market. We weren't buying share with price. We were taking share with our competitive ability because we've been doing this for a long time. We put people in the market, we put more people in the market through the course of the year, and we invested in that with a balance sheet that, for us – when we look at our capital allocation strategy – has among the highest ROE efficiency and growth rate and doesn't compromise our risk appetite.

So for us, it is a little bit of a no-brainer. I have to say, when you go back two or three years and say, where we have a real opportunity to differentiate and compete and put the marginal investment dollar, and we're very happy that we did. Now I will say, before you go on to your next question, we have also said you should expect that to moderate. I don't think we're going to see double-digit increases in our commercial lending business in the United States this year. That'll mostly be driven by demand, that's the slowing of the U.S. economy that I've talked about, so we'll have a demand reduction this year. We think we'll still be pretty strong as we come through the early part of the year, but our forecast is as the year goes on, we're going to see a reduction in the growth rate of that based on market demand. But whatever that market is, we think we'll continue to grow faster than the competitors.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

And of course, with the slowdown in lending and the rate environment, one would expect NII growth to be significantly slower in 2020. That's a fair, I think, observation.

Darryl White – Bank of Montreal – CEO

It's harder to predict, I must say, in the U.S. than in Canada. But if you look at the NIM compression through the course of 2019, you saw the compression, we've made no apologies for it because the marginal loan was generating better ROE than some of our other businesses in the historical legacy book, so we went with the market through the course of '19. I think you heard us say in our fourth quarter call we would see a little bit more compression in the beginning of the year. I think that's probably going to be the case in the first quarter. But after that, it feels like we've cycled through the rate change. If you think about where we now are in the calendar, we're in the second quarter calendar of 2020. I think you'll probably see – my best guess, Darko, would be – flattish from thereon and for the rest of the year in the U.S.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Sometimes I get this question, and it's an interesting one because we just saw you deploy a lot of capital organically in the U.S., and yet the question often comes back to, well, what about acquisitions in the U.S., and given the environment that we're in – a little bit of a slowdown – are there opportunities for you to build out your capabilities?

Darryl White – Bank of Montreal – CEO

There are always opportunities, there's just not a lot of good ones, that's the problem. It's really not that complicated, we look at the comparison of the opportunity to do basically what I just said, and build the business, generate earnings growth within the risk appetite and build more clients for the long term, versus going out and doing an acquisition, we compare them all the time. We get shown probably most of what traffics in the space in the U.S. and, so far, we haven't seen anything that's competed effectively from an IRR perspective in addition to the other things that we talk about, of course, strategy, culture. But from an IRR perspective, with what I've just described to you in terms of how we've built the business organically – there could be a point in time at which that changes – but we haven't seen it in the last couple of years.

And you just don't know, it's also circumstantial, right? Sometimes these things come along. If I look at some of the great acquisitions we've done in the U.S., if you go back to the transportation finance business we bought from GE in Dallas-Fort Worth, if you go back to the M&I acquisition – book value acquisition in 2010 – if you look back to some of the smaller ones we've done in capital markets, there have been fantastic additions like the KGS acquisition, I couldn't have sat there and forecasted any of them to you three or four or five months before they happened. They happen, you look at them. But the ones that we've looked at in the last three or four, five months, and the year before, and the year before, just haven't stacked up against our organic opportunities.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

And you mentioned KGS-Alpha, I was actually going to go there as a follow-through for the next question, which is, we've seen you build out the investment banking platform, are you finished, is there more to do?

Darryl White – Bank of Montreal – CEO

I don't know if you're ever finished, I think the better way – the way I think about it is – where are you in the trajectory of investments relative to harvesting returns in consideration of the environment as well as where the competitors are. And I would say where we are right now is, absent something just too good to be true showing up on our doorstep, we're probably on some version of pause and harvest to get the returns out of what we've invested in, both people, capital, some small acquisitions. But at the same time, there could be something that just looks great, it's a capability that adds to what we're already doing, and we can fill in a hole in our offering. If that comes along and it's not outsized, we'll do it.

Absent that, Darko, I would say we're really happy with what we've built in the capital markets business, in the U.S. and in Canada. There was a note out yesterday in one of the mainline press outlets on lead tables and market shares, I think we showed up very well relative to any of our Canadian competitors. We're sort of in the top 3 almost everywhere, in a slower market, I would say, in Canada. And in the U.S., I remember talking to you and others three years ago about having an aspiration to get our U.S. capital markets business to start contributing over $70 million of net income per quarter – now you've seen us contribute well above that, well above $80 million or $90 million, and that's been driven by the investments that we've made. You saw us take some action early in the year on our capital markets headcount. We took that action because we saw this environment that I'm talking about coming. I think you'll see us in the next bit here really work hard to deliver positive operating leverage out of the capital markets business, and we started to differentiate there towards the end of last year. I think we'll start differentiating in the second, third, fourth quarter of this year on operating leverage. And all the way back to your question, if something really interesting comes along, then we'll add to it, but in the meantime, we think we're really well positioned to harvest the gains from what we've invested in.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

With Dave up here earlier, I mean, his view was that RWA growth will be slower in the cap markets business, is that something that you are planning for your cap markets business?

Darryl White – Bank of Montreal – CEO

Slower than?

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Well, slower than in the past. Are you looking to extend balance sheet aggressively in the cap markets business, and in the U.S. in particular?

Darryl White – Bank of Montreal – CEO

Yes, we're continuing to grow the capital markets business, but we don't see ourselves growing the capital markets business at a faster rate than the rest of the bank. If you look at the amount of capital that we have to deploy, it would be surprising to me if you and I were sitting here in a year from now and you say, gee, capital markets balance sheet grew at X and the rest of the bank grew at X minus something – we'll just continue to invest at our regular organic pace.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Fair. Let's switch gears and go back to Canada, and let's touch on commercial lending growth, because there, too, you say you're a top 2 player, I guess, in Canada on commercial lending side, strong growth last year. What are you seeing on the commercial lending side now, are we seeing increased competition, lending terms loose or tightening, any description there? Because, similar to the question in the U.S., the question that I get often is: What is BMO doing to get such strong growth in Canada?

Darryl White – Bank of Montreal – CEO

Yes, so there, while the similarity with our business in the U.S. – and by the way, we run them together, we run this as an integrated business. The sales spine is set up from an organizational perspective, where we've got commercial lenders who understand sectors, we swap best practices across border every day, every hour some days. And so, we run this as a really tight, integrated business, which we think is a real differentiator for BMO.

Now back to Canada. The difference between Canada and the U.S. is: here, we are the #2 player. What we find on the competitive point is, yes, there's competition, there should be competition, we've got good competitors and the competition on price or terms comes and goes. I would say when you're the #2 player, a lot of people come at you. We have seen more competition come at us, trying to knock us off the puck on pricing or terms or hold sizes, than the other way around. When we look at the data carefully, we can see no evidence – and I want to be clear on this – that we are out buying business, I look at it every month, and I look at the credit data every single month – and we can see no evidence in the Canadian commercial business that we are sacrificing spread. In fact, our spreads have gone up over the last few months. And then, what we do is we look at where there are contested situations and how often do we end up winning or losing, and we actually lose more often on price than we win, so we make pretty disciplined decisions on returns, and that's the luxury, frankly, when you have a leadership position. We do see some aggressive behaviour in the marketplace today, but if you took me back over the course of 5 or 10 years, I'd be able to point to 20 different short bursts of time where that behaviour has been aggressive, and then it might go away, and it might come back. So, I don't really read too much into it other than we've been really, really, really clear on our strategy, which is we're going to defend that #2 position in Canada. And in the U.S., we're going to continue to grow the position.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

And what about the health of the commercial borrower, are we seeing more leverage in the system for the commercial borrower, however you want to describe it?

Darryl White – Bank of Montreal – CEO

I would say the commercial borrower is generally very healthy. I say generally because when you look across the board, you can't see any secular trends that would lead you – I spend a lot of time on this with our Chief Risk Officer, with our Risk Management Committee, and we dissect it, we turn it over and we ask ourselves the question again – we say, do we see clear deterioration where we can draw trends or themes through the commercial book in Canada or in the U.S., regionally in Canada, regionally in the U.S., by sector, and the answer is – generally, no. So, the commercial borrower is healthy.

Now, if I go specifically, you've heard us say we can see some hotspots. The oil and gas sector, for sure, there are some idiosyncratic hotspots that are emerging, and we can see some places there. We talked earlier about agriculture as well – it's small for us, but certainly it's under pressure, particularly in the U.S., not so much in Canada.

And so, we do see some areas where the heat map sort of flashes a little bit. And then, of course, when you have a big commercial book, you're in a lot of credits and a lot of places, and you'll have some lumpiness, you'll have some idiosyncratic events that really have nothing to do with anything other than the borrower itself had run into some problems that they didn't foresee, and you'll always see that for us and others. You have to really be particular in the answer to this question, but I would come back to where I started, which is, generally, we haven't seen a deterioration in the level of health. Those would be the hotspots that we're watching carefully today.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

And so, what'd your expectation be for growth in this loan category for 2020?

Darryl White – Bank of Montreal – CEO

You should look at the U.S. coming – I said to you before in commercial, our U.S. loan growth was double digit, low double digit – I think it'll be not double digit this year. I don't know how to be more particular than that, other than that I'd be surprised, quite surprised, I would say, if we showed you 10% growth in the U.S. We might be there in the early part of the year but taper off as the year goes on just from what I can see in the economy and the borrower appetite.

In Canada, we'll continue to participate at the rate of the growth of the market, and we'll defend our share. So, what will that end up being? I have to be honest with you that the market growth itself has surprised me on the upside in Canada for the last couple years. And so, I'm not particularly good at projecting that, I've been wrong before. But what I've been right at is saying that we're going to defend our share, and we're going to continue to make sure that we protect those client relationships. So, wherever that market growth rate is in Canada, we'll be there and maybe a little bit better.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

We had acute NIM compression in the U.S., what's your expectation for Canada?

Darryl White – Bank of Montreal – CEO

I think Canada will be a little bit better. I think in Canada, we'll see NIM flat to improving slightly over the course of the year.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

That's with one rate cut assumed?

Darryl White – Bank of Montreal – CEO

That's with one rate cut assumed. We could have a long debate on whether that rate cut will in fact happen.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Okay, fair enough. Let's turn to some of those idiosyncratic one-offs that we saw last year on credit quality, and you mentioned – I think you were touching on it – just want to be sure that there isn't this particular trend that you saw that stood out for you. And maybe you can just talk to your guidance for the year going forward, because you guys have sort of provided a range on your PCL. And so, when I sit back and I say to myself, well, if you had all these one-offs, and I take out the one-offs, why would your range be higher in 2020? So maybe you can just talk to that.

Darryl White – Bank of Montreal – CEO

The range that I think you're talking about is – as we've said and Pat said pretty clearly – that we're guiding to the low to mid-20s on our PCLs. You really have to remember that the period of time where we and others were moving through really low PCL levels is pretty unusual. So, if you get into the low to mid-20s, we'll still be – you have all the data, Darko – but we'll still be materially below most of our peers, in the sort of mid-20s, of course.

And there, your question is a good one because when you go back to last year and you say, well, if you have more idiosyncratic events – I don't know if we're going to have more idiosyncratic events, right? We may, we may not. There's always going to be something. There'll be one this quarter, there'll be two the next, there'll be zero in the next, so you really don't know what there's going to be in the year to come.

And then when you look back, you have to remember that it’s not only what you might have had – that pattern that I've just described – but you might have had idiosyncratic recoveries, which you also call out. We've called out – and we had a couple of those last year, particularly in the U.S. – and you don't plan for that, you don't sort of put in your business plan, I'm pretty sure, that this credit that we wrote down by $20 million four years ago is, in fact, going to show up in Q2 of this year. But it does, it just shows up. And you have a big, diversified business, and these things will come and go, as well they should, so I think that's generally the answer to your question. What we see is just a slight move up in the PCL trend overall. Assuming you neutralize for idiosyncratic ups and downs, you just see a slight move up, which, for us, by the way, that slight move up, for people who've followed us closely, is kind of from the mid to high teens. It's amazing that that's the case, but it's mid to high teens into the low to mid-20s.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Thinking about credit, we had a question earlier, which is: we're starting to see insolvencies rise in Canada, why is this not a concerning trend and why isn't this something that's got banks on high alert?

Darryl White – Bank of Montreal – CEO

I can't speak for everybody else, when you say banks, I'll speak for us, though. We are starting to see insolvencies increase. The headlines, I think, first of all, you have to be careful, because you see these massive percentage increases basically coming off something that's close to zero. So be careful with the baseline. No question, in the meantime, insolvencies increasing are a concern.

Speaking for our bank, remember, our Canadian consumer lending portfolio is less than 15% of the revenues of the bank, so we're underweight the Canadian consumer relative to others. If things were really bad, they'd be better on a relative basis for us. Doesn't mean I'm not concerned about it, I am concerned about it.

And I think that the last point I'd make is that it's really important when you look at the health of the Canadian consumer that you pay attention to both sides of the balance sheet. There's a little bit too much work out there, in my view, that talks about the consumer debt level that doesn't balance it out against the consumer, the household assets, the liquid assets that are held in houses and the investment portfolio of the average borrower in Canada. When we look at that put together, we can see a bit of a rising concern, but it's not nearly as acute as some of those headlines would lead you to believe, when you just look at big insolvency increases or you just look at debt levels, absent looking at the other side of the consumer balance sheet.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

And yet, all the same, we saw from Bank of Montreal throughout the year – not a massive change – but we saw you go a little more pessimistic on your reserves in Stage 1 and Stage 2, slightly more pessimistic scenario that we saw in the annual report. Can you talk to the level of reserves and, I guess the question that everybody is really interested in is, but are they sufficient and are you prepared for, and is the bank ready for, economic uncertainty that could evolve into a recession, and how should we think about how prepared and how reserved Bank of Montreal is?

Darryl White – Bank of Montreal – CEO

I'll give you the long view, then I'll give you the short view. The long view, when I look back, if you consider the Bank of Montreal's track record – and we have this chart in our investor presentation that goes back a couple of decades, that shows how we performed through cycles on losses, on performing losses – and we look at provisioning and then we look at actual losses, and we think we're pretty good at this, bluntly, relative to just about anybody. So, we come from a culture of conservatism that we build in, and we haven't just invented that in the last five years, it's been in the DNA for a very long time, and that's front line, second line as well.

When I look at the shorter run, if you look at the provisioning that we did through the course – I think the time period you're talking about is through 2019 – you do adjust your view of the economic cycle, you do adjust your view from time to time on the scenarios that you use on the performing. And when I look through it over the course of year, and then I look at the stack of our most direct competitors, there's not anything that I could see that doesn't tell me that we're not reserving at the conservative end relative to others. That doesn't mean, by the way, we're perfect and we're right. It just means we're reserving a little bit more conservative than the average of our peers. Depending on which metric you choose, I think you've done this analysis, too, we might be the most conservative or the second most conservative relative to the peer group.

And then, Darko, you have to kind of go down and spend time with sleeves rolled up and fingernails dirty, and talking to the people who are in the businesses and talking to the customers. In our case, I talked about underweight personal, overweight commercial. You go back to the commercial story and how healthy is the consumer and how healthy is the commercial borrower. And, as I said, the theme is general health. And so, I compare that to our level of relative conservative provisioning, and I come to the conclusion that it feels to me like we're in a pretty good spot.

And if we pop up with an idiosyncratic event at some point in the year, it'll really have nothing to do with anything I just said. Because your provisioning is an art and a science, you're effectively trying to forecast prudently the probability of every single credit in your book ending badly, and then you bring that forward on a fair value basis. And we do that, and we turn it over, and we test it, and we bring the committee back together and we test the models, and we bring the committee back together and we test the models, and then you come out with the provisioning that we've got. So, it's quite a rigorous and elaborate system. And then, as I said, I match that up with the anecdotal work that we do through the client base, and we get pretty comfortable with where we are.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

I want to ask a capital question here and there amongst all the Canadian banks. And so, I flipped a coin a couple of times outside, and your bank came up for the capital question, so you're going to get the question on capital.

I want set this up. So OSFI had created a domestic stability buffer, and it increased it three times in a row, at every opportunity that it could. When we started the journey, the banks generally were at a level. OSFI increased the domestic stability buffer three times and, today, the bank's capital ratio is actually lower from where we started that journey. So, the question is to you: I mean, is there an optimal capital common equity tier 1 ratio for you in 2020, irrespective of what's going on with the domestic stability buffer, or how should I think about that?

Darryl White – Bank of Montreal – CEO

I think the short answer to your question is you should think about it as somewhere right around where we are now. If there's a slowdown in the demand for commercial lending, for example, that I talked about earlier, then you're going to see us build capital and you're going to see by the end of the year that we'll have a higher capital ratio than we do right now. But if we ended the year where we are right now, that would be low relative to our peers, but it wouldn't be something that would be anywhere near the threshold on the domestic stability buffer, on the OSFI ratios, on the OSFI provision.

So I think the way you should think about it, as you look back over the course of the last year – here's an interesting – this is right at the heart of the capital allocation decision you make kind of every week, every quarter, every day, when you're trying to run businesses and maximize the value for the shareholders.

You asked me earlier about beating the market on growth in commercial lending, had we not done that – this is quite interesting – had we actually grown at the rate of the market in commercial lending in the United States and not increased relative to the market, our current CET1 ratio would be 30 basis points higher than it is today. So I sit there and I look back, I mean, is that a good trade? And I think, absolutely, it's a good trade. Because what we've done, as we've said, the best deployment of that capital is so that I can invest in existing clients and new clients where I'm going to have real relationships, within a risk appetite, that are going to continue to pay us for years to come, relative to hoarding the capital or buying back shares.

And so, I look at that and I say, we ended up where we are now at 11.4%, that's a pretty good place to be and, absent really aggressive balance sheet growth or M&A, that'll build at the end of the year, and if it doesn't, it'll be because we found more attractive deployment of capital opportunities. I think you also heard Tom say that, if it continues to build towards the end of the year, we could be back in the market buying back our shares, but we're not, in the meantime, given where we are.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

We're going to turn to the questions, the number one question from the floor is, restructuring charges are just a pull forward of expenses, why can't BMO not do this on a normal recurring basis, is growth focus overwhelming management focus on other operating fundamentals?

Darryl White – Bank of Montreal – CEO

This is important. I'm actually glad it's come up because it's important that we talk to shareholders clearly about this. We announced in our fourth quarter a sizable restructuring charge. We were very clear, I was very clear, that we do not intend to pull this lever again and the reason for that is because there's a lot different in what we're doing right now. If you look at prior restructuring charges, we have heard shareholders when they have said that there's restructuring fatigue with respect to the Bank of Montreal. We've heard you loud and clear on this. And we have said, at the same time, we need to do at this time, and we need to be clear with you that we're not going to need to do it again. And that is because, if you look fundamentally at where we are in our trajectory today, our expense growth in the fourth quarter of 2019 fiscal was less than 2%. And we're already on a trajectory that was very different from where we had been in the past, number one. Number two, we're driving very different accountability through, like if you think about working for an organization that has, I'll call it, a habit of going to the well on restructuring charges and then going back to that well, what you create is a management incentive to wait and not manage through all the way down through very specific LOBs, through the spine of an organization, and not manage through the discipline of annual, can you keep, Darko, your expense growth this year at 2% or 1%, at 3%? Well, I don't know, maybe yes, nobody knows, but if I go higher, I know that the gift is going to come along in a little while.

So, we said not just to shareholders but internally, this is very different this time. We're going to have rigorous business plans that people are going to be accountable for delivering, because you're not going to be able to use this technique. And we're using it for the last time because we actually have to eliminate real work in the meantime. So I could show you – you're out of time on the clock – but I could show you lots of examples of this current round, where it's delicate to talk about right now, I must admit, because we're right in the middle of executing it. You can imagine we just announced it a month ago. But there's some serious work going on to say, when we execute against this, because we've said 5% of our population, we have to make sure that 5% of the work goes away. In order for 5% of the work to go away, we have to make sure that when this box is eliminated on the chart, that it's absorbed by others, it doesn't just sit vacant for six months before we have somebody else come in and fill it, in which case we haven't satisfied our deal with our shareholders on the restructuring charge. And so, we're doing that through technology, we're doing that through rewiring the organization on the org chart, on work, on flow, and it's completely different from anything we've done in the past. And therefore, we don't think, as I've said pretty clearly, we're not going to need to do this again.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

Thank you very much for that. That sounded like a key message, but is there another key message, or two, that you want to leave with your shareholders?

Darryl White – Bank of Montreal – CEO

I think we talked about most of them. I'd be very brief on it, Darko, I would say – I go all the way back to where we started – I think that the relative momentum of what we've built for this bank. Two years ago, we talked about having increased our technology spend by 10% each year for the last three years. Now we feel really good on what we've been able to deliver digitally. We've got an offering in the U.S. where our digital bank is collecting deposits in all 50 states, we have been #1 in the App Store in Canada, top 10 in the App Store in the U.S., by the way, and so our digital platform is enabling everything I've just talked about. That's the only thing we didn't really touch on here, you and I, so I wanted to make sure I got that in at the end. But relative to our strategy, hasn't changed, but our operating agenda, all four businesses delivering with a balanced portfolio, we think we've got relative momentum that we haven't really had in quite a long time. So I feel quite optimistic about it, regardless of what the macro environment delivers for all of us.

Darko Mihelic – RBC Capital Markets, Research Division – Financials Analyst

With that, we'll leave it there. Thank you very much, Darryl, for participating.

Darryl White – Bank of Montreal – CEO

Thank you.
