BMO Financial Group

Q3 2007 CONFERENCE CALL

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PRESENTATION

Operator

Good afternoon and welcome to the BMO Financial Group's third-quarter 2007 conference call for Tuesday, August 28, 2007. Your host for today is Viki Lazaris, Senior Vice President, Investor Relations. Ms. Lazaris, please go ahead.

Viki Lazaris *- Bank of Montreal - IR*

Good afternoon, everyone, and thanks for joining us. Presenting today are Bill Downe, BMO's CEO; Karen Maidment, our Chief Financial and Administrative Officer; and Bob McGlashan, our Chief Risk Officer. The following members of the management team are also here this afternoon. Yvan Bourdeau from BMO Capital Markets; Gilles Ouellette from the Private Client Group; Frank Techar, Head of P&C Canada; Ellen Costello from P&C U.S., and Barry Gilmour, Head of Technology and Operations.

After the presentation, the management team will be available to answer questions from prequalified analysts. To give everyone an opportunity to participate, we ask that you please ask one or two questions, then requeue.

At this time, I would like to caution our listeners by stating the following on behalf of those speaking today. Forward-looking statements may be made during this call, and there are risks that actual results could differ materially from forecast, projection or conclusions in the forward-looking statements. Certain material factors and assumptions were applied in drawing the conclusions or making the forecast or projection in the forward-looking statements.

You may find additional information about such material factors and assumptions and the material factors that could cause actual results to so differ in our caution regarding forward-looking statements set forth in the news release or on our Investor Relations website. With that said, I will hand things over to Bill.

Bill Downe *- Bank of Montreal - President and CEO, BMO Financial Group*

Thank you, Viki, and good afternoon. I know it's a busy day, so we're going to move along quickly. As Viki just explained in detail, my comments may include forward-looking statements.

Q3 was a quarter in which we made material progress on a number of fronts. In each of our core businesses we advanced against our stated agenda. On a reported basis, we earned $660 million or $1.28 per share representing cash earnings per share of $1.30, and our return on equity was 18%. While we did record a loss in commodities, we have now reduced the size of our exposure to a manageable level.

Outside of our commodities business, which I will turn to shortly, we earned $757 million or $1.47 per share on a cash basis. In the other businesses, revenue grew by a solid 5.9% from a year ago, and net income rose by $47 million or 6.6%. On a year-to-date basis, excluding the losses and restructuring charge we announced in Q1, cash productivity has improved by 148 basis points.

These results demonstrate the momentum we are achieving in our core business, in P&C Canada, in P&C U.S., in BMO Capital Markets, and in the Private Client Group the emphasis on core growth and the needs of our customers are paying off in improved efficiency and higher net income.

The last quarter-end, the issues relating to commodities were clearly at the forefront. At that time, we anticipated it would take as long as a year to work the position down to a level consistent with the long-term business objectives. And we made considerable progress this quarter to reduce both the size and risk of our commodities portfolio.

About half of the trading losses related to a large block of proprietary positions that we eliminated by entering into offsetting contracts with a counterparty. The other half is largely attributable to other trading activities, including actions to manage and reduce the risk in the remainder of the portfolio.

We recorded a loss of $97 million after-tax or $0.19 per share, a cost that allowed us to accelerate the overall reduction of risk. We are now much closer to where we want to be in our natural gas business, consistent with serving our energy customers.

We have made further management changes, promoting Jeff Poulsen to Head of our Energy Trading Group. Jeff has been working with the group since the beginning on May in an effort to carry out risk reduction. At the same time, he has been leading our effort to enhance our front and back- office systems, and we have hired key personnel. We are confident that Jeff and his team have the ability to return the business to a positive revenue generator.

As well, our sales team in Calgary and Houston has done an outstanding job in supporting our clients and cementing the producer relationships that define BMO's leadership in this sector.

We continue to conduct the internal review of BMO's risk management practices, and expect this to be completed by the end of our fiscal year. That said, we have acted on information we have already brought forward. Further reductions to the portfolio will occur within the ongoing trading activity of the business over the next two quarters.

Before returning to the operating group highlights, let me say a few words on the recent uneasiness in the short-term commercial paper markets. This resulted in large part because of tight liquidity. I want to reiterate that BMO supports asset securitization as an efficient way to offer borrowers access to a reliable and liquid market, and provide investors an opportunity to diversify risk. We pioneered this business in Canada and are the leader in Canada's bank-sponsored programs for short-term commercial paper.

The conversion of bank-sponsored conduits to global style liquidity backup will provide a contractual confirmation to the support we have provided in this difficult period. The experience in subprime markets in the US has colored a much broader asset category, and many asset-backed securities that contain no subprime exposure are now trading below their intrinsic value. It is our view that the rebalancing of this market will take some time, but we are standing behind the liquidity lines we provided to BMO sponsored programs to ensure their efficient operation.

Conversion of these facilities to global style liquidity should promote a long-term stable framework for the Canadian market, and Bob will provide further details on our positions within this business.

There is no question that recent events have been challenging. But it should also be clear that BMO is taking deliberate competitive steps to move each of our businesses forward. P&C Canada delivered a record quarter generating earnings of $350 million, up 14% over a year ago, excluding the IPO gain related to MasterCard International recorded last year and recoveries of prior-year income taxes in both years.

Frank and his team have made extraordinary progress in executing against previously stated priorities. A highlight from P&C Canada this quarter was commercial banking, which is an area of focus for this management team and a business at which we excel. We saw continued strong revenue growth, and BMO's business banking market share increased strongly for the second quarter in a row, rising 56 basis points year-over-year.

In the US, P&C has posted three consecutive quarters of rising net income before acquisition integration costs. The environment since 2005 has been challenging, but we have turned a corner. While year-over-year earnings declined 17% in the quarter, we are now seeing the benefits of the expense reductions we undertook at the end of 2006. Loan and deposit volumes were up both year-over-year and relative to the second quarter. Margins were stable compared to last quarter, and we expect them to remain stable.

Harris made a strategic decision to not originate subprime mortgages during the housing market boom. We are positioned well in the current environment as we continue to lend with our traditional standards, and we are optimistic about our opportunities to grow share as we begin to see a recovering market.

In the quarter, we announced the acquisition of Ozaukee Bank and Merchants and Manufacturers Bank, which expands our network into Milwaukee and will increase our Midwest branch network by 20%. The Integration of First National Bank and Trust, which we completed earlier this quarter, demonstrated how we are able to make these additions to our network with minimal disruption to our customers.

Two years ago we had no presence in Indiana or Wisconsin. We now have 51 branches in Indiana and 40 full-service branches in Wisconsin when the transactions close.

Across our Private Client Group, we achieved strong net income levels not seen since we sold our US brokerage business in 2005. Year-over-year, net income increased 26% to $105 million, and cash productivity this quarter has improved 329 basis points over the prior period -- or over the prior year, rather.

We continue to introduce innovative products such as BMO LifeStage Plus Funds, and we are very proud that once again Euromoney Magazine has ranked Harris Private Bank among the top five US banks for locally-based wealth management services.

Finally, let me turn to BMO Capital Markets which reported net income of $196 million. Apart from the impact of the commodities losses, they had an exceptional quarter as earnings grew 45% from a year ago to $293 million. The growth in net income was driven by trading revenues, merger and acquisition fees, and debt underwriting.

We expect some headwinds in equity underwriting and M&A, given the current market conditions, while market volatility and wider spreads may benefit our trading operations in the corporate loan book. We will continue to build our business, especially in the US, where we expect to see wider margins in our solid midmarket business.

The overall picture here shows very encouraging performance in all our groups. The bank's capital position remains strong, and this morning we are pleased to declare a dividend of $0.70 a share, a $0.02 increase over last quarter. Our dividend increased 12.9% over the prior year, and our payout ratio was almost 48% for the last 12 months measured on a lag basis, near the midpoint of our target range.

Since we increased our payout range in the third quarter of 2006, dividends paid have increased by 28% per share. This results this quarters -- the results this quarter give us confidence in our ability to generate high-quality, sustainable earnings. With that, I will turn it over to Karen.

Karen Maidment *- Bank of Montreal - CFAO, BMO Financial Group*

Good afternoon, and thanks, Bill. As some of my comments may be forward-looking, I would also kindly draw your attention to the caution regarding forward-looking statements.

Third-quarter earnings were $660 million or $1.28 per share, down 7.2% year-over-year, which as Bill mentioned included the $97 million after-tax impact of commodity losses. Revenue growth was 0.2%, while expense growth was 3.6%. ROE was 18%, and we ended the quarter with a Tier 1 capital ratio of 9.29%.

Highlights of the quarter excluding the commodity losses are, earnings per share was $1.47, up 6.5%, driven by solid performance across the operating groups. Revenues grew 5.9% year-over-year. Expenses were well-managed, growing only 3.6%, resulting in operating leverage of 2.3%.

A 135 basis point year-over-year improvement in cash productivity brought the ratio below 60% to 59.7%. Net interest margins were down from a year ago, due primarily to growth of lower spread assets in BMO Capital Markets. However, on the retail side, margins in Canada are improving, and in the US, margins are stabilizing. Asset quality and credit risk management remain strong, which Bob will speak to later.

On slide 4, you can see that quarter-over-quarter, cash EPS is down $0.01 to $1.30. The two key drivers of the quarter-over-quarter change were the higher PCL and the lower tax rate. Additional days in the quarter and the strong revenue growth were offset by a lower contribution from the corporate services area.

On a year-over-year basis, despite higher provision for credit losses and commodities losses, there was strong operating growth across most business lines accounting for $0.18 a share.

Moving to slide 7, on a total revenue basis you can see that revenues were up 1.5% quarter-over-quarter or 0.6%, excluding the commodity losses in both quarters. On a quarter-over-quarter basis in P&C Canada, revenue growth was driven by volume growth in all of the personal, commercial and cards and payment services area. In our personal businesses, we saw volume growth in personal loans and branch-originated mortgages, higher securitization revenue and mortgage refinancing fees, as well as increased sales of term investment products and mutual funds.

Capital markets revenues increased across a number of segments, and while Q3 had three more days than Q2, we recorded a number of items last quarter that offset this benefit. Year-over-year, revenues were up 0.2%. However, excluding the impact of the losses, revenues were up by 5.9% with good growth across a number of areas.

In P&C Canada, volume growth across the business drove the revenue increase. Personal loans grew 11.6%, card balances grew 12.4%, and commercial loans and acceptances grew 7.7%.

Moving on more specifically to the components of revenue on slide 8, net interest income was $1.3 billion in Q3, which was up 2.7% year-over-year and 4.4% quarter-over-quarter. On this slide you can see that net interest margins were up in Canadian retail, both quarter-over-quarter and year-over-year, benefiting from a change in mix to higher spread assets.

In P&C U.S., volume growth has been offset by lower spreads due to competitive pressure. Our Canadian retail margin is increasing and our US retail margin has stabilized. While we are experiencing a decline in margins in BMO Capital Markets due to increased lower spread trading and lending assets, net interest income was flat quarter-over-quarter.

Looking at slide 9, reported noninterest revenue decreased $16 million quarter-over-quarter and $28 million year-over-year. If you exclude the commodity losses, noninterest revenue decreased $32 million quarter-over-quarter but increased $119 million year over year.

Quarter-over-quarter there were increases in mutual fund revenues, M&A fees, debt underwriting, which are included in the underwriting and advisory fee category in the chart, as well as lending fees which are included in other. Quarter-over-quarter securitization revenues, equity underwriting, securities gains, and insurance revenues decreased.

Specifically, on securitization revenues while the revenues were higher in P&C Canada, they were lower in corporate. This was largely attributable to higher interest rates reducing the value of mortgages securitized. We expect to earn back a portion of this revenue over time, as lower funding cost is used to support the growth.

Year-over-year, there was solid increase in securities commissions, mutual fund revenues, equity underwriting and M&A fees, as well as lending fees. These were in part offset by the gain on the MasterCard IPO which was recorded as a securities gain last year.

Turning to slide 10, you can see the expenses are being managed carefully with expenses up 2.8% or $45 million quarter-over-quarter, and 3.6% or $59 million year over year.

On slide 11, you can see that the increase in expenses year-over-year are primarily due to higher performance-based comp and computer costs, offset in part by lower capital tax expense in salaries and benefits. On a quarter-over-quarter basis, the increase in expenses was primarily due to higher performance-based comp, as BMO Capital Markets' non-commodities businesses are performing well.

We continue to make good progress on our initiatives to improve the efficiency and effectiveness in relation to the restructuring announcement made in Q1. The expected run rate savings of $300 million will assist our revenue growth and customer service initiatives.

To date, we have eliminated roughly 700 positions while adding to our customer-facing personnel. While there is some seasonality in our Q3 headcount numbers, on a normalized basis, headcount is down in corporate which includes Technology and Operations, and up in Canadian retail and capital markets.

As an example, in P&C Canada we have added to the sales force, including mortgage specialists and commercial banking account managers. We remain on track to achieve our objective by the end of the fiscal year. We have seen a small benefit from it this quarter as we progress against these initiatives. However, our expectation is that the majority of the benefit from these initiatives will be reinvested.

On slide 12, our Tier 1 capital ratio of 9.29% declined, primarily due to growth in risk-weighted assets. Risk-weighted assets in P&C Canada declined due to capital management activities. However, in BMO Capital Markets, risk-weighted assets are up as a result of growth in loans as well as higher market risk, due to the adoption of a more conservative translation of certain of our risk positions for regulatory capital purposes. This does not indicate a change in underlying business activities. Our total capital ratio of 11.18% and the bank's risk weighted assets of $181 billion in Q3 were up $6 billion over Q2.

Slide 14 shows our '07 targets, and as we said last quarter, it would be extremely challenging to achieve most of our annual targets based on the commodities losses. However, we will continue to monitor performance on a basis that excludes the impact of the losses to provide a checkpoint on the success of growing our business and meeting our strategic objectives.

On this basis, all financial targets would be on track. EPS growth would be 11.6%, ROE would be 19.8%, and the cash productivity ratio would have improved by 146 basis points.

With that, I will turn things over to Bob.

Bob McGlashan - ***Bank of Montreal - EVP and Chief Risk, BMO Financial Group***

Thanks, Karen. Good afternoon, everybody. Before I begin, I would like to draw your attention to the caution regarding forward-looking statements on slide 2. I will begin with an update on our commodities portfolio, followed by a review of US subprime residential mortgages and our participation in the asset-backed commercial paper market, and I will finish with a review of credit quality.

As Bill mentioned, we have made further progress in the quarter in reducing the size and risk of our commodities book. A large proprietary position has been neutralized that have been contributing significant P&L volatility at a cost that will not have to be incurred again. And near-term seasonality risk has been reduced to a manageable level.

The stated time decay associated with amortization of option cost has been reduced to very low levels and well within our target limit. And VAR, as shown on slide 3, has declined significantly from a Q2 quarterly average of $7.5 million to a Q3 quarterly average of $4.7 million. VAR on July 31st was $3.3 million and within our target limit.

As well, stress loss was reduced by two-thirds, and reduction in the aggregate size of the book continues, evidenced by a 50% reduction in fair value, 17% reduction in monthly notional outstanding on slide 4, and on slide 5, a reduction of 12% in net open interest contracts during the quarter.

As mentioned during our presentation last quarter, we increased the number of risk measures with limits for our commodities book from 11 to 18. Step-down and target limits were established for each measure, and we were on track with several of the measures already within target. We expect to accomplish the balance of the risk reduction in this book over the next six months through the ongoing trading activity of the business, as we continue to reduce the aggregate size of the book and reduce exposure to future seasonal periods.

Turning to current market concerns, as you can see on slide 6, the bank as no material exposure to US subprime mortgages, and neither BMO nor any of its subsidiaries originates subprime mortgages. There is a small book of business at Harris that meets the technical definition of subprime, in that credit scores are less than 620.

However, typically this business is down with low loan to values or with a strong guarantor, and does not carry the risk associated with a subprime mortgage. Our commercial paper liquidity lines for BMO sponsored asset-backed programs are C$26.4 billion and US$11.4 billion. The underlying assets within these programs are of high quality, and all of the programs remain investment-grade rated.

Nominal exposure to US subprime residential mortgages within these programs is held in the form of a warehouse facility provided for the purchase at a discount of defaulted mortgages, some of which are subprime. The discount, however, insures good underlying asset coverage and a 60% loan-to-value range. We did not provide liquidity backup facilities to nonbank sponsored asset-backed programs in Canada.

The US $1.1 billion liquidity backup facilities provided to third-party conduits in the US has no US subprime exposure. None have been downgraded. All are investment-grade and performing as expected.

Within the bonds backed by the CDO and residential mortgage-backed securities investments we hold in our trading book, there is no significant direct exposure to US subprime mortgage assets. The bank is holding a small amount of commercial paper in third-party asset-backed programs. These assets are being monitored closely in light of the current market conditions, and none of the Canadian money market funds offered by BMO Mutual Funds and GGOF Guardian Group of Funds have exposures in their portfolios to asset-backed commercial paper issued by nonbank sponsored conduits.

Our LBO exposure transactions within our underwriting book is less than $450 million, and to date these transactions are being sold down as expected. We continue our measured approach with respect to the hedge fund sector. And as indicated on slide 7, advances to hedge funds are modest at $205 million, and predominately for treasury and foreign exchange trading.

Advances to fund the funds are provided predominately for short-term working capital needs. As investors and portfolios of hedge funds, they are not subject to margin or capital calls from the same way hedge funds may be, as a result of mark-to-market of their portfolios. As such, illiquidity has had no material effect on them.

Our hedge fund and fund of funds portfolio is well diversified with no concentration in any strategy, and prime brokerage accounts are well-collateralized.

As you can see on slide 8, BMO's credit quality remains strong. Although quarter-over-quarter PCL has increased by 54%, PCL levels remain low. Slide 9 shows an increase in US consumer delinquencies, however, delinquencies are still low and the portfolio is sound.

Slide 10 shows exposure to the auto industry remains modest and continues to perform well. On slide 11, the provision for credit losses was $91 million, up $49 million from a year ago, and up $32 million from the second quarter. The increase was driven by higher volumes as well as lower reversals and recoveries particularly relative to the prior year. Higher specific provisions were in part attributable to a loss in our Canadian mortgage business, unrelated to subprime mortgages.

On slide 12, new specific provisions have increased, however, allowing for the unusual residential mortgage loss, remain in line with our prior eight quarter's experience.

On slide 13 on a comparative basis, Q3 specific PCL represents 18 basis points of average net loans and acceptances including reverse repos or 15 basis points excluding the unusual loss in our mortgage portfolio. Specific PCL remains low compared to our 15-year average of 34 basis points and the Canadian peer group average of 56 basis points for the same period.

As seen on slide 14, both GIL formations and gross impaired loan balances remain at historical lows. As shown on slide 15, we continue to anticipate that specific provisions in fiscal 2007 will be $300 million or less representing 14 basis points of average net loans and acceptances. This is down from our 2007 target of $400 million or less that was established at the beginning of the year. We expect the credit environment to remain somewhat volatile over the balance of fiscal 2007, however, the silver lining is a return to more normal deal structures and pricing more in line with the underlying risk.

Slide 16 shows our trading and underwriting portfolio excluding commodities remained relatively stable and profitable during the quarter. The largest daily P&L gains for the quarter were $33.8 million on June 29, consisting mainly of underwriting fees in addition to normal trading profits and $46.6 million on July 31, consisting mainly of hold back reversals due to widening credit spreads and profit on liquidation of a warrant position in addition to normal trading profits.

With that, I will turn it back to the operator to take questions.

QUESTION AND ANSWER

Operator

Thank you. We will now take questions from the telephone lines. (OPERATOR INSTRUCTIONS) Andre Hardy, RBC Capital Markets.

Andre Hardy - ***RBC Capital Markets - Analyst***

Thanks, a quick one for Bob to start and another one for Yvan. So Bob, I understand that in the Canadian asset-backed commercial paper market, these third parties were often selling CDOs or CDS. And other organizations would be buying those credit default swaps. Is there counterparty risk there with BMO?

Bob McGlashan - ***Bank of Montreal - EVP and Chief Risk, BMO Financial Group***

Sorry, is there counterparty risk with who?

Andre Hardy - ***RBC Capital Markets - Analyst***

With some of the conduits that may have written credit default swaps?

Bob McGlashan - ***Bank of Montreal - EVP and Chief Risk, BMO Financial Group***

No material counterparty risk that I am aware of with respect to those conduits.

Andre Hardy - ***RBC Capital Markets - Analyst***

Thank you, and Yvan, it was very impressive trading performance in July considering everything that happened. Interest rate trading revenue benefiting from steeper yield curve, widening spreads and increased volatility. Would things be any different in August? Did you take some bets off the table or directionally you are still positioned that way?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

So you're absolutely right, as to the elements that contributed to our profitability emanating out of our interest rate trading in the third quarter, particularly toward the latter end of the quarter. Looking into Q4, I think as Bill has indicated, there is definitely some headwinds that we are faced with. There is no question that there is turbulence in the financial markets and also there is some clouds on the horizon with regard to potential credit crunch that may appear in the US, particularly and this may become more evident in other regions around the world.

So given all of that context, I think it is fair to say that the trading opportunities were not as conducive during the month of August as they were toward the latter part of Q3. As to whether or not this will continue in September and October is still a question mark. And it is difficult to say at this point in time. We did see some improvement since the beginning of last week in terms of the market stabilizing both in Europe as well as North America. And this trend has been gradually improving as we move along.

But as you know, the market is still nervous and there is still some reluctance on the part of some institutional investors, so I think the next couple of weeks will be very important as we move out of the summer holidays and we see institutional investors returning full swing in the US and Canada and Europe and then take the temperature at that point in time to answer maybe more specifically to your question.

Andre Hardy - ***RBC Capital Markets - Analyst***

That's helpful. Thank you.

Operator

Ian de Verteuil, BMO Capital Markets.

Ian de Verteuil - ***BMO Capital Markets - Analyst***

Karen, you said that the growth in the market risk assets was due to the adoption of more conservative translation of risk positions as opposed to incremental risk. Has OSFI rejected some of your models that previously they had approved?

Karen Maidment - ***Bank of Montreal - CFAO, BMO Financial Group***

Ian, I couldn't comment on any specific discussions with OSFI. But as I indicated, we didn't have any change in underlying business activities, we have just taken a more conservative approach for the time being.

Ian de Verteuil - ***BMO Capital Markets - Analyst***

So -- and I appreciate the sensitivity here. But the normal cause is the banks have model approved, or they go through the entire business, they use a standardized approach, eventually you develop models and you have those improved. I have just never seen an environment where models have been removed. Is it anything on the rating agency side? I mean I know the rating agencies have expressed --?

Karen Maidment - ***Bank of Montreal - CFAO, BMO Financial Group***

No, Ian, nothing there.

Ian de Verteuil - ***BMO Capital Markets - Analyst***

Okay.

Operator

Jim Bantis, Credit Suisse.

Jim Bantis - ***Credit Suisse - Analyst***

Hi, good afternoon. Just some smaller questions. When looking at the higher PCL's that came from Canadian residential mortgage, it seems unusual given the strength of the marketplace. Maybe, Bob, you could just elaborate a little bit more on what that was and why it is maybe just a hiccup as opposed to a trend?

And secondly, a question, still staying in retail, for Frank, good rebound in terms of personal lending market share, still more work to do on the deposit side. And the reason I ask about the deposit market share, you're seeing another bank, TD make a dramatic move in terms of increasing its branch hours. How do you interact with that type of movement in the marketplace with respect to trying to rebound in terms of deposit market share? Thanks.

Bob McGlashan - ***Bank of Montreal - EVP and Chief Risk, BMO Financial Group***

Thanks, Jim. It's Bob. I will tackle the first question first. Some things I can tell you and some things I can't here. So what I can tell you is that it is in the prime mortgage book. It has got nothing to do with any aspect of subprime or serious other market concerns. I can tell you that it has nothing to do with any systemic issue within our mortgage handling and it has nothing to do with any market related issues.

Having said that, it is an isolated situation that is under investigation and I really can't provide any further comment on that.

Jim Bantis - ***Credit Suisse - Analyst***

Thanks, Bob.

Operator

Darko Mihelic, CIBC World Markets.

Darko Mihelic - ***CIBC World Markets - Analyst***

Hi, actually I thought we were going to listen to the second half of the answer to Jim Bantis' second question.

Frank Techar - ***Bank of Montreal - President and CEO, Personal and Commercial***

It's Frank, sorry, I got cut off prematurely there. Relative to deposits and our position relative to the competition, obviously from the share trends that you see, we are not satisfied. We did one major market initiative during the quarter. We changed our air miles offer connecting it to our debit card and what I can tell you is at this point in time, the results from that program are really encouraging.

There is no doubt that we are opening more checking accounts, we are acquiring more everyday banking customers and to give you an example, prior to our launch in the first week in June, our year-over-year growth in everyday banking accounts was on the order of 14%. For the month of July, that was up at 25%. So no doubt our initiative is having an impact. No doubt we are starting to gain deposit account customers.

Specifically relative to TD and their hours initiative, we are still standing by. Our strategy which is we are leaving our hours up to our local market leaders. And they will address the hours and the staffing levels accordingly depending upon how they see the competitive environment unfold around them.

So net net, we think we have an opportunity given our capabilities to compete in a different way. We are starting to see improvement relative to deposit customers, and we are going to continue on that front going forward.

Darko Mihelic - ***CIBC World Markets - Analyst***

I wonder if I am still on. Can you hear me?

Frank Techar - ***Bank of Montreal - President and CEO, Personal and Commercial***

Yes.

Darko Mihelic - ***CIBC World Markets - Analyst***

Okay, thanks. I guess I will ask my question now. A question for Bob. With respect to the current concerns in the marketplace, the next sort of hot potato is the SIVs and I know that BMO manages a rather large one. The disclosure in the annual report seems to suggest that your exposure is rather small. I wonder if that is embedded in on page 6 of your presentation, and I wonder if BMO would consider actually increasing its support for the SIV should it have trouble funding itself in the commercial paper market?

Bill Downe - ***Bank of Montreal - President and CEO, BMO Financial Group***

Darko, it's Bill. I'm going to have to pass this question to Yvan. He can expand a little bit on the SIV itself and answer your question.

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

The first thing that I would like to mention because there has been some press release and also a few headlines that have hit the market today and they relate to SIV-Lite, and I just wanted to make sure that they understand that we are actually not involved at all in so-called SIV-Lite. My understanding of the definition of that type of vehicle is that they actually purchased high yielding assets and they would apply leverage against it and they would fund themselves solely in a very short-term as opposed to protecting their liquidity risk by issuing a medium-term to long-term liability.

And as well, the last characteristic is that they were not in additional to the capital base that they have. They would not maintain any kind of a further capital cushion in their SIVs to protect themselves against mark-to-market swings. So having said the characteristic of those SIVs, I just want to reiterate that we have none of those. We have two vehicles that are located in London, England. One is called [Links], has been established for many years now. It has US$23.1 billion in assets, and it is leveraged slightly above 10 to 1.

Some of the characteristics of that vehicle is the assets, the individual assets are actually rated by both S&P and Moody's and just to give you an idea of the profile of those assets, I'll use S&P ratings. 88% of the assets are rated AA or better and the remainder are all investment-grade As or above at 12%. So 100% of the vehicle is actually rated A or above.

In terms of Parkland, we have, which is the second vehicle that we have there, is a more recent one, is denominated in euros. It has -- it has -- I am just looking to make sure, an outstanding of 3.6 billion in euros and the risk profile again rated by S&P and Moody's would be very similar profile.

One more additional information that I am sure is topical these days as to whether or not they have any US subprime residential mortgage exposure. In the case of Parkland I can say that they have no direct exposure to the US subprime and in the case of Links, out of the $23.1 billion, their exposure is actually $4.5 million, which is .02 of one percent exposure. So as you can see, we can see in effect, hardly any exposure.

In terms of the liquidity associated with those vehicles at this point in time, they are funding themselves, and we are not at this point in time contemplating in providing them with additional liquidity. Obviously, we are following the market condition in Europe as well as in North America, and if indeed they were to experience some difficulties, at that point in time, we may or may not consider whether or not to provide them with liquidities. Does that answer your question?

Darko Mihelic - ***CIBC World Markets - Analyst***

That gives me a lot of detail to work with. I appreciate that very much. Just one last question if I may on that same topic. It is a pool that sounds like close to -- let's call it almost [C$30] billion. What kind of spread do you actually earn as a manager of those assets? Is this a high return business for you?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

At this point in time, we are actually very proud of the fact that we can say that actually the spread that we are earning on the business has been decreasing for the last 12 months. And this was deliberate on our part because we felt -- uneasy with the credit tightening that was taking place and also with some of the other vehicles that are being actually some other activities in the marketplace. And we felt there would be an opportunity at one point in time for us to take advantage of our lower leverage and also the quality of our assets.

And because of that, we are not earning as much as we used to two or three years ago. But as I said, that was deliberate on our part.

Darko Mihelic - ***CIBC World Markets - Analyst***

Great, thanks very much.

Operator

Sumit Malhotra, Merrill Lynch.

Sumit Malhotra - ***Merrill Lynch - Analyst***

Good afternoon. The first question is for Frank. Frank, it sounds like a lot of the expense savings that Karen has talked about both this quarter and last quarter are going to be running through your business and some very solid operating leverage that we see come through P&C Canada. At the same time in answer to one of the questions, you said there's a few campaigns ongoing. We heard about the air miles deposit situation and the marketing you have been doing in that regard.

What in your view is a normalized expense run rate we should look at for this segment considering you still have some initiatives on both the deposit side and I am guessing the mortgage side as we head into 2008 that you want to run with?

Nice performance this quarter, but is there a run rate that you have in mind that we should look at as reasonable for P&C Canada?

Frank Techar - ***Bank of Montreal - President and CEO, Personal and Commercial***

Yes, I would echo your comments, we are real happy with this quarter but I think the level is unsustainable. And in fact, if you go back over prior years, Q4 usually is one of those quarters where our initiatives do tend to pick up a bit so we do have some work in the hopper we are trying to compete and we are trying to grow in line with our strategy. So my expectation is that we will see expenses tick up a bit.

And the savings from the restructuring are definitely going to help us manage over the coming quarters, manage that expense increase. So it is working and we are encouraged by it. But I would expect to see expenses tick up a bit, but our plan really is to manage the revenue and expense ratio at an appropriate level and 3% is what we are shooting for to manage that operating leverage number. So that is really what we are trying to hold our expenses to dependent upon our revenue outlook for the coming quarters.

Sumit Malhotra - ***Merrill Lynch - Analyst***

Managing that leverage sounds familiar to some of your larger peers as well. Just last one for me on the corporate spread side, BMO obviously has always been open about the fact that midmarket commercial in the US is an area where they have some success. And we have certainly seen the loans grow there pretty aggressively over the last couple of years.

Yvan, you mentioned that -- I think it was you that mentioned that as spreads start to widen here assuming that your credit quality, you are still very happy with that. This is an opportunity for you to get some natural growth in the net interest income number. It doesn't look like we saw too much of that in Q3. Is that something that is going to be more evident to us as we move forward in this new environment for credit?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

I think my assessment would he that in Q3, in fact, the spreads were remaining relatively flat. They may have improved by a few basis points, but not more than that. I think the phenomenon that we are experiencing at the beginning of Q4, though, are quite different in nature, and in my opinion, will probably lead towards wider spreads in the corporate world in the United States and in potentially here in Canada. And that is the, I think, the historical trend that we are seen developing here, where some of the participants in providing credits in the marketplace are becoming more cautious and more conservative and therefore, there is a reduction in supply of credit that is taking place.

And whenever that happens, two things are directly the result from that, is spreads are normally start to widen and in fact, during the month of August, we can see a trend towards that, especially we can see that as were negotiating some of our loan underwriting that are taking place. And also as you can imagine, the same thing applies in terms of the structure of those facilities and those structures are now, I would say, better structures, they are better structured than they were a few months ago.

And both of these developments are actually positive for us. As usual, it takes time for a book of our size to reprice itself. But I think if you look at the trend, and I'm guessing that the trend will continue to improve as we move along towards 2008, that could be a positive factor that will probably counterpoint some of the headwinds that some of our trading activities may be confronted with.

So that is point number one that I would like to mention.

The second one is as you have noticed, the growth in our asset has continued to grow and I would just give you as I do normally each quarter some figure that illustrates this and this would be for our US portfolio and it will be in US equivalents here. And the first thing I will mention is if I compare at the end of July versus last year, the outstanding have increased by $4.5 billion and that represents 33% increase year over year.

And if you compare the -- as at the end of July versus the end of August, at the end of April, sorry, the outstanding have increased by still 1.2 billion and I would say for that quarter-over-quarter, an increase of 7%. But that once again illustrates the strategic plan that we put in place to try to continue to penetrate particularly the midmarket in the US and we have been building momentum in that regard.

And I would just wrap up in my comments, and Bob may want to comment on this, to add some comments, the fact that as you said earlier, our portfolio we're still very high-quality and despite some of the difficulties that the market has been experiencing in the last several months, I would say that the quality of the portfolio has not worsened, and therefore, I am quite confident looking forward.

Sumit Malhotra - ***Merrill Lynch - Analyst***

So short term is not unreasonable to expect better net interest margin performance from US IBG and not necessarily a corresponding uptick in provisioning or gross impairments? That is what I take away from that? Is that fair?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

Yes and the other point that I would also emphasize is what Karen mentioned in the case of IBG particularly, you probably saw on page 10 that our margin has remained relatively stable around 61 basis points and the reason for that is even though the corporate loan margins have increased, on the weighted average basis, we have increased, there is proportionally a greater pace our so-called trading assets which carry with them a much lower margin. So that is masking the fact that terms and conditions are improving in the corporate world.

Sumit Malhotra - ***Merrill Lynch - Analyst***

Okay, thanks guys.

Operator

Mario Mendonca, Genuity Capital Markets.

Mario Mendonca - ***Genuity Capital Markets - Analyst***

Good afternoon. I want to follow up on a question Andre had. I think the question was did the bank take a little bit off the table, a little risk off the table at the end of the quarter? I want to see if things sort of tie-in with my thinking? The excess of liabilities over assets in the US going back to that 14.8 billion or so, 14.6 billion. That is on a zero to three month's bucket, essentially evaporated this quarter. It is down to 1.5 billion. And your sensitivity to changes in interest rates has declined dramatically from last quarter as well.

Is this a reflection of the steeper yield curve, BMO essentially taking advantage of that and that is why we saw the great trading numbers, the fixed-income trading numbers and essentially on a go-forward basis that element of the trade is now gone? Am I putting the pieces together correctly, Yvan?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

The answer is yes. During the third quarter, we saw an inflationary risks were being talked about on a much greater extent and we took advantage of the position that we had in place. We reduced our risk and it shows into the result of our interest rate trading that you saw. But on the same token, there has been a wild swing since the end of the third quarter because if you remember at one point in time during Q3, the 10-year U.S. Treasury went as high as 535 and its trading now approximately 460.

So -- and that is basically because of flight to quality. So it will be interesting to see what happens in the coming weeks as we head towards a September 21 when the Fed is meeting again and what will take place between then and between now and then. And we may have again opportunities to because of a client volume and also because of the volatility that will probably continue to exist be able to create some situation where we are going to be able to take advantage of it and our trading desk actually doing reasonably well.

So I would say yes, your analysis is good for Q3. I still have -- my comments are in Q4, it is a different environment, and we still have to see how this is going to play out.

Mario Mendonca - ***Genuity Capital Markets - Analyst***

I see your point, though. I am looking at it at a point in time and the bank may have repositioned themselves days after that supplement was presented anyway?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

That is correct.

Mario Mendonca - ***Genuity Capital Markets - Analyst***

Okay, I follow you. The sort of the second question goes back to the commodity losses and I think you gave us more than sufficient heads up, Bill, that there could be other losses as the bank exited the business. Maybe not exited but you also said that you are continuing to service your clients and what is catching me off guard here is when you remove the trading losses that you are referring to this quarter from the commodity trading earnings, the commodity trading revenue, you essentially get to zero, and that has been true for the last three quarters.

So what I am having trouble following is if you are servicing these clients, where is the revenue associated with that in your commodity -- your commodity trading revenue? Why is it zero essentially?

Bill Downe - ***Bank of Montreal - President and CEO, BMO Financial Group***

Well, it nets and we are continuing to generate trades with producers in the marketplace and obviously, we are reducing the book at the same time. Every time we serve a customer, it results in a net addition to the book. And so it is a constant turnover in the book and I think that the comments I made about risk reduction I would say that at the end of the last quarter, we were looking forward 9 to 12 months for the reduction of risk and in the last 90 days, we really did have opportunities, because of market availability to reduce the book.

And so, what I said about the natural core business and the team that we have in place is that we are looking forward to them generating positive trading revenue as we have -- as we reduce the remaining surplus risk. And Yvan, I don't if you want to elaborate further on that?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

The only point that I would add is as you probably know during the summer months, the price of gas has been relatively low from the recent quarters that we've experienced and when that happens normally you would have a significant reduction in client's activities. So that is another contributing factor.

Mario Mendonca - ***Genuity Capital Markets - Analyst***

But what I am having trouble understanding is we all dutifully ignore things like these significant trading losses and the market is doing it as well, taking up 149 million. The challenge I'm having is that there is a core business here that is ongoing and are we also stripping that out when we are taking out the 149 million?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

So the answer is no, in the sense that we continue to trade and to service our clients. As you know, the global resources sectors is one area where BMO Capital Markets is truly a top franchise in that -- in those sectors and therefore, we feel that providing our clients with the products that our commodity desk offers is complementary to all of the other advisory service and other products that we offer to them. And we intend to continue to offer that to those clients.

And in addition to that, there is no question on our mind by doing so that we should be able to make some money and contribute positively to the bottom line of BMO Capital Markets.

Mario Mendonca - ***Genuity Capital Markets - Analyst***

Did it make a contribution -- a positive contribution this quarter? The ongoing business?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

It was basically flattish, I would say.

Mario Mendonca - ***Genuity Capital Markets - Analyst***

As in zero?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

Just because of the lack of client activity.

Mario Mendonca - ***Genuity Capital Markets - Analyst***

So zero this quarter?

Bill Downe - ***Bank of Montreal - President and CEO, BMO Financial Group***

Mario, for approximation purposes, you are probably close enough. At natural gas prices where we have seen them, the motivation for producers to hedge their production is not very high. As you see moving into the fall season, I think this is what Yvan was saying, is they move into the fall season and you see higher prices or more price volatility that is when we see the natural hedging activity of our producing clients.

Mario Mendonca - ***Genuity Capital Markets - Analyst***

Thanks.

Operator

Michael Goldberg, Desjardins Securities.

Michael Goldberg - ***Desjardins Securities - Analyst***

Thanks. I wonder if you could give us a little more color on what accounts for the low effective tax rate in the third quarter? Specifically how much was due to the favorable resolution of taxes or other items that are sort of abnormal and should we expect that in the fourth quarter and in 2008, that you will be more inside the 25% to 28% range that you talk about as being normal?

Karen Maidment - ***Bank of Montreal - CFAO, BMO Financial Group***

Sure, Michael. The effective tax rate was 21% this quarter. But if you took out the commodities loss, it was 23.1%. So the difference between that and our sustainable rate of 25 to 28 really relates to mix of business as well as settling outstanding matters.

Michael Goldberg - ***Desjardins Securities - Analyst***

How much was the favorable resolution of taxes this quarter?

Karen Maidment - ***Bank of Montreal - CFAO, BMO Financial Group***

We don't specifically disclose those, but we did show you that in the P&C Canada, there was a tax reserve release in their numbers of $16 million. But I think the sustainable rate of 25 to 28 still is appropriate for the longer-term, but for the balance of this year, we'll be likely underneath it.

Michael Goldberg *- Desjardins Securities - Analyst*

You will be underneath it on a like on a full year basis or in the fourth quarter and what about through 2008?

Karen Maidment *- Bank of Montreal - CFAO, BMO Financial Group*

You know, it is too early to predict for 2008. Again, it really depends on where the earnings are generated, but I think that the trend if you look at the second quarter was 23, the third quarter, excluding the commodities was 23. So that is sort of the ballpark we are in right now in the lower end of our range, or just below it.

Michael Goldberg *- Desjardins Securities - Analyst*

Okay. I have one other question for Bill. You know, there is a lot of uncertainties that are out there right now, and Yvan has talked about some of the headwinds that capital markets could be facing. Could you give us some of the thinking that went into the decision to increase the dividend?

Bill Downe *- Bank of Montreal - President and CEO, BMO Financial Group*

Michael, that is a pretty simple answer. The core businesses all have very well-established programs that they are working on to grow their revenue and grow their net income. And as I said in my comments at the outset, all of them are making progress. So the dividend increases that you have seen in the last 18 months and the dividend increase today are a reflection of confidence that we have in the core earning power of the company.

Michael Goldberg *- Desjardins Securities - Analyst*

Thanks.

Operator

John Aiken, Dundee Securities.

John Aiken *- Dundee Securities - Analyst*

Good afternoon. I know what it's rather early days but are you seeing any disruption in the Chicago land market relating to what is happening with LaSalle?

Ellen Costello *- Bank of Montreal – CEO, Harris Bankcorp*

Early days -- it is still pretty early days, John. I think what we will start to see is once the deal is closed in the fourth quarter, and BofA starts to undertake some integration activities in some steps they are planning around job layoffs and changes, that we will start to see some disruption. We have already seen some customers concerned and have been talking to them about that and there is some interest by some employees who aren't certain of their future as to what that might play for them. So those are there, but I wouldn't say that anything will come of it until you get into the first quarter of next year.

John Aiken *- Dundee Securities - Analyst*

That's great. Karen, in terms of expense reductions coming through from the restructuring, are you happy with where you stand right now? Are there any milestones that we as external observers might be able to take a look at to see how successful you have been?

Karen Maidment *- Bank of Montreal - CFAO, BMO Financial Group*

We are very happy because we are on track with the program that we have outlined. It is very difficult to see the milestone specifically, but if you look at some of the businesses where we are investing, like P&C Canada, we're hoping this translates into opportunities for revenue growth, because we are funding -- we are helping to fund strategic initiatives to drive revenue growth while still achieving our targets.

That is really the way we are looking at it and the operating leverage that Frank spoke about is really the result of it. So we are on track. We will be able to give an update at the end of the year, where we stand on our restructuring charge, but it is moving well ahead. You would see the corporate costs were down in the corporate segment and they get allocated out to the lines of business, and again, that is another small piece of evidence of the progress.

John Aiken - ***Dundee Securities - Analyst***

Great. Thanks, Karen. I look forward to the update.

Operator

Brad Smith, Blackmont Capital.

Brad Smith - ***Blackmont Capital - Analyst***

Thanks very much. I just wanted to circle back on the commodities trading losses. I note that the unwinding process will go for another couple of quarters. I was just wondering at the beginning of the call, there was some comment about the cost of dealing with the proprietary position and I'm wondering am I to interpret that that in your view the risk of additional losses coming out of that unwinding is going down at this point in time?

Bill Downe - ***Bank of Montreal – President and CEO, BMO Financial Group***

Yes. Yes, that is correct.

Brad Smith - ***Blackmont Capital - Analyst***

Okay, so we should not be anticipating further losses then?

Bill Downe - ***Bank of Montreal - President and CEO, BMO Financial Group***

Well, in any trading business, you have to recognize that in a single period there could be trading losses. I think the point that we made is that we are well ahead of where we thought we would be and that with respect to about half of the loss that was the onetime elimination of a large proprietary position and we are not -- we don't have another position that we would seek to eliminate in the same way.

Brad Smith - ***Blackmont Capital - Analyst***

So one-half of the 149 was related to that large proprietary position?

Bill Downe - ***Bank of Montreal - President and CEO, BMO Financial Group***

That's correct.

Brad Smith - ***Blackmont Capital - Analyst***

Okay, great. Thank you.

Bill Downe - ***Bank of Montreal - President and CEO, BMO Financial Group***

You're welcome

Operator

Ian de Verteuil, BMO Capital Markets.

Ian de Verteuil - ***BMO Capital Markets - Analyst***

Yvan, just to follow up on the question of the SIV's. So as I read the annual report, the bank has no -- does not provide liquidity backup to the SIV's beyond the 184 million that you had as of October? And am I right that you have no commitment in the event of the SIV's not performing to top up in any way?

Yvan Bourdeau - ***Bank of Montreal - CEO, BMO Capital Markets***

That is correct.

Ian de Verteuil - ***BMO Capital Markets - Analyst***

Thank you.

Operator

Thank you. There are no further questions registered at this time. I would now like to return the meeting back over to Ms. Lazaris.

Viki Lazaris - ***Bank of Montreal - IR***

Great, thank you, operator. I just want to thank everyone for joining us today and if you have any further questions, please call the investor relations group. Thanks and have a great day.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time. We thank you for your participation and have a great day.