BMO Financial Group

Q3 2016 CONFERENCE CALL

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AUGUST 23, 2016 - Q3 2016 Bank of Montreal Earnings Call

PRESENTATION

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

Thank you. Good afternoon, everyone. Thanks for joining us today.

Our agenda for today's investor presentation is as follows. We will begin the call with remarks from Bill Downe, BMO's CEO; followed by presentations from Tom Flynn, the Bank's Chief Financial Officer, and Surjit Rajpal, our Chief Risk Officer. After their presentations we will have a short question-and-answer period where we will take questions from pre-qualified analysts.

Frank Techar, Chief Operating Officer; Cam Fowler, from Canadian P&C; Dave Casper, from U.S. P&C; Darryl White, from BMO Capital Markets; and Gilles Ouellette, from Wealth Management, are here with us this afternoon to take questions.

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

Management assesses performance on a reported and adjusted basis and considers those to be useful in assessing underlying business performance. Bill and Tom will be referring to adjusted results in their remarks, unless otherwise noted. Additional information on adjusting items, the Bank's reported results, and factors and assumptions related to forward-looking information can be found in our Annual Report and our first quarter report to shareholders.

With that said, I will hand things over to Bill.

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

Thank you, Jill, and welcome to everyone joining us on the call. Results were strong this quarter, with net income[1] of $1.3 billion, up 5% from last year and earnings per share[1] of $1.94, up 4%. Pre-provision pre-tax earnings[1] increased 14%. Operating leverage[1] was 3.8%, positive in each of our groups, and the efficiency ratio[1] improved to 61.2%. Provisions for loan losses were up this quarter, in line with our expectations.

This performance reflects continued operating discipline and execution against our commitment to customer experience. We continue to demonstrate sustained momentum in an environment of low interest rates and moderate economic growth. EPS[1] is up 6% on a year-to-date basis, earning through our loan loss provisions that increased from historic lows.

Overall credit quality remains good and Surjit will provide more detail in his remarks. Our CET1 ratio was strong at 10.5%; ROE[1] was 13.5%, both up from the prior quarter, reflecting growth in earnings.

I'll touch on a few highlights from the operating groups.

Combined Personal & Commercial banking delivered net income[1] of $851 million, up 7% from last year.

In Canadian Personal & Commercial Banking, pre-provision pre-tax earnings[1] growth continues to be good, up 6% this quarter and year to date. Operating leverage was positive for the fourth consecutive quarter, driven by consistent revenue growth and disciplined expense management. The efficiency ratio was below 50% on a year-to-date basis.

Canadian P&C is seeing results from ongoing investment in digital capabilities that matter to our customers. In our Personal business, customers are now able to open a deposit account in minutes, using their smartphone; notably this service is the first of its kind from a major Canadian financial institution. In our Commercial business, customers continue to expand their use of DepositEdge, with roughly a million cheques processed each month. This innovative and time-saving solution allows customers to securely image and deposit cheques directly to their account without having to go to a branch. These are both examples of how we're investing in digital solutions which empower our customers and improve efficiency.

1 On a reported basis: Net Income: $1.2 billion, up 4% Y/Y; EPS: $1.86, up 3% Y/Y; PPPT up 13% Y/Y; Operating Leverage: 3.2%; Efficiency Ratio: 62.6%; EPS up 3%YTD; ROE: 13.0%; Total P&C Net Income: $838 million up 8% Y/Y; Canadian P&C PPPT: up 6% Y/Y

In U.S. Personal & Commercial Banking, performance was strong. Net income[1] increased 19% in constant currency, reflecting continued strength in Commercial Banking including the benefit of BMO Transportation Finance. Operating leverage was strong in the quarter, reflecting revenue growth and well-controlled expenses. The efficiency ratio[1] was 61% on a year-to-date basis.

BMO Capital Markets also had a strong quarter, with net income[1] up 18% on good revenue performance across a number of business units and tight expense management. Operating leverage was positive for the fourth consecutive quarter. We're seeing a growing contribution from our U.S. business, which has further expanded M&A capabilities with the addition of Greene Holcomb Fisher, which closed on August 1.

BMO Wealth Management had solid underlying performance in both Traditional Wealth and Insurance. Results were impacted by both market pressures and divestitures and remain well-positioned in a recovering market as we leverage investments we've made.

While closely managing expenses across the Bank, we're at the same time continuing to invest to enhance customer experience and efficiency. Across the company, we've gotten closer to our customers, made banking simpler, and expanded our footprint. We remain confident that our strategy and diversification by businesses, customer segments, and geographies will deliver sustained growth. And with that, I'll turn the call over to Tom.

Tom Flynn - *Bank of Montreal - CFO*

Thanks, Bill. I'll start my comments on Slide 8. Q3 EPS[1] was $1.94, up 4%. Net income[1] was $1.3 billion, up 5%.

As Bill said, results were strong and demonstrate continued operating momentum, the benefits of our diversified business mix, and good contribution from our U.S. operations. Adjusting items are similar in character to past quarters and are shown on Slide 25.

Net revenue was up 7%, or 6% excluding the impact of the stronger U.S. dollar. Net interest income was up 11% from last year, benefiting from the addition of BMO Transportation Finance and organic volume growth. Net non-interest revenue was up 4%, primarily from higher trading revenues and other non-interest revenue, partially offset by lower security gains.

Expenses[1] continue to be well-managed, up 4% from last year, and just 2% excluding the impact of the U.S. dollar. Operating leverage[1] was strong at 3.8% on a net revenue basis. Efficiency[1] of 61.2% improved over 200 basis points from last year. The effective tax rate[1] was 22%, or 26.7% on a TEB basis.

Moving now to Slide 9. The Common Equity Tier 1 ratio was 10.5%, up from 10% last quarter. The increase reflects good capital generation, more than offsetting higher risk-weighted assets. As detailed on the slide, risk-weighted assets increased by approximately $3 billion, largely from the impact of FX and business growth, net of changes in book quality and methodology changes.

Moving now to our operating groups and starting on Slide 10. Canadian P&C had net income[1] of $562 million, up 1% from last year with good pre-provision pre-tax earnings[1] growth of 6%. Revenue growth was 4% reflecting higher balances across most products. Total loans were up 6% and deposit growth was good at 8%. NIM was up 4 basis points from last quarter as a result of above trend interest recoveries and prepayments.

Expense[1] growth was 2%, reflecting disciplined expense management and ongoing investments in the business. Operating leverage[1] was positive 2.1% and the efficiency ratio for the year-to-date was below 50%, at 49.8%. Provisions for credit losses reflect higher provisions in the commercial portfolio and below trend consumer provisions last year.

Moving now to U.S. P&C on Slide 11. Net income[1] was $289 million, up 22% from last year. The comments that follow speak to the U.S. dollar performance.

Net income[1] of $221 million was up 19%. The acquired BMO Transportation Finance business represented approximately 15% of U.S. P&C's revenue and adjusted expenses in the quarter, similar to Q2 levels. Excluding the acquisition, performance was good, with double-digit pre-provision pre-tax earnings growth.

Revenue growth of 23% year over year reflects the acquisition and higher loan and deposit volumes. Average loan growth of 17% includes organic commercial loan growth of 15% and lower personal loans including the planned reduction in the indirect auto portfolio. Net interest margin decreased 14 basis points from Q2, driven by lower loan spreads and interest recoveries, changes in mix and lower purchase accounting impacts.

Expenses[1] were up 14% year-over-year, and down 2% excluding the impact of the acquisition. Operating leverage[1] was strong and the efficiency ratio improved to 59.2%. Provisions were up from a below-trend level last year, primarily due to higher commercial provisions.

1 On a reported basis: U.S. P&C Net Income: up 21% Y/Y, Efficiency Ratio: 63%YTD; BMO Capital Markets Net Income: up 18% Y/Y; EPS: $1.86, up 3% Y/Y, Net Income: $1.2 billion, up 4% Y/Y; Expenses up 4% Y/Y; Operating Leverage: 3.2%; Efficiency Ratio: 62.6%, improved almost 200bps; Effective tax rate: 21.86%, Effective tax rate (teb): 26.7%; Canadian P&C: Net Income: $561 million, up 1% Y/Y, PPPT up 6% Y/Y, Expenses up 2%, Operating Leverage: 2.1%, U.S. P&C: Net Income: $277 million, up 24% Y/Y, Net Income: US$212 million, up 21% Y/Y, Expenses up 13% Y/Y, Efficiency Ratio: 60.6%

Turning to Slide 12. BMO Capital Markets had good net income[1] of $322 million, up 18% from a year ago, with pre-provision pre-tax earnings[1] up 23%. Revenue was $1.1 billion, up 9%. Trading products growth reflects higher client activity and in investment & corporate banking, higher corporate banking revenue was partially offset by lower advisory fees. Net security gains were down from last year.

Expenses were well-managed and were essentially unchanged from last year. Operating leverage was positive for the fourth consecutive quarter and the efficiency ratio improved to 57.2%. Provisions for credit losses were up from last year's levels.

Moving now to Slide 13. Wealth Management net income[1] was $227 million. Traditional Wealth and Insurance earnings were essentially flat from last year, as operating growth was offset by market impacts.

Expenses[1] declined 4% year-over-year, primarily due to divestitures and disciplined expense management. Assets under management and administration were up 2% year over year, including the impact of FX movements.

Turning now to Slide 14 for Corporate Services. The net loss[1] was $105 million compared to $68 million a year ago. Adjusted results declined due to lower non-TEB revenue from an above-trend level last year and higher expenses, partially offset by lower provisions for credit losses.

To conclude, results in the quarter demonstrate the benefits of our diversified business mix and good operating discipline. And with that, I'll hand it over to Surjit.

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

Thank you, Tom, and good afternoon everyone. Starting on Slide 16, our PCLs increased this quarter to $257 million, or 29 basis points, primarily as a result of higher Oil & Gas provisions and two accounts in other sectors. As Bill said, overall credit quality is good. For the quarter, both the GIL ratio and delinquencies remained stable.

In Canadian P&C, consumer losses were flat quarter over quarter. In Alberta, marginally higher consumer delinquencies were more than offset by improved performance in the rest of Canada. Commercial losses increased due to higher Oil & Gas provisions.

In U.S. P&C overall provisions were up, with higher PCLs in commercial partially offset by lower losses in Consumer. Commercial had a large provision on one account in the agricultural sector.

Capital Markets PCLs fell modestly quarter over quarter, with most provisions in Oil & Gas. Corporate Services PCLs were impacted by lower recoveries in the quarter.

On Slide 17, impaired loan formations were lower. Oil & Gas formations reduced from $286 million last quarter to $88 million this quarter. Gross impaired loans were essentially flat, at 63 basis points.

Turning to Slide 18, our direct Oil & Gas exposure increased due to new commitments to the pipeline sector and because of the stronger U.S. dollar. We remain comfortable with our Oil & Gas portfolio and the associated allowances.

In summary, Q3 credit performance was in line with expectations, and, in the current environment, I expect to see losses over the next four quarters in the mid- to high 20 basis points with some quarterly variability. I will now turn it over to the operator for the question-and-answer portion of today's presentation.

QUESTION AND ANSWER

Operator

(Operator Instructions)

The first question is from Meny Grauman with Cormark Securities.

Meny Grauman - *Cormark Securities - Analyst*

1 On a reported basis: Capital Markets: Net Income: $321 million, up 18%, PPPT up 23%, Wealth Management: Net Income: $201 million, Expenses down 4%; Corporate Sector: Net Loss: ($115) million, ($68) million

Hi, good afternoon. Just a question on cost savings. How much in run rate savings do you still have left after two rounds of restructuring charges? And if you could also remind us just in terms of how you foresee the timing of those coming into the results?

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

It's Tom. Thanks for the question. The restructuring that we took in the last quarter was close to $200 million and we talked about savings from that being realized over about a year and in total, being around $200 million, and in the current quarter, we've got benefits equal to around 25% of that amount.

And I'd expect to build to the full amount, pretty much smoothly, over the next three quarters, and then the charge we took a year ago is fully reflected in the operating earnings that you see in the quarter.

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

Thanks for that. If I could just change gears just to talk about a topic we've been talking about for a long time now, but definitely is back in focus, just on housing, Bill, a number of your peers have talked -- been more outspoken about the need for further government action in the housing market, especially in Toronto and Vancouver. And I'm wondering if you could share with us your view about that specifically. And a related point, just your view on what kind of role government policy is playing in terms of the supply of land and whether that is a bigger issue, or is a big issue in your mind in terms of what's going on, specifically in Toronto and Vancouver?

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

Thanks, Meny. I don't have a great deal to add to what has already been said. I think public policy is working to try to dampen any evidence of speculative pressure in local markets, specifically identified as Vancouver and also a concern about Toronto and I suppose some parts of Montreal, but I think you just have to let the adjustments that have been made run through and see what the impact is. Real estate is cyclical and it always has been and I think there's been so much discourse on this topic, I don't have a great deal to add.

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

Thank you.

Operator

Thank you. The next question is from Robert Sedran of CIBC.

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

Hi, good afternoon. Tom, there's some information on the slide but I'm hoping you can provide a little more colour on the moving parts on the capital ratio. A 50 basis point jump is larger than what I might have expected and it looks like AOCI, in particular, was up almost $1 billion this quarter. And I'm curious how much of that is just normal quarter volatility? How much might have been FX? What else is going on and how you'd see the progression of that ratio in coming quarters?

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

Sure, so I would say we feel good about the change in the ratio in the quarter and with the ratio landing at 10.5%, we've really rebuilt the ratio after the closing of the Transportation Finance acquisition, which is good. The AOCI movement that you see is largely related to the impact of the U.S. dollar and it basically is offset by higher U.S. dollar risk-weighted assets and U.S. dollar deductions from capital.

So U.S. goodwill coming through at a higher level so big change in the balance, but not a significant contributor net to the change in the ratio. And the change in the ratio this quarter did benefit from a good level of capital generation. We had strong earnings and that certainly helps. And then as well, typically after doing an acquisition, we managed the balance sheet in a tighter fashion to help get the ratio back up. We did that in this quarter and you're seeing the benefits of it in the ratio that we reported.

Robert Sedran - *CIBC World Markets - Analyst*

Would you say perhaps it takes you back to a neutral position or is this a level at which you feel comfortable restarting the buyback?

Tom Flynn - *Bank of Montreal - CFO*

I would say, we're back into a normal range and as you know, the number moves around in any quarter and having come back into a normal range, I'd expect that you'd see from us over time, what I think of as our normal pattern. So job one, from a capital deployment perspective, is to generate good organic growth and we're seeing that in our business.

We've got good growth in our Commercial portfolios, in particular, really across the board. Canada P&C, U.S. P&C and Capital Markets, we expect that to continue and to feel good about it. And as time goes on, we'll look at inorganic opportunities to deploy the capital. So I'd say we're back into a normal pattern of looking for opportunities to grow in a variety of ways and if the ratio gets above what we think is a needed level, we would activate the buyback as we have in the past, but that's not likely to be in the near term.

Robert Sedran - *CIBC World Markets - Analyst*

Thank you.

Operator

Thank you. The next question is from Gabriel Dechaine with Canaccord Genuity.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Hi, good afternoon. I have a quick numbers one and then a follow-up on the capital. The quick numbers one, 8% revenue growth in Capital Markets, very strong but the expense growth was negative. I'm wondering, is there some sort of true-up we could anticipate by the end of the year because normally they move in the same direction expenses and revenues. That's my first question.

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

Gabriel, it's Darryl, I don't think you can expect a true-up per se. I think that underlying what you've pointed out is that you've got some good core client driven revenue growth in both of our businesses, the I&CB business and the Trading Products business.

In the expense category, I think you should think about a couple things. We've gone through, as Tom alluded to earlier, two rounds of restructuring. We've taken our share of that in the Capital Markets business and we've held the line very tightly in terms of controlling those costs going forward, while at the same time, investing in the places that we need to invest.

And the other thing that you might notice is that in the Q3 of last year, if you're comparing year over year, we had the GKST business. In this Q3, we do not, so we have sold that business so that had a little bit of a contribution to the good expense year-over-year performance that you've seen in the U.S. but going forward, I don't think you should see a true-up. We may have some small increases as we go forward, but we'll manage it pretty tightly.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. Thanks, Darryl. That's very helpful. Then on the capital, I guess you touched upon it, Tom, and Bill, if you want to contribute as well, inorganic opportunities. In the past, you've been opportunistic and you bought into the U.S. at a very low point of the cycle in 2010; F&C, I'm not sure how well it's doing right now, but you didn't pay a big multiple for it, for sure. There are certainly some areas in the U.S. that are out of favour, Texas, and you've always said that's a contiguous state you'd like to be bigger in. Are you actively on the hunt for acquisitions right now or is it more of a passive stance that you've got? And what's the size of acquisition that BMO could stomach at this stage?

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

Well, thanks for the question, Gabriel. I think you answered it when you asked it, which is that we've been pretty consistent over time in our approach and I wouldn't signal any change. We maintain an active dialogue across a wide range of opportunities at all times, when our capital is building and when it's in the area where we have the most flexibility, and it's so often simply driven by where opportunity arises.

And some of that is just a question of what's on the minds of potential partners. We're going to maintain the discipline we have around price and if we have the opportunity to expand within footprint or adjacent to footprint in things that are complementary to our business, of course, as we always have, we'll pursue it but I wouldn't imply that there's something imminent.

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

Okay, I guess to follow on for Tom just to hear his voice.

So 40 basis points of internal capital generation, if I exclude the book quality improvement and the other model refinement items so that's quite a bit more than what your old guidance would have been, I believe, which was in the 15 to 20 basis points a quarter range. Looking ahead, could you quantify what you think your normal run rate for internal capital generation is, considering the environment, considering the regulatory changes on the horizon, of which there are several that you list in your disclosures that we're all aware of but can't really quantify?

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

So I'll answer the question but I'll give just a caution that, as you know, the number can move around in any quarter, but this quarter was a good quarter for the reasons that we've talked about. But we've been saying for the last few quarters that in a typical quarter, we would expect the ratio to build in the zone of 10 to 15 basis points and there's variation around that but that's what I would expect in a typical quarter, or quarter-over-quarter.

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

Okay, thanks.

Operator

Thank you. The next question is from Sumit Malhotra with Scotia Capital.

Sumit Malhotra - ***Scotia Capital - Analyst***

Thank you. Good afternoon. Tom, sorry if I missed it, but I was just hoping you could give some details on what exactly were the methodology changes or the improvement in book quality. When you say book quality, not that the credit quality numbers are deteriorating materially or anything, but it seemed like it was a stable to slightly up quarter in terms of impairments, provisions; so just hoping you could give a little bit more detail on what those two factors were that drove the increase in capital?

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

Sure, so we had improvements in both areas. They weren't significant but they were helpful. On the methodology side, it was about $1 billion of RWA, and included in that, we had one U.S. portfolio that moved from a standardized risk weight treatment to AIRB, and so that was an item that contributed to the methodology change.

On the book quality, I referred to how we've been managing the balance sheet in a tight fashion post the acquisition. And included in that, we did have transactions to lay off some of the risk in a risk transfer transaction that shows up in book quality in the quarter, sort of a CDS-like transaction, and we also have the benefit of the recognition of collateral values in our LGD calculations that are helping. So the book quality change is more reflective of those things than fundamental migration in the portfolio which, overall, is pretty stable.

Sumit Malhotra - *Scotia Capital - Analyst*

And the first part of that, the U.S. portfolio that got transferred to, or migrated to the advanced approach, that was the one I was looking for. You mentioned one specific portfolio and I know you may not want to go into full details but is there more of that, that we can expect from the Bank that there are further components of the U.S. portfolio that as they, I'll use that term again, migrate, to the AIRB approach that you should get some RWA relief?

Tom Flynn - *Bank of Montreal - CFO*

There's likely to be a little bit over time but the strong majority of that transition has taken place and most of it took place last year, so I would say yes, but not in a way that's significant.

Sumit Malhotra - *Scotia Capital - Analyst*

Thanks for that and the second part of the question, or my final part of the question, is likely for Bill and to go back to expenses. So as you mentioned, it's been four or five quarters now that BMO has had positive operating leverage on an all-bank basis. It certainly looks like, at least the way I'm looking at the numbers, that it's accelerated in the past two quarters.

Is this as simple as you've now had the benefit of two restructuring charges that are making their way through the expense line that we're seeing or is there something on your end? Have you slowed the pace of investment spend or some of the regulatory projects that were underway and is that one of the factors that's really driving an even stronger expense metrics that we're seeing from BMO of late?

Bill Downe - *Bank of Montreal - CEO*

Well, I'd say that the cumulative effect that you've identified two years in a row of progressive changes on the same agenda, basically working the same agenda, is paying off. And I think Tom talked about the fact that, really, not a large portion of the most recent one has flowed through yet. And it's, really, as we've spoken about it, it's been focused on two things.

The evolution or the movement of client transaction volume into the mobile space, which drives higher customer satisfaction and a more efficient fulfillment process. You can imagine account opening on a mobile device in seven to eight minutes is pleasing to the customer. It's also a much more efficient way, lower error rates, higher levels of confidence, all of those things, so I think these things are building on each other.

Also, the work that we've done on process simplification builds on itself. The capabilities necessary to start the change, the processes cost more money around just the basic architecture upfront and then as you move across different applications in the organization, it becomes more efficient, so I think that's really that -- where you're seeing benefit.

Contrary to any suggestion that investment in the future has moderated, I would say that the regulatory and supervisory agenda, which has been big for all banks, it's been complementary to the things I just spoke about because the digitization of information and process makes compliance more reliable and brings down the cost.

And I would say that there is some repurposing, if you like, of investment dollars that were really focused on getting to a high level of capability now being more available to apply to both customer experience and then contributing to the flow-through and efficiency. So I think it's a good story. It's a progressive story and it's pretty consistent with what we've been talking about, I would say, going back to the first charge that we took.

Sumit Malhotra - *Scotia Capital - Analyst*

Thanks for the details, Bill.

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

My pleasure.

Operator

Thank you. The next question is from Sohrab Movahedi with BMO Capital Markets.

Sohrab Movahedi - ***BMO Capital Markets - Analyst***

Thank you. Two quick, hopefully, questions. One for Darryl. Darryl, the trading revenue, in particular, was yet another good quarter -- just north of 400 million-type trading revenues. Is this now what you look to be a sustainable set of numbers? And if yes, maybe talk a little bit about if there's any new businesses you've entered or what is it that's helping that topline growth in trading?

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

Sohrab, I would say if you look through the contributors to the trading business, I agree with you it's another good quarter. It's off a snick from Q2, which was very strong. I think it's 95% or 96% of the Q2 number. When I look through it, you see rates consistent. You see a small drop in FX and in equities, and you see a pick-up in commodities so all told, I think it's a good mix and a good quarter.

What's driving it, I think what you're seeing is the benefit on the revenue side because there are revenue benefits as well from the restructuring that we undertook last year when we reorganized around trading asset classes and our customer focus enhanced and we got a lot better at getting closer to the customer.

I think you're seeing really good client execution. I think we're also seeing -- when you ask about new products, we're seeing good product development and we're seeing ourselves close gaps in areas where perhaps our competitors were and we weren't, I guess -- you asked for an example. An example might be our SSA business.

Our SSA business, if you looked at it a year ago you'd see that globally, we were somewhere around 20th in the Global League Tables, and today, we're around 13th. I think we've done 22 transactions this year on a lead basis relative to three last year. I could give you other examples but we sought out about a year-and-a-half ago to close some of those white spaces relative to market opportunities. And I think we're executing on some of those.

Going forward, the short answer -- that was the long answer to your question. The short answer to your question is yes, I would expect if markets remain constructive, we would be able to continue to perform at or about these levels on the trading side.

Sohrab Movahedi - ***BMO Capital Markets - Analyst***

Okay, thank you and maybe a question for David out of the U.S. P&C segment. The Commercial loan growth, in particular, organic, up 15%. David, can you just confirm that you haven't adjusted -- or the Bank hasn't adjusted its risk appetite, and that you're not getting this loan growth by kind of going down market as it were as far as credit quality is concerned?

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

Yes, I can confirm that. The growth has been good. It's 15%. It really has come over a long period of time, largely, really starting with the time we purchased M&I and we felt that there were some businesses that with the size we had become, that we were not at scale. Mostly businesses where they're secured, by assets, like our asset-based lending business, our auto dealer finance basis and also our equipment finance business.

So we've grown probably larger and faster in those businesses, really, as we've tried to grow to scale and fill those businesses -- fill the pipeline up with our clients where we didn't have those businesses before. But there's no change in our risk appetite. The commercial business is a really good business for us. We've been in it for almost 200 years now and we like it and we like going through the cycles.

Sohrab Movahedi - ***BMO Capital Markets - Analyst***

And so are there other pockets where you think you still have the opportunity to improve to, let's say, to punch at your weight that you maybe were punching below your weight? Or will these just become now the type of run rate loan growth -- I guess what I'm trying to get at, we're going to get into a more difficult comp period, you're not going to be able to grow at 15% forever, but are there some one-off pockets still that can still help maintain that kind of a growth trajectory?

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

Well, we are always looking for new areas where we can be helpful to the clients and bring the whole Bank. I do think that the growth we've had at the 15% level is probably not -- I wouldn't expect it would stay at that level but we still expect good growth, good commercial growth, as we gain market share and add businesses.

Sohrab Movahedi - ***BMO Capital Markets - Analyst***

Okay, thank you very much.

Operator

Thank you. The next question is from Mario Mendonca with TD Securities.

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

Good afternoon. If we could look at the other side of that question in the U.S. loan growth, specifically the U.S. Consumer, that hasn't played out as well and Bill, I think you've guided in the past to an improvement in the second half of 2016. What's your outlook on why that hasn't played out and what your outlook is going forward?

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

So this is Dave. I think first of all, the Personal business is actually doing pretty well, as we look at it over the last couple of quarters. We've invested in it. We built it on both sides in both the retail deposit gathering business which is the core part of our business and critical for our loan growth that we just talked about.

But also on the consumer lending side, where we've made progress, we've had a couple of our regions where we've actually had good sequential growth. We're not where we want to be at this point, but we're making really good progress and it's an important part of our business, but the larger and more important part of our lending business, or our Personal business, is really in the deposit side and there we've had very good growth, 6% year over year and that continues to grow.

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

Help me think through that answer. You were suggesting that, sorry, the Consumer had been growing, and that you've been generating consumer loan growth?

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

No, in a couple of our regions, we have seen the consumer growth actually grow sequentially from month to month. We haven't seen that throughout our whole footprint at this point.

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

I see; is it your expectation that eventually, everything will start to grow or the total will grow?

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

No, I think one thing you'd want to back out, because as you may recall, we intentionally reduced our indirect auto lending last year, in essence to help fund the acquisition of Transportation Finance. But ex that, we absolutely would expect the personal lending to grow over time and we're seeing signs that it's moving in that direction now.

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

So Bill, just going back to your guidance in the past, is that no longer appropriate to rely on that guidance that the consumer will grow in the second half?

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

I think if we are talking about one quarter of movement Mario, that would be the only adjustment. I think I expected we would see absolute growth in the second calendar half and I would say I would adjust that by a quarter and I think next quarter and the quarter after, we're going to see the plateau in the balances on the loan side, but as Dave said, and I think this is an important part of the answer that he gave you, deposit growth has continued to be very strong.

We're adding customers. The uptake of borrowing, as you know, in the market, most of the mortgage activity across the marketplace has been refinancing. New home construction is still lagging natural demand and I think, plus or minus, 180 days or 90 days, we still have expectation that loans will grow and we're pleased with the deposit growth.

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

Okay, so we'll just move on another issue and I'm not sure whether I care about this or not, maybe you could help me think through it. The zero-to-29 -- or the one-to-29 day delinquency bucket did move substantially year-over-year, not so much quarter-over-quarter. It seems elevated and I'm not sure whether that short a perspective really matters, if maybe Surjit can take me through that?

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

You're talking about the U.S. still, aren't you?

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

Yes.

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

In the U.S., I think some of it has got to do with the early-stage delinquencies and I think I've explained this before. When you have a quarter end that's on a holiday and this time on the Saturday, when two days of receipts sometimes get delayed. So that's one reason when you compare year-over-year, that becomes an issue, and I think there is one part of the portfolio that is going through the system, which we watch very carefully which is, call it, we refer to it as the end-of-draw, where we are actually talking to our HELOC clients -- where they have these 10-year interest only and then have to be converted back to our repayment schedule.

So it could be attributed to that but I'm not sure at this point in time, but there's nothing with the quality. From a quality perspective, in fact, when I look at the rates that we've had from a loss perspective, this quarter, our PCL rates have gone down and I don't see the 30 day early-stage delinquency as anything other than an indication of perhaps the first point I made which is the weekend.

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

That's helpful. Let me just drive on to the final question then. The tax rate, normally I don't get into this in too much detail, but is there anything happening with the total return swaps that may be causing the tax rate to move higher this quarter?

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

Not in the current quarter, no. Tax rate was to me -- and it's Tom speaking, a pretty normal tax rate.

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

Okay. Thank you.

Operator

Thank you. The next question is from Peter Routledge with National Bank Financial.

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

Just a quick follow-up for Dave -- he mentioned indirect auto. You pulled back for the acquisition of Transportation Finance. I thought you'd pulled back because you didn't like the risk return dynamics in that market. Did I misunderstand that?

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

Well, no. I think they are both right. We wouldn't have pulled back had we not seen a better opportunity and this was a portfolio that really -- it's a very, very high grade portfolio but with that comes pretty low spreads so it was a good opportunity to reposition the balance sheet a little bit. We still are in that business, just not to the extent that we were before.

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

Okay and related questions for Surjit. The pullback from indirect auto is consistent with what I've seen from BMO in terms of being a bit more conservative in terms of credit risk management. So I wonder -- if I look at uninsured mortgages in BC and Ontario and they were up about $3 billion quarter over quarter in an environment of elevated home prices and I guess the question is why not more restraint in those portfolios?

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

Okay, I'll decouple your question into two. The first point you make with respect to our indirect auto being a reflection of our risk appetite is not necessarily correct. I think you've got to look at risk in the context of return as well, and when we look at these businesses, you never look at them just from a risk perspective. From a risk return perspective, when it's not attractive then we tend to slow down.

Now going back to your second point on mortgages per se, we are very selective in how we underwrite our mortgages in all of the geographies and we recognize that there are markets that are more frothy than others, but we adjust our parameters given where we see every market. So we have various -- we have the ability to change our loan to values and if you look at our charts, you'll notice in our mortgages that we give you by -- the province as well, and I think it's Slide 20, you will notice that our growth in mortgages is quite secular.

It's in all the areas and our loan to values on the uninsured portfolio is still at 56%, so we are mindful of markets, the conditions they are in and we make our adjustments; and what should give you some satisfaction is that the loan to value that you're seeing and the fact that these are more fixed term, the fact that the delinquencies are not bad at this point in time, the fact that our condos are, again, not growing at the same level as the rest of the portfolio, all give us comfort. But we do adjust our parameters all the time to make sure that, as a portfolio mix, we remain comfortable.

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

I recognize that the very good point you make on the 56% average LTV, but there's got to be some portion of mortgages within that number that are north of 65% LTV at origination and although that seems still low today, I wonder with Vancouver up 25% year over year, if those LTVs are really accurate? If we look back on it a year or two from today, will they be as accurate? And will those credit risk decisions seem as prudent?

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

Yes, and so you're absolutely right. So what we tend to do is we tend to watch our originations in those markets and make sure the originations at those levels are contained and we do run our stresses as well. We look at our numbers and we stress our portfolios, given the distribution across the LTV curve and we are satisfied that our portfolio is very robust in that sense.

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

But if you see detached homes going up too much in a particular area, you might pull back from that area and maybe put more into condos or houses in different areas?

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

That, and we would also lend less for the higher value homes, which we already started doing, by the way.

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

Right. Okay, thank you.

Operator

Thank you. The next question is from Doug Young with Desjardins Capital.

Doug Young - ***Desjardins Capital - Analyst***

Hi, good afternoon. I guess my first question is for Surjit. Hopefully, this is a relatively straightforward one. But I just wanted to get a little more colour on the Oil & Gas PCLs that did go up quite substantially sequentially, but your gross impaired loan formations in the segment went down substantially. So I guess my question is, was there a catch-up here or is this just a function of the loss on the loan or loans that went bad, just hoping to get a little extra colour?

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

Yes, it's a good question, Doug. I wouldn't use the word catch-up. You can never predict the timing of when you make a determination as to a client's ability to pay back. There was one particular largish loan in Capital Markets and there was some in the Oil & Gas services sector, which we saw reflected in our Commercial business in Canada, and that was spread out. So they are higher than the last quarter and this is something that we had said would perhaps happen, if oil prices remain low so it didn't come as a surprise at all.

On the other hand, the formations have come down quite significantly, as you noticed, and that's what gives me a lot more comfort. We've gone through our portfolio. Now we are well past the stress test days, where we actually know every part of our portfolio and see how it performs in a low oil price environment and with the slowdown in our formations to the level it is, that should point you to the fact that -- I think a lot of the issues that the $40, $35 to $40 oil would have indicated are behind us.

But also depends how long prices remain depressed but we are very comfortable with our portfolio and the way we manage it. In fact, I did mention in my remarks that we will actually grow -- we will grow the portfolio selectively if the opportunity arises.

Doug Young - ***Desjardins Capital - Analyst***

So when I think about it, just thinking about it going forward, are we at kind of steady state at this portfolio or is there a little bit more potential erosion that could happen if oil price stays flat from these levels?

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

That could be, if potentially oil prices stay flat. Depending on the duration of them staying where they are, there could be a little bit more that comes our way because cumulatively, when I look at the losses through this point in time over the last six quarters, our loss rate is about 1.8%. And this is not annualized; this is at a cumulative loss rate. And I can see that going up and we do have, and I think I mentioned again in my comments, that the allowances that we've kept for the remainder of the 12 months is more than adequate; but I can see it going up under certain circumstances.

Doug Young - ***Desjardins Capital - Analyst***

Okay, thank you and then I guess my question, next question would be just for Cam on NIMs in Canada. And I think the NIM last quarter was 2.51%. I think you guided to in the back half, another 1% to 2% decline in NIMs yet we had a nice bump up. Is that delta really just the prepayments or higher interest recoveries so is it above -- was that about a 5 to 6 basis point positive impact in NIMs? I'm just trying to think of the sustainability of that as we look forward to the latter half of this year and into next year.

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

Thanks. It's Cam. The guidance I gave last quarter, I would say, stands, yes, the majority of the bump this quarter is on the above-trend interest recoveries and prepayments so I would expect that in Q4, we're back in the Q2 range as guided. There are good components of the performance in there on the NIM to be sure, including good deposit growth but you're right. I would stick with the guidance I gave last quarter, which is where I expect Q4 to be closer to Q2.

Doug Young - ***Desjardins Capital - Analyst***

Okay, great. Thank you very much.

Operator

Thank you. The last question is from Darko Mihelic with RBC Capital Markets.

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

Hi, thank you. I just want to get a little more specific with Tom on some of the answers that he gave earlier. First, Tom, the question is when you answered the question on the restructuring, you said you're 100% through the first charge and 25% through the second. Is that the same as you've drawn down on the provision by those amounts; is that correct?

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

From an income statement perspective, I'm not sure that's how I would put it but I'm not sure what you mean; so I'll explain how I was thinking about it. We took a charge in Q2 of last year; we said savings would be in the zone of $100 million and those savings are now in our run rate so we've achieved those benefits.

And then we had a charge in the second quarter of last year or -- sorry, second quarter of this year around $200 million. We said we would realize savings of around $200 million over the next year and of that amount, a little over 25% is in the results for the current quarter. So that's hitting the P&L and the balance, we'll get over the next three quarters.

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

Okay and then just with respect to the actual provision, how much have you drawn down on it?

Tom Flynn - *Bank of Montreal - CFO*

If by the provision, you mean the amount of the charge, how much of that have we consumed, it would be under half of it.

Darko Mihelic - *RBC Capital Markets - Analyst*

Okay, so under half but you have about half of all of the savings that you've talked about so far?

Tom Flynn - *Bank of Montreal - CFO*

No, there, I'm just referring to the most recent charge, the Q2 charge, but all of the charge from last year would be gone.

Darko Mihelic - *RBC Capital Markets - Analyst*

Okay, that's helpful and so -- I've done a little back of the envelope math to the first decimal point and so if I take the run rate savings of $150 million so far that's annualized, that's in your number, I can effectively say, to some extent, keeping the revenue number as is, that about 1.3% of your 3.8% operating leverage is coming from the restructuring initiatives. And the rest of it's coming from normal course discipline. Have you looked at it that way and do you think that's a correct way of thinking of it?

Tom Flynn - *Bank of Montreal - CFO*

Directionally, I would say yes. The savings that are coming through, they are absolutely contributing to in a key part of the operating leverage and your math sounds like it's in the right zone.

Darko Mihelic - *RBC Capital Markets - Analyst*

Okay. That's very helpful. Thanks for the colour, Tom.

Operator

Thank you. I would now like to turn the meeting back over to Mr. Bill Downe.

Bill Downe - *Bank of Montreal - CEO*

Thanks very much, operator. Before we wrap up, I'd like to recognize Russ Robertson, Executive Vice President, who has announced his intention to retire from banking at the end of this month.

As many of you will remember, Russ joined the Bank in 2008 as Chief Financial Officer from Deloitte Canada, where he was Vice Chair. He went on to oversee the integration of Harris and M&I, the largest and most complex acquisition the Bank had ever undertaken. Russ has earned the deep respect of colleagues across our organization and the industry.

He's been a tremendous partner and will leave a lasting legacy. Russ accomplished all of this while championing integrity, empathy, diversity and responsibility, the best of our values, and for that, I'd like to personally thank him and on behalf of everyone at BMO, wish him the very best.

And with that, thanks everyone for joining today and have a good afternoon.