BMO Financial Group

Q1 2003 CONFERENCE CALL

FINAL TRANSCRIPT

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PRESENTATION

Operator

Good afternoon, welcome to the Bank of Montreal first quarter 2003 conference call for February 25th, 2003. Your host for today is Susan Payne, Senior Vice President of Investor Relations. Miss Payne, please go ahead.

Susan Payne – *BMO Financial Group - SVP Investor Relations*

Good afternoon, everyone. Thank you for participating in today's conference call.

This afternoon's overview of our first quarter results will be provided by Tony Comper, our Chairman and CEO, Karen Maidment, our CFO and finally, Mike Maila, Head of Corporate Risk Management.

After Mike's presentation, the following members of his management committee will also be available to answer your questions: Bill Downe, Deputy Chair, Ron Rogers, Deputy Chair, Frank Techar from the Harris Bank, Rob Pearce from the Personal and Commercial Client Group in Canada. From the Private Client Group, Gilles Ouellette, Yvan Bourdeau, Investment Banking, and Lloyd Darlington, who heads up Technology and Solutions in E-Business.

At this time I would like to refer our listeners to our investor relations website at www.bmo.com to review our forward-looking statements and the risk factors pertaining to these statements.

Now, I'd like to hand the floor over to Tony.

F. Anthony Comper – *BMO Financial Group - Chairman, CEO*

Thanks, Susan. Good afternoon, everyone. My colleagues and I are very pleased to discuss our first quarter results with you from the nation's capital where we held our annual meeting earlier today.

Overall net income for BMO Financial Group rose 7% to $399 million in the first quarter, with solid growth in the personal and business banking in Canada and the U.S. driving the increase. I think that was a pretty encouraging performance in light of the challenging environment that's been faced by our investment banking and wealth management businesses.

Earnings in the Personal & Commercial Client Group were strong, rising 18% to $225 million from the first quarter last year. And I'm pleased to report that the productivity ratio for this group improved to 64.2%, and that's from 66.1% as revenue growth outstripped expense growth in both Canada and the U.S.

In the core personal and business banking operations in Canada, which continue to form the backbone of BMO Financial Group, retail and commercial deposits grew $3.6 billion, that's 11% from a year ago, an increase of $1.1 billion from the fourth quarter. So good momentum there.

Market share for the retail banking segment increased 28 basis points to 13.63% from the year before, and for business loans up to $5 million, our market share increased 64 basis points year-over-year to 19.44%, as we continued to gain on the market leader in what is a priority market for the BMO Financial Group.

In our vibrant and growing U.S. personal and business banking operations, loans were up 27% from the same period a year ago. That's mostly due to mortgage and other consumer loan increases with deposits growing 9% or a billion U.S. dollars from last year. We're on track to add 50 branches to our Harris Bank network with 13 slated to open in this calendar year alone.

Meanwhile, the Investment Banking Group and Private Client Groups held steady in profit contribution year-over-year, and both improved in comparison to the fourth quarter, and that was despite the challenging environment. The Investment Banking Group, where we added $185 million to the bottom line in the first quarter, management's continuing to focus on decreasing volatility while increasing profitability. The group is well-positioned for growth, as soon as market and economic conditions improve, and our mid-market clients, in particular, start to make capital investments again.

In the Private Client Group assets under management and administration and term investments increased 13% year over year. Excluding acquisitions, assets declined only 3% as we managed these businesses effectively during a time when the TSX and the S&P 500 declined by 14% and 23% respectively. Another highlight of the quarter for this group was BMO InvestorLine’s repeat success in being named the top on-line broker in the Globe & Mail's annual ranking.

Overall, the wealth management team is successfully containing costs, while absorbing the acquisition-related expenses that will help ensure a significant performance improvement when the inevitable market turnaround finally arrives. I'd also like to draw your attention to some other encouraging trends, starting with our strong and improving asset quality.

Mike Maila's going to go into more detail, but let me just say, we expect to continue to demonstrate our credit quality advantage, vis-à-vis our competitors this year, as we did in 2002 and over the preceding decade.

Just this morning, you might have noted, Moody's Investors Service changed the rating outlook on Bank of Montreal to stable from negative. Expressing the view that earnings are the first offense against asset quality problems for a bank, Moody's said BMO's core earnings give us sufficient flexibility to address any asset quality concerns.

Another positive trend, although not yet as positive as we would like, is productivity improvement. Due to the impact of market and economic conditions on the revenue line, the only significant productivity improvement was in our core personal and business banking operations, where as I said, the expense-to-revenue ratio improved by 190 basis points.

Improving operational efficiency continues to be our number one priority all across this enterprise and we're very focused on having more encouraging news to report as the year progresses.

As we look ahead, the overall outlook for 2003 remains unchanged, and we continue to anticipate that we'll achieve our annual targets for 2003. Softer economic growth than previously expected should be offset by lower provisions for credit losses.

Looking even further ahead, this management team continues to believe that BMO faces the future from a position of particular strength. As the U.S. banking industry continues to undergo a major wave of consolidation, and the Canadian-U.S. economies become increasingly intertwined, we believe we're the best positioned of all of our Canadian competitors to flourish in the North America economic space.

As you know, our vision is to become a leading, Canadian headquartered, Canada-U.S. bank, and our growth strategy is to invest in our core Canadian franchise, which is our enduring primary strength, while expanding selectively and substantially in high growth U.S. markets.

We were the first in Canada to build out our U.S. franchise in anticipation of the market forces that are now in play; and one of the first to transform our business mix to ensure consistently high returns in the future. We believe that our improved relative performance in 2002, as well as our continued progress in the first quarter of 2003, indicate we're on the right track.

Let me be absolutely clear, we will continue along our chosen strategic path regardless of what transpires regarding domestic bank mergers. Yes, a merger would give us the capital scale to implement the strategy faster. But with or without a merger with a like-minded partner, we're exceptionally well positioned for continued growth in our selected markets in the North American economic space. And with or without a merger, this team is devoted to increasing returns to our shareholders.

BMO Shareholders earned a return of 9.2% on their investment in common shares in the first quarter. For the 12 months ended January 31st, 2003, the total return to BMO shareholders was 18.4%, and that was the best return of Canada's major banks.

During this quarter, we announced a 10% increase in the quarterly common share dividend to 33 cents, marking the 11th consecutive year of dividend increases, and to underscore our continued confidence in our growth strategy, we also increased the dividend payout goal to between 35 and 45% of net income.

Having made significant progress in executing what we believe is the perfect strategy for a Canadian bank in these times on this continent, we face the future with confidence.

Karen, our Chief Financial Officer, will now provide more details on our first quarter results. Karen?

Karen Maidment – ***BMO Financial Group - CFO***

Thanks, Tony.

I would like to take you through the first quarter results, which we believe are a reasonable start to fiscal 2003. Results for this quarter are solid as evidenced by first quarter net income growth of 7% over the first quarter of last year. And compared to fourth quarter, net income is down 6%, but income before taxes is actually up $31 million or 5.3%.

Slide one shows a summary of our targets to the left and the highlights for the quarter. Overall, performance this quarter compared to a year ago was driven by strong results in Personal and Commercial, lower provision for credit losses, higher pension and benefit costs, and medium-term incentive compensation, as well as higher expenses from acquisitions.

Revenue growth of 5.1% falls short of expense growth of 7.5%. However, excluding the full year effective acquisitions, revenue and expenses grew approximately 2%.

As Tony mentioned, our Personal and Commercial Banking business continues to show improvement with 7% revenue growth, careful expense management, and net income growth of 18% year-over-year, and 4% versus the fourth quarter of last year.

Our Investment Banking and Private Client Groups earnings were essentially unchanged from a year ago in continued challenging operating environments.

The effective tax rate for the quarter was 30.3%, higher than the fourth quarter's rate. However, we still expect the effective tax rate for fiscal 2003 to be 28-29%.

As shown on the slide, we met three of our four targets this quarter and we believe we will meet all of our targets for the year, despite somewhat slower economic growth than previously anticipated.

While some improvement was made in lowering the productivity ratio of last quarter of 68.3%, down to 67.9% this quarter, higher pension, benefits, and performance-based compensation costs increased the productivity ratio to 67.9% from 66.3% a year ago. Excluding these costs, our core expenses decreased from the first quarter of last year due to a reduction in staffing levels and the on-going management of discretionary expenses.

Our provisioning ratio for the quarter was 39 basis points, an improvement over last year, which Mike will review in more detail in his presentation. Our outlook is that the provision for credit losses will not exceed $700 million this year. This reduction in provision for credit losses will offset the slower than expected economic growth we are experiencing in the capital markets, the slower recovery in the U.S., and the geopolitical uncertainty.

Turning to slide three, you'll see we have reclassified the U.S. operating results with the introduction of a new state of the art transfer pricing system this quarter. This change does not impact the total U.S. income, it just moves it around. The new system takes the interest rate risk out of the groups and centralizes the management of that function, much like we centralize the management of credit risk in corporate. The reporting is consistent with how we manage the business and includes allocating all capital to the lines of business.

Going forward, the gains in corporate support are expected to be minimal and will relate to the rebalancing of investment securities to achieve stable and less-volatile, high quality earnings. This new system provides a higher degree of accountability, increased transparency, and disclosure on the underlying operations, including the impact of acquisitions.

Slide four provides details of our U.S. operations. Our Canadian contribution to net income is up, while revenue earned in the U.S. is being maintained at around 30%. Therefore, earnings from the U.S.-based businesses were 18% of total North American net income, compared to 34% a year ago. Improved first quarter performance from our Canadian operations relative to the U.S., a strengthening Canadian dollar, and amortization costs of acquired wealth management businesses all contributed to this decline.

Slide five focuses on revenue growth. The main drivers behind the revenue growth were volume growth in P&C, accompanied by wider spreads in P&C Canada, acquisitions by PCG, together with a modest improvement in client-driven activity over Q4, and a continued challenging market environment.

Slide six shows that excluding acquisitions, expense growth was 1.8% from a year ago, and somewhat less than revenue growth, and flat relative to the fourth quarter. As I said earlier, expense growth versus the fourth quarter of last year was driven by the costs associated with acquisition, higher pension and other benefit costs, and costs associated with our medium-term performance based incentive plan.

Slide eight illustrates the continued improvement in Personal and Commercial Banking. Volume growth in both Canada and the U.S. was the main driver, accompanied by wider margins in Canada. U.S. margins declined, mainly due to spread compression on deposit accounts with the recent reduction in market rates. The revenue growth, combined with careful management of expenses, resulted in the expense-to-revenue ratio improving to 64.2% while investment in additional strategic initiatives was maintained.

Slides nine and ten highlight market share and volume growth. Strong volume growth demonstrates that we have grown the core franchise. Market share for personal products grew year-over-year and declined only slightly from fourth quarter. Declines in market share for personal lending and retail deposits reflect lower growth in non-core portfolios, as well as renewed competitive pricing pressures by several major institutions.

Slide eleven shows that our Private Client Group has managed to hold ground despite a difficult environment and with both revenue and expense growth driven largely by acquisitions. Excluding acquisitions, revenue and net income increased over both prior periods.

Revenue this quarter benefited from the group's share of the TSX gain of $14 million after tax, but client activity also showed a modest improvement over the fourth quarter levels.

Attention to cost management has maintained expenses at the same level as a year ago with increased benefit costs being off-set by lower variable compensation.

Slide thirteen illustrates the sound performance of the Investment Banking Group despite challenging markets. Fee based revenue from mergers and acquisitions and from equity origination activity rose compared with both prior periods, and the increase was boosted by the TSX gain. However, net interest income was lower than a year ago as the maturing of higher yielding assets resulted in lower spreads in capital markets businesses. Corporate lending volumes were also down due to an uncertain credit environment.

Compared to the fourth quarter, net interest income increased as the recent market interest rate cuts reduced funding costs in the capital markets businesses. Expenses were reduced by 2% from a year ago and were unchanged from last quarter, reflecting cost containment measures.

Net income from U.S. operations declined relative to both prior periods due to narrowing spreads, the negative effect of economic and political uncertainty on client transaction volumes, and the strengthening of the Canadian dollar. At the same time, the performance of our Canadian operations has improved.

Finally, slide fifteen shows net income for Corporate Support, which has fluctuated substantially. The majority of the variance over the fourth quarter is driven by the higher income tax rate in the quarter. The balance is primarily due to securities gains earned this 2002.

I will now turn it over to Mike.

Michel Maila - ***BMO Financial Group – Head of Corporate Risk Management***

Thanks, Karen. Good afternoon, everyone. Let me walk you briefly through the key highlights of this quarter's risk review.

As slide one shows, the credit picture is significantly brighter this quarter than this time last year as highlighted by lower specific provisions for credit losses and reduced formations of impaired loans. These favorable trends, tempered by continued uncertainty in the operating environment and in financial markets, underlie our revised guidance for the provision for credit losses for this fiscal year of $700 million or less.

Taking a closer look at formations of impaired loans on slide two, you can see the declining trend over the past few quarters, both in absolute dollar terms and as a percentage of the loan book.

And as slide three indicates, the lower formations this quarter arise from a broad cross section of industries. Less than 10% of the formations relate to the power generation sector and no material loan in the telecom and cable category was classified as impaired this quarter.

Turning to the consumer portfolio on slide four, you can see from the chart on the left that the proportion of delinquent accounts in that portfolio, 90 days or more overdue, has been declining or stable over the past five quarters. As the table on the right indicates, the consumer portfolio continues to show solid growth and so is the commercial portfolio, albeit at a slower rate. Taken together, these stable portfolios now represent 74% of the loan book versus 70% a year ago.

Moving to market risk on slide five, you can see that our trading and under-writing activities this quarter were consistently profitable with 62 trading days out of the 64 in the quarter showing a positive P&L, or net revenue.

Before handing it over to the conference operator for the question-and-answer session, let me point out that in addition to the appendix to this presentation, the supplementary information package this quarter includes enhanced risk disclosures by industry sector and geographic region.

Operator, over to you.

QUESTION AND ANSWER

Operator

Thank you, sir. We will now begin the question-and-answer session. To place yourself into the question queue, please press star 1 on your touchtone phone. If you are using speaker phones, please lift your receiver and then press star one. Please go ahead if you have questions.

Your first question comes from Jamie Keating. Please go ahead.

Jamie Keating - *Merrill Lynch - Analyst*

Good morning. Afternoon, actually, I guess. Long day. I had a couple of quick questions, if I could? One of them relates to, if I may, the reclassification. And I'm wondering if I could ask Karen or others to explain why P&C and Wealth Management seemed to take a larger hit and IBG didn't.

And if I may, another follow-up question, this may be for Rob or someone, but relates to clearly the improvement in operating margin in the domestic bank. I'm wondering if you could comment on what the scope is for more improvement on that operating margin and to what degree the Pathways Connect installation has contributed to that in terms of either revenue yield or cost efficiency, if you can scope that out as well?

F. Anthony Comper – *BMO Financial Group - Chairman, CEO*

Good afternoon, Jamie. Tony here. Good questions. We'll get Karen to handle the first one, and then we'll get Karen and Rob to handle the second one. Karen.

Karen Maidment – *BMO Financial Group - CFO*

The new system is really a state-of-the-art system where we are able to do match funding for all of our assets and our liabilities. And as we also looked at our U.S. reporting, we thought it would really enhance the transparency if we were able to line it up exactly with the way it's managed. And so Jamie, the management of the balance sheet, the structural balance sheet, is really a corporate function and that's included in corporate.

The discretionary trading is included in the IBG line. Previously those were commingled and were included in, allocated to the various lines of business. So what you now see is that P&C Chicagoland and PCG shows the deposits, the loans, the actual business activity, the expenses, and the balance sheet management is pulled out and being classified in the corporate area and the IBG area.

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Thanks, Karen. Rob, do you want to respond to Jamie's second question?

Robert Pearce - *Personal and Commercial Client Group-President, CEO*

I think there were a couple points, Jamie. I think you referred to our margins, firstly, which have improved a little bit, both versus fourth quarter and versus first quarter last year. That's basically due to business mix, you know, the growing of the consumer loan portfolio a little better and some improvement in the deposit books have helped our spreads.

Looking forward, we think as rates increase in Canada, should the Bank of Canada increase rates, we've got a little bit of room for margin improvement there too, looking forward.

Specifically, you asked about Pathway Connect which we finished the installation of in the first quarter and all of our branches and in our call centers. It's hard to pinpoint dollar-for-dollar, sort of, the benefits out of that, but clearly, it's creating capacity in the branches, simplifying tellering batch processes and that have all been automated, which has freed up a fair amount of capacity in the branches, which we're either turning into service or cost reductions or more sales.

And importantly too, there's better customer information on that system than in the past. Things like cross sales and referrals to our partners, and that, have been moving up quite nicely. It's early days yet, but certainly the early indications are quite favorable.

Jamie Keating - *Merrill Lynch- Analyst*

Thank you.

Operator

Okay, your next question comes from Jim Bantis. Please go ahead.

Jim Bantis - *Credit Suisse First Boston- Analyst*

Hi, good afternoon.

F. Anthony Comper – *BMO Financial Group - Chairman, CEO*

Good afternoon, Jim.

Jim Bantis - *Credit Suisse First Boston- Analyst*

I'm calling in regards to the Private Client Group in the U.S., and specifically looking at page 14 of the supplemental package, recognizing that the bank has made some significant investments on the direct investing through CSFB direct, Morgan Stanley, and Freeman Wellman, we've had a number of quarters now in a row in terms of having net losses coming out of that operation.

I know they're small, but at what point do you see this turning around in the respect of a catalyst coming from expense savings? Are you at your fixed cost already? Is there more variable costs to reduce this? Can you give us a little guidance in terms of how we can turn this business around in a tough environment where, even if equity markets turned around tomorrow, we certainly recognize the retail investors are going to lag that turn around? So, any color on that would be helpful.

F. Anthony Comper – *BMO Financial Group - Chairman, CEO*

Okay, Jim. I'll give a couple opening comments and then I'll turn it over to Bill and Gilles to respond in detail.

Yeah, we're disappointed that those businesses, in particular the components of our U.S. Wealth Management business that are exposed to equity markets aren't performing very well, and we all know the story there. That's not good news.

The good news though, is that we think that we got the acquisitions at favorable price points in the market, they've really managed the cost down. What you're seeing in terms of the net includes the amortization of some of the goodwill on a cash basis, in fact. It's positive, and given the environment, we're not unhappy with the performance of the acquisitions we've made, but obviously for dramatic improvement, we are going to have to see some return to the equity markets.

Bill or Gilles, over to you.

Gilles Ouellette - *BMO Financial Group - President, CEO Private Client Group*

Thanks, Jim. Yeah, I can add a little bit to this. We've been, as you know, we've been investing in the U.S. for the last couple of years to build our wealth management platform, and what's happening now is that we're continuing to invest. You know, there are a lot of things that have to be done, a number of things we have to change, but clearly, I mean, the performance has been impacted by the markets. And you know, what we're seeing, and I think, what we're seeing is not unlike a lot of our competitors and they've gone public with the fact that, certainly you know, the war's having a big impact down there, the volume's have slowed down.

We're particularly happy with the way we've been able to deal with our costs in this kind of an environment. You know, they've done an extremely good job of managing their costs, and I think that positions us extremely well to get even a very small turnaround, because as you know, the kind of businesses that we have in the U.S. on the broker side, are particularly levered, so we don't need a big improvement in revenues to get a large impact on the bottom line. But this is something, I mean, we're constantly looking at the cost structure because in this kind of environment, I mean, you're limited to some extent what you can do on the revenue side.

Jim Bantis - ***Credit Suisse First Boston- Analyst***

Okay, great, thank you. Just a follow-up question regarding costs. Tony, slide five of your presentation, top priority in terms of operational efficiency, can you give us some specific points in regards to how we can improve the efficiency ratio? What targeted areas are you looking for in terms of expense savings for 2003?

F. Anthony Comper – ***BMO Financial Group - Chairman, CEO***

Good point. Let me respond to it by saying a combination of two macro sets of activities, one of which is each one of the business group heads, in their business plans, have been given specific targets, and I'm particularly encouraged with the improvement we've seen on a year-over-year basis in our personal and commercial business on that important measure, where it's really coming home to it.

Over and above that, we have a multi-point program that we refer to as our performance enhancement program, which is looking at initiatives that are broader than just the day-to-day operating improvements that the line business heads are doing, and that's looking at what I would characterize as enterprise-wide initiatives.

To give you a very specific example, Gilles Ouellette is leading one element of that program, which is called sales effectiveness, in which we're looking at macro level ways we can improve sales stimulation, taking best practices from different units of the organization, regardless of where they come from, whether they be in our U.S. operations, in our Canadian operations, and applying them universally.

So, a combination of what I would call tactical initiatives, which are operating performance goals and targets the business has got, augmented and aided by what will an effect be, kind of multi-quarter initiatives, that are being led by each one of the executive community members on an enterprise-wide basis. And so we've set ourselves some fairly specific objectives in both of those categories, and we expect to see that, kind of, take hold as we focus on that.

Jim Bantis - ***Credit Suisse First Boston - Analyst***

Is there a dollar target you're focusing on for 2003?

F. Anthony Comper – ***BMO Financial Group - Chairman, CEO***

More what we have done is, in terms of the operating group objectives, we've said that each business group should be improving its cost-to-income ratio by between 150 and 200 basis points over the course of the fiscal period.

Jim Bantis - ***Credit Suisse First Boston- Analyst***

Got it. Thanks very much.

Operator

Your next question comes from Heather Wolf. Please go ahead.

Heather Wolf - ***Goldman Sachs - Analyst***

Hi, good afternoon.

F. Anthony Comper – ***BMO Financial Group - Chairman, CEO***

Good afternoon, Heather. Congratulations on your new assignment, as to Jamie.

Heather Wolf - ***Goldman Sachs- Analyst***

Thank you very much. Two quick questions for you. First, I wanted to dig a little bit more into the diverging trend, margin trends between the U.S. and Canada. I'm wondering if there's anything else going on behind the scenes other than just the interest rate environment that would cause such a big difference in margins north and south of the border. And my second question is with respect to your retail provisioning, your Personal and Commercial Banking provisioning. I know that you indicated trends there are good, but your provision did increase just slightly this quarter, and I'm curious why that might be?

F. Anthony Comper – ***BMO Financial Group - Chairman, CEO***

Okay, thanks, Heather. I'll get Karen to handle the first part and then turn it over to Mike.

Karen Maidment – ***BMO Financial Group - CFO***

Actually, Heather, we don't see anything substantially different happening in margins north and south other than the effect of the absolute low interest rate environment in the U.S., which has provided some compression. We experienced that last year and we're starting to feel a little bit of relief on that north of the border.

Heather Wolf - *Goldman Sachs - Analyst*

Can I just ask a quick follow-up? I don't know if I've missed this somewhere in here, but is there a way to back into your net interest margins in retail land north and south of the border?

Karen Maidment – *BMO Financial Group - CFO*

I don't -- I think you could -- there's the U.S. Chicagoland income statement in the sup pack that you could probably back into it, but I think you'd have to calculate it, I don't think we have it disclosed separately.

Heather Wolf - *Goldman Sachs- Analyst*

Maybe I'll talk to you off-line then.

Karen Maidment – *BMO Financial Group - CFO*

Sure. The other point, Heather, I'd make is that in our U.S. operations, our Investment Banking operation also has a fair bit of commercial mid-market lending activity, which some organizations would classify as personal and commercial. So when you're thinking about margins, we tend to think -- we tend to look at both.

Heather Wolf - *Goldman Sachs- Analyst*

Okay, thank you.

Michel Maila – *BMO Financial Group -Head of Corporate Risk Management*

I'd like to respond in two parts with respect to the consumer side, you can see from page 30 of the sup pack that our provisioning ratio for the consumer portfolio is down actually this quarter, to 20 basis points, and essentially has been in the range of 20 to 24 basis points for the past two years. With respect to the commercial, it's actually not disclosed separately as we combine it with the corporate, but I can tell you the trends are stable there as well.

Heather Wolf - *Goldman Sachs- Analyst*

Okay, great, thank you.

Operator

Okay, your next question comes from Ian De Verteuil. Please go ahead.

Ian De Verteuil - *BMO Nesbitt Burns- Analyst*

Thank you. The question follows up on Jamie's question on, sort of, the changes in the segmented disclosures. If I'm right, Karen, you said that the biggest change is that you have removed the structural balance sheet mismatch from Harris and put it in the corporate line. Does that mean that the corporate line, in addition to varying based on where we are in the credit cycle between actual provisioning and forecast provisioning, or normal provisioning, will it also vary by the shape of the yield curve in the United States?

Karen Maidment – *BMO Financial Group - CFO*

Your question relates to the provisioning, Ian?

Ian de Verteuil - *BMO Nesbitt Burns*

No --

Karen Maidment - *BMO Financial Group - CFO*

I'm sorry, I didn't follow it.

Ian de Verteuil - *BMO Nesbitt Burns*

You said you've pulled the structural balance sheet risk out of Harris and put it into corporate.

Karen Maidment - *BMO Financial Group - CFO*

Right, so what we're doing there is the structural balance sheet is the asset liability management or the hedging activities that relate to the balance sheet, where we're trying to maintain, minimize the volatility of earnings, and minimize the risk. So that's in there.

In addition, in the last couple of years, because the deposits in Harris were a lot greater than the loans, the difference between the two were investment securities, we referred to as the investment portfolio, and we have had some gains in those investment portfolios over the last couple of years. In 2002 you would have noticed from the Harris press release, it was about $70 million U.S., so we've pulled that as well. So it's the structural, as well as the investment portfolio gains and losses.

Ian de Verteuil - *BMO Nesbitt Burns*

So the corporate line will vary now depending on the performance of these investments securities?

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

That's correct.

Karen Maidment - *BMO Financial Group - CFO*

Yes, yes.

Ian de Verteuil - *BMO Nesbitt Burns*

The follow-up question I guess then is, if I were to look at what Harris was before you did this change, it's Personal and Commercial bank earned $188 million, and now based on the new accounting, this is in 2002, it made $91 million. Is it fair to say then that $91 million of Harris' earnings were this structural, mismatch, which will vary depending on -- ?

Karen Maidment - *BMO Financial Group - CFO*

A big portion of it were, yes. Now going forward, in this low interest rate environment, you wouldn't expect to see that occur. Those are really opportunities because of the low absolute interest rates and the ability to realize gains on some of those securities.

Ian de Verteuil - *BMO Nesbitt Burns*

So you held bonds and as rates went down you booked gains.

Karen Maidment - *BMO Financial Group - CFO*

We realize -- we sold them and booked the gains, and so as we look going forward, you wouldn't see the same opportunities in the current interest rate environment.

Ian de Verteuil - *BMO Nesbitt Burns*

Thank you.

Operator

Okay, your next question comes from Quentin Broad. Please go ahead.

Quentin Broad - *CIBC World Markets - Analyst*

Just a follow-up on Jim's question with respect to cost saves, Tony. Perhaps, you gave us some sense of specific instance in terms of sales effectiveness. Is it possible to get perhaps a specific cost-saving measure in PCG, P&C, and IBG? So one example of a cost-savings measure from each of these to try and generate the 100 to 150 basis points in each unit?

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

It will -- the impact of the programs that we have will vary by group, and so it will be more revenue-intensive, if I can put it that way, in the Personal and Commercial group. And as you move away from the front lines, for example into technology and solutions or corporate areas, the focus will be much more on cost.

And so another example, we refer to it as demand management. For several years now, we've been making some significant investments in our capacity to focus on sourcing of a lot of the variable expenses that we have in the bank, whether that be consulting, travel, entertainment, all the usual line items you might have. In fact, we're proud of the capacity we've had, we've developed to manage that line item, and we're focusing on a very specific target that will be realized across all the business groups in that one activity of demand management. In fact, we're stepping up our focus on that one area. So those are a couple of specific examples of the focus of the cost-improvement programs, the performance-enhancement programs.

Quentin Broad - *CIBC World Markets*

So from that then, the business lines themselves have -- from your comments, they have limited opportunity for expense save, and that's really the back office support initiative versus the front office is almost purely sales initiative focused?

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Let's put it this way, it's more a matter of emphasis, and I'm going to get Gilles to comment on this, because he has the sales stimulation enterprise-wide objective on all of our behalf, but....

So it's more of a matter of emphasis. We would expect to see more improvement on the cost-to-income ratio on the revenue side in the line groups, in particular the Personal and Commercial group, and you've seen that already in the first quarter, and then as you move farther away from that into technology solutions in the corporate areas, you'd expect to see more of the emphasis on the cost side.

Gilles Ouellette - *BMO Financial Group - President, CEO Private Client Group*

Quentin, specifically with respect to the Private Client Group, you're looking for specific examples. In our direct investing company in Canada, BMO InvestorLine for example, we've closed the Calgary and Vancouver call centers and we've moved some of the people to Toronto, but we're also going to be using the bank branches as marketing outputs much more, because they were originally set up as marketing outlets, so we're looking, for example, to be able to probably save in the order of about 50 FTE's in that one move. And there's a series of other things we're doing in Canada and the U.S., but that's a specific example in our group.

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

And when you turn to look for example the -- it will come as no surprise to you that a significant chunk of our cost basis on the employee or FTE line, if you look at the Q1 over Q1, FTE line is down about 500 FTE's.

Quentin Broad - *CIBC World Markets*

Thank you for the segue, Tony, because I'm confused on the FTE's and I don't know whether it's part of a risk statement, but when I compare the Q4 sup pack on FTE's on each line group, I get, you know, significantly different numbers. So I'm just wondering what has transpired, I guess, because you reported Q4 2002 18,000 employees, roughly, in P&C and now you're reporting 19,700 roughly. So, I don't -- and that's the same across all the groups, so you just give us some insight what the relocation allocation is?

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

You see there's a bit of a reallocation. In fact, there was one very significant function, which is a group of support service activities we used to have in Lloyd Darlington's Technology and Solutions shop that we've moved out into the line to get the cost of that. In fact, the general theme there is get the cost out into the line areas that drive the cost so they can have the most impact on moving that, and that was about 2,000 FTE's, Rob, is my recollection on that.

Robert Pearce – *BMO Financial Group - President, CEO Personal and Commercial Client Group*

In the P&C world, I mean, the FTE, without the adjustments for what Tony just talked about, has been flat, basically. Within that though, we're constantly trying to convert back office jobs and support jobs into sales jobs. So that's going on at the same time.

Quentin Broad - *CIBC World Markets*

Okay. Thank you.

Operator

Your next question comes from Rob Wessel. Please go ahead.

Rob Wessel - *National Bank Financial- Analyst*

Yes, my questions were asked and answers, thank you.

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Thanks, Rob. Good afternoon.

Operator

Your next question comes from Susan Cohen. Please go ahead.

Susan Cohen - *Dundee Securities - Analyst*

Thank you. Your Q1 capital ratio was quite strong at 9% with your objective in excess of 8%. Are you satisfied with the 9%, or might you consider a share buy-back program or something of that order to perhaps lower it a little? That's my first question,

And my second question is, in the supplementary pack on page 17, you showed you had investment security losses of $16 million this quarter. Can you talk about that a little bit, please?

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Yes, Susan, we will. A general response, which is, that when we look at managing the overall capital, there's several levers that we lean on, one of which is, well, you've seen action on that front where, in fact, we increased both the absolute dividend, and we increased our target for the dividend payout ratio. So we start with the principle of we're not going to hold onto the capital if we don't need it to grow our business, that's point one.

But point number two is we'd love to use whatever capital we have to support growth in the businesses that are attractive, but we'll use the other levers, selectively, i.e. the dividend payout ratio, the actual dividend rate, and share buy backs selectively, all as methods of looking at the overall capital ratio. And in different periods we'll land on different degrees of that.

Karen, do you want to -- ?

Karen Maidment - *BMO Financial Group - CFO*

In terms of page 17 of the sup pack, a couple points. First of all, the other revenue, which is at the bottom of that column of 103, includes the TSX gain of 32 pretax. So that's not in the investment security gains and losses line.

The investment security gains and losses reported a loss of 16, and that would relate to both realized and unrealized gains and losses on the securities portfolios, the fixed term, the mid-grade bonds, the preferred shares, the common shares, and in this case this quarter, there were no significant writedowns, but we, as a matter of practice, look at that portfolio every quarter.

And when it is -- when the book value is less than the market value for over six months, and if we don't have a reason why we believe it will increase in the next 12 months, we would typically take a writedown. So, I think we've been fairly conservative in that approach, and the portfolio then total would have a fair market value exceeding book value, but we've taken some writedowns on individual securities.

Susan Cohen - *Dundee Securities- Analyst*

Thank you very much.

Operator

Your next question comes from Michael Goldberg. Please go ahead.

Michael Goldberg – *Desjardins Securities - Analyst*

Thanks very much. Good afternoon.

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Good afternoon, Michael.

Michael Goldberg – *Desjardins Securities - Analyst*

I have a few questions. First of all, now that you have all of your interest rate risks centralized, can you tell us what your treasury contribution to net interest revenue was -- that is the difference between your fully-matched net interest revenue and your reported net interest revenue and how that treasury contribution would compare quarter-over-quarter and year-over-year?

And my second question is, what comfort can you give us that the higher level of non-investment grade loans in the power sector won't translate into new classifications sometime going forward?

And finally, you're using 150 million provision in the latest quarter, and yet signaling that the provision for the full year won't be any higher than 700 million. So it seems like you're trying to caution, to some degree, that the possibility, that the provision could be higher in the remainder of the year than it was in the first quarter. Can you just give us a little bit of color on your thinking around that issue? Thanks.

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Okay, we'll take them in reverse order. Mike, do you want to respond to the credit issue that Michael's raised?

Michel Maila – *BMO Financial Group -Head of Corporate Risk Management*

Michael, thank you. The first question, I guess to answer, is about the guidance. As I mentioned in my remarks, we were looking at a balanced judgment, looking at, on the one hand, positive indicators in our portfolio that we have shared with you, and on the other, an uncertain environment, both in the sense of markets and the credit environment. So, we got to a balance of $700 million or less on that basis.

With respect to your point about non-investment grades in the power sector, as I mentioned before, Michael, this is a classification just to sort out on a comparable basis between banks. The answer is, we're watching that sector carefully, particularly in the U.S. and we will be recognizing impairment as soon as we can identify it on a quarterly basis.

Karen Maidment - *BMO Financial Group - CFO*

Michael, in terms of treasury operations, we typically think about it in two components, one is the management of the balance sheet, the structural balance sheet, which is the asset liability management, and that, as I said earlier, is where we try to minimize the risk as we try to maximize our ability to match the assets and liabilities. That would reflect in the corporate account.

Any treasury trading activities are in the IBG lines. If you wanted to look at sensitivity to those areas, in our supplementary package on page 39 we show interest rates sensitivity and you can see the structural line, you can see the money market, and the mark-to-market, which gives you a sense of the risk in those areas, and you'll see the structural is very low. The money market is higher, but it's a very short-term business and we're able to move quickly on that, should interest rates move.

Michael Goldberg – *Desjardins Securities - Analyst*

I'm just thinking on the asset liability management front, now that you have all this data centralized, it could be useful information to help us get a better handle on one of the key moving parts to the changes in net interest revenue from period to period?

Karen Maidment - *BMO Financial Group - CFO*

Well, we'll continue to provide this disclosure as appropriate. But we do have a very good system for us to be able to manage that, and you're right, the new system will just enhance that.

Operator

Your next question comes from Steve Cawley. Please go ahead.

Steve Cawley - *TD Newcrest- Analyst*

Hi, Karen. This reclassification is interesting, and I wonder if you had put any consideration that perhaps by removing some of the profitability from a higher multiple business, like P&C, into what I would consider a lower multiple business like corporate and support would affect the overall evaluation of your company.

Karen Maidment - *BMO Financial Group - CFO*

Well, I did think about that, Steve, and first, we wanted to report on the business the way it's managed. Secondly, we did look at the impact on overall multiple and we don't think there's any negative impact. And the third point I would make is a reminder that in our Investment Banking Group, a substantial portion of our U.S. business relates to commercial, mid-market-type activities. Those would be considered in the Personal and Commercial lines of U.S. regional banks, and in my view, should attract the higher multiple.

Steve Cawley – *TD Newcrest - Analyst*

Because like, just on the surface, as I said, I won't give the corporate support income the same sort of multiples I would P&C. So are you being unique in your disclosure here, and let's say the same level of treasury income that we're seeing at Harris is something we should be seeing at all the various banks and so your unique approach shouldn't be penalized?

Karen Maidment - *BMO Financial Group - CFO*

We shouldn't be penalized for our unique approach. I think it's a leading-edge approach and I think you'll see others moving in this direction over time.

Steve Cawley –*TD Newcrest - Analyst*

Because just to be able to differentiate between the structural and the trading -- can you just help explain this to me?

Karen Maidment - *BMO Financial Group - CFO*

Well, the structural activities are really not a profit center. Really, the activities there are trying to hedge the balance sheet -- the assets and the liabilities, in terms of duration, interest rates, and all the typical things you would try to hedge your balance sheet. Any discretionary risk or trading would happen in the Investment Banking Group where the expertise lies, and that's where the earnings are reported.

Steve Cawley– *TD Newcrest - Analyst*

Right, but -- Harris' net income now looks a lot lower than it did previously.

Karen Maidment - *BMO Financial Group - CFO*

Well, the net income of Harris hasn't changed, and when we reported the net income, we reported last year that we had 70 million U.S. of securities gains, and all we've done essentially is taken those securities gains and moved them out of the Chicagoland line into the corporate line. Now you should be able to see what the various management people are accountable. The Chicagoland banking line will reflect the loans, the deposits, the expense management-type activities, where the balance sheet management will sit outside of that.

Steve Cawley – *TD Newcrest - Analyst*

Okay, I wouldn't mind talking to you about this more, if you wouldn't mind, afterwards?

Karen Maidment - *BMO Financial Group - CFO*

Sure.

Steve Cawley – *TD Newcrest - Analyst*

Sticking with Harris, I believe, is Frank Techar on the phone?

Karen Maidment - *BMO Financial Group - CFO*

Yes, he is.

Steve Cawley – *TD Newcrest - Analyst*

Frank, maybe if you could give us a little bit of insight in terms of where you sit now? You've had some chance now to take a look at the environment in the Chicagoland market and maybe describe their being acquisition opportunities or not? It appears as if there's a lot of banks out there that are looking for assets in that market.

And at the same time, you could also talk about states contiguous and how attractive acquisition opportunities look in states that are contiguous.

Frank Techar – *The Harris Group - President, CEO*

Sure, Steve, be happy to. The first place I would start is, just from a first impression perspective. I think we're really well-positioned within the Chicagoland marketplace. You know, we've got 145 branches in Chicago, as you know, and that's second largest. And the brand that we hold in the market and our customer service scores relative to all of our very good competitors right now, is outstanding. So, from a going-in position, I feel pretty good from a competitive situation in the Chicagoland marketplace.

And I think Karen's already pointed out that our balance sheet is growing very strongly, even in a tough economic environment, so from an operating capability perspective, I feel pretty confident as well.

There is a bit more competition heating up in the market for new locations, and we're starting to see a little bit more competition for sites, so from an expansion perspective, while I think we'll meet our targets this year for growth in new locations, future periods we might be a little more challenged if we continue to see the level of activity.

So, to the question you really asked around acquisitions, I think we're going to need to ramp up our activities with respect to acquisitions, not only within Chicagoland, but outside of Chicagoland as well. I think that the way that we win, relative to others who have the same designs, is to continue to demonstrate that our business model is going to generate growth and efficient performance from a financial perspective, and we're on track to do that.

As we continue to move the business forward, so, I like our position. We've got room to grow and a ways to go in a couple of areas, but we are out actively looking, not only within Chicagoland, but also in the surrounding states as well.

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Just a supplement to that too, I was in Hinsdale last week, which is a suburb in the western part of Chicagoland, and the interesting thing is, that one of the rules of retail banking is that those early into the marketplace get, and can hold, a significant share of the business. Our bank in Hinsdale was, in fact, established in 1903, celebrated its 100th anniversary recently, and if you go through the charters, whether it be Bearington, Winnetka, Naperville, you see that the banks that have become part of the Harris Bank Chicagoland have been around a long time.

So we've got a pretty well-established, now there's no excuse for execution, you've got to execute on that, but if being in the marketplace for a substantial period of time is a good indicator of our probability of being successful, we're very well established with the assets we have in that to date. So as we do the in-fill around the established locations, that gives me a pretty strong sense of our position in those multiple communities.

Steve Cawley – *TD Newcrest - Analyst*

Maybe just two quick follow-up's. Is there a number that you're budgeting for acquisitions over the next couple of years? And the second part of that would be with a bit of uncertainty we're seeing in the Canadian market in regards to the potential or not of mergers, does that impact the timing of transactions?

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

The answer to the second question is no, not at all. We've got our strategy pretty clearly mapped out and we're executing on that and anything that happens in the consolidation environment in Canada is C&AD on that one.

With respect to the budget for acquisitions, we don't have an explicit budget for acquisitions, but you've seen the kind of pattern that we've followed over the last couple of years, and so I would consider it, and I'll get Frank to comment on this, but it would be more of an opportunistic situation if there was a location or an area that was attractive to us and we felt that there might be a small bank there. And as you know, the Illinois environment is populated with a lot of relatively small players, and if they were willing and anxious to become part of the family, and that was a faster alternative to growing than building a branch and watching it grow organically, then we'd do that.

But Frank's got a team who's looking at that, but it's more opportunistic than having an explicit budget we have to spend on that. Frank, do you want to --?

Frank Techar - *The Harris Group - President, CEO*

The only thing I would add, Steve, is my team is looking at opportunities, and the larger ones would be outside of Chicago, up to a billion and a half dollars or $2 billion from a cost perspective or a value perspective. Anything larger than that I think would be looked at by the BMO team north of the border. So we're looking at, sort of, small regional players, and as Tony mentioned, smaller banks within the Chicagoland marketplace. So that just gives you some idea of the type of potential banks that we're looking at.

Steve Cawley –*TD Newcrest - Analyst*

Those were U.S. dollars, were they, Frank?

Frank Techar - *The Harris Group - President, CEO*

Yes, U.S. dollars.

Steve Cawley –*TD Newcrest - Analyst*

Okay, thanks for your time.

Frank Techar - *The Harris Group - President, CEO*

Sure.

Operator

Your next question comes from Jamie Keating. Please go ahead.

Jamie Keating - *Merrill Lynch- Analyst*

Hi, I apologize if I missed something in Mike's comments about the credit provision, but to follow up on Michael, on Goldberg's comment --Do we want to use a balance somewhere in between what the first quarter implies and what the guidance might indicate, or, I wonder if you could help clarify that?

And then, a quick follow-up, all this discussion about acquisitions, do you have any comment on whether discount broker space holds anymore appeal going forward or whether you're kinda' done in that space in the U.S.?

Karen Maidment - *BMO Financial Group - CFO*

Jamie, it's Karen. Regarding the provision for credit losses, I want to make it clear that we book that provision each quarter as if each quarter was a year-end. So we book actual provision. We don't take the estimate for the year and divide it by four. So as a result, you shouldn't assume a smooth emergence of the provision per credit losses, and that's why we've given you the guidance that Mike articulated.

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

And on the direct investing business, we'll always look at it, but I'd say we're at critical mass. We're number six on a North American scale in that business, we've got a critical mass of clients, and that's the attractive feature of that. We've got the best technology on either side of the border.

And I keep reminding myself that this isn't really a new business, this business has been around for 25 years or more. And so it's a mature business. The only thing that's new about it, really, is the technology for getting access to it. We're suffering from the fact that markets have been depressed for 3 1/2 years, which nobody finds particularly exciting, but nevertheless, with the platform that we've got, and the client franchise that we've got, I think we're positioned for growth. Gilles, do you want to add to that?

Gilles Ouellette - *BMO Financial Group - President, CEO Private Client Group*

Obviously, we are going through some slow times, but when we made this investment it was really with the idea that we, you know, we like the potential for wealth management, and there's no question that direct investing is going to grow over time.

But we do, as Tony said, we have critical mass in there and I think it's really a matter of looking at going from market to market. I mean, we are in roughly among 25 of the fastest growing markets in the U.S., and there may be some opportunities to buy some of the smaller, direct investing houses in some of these markets, because there are some areas in particular where we want do want to bulk up, but it's really, you know, it's really market by market we're looking at.

Jamie Keating - *Merrill Lynch- Analyst*

Thanks, that's very helpful.

Operator

Your next question comes from Heather Wolf. Please go ahead.

Heather Wolf - *Goldman Sachs- Analyst*

Hi, two quick follow-up's. I'm going to dig one more time on the margin front. I'm curious if you think the increased competition from new entrants in Chicago, and those trying to expand current franchises in Chicago, might also be compressing your margins?

And secondly, I just wanted maybe a little more color on the compensation expense. You had a pretty big increase quarter over quarter. I'm curious if that's just a result of the fact the markets did improve a little bit during your first quarter or if that's a result of market conditions? I'm sorry, employment market conditions?

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Thanks, Heather. I'll get Frank to handle the first one and then turn it over to Karen.

Frank Techar - *The Harris Group - President, CEO*

Hi, Heather. On the margin front. I think you already know that Chicago's a really competitive market already, with a couple hundred banks in the marketplace. Spreads on deposits and loans relative to surrounding states are 20 basis points lower. So, I believe in what we actually see in our analysis is, there has not been any impact of new entrants on our margin, and really the thing that's going on is, the rate decline in the marketplace has put a big squeeze on our deposit margins.

And the reason why there's a little bit of a difference I believe, between Canada and the U.S., is U.S. rates came down a little later than in Canada and the compression we saw north of the border last year is really starting to affect us in the U.S. this year. So it just has to do with the timing of the rate declines. We really haven't seen a lot of new pressure on pricing over and above the level we already have within Chicago.

Heather Wolf - *Goldman Sachs - Analyst*

That's great. Thanks a lot, Frank.

Karen Maidment - *BMO Financial Group - CFO*

In terms of the expenses, Heather, year-over-year expenses in total went up $111 million. Acquisitions added 84 of that amount, and that's because we got the full year effect of CSFB. You recall we disclosed that deal in the second quarter of last year.

So that accounts for a big chunk of the increase, but we also had an increase of $58 million related to pension costs, which we discussed in our last call, the fact that pension costs overall are going up about $70 million for the year, but the most significant item, as well, is our mid-term incentive program.

Our mid-term incentive compensation program is a 3-year program where payments are made in cash after three years, based on relative total shareholder return. And in this case, we've actually for the last two years, we've hedged those programs, and so the impact on the earnings has been relatively smooth. But the program three years ago is un-hedged, and because the total shareholder return for BMO was the highest among all of the banks this quarter, we had to accrue a large amount, and that's why there is the $34 million increase in the accrual related to what we call the M-tip.

That actually -- every quarter we'll look at the stock performance on a relative basis and adjust that accrual, so that could bring some volatility over the balance of the year. That's something that I didn't anticipate this quarter when I was talking about the outlook at end of the fourth quarter. When you actually take that out, you can see that the core expense management initiatives that we have put in place are taking hold.

Heather Wolf - *Goldman Sachs - Analyst*

Okay, that's very helpful. Thank you.

Operator

Your next question comes from Ian de Verteuil. Please go ahead.

Ian de Verteuil - *BMO Nesbitt Burns - Analyst*

Just to follow up on the issue of the profitability of the retail bank in Chicago -- I see -- I think I understand what you have done on the reallocations, but if I look at, you know, Q1 '03, and Q1 '02, and fiscal 2002, and fiscal 2001, and I look at the P&C bank in the U.S. and the private client operation in the U.S., it doesn't look like that much earnings.

And I was wondering, I mean, I think of the Harris as 145 branches in Chicago, you know, one of the top 50 private banks in the U.S., the CSFB -- wouldn't -- I would have thought the earnings would be higher than that, just on the retail footprint of the BMO in the U.S. Am I missing something?

F. Anthony Comper - *BMO Financial Group - Chairman, CEO*

Ian, I'm going to get Bill Downe to respond to your question there. Bill?

William Downe – *BMO Financial Group- Deputy Chair*

Ian, I think you need to put the parts back together. First of all, in the case of the private client group, you can see the buildup of revenues over the last five quarters. And what's impacting the bottom line is the intangibles with each of the acquisitions the intangibles have built up. So,as Gilles said, in answer to an earlier question, while on a reported basis, those numbers are showing up as negative, on a cash basis they're positive. So those businesses have built up their revenues, not as fast as we would have hoped, given the market conditions, but the cost control and on a cash basis, they are positive.

And then Karen made the comment, and I think it's one that should be focused on, is if you look at the IBG income in the United States, and it's the third part of the Harris franchise. Harris Nesbitt's a very big part of it, so, out of that same community, out of the attachment area of the Harris Bank in the Chicago area have a big contribution from Harris Nesbitt and the mid-market.

And when we look at the value of the U.S. businesses, there's really those parts. There's the retail bank, the private client part, there's the commercial banking part, and then, of course, there's a traditional investment banking businesses of the BMO.

F. Anthony Comper - ***BMO Financial Group - Chairman, CEO***

When we assume the management of that client franchise, what we used to call the corporate banking franchise of the Harris Bank in the eight state mid-west region, when that came under the management direction of Bill and our colleagues in investment banking, it basically moved a portfolio of 1200 clients that, in Canada, we would regard as commercial banking clients, and moved that into the investment banking line, is the point Bill's making there.

Ian de Verteuil - ***BMO Nesbitt Burns - Analyst***

Can you quantify what -- because I think in the note to the financial, you said 18% of the group revenues was in this mid-market. Can you give us a sense of if we were try to Humpty-Dumpty this and put it back together the way someone else would, how much earnings would we have out of that mid-market business? It looks like it's about $500 million of revenues.

Karen Maidment - ***BMO Financial Group - CFO***

It's a fairly significant part of IBG, and next quarter we're going to separate that out so that you can see that component,, so you can assume a fairly large chunk of the U.S. IBG business is Harris Nesbitt.

Ian de Verteuil - ***BMO Nesbitt Burns- Analyst***

Thanks!

Susan Payne –***BMO Financial Group -S VP Investor Relations***

Operator, we'll take our last question.

Operator

Okay. Your final question comes from Quentin Broad. Please go ahead.

Quentin Broad - ***CIBC World Markets***

Thank you. I'm looking for "all the kings' horses." A couple of questions, if I can. First, just on your guidance for this year. You talk about provision for credit losses is offsetting your lower -- the lower revised economic outlook, and I was intrigued as to how a, you know, 0.3 gap in Canada and a 0.4 gap in the U.S., the magnitude of that earnings impact as you estimate it, I guess is worth about $100 million -- $120 million equivalent?

Karen Maidment - ***BMO Financial Group - CFO***

Quentin, that's extrapolating it a little further, I think it's just the general geopolitical uncertainty is something that we consider a factor here, and while the forecast isn't that different in terms of the overall economic growth, I think you can appreciate that the environment right now is very uncertain, and as a result, we're not seeing the return to capital markets and other areas that we might have otherwise seen. So it's not just directly GDP growth.

Quentin Broad - ***CIBC World Markets - Analyst***

Okay, and then just on the drivers that you have now, let's say over the next one or two years, if PCL reduction can only go off of this base quarter lower by about 50 million, I would think about 100 million is, kind of, your core level, and NIM currently is about 20 basis points better than what we've seen since an average, 1998. You know, you wonder if there's material upside, perhaps by virtue of your product mix. Your consumer loan growth is up pretty nicely on the back of an unbelievable consumer, and one has to wonder whether that's going to stay around?

Just looking at what levers are there for the BMO, are we really backing into capital markets expectation and recovery and what that will do for PCG and IBG, or it's three points on the efficiency ratio? What are the -- you've talked lots about efficiency, is that what we have to rely on in the next two years to really drive home earnings growth for the BMO?

F. Anthony Comper - ***BMO Financial Group - Chairman, CEO***

That's going be a part of it, Quentin, no question about it. But we're also seeing, and I think you saw in the numbers, a pretty strong momentum. In fact, growth well in excess of economic growth in the retail and commercial environment on both sides of the border.

So I'm looking to continued sales effectiveness and momentum in the retail and commercial business. We're going to continue to focus on cost and the efficiency ratio on the other side of the equation, so there are some levers on both the revenue side and the cost side in that.

Quentin Broad - ***CIBC World Markets - Analyst***

Thanks.

Operator

There are no further questions.

Susan Payne - ***BMO Financial Group -S VP Investor Relations***

Thanks for joining us today and as always, if you have any further questions, please either call Investor Relations at 416-867-6656 or e-mail us at investor.relations@bmo.com.