Q3 2006 CONFERENCE CALL

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Assumptions about the performance of the Canadian and U.S. economies in 2006 and how that will affect our businesses are material factors we consider when setting our strategic priorities and objectives, and in determining our financial targets, including provision for credit losses. Key assumptions include our assumption that the Canadian and U.S. economies will expand at a healthy pace in 2006 and that inflation will remain low. We also have assumed that interest rates will increase gradually in both countries in 2006 and that the Canadian dollar will hold onto its recent gains in value. In determining our expectations for economic growth, both broadly and in the financial services sector, we primarily consider historical economic data provided by the Canadian and U.S. governments and their agencies. Tax laws in the countries in which we operate, primarily Canada and the United States, are material factors we consider when determining our sustainable effective tax rate.

PRESENTATION

Operator

Good afternoon and welcome to the BMO Financial Group third-quarter 2006 conference call for August 22. Your host for today is Viki Lazaris, Senior Vice President of Investor Relations. Ms. Lazaris, please go ahead.

Viki Lazaris - ***BMO Financial Group – SVP, Investor Relations***

Good afternoon, everyone. This afternoon's brief overview of our third-quarter results will be provided by Tony Comper, our Chief Executive Officer; Bill Downe, our Chief Operating Officer; Karen Maidment, Chief Financial and Administrative Officer; and Bob McGlashan, Chief Risk Officer. After Bob's presentation, Tony, Bill, Karen, Bob, and the following members of the management committee will be available to answer your questions -- Yvan Bourdeau from Investment Banking; Gilles Ouellette from Private Client Group; Lloyd Darlington, Head of Technology and Solutions; as well as Frank Techar, who will take questions pertaining to both the Canadian and U.S. Personal & Commercial Client Groups for this quarter.

At this time I would like to caution our listeners by stating the following on behalf of those speaking today. Forward-looking statements may be made during this call and there are risks that actual results could differ materially from forecasts, projections, or conclusions in the forward-looking statements. Certain material factors and assumptions were applied in drawing the conclusions or making the forecasts or projections in the forward-looking statements. You may find additional information about such material factors and assumptions and the material factors that could cause actual results to so differ in the caution regarding forward-looking statements set forth in the news release or on our investor relations website at BMO.com.

With that said, I would like to hand the floor over to Tony.

Tony Comper - ***BMO Financial Group – Chief Executive Officer***

Thanks, Viki. Good afternoon, everyone. Let me just remind you that some of my comments today will be forward-looking just as Viki noted in the cautionary statement.

Well, I think the facts speak for themselves. We had an excellent third quarter. Net income increased 30% to a new high of $710 million. Earnings per share grew 29% and all three operating groups delivered strong year-over-year growth. I'm actually delighted with BMO's record performance.

The Personal and Commercial Client Group earned record net income and also led earnings growth from the second quarter and as we anticipated there was an improvement in net interest margin in Personal and Commercial Canada. Given our focus on increasing revenue throughout the enterprise, we are also encouraged by revenue growth of 6.7% enterprise wide. In fact revenue grew 8.9% if you exclude the sale of Harrisdirect and 11.5% after also excluding the impact of the weaker U.S. dollar.

Productivity strengthened considerably to 61.5% or 61.1% on a cash basis. Our credit performance was very, very strong, reflecting BMO's high-quality loan portfolios. If you look at the year-to-date performance now, slide four shows that we are making very good progress towards our annual targets. With our credit portfolio performing better than we had expected, we now anticipate a specific provision for credit losses of $250 million or less in fiscal 2006 and that is down from our estimate of $325 million which was at the end of the first quarter. And we are solidly on track to achieve all our other targets for the year. What's more, we are successfully balancing investments to achieve these targets with strategic investments for future growth, and Bill is going to comment on that further.

The recent announcement of our intention to purchase bcpbank Canada, which increases our presence in growing multicultural markets in the high-growth Toronto area, also reflects our determination to seize opportunities to expand and to grow our Canadian franchise. This is in addition of course to the de novo expansion of our Canadian distribution network in other high-growth areas including Alberta and British Columbia and the expansion of our retail sales force.

In the U.S. we continue to focus on our goal become the leading personal and commercial bank in the Midwest with a network of 350 to 400 branches and we want to accelerate progress towards this goal through a combination of aggressive organic growth, de novo branch expansion, and acquisitions.

I also want to draw your attention to important leadership changes announced during the third quarter including new leadership in both Canadian and U.S. personal and commercial banking, Frank Techar, is now head of P&C Canada and Ellen Costello succeeds Frank as head of Harris' retail and commercial operations in the United States. And Ellen is going to be joining us on this call next quarter. These key appointments and a number of other senior leadership changes made at the same time and the leadership appointments announced earlier this year give us great confidence in management's capacity to develop and implement strategy, grow our businesses, and increase profitability.

So while our major focus remains very firmly on BMO's target markets in North America, we are also optimistic about the progress that we are making in expanding and deepening our long-standing presence in China. Our branches in China offer a wide range of products and services including trade finance, foreign exchange, corporate lending, and risk mitigation products for our North American corporate client base and immigration banking advisory services to help new Chinese immigrants establish banking relationships with our retail and private banks in Canada.

Through our investment in Fullgoal Investment Management Company, we also help the Company manufacture and distribute mutual funds for the Chinese domestic market. And although our investments in China do not yet make a significant contribution to the bottom line, this management team is taking the steps necessary to secure BMO's long-term future in China's rapidly expanding financial services market. In June, BMO was the only Canadian co-lead manager of the Bank of China's IPO in Hong Kong. At the end of July, BMO became the first Canadian bank to begin the green light by Chinese authorities to provide banking services in Beijing and local currency in addition to foreign currency. Last week we took the next vital steps toward our objective of becoming the most trusted adviser to Chinese business leaders, announcing the opening of a BMO Capital Markets representative office in Beijing.

Overall, the management team is energized by the strategic progress that we are making and the performance that we are delivering today while building for the future.

Over to you, Bill.

Bill Downe - ***BMO Financial Group – Chief Operating Officer***

Thanks very much, Tony. I'd like to make a few additional comments before turning it over to Karen and I'll also remind you that while I'm looking back over the third quarter, some of my comments may be forward-looking and should be treated accordingly.

From the perspective of a Chief Operating Officer, this is a quarter where we are able to see actions that we have taken generating results; growth across our businesses, on track to meet our targets and bottom line growth from core operations. What's more, we have delivered record results while making substantial investments to increase shareholder returns in both the short and the long term.

In Canada for example, we are in the process of replacing all of our automated banking machines to make our network more customer friendly and secure. We've replaced more than 1000 ABMs as of the end of the third quarter and are on track to replace the entire network by the end of the year. We also continue to invest in upgrading and expanding our branches with 85% of our branches refreshed in the last 18 months. And most important of all, we continue to invest in our people. Since the end of 2005, we have recruited and successfully deployed 1000 additional people to serve our Canadian banking customers. In parallel we are increasing our sales force in the Private Client Group to grow our share of wallet in the personal banking market.

We are also making significant investments in our U.S. retail network. The Harris Connect initiative to replace the current branch infrastructure is slated for completion by the end of the fiscal year. This technology platform allows our sales and service staff to be more proactive in meeting our customers needs. At the end this month, when the conversion of the Mercantile acquisition is complete, all 200 Harris branches will be operating on the same advantage platform, marking the end of a major undertaking that began 24 months ago with the consolidation of the individual bank charters.

Finally I would like to reinforce Tony's comments on the recent senior leadership changes at BMO. We are confident that we have the right leader for P&C Canada with the appointment of Frank Techar. We expect his management team to capitalize on our recent investment in people, systems, and branches to take market share in both personal and commercial banking in Canada.

I feel just as positive about the appointment of Ellen Costello as his successor in the U.S. Having worked closely with Ellen for many years, I have confidence in her demonstrated ability, leadership including both her financial discipline and her people management. She has done an outstanding job in a progression of assignments, most recently her work on the acquisition of GKM, which was critical to the successful integration of the business. As she takes on her new role I have every confidence she will extend her track record of success.

We also feel very good about the experienced management team in Chicago working with Ellen. Tim Crane is now in charge of personal banking in the U.S.; Peter McNitt heads up commercial banking, two highly experienced professionals. Underlying the fundamental importance of reaching out to develop and deepen relationships in the communities we serve, Yasmine Bates is now Head of Community Affairs and Economic Development.

The U.S. team has the ability to generate strong organic growth from an existing position of market leadership and customer service and they have a scalable platform to support future acquisitions. Like Tony, I feel very positive about the steps we are taking to boost revenue and increase returns for our shareholders.

Karen will now take us through the numbers for the quarter.

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

Thanks, Bill, and good afternoon. Looking at the numbers, we had a record quarter. Net income was $710 million, up $163 million or 30% from a year ago, driven by strong retail and commercial banking results. This quarter's results included a $25 million after-tax gain on the MasterCard International IPO, which was in line with the estimate I provided at the end of last quarter.

On the capital side, we generated an ROE of 20.3% for the quarter and ended the quarter with a strong Tier 1 capital ratio of 10.07% and as Bob will cover, asset quality remains strong.

Before I go on, I would like to point out that there were two minor accounting changes that affected our results this quarter. The first relating to the adoption of the new accounting requirements for stock-based compensation. And secondly, for balance sheet purposes, a change in the way we account for purchase and sale of securities from trade date basis to settlement date basis, aligning us with most of the other Canadian peers. Prior period results were restated to reflect these changes and the impact on EPS is negligible as you see on slide 29.

Turning to slide four and looking at group net income, all operating groups performance was up year-over-year. Personal and commercial earnings were driven by revenue growth in both Canada and the United States in source currency and the $25 million after-tax gain on MasterCard as well as a low effective tax rate relating primarily to a $26 million recovery of prior year income taxes.

The Private Client Group continued to achieve very strong year-over-year growth through increased operating revenues across all lines of business posting earnings of $85 million, up $22 million or 35% or excluding Harrisdirect up $10 million or 13%. The Investment Banking Group's earnings increased $17 million or 9% year-over-year and this was largely due to higher trading and commission revenue and increased M&A activities.

Quarter-over-quarter P&C earnings were up $90 million or 31%. P&C Canada benefited from good volume growth, improved net interest margin, the lower effective tax rate and the gain on the MasterCard IPO, as well as the impact of three more calendar days. P&C Chicagoland banking's improvement was driven by higher revenues and lower costs.

The Private Client Group earnings declined $11 million or 12% as capital markets were less robust than in the second quarter and there was seasonally lower client trading volumes while costs rose due to increased investment in our sales force. Investment Banking Group net income also declined quarter-over-quarter by $44 million or 18%, although trading revenues were high, they were down from the strong second quarter, as were underwriting revenues and investment security gains.

The next slide shows the quarter-over-quarter and year-over-year change in cash EPS. Looking at the bottom of the slide, you can see year-over-year, the increase in cash EPS was $0.30 or 27%, driven by strong net income growth in all operating groups, benefiting from robust revenue growth tax initiatives and recoveries, while continuing to invest in our businesses. Looking at the top of the slide quarter-over-quarter, cash EPS increased $0.13 or about 10% driven by operating growth, the MasterCard IPO and less robust capital markets affecting our wealth management and investment banking businesses.

You'll see on the bottom of slide six that revenue growth was 6.7% year-over-year but really 11.5% if you factor out the impact of the U.S. dollar and the disposition of Harrisdirect. This was achieved by strong growth in all operating groups. More specifically, P&C Canada increased $129 million driven by strong volume growth in both personal and commercial products, the MasterCard gain, higher card insurance and securitization revenues, as well as increased sales of term investment products and mutual funds, partially offset by the impact of a lower net interest margin.

The Investment Banking Group was up $31 million on higher trading revenues, security commissions, and M&A activities. Private Client Group was down $2 million but up $46 million if you exclude Harrisdirect on broad-based revenue growth. And P&C Chicagoland was unchanged, but up $24 million in U.S. dollars, driven by strong consumer and commercial loan growth and improved noncore deposit spread and the acquisition of Villa Park. On the top of the slide, revenue grew 4% quarter-over-quarter mostly as a result of P&C Canada, which was up $131 million on volume growth, MasterCard gain, improved net interest margin, and higher revenue from card securitization and insurance as well as the impact of three extra days.

On slide seven, you'll see that the total bank margin was 160 basis points in the third quarter, up 5 basis points from last quarter and down 8 basis points from a year ago. The quarter-over-quarter increase was mainly due to an 8 basis points improvements in P&C Canada's net interest margin. This was due to pricing actions in our premium rate savings accounts, shifts to higher spread products, and increased mortgage refinancings fees as customers transferred from variables to fixed-rate mortgages.

As previously discussed, we changed our mortgage pricing strategy in May and we are beginning to see mortgage spreads stabilize. Looking at it by group quarter-over-quarter, in addition to P&C Canada which I just mentioned, you'll see that P&C Chicagoland banking is down 7 basis points as improved spreads on deposits was offset by competitive pressures on loans in a rising interest rate environment. And the Investment Banking Group's net interest margin rose 2 basis points quarter-over-quarter on approved trading net interest income and higher cash collections on previously impaired loans.

Slide eight shows that expenses increased $40 million quarter-over-quarter and $31 million year-over-year excluding the impact of Harrisdirect in 2005 and the impact of the weaker U.S. dollar, expenses increased $139 million or 9.3% year-over-year. I think Bill has provided a strategic overview of the initiatives and expenses, so I won't provide any further details on that.

As you can see on slide nine, there is an improvement year-over-year in the cash productivity ratio of 226 basis points and quarter-over-quarter of 78 basis points. On a year-to-date basis, our cash productivity improved 162 basis points against our target of 100 to 150.

Turning to the U.S. performance on slide 10, results in sourced currency totaled $101 million, up $2 million year-over-year or quarter-over-quarter and $33 million year-over-year. Lower provisions for credit losses and the Harrisdirect operating loss a year ago were the main contributors of the year-over-year growth.

On slide 11, you can see the Tier 1 capital ratio was 10.07%, well above our stated goal of a minimum of 8% while our total capital ratio was 11.59. The bank's risk-weighted assets reached $161.7 billion in Q3, representing a quarter-over-quarter increase of $5.3 billion, which was mainly in investment banking where there was a broad-based increase in risk-weighted assets associated with lending activities, market risks, and derivatives and approximately $1 billion of those was related to timing.

Wrapping up on slide 12 and drawing your attention again to the caution regarding forward-looking statements on slide one, you'll see as Tony mentioned, we're solidly on track to achieve all five of our financial targets for the year and in order to achieve our EPS growth target, we need a Q4 EPS between $1.01 and $1.24.

That summarizes my comments and I will turn it over to Bob.

Bob McGlashan - ***BMO Financial Group – Executive Vice President and Chief Risk Officer***

Thanks, Karen. Good afternoon, everyone. Before I begin, I too would like to draw your attention to the caution regarding forward-looking statements.

As you can see on slide three, credit performance exceeded expectations for this quarter and on slide 4, credit quality remains strong. Gross impaired loan balances continue at historical lows with GIL formations in the quarter moderating after an unusually high second quarter. High second quarter was driven by one large transaction in the forest industry of $71 million which has since been fully repaid.

Slide five shows total PCL at $42 million decreased $24 million quarter-over-quarter, which reflects a strong net recovery from the corporate portfolio. On slide six, new specific provisions remain low and in line with where we are in the credit cycle. On slide seven, Q3's specific PCL represents 9 basis points of average net loans and acceptances including reverse repos while Q2 was 14 basis points. Specific PCL remains low compared to our fifteen year average of 38 basis points and the Canadian competitor average of 59 basis points.

As shown on slide eight, our specific PCL target for fiscal '06 has been reduced to $250 million or less. This represents 14 basis points of average net loans and acceptances again well below our fifteen year average and up 1 basis points over 2005. While current PCL levels are very low, looking at indicators like GIL formations we're not yet seeing signs of an increase in losses. When the credit cycle does turn, the availability of hedging tools and the deeper secondary market should have a moderating effect resulting in a shallower and more gradual increase in PCL than otherwise may have been the case. In addition, current economic forecasts and fiscal policy do not suggest the deep economic decline in Canada or the U.S. barring some unexpected event.

We continue to monitor those industry sectors considered to be of most concern in today's economy including the Auto and Forestry sectors as well as those sectors considered to be particularly sensitive to high energy prices and a strong Canadian dollar. BMO's exposure to these sectors remains well within acceptable levels.

As we have reported in the past, slide 9 illustrates our exposure to the auto manufacturing and supply sectors and of note there were no significant losses in this sector this quarter or last.

Finally slide 10 shows our trading and underwriting performance has been relatively stable with the largest P&L loss of $2 million primarily attributable to a decrease in natural gas prices and implied volatilities. The two largest daily P&L gains for the quarter were approximately $15 million on June 14 and 15 and the largest contributors to these gains were from the commodity line of business primarily driven by increased client trades and increased natural gas prices and the equity line of business driven by market advances.

Market value exposure has increased mainly as a result of increased money market and commodities exposures. The increase in money market accrual book exposure reflects the addition of longer dated assets.

With that, operator, we can now go to questions.

QUESTION AND ANSWER

Operator

Jamie Keating, RBC Capital Markets.

Jamie Keating - *RBC Capital Markets - Analyst*

Congratulations on a good quarter. Two quick questions. One simple. Karen, you referred to the mortgage prepay or financing fees being up I believe and it was mentioned on a couple of slides. I'm just wondering if we might get a little more detail around the delta either year-on-year or perhaps the actual dollar amount. It's helpful to know where that is tracking relative to run rate.

Karen Maidment – *BMO Financial Group – Chief Financial and Administrative Officer*

Jamie, in terms of the margins, when we look at the 8 basis point improvements in the P&C margin, we would say about 3 basis points relates to that.

Jamie Keating - ***RBC Capital Markets - Analyst***

Okay, that's helpful. Then the follow-on question to that would be are those spreads still kind of coiled for a bit more improvement as the last of the rate guarantees rolls off the mortgages and refining pricing on deposits, have we kind of turned the corner and started to head up a bit or are we kind of seeing what we're getting? Could we have some guidance or thought on that one?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

I think the rate of increase looks slow, but I'll ask Frank to provide some more color on that.

Frank Techar - ***BMO Financial Group - President and CEO, Personal & Commercial Banking Canada***

The reasons for the spread improvement on a linked basis, the first one was we've seen some improvement on our deposit spreads as a result of some of the pricing decisions that we made. The second one would be we have got some higher growth in some of the higher spread products, cards and commercial deposits. The third one is the mortgage issue, where we actually have seen better spreads on our new branch originated mortgages as an example, 20 basis points higher than five months ago and we have seen these refinancing fees follow through.

We don't think the refinancing fee piece is going to continue as the transfer or the switch from variable to fixed starts to wind down over the following quarters, but we would expect that the other reasons would continue unless we make some different decisions. So I think Karen's comment about, we're really happy that spreads are up 8 basis points but probably unlikely to continue on that trend line if you look out over the next few quarters.

Jamie Keating - ***RBC Capital Markets - Analyst***

That's very helpful. Thanks. The buyback was relatively low this quarter and certainly there was a highlight in I think either Bill's or Tony's comments about aggressively growing Harris. Just wondering if you want to give us a little colour as to how those three buckets of growth potential may be deployed over the next little while? Certainly a lot of arrows pointing towards you could be poised to do an acquisition. Is there anything to get done out there or is it still pretty quiet?

Bill Downe - ***BMO Financial Group – Chief Operating Officer***

Jamie, it's a repeat of the story in each quarter. We are devoting considerable effort to maintaining an open dialogue in the marketplace. We believe that there will come a moment in time when transactions that we see off in a distant pipeline will come in closer. You just can't predict from one quarter to the next. The fact of the matter is that we have about $3 billion of capital available for acquisitions because we anticipate that the pipeline will be there.

Jamie Keating - ***RBC Capital Markets - Analyst***

Excellent. Thanks.

Operator

Ian De Verteuil, BMO Nesbitt Burns.

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

This is a question for Karen and it relates to tax. Karen, one of the things we see at the BMO has been consistently the tax rate coming in a bit lower quarter-to-quarter and year-over-year than I think most of us would have unexpected. Can you talk to how sustainable these improvements are? The way I looked at it is I think if you add back the tax recovery, the tax that was around 27%, so could you talk to that number?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

Sure. We have been working hard on the management of taxes and trying to take advantage of opportunities that makes sense for us. The actual rate for the third quarter was 24%. The rate at the end of Q2 was 23%, although the make up was a little different. The sustainable rate that we have previously quoted in our press release was 30 to 32% and this time we moved it down to 28 to 30%, to kind of reflect the lower tax rate. But there will be some natural volatility in that number. But I think 28 to 30% is a more reasonable sustainable rate.

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

Just to take issue with that, when I go back a year ago, you said I think in the press release it was 31 to 32 in Q3 of last year. In Q4 it was 30 to the 31. In Q1 and Q2, 29 to 31 and Q3 was 28%. It seems as if the effective rate goes down and then you tell us afterwards the sustainable rate goes down. Is that sort of a normal progression that you work on things, you get progress, and then you reduce what you call sustainable tax rate?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

You know, I think that is a fair comment, but on the other hand the tax planning initiatives are lumpy and there will be some volatility in that number. So yes, we are making good progress and that is reflected in bring the tax sustainable rate down. I think 28 to 30 is a prudent number right now.

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

Thank you.

Operator

Steve Cawley, TD Newcrest.

Steve Cawley - ***TD Newcrest - Analyst***

First question for Frank. Frank, I've got to admit that I have been pretty critical of Harris' performance over the past few quarters. I guess the most obvious thing that we did not see was a more meaningful acquisition, but something tells me you were doing lots of stuff behind the scenes to improve the long-term performance of this organization and on slide 9 you talk about integrations. You talk about branch technology initiatives.

Can you talk about what you hope you have done in the back office area will do to the bottom line moving forward and maybe more qualitative type comments as well?

Frank Techar – ***BMO Financial Group - President and CEO, Personal & Commercial Banking Canada***

I think Bill touched on it a minute ago. If you look at the amount of investment that is going into the business, it's pretty substantial. And Bill mentioned I think the fact that our onetime acquisition costs year-over-year went up $10 million. In fact if you look at the year-to-date one-time expenses, they are $14 million in the business. So our expense growth over the last couple of quarters have been pretty high, but it has been associated with the acquisitions that we have been integrating over the course of the last 12 months.

One of the things we have talked about is the fact that some of those have been pretty tardy relative to the closing date and what we have been doing is upgrading the backbone of the technology infrastructure in the branch network. New communication line servers, those types of things to allow us to operate on a scalable platform going forward. And we have also been investing money in our teller platform which we needed to relative to some obsolescence issues also with the intent of making it scalable. So those expenses are also included in the business, but the way I would look at those would be we're always going to have some initiatives that we are going to be looking to invest in going forward to try to improve the business.

So the two points I would just leave you with to see if I hit the question, one, we think there is a level of expense in the quarter and in the year-to-date numbers that are associated with the one-time acquisitions. And two, we think we have got a platform that is now sustainable and scalable relative to any other acquisitions that we would make.

Steve Cawley - ***TD Newcrest - Analyst***

What initiative are you most proud of that you were able to accomplish at Harris?

Frank Techar - ***BMO Financial Group - President and CEO, Personal & Commercial Banking Canada***

I think what I just said is a big part of it. But if I am adding one thing to it which is something we don't talk about on the call a lot, if you look at the loyalty scores and customer service scores, they have gone up every single year in a dramatic fashion and we have closed the gap on the smaller banks in the marketplace and we have extended our lead relative to the big players. I think that again just sets us up well relative to our ability to compete in a very competitive marketplace.

Steve Cawley - ***TD Newcrest - Analyst***

One more. Karen, you gave a bunch of reasons why the investment banking in the U.S. saw its assets shoot up so much in the quarter. It did not feel it was quite as positive as I guess I had once maybe thought it was when I was looking through the numbers. Are you seeing a significant increase in corporate loan demand at this point in time?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

We are seeing an increase in loan demand as well as increases for some of our trading activities, but Yvan could probably provide some color on the loans.

Yvan Bourdeau - ***BMO Financial Group - CEO, BMO Capital Markets***

Yes, Karen, thank you. Steve, I will give you a rundown of the numbers as I do normally each quarter and I'll give that to you in terms of U.S. source currency. That is where the bulk of the increase took place on the loan front. So first of all I have mentioned that over the last 12 months on an ongoing basis, our authorizations are going up and in fact if I look back over the last 12 months, our authorizations have increased by US$4.2 billion.

Now in terms of average earning assets in IBG, last year in U.S. currency as of July '05 we were at $11.7 billion and as of July '06 we were at $13.6 million. So that is nearly a $2 billion increase year-over-year or 16%. So these two elements, an increase in authorization as well as tangible increase in average asset really indicate that we are continuing to penetrate quarter after quarter the U.S. market and if you were to see the trend that I have in front of me, there is no question the trend is about 35 to 40 degrees positive, so we're very pleased with this.

In Canada the increase in earning asset quarter-over-quarter has been somewhat a bit more modest. It moved from 8.2 to 8.6, which is $400 million and quarter-over-quarter in the U.S. we moved from $13 billion to $13.6 billion which is $600 million in increase. So that is in terms of the average earning assets in the U.S.

In addition to that, we have had increases in our trading securities. As we saw the yield curve flattening and in our own mind probably coming to an end for the Fed to pause and at one point in time we believe given that what we anticipate in terms of slowdown, not a recession in the U.S. economy, at one point in time the Fed will actually in our mind start to reduce their Fed funds. So we're starting to position ourselves towards that and that implies obviously increase in trading asset as well as in our repo books. And those were the three main components that contributed to asset growth quarter-over-quarter and year-over-year.

Steve Cawley - ***TD Newcrest - Analyst***

Thanks for that.

Operator

Mario Mendonca, Genuity Capital Markets.

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

The mortgage rates were raised and it looks like although there was a small give up in market share, residential mortgages, nothing terribly dramatic there. What I'm interested in understanding is going into the next quarter, is there any sort of residual effect you can envision in terms of residential mortgage market share from having raised rates in the quarter?

Frank Techar - ***BMO Financial Group – President and CEO, Personal & Commercial Banking Canada***

I am not sure I understand the question.

Mario Mendonca - Genuity Capital Markets - Analyst

I could rephrase it.

Frank Techar – ***BMO Financial Group – President and CEO, Personal & Commercial Banking Canada***

Why don't you take a crack at it?

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

Sure. The bank raised residential mortgage rates substantially in the quarter. We see market share residential mortgages down I think it's about maybe 16 basis points in your presentation. What I'm trying to understand is is there a residual effect here, a further loss of market share as these higher mortgage rates and perhaps removing some discretion in the in-branch? Is there any sort of residual effect of lost market share going forward that you can envision or essentially was this quarter -- that was the effect, the 16 basis points?

Frank Techar - ***BMO Financial Group – President and CEO, Personal & Commercial Banking Canada***

Well, I think one of the things that I am talking to my team about and we're talking about here as a leadership team is what the trend in share for the mortgage product should be for our Company and so we're having some conversations about mix and we're having some conversations about the products that we think will benefit us the most. So in specific answer to your question, I would not expect a dramatic fall off in share in the mortgage product. At the same time, if we saw a further slight decline I would not be too concerned about it because we have taken some actions that were clearly directed at spread and we think that on a revenue trade off perspective we are actually in a better spot.

So when I'm looking at the share numbers, a little bit of a decline on the mortgage side does not feel too bad. A large decline would. I am not anticipating a large decline and we are really happy about the consumer lending pick up on the share numbers. So that trade from one product category to the other is a good one.

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

Can I interpret that to mean that as long as you are picking up or at least maintaining share in some of the higher margin businesses, say the cards for example or commercial lending, you are content to watch mortgage market share decline a little bit? That is an appropriate characterization?

Frank Techar - ***BMO Financial Group – President and CEO, Personal & Commercial Banking Canada***

I think where we're sitting right now the answer to that is yes.

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

Okay. And personal deposits, you refer to this personal deposits offer. You call it attracting -- it's attracting more interest and its doing better than you anticipated. Are we talking about a premium rate savings account there or --?

Frank Techar – ***BMO Financial Group – President and CEO, Personal & Commercial Banking Canada***

No, it is actually a core chequing offer. We have reconfigured our plans and are out in the marketplace trying to sell those. In fact we have seen about 17% of our core deposit portfolio switch over. This is again along the lines of one monthly fee, a lot of services and features that go along with it. So the good news is we have seen a very rapid uptick from our customers relative to the product which we think has got some great service features and great features associated with it, but again if you look at slide 15 and you look at our core deposit share, it is declining. And so that is one of the share areas where we're not happy and we need to do more than we're doing, but we're happy with the early results on the offer that we have in the market.

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

So is the trade off there you pick up some core deposits, good low-cost funding, but you give up a little bit on the fees then? That is the logic in that one?

Frank Techar - ***BMO Financial Group – President and CEO, Personal & Commercial Banking Canada***

I think that's right.

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

A couple of other quick things. There was a fairly significant increase in lending fees, $92 million this quarter up from, say, $77 million. Is that what we are seeing -- is that really the results of what is happening in the U.S., growing the commercial book in the U.S.?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

That would be one of the factors, yes.

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

Anything else that would cause that to move -- because that just seemed a little bit higher than I would've expected.

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

No, nothing else that is unusual there, just volume of activity.

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

Growth in commercial lending in the U.S. primarily? I guess that is the explanation. Is that true?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

Yes.

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

Finally with respect to your guidance, you did the math for us there, Karen, $1.01 to $1.24, pretty healthy range there for Q4 '06. What do you figure causes that delta, the $0.23? Is it mostly your PCL guidance where you're still looking for -- I know you're not looking for this. You are saying 250. You are at 160, so you are talking about 90 million in the quarter. That would be more than double what you had this quarter. Is that the real difference between the $1.24 and the $1.01?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

Yes, the PCLs will cause variability in the range but I was just really doing the math to show you where it would be against the targets. To hit the productivity target, we need to be fairly close to the high-end of the EPS range.

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

So good productivity --?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

And the real biggest variable is the PCL.

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

Right. Thanks very much.

Operator

Susan Cohen, Dundee Securities.

Susan Cohen - ***Dundee Securities - Analyst***

Thank you. The MasterCard International, how much do you have left on your books?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

Our book value is nominal because it is at cost, so it is almost zero. But we do have some shares that we are not allowed to liquidate for four years.

Susan Cohen - ***Dundee Securities - Analyst***

Okay. Secondly, Karen, you've mentioned a lot about your initiatives in China. Is that contributing to your bottom line yet or is that something that we can look forward to down the road?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

It is pretty much covering its costs and all the earnings potential is in the future.

Susan Cohen - ***Dundee Securities - Analyst***

By the future can you quantify that in any way?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

I think it's going to take some time before it is a material component of the bottom line.

Susan Cohen - ***Dundee Securities - Analyst***

Thank you.

Operator

Jim Bantis, Credit Suisse.

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

Just a couple of quick questions. Karen, I'm looking at the press release and total trading and underwriting summary in terms of volatility, VaR, a pretty big pickup that we saw quarter-over-quarter particularly on the commodity trading side. I know the bank has picked up its activity on that, but my understanding was that most of the activity was client driven. So has there been an increase on the proprietary trading side?

Then the second question, while you're looking at that perhaps, is I want to get an update on the cost of the branch system and ABM expansion. I think you've given update in prior quarters but I just wanted to see how that is trending upward, like a government contract or anything of that nature?

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

First of all, the trading revenue is up across the whole -- all the elements of trading interest rate, FX and commodities, but I will give it over to Yvan to talk about the specifics around client-driven versus proprietary.

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

This is specifically related to the VaR that is highlighted in your press release, page 17?

Yvan Bourdeau - ***BMO Financial Group - CEO, BMO Capital Markets***

Yes, thank you, Jim. The increase that you saw in the VAR is somewhat related as you were mentioning to commodities. There is no question that still in Q3, not as much as Q1 and Q2, but still in Q3 we had a fair amount of volatility related to the two primary commodities that we trade, which is natural gas and oil. There is no question that the volume emanating from our producer as well as on the buy-side has continued to be very large. And in that context, we do take slightly more proprietary risk but I would not consider it a material increase in our proprietary risk that would contribute all that much to VaR.

During Q3, there were also increases in volume on the trading side on the FX because the Canadian dollar was also trading in a fairly wide range in terms of volatility as well as interest rates, as there was a lot of debate in the marketplace as to whether or not the Fed was about to stop increasing interest rates. That created also a lot of interest on the part of our clients to hedge one way or the other their position on their books. So it is accumulation of all the aspects of trading that in Q3 saw some increase in the VaR and as you saw in our overall results quarter-over-quarter, still a very solid quarter in terms of revenue emanating from all of our trading businesses.

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

Yvan, I guess the take away for us is that although there was a spike-up near quarter end, we don't really anticipate the higher level of risk with respect to the trading operations.

Yvan Bourdeau - ***BMO Financial Group - CEO, BMO Capital Markets***

I'm sorry, if you would repeat that please, Jim.

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

Your take away from your comments is that there is not a higher level of proprietary risk, abnormally high relative to what was done in the past?

Yvan Bourdeau - ***BMO Financial Group - CEO, BMO Capital Markets***

There is a slightly higher one as the volume across the board increased, but I would not considered it as a structural one or at this point a material one.

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

That's great, thank you.

Karen Maidment - ***BMO Financial Group – Chief Financial and Administrative Officer***

Jim, on the expense side, on P&C Canada, those initiatives that Bill had referred to have both capital related items as well as expense related items, but when you look at the P&C expense increases, most of it relates to investment type spending, because we are holding the line very, very tightly on the other spending and Frank can add to that.

Frank Techar – ***BMO Financial Group - President and CEO, Personal & Commercial Banking Canada***

Yes I think, Jim, if you look at the increase year-over-year in expenses of $62 million, about one-third of that is associated with increased employee headcount mostly associated with our line jobs. About one-third of it has to do with initiative spends which I would put the ABM refresh and the investment in our branches in it. And about one-third of it has to do with other systems infrastructure work that we are undertaking. So it gives you some sense of the make up of that increase.

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

Got it. Thanks very much.

Operator

There are no longer any questions registered in the conference. I would now like to turn the meeting back over to Ms. Vicki Lazaris.

Viki Lazaris - ***BMO Financial Group – SVP, Investor Relations***

Thank you, operator. Thank you for joining us today. If you have any further questions, please either call the Investor Relations group or send us an e-mail and thank you and good afternoon to all.

Operator

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