BMO Financial Group

Bank of Montreal at CIBC Eastern Institutional Investor Conference 2019

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Bank of Montreal's public communications often include written or oral forward-looking statements. Statements of this type are included in this document and may be included in other filings with Canadian securities regulators or the U.S. Securities and Exchange Commission, or in other communications. All such statements are made pursuant to the "safe harbor" provisions of, and are intended to be forward-looking statements under, the United States Private Securities Litigation Reform Act of 1995 and any applicable Canadian securities legislation. Forward-looking statements in this document may include, but are not limited to, statements with respect to our objectives and priorities for fiscal 2019 and beyond, our strategies or future actions, our targets, expectations for our financial condition or share price, the regulatory environment in which we operate and the results of or outlook for our operations or for the Canadian, U.S. and international economies, and include statements of our management. Forward-looking statements are typically identified by words such as "will", "would", "should", "believe", "expect", "anticipate", "project", "intend", "estimate", "plan", "goal", "target", "may" and "could".

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The future outcomes that relate to forward-looking statements may be influenced by many factors, including but not limited to: general economic and market conditions in the countries in which we operate; the Canadian housing market; weak, volatile or illiquid capital and/or credit markets; interest rate and currency value fluctuations; changes in monetary, fiscal, or economic policy and tax legislation and interpretation; the level of competition in the geographic and business areas in which we operate; changes in laws or in supervisory expectations or requirements, including capital, interest rate and liquidity requirements and guidance, and the effect of such changes on funding costs; judicial or regulatory proceedings; the accuracy and completeness of the information we obtain with respect to our customers and counterparties; failure of third parties to comply with their obligations to us; our ability to execute our strategic plans and to complete and integrate acquisitions, including obtaining regulatory approvals; critical accounting estimates and the effect of changes to accounting standards, rules and interpretations on these estimates; operational and infrastructure risks, including with respect to reliance on third parties; changes to our credit ratings; political conditions, including changes relating to or affecting economic or trade matters; global capital markets activities; the possible effects on our business of war or terrorist activities; outbreaks of disease or illness that affect local, national or international economies; natural disasters and disruptions to public infrastructure, such as transportation, communications, power or water supply; technological changes; information and cyber security, including the threat of hacking, identity theft and corporate espionage, as well as the possibility of denial of service resulting from efforts targeted at causing system failure and service disruption; and our ability to anticipate and effectively manage risks arising from all of the foregoing factors.

We caution that the foregoing list is not exhaustive of all possible factors. Other factors and risks could adversely affect our results. For more information, please see the discussion in the Risks That May Affect Future Results section on page 79 of BMO's 2018 Annual Report, and the sections related to credit and counterparty, market, insurance, liquidity and funding, operational, model, legal and regulatory, business, strategic, environmental and social, and reputation risk, in the Enterprise-Wide Risk Management section on page 78 of BMO's 2018 Annual Report, and the Risk Management section on page 27 in BMO's Third Quarter 2019 Report to Shareholders, all of which outline certain key factors and risks that may affect our future results. Investors and others should carefully consider these factors and risks, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. We do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by the organization or on its behalf, except as required by law. The forward-looking information contained in this document is presented for the purpose of assisting our shareholders in understanding our financial position as at and for the periods ended on the dates presented, as well as our strategic priorities and objectives, and may not be appropriate for other purposes.

Material economic assumptions underlying the forward-looking statements contained in this document are set out in the 2018 Annual Report under the heading "Economic Developments and Outlook", as updated by the Economic Review and Outlook section set forth in BMO's Third Quarter 2019 Report to Shareholders. Assumptions about the performance of the Canadian and U.S. economies, as well as overall market conditions and their combined effect on our business, are material factors we consider when determining our strategic priorities, objectives and expectations for our business. In determining our expectations for economic growth, both broadly and in the financial services sector, we primarily consider historical economic data provided by governments, historical relationships between economic and financial variables, and the risks to the domestic and global economy. See the Economic Review and Outlook section in BMO's Third Quarter 2019 Report to Shareholders.

Non-GAAP Measures

Bank of Montreal uses both GAAP and non-GAAP measures to assess performance. Readers are cautioned that earnings and other measures adjusted to a basis other than GAAP do not have standardized meanings under GAAP and are unlikely to be comparable to similar measures used by other companies. Reconciliations of GAAP to non-GAAP measures as well as the rationale for their use can be found on page 4 of BMO's Third Quarter 2019 Report to Shareholders and on page 27 of BMO's 2018 Annual Report, all of which are available on our website at www.bmo.com/investorrelations.

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

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

PRESENTATION

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Our next participant is Dan Barclay. He is the Chief Executive Officer of BMO Capital Markets. He has been in that role since, I guess, almost a year now, but he has been with BMO since 2003. Welcome to Montreal, Dan.

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Great. Thank you. Thanks for having me.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

I want to start with a bit of a strategic outlook question. You've got presence in both Canada and the United States, and I wonder if you can talk to me about the difference between having a presence in Canada and United States and having a North American platform.

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

I think of that question really around the conversation of client centricity, putting your client at the center of what you do. Most of the way we've organized our businesses around is what client needs. If we think about the investment in corporate banking side, we have businesses that need a global aperture, something that you need to think about the world globally. A good example would be energy, what happens in Saudi Arabia greatly impacts what happens in the North American energy business, so we're organized globally in energy and in mining. There're other businesses where you don't need a lot of global insight. I'll use real estate as a good example. Our real estate teams would be a Canadian team and a U.S. team, they're highly coordinated and they talk to each other, but they don't really, from a client point of view, need to work across the board, they can work domestic.

We have other businesses where we do run the North American – think industrials, food and Ag – those things we run on a North American basis because the inputs and the impacts are cross-border. If we move to the market side of the business, think about equities in this crowd, there're actually different needs in different markets to have product specialists. Canadian equity trading group versus U.S. equity trading group, are they coordinated? Do they know what's going on? Yes, but they don't need to be fully integrated.

When I think about that lens overall, we try to manage them as a client need and then be specific around that. The other piece that comes out is: where do you get your synergies? We try to put in place now the synergies where it makes sense, or the systems where it makes sense, to cross that border. If you think about the way, what's the simple one – electronic trading stuff. What we use, I think people are aware we've imported Clearpool in Canada this year, we use that same system in the U.S. It's the foundation of our electronic trading, and it works in both markets.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Would you say that the support functions, whether it's operations, whether it's risk and the rest, are North American in nature or are they, similarly, you've got a U.S. support function and a Canadian support function?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Again, it depends on the marketplace. From a risk point of view, we're in all risk globally. It's one team, one structure, doesn't matter if it's market risk, credit risk or otherwise. It runs on a global basis because that's really the nature of how we manage that risk stuff. If we think about the finance teams, the finance teams are actually by geography and by legal entity, so they'd be different. The systems behind them both are global, but the actual people are regional.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Do you feel like there's more here that can be done or are you pretty much where you'd like it?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Where we are today, I'd say, we are exactly where we want to be on a North American basis. We think of ourselves as a North American bank with global reach, that's how I've framed it for our teams overall. I think we have the right pieces in place now. I think there're still some synergies, both within Capital Markets as well as in other areas of the bank, and that's really the next leg of our journey there.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Just following on that topic, the idea of corporate culture is one that we don't talk a lot about in the Capital Markets side, but I think especially in today's market and today's era we're bank employees as much as anything, and so, how do you think about the connectivity of BMO Capital Markets with the bank itself?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Again, I'll come back to a client centricity point. One of the things that's changing today is client expectations of what we deliver. Once upon a time, a long time ago, you could be a single product, single relationship and that's all that matters. Today, when we think about the client relationships, the way they measure us or the report card that's used to see if we're delivering good service has changed dramatically. If at one time, you could have said the investment bank was just the investment bank. Then you added the corporate bank. Now you have got markets. And now we're moving into wealth or the commercial bank in terms of what we do. Some of our bigger client relationships, what we call our franchise clients, will actually have the entire bank delivered for the client. It's particularly pronounced in the private side, but you could have a corporate loan to a public company, you could have the holding company with a loan out of commercial, and then the individual wealth will be managed by wealth. And once upon a time, none of them would talk to each other. Now it's integrated coverage, we talk to them all the time. That evolution of client expectations has changed a lot and I can see that continuing on for quite a while.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

The evolution in the client expectations has changed, but how do you change the delivery model to incent people to do it?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Incentives is a tough word, because I think really what we think about is behaviours rather than incentives. We've tried places where you create deep incentives to make behaviours happen, and they may or may not work. They usually come up with answers that you're uncomfortable with at the end. The first place is behaviours. How do you think? What do you do with client risk? Do you put them at the front of your process, do you put them at the back? Is it just a P&L conversation? We try to actually work on the behaviours and the culture, as you said, first. The second is organizational structure. Today, if you think about our corporate bank, it used to be in two places, then we created a merged leadership team, and then we created industry group teams that actually sit inside the industry groups today. They are not separate, they are not a separate product, they are actually part of that coverage effort.

Similarly, if you think about – what's a good example – our interface with commercial, our commercial bank in the U.S. has a substantial presence. It's a great opportunity for Capital Markets. We started off with some overlap. I'll use M&A as my example. We brought a firm called Greene Holcomb Fisher, which was a mid-market M&A specialist. It was brought onboard entirely to help deepen our relationships with our commercial customers and open up opportunities. That's turned into a home run. But if you think about it from an organizational point of view, they sit in Capital Markets, their client base is actually in commercial. So that's a good example of where we've organized in a different way to try and derive different outcomes.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

I was actually going to ask about the cooperation between that part of the bank and the commercial side in the U.S. Does your industry specialization or industry expertise in any way focus on areas that BMO in the commercial side is strong, are there that level of synergies or is it just cooperation where you can get it?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Inside the investment and corporate banking part of Capital Markets, we're all purely industry focused. We have some regional focus, so think Montreal, we have a great office here, a very powerful franchise. But really, we're focused around industry groups. The commercial bank has both industry specialties and geographic, and they manage to both places. In the places where they manage to industry groups, we're almost perfectly aligned now. We don't have exact 100% alignment, we're getting closer and closer, but it is a conversation that Dave Casper and I have on a regular basis is – making sure we line up better and better. We do joint pipeline and opportunity meetings together now. If you think about the food and consumer group in Dave's world and the food and consumer group in my world, they meet regularly to review client list, opportunity sets and what they could do going forward.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

If I have my numbers right, the U.S. franchise is about 50% of the corporate loan book, it's about a third of earnings, so do you see an opportunity to increase the fee generation and just the depth of relationship in the U.S. side or is that more a difference in the market?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

I'll answer this question in two different ways. One is, when I think about our corporate loan book – think of it as client acquisition, as I said earlier, we talk about this client report card of the one bank – we work off the universal banking model. If you went to a U.S. corporate and said, "All I want from you is M&A services," they would say, "I don't expect that from you, my report card says you're going to show up with a competitive lending product, competitive cash management, as well as a competitive M&A product." And so, that report card drives us into that relationship, and that relationship starts really with the loan. In different parts of the bank, the loan is a very profitable thing all by itself. If large corporations are the nature of competition, the profitable relationship has to cover your full product suite. To build the right relationship, you're into a credit relationship, you try to build the ancillary services with treasury, and then you're indurating other higher-margin services. But that wall or that client opportunity set is really where you drive your ROEs and you drive your returns. When I think about the loan book, I think both the corporate loan book as well as the commercial loan book in terms of that opportunity set.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

So it's not really the right way to look at it for now, is it just a question of, it will take time to deepen it, or is it…?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Yes, we think about we made a 15-year deep investment in the U.S., in particular, and we're now at the place where I think that's a scalable platform. We've achieved critical mass in almost everything we needed to do, and it's not full-scale in the U.S., that's not we're trying to be, but it's critical mass now to build those cross relationships and full functional relationships. We have the relationships, we have some balance sheet and we have the product capability, and those pieces go together to drive that return relationship. In my mind, there's still going to be more investment in the U.S., but it's really now less for the amount of margin you'll generate than we had in the past.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Your bank has not been shy about making tuck-in acquisitions or acquisitions that give you a different capability in the U.S. or in Canada, for that matter, in your area. One of the more recent ones was KGS Alpha. Could you just give us an update on how it's going and maybe remind people exactly what it is that you've done down there?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

I used to run the M&A business for a while, so I always dream of acquisitions that come with 100% of what you want. Often what you do is you buy some, you don't want it all. KGS is one of those very unique things where we had an MBS/ABS business, it had top 10 market position in the U.S., and that's all they did. They needed balance sheet and global reach, and that's what put them in a place where they were attracted to us and we were attracted to them. It's a great opportunity that, when we took a look at our U.S. franchise, we have been building it organically for a while, and it was improving, but not at a pace we were comfortable with. KGS came for sale, we acquired it, and I think of that as my acceleration strategy. It would've taken us three, four, five years to build, and we were able to do it really in one step. The performance has been exactly what we would like from it, they're ahead of plan, ahead of our acquisition case, they're getting the balance sheet they need, they're rolling out new products. We're adding market share and they're getting a global reach. So, if you think about what we're selling in Asia or in Europe that we never sold before because we didn't have the expertise to the product, it's turned out well and well ahead of financial projections.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Can you talk about the risk in that business?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

The risk in that business is slightly different than some of our others. One of the things – as we went through that acquisition process, taking effectively a new and much broader product suite onto our platform – to get the models right, to get our risk management right, took a little bit of time, but today we have it back where we would've expected it to be.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

We talked about the corporate book in the U.S., how is it different than the Canadian side in terms of the opportunity and the depth of relationship, I would imagine it's probably a bit of a different market, can you compare and contrast it for us?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

I use a conversation around Venn diagrams. If you think about the expertise, you have somewhere and the client suite that you would do or could be able to profit inside one loop, you take that by different relationships, by different products. The beautiful thing about Canada, with the history, the nature of the relationships, the multi-product experience is, those Venn diagrams have enormous overlap. When you think about the network effect that goes on inside that set of Venn diagrams, or those cascading rings and the Venn being the middle, is exceptional in Canada. It's that network effect that drives a lot of why we all have exceptional returns and business models here in Canada. In the U.S., you're building those Venn diagrams. When we acquired Greene Holcomb, I'll use that as an example, what their sweet spot for clients set was didn't perfectly overlap with the commercial. Over time, you machine it so they get to the much more overlap in terms of change in both places and opportunity sets. If you think about our U.S. platform overall, we're in that process today of creating that overlap with that network effect. Sometimes you hear us call that alignment, where we get to better and better alignment, and that process takes time, especially when you bring in someone new. Imagine a new investment banker coming on, joining the platform, he's got a client set that maybe you didn't lend money to before, and so, you've now got to actually extend loans in the rest and build that stacking set of relationships. In the U.S. today, our best relationships are identical to Canada. Our best industry groups are identical to Canada – same revenue model, same relationship model, same opportunity set. In other places, we don't yet have all that full alignment, and that's what we're now creating.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

We've talked today in a few different instances about some of the macro uncertainty, whether it's interest rates, whether it's global trade, whether it's political, and your corporate book has been growing rapidly, despite some of that uncertainty. Can you talk a little bit about whether you're seeing any behaviour from your clients that might indicate things are set to slowdown, just as they become a little more cautious in the environment? Because, especially, on the corporate side, they tend to be more globally aware of what's going on. And then also, whether you're changing your standards or changing your practices at all, considering some of the uncertainty out there right now?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

When we think about our overall book, I hope people realize at BMO, we're a very conservative organization, we believe in a very big and diversified portfolio and don't want to overleverage any one sector, any one client in any way. Nothing's changed in any of our underwriting standards as we go forward and we underwrite for a full cycle – both what we expect and we don't expect. There's literally nothing in our book today where I'm seeing broad credit degradation. In fact, if I looked over the last few years, even though we grew the loan book as fast as we did, we actually were increasing credit quality, particularly in the U.S., and that increasing credit quality was really driving up more into the BBB investment-grade credits, where our book wasn't as robust before. In that growth and experience place, we're not seeing anything. There's a couple of places we're watching, of course. Oil and gas in Houston, in particular – we're watching. We've had some formations there, nothing that we think is truly deep or challenging for the book, but really it's idiosyncratic with individual companies. In an industry, that's going to go through some adjustments in the next while.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

And in terms of demand for credit?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

We have slowed our demand growth, consciously, since the first part of the year. Mostly that was really our ability to digest: how much can we grow? As I said earlier, as you think about a new client relationship, you extend credit and you've got to build the rest of the relationship and make it more fulsome, there’s a certain amount of capacity that you can do that on. I think market receptivity, the way we do business in the U.S., is very high. If I wanted to grow the book faster, I could. I'm not nervous about the type of clients. We're not chasing clients. We have clients who want to do business with a relationship bank, but we've tempered it now, so that we can get the benefit of what we've invested in so far. And once we started to get the full benefits of that, then we're going to relook at how we want to grow there.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

It sounds like you're not really seeing any actions on the part of the customer base to say, "I don't like the way things are looking for the next 12 months. I'm going to delay. I'm going to wait." It's more your decision to slow things down a bit and digest what you've done rather than the customer pulling back?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Yes. If we went to an aggregate overall U.S. marketplace, there's definitely a slowdown in business investment, and there should be then a slowdown in credit growth and a slowdown in opportunity set.

In our place, where, if you think about our corporate banking book being $50-odd-billion in the U.S., compared to the scale of that marketplace, we're an infinitesimally small player. I don't mean that in a negative way to us, just we're small. When we're growing, we're taking market share, we're growing into a much bigger portfolio. If you think about, in the Canadian context, where you're at your market share and we're all in the spots we're in, then the aggregate market moves become very, very big. When you're a smaller player growing share, which should be the case for all of our Capital Markets businesses, even if market conditions are trending a bit lower, if you're grabbing share, you can actually have an outsized performance.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

And just to sort of stay on the lending side for the moment, the leveraged loan market in the U.S., how do you think about your exposure to that business?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

I'll speak only from a Capital Markets point of view, I think people often misunderstand that we're a distributor of risk, not an owner of risk. If you think about a leveraged finance transaction coming into the firm, whether that's a leveraged loan or a high-yield bond, we underwrite the risk and then we distribute it, and we don't keep it on our hold book. The aggregate transaction volume we do, I don't have it on the top of my head, but we distribute all of that except for a small piece, which is, in an LBO, you need a line of credit for a revolver for short-term liquidity needs. We've got about $1.7 billion book for that, the average hold side south of $25 million. That's broadly distributed and diversified, both by sector, by credit quality, by region, by industry, and so, we look at it as that. And then on top of it, we actually manage tail risk on that by selling insurance – we've taken the tail off that book as we go forward. Our history of exposure there is: we have very, very little in terms of historical losses, and we would project go forward based on the nature of that book that we don't anticipate a lot.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

The misunderstanding is real, by the way, because I think people assume that you are taking on a fair bit of risk in that business, but you're saying this is basically a fee-generating business for you.

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Correct.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Not an accrual book.

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Yes.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Interesting. Are you seeing anything in that market even from a fee-generating perspective that can – it's just going to keep going for a while or are you seeing signs that things may be slowing down?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

The overall leverage credit market is probably a little more volatile than other markets. And in terms of investor appetite, investor appetite has gotten substantially larger. The business is substantially larger than it was 10 years ago, but it goes through a little more volatility in terms of credit and then appetite. There're periods of indigestion in that market that are probably a little more regular than in the equity market or the investment-grade market, but they're really small periods as you go through. Think back to last December, there was a real big pullback in that marketplace. All firms went through that. Today, it's not as robust as it was two, three months ago, but there's no reason it couldn't be more robust two, three months from now.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

I want to talk a little bit about technology. The technology spend across the bank, there's got to be a lot of mouths looking to be fed, a lot of projects going on, there're obviously a lot of needs on the technology side and the Capital Markets organization, as well from a front office perspective and from a risk perspective. How do you think about the importance of technology and how higher-priority is it within the bank to send money to the Capital Markets organization?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

The first place is the way we allocate our technology dollars is on a bank-wide basis based on returns. Whenever we look at where we're going to spend what is a fixed resource, we want to do in the most efficient way we can. Obviously, there's a business balancing to that and Capital Markets has a number of opportunities for that. I generally think of technology in two things, or two ways to think about our technology spend. The first is: how do I generate new opportunities, new revenue, new sources of a business? Investing in – a good example, Clearpool – bringing Clearpool to Canada was an investment to create a new revenue line, new revenue opportunity. We also look at it in terms of how we create cost savings and efficiency, and that's really driving out whether it's manual processes, automation bots or the whole gamut. I know, in Capital Markets, our projects are just as compelling from return point of view as they are also in the bank.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Do you think, there's got to be an element of the tax spending, with all of it just the tax on the business, you have to spend the money. Or is it, can you always have that financial benefit associated with some of these things? There's got to be an element of that, "I have to do the minimum, I'm not really going to get a benefit from them."

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

I think, for all banks, there's a piece around the regulatory spend, which you could call a tax. Ironically, I think we're starting to think of it as an enablement tool. I'll use a good example: the amount of investment all the banks have made now in AML, huge investment over the last decade. As we went through that process, what we actually found was, you start off with a manual response, you start to automate, you start to build systems, you start to build creativity. People have seen the bank moved into the cannabis space. The only reason we go into the cannabis space, and the place that we went, was because the control systems that we built, ironically for regulatory outcomes, allowed us to have a better insight in risk management system that we could actually execute in that space. And it's those two things. If you think about, yes, it was a cost and it wasn't a productive cost, in terms of it does not generate new revenue or lower your expenses, you could argue that was the tax. In the end, it turned out, because it was a mandatory spend, we created opportunity to do something different later. I think we're seeing more and more of that, where we make those investments into technology pay somewhere else. AI is a great example, the more we learn about AI and how it applies to our systems, the more newer places we can take it. Some of the AI is in our control environment, now we can use in the business opportunity environment.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

So do you think technology is a potential competitive advantage in the capital market space, not just in Canada, but on your global competitors as well, is it an area where you feel like, if you invest properly and smartly, you can actually create advantage?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

I do believe we can create advantage. In our mind, when we think about technology today, think about some of the lenses that we look at. Let's use customer experience. We've put out a new research portal that, hopefully, everyone here has had the joy of using. The investment in that was to make...

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Maybe there're other research departments. Now you went and told them, though.

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

But that was an example though, where we've put investment dollars in to improve the experience. I'm sure CIBC is doing the same thing in terms of the way it invests in technology. We have other things where we're doing trade processing in a different way. And it's about designing efficiency in the back office, but also changing that client experience. If you think of client experience as a journey, you don't often hear that from a Capital Markets person, we usually just talk about the trade. Now we're using the same vocabulary that the retail bank or the commercial bank uses in analyzing our end-to-end processes around client experience, employee experience, how do we work with our vendors, all that's coming together. That's all technology. I swing a little bit on the competitor advantage. I think we do it well. But I also think it's minimum table stakes for all of us today.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

I want to talk a little bit about market risk. It feels like you've had some of the lower volatility on your trading line than a number of your peers, is this a scenario where you think you can take more risk?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

We can. The nature of how we think about the risk capital we put up, and that's really what drives those numbers, is we're very focused on client-driven business versus trading business. The dynamic of how and when we put extra capital in, when we're leading to the marketplace, is really what our clients want to do. Other banks have a different approach to that, in terms of how they want to take risk and how they want to generate those trading dollars. We look at risk in the aggregate. What I often say is we have more capacity than we use, and it's typically because we don't see the risk/return opportunity in the marketplace to do so. There will be times in different markets, particularly I think like steepening yield curve, where we'll put more risk into the market and make more money.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Is it the frontline staff that just doesn't utilize it or is it you guys are sort of pulling it back because you're not comfortable to make it utilized most profitably?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

I would say it's an overall risk culture at BMO. We have the same dynamics that we've had for a long time. We're a very conservative bank. We run our Capital Markets business conservatively. We like diversification. We like client penetration. And when we think about risk management, it's the same thing. Everything on risk decision we make today is both frontline, it's market risk. We make decisions together, they're not competing factions or anything. Those days are long gone behind us. We put out what we think is the appropriate risk for the market conditions we're in, collectively, as opposed to one versus the other.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

I want to spend a couple of minutes talking about expenses. You've had an interesting year. An aspirational target put out at Investor Day, in terms of where you'd like the efficiency ratio to get to. Pretty sizable – like I said, can't call it a restructuring charge because you just booked it through earnings – but a pretty sizeable restructuring, I guess, earlier this year. When you think about expenses in this business, how are you progressing towards where you want to get to?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Every one of the business units at BMO is driven to deliver operating leverage. Capital Markets last year wasn't what it was supposed to be in terms of delivering its share of operating leverage. As we started to think about some of the market conditions you talked about: change, revenue growth rates, what we see out there – we saw the world starting to taper. In that environment, when revenues are starting to flatline or taper a little bit, if you're going to deliver operating leverage, you have to make choices. We made some hard choices around our expenses – across the business, it wasn't in any one business in particular – to kind of right-size that expense base, so that we can deliver the operating leverage for the shareholders.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

I don't often think about efficiency ratio when it comes to the Capital Markets business, simply because I feel like – the marginal NIAT dollar is what I'm looking for, not necessarily an improvement on the expense line, and you can get a little too focused on expenses and then run out of revenue pretty fast.

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Correct.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

When you think about hiring and personnel and the rest, and maybe if there's a difference in Canada versus the U.S., like there's one in stable mode and the other in growth mode, is one shrinking to feed the other, how do you think about that dynamic?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

We look at all our businesses in the context to where they sit, so Canada versus U.S. Obviously, our biggest upside is in the U.S. Whenever we think about efficiency ratio, people get trapped often thinking it's an expense ratio. It's not. It's a relative relationship between expenses and revenue, so growth and growth. You just need to have a different trajectory for each. The primary driver for us in the U.S. is market share growth. As we grow more market share and investment in core banking, we grow market share in our global markets businesses, we add product densification, we'll have faster revenue growth than we'll expense growth. That's the primary driver for us for productivity, and for those that didn't see Investor Day, we're targeting at sub-60% efficiency in Capital Markets. The other piece is making sure that revenue engines don't change. We'll continue to grow the corporate loan book at a measured pace. We're continuing on the hiring plan we have at a measured pace. Really what we think is happening is we've made a large set of investments over the last two, three years, and now we're going to reap the benefit of those investments.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Got about 30 seconds left here. You want to have any closing remarks, closing thoughts on the outlook for the business?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

As you think about Capital Markets inside the framework of the Bank of Montreal, we're part of the diversification of its earnings stream. We've been a reliable, relatively low volatility earnings stream, we'll continue to keep that. Things to watch from us: we'll continue to grab market share, particularly in the U.S., we're also focused on market share in Canada, just it's a different delta in terms of what you can get, and really you get to hold us accountable for delivering on those promises. So, thank you.

Robert Sedran – CIBC World Markets – Analyst, MD & Head of Research

Thanks for your insights and thanks for visiting this year.

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Thanks for inviting me, I appreciate it.
