BMO Financial Group

Q4 2015 CONFERENCE CALL

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PRESENTATION

Operator

Please be advised that this conference call is being recorded. Good afternoon and welcome to the BMO Financial Group's Q4 2015 earnings release and conference call for December 1, 2015. Your host for today is Ms. Sharon Haward-Laird, Head of Corporate Communications and Investor Relations. Please go ahead.

Sharon Haward-Laird - ***BMO Financial Group - Head of Corporate Communications, Government & Investor Relations***

Thank you, operator. Good afternoon, everyone and thanks for joining us today. Our agenda for today's investor presentation is as follows: we will begin the call with remarks from Bill Downe, BMO's CEO, on our annual performance; Tom Flynn, the Bank's Chief Financial Officer, will then review the results for the quarter; followed by remarks from Surjit Rajpal, our Chief Risk Officer. Cam Fowler from Canadian P&C, Dave Casper from U.S. P&C, Darryl White from BMO Capital Markets, and Gilles Ouellette from Wealth Management will then provide comments on their outlook for 2016, followed by remarks from Frank Techar, our Chief Operating Officer.

After their presentations we will have a short question-and-answer period where we will take questions from pre-qualified analysts. To give everyone an opportunity to participate, please keep it to one or two questions and then recue.

On behalf of those speaking today I note that forward-looking statements may be made during this call. Actual results could differ materially from forecasts, projections or conclusions in these statements.

I'd also remind listeners that the Bank uses non-GAAP financial measures to arrive at the adjusted results to assess and measure performance by business and the overall Bank. Management assesses performance on a reported and adjusted basis, and considers both to be useful in assessing underlying business performance. Bill and Tom will be referring to adjusted results in their remarks unless otherwise noted. Additional information on adjusting items, reported results, factors and assumptions related to forward-looking information can be found in our annual MD&A and our fourth-quarter earnings release.

And with that I will hand things over to Bill.

Bill Downe - ***BMO Financial Group - CEO***

Thank you, Sharon. Welcome to everyone joining us on the call. Today we announced record results with earnings[1] of $4.7 billion and EPS[1] of $7.00, up 6% from last year. Revenue[1] was up over 8% and credit performance remains strong.

Operating leverage improved over the course of the year and was positive in each of the last two quarters. ROE[1] was 13.3% for the year with book value per share increasing by 17% to $56.31. We also announced an increase to our quarterly dividend of $0.02 per common share, bringing our annual dividend to $3.36, up 5% from last year.

These results reflect a strong finish to the year in line with our expectation that performance would improve in the second half. Let me touch briefly on some of the highlights.

Back in 2011, we set an ambitious goal to generate more than $1 billion after tax in earnings in the medium term from our Personal, Commercial and Wealth businesses in the U.S., and for the first time this year we exceeded this goal. We had record results in Personal and Commercial Banking on both sides[1] of the border as well as in Wealth. And together these businesses now represent more than 80% of the Bank's earnings.

We also maintained a strong capital position, ending the year with a common equity Tier 1 ratio of 10.7%. Our disciplined approach to capital management gave us the flexibility to buy back 8 million shares and to complete the acquisition of GE Transportation Finance.

This acquisition builds on our position as a market leader in North American commercial banking, adding diversification, scale, and enhancing profitability and margins. As the acquisition closed today, I'd like to welcome the customers and employees of GE Transportation Finance to BMO.

In addition to these financial achievements, we made significant progress on our technology and innovation agenda, which Frank Techar will cover in a moment.
Moving to slide 5, there was good performance across our operating groups, particularly in the combined Personal and Commercial Banking businesses which posted earnings[1] of almost $3 billion, up 10%. Canadian Personal and Commercial Banking had a good second half of the year resulting in annual earnings[1] of $2.1 billion, up 4% from the prior year. Operating leverage[1] improved over the course of the year and was positive in the fourth quarter, while credit remained stable.

U.S. Personal and Commercial Banking also had a good year, with net income[1] up 25% or 9% in source currency. Revenues were flat year over year as the benefit of continued robust C&I loan growth was offset by margin compression, which moderated over the course of the year. Expenses were well controlled and credit continued to improve.

1 – On a reported basis: Net income was $4.4B; EPS was $6.57, up 2% Y/Y; Revenue was up 6% Y/Y; ROE was 12.5%

In Wealth Management, good organic growth and the addition of F&C drove net income[1] up 13%. Traditional wealth was up 28%, partially offset by a lower contribution from the Insurance business which was above trend last year.

In BMO Capital Markets, net income[1] was over $1 billion. We took a prudent approach to risk in a period when we saw meaningful shifts in volatility. Revenue was flat excluding the impact of the stronger U.S. dollar as higher trading and lending revenue was offset by lower investment banking fees and security gains. Expenses were well managed, flat from last year excluding the impact of the stronger U.S. dollar.

And with that I'll turn it over to Tom to talk about the fourth quarter.

Tom Flynn - *BMO Financial Group - CFO*

Thanks Bill and good afternoon. I'll start on slide 9. EPS[2] for the quarter was $1.90, up 17%, and net income[2] was $1.3 billion, up 14%. As Bill said, these results reflect a strong finish to the year. Adjusting items this quarter are similar to prior quarters and are shown on slide 27.

Net revenue[2] is higher across operating groups and up 9% from last year. Net interest income was up 9% driven by the U.S. dollar and volume growth, partially offset by a lower net interest margin. Net non-interest revenue was also up 9% driven by the U.S. dollar, other non-interest revenue, and mutual fund revenues, partially offset by lower net insurance revenue, underwriting and advisory fees and security gains.

Expenses were well managed, up from the prior year due to the stronger U.S. dollar and operating leverage[2] was 1.8%. Excluding the impact of the U.S. dollar, net revenue was up 3% and expenses were unchanged from last year. The effective tax rate[2] was 18.9%, up from 16.8% last year, and on a TEB basis the rate was 24.7%, also up from last year.

Moving to slide 10, our Common Equity Tier 1 ratio was 10.7%, up 30 basis points from Q3. Capital levels increased primarily due to higher retained earnings.

Risk weighted assets declined by approximately $1 billion as changes in book quality and lower market risk were offset largely by increases due to changes in methodology and business growth. As a reminder, the GE transaction is expected to reduce the CET1 ratio by approximately 70 basis points in Q1.

Moving now to our operating groups and starting on slide 11, Canadian P&C had net income[2] of $561 million, up 7% from last year. Revenue was $1.7 billion, up 3.4%, reflecting higher balances and fee revenue. Total loans were up 4% and deposit growth was good at 5%.

Personal loan growth, excluding retail cards, was 3%, with mortgage growth of 4%. Commercial loan growth was 6%. Expense growth moderated, up 3%. Operating leverage was positive with an improving trend, and the efficiency ratio was below 50%. Credit performance was strong with provisions down from the prior year.

Moving to U.S. P&C on slide 12, net income[2] was $221 million, up 22% from last year. The comments that follow speak to the U.S. dollar performance. Net income[2] of USD$167 million was up 3% due to lower credit losses. Loan growth was 3% driven by double digit C&I performance.

NIM was up 2 basis points in Q4, primarily due to changes in mix including deposits growing faster than loans. Expenses continue to be well managed with Q4 expenses up 3% and expenses for the full year up less than 1%.

Turning to slide 13, BMO Capital Markets' performance this quarter was solid, with net income[2] of $243 million, up 27% from a below-trend fourth quarter last year. Revenue was $938 million, up 16%. Excluding the impact of the stronger U.S. dollar, revenue was up 9% due to higher trading and corporate banking revenue and securities commissions and fees, partially offset by lower security gains. Expenses were well managed and were flat year over year. Credit was good with recoveries of $2 million.

Moving on to slide 14, Wealth Management net income[1] was $271 million, up 8% year over year. Traditional wealth earnings were up 60% from last year, benefiting from a gain on the sale of BMO's U.S. retirement services business and underlying business growth, net of a legal reserve.

Insurance net income of $57 million was down primarily due to high actuarial benefits in the prior year. Expenses were up year over year primarily due to the impact of the stronger U.S. dollar. Net income was up 16% from the prior quarter.

Turning now to slide 15 for Corporate Services, results compared to last year were better due to higher credit recoveries and lower expenses. Results improved from the prior quarter driven by above-trend revenue due to a legal settlement.

To conclude, our performance in the quarter was good across the operating groups and reflects the benefits of our diversification. And with that I'll hand it over to Surjit.

Surjit Rajpal - *BMO Financial Group - Chief Risk Officer*

1 – On a reported basis: Total P&C net income was $2.9B, up 10% Y/Y; CAN P&C net income was $2.1B, up 4% Y/Y; Op. leverage was (0.1); U.S. P&C net income was up 26% or 10% in CDE; Wealth net income was up 9% Y/Y;
2 – On a reported basis: EPS was $1.83, up 17% Y/Y; Q4'15 net income was $1.2 B, up 13%; Revenue was up 7% Y/Y; Op. leverage was 0.3%; ETR was 18.8%; CAN P&C net income was $560MM; U.S. P&C net income was $207MM, up 23% Y/Y or $157MM in USD up 4% Y/Y; BMO CM net income was $242MM, up 27% Y/Y

Thank you, Tom and good afternoon everyone. Starting at slide 17, our PCLs were $128 million, an improvement of $32 million from the prior quarter. In Canadian P&C, PCLs were stable quarter over quarter. Last quarter benefited from the sale of charged-off consumer loans and this quarter had reduced commercial losses.

In U.S. P&C, PCLs were in line with our expectations. Lower consumer PCLs because of recoveries from the sale of mortgages were offset by higher commercial reservations. The higher commercial reservations represent the normal variability of a commercial loan portfolio and are not concentrated in any sector.

PCLs were down in Capital Markets, which had a small net recovery in the quarter. Corporate Services also had a net recovery largely due to the sale of purchased loans, not unlike what you've seen in several quarters in the past.

Turning to slide 18, impaired formations were down 13% this quarter to $484 million as a result of reduced commercial formations, which are down both quarter over quarter and year over year. Our GIL rate improved 8 basis points this quarter and is now at 58 basis points.

Considering our full-year credit results, the PCL rate remained low at 19 basis points, unchanged from the prior year, reflecting a benign credit environment and strong credit recoveries. Looking ahead to 2016, we foresee PCLs increasing moderately from current low level due to reduced loan recoveries. We also expect challenges related to oil and gas, some of which are likely to be offset by the benefits from the continuing strength of the U.S. economy.

Turning to slide 19, oil and gas GILs were flat and PCLs were minimal. This performance reflects the Bank's strong capabilities and experience in this sector as well as significant actions taken by our clients, which included cutting capex, reducing costs, raising alternative financing, and reducing dividends. Also note that oil and gas is only 2% of the Bank's total loans, and over half is investment grade.

On Alberta consumers, we have noticed a modest increase in delinquencies on non-real estate products but have not seen an increase in losses. This non-real estate portfolio is small at 1% of total loans. On the Alberta real estate portfolio itself, 60% is insured, and of the uninsured, the loan-to-value is strong at 56%.

As you would expect, we actively monitor our portfolios impacted by oil and gas and remain comfortable that even under adverse scenarios, the losses will remain manageable. I will now turn the call back to Bill.

Bill Downe - ***BMO Financial Group - CEO***

Thanks, Surjit. We'll hear in a moment from each of our group heads with their outlook but I'll first make some comments about how we see the economic environment.

In Canada, GDP growth has improved from the first half of the year and is expected to be 2% in 2016. We expect steady growth across most of the country, which benefits from the weaker Canadian dollar, employment growth and low interest rates, while the oil producing regions will continue to be impacted by low oil prices.

In the U.S., the economy continues to strengthen at a moderate pace, holding up well against the stronger dollar and the global landscape. As a result, we expect U.S. GDP growth of 2.6% accompanied by modest interest rate increases.

Against this backdrop our well-diversified portfolio of businesses provides a strong platform from which we will continue to deliver profitable growth.

And now Cam Fowler will provide some comments on the outlook for Canadian banking.

Cam Fowler - ***BMO Financial Group - Group Head, Canadian Personal & Commercial***

Thanks, Bill. As I guided to earlier this year, we expected the second half of 2015 to be stronger and it has been, resulting in record net income[1] of $2.1 billion. I think we're well positioned to build on these results and I'm confident we can maintain our momentum.

Three areas in particular give me confidence. First, we had good results this quarter in our retail cards business, with revenue up 6% year on year. Our new World Elite products are doing well and we're seeing benefits from the investment we made in our cards platform.

Second, our commercial lending growth in Q4 was broad-based by geography and well-diversified across industry sectors. We're gaining momentum as we're capturing capacity from our lending platform upgrade.

And, finally, we continue to see good deposit growth across the business, with commercial deposits consistently performing well and strong results in personal chequing, which is up 10% year on year as more customers are choosing to bank with us. We're also realizing the benefits of the investments we've made in our digital channels and the simplification of our core processes, and this is creating capacity for our front-line team.

So, for these reasons I expect 2016 revenue growth to be in the mid-single digit range, with low single-digit expense growth, resulting in sustainable positive operating leverage and earnings growth similar to what we posted this quarter. I'll pass it over to Dave Casper.

1 – On a reported basis: CAN P&C net income was $2.1B

Dave Casper - *BMO Financial Group - Group Head, U.S. Personal & Commercial*

Thanks, Cam. We had a good year in U.S. P&C, with adjusted net income growth[1] of US$57 million or 9%. In Canadian dollars, we were up $174 million or 25%. As we look forward to 2016, we expect margins to be more stable than last year and continued good loan growth in our strong commercial franchise.

I also expect our revenue trends to improve for several additional factors. First, I expect improved growth in our personal business, particularly in the second half of the year. We have a new loan origination system which focuses on reducing processing times for mortgage originations. I expect continued growth in our deposits, as well, and we're seeing good leading indicators.

Second, the addition of GE Transportation Finance business, which today was rebranded BMO Transportation Finance, will add significantly to our growth. And, lastly, the potential for higher rates in fiscal 2016 should be a positive for our business as we continue to grow our deposit base.

We will continue to make investments in areas that will generate top-line benefits in fiscal 2016, including innovations in channels, expanding the smart branch and building online capabilities to drive digital sales, as well as enhancements in our treasury management platform. For all these reasons, combined with a strong focus on expense management and what I expect to be a good, stable credit environment, I'm very confident that we are well positioned for good growth in 2016.

I'll turn it over to Darryl.

Darryl White - *BMO Financial Group - Group Head, BMO Capital Markets*

Thanks, Dave. Looking into 2016 for Capital Markets, we feel that we're positioned for good and improving net income performance. We like the diversification of our Capital Markets model by product, by client segment and by geography.

In our U.S. business, we continue to see opportunities to capture share, and we like the ability to support our clients with balance sheet in a period of economic growth. Underneath all that, we intend to continue to manage our expenses carefully, as we did this year, which resulted, as Tom pointed out earlier, in flat expenses year on year on a constant currency basis. So, assuming that markets are constructive, I do feel confident about our business looking ahead into 2016.

And with that I will turn it to Gilles.

Gilles Ouellette - *BMO Financial Group - Group Head, Wealth Management*

Thanks, Darryl. As Bill mentioned, Wealth Management had a record year this year, with net income[1] of $955 million. We gained market share across all our businesses and our assets grew over 9%.

Over the last several years, we've made conscious decisions to drive future growth by investing in our businesses. We invested in technology and we've invested in our distribution network and we developed new products to better serve our customers.

In 2016, we're focused on realizing the benefits of these investments and we expect this to drive a significant improvement in our operating leverage. We are going to continue to focus on attracting new clients and deepening our relationships.

To close, I'm very proud of what we've achieved in 2015 and we have great momentum going into 2016. Frank, over to you.

Frank Techar - *BMO Financial Group - COO*

Okay, thanks Gilles. Good afternoon everybody. Before we move to Q&A I'd just like to comment on a couple of things that we're focused on that will be important to our growth and success in the new year and the first one is this: productivity will continue to be a focus for us and our efficiency ratio will improve in 2016.

There are a number of reasons that give us confidence that we will deliver on this statement. We are building on a very strong position as we start the new year. As Bill said, we've had positive operating leverage at the total Bank level in each of the last two quarters. And we've seen improving trends in expense management across all of our operating groups.

In Capital Markets and P&C U.S., expenses were flat for the year excluding the impact of the stronger U.S. dollar. In Wealth Management, we had positive operating leverage for the last three quarters. And in P&C Canada, the rate of expense growth has slowed over the year resulting in positive operating leverage in Q4.

We've made steady measurable progress in managing our expenses in 2015 while we also grew our revenue by 9%. We're also seeing a return to more normal levels of investment attached to our enterprise regulatory agenda.

1 – On a reported basis: U.S. P&C net income growth was $62MM, up 10% Y/Y; in CDE, U.S. P&C net income growth was $173MM or 26%; Wealth net income of $850MM

And the last thing I would point out is that we have many great things under way that give us confidence that we're going to see more of the same in 2016. Ongoing work on digitizing our processes and building enterprise level data solutions will help us deliver a great experience to our customers and allow us to manage our operating risk and regulatory agendas more efficiently.

The second thing I wanted touch on today, as we talked about on our Investor Day a number of months ago, we have measurably improved our technology capabilities over the last few years. We don't often talk about this but we feel confident in the progress we've made in designing and building an enterprise technology architecture that will allow us to compete and thrive in a changing competitive environment.

Along the way, as was mentioned earlier today, we've also refreshed several important platforms such as our North American retail cards platform, our commercial lending platform in Canada and our consumer lending platform in the U.S. And during the year, our technology investments have allowed us to introduce leading capabilities that are both convenient and secure for our customers such as Touch ID which allows customers to log into mobile banking using fingertip recognition, Mobile Cash which allows ABM withdrawals using a smartphone, and BMO DepositEdge which allows business customers to deposit cheques remotely.

With a strong finish to 2015 and a number of important investments underway that will reinforce the work we've already done, we are very well positioned for a great year in 2016. Operator, with that, we are now ready to take questions.

QUESTION AND ANSWER

Operator

The first question is from Gabriel Dechaine from Canaccord Genuity.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Good afternoon. I just want to talk about your U.S. business a bit. I'm not quite sure that I got the guidance in terms of revenue and expense, the outlook for those items. But I'm assuming expenses will probably be a bit more “growthy” next year than they were this year. If that's the case, what's the outlook for earnings growth? Or what do you expect is going to drive earnings growth? Because overall we had 9% growth, in U.S. dollar terms, and 90% of that was from lower PCLs. So, which drivers are going to contribute to the growth in the U.S. next year?

Dave Casper - *BMO Financial Group - Group Head, U.S. Personal & Commercial*

This is Dave. A number of things I think will help us. First of all, I think we had a pretty good year on the expense side this year. Our revenue was stable and our expenses grew less than 1%. But as we go into 2016, a number of things, as I said earlier, I think give us good pause. We're seeing good leading indicators on the personal side, both on the mortgage side as well as deposits. We expect more stable NIM in 2016 than we had in 2015. And the GE business, which will add expenses will also add significant revenue and will be a net positive. Commercial growth should continue. And I expect those margins will be better than they have in the past. So, all that, and continued tight expense management, I think, will lead to a good year for the U.S. in 2016.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

So you think you'll have positive operating leverage next year?

Dave Casper - *BMO Financial Group - Group Head, U.S. Personal & Commercial*

Yes.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. And then for Bill or Tom, just a broad question on capital. I'm assuming you're still targeting somewhere in the 10% to 10.5% core Tier 1 ratio. We heard from another bank this morning that OSFI is not really pushing for anything higher than what they already are as far as core Tier 1 targets go. Is that the same thing at BMO? You're still in that 10% to 10.5% range? What items do you see on the horizon that might give you a bit of pause as far as capital deployment goes? We've talked about mortgage risk weight inflation potentially, there’s the trading book, market risk-weighted asset inflation. That's not until 2019 but these are things you've got to think about now, right?

Bill Downe - *BMO Financial Group - CEO*

I'd say, Gabriel, there's no change in the way that we're thinking about capital. We've been pretty clear and consistent in saying that we've been taking the capital ratio up in order to create flexibility. That flexibility has paid off in sequential years. We've either had significant buybacks or we've had significant acquisitions. In the most recent year, 2015, we had a combination and I think we're really in the comfortable zone here that allows us to do both of those things. And you're right, there is always the potential for changes in the future but there isn't anything that we see that causes us at the present time to take a different view.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. And as far as buybacks, probably later this year you might become active on that again?

Bill Downe - *BMO Financial Group - CEO*

You can do the arithmetic. As Tom said, the acquisition will consume about 70 basis points of common equity. And that will show up in the first quarter so it will take us a couple quarters to be back in a position that we would be able to do a transaction out of available capital.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Thanks, Bill.

Operator

The next question is from Robert Sedran from CIBC.

Robert Sedran - *CIBC World Markets - Analyst*

Hi, good afternoon. Tom, you touched on this in your prepared remarks but risk-weighted assets have been remarkably flat this year, especially when you consider the currency moving. Can you give a little bit more colour in terms of how you're doing this, and how much more you could possibly do in terms of mitigating risk-weighted asset growth?

Tom Flynn - *BMO Financial Group - CFO*

A few things. As we've gone through the full year, we have had the benefit of some methodology changes. And as we've talked about before, some of those related to, given the maturity of our U.S. AIRB models, moving to more of a straight AIRB approach on more of our U.S. portfolio. And in the current quarter we had some changes related to updating loss experience in our models.

In terms of a go-forward view, I would not expect as much activity as we had this year. So, I'd expect most of the capital build over the next year to come from the retained earnings that will accumulate through time.

Robert Sedran - *CIBC World Markets - Analyst*

We generally assume that you get asset growth and then you get earnings growth. And I guess in this case, the fact that assets haven't been growing, it won't have an impact on your earnings, am I fair to assume? Just because effectively you're increasing your return on risk-weighted assets because you're just bringing risk-weighted assets down without really shrinking the balance sheet. Is that fair?

Tom Flynn - *BMO Financial Group - CFO*

I think that's fair as it relates to what you've seen over the last year from an RWA perspective, yes. But we've obviously had growth in the business. So, we have had business growth that has driven growth in revenue. So, there's been some normal business growth across all of our businesses. We've also had FX impacting the risk-weighted assets. And not fully but to a degree those things have been offset by some of the things we talked about a minute ago.

Robert Sedran - *CIBC World Markets - Analyst*

But if I understand you correctly we should assume going forward that risk-weighted asset growth and asset growth are generally going to move in the same direction.

Tom Flynn - *BMO Financial Group - CFO*

That's correct.

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

Okay, thank you.

Operator

The next question is from John Aiken from Barclays.

John Aiken - ***Barclays Capital - Analyst***

Good afternoon. Surjit, we've seen within the consumer loan book the past due but not impaired 90 days or more showing a lot of stability. You reported the sub 90 days have actually seen an uptick, particularly on the credit card and the consumer loan portfolios. How much of an indicator is this that you may see additional deterioration in the consumer loan book in 2016?

Surjit Rajpal - ***BMO Financial Group - Chief Risk Officer***

Let me clarify. The uptick that I referred to in the early stage delinquencies was limited to Alberta. Overall we are not seeing much of a change. The uptick you're seeing in the 90 days overall is again because, I think we've looked at this before with you, when the quarter ends on a weekend there are some system limitations and some things that are in the mail or on the way that don't get credited until the next day. So, we check right after the weekend and the delinquencies on that do come down quite a bit to levels where I think they are very reasonable. So, we're not getting any indication for the delinquencies at this point in time.

John Aiken - ***Barclays Capital - Analyst***

No, understood. And when we look at the consumer loan ratios over the 90 day-plus, we've actually seen some year-over-year growth in terms of the U.S. credit card portfolio. Is there anything underpinning that or am I just trying to nit-pick a little bit too much?

Surjit Rajpal - ***BMO Financial Group - Chief Risk Officer***

It's a very small portfolio. There's nothing that we can read into it.

John Aiken - ***Barclays Capital - Analyst***

Great, thanks, Surjit.

Operator

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

Sumit Malhotra - ***Scotiabank - Analyst***

Thanks, good afternoon. Just to go back to Surjit, I wanted to make sure I heard your outlook statement correctly. You mentioned your forecast is for a modest increase in the PCL ratio in 2016. I think that was what you said. Roughly 19 basis points this year, still the benefit of some recoveries. And last quarter you shared with us that your stress test scenario didn't envision losses getting worse than 40. So, it's a pretty wide range between where you are now and where that stress test would take you. When you think about the balance of probabilities here, what are the key components you're envisioning in that ratio moving higher in 2016? And what sort of magnitude do you describe as modest in terms of an increase?

Surjit Rajpal - ***BMO Financial Group - Chief Risk Officer***

We've already finished a month of the current fiscal year. And I think the oil and gas impact and the stress test that you referenced, the numbers that I've given you before was that even in an adverse scenario we don't go to our cycle average numbers. We are currently well below those cycle average numbers at 19 basis points. And when I talk about it going up moderately, I mean that the impact of oil and gas, or not just the oil and gas portfolio but even the secondary impact, I think it could tick up a little bit. It could go a little bit higher.

Timing is very difficult to predict so if I was just giving you an estimate I'd think in the mid-20s or maybe high 20s is about where it will land. It's not going to go to the cycle average at this point in time because things are taking time to trickle through the system. As you can tell, we are still looking for signs of, I would say, losses on our consumer books which we haven't seen at all at this point in time. So, I think there's a delayed effect. So, I'd stick with, let's say, mid-20s to high 20s for the next year.

Sumit Malhotra - *Scotiabank - Analyst*

And somewhat related, coming into this quarter there was a lot of talk about potential volatility that may arise from the energy reserve base lending or credit redetermination reviews. As you went through that process, it didn't look like there was any significant pullback in the exposure of the Bank to the energy sector. Maybe you could give us a little bit of colour on how that process has been playing out for BMO.

Surjit Rajpal - *BMO Financial Group - Chief Risk Officer*

Yes, we've done the vast majority of the redeterminations on the reserve base loans and what we found is that it's roughly 50/50. About 50% of them have actually stayed at the levels that they were, and perhaps even gone up, in some cases, and in 50% we've had reductions in exposure. I think the difference this time is the companies have been extremely prepared for the decline. And, as I mentioned in my remarks, they've taken all the right steps. So, in some ways it's been better than I would have anticipated at the last quarter.

Sumit Malhotra - *Scotiabank - Analyst*

A very quick one for Tom Flynn, just hoping you could give us a little bit of help thinking about the tax rate for next year. If I look at this on a TEB basis you've been pretty steady for a few years in and around 25%. We've heard about some of the moving parts. I think there may have been a delay in one of the key issues we were worried about in terms of its implementation going forward. How are you thinking about taxes? And is this any kind of a major change for the Bank in 2016?

Tom Flynn - *BMO Financial Group - CFO*

We're not expecting a major change in 2016. The number could move up a little bit but it would be a little bit and we're not expecting anything of a material nature.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks for your time.

Operator

Thank you. The next question is from Steve Theriault from Bank of America Merrill Lynch.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Thanks very much. A couple questions, first for Darryl, if I could. Darryl, could you give us some detail on the timing of the run-off of the dividend rental trades? We heard a bit about this from one of your competitors this morning. How much of that did you feel this year and how much runs off in 2016 and 2017? And then stepping back, to what extent would you say the run-off jeopardizes potentially the division's ability to achieve, let's say, the 7% to 10% consolidated target within the division? How much should we worry about that in the next year or two as that business runs off?

Darryl White - *BMO Financial Group - Group Head, BMO Capital Markets*

The first part of your question, for us, if we look at the structure of our trades, I think that, without being specific on it, I can tell you we felt a little bit in the quarter. I think we'll feel a little bit in 2016 but this is for us more of a 2017 and beyond story in terms of where we effectively feel the impact given the structure of our contracts. And, I'm sorry, I'm not sure I understood the second half of your question.

Steve Theriault - *BofA Merrill Lynch - Analyst*

It was more, I was thinking that you might feel more in 2016. But maybe extend that to 2017. As the majority runs off, does that make it -- you're obviously looking ahead and planning on how to redeploy some of that capital, but for 2017, for example, would we expect that to be a year where it's pretty tough for BMO Capital Markets to do that 7% to 10% earnings growth that you would hold to more at the consolidated level?

Darryl White - ***BMO Financial Group - Group Head, BMO Capital Markets***

Now I do understand your question. I think that as we look to redeploy the resources that we currently have in that business, we think about that as legging in through 2016 and having a 2017 replacement impact. So, overall I don't think the impact would be material when you roll it all up to the BMO Financial Group level at all.

Steve Theriault - ***BofA Merrill Lynch - Analyst***

Okay. Thanks for that. If I could just quickly follow-up with Dave, as well. Just on C&I lending growth, it wasn't that many quarters ago we were near 20% growth. I think, if memory serves, it was around 11% this quarter. So, does that continue to head lower and other areas pick up the slack? Or what's the outlook for C&I lending growth? Is that re-basing around 10% after coming off of maybe what was unsustainably high levels of growth?

Dave Casper - ***BMO Financial Group - Group Head, U.S. Personal & Commercial***

I think that's probably in the range. I think we feel that around 10%, plus or minus, is a good number for 2016. That's not including the GE business which will be additive to that.

Steve Theriault - ***BofA Merrill Lynch - Analyst***

Okay, thanks very much.

Operator

Thank you. The next question is from Meny Grauman from Cormark Securities.

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

Hi, good afternoon. Just wanted an update on reported plans to launch robo-advisory services. Is there anything you can tell us about that?

Gilles Ouellette - ***BMO Financial Group - Group Head, Wealth Management***

I think we've chatted about it going back a couple months ago. I would say we're close so stay tuned.

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

Okay. There are about 10 independent platforms right now in that space, so do you see yourself as a consolidator in that space, a natural consolidator? What's your view on that?

Gilles Ouellette - ***BMO Financial Group - Group Head, Wealth Management***

It's a little early. We'll launch it and see what the reaction is. But we do have very good distribution. I think we've proven that with our ETFs and we expect to be pretty successful. As you saw with ETFs, it was all organic growth. I'd say at this point, that's what we would expect to do with this business also.

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

And on the subject of ETFs, it seems like there is definitely a very tough pricing environment in the U.S. I'm wondering what the environment is like in Canada. Do you have those same price pressures? And can you talk about flows in that business, as well?

Gilles Ouellette - ***BMO Financial Group - Group Head, Wealth Management***

The pricing has been competitive from the very beginning. We've had some pretty formidable competitors in there and some of them lead with pricing. We've been able to maintain some pretty nice margins in this business mainly, I think, because our people have been pretty innovative in this space. They've come up with new products, and products that have been appealing. So, if you have a good product, a few basis points is not going to deter the client.

We've had some good success in maintaining our margins but there's no question that over time this business is going to be more and more competitive. But to survive we will have to be innovative. I'm just thankful that we have a good market share at this point.

Meny Grauman - *Cormark Securities - Analyst*

Thank you.

Operator

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

Peter Routledge - *National Bank Financial - Analyst*

Yes, hi. A question for Surjit. I appreciate all the colour you've given around the credit situation in Canada. And I'm surprised that outside of Alberta we're not seeing more signs of trouble in household credit. And I'd just like to get your thoughts as to why that's the case. You would have thought if we had two consecutive quarters of negative GDP growth, rising unemployment in the west, and some weakness in house prices in Alberta, that we would see more. And the question is why do you think we're not seeing more and how sustainable is it?

Surjit Rajpal - *BMO Financial Group - Chief Risk Officer*

That's a really good question. I think there are some indicators in the economy that cause a risk person to worry. And I ask the same question you're asking me. And, really, there's no one single answer that can satisfy why is it not worse than it currently is.

There are lots of factors. There's a lot of money and, this is my personal view, there's a lot of money that comes from overseas looking for a safe haven, and that comes to North America. That could be a factor. The supply of land in the cities is somewhat limited and so single family homes continue to not fall as rapidly as one would imagine based on affordability.

Also, the employment numbers are pretty good. Canada is still at 7% unemployment. And even Alberta, which has gone up quite considerably since October from, I think it was 4.7% or 4.4% to 6.6% in October, is still pretty attractive on an overall basis. I think some of it is that the effects of oil and gas haven't filtered through the overall economy, even the Alberta economy. Some of it is a question of timing.

But, on the positive side, as you give people more time to react, I think things do settle down and compensate, to some extent. I think the low Canadian dollar helps. Businesses are doing well. And sales are still happening. So, it's a combination of factors. But it's a question that we constantly ask ourselves and I look for any break in any aspect of it.

Frank, do you have anything to add? I don't think anyone thinks that I've said anything very controversial here. So, if that satisfies you I'll leave it at that.

Peter Routledge - *National Bank Financial - Analyst*

That's helpful. And then a quick one for Bill. The Bank of England has mused publicly about implementing a counter-cyclical capital buffer. If OSFI ever decided to do that and I'm not implying they have thought about that, but if they ever decided to do that, would you need to raise your CET1 ratio? Or is the buffer at 10.50%, and I understand it will happen next quarter with the GE acquisition, but is the buffer at around 10.50% sufficient to absorb an increase in the counter-cyclical capital buffer?

Bill Downe - *BMO Financial Group - CEO*

That's a beyond hypothetical question. First of all, I can't guess what the Bank of England is going to do. But I would say that what we have seen from our domestic regulator is pretty good transparency about future plans. So, if your question is would we anticipate a surprise move, I don't think we would. I can leave it at that. I think there would be plenty of visibility in advance.

On a less hypothetical question, one of the parts of your question to Surjit was specific to Alberta, why haven't we seen consumer impact right away? I do think that after the end of the calendar year, it's likely that things like salary continuation and a number of the things that modify the impact of job reduction, which has very clearly taken place in Alberta, will start to show up. I think that is a natural occurrence and it's one that we've seen before.

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

Okay, thanks for that. Appreciate it.

Operator

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

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

Hi, good afternoon. The first question, just for Tom, your risk-weighted assets, as you discussed, actually declined. And part of that was attributed to an improvement in the book quality. And I'm just hoping you can enlighten me as to the details of what actually occurred that drove down the risk-weighted assets related to improved book quality?

Tom Flynn - ***BMO Financial Group - CFO***

Sure. The book quality improvement in the quarter reflected an update that we had around some parameters for our corporate and commercial portfolio. We basically updated the data set that goes into the model to reflect our experience over the last couple of years, which had a net positive impact on the assessment of quality. That was the big driver. When you look at the underlying performance of the portfolio and think about credit fundamentally through the quarter, there was a very small level of net negative migration, but it wasn't significant.

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

Okay. And then just so I make sure I've got this right, you talked about the negative impact from model refinements but through the year, correct me if I'm wrong, you had benefits from model refinements as you moved from standardized to the AIRB, on certain of your U.S. portfolios. But in Q4 you did have a bit of tweaking that negatively impacted you. Is that essentially correct?

Tom Flynn - ***BMO Financial Group - CFO***

That is correct.

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

Okay. And then, just secondly, on the traditional wealth management business, if I did the math right, and correct me if I'm wrong, it looks like, again traditional wealth, that earnings increased 32% year over year. And I've tried to back out the gain on the pension sale and the legal settlement impact. 32% looks high and I'm sure there's something in there because AUA, I think, increased 12%, AUM increased 5%. So, are my numbers right? And I'm just trying to figure out what I'm missing. Thank you.

Gilles Ouellette - ***BMO Financial Group - Group Head, Wealth Management***

I think your numbers are right, Doug. We had this gain in the U.S., which offset with a reserve. I think in the past we've talked about our normal numbers being somewhere between $235 million and $240 million. I think we're roughly around there. Actually, we're quite pleased with these numbers because, as you know, the months of August and September were just horrible for the markets. We have a big book of fee business. We now manage north of $800 billion so the markets do have an impact. So, we're quite pleased with the results this quarter.

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

But is there anything in particular that drove the outsized gains? Or was it just it was much weaker in Q4 of last year that caused the year over year to look abnormally high? I'm looking for if there's any noise in the numbers here.

Tom Flynn - ***BMO Financial Group - CFO***

There are basically two things going on. As Gilles said, very good underlying business performance in a variety of ways. And then a year ago, we did have a legal reserve that impacted the results and that is contributing to the big growth number you're calculating. So, the number would be good in any event but it's outsized and above normal because of the legal reserve a year ago.

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

Okay. Where I'm going is, should we look at just asset growth as an indication of what earnings growth should be for this business excluding any abnormal legal items? Is that essentially what we should be looking for? And is that what it was in the quarter?

Gilles Ouellette - ***BMO Financial Group - Group Head, Wealth Management***

I think that's fair, but what's happened in the last couple of years that impacts our businesses is that interest rates have come down. So, the spreads have been very narrow. So, what we expect going forward, at some point in time the rates are going to start going up and I think that you're going to get outsized gains. I think you're going to get gains in revenues that are going to be higher than the gains in the asset because in the last three or four years we've suffered the reverse.

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

Okay, thank you very much.

Operator

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

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

Good afternoon. A question for Cam. Cam, around this time last year you offered a similar outlook on domestic retail earnings. You talked about good momentum and loan growth and, for the most part, you were bang on. The only thing I'd offer is that it was in the second half of the year. Is there any reason to suggest that a similar pattern will play out in 2016 specifically? You're offering some pretty optimistic outlook but it will play out in the second half not the first half?

Cam Fowler - ***BMO Financial Group - Group Head, Canadian Personal & Commercial***

Thanks for the question. The difference, I think, between last year and this year is I think we have a little more certainty around the environment in which we are operating. We made adjustments in the first half of the year to ensure that we were adjusting our spend to the revenue that I think was available. That's all in place now.

The three points I raised at the beginning of the call around revenue confidence that are driven by cards, commercial lending and continued deposit growth, I think with confidence we will deliver mid single-digit revenue growth. And we're travelling into the year already with our expenses in a position in the high 3, early 4's.

So, I think just a little more clarity about the environment, more clarity on the key blocks of revenue growth. And I think a little bit less change going on within the business, as well, I would add that because we've digested a couple of large platform changes. Those to me are the things that make this year different perhaps than last year.

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

That's helpful. Let's flip over to the U.S. and think about higher rates. There are a number of regulatory filings from U.S. regional banks that speak to just how important it is, the extent to which higher rates can really drive earnings. Now, they make a point in their regulatory filings, and where I'm getting at is I wonder if the same is true for BMO. The point they are making is that if short-term rates were to move higher but the long end of the curve came right back down such that we started to see a pretty flat curve, they would still really benefit from the effective higher rates. Is that something you can speak to?

Tom Flynn - ***BMO Financial Group - CFO***

It's Tom, Mario. I'll say a few things trying to address your question. First is that we do have what we think is a good sensitivity to short rates in the U.S. And to give you a sense of that, in total, if rates were up 100 basis points it would mean, in our banking business, about $200 million of revenue, and around $100 million of that would be off of the U.S. short rate. And if short rates moved up and long rates didn't move, I think in the U.S. that would be the end of the story. And if long rates declined, which to me would be odd if short rates are moving up, there would be a bit of a give back. But the sensitivity to longer rates takes time to work in because, as you know, you're basically repricing a book over, depending on the individual book, five to seven years, so the impact is more modest.

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

Okay. But we still see a benefit even if the long end of the curve doesn't cooperate?

Tom Flynn - ***BMO Financial Group - CFO***

That's correct.

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

Okay, thanks.

Operator

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

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

Hi, thank you. My question is on page 11 of the supplemental pack, the other line in revenue, $273 million, up significantly from the recent run rate. Can you help me understand what's in there? And perhaps more importantly, what would be a normal run rate for that line item?

Tom Flynn - ***BMO Financial Group - CFO***

It's Tom, Darko. A couple things. The number, as you point out, and we noted in the remarks, is above the run rate. Contributing to that, we have the gain in the Wealth business that we've talked about and also the recovery in Corporate that we've talked about. So, those two items are both showing up in that line item.

I would note that the tax rate on those two items is high and it blends to a 36% tax rate. So, the net income impact isn't as big as you might think from the above-trend item itself. And then, more broadly, if you look at the non-interest revenue in the quarter, we absolutely had some upside in that line.

But on the flip side security gains, as we did note, were lower than average, about $25 million below the six-quarter average. Foreign exchange other than trading was about $10 million below. And underwriting and advisory were about $40 million below. So, there is a degree of inherent volatility or variability, really, in all of those lines. On more of a normal basis, I'm not sure I could do better in terms of guiding to that one specific line than looking at the kind of number you'd get by averaging all of the numbers on the page and attaching some growth rate to it.

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

Okay. And is there no DVA? Is that the line item that would have the DVA adjustment?

Tom Flynn - ***BMO Financial Group - CFO***

No, it's not.

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

Okay that's fair. That's good intel. Thank you very much.

Operator

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

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

Thanks. I have just a quick question, maybe Bill. You started off by talking about the economy in Canada maybe in and around a 2% for 2016, a bit higher than that in the U.S. If that ended up being the type of economic growth rates we had over the next two or so years, is a, call it, 5% to 10% EPS growth at the total bank level or 7% to 10% EPS growth, the medium-term target, is that something that's achievable in those types of economic environments?

Bill Downe - ***BMO Financial Group - CEO***

I think we have to look at real GDP growth at that level as not unreasonable. When the growth rate is above 2% to 2.5% it's because you're picking up a very significant increase in productivity. And we haven't seen productivity gains coming through broadly in the economy, in the North American economy, for the last two or three years. Barring that, you have to think about how to make your businesses more efficient and how to grow your customer base. That's how you get to medium-term EPS growth rates that we still think ought to be the target that we're striving to achieve.

There are many parts of the world that would like to have a 2% to 2.5% growth rate. Our business happens to be centered in North America, and in that sense I don't think you could ask for much more natural advantage.

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

That's perfect. Thank you very much.

Operator

Thank you. The next question is from Mike Rizvanovic, Veritas Investment.

Mike Rizvanovic - ***Veritas Investment Research - Analyst***

Good afternoon. A quick question for Surjit, just back to credit. When I look at insolvency data in Canada we've seen a pretty meaningful jump from personal bankruptcies to consumer proposals. Just wondering, in your view, how much of a factor is that playing in keeping PCLs on the consumer side suppressed?

Surjit Rajpal - ***BMO Financial Group - Chief Risk Officer***

While they are up? While there's an uptick in bankruptcies and proposals?

Mike Rizvanovic - ***Veritas Investment Research - Analyst***

No, just the shift moving from -- if you look at total insolvencies, it's shifted quite significantly from the mix towards consumer proposals. So now it is north of 40% of total insolvencies, whereas a few years back it would have been in the low 20% range.

Surjit Rajpal - ***BMO Financial Group - Chief Risk Officer***

That is correct. That shift, we are examining that quite closely, actually, as we speak because that is a new phenomenon. We saw that happen in the U.S. and that experience, if it plays out here, will have an impact on credit cards, particularly. But it's something that we are examining quite carefully. But at this point in time it hasn't had an impact.

Mike Rizvanovic - ***Veritas Investment Research - Analyst***

Okay, thank you.

Operator

Thank you. There are no further questions registered at this time. I'd like to turn the meeting back over to Mr. Downe.

Bill Downe - ***BMO Financial Group - CEO***

Thanks very much, operator. As this is the last call of the calendar year, and I'm speaking on behalf of everyone here at BMO, we would just like to thank you for your participation in the call and your participation through the year. It's always a constructive dialogue and we appreciate it. And we just want to wish you and your families the very best for the holiday season. Thanks for your participation and we look forward to getting back together again in January. Thanks, operator.