BMO Financial Group

Q2 2020 Conference Call

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By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties, both general and specific in nature. There is significant risk that predictions, forecasts, conclusions or projections will not prove to be accurate, that our assumptions may not be correct, and that actual results may differ materially from such predictions, forecasts, conclusions or projections. The uncertainty created by the COVID-19 pandemic has heightened this risk given the increased challenge in making assumptions, predictions, forecasts, conclusions or projections. We caution readers of this document not to place undue reliance on our forward-looking statements, as a number of factors – many of which are beyond our control and the effects of which can be difficult to predict – could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed in the forward-looking statements.

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 severity, duration and spread of the COVID-19 pandemic, its impact on local, national or international economies and its heightening of certain risks that may affect our future results the possible impact on our business and operations of outbreaks of disease or illness that affect local, national or international economies; the Canadian housing market and consumer leverage; 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; natural disasters and disruptions to public infrastructure, such as transportation, communications, power or water supply; technological changes; information, privacy and cyber security, including the threat of data breaches, 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 refer to the discussion in the Risks That May Affect Future Results section, and the sections related to credit and counterparty, market, insurance, liquidity and funding, operational, legal and regulatory, business, strategic, environmental and social, and reputation risk, in the Enterprise-Wide Risk Management section that begins on page 68 of BMO's 2019 Annual Report, and the Risk Management section on page 35 in BMO's Second Quarter 2020 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 Economic Developments and Outlook section on page 18 of BMO's 2019 Annual Report and updated in the Economic Review and Outlook section set forth in BMO's Second Quarter 2020 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, we primarily consider historical economic data, past relationships between economic and financial variables, changes in government policies, and the risks to the domestic and global economy. Please refer to the Economic Review and Outlook section of BMO's Second Quarter 2020 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, the rationale for their use, as well as the effects of changes in exchange rates on BMO's U.S. segment reported and adjusted results can be found on pages 7 and 8 of BMO's Second Quarter 2020 Report to Shareholders and on pages 17 and 23 of BMO's 2019 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 (i.e. constant currency basis or CCY), 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, reinsurance adjustment, 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 benefits plan.

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

PRESENTATION

Jill Homenuk – Bank of Montreal – Head of Investor, Media & Government Relations

Thank you. Good morning and thanks for joining us today. Our agenda for today's investor presentation is as follows.

We will begin the call with remarks from Darryl White, BMO's CEO, followed by presentations from Tom Flynn, the bank's Chief Financial Officer and Pat Cronin, our Chief Risk Officer. We have with us today Ernie Johannson from Canadian P&C and Dave Casper from U.S. P&C. Dan Barclay is here for BMO Capital Markets and Joanna Rotenberg is here for BMO Wealth Management. After their presentations we will have a 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 question.

On behalf of those speaking today, I note that forward-looking statements may be made during this call. Actual results could differ materially from forecasts, projections or conclusions in these statements. I would also remind listeners that the bank uses non-GAAP financial measures to arrive at adjusted results to assess and measure performance by business and the overall bank. Management assesses performance on a reported and adjusted basis and considers both to be useful in assessing underlying business performance. Darryl and Tom will be referring to adjusted results in their remarks unless otherwise noted as reported. Additional information on adjusting items, the bank's reported results and factors and assumptions related to forward-looking information can be found in our 2019 Annual Report and in our Second Quarter 2020 Report to Shareholders.

With that, I will hand things over to Darryl.

Darryl White – Bank of Montreal – CEO

Thank you, Jill. And, thank you all for joining us this morning, we always value the opportunity to connect with you, and particularly do during this extraordinary time.

The global COVID-19 pandemic is having a profound and deeply personal impact on all of us. We want all of our stakeholders to know that as one of the largest banks in North America, we feel a clear responsibility to do our part to support the health of the economy. We're working together with policymakers, customers and other stakeholders to develop solutions to the complex challenges presented by the pandemic. The measures taken by governments and central banks to support the overall economy, individuals and businesses have been significant and unprecedented.

For BMO, the strength and the clear momentum that we had going into the crisis means that we can provide needed support to employees, to customers and communities and to ensure the operational and financial stability for the long-term benefit of our shareholders.

Our top priority has been, and continues to be, the health and safety of all of our employees and customers, while maintaining critical banking services. We mobilized quickly to transition 90% of our non-branch employees to work remotely. We implemented strict safety procedures to protect those who need access to physical locations.

We're acutely aware of the uncertainty and financial concerns our customers are facing, and we're committed to helping them navigate these challenges. We've provided personalized advice and access to a variety of flexible relief options, including payment deferrals for over 200,000 customers in Canada and in the United States. As of last week, we facilitated over $2 billion in funding under the Canada Emergency Benefit Assistance program, and over US$5 billion in loans in the U.S. SBA Paycheck Protection Program, helping 75,000 businesses to keep operating and pay their employees.

We're maintaining access to our branches, ATMs and call centres, and we're also connecting with customers, and each other, in new and innovative ways. We've very successfully expanded our virtual and digital tools to meet customers' needs, including broad use of e-signatures, phone and video meetings and digitized processes. Our ability to implement these changes quickly has directly benefited from the investments we've made over many years in our technology and our digital infrastructure.

Turning to community, guided by our Purpose, to boldly grow the good in business and life, we've announced several initiatives aimed at helping the communities where we live and work, including donations through the United Way to help get support to those in greatest need. For our front-line health care workers, who go above and beyond each day to help keep us all safe, we've converted our Institute for Learning building to provide a safe place for them to rest and recover. Together with MLSE, we've repurposed the kitchens at BMO Field to prepare and deliver meals to hospitals and shelters across Toronto communities.

We also know the impact the pandemic is having on mental health as people of all ages struggle with the challenges of social isolation and an uncertain future. That's why we remain fully committed to our ongoing sponsorship and as a founding partner with Kids Help Phone, re-imagining our annual "Walk so Kids Can Talk" to a virtual "Never Dance Alone-a-thon" – I invite you join us on May 31 to help raise funds and awareness

for mental health in Canada. And just yesterday we announced that we joined others to support a promising pan-Canadian COVID-19 clinical trial being coordinated by a Sunnybrook research team, donating $300,000 to this potentially ground-breaking research.

Turning now to our financial results, while COVID-19 had a meaningful impact on the bank's earnings this quarter, the bank's operational performance and capital position remain solid. We benefited from positive momentum across all our businesses going into the crisis with a focused strategy and a very disciplined approach to expense management.

This quarter we delivered $2 billion in pre-provision, pre-tax earnings, demonstrating the resilience and earnings power of our diverse businesses. We fully absorbed a significant increase in loan loss provisions, including a $705 million provision for credit losses on performing loans.

Our Personal and Commercial businesses in Canada and the U.S. continued to drive core profitability and revenue growth as both businesses worked very closely with customers. Strong loan and deposit growth was in part driven by customer reaction to the pandemic, with increased loan utilization and a movement to deposit safety. We are now seeing these trends stabilize.

Our Capital Markets and Wealth Management businesses were impacted by the market volatility and dislocations during the quarter. Capital Markets results reflect the increase in provisions for loan losses, primarily for performing loans. Client driven trading revenues were mixed, with strong performance in certain asset classes offset by negative impacts from the market environment.

Underlying performance in Wealth Management held up very well, with good net new asset growth in our advisory businesses and very strong online brokerage revenue as our teams supported a doubling of transaction volumes and account openings compared to a year ago. These good Wealth results were negatively impacted by market movements on our insurance business and a legal provision.

Capital Markets and Wealth Management continued to demonstrate their competitive strengths in supporting the efficient and effective functioning of global markets. BMO Capital Markets was a lead bookrunner for the US$8 billion global benchmark sustainable development bond issuance with the World Bank, aimed at strengthening health systems in developing countries. BMO GAM was proud to be selected as the asset manager for the Bank of Canada's Provincial Bond Purchase Program, which aims to support the liquidity and efficiency of provincial government funding markets.

While the scope and scale of the economic and social impact of the pandemic remains uncertain, our strong liquidity and capital provide the strength and stability to withstand a period of prolonged economic recovery. Our CET1 ratio at 11.0% is well-above regulatory requirements and supports our commitment to maintaining our dividend payment record.

We've prudently provisioned for future losses, have a demonstrated track record of strong risk management, and are singularly focused on working with our customers across industries and geographies to help them withstand and recover, as we always have through every part of the business cycle.

Our commitment to improving the bank's efficiency is as strong as ever. On a year-to-date constant currency basis, we've held expenses flat to last year and maintained positive operating leverage. And, we'll harness the speed and agility with which we've been executing change during this period to further improve efficiency in each of our businesses over the long term.

We're not alone in finding efficiency improvements that will sustain future growth. The economic recovery is likely to be uneven, with some sectors able to rebound quickly and even outperform as they take advantage of accelerating trends that were already emerging. Economies have proven to be resilient, and we salute our personal and our business clients who are incredibly resourceful as we work together with them to overcome challenges and close innovation gaps. We all have a shared accountability to make things better when we get through to the other side of this crisis.

At BMO, through the pandemic, we've developed a new way of working that has been core to our strategy for a long time but has now accelerated, as we build a stronger, more competitive BMO for the future. We will continue to show discipline and accountability on how we allocate resources to areas with clear competitive advantages, strengthening value for our customers and delivering a more sophisticated, integrated approach on digital first, combining the power of our modern technology platform and proactive analytics.

Before I close, I'll leave you with my summary reflections on how I feel about our quarter in such an unprecedented and remarkable environment. First, I'm extremely proud of how our employees responded, so admirably supporting each other, our customers, and our communities in moments of extreme anxiety and need. I'm proud of our brand and our ability to live our Purpose when it truly matters most – here, I could not have asked for more.

We earned $2 billion of PPPT, comfortably absorbing significant and prudent increases in provisions for credit losses. And we earned this despite meaningfully lower revenues in some of our market-sensitive businesses. We have a strong capital and liquidity position, a disciplined operating plan and very good momentum. The strength and resilience of our overall diversified business model has been tested and we are performing well through these challenges. As a result, I'm confident that our bank has never been positioned better to face the environment ahead.

I'll now turn it over to Tom to talk about the second quarter financial results.

Tom Flynn – Bank of Montreal – CFO

Alright, thank you, Darryl, and good morning everyone.

My comments will start on slide 9, beginning with the highlights of our financial results for the quarter. Despite the challenges of the environment, our pre-provision, pre-tax earnings and our operational performance remained resilient. From a balance sheet perspective, we are also in a very good spot with strong capital and liquidity positions.

Q2 reported EPS was $1.00, and net income was $689 million. Adjusted EPS was $1.04, and adjusted net income was $715 million, both down from last year primarily due to higher provisions for credit losses, which drove 85% of the decline. Pre-provision, pre-tax earnings were approximately $2 billion, down 5% and comfortably absorbed the impact of higher PCLs.

Adjusting items are similar in character to past quarters and are shown on Slide 29.

Turning now to revenue. Second quarter net revenue was $5.5 billion, down 3% from last year. Higher revenue in P&C businesses from strong loan and deposit growth was offset by lower revenue in our market sensitive businesses. Net interest income of $3.5 billion, was up 12% or 10% in constant currency, driven by higher deposit and loan balances. Net non-interest revenue was $1.9 billion compared to $2.5 billion last year, with the decline largely driven by lower trading, insurance and market related fee revenues.

Expenses decreased 2% from last year and reflect disciplined expense management. The provision for credit losses was $1.1 billion, and Pat will speak to this in his remarks.

Moving to slide 10 for capital. The capital position is strong and well above regulatory requirements. The Common Equity Tier 1 Ratio was 11%, down from 11.4% in Q1. The change in the ratio reflects higher risk weighted assets and the Clearpool acquisition, partially offset by the expected credit loss provisioning adjustment, and other smaller net positive items.

Growth in risk weighted assets was driven by strong loan growth in support of our customers and changes in asset quality. As you are aware, during the quarter we instituted a 2% discount on our dividend reinvestment plan. We viewed this as a prudent action given the uncertain environment and the loan growth we had in the quarter.

Our liquidity position has remained strong and benefited in part from excellent customer deposit growth which exceeded loan growth. Liquidity metrics, including the LCR which was 147%, improved during the quarter.

Moving now to our Operating Groups and starting on slide 11.

Canadian P&C maintained good core profitability with pre-provision pre-tax earnings of $985 million, up 1% from last year, and net income of $362 million reflecting higher credit provisions. Revenue increased 2% as the benefit of higher balances was partially offset by lower non-interest revenue and lower margins. Average loans were up 7%, with commercial loans up 14%. Deposit growth was strong with personal up 12% and commercial up 20%, reflecting higher liquidity retained by customers due to the impact of COVID-19. Net interest margin was down 10 basis points from last quarter, primarily due to lower loan spreads, as a result of the narrowing of the Prime to BA relationship. While projections are difficult, the net interest margin is likely to drift somewhat lower over the balance of the year due to the impact of lower interest rates. Expenses increased 3% primarily due to higher technology and pension costs.

Moving to U.S. P&C on slide 12, and my comments here will speak to the U.S. dollar performance. Net income of $253 million was down from a year ago due to higher credit provisions. Pre-provision pre-tax earnings growth was strong at 11%. Revenue was up 6%, driven by deposit and loan growth and higher fee income, partially offset by lower deposit margins. Commercial loans were up 13% and personal up 9%. Average deposit growth was 18%. Net interest margin was up 2 basis points from last quarter, as the negative impact of lower rates was more than offset by an elevated LIBOR, and strong deposit growth relative to loan growth. The net interest margin is expected to move down somewhat over the next two quarters reflecting a more normalized LIBOR and the impact of rate cuts. Expenses were up just 2% from last year.

Turning now to slide 13. BMO Capital Markets had a net loss of $68 million, as performance was impacted by higher credit losses and the market environment. Pre-provision pre-tax earnings were $300 million. Revenue was down 15%. Global Markets revenue declined in the quarter, although performance was good across rates, foreign exchange, commodities and cash equities. Trading non-interest revenue was negative given the impact of extraordinary market conditions on our equity linked note related businesses, as well as credit and funding derivative valuation adjustments. In Investment and Corporate Banking, revenue decreased as higher corporate banking-related revenue was more than offset by markdowns on held-for-sale loan portfolio, and lower underwriting and advisory fees. Expenses were down 15% from last year, due to the impact, primarily, of the severance expense in the prior year. The provision for credit losses was $408 million and included a provision on performing loans of $335 million.

Moving to slide 14. Wealth Management net income was $153 million. Traditional Wealth net income of $169 million was down from $236 million last year, largely due to the impact of a $49 million after-tax legal provision and lower fee-based revenue, partially offset by strong online brokerage revenue. Loan and deposit growth continued to be strong. The insurance business had a net loss of $16 million compared to average income of approximately $60 million a quarter over the last couple of years. The decrease was primarily due to the impact of unfavourable market movements in the quarter. The impact of market movements on our insurance business and a legal provision, together, reduced earnings per share by approximately 15 cents in the quarter. Expenses were well-managed and up just 1%.

Turning now to slide 15 for Corporate Services. The net loss was $81 million, relatively unchanged from last year, as lower expenses and higher revenue were largely offset by the impact of a less favourable tax rate in the quarter.

To conclude, our pre-provision, pre-tax earnings and underlying operating performance demonstrate the strength of our franchise. In what was an extraordinary quarter, we earned through higher credit losses, supported our customers and employees, and maintained a strong balance sheet.

And with that, I'll hand it over to Pat.

Pat Cronin – Bank of Montreal – CRO

Thank you, Tom, and good morning everyone.

The current COVID-19 pandemic has had a meaningful impact on all of our risk types. With that said, we went into the crisis in a very strong risk position with a long track record of successfully managing risk through challenging times. As such we expect to navigate the risks of the current crisis successfully and continue to serve our customers across all businesses.

The most evident COVID-19 impact in the quarter is on our provisions for credit losses. As shown on slide 17, our total provisions for credit losses were $1.1 billion or a provision rate of 94 basis points, significantly higher than what has been seen in recent quarters.

The total provision was made up of a provision for impaired loans of $413 million, or a provision rate of 35 basis points, and a provision for performing loans of $705 million. Based on our estimates, we see approximately 1/3 of the impaired provisions being related to COVID-19 impacts in the quarter.

As per slide 17, this increase in provisions on impaired loans was due to increased provisions in Canadian P&C and in Capital Markets. In the Canadian P&C segment, the $212 million of losses were driven by elevated consumer losses, with the increase versus Q1 largely related to the impact of COVID-19, and elevated commercial losses, in part related to COVID-19 as well as one larger credit loss that occurred before the pandemic and that involved fraud.

In Capital Markets, the PCL of $73 million, an increase of $20 million versus Q1, was driven by continued stress in the Oil and Gas markets, exacerbated this quarter by COVID-19 related demand declines for oil. In addition, Capital Markets had a larger PCL in the Apparel Retail sector, largely related again to the impact of COVID-19 on store operations.

U.S. P&C impaired loan provisions were $124 million, a decline of $8 million from the prior quarter. Transportation Finance provisions accounted for approximately $41 million, or 37% of our U.S. Commercial provisions this quarter. The remainder of our U.S. Commercial businesses saw impaired provisions decline by 17% quarter-over-quarter.

Turning to slide 18, the $705 million provision for credit losses on performing loans was primarily due to the weaker economic outlook with other factors, like changes in scenario weights, balance growth, credit migration and model changes, largely netting out. While cognizant of the unique nature of this economic disruption as well as the substantial support provided by governments, we followed our normal process and portfolio overlay type adjustments were not a large determinant of the overall provision.

Our closing allowances by line of business are shown on Slide 18. We feel our closing allowances are appropriate when compared to our actual historical impaired loan experience as well as our own expectations for impaired losses in the future. In particular, this quarter we saw a significant increase in the Capital Markets allowance reflecting expected continued stress in the Oil & Gas sector.

On Slide 19, impaired formations were $1.396 billion and gross impaired loans were $3.645 billion, or 74 basis. The elevated level of both formations and gross impaired loans are largely a reflection of continued stress in some industry sectors like Oil and Gas, U.S. Agriculture and Transportation as well as more recent stress on other sectors more impacted by COVID-19, like Retail Trade and Services.

Loan growth shown on Slide 20 was largely due to borrowings by our existing accounts, in many cases driven by draws against previously committed facilities. This utilization of revolving lines of credit peaked at the end of March and has been declining steadily and notably ever since.

Consumer loan growth was modest, with utilization levels actually declining in Q2 relative to Q1 in several products. This was particularly noteworthy in credit cards where balances declined by 12% quarter-over-quarter, explaining about 2/3 of the increase in overall credit card delinquency rates in the quarter.

Turning to Slide 21, we've included a view of our loan portfolio with additional balance information for some sectors that are generally viewed as more impacted by COVID-19. For the purposes of this disclosure, we have taken a very broad view of what sectors to include, and while we are not immune to the stress these sectors may experience, on Slide 22 we note numerous important considerations that give us some comfort when evaluating the potential for that stress to ultimately translate into loan losses.

On Slide 23, we provide further detail on our Oil & Gas loan portfolio. Although the impaired loan rate of over 4% is clearly elevated, we expect to continue to benefit from the reserve-based nature of virtually all of our sub-investment grade exposures in the Extraction segment. In addition, we have a prudent Oil & Gas performing provision of $357 million as of the end of Q2, representing roughly 2.4% of the balance of the entire Energy portfolio and 3.2% of the entire portfolio, excluding Pipelines.

You'll note additional disclosure on payment deferral programs in our MD&A this quarter. As of the end of Q2, we had 11% of our Consumer balances and 9% of our Commercial balances under deferral arrangements.

With respect to Consumer deferrals, 89% of the deferred balances are Real Estate Secured Lending, with 94% of those deferred RESL balances in Canada. Of the deferred Canadian RESL balances, the large majority are mortgages, of which 33% are insured. The Credit quality of Consumer deferrals varies by product, but the average bureau score weighted by deferred balances is approximately 750 in Canada and 730 in the U.S. And the average LTV of deferred RESL balances is approximately 60% in Canada and 55% in the U.S.

Commercial loan payment deferrals are adjudicated case by case, based on a strict set of criteria, including, but not limited to, a requirement for all loans to have been current prior to COVID-19, minimum credit ratings and an assessment that the business is likely to recover.

Turning to Slide 24, our Trading related net revenue shows several days in the quarter where we experienced notable losses. These days coincided with periods of extreme volatility, historic price declines in equity markets and unprecedented discontinuity between previously well correlated assets. Although many parts of our trading businesses performed exceptionally well this quarter, a small number of specific segments saw elevated losses. These segments have been closely evaluated and, where appropriate, material risk reduction actions have already been taken.

Although the majority of the company is now working remotely, our operational risk remains within acceptable ranges and our control activities across all three lines of defence are largely operating business as usual.

In terms of outlook, given the historic level of economic stress due to COVID-19, we would not expect to see a reduction in impaired loan losses over the next few quarters and, depending on the length of the crisis and the impact on specific industry sectors, we could see further increases in impaired loan loss rates. We view our allowance coverage as appropriate given our current forecast for future loan losses and, as such, would expect the performing provision in the next few quarters to be largely a function of the normal factors that influence this provision in any given quarter.

With that, I'll turn the call over to the operator for the question and answer portion of today's call.

QUESTIONS AND ANSWERS

Ebrahim Poonawala – BofA Merrill Lynch, Research Division – Director

I guess, first question just on credit, Pat. If you can talk to us around the reserve coverage, so when you look at Slide 18, one, like a comment you made about future performing PCLs, why is 49 basis points reflective of this macro backdrop, and why is that enough, because we've already seen some sort of concern from investors whether this stack ranks lower against your peers and whether this might be enough, given some of the COVID sector exposures that you outlined, so I would appreciate some thought process around why 49 basis points is enough, and why we shouldn't expect a meaningful increase in that number going forward.

Pat Cronin – Bank of Montreal – CRO

Sure. I think I caught most of your question. I would start with, I don't know if you suggested that there was a meaningful increase coming in the provision. I wouldn't say that at all. The performing provision we would expect to come down from this level starting next quarter. And so, we don't see an increase coming in the quarterly provision.

With respect to the appropriateness of the coverage, obviously, we spent a lot of time thinking about that appropriateness. I think, first of all, you can look at it on an overall coverage basis. If you look at the roughly $2.4 billion of the total allowance, we think a good way to look at it is versus trailing four quarters of specifics. And that gives us about 2x coverage of trailing four quarters, and that includes two quarters of, as you know, significantly elevated impaired PCL. Or, you could even look at it based on the current quarter annualized, so a fairly stressed impaired quarter annualized for four more quarters, and that's still about 1.5x coverage. I think when you compare that to the peer set, you'll see that we're actually pretty much in line with most of the group.

And then we also look at it by line of business. I think for me, I look at the closing GA in terms of basis points and how that compares to the historical range of specific loss rates. And if you look across every business, U.S. Commercial is a good example, we have 49 basis points of coverage now in U.S. Commercial – the historic impaired rate of that business, and for the last six years, has ranged between 6 basis points and 27 basis points, so we think we're actually quite well covered in that sector. And then I think we look at the experience even this quarter in U.S. Commercial, we actually saw the non-TF specifics go down this quarter, including incorporating some specific impacts from some of the sectors you talked about that are impacted by COVID.

So, I guess, two comments. We're not really seeing significant stress yet in the U.S. Commercial book. We think it's a really well put-together book that can withstand a lot of stress. And at 49 basis points compared to the historic loss rate of that segment, to us, that feels like adequate coverage. And I think if you look across all of the business segments and compare them to their historic loss rates, or even some version of a stress loss rate like we're seeing now, you'll see that we're over-covered in every single one of the business segments.

Scott Chan – Canaccord Genuity Limited, Research Division – Director of Research of Financials & Financial Services Analyst

Pat, in the Capital Markets side, you talked about trading losses on separate several days on certain segments or sectors. Can you talk about those certain sectors, is it the sectors that are more kind of commodity driven, or is there something else, kind of that was a bit unusual during the volatility?

Pat Cronin – Bank of Montreal – CRO

Thanks for the question, Scott. I think what I'll do is maybe I'm going to ask Dan to make some preliminary comments on this, and if I have anything to add, I'll jump in after that.

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

Sure. Thanks for the question, Scott. I think as you'll appreciate, the quarter was a fascinating quarter, where the early part of the quarter we had some adjustments as COVID came in. The two weeks in March were extraordinarily volatile. And then subsequent to that, in April and now going on into May, we've actually had, I would call it, exceptional results. In that period of high volatility, we had a couple of places where we had such extreme market dislocation around historical patterns where we had some exposure. The first is what we call our equity-linked note business. And then the second is how we're covering off the hedging of our exposure around our derivative book, which you would have known as XVA. So those are the two places that we worked through some of that dislocation to the marketplace.

Gabriel Dechaine – National Bank Financial, Inc., Research Division – Analyst

Just on the energy provisioning, I was a bit surprised that is $54 million of specific provisions, and then, thankfully, you gave some additional disclosure on the provisions on performing. Similar question to Ebrahim there, given all the issues that we're seeing in that sector, why does that number make sense? I'm just like devil's advocate here.

Pat Cronin – Bank of Montreal – CRO

Yes, sure, that's a great question. And we think with that rate of coverage, we size it relative to a couple of things. I mean, first of all, that's well above the current loss rate we've seen on specifics over the last couple of quarters and, as you know, the sector is already quite stressed and that specific PCL rate has actually been pretty stable in the book for the last three quarters. And so, we've had a pretty good picture of what stress looks like.

The other thing you can look at is what level of stress we would have seen in our book back in 2015-16. '16 would have been the worst year during the last downturn, and there, we averaged about 150 basis points of loss in that year. As you know, we recovered a fair bit of it later, but that was the rate in that quarter, so that kind of gives you another bookmark.

And then lastly, obviously, we do a ton of stress testing on the portfolio. And I would tell you that a $35 flat for three years stress test – and keep in mind, this is just a stress test, there's assumptions baked into it – but our best guess of a $35 flat environment for three years running would be roughly about a 2% loss rate per year in that portfolio. And so, that kind of gives us some sense that at 250 basis points of coverage or 3% plus, if you exclude pipelines, is a pretty reasonable number for a sector and actually would incorporate higher levels of stress than we've seen in some of the more stressed periods in the past for that sector and is quite consistent with our stress tests.

Gabriel Dechaine – National Bank Financial, Inc., Research Division – Analyst

When you take the specifics, are you looking at when an actual account goes bankrupt or whatever, are you doing any – I think these guys are going bankruptcy, so I'll take a specific now?

Pat Cronin – Bank of Montreal – CRO

No. We would take a specific provision on every oil and gas account that is currently classified as impaired, and that provision would fully reflect our complete expectation of what the loss would be. So, everything in the oil and gas impaired portfolio right now has a specific provision that's been taken on it, if it needs one. I would remind you that a huge chunk of that oil and gas portfolio is reserve-based. For example, we had a fair, one very chunky addition into the impaired oil and gas portfolio this quarter. In fact, it accounted for almost 2/3 of the increase – of the formations we had in the sector this quarter. And given the reserve-base nature and the significant amount of junior debt that's below us, we actually don't expect to take any provision at all. And so, that also gives us some comfort.

And the other thing to keep in mind, too, is a lot of the producer clients that we deal with, particularly in the United States, are hedged, and a lot of them are hedged to the balance of the year. So, they can weather quite well short-term storms. We'll see as prices play out. But in the short term, given that, plus the reserve-base nature of our lending, plus our stress testing and our own historic experience, we feel pretty well-covered in the sector.

Stephen Theriault – Eight Capital, Research Division – Principal & Co-Head of Research

Could we go back to Capital Markets for a moment, and just the equity-linked note marks. It didn't look like these products really rear their head to the equity line at the last time. I appreciate it wasn't as adverse, but when I go back to '08 and we had a big sell off. Maybe can you talk about the differences there, and would you expect that to come back linearly as the market comes back, or it's come back in, since quarter end somewhat, or is it a situation – I think maybe it was Tom earlier mentioning that you've taken some risk off the table in some spots – so does that come back with the market?

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

Yes. Thanks for the question, Steve. I think the piece I would give you is there was extreme volatility as we moved through that two weeks in March. And so, as you think about some of that normalization, you're right, we will get some of that back over time, with that normalization. But also, as we went through there, we were doing dynamic hedging. And some of that dynamic hedging will then be permanent in terms of a realized loss. As we think about going forward, we've done a lot to take risk off the book, both in terms of market downside protection, making sure that we have matched our term volatility profiles, and then, our exposure between different marketplaces, so I think Canada versus the U.S., and have worked very, very hard to take that book out and look at it today as being relatively balanced, strong and immunized. And again, I do think there'll be some recapture as we go forward. It's a strong business for us and has been and will continue to be so.

Stephen Theriault – Eight Capital, Research Division – Principal & Co-Head of Research

Is that dynamic hedging program for that book new or just enhanced?

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

It's enhanced from where we were. And, if you think, we've taken a more conservative view of our risks, and so, we're managing the business that way.

Stephen Theriault – Eight Capital, Research Division – Principal & Co-Head of Research

And if I look at the trading days in the appendix, the day that had the $180 million – I think I'm reading that right – loss date, is that primarily this book, or is that a combination of things?

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

In every one of those loss days, it is a combination of many things, if you think about the breadth of our positions. That day, in particular, there was a combination really of the equity-linked notes as well as XVA. If you remember, that was the day of extreme market dislocation, just before the Fed came in and put in place its positions, with dramatic asset sale prices moving and dislocating. And so, you saw some of the volatility there to the negative. You see the volatility to the positive after that, as markets started to normalize. But I think of it, in my mind, it is about 2/3 for the equity-linked notes and about 1/3 for the XVA.

Meny Grauman – Cormark Securities Inc., Research Division – MD & Head of Institutional Equity Research

As I'm thinking about, sort of, where PCL ratios peak and also going back to the discussion of the adequacy of coverage on the allowance, I'm wondering how appropriate is it to look back, you referenced sort of the past few quarters and years, but if you go back further to past deeper recessions in Canada, early '80s, early '90s, how appropriate is it to look back to those historical examples to kind of gauge the magnitude – and, I guess, government support is probably one factor, are there other factors that would make that comparison not the best in your view?

Pat Cronin – Bank of Montreal – CRO

Yes. Thanks for the question, Meny. I think you answered your question a little bit right there. I certainly wouldn't discount the possibility that loss rates could end up being higher than what we factored into the performing provision. I mean when I think about impaireds going forward, we're running this quarter at 35 basis points, that's clearly a rate lower than what you would have seen in the Financial Crisis or what you would have seen in prior recessions. But as you noted, there are some things that are quite a bit different this time around, not the least of which, as you mentioned, is some very, very substantial and quite targeted and direct stimulus provided by the government.

The second thing I would suggest is loss rates tend to be very much a function of duration of the economic stress. And in prior recessions, you could think of those as running two to three years before we started to see recovery. In this one, just given the unique nature, most of the economic consensus forecast would see a recovery much, much faster than that. And think about stress on corporates or consumers, a lot of them, particularly when you get to higher-quality credit folks like ours, can withstand short periods of stress, but things start to get non-linear in terms of PCL as that duration goes longer.

So I would say the risk to our forecast is if a sharper correction or a correction that is anticipated by the consensus turns out to be much longer than we expect, then you're going to see some upward pressure and likely to push up into some of those more stressed loss rates that you're talking about from prior recessions.

The other thing I'd highlight, too, is mix has changed over the course of time as well. Our CRE portfolio is a great example. We had fairly elevated CRE losses during the last recession. That book looks dramatically different today than it did back then. And so, when we run a stress test today, on that portfolio, we see very different loss rates than what we would have seen in '08. So, I would say those three things: mix, duration and government stimulus, would likely see loss rates lower.

I'll caveat all that with, we're in dramatically uncertain times, and so, that forecast could be different. But I think about loss rates as: from 35 basis points, where we are today, are they likely to drift up higher? I think, likely into the 40s. The other end of that bookend would probably be at the 70-basis-point range, which would be closer to what you saw during the GFC. So hopefully, that answers your question, Meny.

Meny Grauman – Cormark Securities Inc., Research Division – MD & Head of Institutional Equity Research

Yes, thank you.

Doug Young – Desjardins Securities – Diversified Financials & Insurance Analyst

Questions for Pat. I think Pat, in your prepared remarks, you talked about just the buildout of performing loans, and I think you mentioned – and I didn't catch it all, so I'm hoping you can flesh it out – the weaker outlook accounted for most of the build and change in scenario weightings, models and whatnot, that all netted out. So, I'm hoping you can kind of just flesh that out a little bit more and talk a bit about, more about the process, and maybe if you can give some weightings in terms of how much was driven by the scenario changes versus the forward-looking indicators and whatnot?

Pat Cronin – Bank of Montreal – CRO

Sure. So as I said in my comments, the single largest factor by far was the macroeconomic variable change. So, of the $705 million provision, that's the size of the macro impact, was actually slightly larger than that. In addition, we had some balanced growth in there, which contributed, call it, about $40 million credit migration, with a little bit of credit migration for about the same amount. There is some FX in there as well that contributed about $50 million. So those were the things pushing upward on the provision. We had some model changes, which are pretty normal course in any quarter. That adjusted it down by about $60-ish million. And then we did change our scenario weights in the quarter because our base case is actually much, much closer to what our prior adverse case looked like and we're now clearly in a downturn. We felt that the probability of a benign scenario was about equally weighted to the adverse scenario now, just given that we're right in the middle of a downturn or entering into it. And so that scenario adjustment actually reduced the provision again by about $50 million. So those other things all netted out to about the impact of the macro change, and that's why I made those comments at the outset.

Doug Young – Desjardins Securities – Diversified Financials & Insurance Analyst

So the modeling reduced the performing loan PCLs, and I guess the scenario weightings, because you're not going to expect a downturn on top of a current downturn, and so that's what you're thinking in terms of scenario, but when you think of the modeling, what did that relate to?

Pat Cronin – Bank of Montreal – CRO

Yes. That's probably more detail than I think I want to get into on the call. There's a lot of technical things, we are constantly evolving our models every quarter. We are always looking to improve the efficiency. And then sometimes we'll add sector-specific models, where we don't have them and we are in. So, these things tend to be quite small. This quarter was a little bit larger than you might normally see. But model changes are completely normal course. We have them fairly often, as I'm sure most other banks do as well.

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

Can I just ask one quick clarification, first, Pat, when you talk about performing loan losses declining, but impaired increasing, can you offer an outlook on just the total PCLs ratio looking forward, could the impaired increase sufficiently such that we're looking at an impaired total PCLs ratio to a level similar to Q2 in subsequent quarters, Q3 specifically?

Pat Cronin – Bank of Montreal – CRO

Yes. I would say, if you're thinking about totals, our current expectation would be that it would not be at the same level as what you would have seen this quarter. Beyond that, it gets pretty hard to predict. As you can imagine, the performing number, there's lots of moving parts in that, that can change from quarter-to-quarter. And so that one's harder to predict. And based on where I sit today, I don't see a large amount of upward pressure on the impaired provision. And so that gives me some confidence that the net of those two things will be a lower total provision number. But just given how much uncertainty there is in the market, I'm a bit loath to try and pinpoint a specific number in terms of loss rate for you at this point.

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

Okay. The actual question I wanted to get to then was, Pat, you talked about the duration being very, very important to the trajectory of credit losses. When you think about setting your performing loan loss reserves, can you talk about when in your models things are normal, by that I mean unemployment returns to a pre-COVID level, GDP activity is essentially back to a pre-COVID level, can you offer some commentary there?

Pat Cronin – Bank of Montreal – CRO

Yes. I think first of all, I'll caveat with by saying that those things are obviously important, but there are many, many other variables that go into the model, BBB spreads, levels of the VIX. So, all of those things can move around, enhancing or offsetting some of the movement – the move back to normal that you're talking about. And then beyond that, I would actually just simply point you, unfortunately, to the MD&A. We have some pretty good disclosure there about what we see. You'll see, for instance, in Canada, GDP declined this year of roughly about 6%. And then in 2021, rebound of 6%. Just the way the math works that doesn't get you back to flat by the end of 2021. But it gives you a sense of how we're predicting the recovery there. And then you'll see similar patterns for the unemployment rate as well.

Nigel D'Souza – Veritas Investment Research – Investment Analyst

So I actually wanted to follow up a bit on the macroeconomic variables for your performing loan loss modeling. And if I could turn to page 32 of your shareholders' report, where you outlined your updated forward-looking indicators. [Technical difficulty] have turned a little bit more positive, so you're expecting a higher home price depreciation, in your base case scenario, and in your adverse scenario, you're not expecting or forecasting a decline in home prices. So I was wondering if you could just provide more colour on your thinking there and maybe also touch on what's the sensitivity of your performing loan allowances if in the future you did forecast a more material decline in the HPI?

Pat Cronin – Bank of Montreal – CRO

Yes. And unfortunately, you cut out there. I don't know if it was on our end or yours, but I missed a good chunk of your question, actually. But maybe I'll try and answer it based on what I heard. I think we actually show the adverse scenario there on page 32, so you can get a sense, and we also disclose if we had 100% weight in the adverse scenario, so that just gives you some perspective. It's about relative to the allowance today. It's about a $600 million increase in the allowance, if we move to our 100% adverse case, and so that just gives you some perspective. And in there, we obviously don't – on Page 32 – we don't disclose all the variables that it would be associated with our adverse case, but that just gives you a sense of the sensitivity. And hopefully, that answers the question, part of which I did not hear.

Nigel D'Souza – Veritas Investment Research – Investment Analyst

So if we have time, just for clarification, just the assumption on your home price outlook, it looks to be more positive now. So I was hoping you could just provide more colour on not forecasting a decline in real estate prices even in the adverse scenario?

Pat Cronin – Bank of Montreal – CRO

Sorry, your question is why are we generally bullish on housing prices?

Nigel D'Souza – Veritas Investment Research – Investment Analyst

Yes, according to your forward-looking indicator, it looks like you're expecting prices to be flat or higher in your scenario ratings here?

Pat Cronin – Bank of Montreal – CRO

Sure. Maybe I'll ask Ernie, she's very close to this market segment, and so she's probably got some very good colour.

Ernie Johannson – Bank of Montreal – Group Head, North American Personal & Business Banking

Yes. Thank you for that question. What we're thinking on forecasting related to housing prices is basically what we're seeing now is some stabilization in certain sectors in certain geographies. And so, I would say, right now, our position would be that we're going to be remaining quite flat on the housing prices. Obviously, in oil-affected regions, et cetera, we're going to see some nuances there. But for now, that's what our indicators are suggesting.

Darryl White – Bank of Montreal – CEO

Thank you, operator, and thank you to everybody on the call.

I'll just wrap up with a couple of summary thoughts. In terms of bringing us back to our core messages, I would remind you that we are extremely proud, I'm extremely proud, of the strong response our teams have had through the crisis. We're very comfortable with our capital and liquidity position, which drives the stability of the bank, the PPPT at $2 billion despite the softness in our market-sensitive businesses is very substantial relative to the prudent provisioning that we've got in our PCLs, and we're very confident in the outlook.

So with that, operator, I will leave the call there, and I wish everyone continued health and safety. Thank you very much.