BMO Financial Group

Q2 2010 CONFERENCE CALL

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PRESENTATION

Viki Lazaris ***- BMO Financial Group - SVP, IR***

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; followed by presentations from Russ Robertson, the Bank's Chief Financial Officer and Tom Flynn, our Chief Risk Officer.

After the presentation, we will have a short question-and-answer period where we will take questions from prequalified analysts. To give everyone an opportunity to participate, please try to keep it to one or two questions and then re-queue.

Also with us this afternoon to take questions are BMO's business unit heads, Tom Milroy from BMO Capital Markets, Frank Techar, Head of P&C Canada and Ellen Costello from P&C US.

At this time, I would like to caution our listeners by stating the following on behalf of those speaking today. Forward-looking statements may be made during this call and there are risks that actual results could differ materially from forecasts, projections or conclusions in the forward-looking statements.

Certain material factors and assumptions were applied in drawing the conclusion or making the forecasts or projections in these forward-looking statements. You can find additional information about such material factors and assumptions and the material factors that could cause actual results to so differ in our caution regarding forward-looking statements set forth in our news release or on the investor relations website. With that said, I will hand things over to Bill.

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

Thank you Viki and good afternoon to everyone on the call. As noted, my comments may include forward-looking statements. BMO's second-quarter results were strong and reflect the ongoing progression of improved results for five consecutive quarters. Three factors were particularly significant in Q2.

First and foremost, our core businesses maintained their positive momentum, a trend which we expect to continue. Second, we experienced a substantial reduction in loan loss provisions. While we expected continued improvement this year, the impact was better than we had anticipated. And third, we had a strong quarter from trading operations as our team capitalized on the market environment.

With $745 million or $1.26 per share net income increased significantly compared to both last year and Q1 of this year. Cash EPS came in at $1.28 per share and our ROE was 16.4%.

Our performance reflects the success we have achieved so far in delivering on our brand promise and providing clear benefits for our customers. The result has been and continues to be robust top-line growth. Specifically in Q2, we generated a 15% increase in revenue relative to last year. Revenue was also up on a linked basis despite fewer days in the quarter.

We have continued to focus on disciplined expense control across each of our operating groups. Q2 cash productivity was 59.7%, better than both comparable periods and year-to-date, our cash productivity was 60.1%. Credit losses declined significantly to $249 million. This was the third consecutive quarterly decrease in the provision while formations of $366 million decreased as well. We expect some variability in credit losses in coming quarters, but the overall trend is positive. And Tom will provide further color and also touch on Europe, which I know is on everyone's mind.

Russ will take you through our group results in some detail, but let me touch on some quarterly highlights. P&C Canada again generated strong year-over-year performance. Revenue growth of 10% reflects volume growth across most products and higher margins. P&C Canada has been delivering strong revenue growth for seven consecutive quarters.

In the quarter, a great deal was accomplished. The integration of Diners Club is going well and results are exceeding our expectations. And new product offers continue to appeal to customers in both credit card, with the launch of the World Elite card, and in mortgages. We are confident with the direction and approach we are taking in the mortgage business. We are seeing positive results from our new five-year low-rate mortgage and customers who take the low-rate mortgage are benefiting from lower total interest payments and being mortgage free sooner, while our traditional mortgage products offer increased features and flexibility.

This product reinforces our belief that the right advice will help our customers get the right home with the right mortgage. Since the launch of the new product, we have generated a very strong pipeline across the mortgage offering with good spreads.

Turning to P&C US, post the commercial realignment, of which I will speak to shortly, net income in the quarter was US$45 million and on an actual basis was slightly positive. On April 23, we announced the FDIC-assisted acquisition of US$2.5 billion in assets and US$2.2 billion in deposits from AMCORE Bank of Rockford, Illinois. We added 52 branches, which reopened as Harris branches the following day. The acquisition expands our branch network into areas of Illinois and Wisconsin where we already have a strong commercial banking presence.

We now have the number one market position in Rockford, which has above-average population growth and household income and a strong position in Madison, which is Wisconsin's fastest-growing city. The integration of this acquisition is on track and the reception from our new customers and employees has been very positive.

Private Client Group generated strong results in the second quarter. Year-over-year, the group generated significant growth both in insurance and in its traditional wealth businesses. Revenue grew 19% on the strength of improved equity markets and success in attracting new client assets. Assets under management and administration improved 20% year-over-year after adjusting to exclude the impact of the weaker US dollar.

BMO Capital Markets' results were strong both year-over-year and versus Q1 reflecting the strong trading results I highlighted earlier. I would note that these results were not yield curve related, but reflect the ability to capitalize on the market environment.

Investment banking revenues were down in the quarter, but the pipeline is building. We continue to make strategic hires in key positions in investment banking, as well as in research and we are well positioned for growth.

I would like to spend a few minutes updating you on our US commercial banking initiative, which is designed to capitalize on an emerging growth opportunity. As I mentioned to you in our first quarter reporting, we identified a number of US mid-market clients in the BMO Capital Markets' business that could be better served under a P&C commercial banking model. We have now migrated 500 relationships, comprising assets of approximately $6.4 billion. The benefits of this initiative are threefold:

First, by changing the client service and coverage model, we can deepen customer relationships, cross-sell other products and leverage our strong platform to a wider footprint.

Second, we can increase market share by acquiring new customers with full banking relationships. This coincides with the strategic relaunch of the commercial bank, with a strong "Bank for Business" positioning.

And third, we can improve productivity and efficiencies by better aligning costs with customer value, including improving the management of capital devoted to accounts with low potential for a meaningful relationship.

Turning to our balance sheet, our quarter-end Tier 1 capital ratio was 13.3% and our tangible common equity to risk weighted asset ratio was 9.8%, underlying our capacity for business expansion. New banking regulations continue to evolve and are expected to have less impact on BMO's balance sheet than on those of most global competitors.

In this context, we are carrying surplus capital in the belief that there are significant opportunities for business growth over the near term and the medium term.

Looking back on the first half of fiscal 2010, I can say BMO is delivering on our strategic agenda. And looking ahead, we'll continue to provide customers with a clearly defined brand. We'll drive solid revenue and balance sheet growth. We anticipate improving credit performance with some quarterly variability. We are investing in all of our businesses while remaining focused on expense control. We're committed to growing organically and through acquisitions and being opportunistic in this environment.

And we are doing all this with a relentless focus on delivering an excellent customer experience across all the markets we serve.

With that, I will turn it over to Russ.

Russ Robertson ***- BMO Financial Group - CFO***

Thanks Bill, and good afternoon. As some of my comments may be forward-looking, please note the caution regarding forward-looking statements at the beginning of the presentation.

On slide 9, you can see the reported first-quarter earnings were $745 million or $1.26 per share. On a cash basis, earnings were $1.28 per share and our Tier 1 capital ratio remains very strong. Return on equity continued to improve to 16.4% this quarter. Credit continued to show improvement in the second quarter with quarterly provisions of $249 million, which Tom will speak to shortly.

I would also like to highlight that about 70% of operating revenue is from our retail and wealth operations in Canada and the US. The remainder is from our capital markets businesses.

Net income from our total US segment was profitable for the second quarter in a row with net income of $26 million on an actual loss basis. This quarter's total bank results continue to demonstrate our strong business performance achieved through revenue growth and continuing attention to expense control.

Turning to slide 10, revenues were up $394 million, or 15% from the prior year, increasing across most businesses. The weaker US dollar decreased revenue growth by 6%. P&C Canada benefited from volume growth across most products, improved margins, and the contribution from the Diners Club acquisition that closed at the end of December.

Our Private Client Group had revenue growth across all businesses, a result of improved equity markets and the success of our focus on attracting new client assets. Capital Markets revenues grew as a result of higher trading revenues and higher investment securities gains. The prior year was impacted by capital markets environment charges.

P&C US revenue decreased as improved spreads in most products were more than offset by lower commercial loan balances and deposit spread compression. Quarter-over-quarter, total bank revenue was up $24 million with improved margins, higher trading income and card fees more than offsetting fewer days in the quarter.

Net interest income was $1.5 billion in the quarter, up $187 million, or 14% from a year ago, driven by strong growth in P&C Canada and improved net interest income in corporate services. Quarter-over-quarter, net interest income decreased $10 million mainly due to three fewer days.

Moving to margins, the total bank net interest margin was up 33 basis points year-over-year. High volumes and more profitable products and higher mortgage refinancing fees improved P&C Canada's performance. Increased loan spreads, despite lower loan balances, helped increase P&C US margins.

Corporate services also contributed to the improvement as management actions to lower the negative carry on certain assets, more stable market conditions and a reduced impact of the prior year's funding activities benefited results. The quarter-over-quarter margin increase of three basis points can be attributed to the lower impact of the prior year's funding activities.

Turning to slide 11, year-over-year expenses decreased $58 million. The weaker US dollar, lower employee costs, as well as reductions in premises and equipment, including computer costs, more than offset increases from acquired businesses and higher performance-based compensation, which is in line with improved performance. The prior year also included a $118 million severance charge relative to a more modest charge in the current quarter.

Quarter-over-quarter expenses decreased $9 million driven by lower employee costs and the weaker US dollar. The current quarter also reflects increased severance costs, as well as modest increases in computer, communications and travel costs.

The prior quarter also included a $51 million charge related to stock-based compensation costs for employees eligible to retire, booked annually in the first quarter in performance-based compensation. By actively managing our expenses, we have been able to keep them relatively flat despite continuing investment spend to grow our businesses and revenues.

On slide 12, we have illustrated the transfer of a number of US midmarket clients that have moved from Capital Markets into P&C US during the quarter. We believe these clients will be better served by a commercial banking model.

P&C US assumed total assets of US$6.4 billion and US$3.2 billion in deposits as a result of the transfer. The addition of commercial midmarket clients to P&C US makes this business more comparable to its US peers and as Bill mentioned, allows us to concentrate on growing this business, a business in which BMO has proven to be very successful. This move is also expected to create an opportunity for deeper relationships as it allows Capital Markets to direct its attention to sectors and clients where we have a differentiated competitive advantage.

On slide 13, you will see that our risk-weighted assets were $159 billion at the end of Q2, down $6.6 billion over last quarter. The decrease was driven by the impact of a stronger Canadian dollar and lower corporate and commercial exposures. Our Tier 1 capital ratio was strong at 13.27% in the quarter and is expected to remain strong through fiscal 2010. Tangible common equity to risk-weighted assets ratio also increased to 9.8%.

Moving to slide 16, P&C Canada had another good quarter. Revenue increased over the prior year driven by volume growth across most products and improved net interest margin. Personal loan balances grew 15% year-over-year driven by our Homeowner ReadiLine product.

While renewed confidence in equity markets decreased personal deposits by 0.9%, our commercial deposits grew 10% from a year ago. Compared to the previous quarter, the modest decrease in revenue is attributable to three fewer days and lower margins, partially offset by volume growth and the inclusion of a full quarter of Diners Club results versus one month in the previous quarter. The group generated cash operating leverage of just over 6%, and a cash productivity ratio of 51%.

On slide 18, P&C US results continue to be impacted by the elevated levels of impaired loans and the cost to manage them. Revenues were also impacted by a decrease in commercial loan balances, largely as a result of lower overall utilization by commercial customers.

As Bill noted earlier, on April 23, we announced the acquisition of certain assets and liabilities of a Rockford, Illinois-based bank from the FDIC. This acquisition was effective immediately and added approximately US$2.2 billion in deposits and US$2.5 billion in assets and was an excellent strategic fit that supports our US growth strategy.

Turning to slide 19, our Private Client Group had strong year-over-year revenue growth across all businesses. Excluding our insurance business, PCG net income was up 79% from a year ago and insurance net income was up 43%. Year-over-year expenses increased as higher commission revenue in line with improved performance and inclusion of the BMO life insurance acquisition more than offset the savings from the weaker US dollar. The cash productivity ratio improved to 71.2% in the second quarter.

The results in Capital Markets were up due to trading revenues being significantly higher than the prior year, as well as positive investment securities gains in the quarter versus the losses of last year. Trading revenues a year ago were impacted by losses arising from our Canadian credit protection vehicle.

Compared to the first quarter, higher trading revenue and improved investment securities gains were partially offset by lower M&A fees, corporate banking revenues and debt underwriting fees. Expenses were up year-over-year due to increased severance costs, as well as higher performance-based compensation in line with improved revenue. Cash ROE for the group was 24.8% in the quarter, the fourth consecutive quarter in excess of 18% in this business.

Finally, on slide 23, corporate services results continue to improve, benefiting from lower provisions for credit losses under BMO's expected loss methodology and improved revenues mainly due to lower negative carry on certain asset liability interest rate positions and more stable market conditions.

In addition, I would point out that we have added some additional disclosure in the press release on IFRS. As you know, Canadian banks will adopt IFRS in six quarters effective November 1, 2011. In anticipation of substantially completing most of our work by Q4 this year, we expect to be able to provide quantification of the main accounting changes in our 2010 annual report.

In conclusion, our results reflect another quarter of strong earnings delivered by our businesses with strong capital levels, revenue growth and good cost management. With that, I will turn things over to Tom.

Tom Flynn *- BMO Financial Group - EVP & CRO*

Thanks, Russ and good afternoon. Before I begin, I draw your attention to the caution regarding forward-looking statements. I will start with slide 26 where we provide a breakdown of our loan portfolio. The portfolio is well diversified with 74% of loans in Canada and 21% in the US. Consumer loans are 63% of the Canadian portfolio and 85% of these are secured. Our US portfolio mix is 43% consumer with commercial and capital market loans making up the larger portion.

Included in our other countries portfolio, exposures to the European countries of Greece, Ireland, Italy, Portugal and Spain are modest at approximately US$260 million.

Moving to slide 27, we provide details on our US loan portfolio. As we have discussed in past quarters, losses on this portfolio were higher than those in Canada. The portfolio represents 21% of total loans, is well-diversified and our underwriting practices were more conservative than the industry overall and as a result provisions are lower.

The US consumer portfolios are relatively evenly spread across first mortgage, home equity and auto loans. The portfolio has been impacted by weak labor and real estate markets, but all three segments continue to perform better than peers.

The general C&I portfolio is well-diversified and is performing reasonably. US commercial real estate continues to experience weakness. Before adding our recent acquisition, this sector represents $3.2 billion, or 2% of total loans. Investor-owned mortgages represent approximately 5% of the US portfolio and the developer portfolio is approximately 2%.

The investor-owned mortgages are mostly confined to our midwest footprint, are well-diversified by property type and were underwritten prudently. This portfolio continues to experience negative migration given the environment.

The developer portfolio has continued to reduce and is under $1 billion in size. We believe that migration in this portfolio has peaked. Information on the AMCORE portfolio that we acquired in the quarter is shown on the bottom right of the page. This portfolio is $1.5 billion in size at its market value. The portfolio is 23% consumer loans with the balance split fairly evenly between C&I and commercial real estate-related. The acquired portfolio benefits from a loss share arrangement whereby 80% of losses on loans will be absorbed by the FDIC.

Turning to slide 28, the chart shows the segmentation of impaired loan formations for the quarter. Impaired migration has slowed compared to previous quarters. Formations were $366 million, down from $456 million last quarter. The US portfolio continues to account for the majority of formations. US formations were $252 million and were diversified across sectors with the commercial real estate and investor-owned mortgage portfolios making up the largest portion at 39%.

The acquired portfolio added $427 million to impaired loans, but did not impact the allowance for credit losses, as under GAAP, the assets were recorded at their fair market value and no allowance was taken on them. As previously stated, these assets benefit from an 80/20 loss share with the FDIC.

Within Canada, formations were well-diversified across a number of sectors. Gross impaired loans were down to $3 billion versus $3.1 billion last quarter before the addition of approximately $400 million from the acquisition that closed in the quarter.

Slide 29 details the provision for credit loss by business group. As a general comment, the provision benefited from lower migration and in certain portfolios, stabilization during the quarter. The Capital Markets and P&C US commercial provisions in particular came in better than expected. The consolidated specific provision was $249 million, better than Q1, which was $333 million, and well below the quarterly average for fiscal '09.

Moving now to the line of business splits that are shown in the table. The P&C Canada provision was up in the quarter due to higher commercial losses and also due to the inclusion for the first time of the Diners Club portfolio, which added $10 million to the consumer line. The higher commercial provisions were driven by a few large accounts rather than a more broad-based weakness in the portfolio.

Consistent with last quarter, the P&C Canada consumer loss number in the table includes losses on securitized credit cards. These losses are recorded in the financial statements as negative NIR under securitization accounting and therefore are backed out of the total number at the bottom of the table to arrive at the total provision.

Moving now to P&C US, provisions decreased quarter-over-quarter. The consumer portfolio continues to be pressured by weak labor and housing markets. Commercial provisions were down in the quarter. Given the level of ongoing strain in the commercial portfolio, provisions will likely be higher here for the next few quarters.

Lastly, Capital Markets provisions benefited from recoveries and reversals in the quarter. In general, although the impact from the recession is not over, the capital markets portfolio is stabilizing as larger companies take advantage of better markets to strengthen their balance sheets and to benefit from the recovery.

Turning to slide 30, you can see a segmentation of the specific provision by geography and sector. The Canadian provision was $139 million, close to the level of last quarter. The consumer and credit card segments continue to be the largest drivers of Canadian provisions. The US provision was $123 million, down $67 million from Q1, largely due to lower provisions in commercial real estate, manufacturing and financials. Consumer loans account for the majority of the US provisions. That concludes my presentation and we can now move to the Q&A.

QUESTION AND ANSWER

Operator

Sumit Malhotra, Macquarie Capital.

Sumit Malhotra ***- Macquarie Capital - Analyst***

Good afternoon. A couple of questions for Tom Flynn to start. Just want to make sure I got the provision information correct. The $69 million in reversals that you identified, when you talk about the variability in the provisioning line over the next couple of quarters potentially, how much does this line play into your thinking? And if you could just give us a little bit of color on what portfolio exactly was in the US or the other countries' line this came from.

Tom Flynn ***- BMO Financial Group - EVP & CRO***

Sure. I think the best disclosure on this is in the press release on page 11 and in the table in the middle of the page there we break down the provision between new specific provisions and then we show reversals and recoveries. And what that shows is that, during Q2, about half of the improvement in the provision in the quarter came from higher levels of reversals and recoveries and the other half came from just lower new specifics. So that is the contribution from the two sources to the change quarter-over-quarter.

Looking forward, I would say that, number one, reversals and recoveries are hard to predict. The number this quarter was higher than we expected. It came both from the US and also from the other jurisdiction portfolio where we had one European provision reverse. And going forward, we expect some recoveries, but not the level probably next quarter that we experienced this quarter.

Sumit Malhotra ***- Macquarie Capital - Analyst***

Yes, the $69 million, I am certainly with you on that page. I think that is the best number we have seen since '04. So this is kind of the line you are pointing to when you say that there is likely to be some variability going forward?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

Yes, this quarter, the provision came in better than expected and we had higher reversals and recoveries. And in addition, we didn't have any significant specific provisions in the Capital Markets portfolio. And so we had a bit of a double win coming from that area. And looking forward, given where we are in the cycle, we think there is still some risk of provisions to pop up on the capital markets side and recoveries may be a little bit lower.

Sumit Malhotra ***- Macquarie Capital - Analyst***

Okay, staying with you, Tom, if we look at the relationship between provisions and net write-offs or net charge-offs, you basically flattened the reserve build this quarter after having built reserves over the last couple of years. If I look back at BMO in say that '04, '05, '06 period, the bank consistently was able to reduce the level of reserves or allowance that it was holding. As we hear Basel make references to dynamic provisioning, how reasonable is it to expect that provisions can be less than charge-offs as we continue to see the credit cycle improve?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

I would say there is a significant question about what approach the industry takes to provisioning will be going forward. There is a lot of debate on the topic right now. I would say there is no clarity as to where that debate is headed. And if I was modeling, I would not be assuming any significant reductions to the general allowance going forward.

Sumit Malhotra ***- Macquarie Capital - Analyst***

I'll keep that in mind. And very quickly I will wrap it up. This is for Tom Milroy. Tom, Bill told us that it isn't yield curve that drove the trading revenue this quarter. Although we do see trading assets at the end of the quarter up about $6 billion sequentially, should we draw any linkage to the extra capital or assets that are allocated to the trading side and the results we saw in Q2?

Tom Milroy - BMO Financial Group - CEO - BMO Capital Markets

No, I actually think what was driving the trading was principally the interest rate trading, which you can see in the materials in the supp pack, and that was a combination of market opportunities, and some increased volatility where we were able to provide services and spreads went in our direction. So, I think in the type of markets we had overall in the quarter, the credit market improving, we were able to take advantage of it.

Sumit Malhotra ***- Macquarie Capital - Analyst***

So the balance sheet growth, don't read too much into that?

Tom Milroy - BMO Financial Group - CEO - BMO Capital Markets

No, the balance sheet growth, as you look at the press release on page 39, you will see the securities that are valued using market prices and about half of it was in companies and agencies, which was a combination of us ramping up our fixed income business in the U.S. and some other trading strategies. Most of the remaining increase was in the equities line and was related really to our structured note business and some of the equity TRS business.

Sumit Malhotra ***- Macquarie Capital - Analyst***

Thanks for your time.

Operator

Robert Sedran, CIBC.

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

Hi there, good afternoon. Just a quick question, I guess it's a point of clarification more for Tom Flynn. Tom, the European exposure you noted, is that on balance sheet direct exposure or does that include anything that you might have off-balance-sheet as well in terms of the SIVs or elsewhere?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

No, that was an on-balance sheet exposure.

Robert Sedran *- CIBC World Markets - Analyst*

And so can you quantify for us how much we should be thinking on the off-balance-sheet side? I think I read in the press release that it is less than the $260 million. Am I thinking of that correctly?

Tom Flynn *- BMO Financial Group - EVP & CRO*

Okay, sorry, what are you asking about?

Robert Sedran *- CIBC World Markets - Analyst*

How much would be in Parkland or …?

Tom Flynn *- BMO Financial Group - EVP & CRO*

Exposure to the countries that I mentioned earlier?

Robert Sedran *- CIBC World Markets - Analyst*

Yes.

Tom Flynn *- BMO Financial Group - EVP & CRO*

It would be, in total, less than the on-balance sheet amount.

Robert Sedran *- CIBC World Markets - Analyst*

Okay. And staying with you for the second question, when I look at the retail and consumer PCLs, they do seem to be staying stubbornly high even though it feels like employment is getting better. Is there some kind of a lag we should be looking for before these numbers start to improve? And I have been working under the assumption that the new loans that you may have added in the past couple of years are, if not bulletproof, are certainly a lot higher quality than they might have been from the previous loans. So is it volume-related or is there some sort of lag that we should be expecting?

Tom Flynn *- BMO Financial Group - EVP & CRO*

I am looking at page 29 of my slides to speak to that. On the Canadian side, last quarter we were at $161 million for consumer and $155 million this quarter. The $155 million includes about $10 million from the acquisition that we did of the Diners portfolio and that was new this quarter. So if you back that out, we are better by about 10%. And we think that the trend is positive in this portfolio. There can be a little bit of a lag and we have had volume growth, so those two things might moderate the improvement relative to what you would expect, but we think the trend there will be positive.

On the US side, provisions are basically elevated and moving around quarter-to-quarter. We are seeing some early signs of stabilization, but not really signs yet of improvement.

Robert Sedran *- CIBC World Markets - Analyst*

Is it more of a 2011 story you think on the US side?

Tom Flynn *- BMO Financial Group - EVP & CRO*

For the most part, I think so, yes.

Robert Sedran *- CIBC World Markets - Analyst*

Okay, thank you.

Operator

Cheryl Pate, Morgan Stanley.

Cheryl Pate *- Morgan Stanley - Analyst*

Hi, good afternoon. I guess my first question is probably for Russ Robertson. I just wanted to talk a little bit about the net interest margin ex-trading and how we should be thinking about that in a rising rate environment potentially and any sort of lag impact you would expect following rate increases.

Russ Robertson *- BMO Financial Group - CFO*

Cheryl, on page 8 of the press release, we have the margin analysis. Just putting aside ex-trading for a moment, the first comment I would make is that while you are seeing improvement certainly in P&C Canada year-over-year, a significant part of the improvement is really from Corporate. If you look at the NII line further on in the press release, the improvement year-over-year and quarter-over-quarter from the negative carry we had on surplus cash positions contains now, with more normal markets, some of those anomalies that we were dealing with a year ago have improved. So you see very significant improvement in NII in Corporate and that is what is driving the overall improvement in NIMs within the bank I would say.

We would expect, in a rising rate environment, that our margins will improve and perhaps with that, I will just ask if Frank wants to speak specifically of P&C Canada.

Frank Techar - BMO Financial Group - President & CEO, P&C Canada

Cheryl, sequentially, we saw a four basis point decline in our margins and as our loan growth continues to accelerate and deposit growth softens a bit, we are going to see that margin moderate at the levels that we have seen for the last couple of quarters. To Russ's point, in a rising rate environment, we would expect our margin to improve. And so we have kind of got two things offsetting it as we are looking forward into the future. And so we are not anticipating in P&C Canada any large increase in margin, but we are not anticipating a large decrease either. We think we will have some offsetting factors and we will maintain the current level at least for the next few quarters.

Cheryl Pate ***- Morgan Stanley - Analyst***

Okay, thanks. That is helpful. And just a second question, if I might. On the securities gains, sort of been running around the $50 million mark the last couple of quarters. Is that a trend that is likely to continue in the near term or how should we think about that line going forward?

Tom Milroy - BMO Financial Group - CEO - BMO Capital Markets

Well, Cheryl, it's Tom Milroy. It is a little difficult to say because obviously the gains are a function of the market movement and the volatility in the market. I think it's fair to say I have trouble forecasting that myself. I would say that obviously given the portfolio we have, that we are likely to have securities gains quarter-to-quarter. The actual amount of them could have some movement in it so it is hard to say it is a fixed non-volatile number.

Cheryl Pate ***- Morgan Stanley - Analyst***

Right. But with markets at sort of improved levels, you should expect something in that line.

Tom Milroy - BMO Financial Group - CEO - BMO Capital Markets

That would be right. If they stay where they are and continue to improve, we should see continued securities gains.

Cheryl Pate ***- Morgan Stanley - Analyst***

Okay. Thank you.

Operator

Steve Theriault, Bank of America-Merrill Lynch.

Steve Theriault ***- Bank of America-Merrill Lynch - Analyst***

Thank you. First question for Tom or maybe for Russ. Some pretty good improvement in risk-weighted assets in the quarter. If I look at page 23, the schedule on RWAs in the supplementary, I note about an $8 billion drop in risk-weighted for corporate and SMEs. And we have seen some declines in past quarters, but this is much larger. It doesn't seem to me to be fully explained by interest rates or runoff when I look at the loan balances or the in-quarter currency movements. So what caused that sharp decline this quarter?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

It's Tom Flynn. I will lead off with that. There were really three factors that contributed to the decline and they were roughly equal in size. The first is FX, the second is lower volumes, which are partly related to lower utilization, and the third, which shows up in the corporate, small and medium enterprise line, correlates to a model recalibration that we introduced in the quarter. So that might be the missing piece from what you would expect.

Steve Theriault *- Bank of America-Merrill Lynch - Analyst*

You said that would be a third, a third, a third in terms of the impact?

Tom Flynn *- BMO Financial Group - EVP & CRO*

Approximately.

Steve Theriault *- Bank of America-Merrill Lynch - Analyst*

Okay. Just to follow on that, Tom, sort of separately, what is the risk-weighting on the loss share AMCORE assets?

Tom Flynn *- BMO Financial Group - EVP & CRO*

It is 80% / 20% and 20% / 150%.

Steve Theriault *- Bank of America-Merrill Lynch - Analyst*

Okay. And secondly, if I could, a question for Ellen. The US P&C margin up quite a bit this quarter. It doesn't often get that much attention, but how much more improvement could we see here in the absence of increased short rates in the US? Is this repricing coming through?

Ellen Costello - BMO Financial Group - President & CEO, P&C US

Yes, it is repricing. Thanks for the question. We have two portfolios that have facilities that continue to come up for renewal in our small business and commercial and as we reprice those, that is coming into the margin. And also the transfer has affected a broadening in the margin because the mid-market loans have wider spreads on them than other parts of the portfolio.

Steve Theriault *- Bank of America-Merrill Lynch - Analyst*

And looking forward?

Ellen Costello - BMO Financial Group - President & CEO, P&C US

Looking forward, I would repeat similar comments to Frank’s. I think we will see a lift when interest rates go up and we could begin to see there is some pricing pressure in the US because of the lack of loan growth that is emerging in the marketplace. So maintaining our discipline there is important going forward.

Steve Theriault *- Bank of America-Merrill Lynch - Analyst*

Thank you.

Operator

John Reucassel, BMO Capital Markets.

John Reucassel - ***BMO Capital Markets - Analyst***

Thanks. A question for Tom Milroy. Tom, I guess one of the problems of moving the SME book out of the capital markets business is you get a little better picture of the BMO Capital Markets US operations. So the $3 million in earnings there, was there something going on in BMO Capital Markets US that was unusual? And I guess the corollary, there's $256 million out of Canada, was there something unusual there as well? And what should we expect out of the US capital markets business?

Tom Milroy - BMO Financial Group - CEO - BMO Capital Markets

Thanks, John. You are quite right to say that with the movement, we focus now on the U.S. business, a smaller business, but I think, as Bill said, it allows us to really focus on what we are trying to do there, not distracted by that commercial loan portfolio.

The Q2 results did have some noise in them. They were impacted by a number of nonrecurring items, both in revenue and expense and so we would expect going forward, given the investments that we are putting into the business, that we would see net income certainly well up from where we were this quarter, but probably not back to where we were in Q1.

So if you look at what we did over the course of the first six months, I think sort of $53 million, we would expect that we would do better than that in the remaining part of the year. And I think going forward, you will see that revenue grow as we start to see the revenue catch-up with the investments we've made over the last number of quarters. So we are pretty broadly optimistic about that business and confident that we can profitably grow it going forward.

John Reucassel - ***BMO Capital Markets - Analyst***

And was there something unusual in Canada that gave you the $256?

Tom Milroy - BMO Financial Group - CEO - BMO Capital Markets

In Canada, it was related to the question I made. I think the Canadian number is cleaner, we obviously had a very good outing in the trading products businesses and trading generally in the interest rate area that I mentioned before. And also we had some gains in our net investment securities.

John Reucassel - ***BMO Capital Markets - Analyst***

Okay. And a question for Bill. With the US financial reform bill being tabled and voted on in the Senate, there just seems to be a lot of headwinds for regional banking in the United States. Could you give us a sense of what -- or Ellen, if it was implemented as proposed, what would this do to earnings out of the US business kind of on a normalized basis and how tough is it to get kind of your targeted returns in the US given these new proposals? Just trying to get a sense of the challenges there.

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

I will start John and if Ellen wants to supplement I will let her do that. But I think there is a couple of things in the financial reform bill that, when we look at it, we actually think might be a little bit helpful and that is there is a big emphasis on responsible consumer practices. If you look at the way we do business, the approach we take to customer relationship management, more of an advice-based high service model, some of the burden around additional consumer regulation I think is just going to reinforce the wisdom of the way we approach the market. So I think there are going to be some competitors that are just going to get squeezed out of some segments of the market.

As you know, we don't have a card business in the US and I think in that area in particular, there is going to be real pressure on some of the competitors. The opportunity for market consolidation for smaller regional banks I think will continue just as a consequence of that. So I feel that, with respect to personal and commercial banking, it won't be disadvantaged.

Obviously, all of the things that relate to the wholesale business are really subject to the reconciliation process. So whether simple things like a swaps business for banks has to go into some other entity. Once again, I think that intelligent minds will prevail. The panel that is going to do the reconciliation, as I understand was identified on Monday. I think there are 16 or 17 very responsible people who have been identified to work through that process. And I also think that they are working against a relatively quick timeline as I understand it. From what I have read, the President wants to sign and reconcile the bill within three or four weeks and I think that reduces the uncertainty as well.

So I think both the Senate bill and the House bill had some extraordinary features. They were allowed to go forward I think in order to give them a good airing out. But aside from the damage that could be done to the wholesale businesses, which I think would fall under the heading of random if it does occur, we feel good about the business model. And with respect to the others, I think that is going to be resolved relatively quickly in any case.

John Reucassel ***- BMO Capital Markets - Analyst***

Okay, so Bill, just so we are clear, you don't expect out of this financial reform bill this to impede your ability to generate reasonable returns on P&C Bank in the US? Is that a fair statement?

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

Yes, I think that's true. I think to the extent that the provisions do put a burden, you have to realize it's a capital-constrained market and our pricing power has increased. And so I think the ability to pass through the costs will be greater than what some of the commentary would suggest.

John Reucassel ***- BMO Capital Markets - Analyst***

Okay, last question. Just a clarification, a lot of question on spreads and a few different people answered. I was just wondering, is the conclusion here on spreads that yes, higher rates are helpful, but competition is going to keep some sort of lid on whether it is all bank or P&C bank spread improvement from material increasing from the levels in Q2? Is that a fair summary of what the view is?

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

I think that is a pretty good summary of what we said on the last call and I think it holds.

John Reucassel ***- BMO Capital Markets - Analyst***

Okay, thank you.

Operator

Peter Routledge, National Bank Financial.

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

Greetings, everyone. I have a question on P&C Canada's strategy, but I would like to direct it to Tom Flynn. Tom, BMO has prided itself over the last many years on having lower credit costs than peers asset class by asset class. And while P&C Canada is healthy, earnings growth medium term may well require some market share expansion. And one means of achieving this is greater tolerance for credit risk and perhaps surrounding some of the outperformance for higher market share. So -- and particularly this could be the case in commercial lending. So from your perspective, how favorable are you to this trade-off? And how would you approach the issue?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

Well, I don't know that I would express our approach to the business through that trade-off lens and we have prided ourselves as you say on outperforming on a like portfolio basis, which we think we are doing through this downturn as we have done in the past. And in the approaches that we are taking to growing the business now, we aren't in any systematic way, either on the consumer side or the commercial side, dialing up the risk profile. And I think we have got really healthy dialogue between Frank and his leadership team and the risk group around trying to identify opportunities in the market that we think will give rise to growth opportunities with the risk profile that we are comfortable with. And our objective is to retain the position that we have had in credit loss leadership.

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

So no real change in your overall profile?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

Correct.

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

Frank, any thoughts?

Frank Techar - BMO Financial Group - President & CEO, P&C Canada

The only thing I would add to that would be that if you look at the performance in our consumer loan book and our commercial book, recently, over the last couple of quarters, I think we are demonstrating that the growth is accelerating and the share is starting to respond. So to Tom's point, I am confident that staying the course relative to our risk appetite is not going to be an impediment for us in competing and growing share across all of our product categories. Our strategy is focused in other places and we think we can compete and grow share with the profile that we have had in the past.

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

One final question. I saw your disclosure on the European countries and the financial institutions in those countries. What about European banks outside the five countries mentioned, say in France or Germany? Do you have any material exposures that you are perhaps watching more closely?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

I would say we don't have any exposures that are of concern. Europe is obviously a massive developed part of the global economy and so we do have exposures to Europe generally, including to European banks. They are not outsized and we are comfortable with them.

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

Thanks. That's it.

Operator

Darko Mihelic, Cormark Securities.

Darko Mihelic ***- Cormark Securities - Analyst***

Hi, good afternoon. My question is for Tom Flynn. Tom, when I look at the expected losses that you have run through your segments and I add them all up, with $221 million in expected losses, annualized about $884 million, but when I look at that number and I look at relative to history, it looks as though it is high, especially in cap markets where you have had a net recovery and you are looking for what I would deem to be elevated losses.

So my question actually is pretty straightforward. Tom, if you had to do it all over again today and said expected losses for the individual segments based upon what you see today, would the expected losses come down?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

Well, Tom Milroy is sitting here beside me with a smile on his face because he would like his expected loss to come down. But we are happy with where they are sitting right now and being within basically 10% of the actual loss I think is really a great outcome because there's a lot of complexity in the process. So having the expected loss that close to the actual to me is a good performance.

And the expected loss does move through the cycle and it moves through the cycle in particular in capital markets. So the expected loss in that segment reflects a degree of migration that we experienced through the cycle. So we would expect the expected loss number for the capital markets portfolio, assuming the portfolio size stays the same, to trend down going forward based on some positive migration.

Darko Mihelic *- Cormark Securities - Analyst*

I guess the follow-up to that question is looking at the expected loss, it is close to about 50 basis points of loan loss provision of average loans and BAs, which for me looks relatively high to what I am used to from BMO. I think in the past, it should've been somewhere closer to 30-35 basis points. Are you moving materially off of that or is --?

Tom Flynn *- BMO Financial Group - EVP & CRO*

No, I think that your observation is correct and what the higher EL reflects is the point that we are at in the cycle, and we are at a relatively bad point in the cycle, and therefore expected loss in the capital markets portfolio is somewhat elevated and we would expect it to trend down over the next few years and to trend down towards the historical average that we have seen. So the higher EL doesn't reflect a difference in the risk profile that we have today relative to what we would have had a few years ago at a comparable point in the cycle.

Darko Mihelic *- Cormark Securities - Analyst*

Okay, great. Thanks very much.

Operator

Mario Mendonca, Canaccord Genuity.

Mario Mendonca *- Canaccord Genuity - Analyst*

Good afternoon. My question is similar to what Darko was asking about. But more along the lines of not only trending down for the long-term average of say 35 basis points, but Tom, what is your outlook on recoveries? You certainly had one this quarter. You are giving us some caution here that we shouldn't expect this regularly. But given the nature and complexion of the way the credit losses unfolded on this cycle, what is your outlook for a recovery say in 2011?

Tom Flynn *- BMO Financial Group - EVP & CRO*

Well, I won't give you a number, but I will give you some flavor. If you look at recoveries, when the economy recovers going back in time, they tend to be not insignificant and the recoveries together with fewer new specifics gives rise historically to a pretty steep drop-off in specifics. So that is the historical pattern.

This downturn, I think dollar for dollar will see a somewhat lower level of recoveries because more of the losses have come from US retail portfolios. And those losses are mainly residential real estate-related and I think the recovery potential from that portfolio would be lower than it would be from say a corporate loan portfolio.

Mario Mendonca *- Canaccord Genuity - Analyst*

That's helpful. On the negative carry and on the excess cash, Russ, you were referring to -- two questions. One, is it essentially -- if we move to a normalized level here or is there room for further improvement next quarter? And secondarily, if you could just describe the mechanism and maybe this is a question for Tom Flynn. What exactly happened in the quarter? Was it a reinvestment of excess cash and higher-yielding securities? Was it a rolling off of higher funding cost? What was the mechanism that caused the margin to improve?

Russ Robertson *- BMO Financial Group - CFO*

Well, on the first question, yes, I think we have reached a more normal level, so the negative NII that you see in the quarter in Corporate would be a normal quarter. The mechanism would be that the surplus cash has, particularly as term maturities have occurred, that excess cash has been used, so the negative carry has just been reduced because the lower amounts are being held in Corporate. And then secondly just more normal market conditions. Some of those anomalies that we talked about in the prior quarters have disappeared and so that has diminished the negative NII as well.

Mario Mendonca *- Canaccord Genuity - Analyst*

So what are the anomalies? If you can just provide one example?

Russ Robertson *- BMO Financial Group - CFO*

Well, one example was the one to three-month issue that we talked about a year ago, where our wholesale funding re-priced on a three-month basis whereas our transfer pricing to groups was on a one-month basis. So as those rates moved apart, that caused residual funding costs to end up in corporate. And that has diminished almost totally.

Mario Mendonca *- Canaccord Genuity - Analyst*

Okay. And then a question for Bill. You have provided in the past sort of a global outlook on what you figured loan growth could look like for the bank. Your last comments that I recall were we perhaps wouldn't see significant loan growth in 2010, but you feel okay about 2011. Has anything changed in your outlook?

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

No, I would say that it is a little more sharply focused in line with what I said in the last quarterly call, I think the U.S. recovery is clearly continuing to be business led and we haven't seen borrowing pick up to the extent that I think it will. Business activity is picking up, what manufacturers are saying is that they are filling orders now on a delay. They haven't fully rebuilt their inventory, so I think that what we see is still quite unusually low line utilization and we are not going to have to put new lines in place to get a pickup in borrowing in commercial banking.

And I think that is really the reason why we focus the resources we have in commercial banking, in the belief that it might not be in the last five months of this year, but I think we are going to see progressively as we go through the next three or four quarters not only a pickup in line utilization, but in new customer account opening. And that is where I think we will see the growth.

With respect to personal lending, in the US, the unemployment rate is basically keeping the consumers in a relatively conservative space. They are maintaining their savings rate. There is not a lot of labor mobility right now. People who have a job are staying put. I think when they have a little more confidence, there will be a little more movement and it will take that kind of movement to create activity in the housing market.

So right now, you have a housing market that I think the correct level is pretty well understood, but there is not very much movement meaning there aren't very many buyers for the available supply of houses. I think that is where we will see the loan growth, first in commercial going into 2011 and there is no telling what next spring will bring for the consumer.

Mario Mendonca *- Canaccord Genuity - Analyst*

And can you tell us a little bit on Canada?

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

I will let Frank speak about Canada. Canada has actually done nicely this year, but I will let him provide a little more background there.

Frank Techar - BMO Financial Group - President & CEO, P&C Canada

Mario, this quarter was the first quarter in four that our loan growth outpaced our deposit growth. So we are seeing a pickup in the growth, both on the consumer side and the commercial side and the expectation is that is going to continue.

I just echo Bill's comment, especially in our corporate finance unit in our commercial business, utilizations are down and the expectation is that, as we go through the next 12 to 18 months, that that should pick up as the economy continues to improve. So my expectation is I am pretty optimistic on both consumer and commercial that growth is going to continue to accelerate on the loan side of the balance sheet.

Mario Mendonca *- Canaccord Genuity - Analyst*

Thank you.

Operator

Michael Goldberg, Desjardins Securities.

Michael Goldberg *- Desjardins Securities - Analyst*

Thank you. We are often told that the best indicator of what is going to happen to trading revenue is the amount of volatility and we have certainly had a lot of volatility since the beginning of May. But perhaps it has been in areas that hadn't been anticipated. Can you give us some idea of the impact of this volatility on your trading revenue? And on bottom line, can the second-quarter level of total trading revenue be sustained given the volatility that we are seeing now that is going in unpredicted directions?

Tom Milroy - BMO Financial Group - CEO - BMO Capital Markets

Hi, Michael. Tom Milroy. I think you are right to say it is a little tricky in the sense of figuring out how the volatility will play out. Obviously, it hurt some of the businesses and it helps others. It does generally dampen market activities so that will have some impact if it carries on for an extended period of time. What we have seen though is a period of volatility and then everything comes back to a more normal spot.

And when I look at the business more on a year-over-year basis, I think it is fair to point out that the lumpy things that we experienced before, all of those positions are either gone or substantially reduced. A number of what I would call ongoing core businesses that turned out to have more volatility than we expected in the last cycle, those have also been reduced.

And finally where we are positioned now, we have consciously reduced risk generally in order to be able to take advantage of opportunities that might come from a further downturn. So depending on how things move, we are pretty optimistic that we can continue to deliver solid trading revenue.

Michael Goldberg ***- Desjardins Securities - Analyst***

But you indicated that you continue to benefit from easing monetary policy and the fiscal conditions out there. Really what I am getting at, is your interest rate trading in particular was very strong and given the volatility, is that type of strength sustainable as you see it?

Tom Milroy - BMO Financial Group - CEO - BMO Capital Markets

Yes, I want to be clear that the interest rate-sensitive businesses, are different than interest rate trading. And those businesses are actually the ones that really benefited from the easing that we saw last year. And as Bill said, that yield curve type business is down sharply year-over-year. So it is less predicated on that.

I think the volatility we are experiencing now is more the shocks that are coming from: one, the uncertainty surrounding regulatory reform and, two, what is happening in Europe generally, and the interrelatedness of that to markets around the world. So again, it is difficult to predict but we feel pretty well-positioned and we think if the market stabilizes, we will be in pretty good shape.

Michael Goldberg ***- Desjardins Securities - Analyst***

Thank you.

Operator

Brad Smith, Stonecap Securities.

Brad Smith ***- Stonecap Securities - Analyst***

Thanks very much. My question relates to the impaired loan disclosures on page 37. If I back out the $437 million of acquired impaired loans during the quarter, it looks like the consolidated number for the US came down about $85 million, or 4% which is great. When I think back though to the March 31 disclosures for your FDIC-regulated US P&C banking business, there was actually an increase of about $123 million. And I guess my question is would the difference between a consolidated U.S. segment loans of improvement of $85 million and $123 million of deterioration in your FDIC-regulated entity reflect that basically the improvement in impaired loans is happening outside the P&C bank and in the wholesale capital markets portfolio?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

It's Tom Flynn. I will answer that. I think there are a few things happening. Number one, as you know, the time periods are different between the two statements. Number two, FX had a positive impact on the numbers, so lowered the numbers, which obviously would not be in the US disclosures. And then number three, some of the capital market activities aren't captured in the public filings that we make in the US and the trends there as we've talked about were generally positive.

Brad Smith ***- Stonecap Securities - Analyst***

Okay. And on a translated basis, would the same entity as your FDIC entity after FX, etc. have seen a flattening or improvement in its impaired loans?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

Well, the currency move in the quarter, in the BMO quarter, was about $0.04 to $0.05. So it would have been just on that basis, roughly flat.

Brad Smith ***- Stonecap Securities - Analyst***

Okay. And then one other quick question just dealing again with the loan portfolio. I see that the financials on page 32 in your supp pack reduced by about $1.35 billion sequentially. And I was just wondering if there was a particular transaction that caused that further reduction in that exposure?

Tom Flynn ***- BMO Financial Group - EVP & CRO***

The biggest cause of the reduction is coming from our two SIVs and we have fairly high maturities in the quarter and also some asset sales. And I think together, those two things accounted for $600 million or $700 million so that is the most significant item.

Brad Smith ***- Stonecap Securities - Analyst***

Okay, terrific. Thanks, Tom.

Operator

There are no further questions registered at this time. I would like to return the meeting to Ms. Lazaris.

Viki Lazaris ***- BMO Financial Group - SVP, IR***

Great. Thanks all for joining us today and we wish you luck tomorrow with a busy day you have ahead of you and as always, if there are any questions, please call the Investor Relations team. Have a great day.