

Bank of Montreal at RBC Canadian Bank CEO Conference

CORPORATE PARTICIPANTS

Darryl White

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MD & Equity Analyst, RBC Capital Markets, Research Division

Caution Regarding Forward-Looking Statements

As noted in the following Caution Regarding Forward-Looking Statements, all forward-looking statements and information, by their nature, are subject to inherent risks and uncertainties, both general and specific, which may cause actual results to differ materially from the expectations expressed in any forward-looking statement. The Enterprise-Wide Risk Management section of BMO's 2021 Annual MD&A describes a number of risks, including credit and counterparty, market, insurance, liquidity and funding, operational non-financial, legal and regulatory, strategic, environmental and social, and reputation risk. Should our risk management framework prove ineffective, there could be a material adverse impact on our financial position and results.

Bank of Montreal's public communications often include written or oral forward-looking statements. Statements of this type are included in this document, and may be included in other filings with Canadian securities regulators or the U.S. Securities and Exchange Commission, or in other communications. All such statements are made pursuant to the "safe harbor" provisions of, and are intended to be forward-looking statements under, the United States Private Securities Litigation Reform Act of 1995 and any applicable Canadian securities legislation. Forward-looking statements in this document may include, but are not limited to, statements with respect to our objectives and priorities for fiscal 2022 and beyond, our strategies or future actions, our targets and commitments (including with respect to net zero emissions), expectations for our financial condition, capital position or share price, the regulatory environment in which we operate, the results of, or outlook for, our operations or for the Canadian, U.S. and international economies, and the COVID-19 pandemic, and include statements made by our management. Forward-looking statements are typically identified by words such as "will", "would", "should", "believe", "expect", "anticipate", "project", "intend", "estimate", "plan", "goal", "commit", "target", "may", "might", "schedule", "forecast" and "could" or negative or grammatical variations thereof.

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, including labour challenges; the severity, duration and spread of the COVID-19 pandemic, and possibly other outbreaks of disease or illness, and its impact on local, national or international economies, as well as its heightening of certain risks that may affect our future results; 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; benchmark interest rate reforms; technological changes and technology resiliency; political conditions, including changes relating to, or affecting, economic or trade matters; climate change and other environmental and social risk; the Canadian housing market and consumer leverage; inflationary pressures; global supply-chain disruptions; changes in monetary, fiscal, or economic policy; changes in laws, including tax legislation and interpretation, or in supervisory expectations or requirements, including capital, interest rate and liquidity requirements and guidance, and the effect of such changes on funding costs; weak, volatile or illiquid capital or credit markets; the level of competition in the geographic and business areas in which we operate; 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 proposed acquisitions or dispositions, including obtaining regulatory approvals; critical accounting estimates and the effects 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; 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; 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 non-financial, legal and regulatory, strategic, environmental and social, and reputation risk, in the Enterprise-Wide Risk Management section in BMO's 2021 Annual MD&A, 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 shareholders and analysts 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 in BMO's 2021 Annual MD&A as well as in the Allowance for Credit Losses section in BMO's 2021 Annual MD&A. 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.

Non-GAAP Measures and Other Financial Measures

Results and measures in both Management's Discussion and Analysis (MD&A) and this document are presented on an IFRS basis. We use the terms IFRS and Generally Accepted Accounting Principles (GAAP) interchangeably. We use a number of financial measures to assess our performance as described herein, including measures and ratios that are presented on a non-GAAP basis. Readers are cautioned that non-GAAP amounts, measures and ratios do not have standardized meanings. They are unlikely to be comparable to similar measures presented by other companies and should not be viewed in isolation from, or as a substitute for, GAAP results.

Examples of non-GAAP amounts, measures or ratios include: efficiency and leverage ratios calculated using revenue presented net of CCPB; revenue and other measures presented on a taxable equivalent basis (teb); pre-provision pre-tax income; 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, and other adjusted measures which exclude the impact of certain items such as acquisition integration costs, amortization of acquisition-related intangible assets, impact of divestitures, reinsurance adjustment and restructuring costs. Bank of Montreal provides supplemental information on combined business segments to facilitate comparisons to peers.

Certain information contained in BMO's Management's Discussion and Analysis dated December 3, 2021 for the fiscal year ended October 31, 2021 ("2021 Annual MD&A") is incorporated by reference into this document. Quantitative reconciliations of non-GAAP and other financial measures to the most directly comparable financial measures in BMO's financial statements for the fiscal year ended October 31, 2021, an explanation of how non-GAAP and other financial measures provide useful information to investors and any additional purposes for which management uses such measures, as well as the effects of changes in exchange rates on BMO's U.S. segment reported and adjusted results, can be found in the Non-GAAP and Other Financial Measures section of the 2021 Annual MD&A and BMO's Fourth Quarter 2021 Earnings Release. Further information regarding the composition of our non-GAAP and other financial measures is provided in the Glossary of Financial Terms section of the 2021 Annual MD&A. The 2021 Annual MD&A is available on SEDAR at www.sedar.com.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

Welcome back, everyone, to our session with Bank of Montreal. Before we begin, I just want to remind you all that Darryl White's comments today may include forward-looking statements. Actual results could differ materially from forecasts, projections, or conclusions in these statements. Listeners can find additional details in the public filings of BMO Financial Group. With that, we're welcoming to our virtual fireside chat, Darryl White. Darryl, good morning and welcome to the conference.

Darryl White – Bank of Montreal – CEO

Thank you, Darko. It's a pleasure to be here as usual.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

So maybe I'm going to kick off with having heard from the regulator this morning about some key things that they are thinking about. And for your benefit, because I realize you probably were not watching that, but the regulator spoke about a number of different things that they're focusing on in 2022, sounded like focus on housing, on climate and on digitization and those risks therein. Sounded like, this is Darko paraphrasing, this is not exactly what Peter said, but it sounded like we should possibly be preparing for higher risk-weighted assets on the mortgage side, specifically with HELOCs. And possibly, again, this is Darko speaking, an increased capital requirement.

He specifically said it was too early for 2022, but its potential is there as we move forward for higher capital requirements for climate risk. So with all of that preamble, to give you a chance to think about that, knowing that you've just made an acquisition or announced an acquisition on Bank of the West and drawing your capital ratio down to 11%. Why don't we start there, drawing your capital ratio down to 11%. It's been a topic of discussion that I've had with a number of investors. Is your level of comfort around that, the same as it was just recently, especially given the Omicron threat that we're in now? And what gives you the confidence that 11% is a great target ratio to be at in view of all these things that I've just discussed this morning. So Darryl, a tough question, but over to you.

Darryl White – Bank of Montreal – CEO

Well, there's a lot in your question. You're quite right, Darko. I haven't had a chance to catch up with everything Peter said this morning. But I will say the fundamental answer to your question is, are we comfortable? Absolutely, we are. Remember, that over time, we have said that we would target 11% to 11.5% in terms of our CET1 ratio. And we have said that if there were an acquisition that made sense for all the good reasons that we think this one makes great sense, then we would go to somewhere around 11% and build from there.

So in our announcement on the 20th of December, that's, in fact, exactly what we've said, and we've been continuing our work and our integration planning and everything else since that date. Nothing between then and now has changed our particular point of view. I will also reference the fact that OSFI does maintain regular bilateral dialogue with, I think, most of its institutions, certainly ours, and we're in regular dialogue with them.

So you can assume that takes place in the normal course as well as in the case where we've got material things to do, like we do right now. And the other thing I would point out, Darko, while, I'm not fully conversant on what might have been said this morning, I am pretty conversant on a lot of the positions that OSFI has taken over time.

And if you look back to some of the things that they had to say in the fall, in particular, the Superintendent's speech when talking about capital and when talking about buffers, 8% is the minimum. There's a 2.5% domestic stability buffer on that, that takes you to 10.5%, and that's meant to be in good times. In bad times, they've shown that they'll take the domestic stability buffer down if they have to. I don't imagine that will be the case in the foreseeable horizon because everything we can see on the horizon, Darko, is pretty positive as we look at it right now.

But it is important to say it's not just 10.5%, it's 8 plus 2.5%. And I think there's a distinction there. The most important distinction, though, I would point out was the reference from OSFI directly that the FRFIs should consider making distributions that enhance the institution's reputation. And I suppose we'd have to ask them whether or not making an acquisition does that versus, for example, buying back a lot of stock. In our case, we can definitely argue that we think that the acquisition in question, Darko, which takes us temporarily to 11%, and then we build from there, absolutely enhances the reputation when you've got a partner with great risk management, a great track record on climate, a great track record on sustainability and community involvement and really consistent with our strategy.

So there isn't anything that I've heard today or otherwise that makes us uncomfortable with where we're seeking to travel on a temporary basis. In fact, it's exactly what we've told shareholders we would do in the right circumstances all along.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

Great. Thank you for that. And for the record, I'm a fan of drawing down excess capital for things like that. So one of the questions that I've received from some investors on the Bank of the West acquisition is loan growth. And it's been pointed out to me and I've looked at Bank of West. There's

many institutions in the U.S. that have been growing slower than your institution. Your institutions had very strong growth in the U.S. over the past five years. But seemingly, it doesn't seem to be the case at Bank of the West. So I guess the question is, what can you tell us about Bank of the West's growth profile? How do you plan to sort of jump start it once you've consummated the transaction? And what area of Bank of the West requires the most attention from you guys as we go forward?

Darryl White – *Bank of Montreal – CEO*

Yes. I think you have to put that question in the frame of where we've been over the course of our journey in the United States over the last few years and then how this fits. So in terms of where we've been on our journey, we had a chart, Darko, in our investor presentation on the 20th of December that showed that over the course of the last ten years, basically since we bought M&I, we've taken our PPPT in the U.S., and it's basically 5x today what it was then. And that's before the acquisition of Bank of The West.

While we've done that, we've driven the efficiency ratio down from the high 70s into the mid-50s, and we've driven the ROEs up comparable to the ROE at the rest of the bank. That's our playbook. How have we done it? 60% of that growth has been organic, 40% of the growth has been the acquisitions that we've done along the way, be it M&I, be it Transportation Finance, be it KGS, and now with the announcement of Bank of the West. And I tell you that story of the breakdown to 60 to 40 because I think it's really important to remember that our playbook has been to acquire assets that fit with ours, integrate them well and quickly. And use whatever terminology you want, jump start, turbocharge the growth rate to be the growth rate that we expect of our overall operations. This should be no different.

When I look at the actual assets in Bank of the West, one of the reasons we thought, and I've thought for a very long time, by the way, that this is such a great fit for us is let's remember putting in the right frame what we're picking up here. We've got a business that has a little over USD \$105 billion of assets, 60% commercial, 40% retail in the loan book. So in the commercial loan book, you've got about \$33 billion, \$34 billion of assets. Think about that in contrast to our own. Our U.S. lending book is about \$100 billion, a little over \$100 billion in our U.S. commercial [and Corporate], which is a distinguished differentiated asset for the Bank of Montreal. We take that \$100 billion, we add the \$33 billion, \$34 billion, and we instantly are growing our U.S. commercial book, which is a strategic edge for us and a competitive edge for us by a little over 30% in one step.

To put that in context, it will probably take us about 3.5 years to grow at that rate if we had sort of 8%, let's say, organic growth to put that type of asset growth on. We put it on minute one, and it's entirely consistent with strategy. When I say that, they are in a lot of the sectors that we're in, but we don't have customer overlap. There is very little, in fact, customer overlap. So we don't see a lot of attrition coming our way. The sectors that they're in are the sectors that we're in. And they're in some that were not, for example, we're not actually that deep in our U.S. commercial business in technology, based in California, they are. In the sectors where we have really good overlap, for example, Food and Ag, which you all know we've been very good at for a very long period of time, they're in the West Coast, we're in the Midwest. They're deeper in protein, we're deeper in grain. So there's a really complementary fit there. That's the commercial side.

On the retail side, we also think there's a really complementary fit. They're in geographies generally that we are not in. And they've got businesses that we like and that we're in, like mortgages, for example, obviously, but also, they've got a book that's \$10 billion or \$12 billion in RV and Marine. We like that book a lot. We looked at it and said, this is one feature of the acquisition where it's a business that we're not in. But when we looked carefully at it, we said it's a top three position in the United States. So they had a top three position in RV and Marine and the business that has good returns, FICO scores of 770 or higher on average and you get instant market power. It kind of feels a lot, frankly, like it felt when we bought the Transportation Financial business in Dallas from GE, we instantly became the #1 player in North America.

So here when we put that together, we say, well, we've got the fourth largest commercial bank in North America with very distinguished, advantaged businesses that we think can grow share over time. So I'll stop talking here in a second, Darko. There is a lot of your questions, you've got to let me finish. We take our track record of assets that fit, integrating them with our playbook and then bringing their growth rates to our own. We think there's no reason that we can't do that here, particularly when you then factor in the nuance that there are a couple of asset classes that they have chosen to deemphasize or have been deemphasized for them in the last year.

For example, they chose to deemphasize indirect auto several years ago. Their book in indirect auto was over \$5 billion, almost \$6 billion, and they've been running it down. Last year alone, they took \$1 billion out of indirect auto. They did a really good job two years ago on PPP. They ran down \$1 billion - the flip side of that coin is, of course, it runs down. So you just take that \$2 billion relative to the size of their \$60 billion loan book. That's pretty important growth that they wouldn't have shown. So you normalize for that, we actually think the growth on their own is reasonable, and then you bring our track record and put it on top of it. And we think we've got a playbook that we can run with going forward.

Darko Mihelic – *MD & Equity Analyst, RBC Capital Markets, Research Division*

Okay. Great. Thank you for that. That's a good answer. And I wanted to touch on one other thing and sort of weave this into overall your performance sort of guidance for 2022 in the sense that part of the reason why you feel comfortable acquiring and bringing your ratio down is you're expecting expenses to be flat in 2022.

And so the question naturally arises is, while we're about to get inflation data that's seemingly very high in the next couple of days. So maybe the question is around the expense side. I mean is it possible that inflation creeps up on you, and you have some sort of defense to that? Or do you see areas where you have really cut back and maybe you want to weave in some digitization here, if you will, in your answer, where you have found areas for removal of expenses, and therefore, you actually might even have some leeway on the expense numbers. So there's a lot in that question, Darryl. I apologize for that. But I am quite interested in touching on your expense outlook especially in light of what might be higher-than-anticipated inflation.

Darryl White – *Bank of Montreal – CEO*

Yes. So it's a good question, Darko. Look, we're comfortable today standing by what we've said, which is that we can keep our expenses flat in the zone of flat for 2022 fiscal. That's basically what we told all of you for the last couple of years and our track record has shown that we've done just that. Now remember, we were also clear in this case that we have the benefit coming at us of about 3.5% NIX reduction from our exited businesses. So the biggest one of those was, of course, the EMEA asset management business that we exited, and that closed the first week of November. So you effectively have a full run rate of a 3.5% benefit. So when we say flat, we mean that we'll increase our investments by about 3.5% to get you back to flat.

Inside of that, we've got lots of ongoing investment in technology, in sales force, in marketing generally and we've got offsetting that, the ongoing benefits of many of the things that you talked about that we've been working so hard on in the last few years, including digitization. So we're not done yet on that journey. We think there's -- we're probably never done on that journey, frankly, and there's lots more to do. When we put those two things in balance, we're going to stick with our commitment today that we're flat.

Is there risk to that? Look, I think that if you assume something like a 4% increase in your labour cost, that assumes increased cost of labour plus the capacity build that you've got. You can, in our case, our business plan, we'll be able to fund that and come out with the flat expenses that I've talked about. If it's higher than that 4%, perhaps that pushes us a little bit higher on the inflation risk that you're pointing out. But at the same time, I would say, if that's the case, there will be more revenue upside based on rate assumptions that may not be in our plan either.

So when I put it all in balance, I sit here today and say, look, am I really in much different a place than I was net-net than I was a month ago when we started talking to you about flat expenses for the year, we're not. We're going to deliver positive operating leverage. That was fundamental to our commitment, and there's nothing I can see today that would suggest that we won't once again deliver that positive operating leverage.

Darko Mihelic – *MD & Equity Analyst, RBC Capital Markets, Research Division*

And so you touched on it. I mean higher interest rates, sounds like everybody is expecting it. It sounds like it could be a whole year of rate increases. It's certainly not expected to just have one. So I get the question a lot. I mean we obviously see the net interest margin sensitivity that's provided. But how do you think about it? It's not just one and done. It's going to be a year of rate increase after rate increase. Should we think about NIM sensitivity getting bigger over time or less with every subsequent rate increase? And does all the benefit flow to the bottom line? How do you think about managing the bank because we haven't been in this environment for a long time? How do you think about managing the bank in a period of rising interest rates?

Darryl White – *Bank of Montreal – CEO*

So the business mix is very helpful, Darko, in that respect. I mean I love to remind people because it's just so fundamentally important that the businesses where we're overweight, like our commercial businesses, 90% of our relationships are sole or lead relationships. So we have a really constructive pricing dynamic on the way down and on the way up with our customers there. I think we're fair both ways. When we told you all in the market that we thought we'd be able to deliver positive operating leverage based on a flat expense profile in 2022, that was assuming very little, frankly, in the way of rate increases.

As you look forward today, I think that the probability, as you all know, has increased that we will have more rate increases through the course of the year. We're still in our business plan assuming pretty close to flat NIMs for the year. I think there's probably some upside to that as we go through the year, and there'll be lots of puts and takes as we go through it.

But I really don't think about managing the business any differently on the way up as we did on the way down. We've got lots of deposit capabilities should we turn to an environment where we're having deposit outflows relative to what we've been enjoying over the last few years, and we'll just continue to manage through it. So I'm sticking with what I've said before, probably somewhere in the neighborhood of flat NIMs for the year, but there's probably upside potential to that prediction.

Darko Mihelic – *MD & Equity Analyst, RBC Capital Markets, Research Division*

And what is your view on loan growth in light of the idea that rates are going higher? I mean they're probably an effect on mortgage growth, possibly could be an effect on growth in the U.S. and commercial at the same time deposits, right? I mean there's got to be a flow-through on the deposit

side. So how do you think about loan growth and deposits in 2022? And maybe you could touch on both businesses. I mean, obviously, there's lots of businesses you got. But you think about loan growth in both Canada and the U.S., maybe give us an idea of what you're expecting?

Darryl White – *Bank of Montreal – CEO*

So look, on both sides of the border, Darko, we're pretty constructive on loan growth. If you look at what we saw in the third quarter of 2021 and then you look at the fourth quarter of 2021, you started to see sequential loan growth quarter-over-quarter on the linked. And that I would expect to continue, and we're feeling pretty positive about that in Q1 of 2022, in particular. And I think within a range, I would say that's across asset classes.

It's particularly strong right now, I would say, in the U.S. and particularly strong in U.S. commercial. We're also seeing strength in Canadian commercial. And then here at home in Canada, we're also seeing some very good trends in mortgage, in cards. We saw a good spending season. We'll have to see whether the revolve sticks on the cards post holidays, but we did see a good spend through the holidays and cards. We're seeing continued mortgage growth. And in those particular products, we're continuing to take share, anywhere between 30 and a 100 basis points over the last year in the personal products in Canada.

And then the last place I'd go is in the business banking in Canada in the low end. There, we've got a very meaningful share, and we continue to grow it. We're the second largest in Canada. I think we have around a 17% market share, and we're growing that market share. And that book continues to grow as well. So all of those categories whether U.S. or Canada, whether it's personal or commercial or business banking, we are seeing loan growth. If I had to roll it all up for you and give you a forecast for the full year, I think we'll see that we'll be pretty comfortably in the mid- to [high] single-digit growth for 2022 across the book.

Darko Mihelic – *MD & Equity Analyst, RBC Capital Markets, Research Division*

And within that, you touched on loan growth. What about deposits? I mean, do you see anything there early on here with the thought process on rising rates and deposits? Or is it just too early to tell? I mean, everyone is talking about deposit betas, but we don't know, right?

Darryl White – *Bank of Montreal – CEO*

It's still pretty sticky. And I will say I'm even surprised at how sticky the deposits have been. At some point, we do anticipate that we'll start to see an outflow of deposits, but we really haven't seen it yet. If I'm a betting man on that, I would say we'd probably start to see that at the back end of this year. We're well positioned if that occurs. But as I sit here today, we haven't started to see that. There's a lot of liquidity in the market.

Darko Mihelic – *MD & Equity Analyst, RBC Capital Markets, Research Division*

Yes, yes. So it's a good outlook for growth for your businesses. Business that had really strong revenue growth was your Capital Markets business, a 15% growth in revenue in 2021. Do you see 2022 as being another good year for that business? Or is it a really tough, really tough comparable? How do you envision 2022 shaping up? And what's the early read?

Darryl White – *Bank of Montreal – CEO*

Yes. We're proud of the -- like really proud -- of the progression that we've had in the Capital Markets business, Darko. I think all Capital Markets businesses on the planet have done reasonably well in the last couple of years. So it all becomes a relative conversation. And we think, it is a relative world, and we think we've done very well relative to our peers. A couple of years ago, we were averaging -- I always find it easiest with Capital Markets to sort of focus on the PPPT. We were averaging in sort of mid-300s per quarter on our PPPT and then we leveled that up into the mid-500s, and here we were last year into the high 600s on PPPT.

When I look out going forward, I actually, based on what we're seeing today, I don't see any reason why that wouldn't continue because we've done structural work to change the business. As you know, a couple of years ago, we really addressed some of the cost structure in the business. We then added to the capacity. We added to the digital capability. We have integrated, in particular, the KGS and the Clearpool acquisitions quite well, and they've performed better than any forecast that we had when we bought them. So I really think about this business for us, Darko, as having really re-leveled our expectations regardless of market environment. Sure, there will be volatility at some point, we've been saying it for several quarters now, but we tend to come out quarter after quarter stronger than the next.

So as I sit here today, might there be more volatility through the markets through the course of 2022. I think there will be, I think there should be when you start to reduce the impact of asset purchases and increased rates, while they were there in the first place to reduce volatility and to increase asset prices where the opposite should be true. You should have increased volatility and some pressure on asset prices. But through the course of that, I think the implication would be that we would continue to perform well, particularly in our markets business. We're seeing continued strength in our market business right now. At some point, usually when that happens, the implication is that you get a pullback on your new issue business and the underwriting business in particular. But there -- we haven't seen that yet.

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So the track record that we put together last year, here in Canada, where we're already #1 in IPOs, #2 in M&A. I think we're the only Canadian bank in the top five in M&A. That's the mandate for our teams going forward this year regardless of the market conditions. And our U.S. businesses continue to perform really well. So my expectations are as high as they've ever been for our Capital Markets business.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

Okay. Great. So have to touch on credit. Before I get to the audience questions, you have to touch on it. Now you -- your bank guided to impaired PCL ratio slowly drifting back to pre-pandemic experience of teens to low 20s, but it may remain low in the next sort of first half of 2022. What are your underlying assumptions on the impaired PCL outlook? And I'm curious if Omicron changed it at all because and there's a lot of hype around Omicron, but early on, has there been any thought on whether or not it will have an impact on, a), your 2022, but more importantly; b), as we get into 2023? And any sort of change in outlook or thoughts on PCLs?

Darryl White – Bank of Montreal – CEO

You said I have to talk about credit. The reason I chuckled when you said that is you and I will both remember that 6 or 7 quarters ago, it was all anybody wanted to talk about and in the last couple of quarters, nobody wants to talk about so I'm glad you asked. And 6 to 7 quarters ago, I will remind you that, that was a period of time where I think some factions of the marketplace thought that we were the bank that was going to be at risk, and we stuck our necks out and said, well, if that's what you think, just watch us.

I will remind people that since that day, if I look at the commercial book that people might have been worried about at that point in time, we have had cumulative five quarters of zero impaired PCLs in our commercial book. So when we say it's benign, it is benign. Will that last forever? Is it abnormal? Of course, it's a little bit abnormal. But I do like to remind people of that because it's a pretty stark difference from what might have been expected of us over time. We said to folks, we've got a 30-year track record of outperforming our peers on credit, and we don't expect that to change through this pandemic. It has not changed through this pandemic.

Now you asked me the question about going forward, where do we go from here? Look, I think it's an early -- believe it or not, even though it's dominated all of our Christmas conversation on Omicron, I think it's actually early to call it on its implications on PCLs. What we can tell you is right now, when I look across economists, I haven't seen a distinct change in the outlook for economic growth, unemployment or inflation relative to, say, six weeks ago when we saw the onset of Omicron. And that input on your expectation on economic growth is a very important one in terms of the model. So we might see a little bit of a prolonging of that growth, it might get stretched out a little bit. But by the time you get to the third, fourth quarter, first, second, third quarter of next year, we actually don't really see a difference relative to a few weeks ago.

So at this point in time, Darko, my answer would be the PCL outlook really isn't any different than what we would have talked to you about at the beginning of December on our analyst call. That could change, but there isn't anything in our models or our lived experience right now that suggests that it should change. And will we drift into that range that we've guided to over time. I assume we will. But as every quarter goes by, we tend to push that notion out another quarter and another quarter. And I think that continues to be the case today.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

Yes. And it's interesting because we -- when I look at the bank's levels of Stage 2 allowances, I think your bank has maybe one of the biggest amounts of those reserves still remaining from the buildup of 2020. And I had been going on the assumption that those would come down. So maybe perhaps we're not expecting it in Q1, a big drawdown in the reserves, but it seems like the expectation would be that -- I don't want to put words in your mouth, but would stage 2 reserves come down, if all else equal, Omicron is not a big threat, should we expect to see those reserves come down significantly in 2022?

Darryl White – Bank of Montreal – CEO

So -- and by the way, you are right in pointing out by our math, we still have the largest share of 2020 reserves built up still in the back pocket as it were relative to our peers. So there is some comfort to having that gas in the tank. I will say, on the other hand, low-quality earnings, as you know, as they get released, but earnings nonetheless.

As you look out into the rest of 2022, assuming the -- I'll go back to what I said to you three minutes ago, assuming the environment remains constructive on the outlook for the economy, which today it does, I think you'll continue to see releases. Will we and others release everything that we built up in 2020 through the course of 2022. I don't know. We haven't begun our committee meetings and our work on how we're going to treat this for the second quarter -- in the first quarter, pardon me. So you'll hear from us in just a few short weeks on how, we thought about the first quarter. But just look at our pattern, I guess I would say to you, over the last couple of quarters, extrapolate your assumptions on how strong the economy is and you probably get pretty close to the answer there.

And all that changes if economically things go sideways and there's a lot of pain felt in the customer base -- or the commercial base for that matter. But I'm repeating myself now, so I'll stop talking because right now, we don't see anything that changes the pattern.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

Okay. Great. I wanted to shift to questions from the audience. We have a question here. I think this is related to the -- I think I recently saw something with the lift out of the BNP Paribas team for prime brokerage. But the question is you're building up our U.S. prime brokerage business, how big do you plan to grow this business? And where do you see it going?

Darryl White – Bank of Montreal – CEO

So that's a good question. Thank you for it. This is an important extension of our equities franchise broadly speaking. As I think people know, we've got a strong equities franchise on both sides of the border. Our offering on both sides of the border, whether it be on the trading side or on the sales side, whether it be on the cash side or on the derivative side, has been very consistent over time, research as well. And where we have opportunities to look at one side of the border, where there's an offering that's not as complete as it is on the other side of the border, we'll take advantage of that.

So that's all that really is, Darko. We've been in the prime business in Canada for a very long time and we have the opportunity to build it out in the U.S. and we like the team that's chosen to join us, and we like the capabilities that we have there. We're going to keep the risk profile of that business really tight, and we're keeping a very close eye on it. But we really like the business.

Most importantly, the clients that we deal with really like us to be in the business. They value us as partners for the Prime product. And really importantly, a lot of them will tell you, there's only so much I can do with you on other products if you're not able to help me with the Prime product. So we'll keep it in perspective, we'll keep it in the right ZIP code as far as size and risk parameters are concerned. But within that perspective, we're actually quite excited about it, it extends what we've been doing for a very long time in other geographies.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

Okay. Great. And we have time for one more question from the audience, which is an interesting one. It seems like private debt is growing. Do you see that as a concerning trend for your Commercial/Corporate business?

Darryl White – Bank of Montreal – CEO

What I'll say, Darko, is -- we haven't seen a material impact at this point on our commercial or our corporate business, but we definitely do see it. And the alternatives are real that people can go to for private debt. I think what you need to have, to be able to counter that as a competitive product, is a relationship model with a competitive offering that you're good at and that you've been at it for a very long time and that you're prepared to grow in.

And so when I look at the things that we're doing in terms of the growth of our commercial businesses. We announced last week an expansion of our businesses in Florida. The year before, we had the expansion of Denver and Los Angeles, in different places. That effectively, at the end of the day is, scaling your franchise and scaling your customer relationships and your brand, is the mitigant to the threat, but the threat is real. I actually don't think it's going to make a serious dent in some of the top providers, and we're one of the top providers, but I will say where I think the biggest risk is they operate in general outside of the regulatory perimeter.

So for those who are interested in the conversation around where the regulatory perimeter ought to stop and start, I mean this is one that I encourage policymakers to think hard about because I think that the risk to the system is much more important than the risk to any one provider in the system, like us, and that's something that -- it sounds to me from your remarks that Peter might have raised something like that in his comments earlier. So if that's something on the minds of regulators, I'm all for it.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

Okay. With that, we're bumping up against the end of our session. And like I'm going to do with everyone, I'm going to turn the floor over to you. I've directed a lot of the conversation, but I really want to hear what your key messages are for shareholders and potential investors for 2022. So over to you, Darryl.

Darryl White – Bank of Montreal – CEO

Yes, sure. I'll be quick, Darko, because I think you've covered a lot of the ground. The first thing I'd say is that the Bank of the West acquisition is a really important strategic step for us. It's a hand-in-glove strategic fit for us. It's accretive to our EPS, it adds to our ROE and it helps our efficiency all at the same time. We're really excited about it. But I want to keep it in perspective.

We're adding through that acquisition, a very material step for our U.S. P&C business, but it's 15% of the total bank. And so we're adding 15% of the total bank's assets. So I want shareholders to remember that that's a really important accelerant to our growth within our risk parameters. And at the same time, the other 85%, we're going to continue to deliver on our commitments.

What commitments? We talked to you guys a few years ago about improving our ROE, improving our efficiency, and maintaining prudent capital and risk. We've done all of those things. We've improved our ROE over the course of 2018 to 2021 by 240 basis points. We've reduced our efficiency over that same period by 540 basis points. We've said to you before, we think there's more fuel in those tanks. And that's before I get to the Bank of the West assets. And so I want people to remember that, we're going to stay committed to those objectives. We're going to deliver positive operating leverage in 2022 on our core business, while we plan for the acquisition.

We think we've got a robust plan to maintain that outperformance relative to our peers, and we've got capabilities to future-proof our bank and our business through everything we're doing on our digital-first agenda. So when I put all that together, Darko, I would say I've actually never felt as confident as I do today about the outlook despite all of the headwinds that could come at us environmentally, we're really, really well positioned.

Darko Mihelic – MD & Equity Analyst, RBC Capital Markets, Research Division

Excellent. Well, thank you very much for that, Darryl. It's been a great session. And take care, and we'll talk soon.

Darryl White – Bank of Montreal – CEO

Thanks for hosting us.
