BMO Financial Group

Q4 2010 CONFERENCE CALL

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In calculating the pro-forma impact of Basel III on our regulatory capital, regulatory capital ratios, and risk-weighted assets (including Counterparty Credit Risk and Market Risk), we have assumed our interpretation of the proposed rules announced by the Basel Committee on Banking Supervision (BCBS) as of this date and our models used to assess those requirements are consistent with the final requirements that will be promulgated by BCBS and the Office of the Superintendent of Financial Institutions Canada (OSFI). We have also assumed that the proposed changes affecting capital deductions, risk-weighted assets, the regulatory capital treatment for non-common share capital instruments (i.e. grandfathered capital instruments) and the minimum regulatory capital ratios are adopted as proposed by BCBS and OSFI. We also assumed that existing capital instruments that are non-Basel III compliant but are Basel II compliant can be fully included in the October 31, 2010 pro-forma calculations. The full impact of the Basel III proposals has been quantified based on our financial and risk positions at year end or as close to year end as was practical. The Basel rules are not yet finalized and are subject to change, which may impact the results of our analysis. In setting out the expectation that we will be able to refinance certain capital instruments in the future, as and when necessary to meet regulatory capital requirements, we have assumed that factors beyond our control, including the state of the economic and capital markets environment, will not impair our ability to do so.

Our expectations regarding the key impacts of our transition to International Financial Reporting Standards (IFRS) are based on IFRS as issued by the International Accounting Standards Board (IASB) that are in effect as of this date. Should IFRS change prior to our transition to IFRS, our expectations of the key impacts of transition could change.

Assumptions about the performance of the Canadian and U.S. economies in 2011 and how that will affect our businesses were material factors we considered when setting our strategic priorities and objectives, and our outlook for our businesses. Key assumptions included that the Canadian and U.S. economies will grow moderately in 2011, that interest rates will remain low and that our assumptions regarding regulatory reforms will be consistent with the implementation of such reforms. We also assumed that housing markets will strengthen in Canada and the United States. We assumed that conditions in capital markets will improve somewhat and that the Canadian dollar will strengthen modestly relative to the U.S. dollar. In determining our expectations for economic growth, both broadly and in the financial services sector, we primarily consider historical economic data provided by the Canadian and U.S. governments and their agencies.

PRESENTATION

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

Great. Thank you, and 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 keep it to one or two questions and then re-queue. We will wrap up the call at 3 p.m.

Also with us this afternoon are BMO's business unit heads, Tom Milroy from BMO Capital Markets; Gilles Ouellette from the Private Client Group; 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 they are subject to a variety of risks and uncertainties. Actual results could differ materially from forecasts, projections or conclusions in the forward-looking statements.

You can find information about the material factors that could cause our actual results to so differ and information about the material factors and assumptions that were applied in drawing conclusions or making the forecasts or projections in these forward-looking statements on page 29 and page 30 of our 2010 Annual MD&A.

With that said, I will hand things over to Bill.

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

Thank you, Viki, and good afternoon, everyone. As noted, my comments may include forward-looking statements.

BMO's fourth-quarter financial results reinforce the trends that have been evident throughout the year. We're generating good revenue growth, momentum is visible across all our business groups, loan-loss trends are generally positive, return on equity continues to increase and our capital position remains strong. We're achieving this success while also investing in future growth. Specifically, the fourth quarter saw increased investment spend in our retail businesses and in technology and operations resulting in higher expenses. This reflects our commitment to invest in front-line staff and to expand our branch network and our online customer experience.

Revenue in the fourth quarter was $3.2 billion, up 8%, and net income was $739 million, 14% above last year. Cash EPS came in at $1.26 per share, and our ROE was 15.1%.

The $253 million fourth-quarter provisions for credit losses were significantly improved from last year, and while slightly elevated from the previous quarter, we believe that there is a credit recovery underway and have confidence in an overall continued positive trend. Tom Flynn will provide more colour later in the call.

For the full year, revenue increased 10.4% to $12.2 billion and net income increased to $2.8 billion. Provisions for credit losses were reduced substantially, and cash productivity improved 440 basis points to 61.9%. Return on equity increased to 14.9% from 9.9% a year ago, and BMO's U.S. operations returned to profitability in 2010, as reported, with actual credit losses.

Pre-tax pre-provision earnings were $4.6 billion, up $937 million from the previous year, reaching the highest level in the history of the Bank, and BMO finished the year with a strong capital position.

Russ will take you through our Group results in more detail, but let me touch on some highlights. P&C Canada continued to excel, delivering strong growth in revenue and net income in the fourth quarter and for the year. Net income for fiscal 2010 grew 16%, and on an actual loss basis, 22.5%. Performance was driven by higher revenues across each of our businesses.

The business has a clear strategy and strong execution capabilities. Everything we are undertaking, from customer offers to the 5,650 employees who completed Customer Conversation sales training this year, lines up to support our brand, Making Money Make Sense.

As a result, in 2010, we generated improved customer loyalty as well as year-over-year increases in the average number of product categories used by both our personal and commercial customers. And as I indicated, we are investing strategically to improve our competitive position, leveraging our customer knowledge base to drive further growth.

P&C US net income in Q4 was US$37 million, down 21% from a year ago, reflecting the costs of the integration of the AMCORE acquisition, which was completed in the fourth quarter. We are pleased with this addition of new customers and the added presence it brings in Wisconsin and Illinois. Excluding the integration costs, net income was essentially unchanged at US$48 million for the quarter.

Harris continues to increase its presence and visibility in the market. In 2010, we added over 7,000 new chequing accounts, increased personal core deposits by US$258 million, increased personal deposit market share by 35 basis points in the Chicago Metropolitan market, and our Net Promoter Score of 40 remained among the highest compared with both large and regional banks in our markets.

We are pleased to see our progress recognized during the quarter, as we were the recipient of the 2010 TNS Choice Award for superior performance in Chicago. Award recipients are chosen by Chicago residents for their strong performance in attracting, satisfying and retaining customers and for winning a larger share of market.

The Private Client Group had a strong fourth quarter and delivered 2010 net income of $470 million, an increase of 31%. For the year, revenue increased 12%, reflecting growth across most of our businesses. This was the result of a 13% year-over-year increase in client assets under management and administration in source currency, along with improved equity market conditions.

China is a key growth market for BMO outside of North America. In the fourth quarter, we opened Bank of Montreal (China) Co. Ltd. With local incorporation in China, BMO joins a limited number of foreign banks in providing a broad offering of financial services to its customers.

The new company gives us a clear advantage in growing our existing businesses and branch network, and gives us the flexibility to expand our product and service offerings, including the possibility of new initiatives in retail banking and wealth management. Because wealth management is a key plank in our greater China strategy, Gilles Ouellette is heading up our International Strategy and is Chairman of the newly incorporated subsidiary.

I should also note that BMO was recognized by the Canada-China Business Council as the recipient of the 2010 Extraordinary Achievement Award at a ceremony in Beijing this October. We were nominated for this award by Sun Life Financial and the Agricultural Bank of China. We now have full branches in Beijing, Shanghai, Guangzhou and Hong Kong, as well as a representative office in Taipei.

BMO Capital Markets generated good overall performance in the fourth quarter and for the year as a whole. Net income for the year was in line with expectations at $820 million, generating an ROE of

18.8%. Net income in the quarter was up nicely from the third quarter, as revenue performance returned to levels experienced in the first half of this year.

We are continuing to build our capital markets bench strength. During the year, we appointed a new head of US Investment & Corporate Banking and a new senior management team in US Equities. Since last year, BMO Capital Markets has made strategic hires across the business globally, and as these additions gain traction, we expect to see returns.

Shifting to capital, international regulators have now provided further clarity on expected capital requirements under Basel III, and these were endorsed by the G20 last month. Based on our calculations, our pro forma common equity ratio, or some call it the Tier 1 common ratio as of October 31, 2010, is estimated to be 7.8%, exceeding today, the announced Basel III 2019 minimum capital requirement of 7%.

We recognize that while the final requirements are not yet known, our prudent strategy of maintaining our current strong capital ratios continue to position BMO well to execute our growth strategy.

BMO's common equity ratio at year-end on a Basel II basis remains very strong at 10.26%.

Before wrapping up, a few words on our economic outlook. Canada's economy is continuing to recover at a moderate pace, with growth expected in the 2% to 3% range during the next couple of years. Support from low interest rates, firm commodity prices and a gradual pickup in US demand will help counter tighter fiscal policy and a stronger Canadian dollar.

The unemployment rate has eased and total employment has returned to its pre-recession level. We anticipate sufficient job growth over the next two years to slightly reduce the unemployment rate further and to support spending by the Canadian consumer. Canadian business investment will remain well supported by strong demand for commodities and solid balance sheets.

The U.S. economy continues to grow modestly. We're currently forecasting growth in the mid 2% range in 2011, with gradual improvement throughout the year.

The big issue for the U.S. is high unemployment, and the so-far jobless recovery. We expect a gradual decline in the unemployment rate over the next two years as the economy strengthens. Corporate balance sheets are strong, and there has been an upturn in U.S. capital investment as companies begin to replace and modernize machinery and equipment. Although real estate remains a key risk area, given ongoing weakness, recent signs of improving employment increase our confidence that the recovery will be sustained.

Following the Q&A session, I'm going to call on our group heads to provide an overview of the 2011 outlook for their respective businesses, and then I will wrap up with some brief comments. And with that, I will pass it over to Russ.

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

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

On slide nine, you can see that fourth quarter earnings were $739 million, or $1.24 per share compared to $1.11 last year. On a cash basis, current quarter earnings were $1.26 per share. BMO's capital position remains strong.

The fourth quarter results closed out a good year where we delivered net income of $2.8 billion, with revenues of $12.2 billion, with significant momentum across our businesses.

Turning to slide 10, revenues were up year-over-year and quarter-over-quarter, driven by solid increases in all operating groups. Net interest income was $1.6 billion in the quarter, up $168 million or 11.6% from a year ago. Quarter-over-quarter, net interest income increased $39 million or 2.4%, mainly due to good growth from our P&C businesses.

The total bank net interest margin was up 16 basis points year-over-year. P&C Canada benefited from higher spreads in personal loans and deposits, as well as additional personal lending interest revenue in the quarter. In P&C US, improved loan spreads and deposit balance growth were partially offset by deposit spread compression. BMO Capital Markets benefited from lower funding costs.

Quarter-over-quarter margins were essentially flat, as increases in our retail businesses and corporate services were largely offset by lower trading net interest income in capital markets.

Turning to slide 11, year-over-year expenses increased $244 million or 14%. The Diners Club and Rockford acquisitions accounted for approximately 25% of the increase, including integration costs. Employee compensation was higher due to increased staffing levels in each of our groups and higher performance-based compensation, in line with improved performance. There were also higher costs related to business initiatives, as we continue to increase our sales force and build infrastructure to support growth and advance our strategic agenda.

Quarter-over-quarter expenses increased $125 million or 6.5%, mainly due to higher employee performance-based costs, in line with increased revenues, higher investment spend and the inclusion of a full quarter's impact of the new Harmonized Sales Tax.

On slide 12, you will see that our Tier 1 capital ratio remains strong at 13.45%. Risk-weighted assets were $161 billion at the end of the fourth quarter, up $4.6 billion quarter over quarter and down $6 billion year-over-year. The sequential increase was primarily due to higher retail and securitization risk-weighted assets, partially offset by lower corporate and commercial RWA.

Slide 13 summarizes our disclosure on Basel III, included in the annual in MD&A, which Bill touched on earlier. If we were to fully adopt the 2019 Basel III rules as known today, at October 31, 2010, our Basel III common equity ratio is estimated to be 7.8%, and our Basel III Tier 1 ratio is estimated to be 10.4%. In other words, we exceed the 2019 Basel III capital requirement today.

Our calculations assume no benefit from internal capital generation, no mitigating actions by management and include the expected impact of the adoption of IFRS. Additional disclosure on the expected impact of IFRS is also provided in the annual MD&A. Effective November 1, 2011, BMO will adopt IFRS as the basis for preparing consolidated financial statements. When we adopt IFRS, we will prepare our financial statements as though we had always used IFRS. The impact of any accounting standard differences you will see as an adjustment to opening retained earnings in our 2011 comparative year.

Our annual MD&A provides information on our estimated retained earnings adjustment for pensions, securitization and certain more significant off-balance-sheet entities.

Moving to slide 16, P&C Canada had another strong quarter. Revenue increased 10% from a year ago, driven by volume growth across most products, the inclusion of Diners Club revenues and improved net interest margin. We continue to invest strategically to improve our competitive position, while managing our operating expenses prudently. The cash productivity ratio was 51.5% in the fourth quarter, consistent with the low 50% range we maintained throughout the year.

Turning to slide 18, P&C US net income of US$37 million was essentially unchanged year-over-year and improved 22% quarter-over-quarter after adjusting to exclude acquisition integration costs of US$17 million, or US$11 million after tax.

In the quarter, higher margins were largely offset by the continued negative impact of impaired loans.

The inclusion of the Rockford transaction increased revenues and operating expenses by US$25 million and US$23 million, respectively.

Turning to slide 19, our Private Client Group results were up $25 million or 25% from a year ago, with net income from our brokerage, private banking and asset-management businesses up a strong 40%. Insurance revenue improved quarter-over-quarter, benefitting from higher premiums and the effects of market movements relative to Q3. Q4 cash productivity of 69.5% significantly improved from both comparable periods.

BMO Capital Markets net income was down 17% from the very strong results of a year ago, but up 65% from the third quarter. Trading revenue improved considerably quarter-over-quarter, driving revenue growth of 23%. There was also higher M&A revenue, equity underwriting fees and investment securities gains, partially offset by accounting adjustments in our equity trading business in the current quarter.

Year-over-year revenues were 2.7% higher due to investment securities gains and higher M&A revenues and debt underwriting fees. Continued weak demand, particularly in the United States, contributed to lower corporate banking revenues and the weaker US dollar also decreased revenue.

Finally, on slide 23, Corporate Services' results were $102 million better than a year ago, mainly due to lower provisions for credit losses under BMO's expected loss methodology.

In conclusion, our results reflect a quarter of good earnings, underpinned by momentum across all of our businesses. With that, I will turn things over to Tom.

Tom Flynn ***- BMO Financial Group - EVP and Chief Risk Officer***

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 continues to be well-diversified both geographically and by portfolio segment. 76% of loans are in Canada, and 19% in the US. Consumer portfolios represent 64% of the Canadian portfolio and 86% of these are secured. Our US portfolio mix is 44% consumer and 56% commercial and corporate.

Slide 27 provides details on our U.S. loan portfolio, which represents 19% of total loans. The portfolio is well-diversified, and we believe our underwriting practices have been more conservative than the industry overall.

The U.S. consumer portfolios are relatively evenly spread across first mortgage, home equity and auto loans. Weak US labour and real estate markets continue to impact these portfolios, however, all three segments are performing better than peers.

The C&I portfolio is performing reasonably considering the environment, and is well-diversified.

As we have discussed in previous quarters, US commercial real estate sector remains under pressure. With the slow pace of the recovery, we expect improvement in this sector to take time. This portfolio is approximately US$3.3 billion or 2% of total loans and 10% of US loans.

Investor-owned mortgages represent approximately 5% of the US portfolio. While impacted by the environment, the investor-owned mortgages are well-diversified across our footprint and by property type and were underwritten prudently.

The developer portfolio has continued to reduce, is well under $1 billion in size, and represents less than 2% of total US loans. This portfolio was impacted early in the downturn, and we believe that formations here have peaked.

Turning now to slide 28, the chart shows information on impaired loan formations for the quarter. Impaired formations were $461 million in Q4 versus $242 million in Q3. As discussed in previous quarters, we expected some quarterly variability in formations and provisions, and so the increases are not unexpected given the environment.

Within Canada, there were a few larger accounts that contributed to the higher level of formations. The U.S. portfolio continues to account for the majority of formations at $289 million and were diversified across sectors, with the commercial real estate related sectors making up the largest portion at 30%, down from 39% last quarter.

Gross impaired loans increased modestly to $3.2 billion from $3.1 billion last quarter. Excluding impaired loans covered by the 80/20 loss share agreement with the FDIC, impaired loans were $2.9 billion.

Slide 29 details the provision for credit losses by line of business. The consolidated specific provision was $253 million, up from $214 million last quarter.

Moving now to business segment details that are shown in the table; The improvement in P&C Canada consumer provisions this quarter is equally split between high recoveries and improved performance in the personal loan portfolio.

P&C US provisions increased this quarter, but are down from the level of a year ago. We expect provisions in this line of business to continue to be impacted by weak real estate markets and high unemployment into 2011.

Lastly, Capital Market provisions increased quarter-over-quarter, not unexpectedly, given the net recoveries we have seen here for the last two quarters. In general, the Capital Market portfolio continues to stabilize.

Turning to slide 30, you can see a segmentation of the specific provision by geography and sector. The Canadian provision was $98 million, down from $110 million in Q3. Credit card and consumer segments continued to be the largest drivers of Canadian provisions at 38% and 28%, respectively. The US provision was $156 million, up from $104 million in Q3, but down from $261 million a year ago. The consumer segment continues to represent the largest portion of US provisions.

Looking forward to next year, we would expect provisions for the first half of the year to be roughly in line with what we have experienced over the last half of 2010. We hope for some improvement from those levels in the latter part of the year. And as always, we note that there is a potential for variability quarter to quarter.

That concludes my presentation and we can now move to the Q&A.

QUESTION AND ANSWER

Operator

Andre Hardy, RBC Capital Markets.

Andre Hardy *- RBC Capital Markets - Analyst*

I have two questions. The first for Bill, please. You raised your EPS growth objective from 10% to 12%. I'm a little surprised you didn't address that in your opening remarks, but perhaps you can tell us now what has given you the confidence to increase your EPS growth objectives now?

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

Thanks for the question, Andre. If you reflect on the last three years or so, I think there has been headwinds in the markets. There has been a slow economy, and obviously, there has been provisions for credit losses at elevated levels.

As we look forward over maybe the same periods, at three years or so, what I think we are going to see is a gradual pickup in economic growth. We've said before that a bank with a very clear expression of its brand and its position in the marketplace is going to have the opportunity to grow share across its businesses. We do expect that we are going to see a moderation in credit provisions over this period, and we think realistically, in this time frame, a slightly higher EPS growth rate is achievable.

We also take confidence from the fact that over the last eight quarters, we've seen good fundamental growth in all four of our major business groups. And I qualified the good part of it because we are growing revenue, and we are reinvesting in the businesses at the same time. So, I think it's an expression of confidence in the positioning of the Bank, the markets that -- and confidence in the markets where we are competing.

Andre Hardy *- RBC Capital Markets - Analyst*

And just to be clear, that's an organic growth target, there are no acquisition assumptions?

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

What I would include in that are the kinds of small acquisitions that we've been making as we've gone along. Over the last two or three years, we've made some very nice tuck-in acquisitions that have been complementary to the businesses, and I would foresee them continuing.

Andre Hardy *- RBC Capital Markets - Analyst*

Okay, thank you. And the second question refers to the disclosure on counterparty credit risk, and the estimate of a $23 billion increase in risk-weighted assets. Do you assume that you will be able to use advanced models for counterparty credit risk, which would be positive for the Bank?

Tom Flynn *- BMO Financial Group - EVP and Chief Risk Officer*

In calculating that number, Andre, we haven't. We've used an exposure at default method, based on the current exposure methodology. And so we've gone with what we think is a conservative number here, both in terms of how we've calculated it and given that we haven't considered steps that we could take to mitigate it, which would include moving parts of the business to clearing organizations.

Andre Hardy *- RBC Capital Markets - Analyst*

Do you know if you use an advanced model the kind of break you would get?

Tom Flynn *- BMO Financial Group - EVP and Chief Risk Officer*

Not with any precision. We think there would be a meaningful impact, but I really can't quantify it for you.

Andre Hardy *- RBC Capital Markets - Analyst*

Okay, thank you.

Operator

John Reucassel, BMO Capital Markets.

John Reucassel *- BMO Capital Markets - Analyst*

Thank you, I want to thank you for your disclosure on that capital. That is very helpful, and too bad your peers out there didn't do that.

I just want to get back to the earnings growth Bill, you also took down your operating leverage target. So I guess you are relying more and more on revenue growth. And is this really a story of getting the U.S. business growing more, or is Frank expected to deliver what seems to be pretty good growth even in a slowing environment?

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

Thanks for the question John, and thanks for the observation on the capital. I think the process of going through the analysis and developing a pro forma was helpful for us as we started to think about the outlook for the future as well.

I think the operating leverage reduction reflects the rate of investment that we've been running recently, and that has been across all of the businesses. I think there are a couple of ways that it is playing out. One is a real focus on the front line. And we have been building expenses at the front line. But the other element of it is the integration across the product lines and the major lines of business as we really pulled the brand together, both in Canada and the United States. And the consistency on both sides of the border is showing up in product offering, in the way that we advertise and promote the type of new product introductions that we are doing.

So the benefit we've seen from the dollars invested has given us some confirmation that consistent investment, focused in this way, will show up on the top line. And I would look to all of the businesses to benefit from it in the same way.

In the sense that P&C Canada is in excess of half of the earnings in the most recent year, you can expect that we would be looking to Frank and his team to contribute a big portion of this, but it applies to all the businesses.

John Reucassel *- BMO Capital Markets - Analyst*

Okay. On the NCIB, the high dividend payout ratio, relatively high, still outside the target range. But you have lots of excess capital and even when you pro forma Basel III, you meet it today. So should we expect you to be active in the NCIB this year, or are there still issues that is holding BMO back?

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

There is no specific signal, we renewed it in the ordinary course, and I would expect that we would use it in the future, and I would differentiate it from any of the discussion about the use of surplus capital. I think it is a tool around managing dilution from existing programs, and we renewed it in the expectation that at some point we would simply start using it.

John Reucassel *- BMO Capital Markets - Analyst*

Okay. Thank you.

Operator

Darko Mihelic, Coremark Securities.

Darko Mihelic *- Coremark Securities - Analyst*

A question for Tom Flynn. And Tom, I apologize if this gets a little technical, but I wanted to just circle back and make sure I've got a good understanding here of Apex and Links.

I'm looking at page 2 of the extra information that you've given us, as well as the annual statements, and a couple things pop out at me. The first question with respect to Apex is the notional maturities. You've got 26% maturing in 2012, 44% in 2013 and the rest in 2016 or thereabouts anyway.

The question is should we care about refinancing risk on any of those maturities?

And secondly, also in respect to the Links and Parkland, you mentioned some of the maturities that are happening there. When I total it all up, is there going to be a significant risk-weighted asset sort of relief that is coming from these maturities?

Tom Flynn *- BMO Financial Group - EVP and Chief Risk Officer*

Okay, I will start with Apex. That slide that you are looking at, we give the maturity dates for the notional amount that we have outstanding. There is no refinancing risk associated with this structure. The underlying credit is in the form of CDS, and they simply expire at the dates that you see there on the page. So that will happen as a matter of course, without incident or risk, on the dates.

On the SIVs, we've got the disclosure with respect to the maturities. And there will be some RWA relief over time as that vehicle reduces, obviously assuming that the credit quality remains the same. So there is some benefit over time, I wouldn't say that it is going to be significant over the next year, just given the amount of maturities that we've got coming up.

Darko Mihelic *- Coremark Securities - Analyst*

And one last question on the Links and Parkland. I am trying to triangulate this with your annual report, and I notice in the annual report that drawn facilities and the loans provided does not equal what you have here, and in fact, it is about $2 billion higher. What other vehicle are you out there funding that would have about -- or close to $2 billion of extra funding?

Tom Flynn *- BMO Financial Group - EVP and Chief Risk Officer*

Where are you looking in the annual report?

Darko Mihelic *- Coremark Securities - Analyst*

I'm looking in the Notes, page 128. I see $6.9 billion of drawn facilities, and it doesn't quite add up to what you've got here on this page.

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

Just give us a second, Darko, we are all looking at the page to make sure we catch up with you.

Tom Flynn *- BMO Financial Group - EVP and Chief Risk Officer*

The correct amount for the Links and Parkland exposures you see on that page, in the top half of the table, so there is about $5 billion. I believe, and we'll come back and confirm this with you, but I think the rest of it relates to capital securities. So things like the BOaTS, innovative Tier 1 securities. But we will confirm that.

Darko Mihelic *- Coremark Securities - Analyst*

Okay, that's very helpful. Thanks for the disclosure.

Operator

Sumit Malhotra, Macquarie Capital Management.

Sumit Malhotra *- Macquarie Capital Management - Analyst*

Good afternoon. My first question is for Frank Techar. Frank, if I look at the level of non-interest expenses in the Canadian Banking segment, clearly, you had a step-up in Q3 and you followed up with that in Q4. We heard the conversation and the commentary around the HST.

When you talk about the investment spending that is still required for BMO in Canadian banking and measure that against the levels we've seen in the second half of the year, what kind of expense growth do you think we're going to see the segment put forth in 2011?

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

You can expect that the expense growth next year is going to be higher than it was in 2010, just for starters. 2010, we were at, for the full year, 4.9%, which was about 1% higher than 2009.

And going back to Bill's earlier comments about the business and the overall performance of the business, we are really confident in our ability to grow our top line. And if you look at the last two full years in P&C Canada, we had revenue growth in excess of 10%. So we are confident that our investments, whatever they will be, will pay off for us over time, as we've continued to change our model and our capabilities.

So the growth in expenses will be higher than last year. What I can also say is I would expect that our cash productivity ratio is going to remain at or near the level that you've seen over the last couple of quarters, in the low 50s. So we are not going to undermine our cash productivity position at this point in time.

And the level of expenses, the absolute level of expenses that you've seen in the last couple of quarters are probably what you can expect for the next couple of quarters as we go into 2011. So we are going to be operating at an elevated level if you look at the full year, more in line with the latter half of this year as we go into next year.

Sumit Malhotra *- Macquarie Capital Management - Analyst*

I'm glad you set it up that way, Frank, because the next part of my question is, and I may be guilty of short-termism here, there has obviously been a lot of handwringing about the state of the Canadian housing market and what that will mean for loan growth for the banks in Canada. And also, if competition heats up in a slowing growth environment, what that will do to net interest margin.

And that short-term comment comes from the fact that at least for Q4, loan growth seemed to be fine and net interest margin for most banks and their Canadian banking segment, including yours, actually expanded.

So is the Bank's view or is your view about real-estate-related lending in Canada and the margin environment in this flagship business not nearly as dire as we may be thinking on our side?

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

I don't think I've changed my opinion from previous quarters. I think what we've said in previous quarters is we would expect to see on the consumer side some slowing in the growth as we go into 2011.

What I've said about margins is we will see some variability around an average that we've seen over the last year or so. We had a little bit of an improvement this quarter, but we know there are competitive pressures that will continue to be apparent. So I'm not expecting any huge margin expansion. I'm expecting the consumer growth to moderate.

But we are also in a position on the commercial side of our business to take advantage of some momentum that we have seen over the last couple of quarters. We are well-positioned as a second biggest player in the marketplace. We've seen both loans and deposits grow very nicely and accelerate over the course of 2010.

My expectation is this business-led recovery that we are sort of in is going to continue, and it bodes well for BMO as we look into the future.

Sumit Malhotra *- Macquarie Capital Management - Analyst*

Lastly for Bill or Ellen. I think most of us on the line today got the invitation a couple weeks ago to attend the bank's investor day in Chicago in a few months' time. And now that we've got a pretty good idea what the Basel rules are going to look like and how well you score, my mind started thinking about whether you would have something new and larger to show us when we are down there.

I heard your comment, Andre, about the tuck-in acquisitions you've done over the last few years, but with that capital clarity now there, Bill, do you feel that the bank is in a position to do something more sizable on the acquisition side? And what is the -- I don't know if you want to talk about it this way, but what constraints are there that would prevent you from looking at deals that are more sizable than the tuck-ins that you've done and FDIC assisted deal that you did earlier this year?

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

I'll take the question because I think it started out heading towards the investor day, but you lapped back around on to the acquisition topic, which I'm happy to speak to. I think what we've been looking for is a shift that I think is taking place a little bit gradually, but a shift in the attitude of potential sellers about their own ability to grow coming out of the recession. I think we're starting to get a lot of clarification in what the capital rules will be.

I'm assuming that there are corporate boards that are working their way through the implication. So I don't know whether it is in the early part of 2011 or later in the year. But as we've always said, we do think that there will be consolidation in the regional banking market, and it will probably start at some point during the year.

And I do think it takes some time for boards to digest and work into their longer-term strategies what the implications are. It looks to me as though the capital situation for most banks now is reasonably clear. And then you really have to put it through the mill and say what are the expectations for growth.

What we are doing in the interim, which I think is important, is looking at ways to take the personal and commercial operating platform in the US and integrate it more completely with Canada, with the objective of driving down the ultimate cost in both markets and the opportunity over time to consolidate more branches in.

And even though we have characterized the acquisitions as tuck-ins, they can be quite incremental, and AMCORE is an acquisition that we are very pleased with. Not only have we been able to add almost a 10% increase in branch counts, in fact, I think it's a little bit more than 10% increase in branch counts, we did that very quickly. We've had almost no loss of customers whatsoever. The retention levels have been extremely high. And we are starting to grow from that business base, because we've opened up two new markets. Specifically, the cities of Rockford and Madison.

And so I think that is an example of the kind of organic growth that we can expect from those acquisitions. So whether it would be a series of those or one slightly larger, I think it really is dependent upon on the seller recognition that consolidation ultimately is going to happen.

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

Thanks for your time.

Operator

Robert Sedran, CIBC.

Robert Sedran ***- CIBC - Analyst***

Just a couple quick follow-ups, actually. Bill, just following on that last answer, given the excess capital that is kicking around, just philosophically, should we assume that anything aside from a transformational deal is likely to be done with cash, and regardless of whether you might fall below the Basel III requirements in the interim?

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

We try not to get too philosophical. We've tried to provide you with a pretty clear disclosure, and I don't want to ruminate on anything in that regard, other than to say that we have stated that we are committed to maintaining strong capital ratios and we've delivered against that.

Robert Sedran ***- CIBC - Analyst***

Okay, and I apologize if I missed it, but is the payout ratio target still 45% to 55%?

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

We haven't changed it.

Robert Sedran ***- CIBC - Analyst***

Are you comfortable with that level, Bill, or is it just a question of you're above the range now, so you will revisit it when you get closer to the range?

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

I'm not uncomfortable, but I think as the earnings continue to grow, we will come back within the range and obviously consider it. I think it is premature right now.

Robert Sedran *- CIBC - Analyst*

Okay. Thank you.

Operator

Mario Mendonca, Canaccord Genuity.

Mario Mendonca *- Canaccord Genuity - Analyst*

Two quick questions. Bill, on several of these calls in the past, you've talked about what it might take to get corporate lending growing again, or business loans. This is the first quarter since Q1 2009 that we actually saw a sequential increase. Is there anything we can read into that?

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

I think it's going to pick up. It is not showing up clearly in the economic numbers. But if you are out talking to mid-market companies, what I am detecting is a little bit of strain that is starting to set in from too many hours of overtime, trying to operate with too little inventory, and some confirmation that they are seeing growth. And that I would speak specifically to the US market, where I think we are going to see a pickup in exports, and export demand is going to provide some confidence to the market. And I think that will be beneficial to both Canada and the United States.

Mario Mendonca *- Canaccord Genuity - Analyst*

Where was the growth in business loans this quarter? Was it in the US? Where did we see it? Because it is hard to tell from the supplemental disclosure.

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

I'll let Frank speak to it, because what we saw mostly in the quarter I think relates to P&C Canada.

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

Mario, our total commercial loans and acceptances in the P&C business, in Q4, our growth was 6.9%, which was the highest in practically two years.

Mario Mendonca *- Canaccord Genuity - Analyst*

Sorry, that's quarter-over-quarter, Frank?

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

No, that's year-over-year. Quarter-over-quarter, we went from, this isn't what you're looking for, but we went from a 4.4% growth in Q3 to 6.9% growth in Q4. So our growth actually went up 2.5 points sequentially.

Mario Mendonca *- Canaccord Genuity - Analyst*

Got it. And Bill, nothing in the US you would point me to in terms of business loan growth this quarter?

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

I'll let Ellen speak to actual loan growth in the US.

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

Mario, just to complement what Frank and Bill said, I would say at this point, we are not seeing specific loan growth. Still a lot of cash on the balance sheets. The strain Bill mentioned is definitely there. People are feeling more secure.

A lot of the new business we are bringing in are customers that want to be ready to draw down and do things, but haven't yet made that call. So we think we will start to see more demand as you head towards the latter half of the year, as some of the cash gets spent on this new investment and there is more confidence building.

Mario Mendonca *- Canaccord Genuity - Analyst*

Thanks. One final thing. Bill, the ROE, 17% to 20%, the top end, comparing that to what you put up this quarter, 15.3%, that is a long way to go. And even if you look, frankly, at the bottom end.

Until you go through the IFRS adjustment, the $1.3 billion hit to the capital adjustment to open and retained earnings, I can see how that would help the ROE somewhat. But why have such a lofty ROE target out there, particularly if you are not talking about being a little more aggressive on capital management, like buybacks?

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

Well, I think the calculation that we've made around capital, as Tom Flynn said, has been conservative with respect to steps that we might be able to take to reduce the impact going through.

I continue to believe that margins are going to hold up. I think that alternatives to bank financing, when you have an economic growth, are going to be a missing element in capital formation in North America. So I think a pickup of bank lending in the commercial sector without an erosion of margin is quite possible. So I think the combination of those two factors means to me that I think the market is a little bit pessimistic about what kind of returns can be achieved over the next couple of years.

And I also think that the strength that we are seeing in the wealth management area, the integration of wealth management product more and more into our retail offering, both in Canada and the United States, means that we are going to be able to start to earn a higher proportion of our earnings from those higher ROE businesses.

So I think there is some complementary mix. As I said, I'm a little bit more optimistic about spreads and growth in the commercial business. And I think you will recall that we put a stepped-up emphasis on commercial banking in the Midwest, where we haven't seen very much growth for the last number of years; we are putting resources in there, and the ROE of those businesses, I think, will be quite good.

As I said in my opening comments, the last two or three years we have had headwinds from provisions and impaired loans. And I think they are abating and you will see them come down over the course of the three years, and I would work that into my expectation of returns as well.

Mario Mendonca ***- Canaccord Genuity - Analyst***

If I could just follow up for one second. You referred to Tom Flynn's calculations and how they are fairly conservative. The only way those conservative calculations can manifest themselves in an improved ROE is if you actually use that excess capital and buy back stock.

So I think that is what I'm struggling with -- trying to reconcile your comments about capital management and not necessarily buying back stock with the 17% to 20% ROE, the math doesn't quite work, unless you actually do something on the capital front. Particularly if the 12% earnings growth estimate is what you are sticking by.

Do you sort of follow where I'm going with this, that the math doesn't work?

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

I understand your anxiety. I would go back to my comment with respect to loan loss provisions and the cost of impaired loans coming down, because I think that does have an impact. And I do think that as you deploy retained earnings and deploy the capital more efficiently that we currently have on our balance sheet, we are going to have higher earnings on the same capital base.

Mario Mendonca ***- Canaccord Genuity - Analyst***

Sorry, the final thing then is how long would it take, do you figure, to get to the 17%?

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

Well, those are medium-term targets, so I said my view of medium term is over the next three years, so I think that is a reasonable timeframe.

Mario Mendonca ***- Canaccord Genuity - Analyst***

That's helpful. Thanks, Bill.

Operator

Brad Smith, Stonecap Securities.

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

Thanks very much. I had a couple questions about credit. In the commentary, you were sounding quite optimistic about the outlook for credit. And I believe that was reflected in your guidance going forward.

The numbers from the quarter, though, sort of tell me a little bit of a different story. I was wondering if you could provide some clarity. Specifically, I was looking at the jump in consolidated formations, which almost doubled to $461 million, and are now at a level that was only surpassed by Q4 2009.

I was also thinking in terms of the outlook for credit, but your decision to accelerate your PCLs in the fourth quarter and hold your allowance levels steady. And then finally, I was wondering if I could get somebody to provide a little bit of colour on the impaired loans at the end of the quarter in the domestic portfolios, which are up 7%, probably one of the bigger jumps I've seen.

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

Okay, Brad. I think all those questions were directed at Tom Flynn.

Tom Flynn ***- BMO Financial Group - EVP and Chief Risk Officer***

You had a lot of questions there, so I will try to tackle them. I guess on the outlook comment, we tried to be more measured than optimistic, and we talked about an expectation over the first half of next year of provisions being in line, give or take, with what we've seen over the last couple of quarters. And over the last couple of quarters, we've averaged about $235 million.

We've said that there will be variability quarter to quarter. We wish that we had a smooth curve to look at, but the reality is you get some variability. So I would suggest you average the last couple of quarters to think about where we are at now, because Q3 was unusually low and Q4 popped up. And we think we are going to be around that territory for the next few quarters. And then, with luck, if the economy improves as people expect and unemployment starts to come down, we would hope for some improvement in the latter part of the year.

On formations, same kind of a story, the formation number in Q3 was 242, which was materially lower than any number that we saw this year. And the number in Q4 was 461, which was the highest in the year, but basically equal with Q1. If you average those numbers out, you are at about 350, and we think we will be running, give or take, around that level for the first part of next year.

So overall, we are seeing stability and improvement in places. And the provisions came down more rapidly this year than we expected, which we've said to you before. We think we are going to run around the current level for a few more quarters and then hopefully we will have another leg down as things improve.

In terms of the Canadian formation number, it was up in the quarter. I don't think it is reflective of any broad-based weakness in the portfolios, either on the commercial side or the consumer side. We happen to have had a couple of larger commercial accounts that went impaired in the quarter, and so that resulted in the number going up. But it doesn't feel like there is a fundamental shift underway. It is more just a case of what I would refer to as variability around a trend.

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

Okay. Thank you very much. And just within terms of the consolidated formations, can you give us some sense of a split between consumer and commercial on the 461?

Tom Flynn *- BMO Financial Group - EVP and Chief Risk Officer*

I can. You will have to work with me for a minute, but the Canadian formation number was $172 million, and of that, 13% is consumer. The US formation number was $289 million, and of that, about 5% was consumer.

Brad Smith *- Stonecap Securities - Analyst*

Terrific. Thanks so much.

Operator

Thank you.

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

Thank you very much. Before we close, I want to turn the call over to our business heads and ask them to say a few words about the outlook for their respective businesses in 2011. And I'm going to start with Tom Milroy and then we will hear from Gilles Ouellette, Ellen Costello and Frank Techar. Over to you, Tom.

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

Thanks, Bill. Obviously, we were pleased with the quarter and the overall year met with our expectations. As we look forward, we believe we are well-positioned for a number of reasons. We are already seeing improved credit conditions and expect a reduced level of provision for loan losses over the medium term.

As the economy improves, there is lots for corporate America and Canada to do. And as Bill said, we're expecting a pickup in exports. This shift will be very positive for all of our businesses. We expect to see our clients pursuing transactions, capital investments, M&A, et cetera.

Our trading products businesses we believe are well-positioned to take advantage of the opportunities as market conditions continue to improve. Obviously, trading revenue is highly dependent on market conditions, but assuming we have a similar market to what we had in 2010, we would expect to see trading revenues in a similar range, with quarterly variability.

You've probably noticed we made a significant investment in our U.S. business, both in people and in our distribution capability. And while we are going to continue to invest in it in 2011, we would expect to see our U.S. operations deliver a meaningful increase in our results, bolstered by, we believe, an improving economy.

And we have strong pipelines on both sides of the border. So overall, for the Capital Markets business, based on our view of the macro factors, you would expect growth across all of our businesses in line with the overall economy, and in particular, better growth from our U.S. operations.

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

Great. Thanks very much, Tom.

Gilles Ouellette *- BMO Financial Group - President & CEO , PCG*

All our businesses are performing well, and they've been improving as the year has gone on, and we're growing market share in all of these businesses.

The wealth businesses are dependent on five things. The first one is growth in new assets. And this year, we grew our assets by 13%, and we've got a great momentum leading to 2011. It is also dependent on levels of equity markets, since about half of our business is fee-based, and we're expecting markets to keep on improving next year.

And also, we're dependent on transaction volumes, particularly in InvestorLine and in Nesbitt Burns PCD. And transaction volume is depended on the levels of markets. As we see levels improving, we expect transaction volumes to improve also.

We are also very dependent on interest rates, and although we don't expect rates to move up in the early part of the year, we do expect them to move up later on. That should improve our spread revenues.

And finally, we are dependent on sales in our insurance businesses, and they are both showing good growth. So we are pretty optimistic about going into 2011.

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

Thanks, Gilles. Ellen.

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

Thanks, Bill. I had two important highlights I wanted to touch on from 2010, and Bill already spoke to our AMCORE acquisition and how successful it has been. We added 34 branches, which, as Bill correctly said, is about 10% to our network in two really important markets.

We also have had great client retention and we're growing the base from there, which is something Bill also touched on.

On the synergy side, we closed 18 branches that overlapped with our Chicago network. And as a result of the synergies were able to reduce FTE by about 50%, and expenses in line with that.

I just want to mention, too, that we talked a little bit about tuck-in acquisitions. Since 2006, we've added a third to our branch network of 109 branches. So these tuck-ins do add up and add up to something more significant. We are now at 312 branches.

Second point I wanted to mention is, as you all know, that we began talking about moving some of our commercial customers from Capital Markets to P&C earlier this year, and we completed that in the second half of the year. These customers are primarily focused on lending and cash management, and might have the occasional Capital Markets need. So we make sure they are well-served there. We see this as a real opportunity for us to take advantage of the market opportunity to accelerate growth, with what we see as being a business-led recovery.

We've significantly expanded our professional calling group, our capabilities in industry sectors and our client-facing professionals. The Group is fully integrated and out calling in the market and has good pipelines already.

And also, we've improved our visibility in the markets through an advertising campaign in the Midwest markets in which we compete.

When I look ahead to 2011, as I talked about, commercial, we really expect to contribute strongly to our results in 2011. We already have robust pipelines in all the segments, and we have particular momentum in the corporate finance, particularly asset-based lending, our diversified segment and our dealer finance business.

And we do expect a business-led recovery, as we touched on. Bill made some comments earlier. But we do think it could be a little muted in the first half of the year as we do set up facilities for customers and then see utilization later on in 2011.

A big focus for us will be growing share of our market and acquiring new customers.

In personal, our focus is on acquiring profitable customers and cross-selling into our existing customer base. We are adding an enhanced online capability next summer. And in light of Reg E, we will be launching new customer offers. We actually have a couple in the market right now, with Helpful Steps, which is a takeoff of what was done in Canada earlier. And also, Bulls and Blackhawks debit card, which is going extremely well, bringing in new customers to Harris.

From a housing outlook, we think low home prices will probably dampen demand from home equity loans, but low interest rates and rising employment should increase demand for residential mortgages, especially from new homebuyers, and we will be very focused on that next year.

We also think that consumer spending will increase at a measured pace in 2011 as confidence returns. Our mortgage pipeline is at the highest level it has been since May 2009, and our indirect auto business is performing very well.

In summary, while the environment is expected to continue to be somewhat challenging, particularly in the first half of 2011, we think we are in a great position in the market, very differentiated. We are able to support long-term profitable growth with the focus that we have. We're very much focused on our customers, new customer acquisition and are backing that up with offers. We're investing in our business. I mentioned the online investment, a very important one for many of our customers. And we've been adding talent and capabilities to our team throughout this period, as well as managing expenses aggressively. Over to you, Frank.

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

Thanks, Ellen. Over to you, Frank.

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

Okay. Thanks, Bill. I think I touched on a couple of these messages earlier in responding to the questions, but I will just reinforce a couple of them. We have come off a very strong year with 10.3% revenue growth. And as Bill mentioned earlier, using actual losses, net income growth of 22.5% for the year, which stacks up pretty well relative to the competition.

It is fair to say that we have a lot of confidence in the path that we are on right now, and there is no doubt we have made up some ground on the competition over the past two years. We've seen broad-based growth across all of our segments and geographies, and maybe most importantly, our customer loyalty scores in both the consumer segment and the commercial segment continue to improve.

Having said that, as we look forward, the areas of growth for us will change a bit. I mentioned this earlier, a little softening of the growth on the consumer side, offset, I believe, by stronger growth on the commercial side of our business. And we are well-positioned in commercial, with strong capabilities, momentum in our balance sheet growth and revenue growth at this point in time to take advantage of it.

We are going to continue to invest in our business, in our strategic agenda over the next 12 months, in particular focusing on improving our distribution capabilities, continuing our branch investments, investing in our specialized sales forces and investing in our telephone banking capabilities through our state-of-the-art contact center, which we've built here in Toronto.

We are going to invest in our online capabilities in 2011, and commercial is going to be a big focus, as I've already mentioned. So expectations are we can keep it up, we have a lot of confidence in our business, we have an objective, and that is to perform well relative to the competition, and whatever the environment throws at us in 2011, we think we are going to be successful.

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

Great. Thanks very much, Frank. Well, let me recap my comments with respect to medium-term financial performance. Over time for EPS, we are looking at average annual growth of 12%, which is an increase from previous objective of 10%. Cash operating leverage of at least 1.5%, down from 2%, reflecting the increased investment spend we've been discussing. An ROE range objective from 17% to 20%, and maintaining strong capital ratios.

In sum, we are very confident in the path we are on and in our ability to grow. 2010 was a year of strong operating performance and the results speak for themselves. We are pleased with the performance of our businesses and, at the same time, this management team and our 38,000 employees understand there is much more to be done.

Thanks again for joining us today. We look forward to reporting to you after the first quarter, and good afternoon, everyone.