FINAL TRANSCRIPT

Canadian Western Bank

First Quarter 2013 Financial Results

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PRESENTATION

Operator

Good afternoon. My name is Sara (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Canadian Western Bank First Quarter 2013 Financial Results Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, please press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key.

I would now like to turn the call over to Tracey Ball, Executive Vice President and Chief Financial Officer. You may begin.

Tracey Ball — Executive Vice President and Chief Financial Officer, Canadian Western Bank

Okay. Thank you, Sara, and good morning or good afternoon, depending on what time zone you're in, and welcome to our 2013 first quarter results conference call for Canadian Western Bank.

Before we begin, please note that the conference call graphs, quarterly results news release, and supplemental financial information are available on our website at cwb.com in the Investor Relations section. I also draw your attention to our advisory on Slide 11 about any forward-looking statements that we may say.

The agenda for today's call is on Slide 2. Joining me today is our outgoing and long-serving CEO, Larry Pollock; and our incoming President and CEO, Chris Fowler, who will be officially transitioning to his new role later this afternoon following our Annual and Special Meeting of Shareholders. Also in attendance are Executive Vice Presidents Randy Garvey, Brian Young, and we are also very pleased on this call to introduce Greg Sprung.

Greg recently accepted an expanded leadership role under the new position of Executive Vice President, Banking, and will now be responsible for CWB's branch operations across Western Canada. He previously served as Senior Vice President responsible for our branch operations in British Columbia.

For today's call I will provide a brief summary of our first quarter financial highlights and fiscal 2013 performance targets. I'll then turn things over to Larry, who will have a few comments prior to an overview by Chris of our longer-term outlook strategy.

Moving to Slide 3. The Bank reported strong first quarter performance highlighted by solid earnings and the achievement of our 99th consecutive profitable quarter, a period of almost 25 years. Loan growth, 2 percent in the quarter and 12 percent over the past 12 months, led to total assets surpassing 17 billion. Loan growth reflected good performance across almost all lending sectors. However, the net number for the quarter was partially offset by expected payouts and the sale of a $28 million portfolio of insured residential mortgages.

This quarter marks the Canadian implementation of the Basel III capital framework. Based on the standardized approach for calculating risk-weighted assets, the Bank's all-in Basel III ratios were 8 percent CET1, 9.7 percent Tier 1, and 14.2 percent total capital, all well above the established regulatory minimums for Canadian banks and within our target thresholds.

We were very pleased with the success of our subordinated debt issue in December, which was significantly oversubscribed and well-priced. The issue further bolstered our total capital ratio by allowing us to take advantage of a transition allowance applicable for non-NVCC capital instruments issued before January 1st.

Moving to the next slide. Net income available to common shareholders of 45.5 million was up 10 percent over the same quarter last year, while diluted earnings per share increased 6 percent to reach $0.57. Adjusted cash earnings per share, which excludes the non-tax deductible change in the fair value of contingent consideration and the amortization of intangible assets, increased 2 percent to $0.58.

Total revenues of 137.1 million represented a 9 percent increase over the same period last year as the positive influence, the strong 12 percent loan growth more than offset the impact of an 11 basis point reduction in net interest margin.

Other income of 22.4 million was up 3.6 million compared to a year earlier, mainly reflecting the elimination of contingent consideration fair value changes, and a $1 million contribution from the sale of an insured residential mortgage portfolio. Net insurance revenues increase 0.8 million, and gains on security sales were 0.7 million higher. Based on current market expectations and the composition of the securities portfolio, we believe net gains on security sales will continue to provide a source of revenues for the remainder of the year. However, they will likely be lower than the level achieved this quarter.

Compared to the previous quarter, net income available to common shareholders grew 6 percent as the combined benefit of growth in other income, 2 percent quarterly loan growth, and stable non-interest expenses was partially offset by the impact of a 5 basis point reduction in net interest margin that was largely the result of higher average liquidity. Adjusted cash earnings per common share increased 4 percent from last quarter.

Overall credit quality remains satisfactory, and the dollar provision for credit losses represented 18 basis points of average loans compared to 17 basis points in the previous quarter and 20 basis points a year earlier. This period marked the 11th consecutive quarter of reduced gross impaired loans.

Yesterday, our Board declared a quarterly cash dividend of $0.17 per common share, unchanged from the previous quarter and 13 percent higher than the quarterly dividend declared one year ago. The Board also declared a quarterly dividend on our preferred shares.

Slide 5 shows year-to-date results compared to our fiscal 2013 targets. As shown, our performance early in the year has us well positioned in relation to all of these objectives.

The volume in the pipeline for new loans is encouraging, and we remain confident about our ability to achieve another year of double-digit loan growth. Based on our current positive view of overall credit quality, the annual provision for credit losses should remain at the low end of our target range of 18 to 23 basis points on average loans.

While the compressed net interest margin has a moderating impact on total revenue growth, after adjusting for the liquidity and funding cost impact of our sub debt issue, we were pleased to see some stabilization in this measure this quarter.

The efficiency ratio of 45.3 percent was favourable compared to our target of 46 percent or less, and we believe it should remain at or better than our target for the year as we continue to manage expense growth in consideration of the strained revenues owing to the margin pressure.

The next slide, which is Slide 6, shows the historical trend of net interest margin, the spread on loans, and the prime lending interest rate. First quarter net interest margin, up 2.66 percent, represented an 11 basis point decline from the same period last year with the difference largely reflecting reduced loan yields, partially offset by lower deposit costs. Net interest margin was down 5 basis points from the previous quarter, mainly reflecting the impact of higher average liquidity and an increase in funding costs from the sub debt issue.

The financial impact of the quarter of slightly lower yields on loans was mostly offset by improved deposit costs, which is shown on this slide by the relatively smaller change in the spread of loans. While lower average liquidity is expected to help offset margin pressure in the future quarters, this key measure will continue to be constrained by variable interest rates, a relatively flat interest rate curve, and ongoing competitive factors. Of course any increases in interest rates or a relative steepening of the yield curve would have a positive impact on margins.

Before I turn it over to Larry, I'd just like to comment briefly on the decision we announced last night not to proceed with the proposed amendment to By-law Three, as described in our management proxy circular. This decision reflects our view that we did not clearly explain the intent and benefits of the resolution to our shareholders, including the fact that any preferred shares issued under the Basel III regulatory capital framework are required to be converted to common shares in the circumstances of non-liability. We will better explain the benefits of this resolution, and will reintroduce the amendment to By-law Three at a future date.

I'll now turn things over to Larry for a few comments before we hear from Chris.

Larry Pollock — President and Chief Executive Officer, Western Canadian Bank

Thanks, Tracey. I'll be stepping down after the AGM this afternoon here in Edmonton. It'll be my 24th Annual General Meeting with the Bank.

I'd just like to add that the Bank is a great organization, and I think we've been able to convince many believers over the years. We have a very unique and proven business model, we have a very strong, experienced management team, and we are presently in our 100th profitable consecutive quarter, and that's a quarter of a century, which is an awfully long time.

Our worst year for growth in the last 20-some odd years was 9 percent asset growth, and that was in 2009 when many banks were experiencing declining assets. We have achieved our goals, but we have enormous opportunities going forward.

I would like to take this opportunity now to thank all of the analysts and reporters. Many of you are on this call and have been for many years. You have followed our progress and come to believe in us. We have a great growth story and it will continue. You have been fair and come to believe we can grow a new bank in Canada; I think the only one of size and scale in the last 150 years.

Chris is a tremendous leader, a real class individual who has the drive and enthusiasm to take us to new levels of success. So thank you and farewell to all of you.

I'll now turn it over to Chris.

Chris Fowler — Executive Vice President, Canadian Western Bank

Thanks very much, Larry. This is of course a very big day for the CWB group, for Larry, as you've heard, and for me.

It's truly an honour to be given this tremendous opportunity to lead CWB group's team as we continue to grow our businesses and develop our collective franchise and brands. As Larry mentioned, I'm going to spend a few minutes on our current business outlook in the context of some key financial metrics, then I'll move on to a more general discussion of our longer-term strategy and vision.

Slide 8 shows our level of net loan growth over the past four years going back to the onset of the global financial crisis, and recognizing the benefit of our acquisition of National Leasing in the second quarter of 2010. As shown, our net loan growth this quarter compared to the same quarter last year was about $100 million lower. However, the current period included significant loan payouts that were largely related to the completion of real estate project loans.

Excluding the impact of expected paydowns owing to the successful conclusion of these products, most of which commenced in early 2010, the level of gross fundings this quarter were actually higher than the same quarter last year.

Looking at our current pipeline for new loans, we remain optimistic about our 2013 minimum loan growth target, and expect the largest growth contributions going forward will come from our focus on commercial loans and equipment financing and leasing. As we stated in previous quarters and due to a number of unrelated factors, we expect a relatively slower level of growth in new real estate project loans, commercial loans, and oil and gas production loans.

Turning to Slide 9. The dollar level of gross impaired loans declined for an 11th consecutive quarter to $56 million or just 39 basis points of total loans outstanding. Normal experience over the course of credit cycles supports our view that gross impaired loans will likely fluctuate above the current very low loan level, but overall credit quality is expected to remain strong. This view is supported by our secured lending practices and disciplined underwriting, as well as positive, yet cautious economic outlook for our key markets.

On Slide 10, earlier in the call Tracey highlighted our results in relation to our current performance objectives. I'd like to expand on that discussion and talk further about our long-term strategic objectives and outlook.

For any organization to be successful a lot of things have to happen. Coordinating these actions, of course, the primary challenge—is a primary challenge and the starting point is tone at the top. Larry has been a master at creating an environment for all of us at CWB group to stretch goals, know what businesses we're in or could be in, and to achieve enviable results to say the least.

Looking at the last 20 years or so of CWB's history tells us an interesting story. We spent the first 10 years of that period building a commercially focused full-service bank primarily funded by stable insured deposits. We spent the past 10 years building on that platform and adding complementary businesses. Today, our prevailing objective is to grow CWB's franchise into a strategic resource for Western Canada and within our other chosen markets.

The future has lots of opportunity as we continue to integrate our complementary businesses to solidify and grow our client base, increase our revenues by client, expand and diversify our deposit base, and grow both organically and through acquisition. Our group goals and objectives, which ultimately cascade down to specific tactics and day-to-day activities, are focused on four important shareholder groups—stakeholder groups: our employees, clients, communities, and our shareholders.

To make our employees successful we need to ensure they have the knowledge, tools, and types of products and services that add meaningful value to our clients. Last September I made a pledge to our employees that I would visit all branches, departments, and affiliated companies to speak with and listen to them directly.

During these staff meetings we talked about the future and what we can do to surpass our goals and overcome challenges. I've also received excellent feedback on what we as a management team can do better to support them, and we're currently taking action on many of these suggestions.

Building our strong—building strong business relationships is the foundation of our vision to be crucial to our clients' future, and in certain ways we are building on and changing our organizational structure to achieve this. We are enhancing both our capacity and ability to help more clients more effectively by making meaningful strategic investments in training, technology, and infrastructure.

We know it's crucial that we fulfill our clients' requirements while sharing their sense of urgency, and we also know that we need to do a better job of communicating our full range of financial solutions. A strong community presence will continue to be a meaningful focus for our company.

At the end of the day, our formula for being crucial to our clients and becoming a strategic resource in our markets is based on the premise that supporting our employees, providing the right financial solutions for clients, and maintaining a strong community presence is what ultimately leads to financial success and creates value for shareholders.

Our future financial objectives are to continue delivering strong asset quality, industry-leading growth, and increasing returns for our shareholders through both capital appreciation and dividends. We are confident in our ability to do so, although of course the future is not without its challenges.

Growth in the global economy remains constrained for a number of reasons, including ongoing uncertainty in Europe. The US has its own set of issues, but their core economic numbers are improving, and that's good for Canada. The activity in Asian markets has also become very important for our economy, and significantly contributes to our country's economic growth and stability.

Within Canada, recent economic growth has been slow, but positive. Part of the slowdown reflects the reality of higher consumer debt levels. Changes to the CHMC mortgage guidelines are also affecting the housing market, and we're definitely seeing slower real estate markets in certain areas, particularly in Vancouver and Toronto.

In spite of these persistent challenges we have a very positive view of the future, particularly over the longer term. Immigration is positive in Canada, and the West in particular remains an attractive place to live and conduct business. The four western provinces have led in economic growth in recent years, and we believe this will continue. Our Western Canadian base is a competitive strength, and as I mentioned, we remain optimistic about our pipeline for new business.

Margin challenges related to the low interest rate environment are expected to persist. However, we have faced similar challenges in the past, and will continue to be proactive in our efforts to mitigate the impacts of circumstances that are outside of our control.

As Tracey discussed earlier, we're on track through the first quarter in relation to all of our performance targets, and we're now looking forward to reporting and celebrating our 100th straight profitable quarter in June of this year.

Overall we're very positive about our ability to continue to produce the consistent results and growth that our stakeholders have come to expect.

Thank you all very much for your time, and I will now turn things back over to Tracey.

Tracey Ball

Okay. Thank you, Chris and Larry. This does conclude our formal presentation for today's call. At this time, I'll ask Sara to begin the question-and-answer period.

Q&A

Operator

At this time, I would like to remind everyone in order to ask a question, please press *, then the number 1 on your telephone keypad.

Your first question comes from the line of Scott Chan from Canaccord Genuity. Your line is open.

Scott Chan — Canaccord Genuity

Good afternoon. My first question is maybe for Tracey. Assets were up 3 percent quarter over quarter, but risk-weighted assets were up over 8 percent quarter over quarter. Can you just explain the dynamic there?

Tracey Ball

Actually I'm not sure I can right off the top of my head. I'll have to get back to you with that, Scott.

Scott Chan

Okay. And I guess like most of the banks showed an improvement of the pro forma CET1 ratio. Yours was down 1 bp quarter over quarter, but I'm assuming it's mostly because of the risk-weighted assets I guess, right? Or am I missing something?

Tracey Ball

Yeah. Just a comment too. Because we switched to Basel III, your risk-weighted assets do go up compared to Basel II.

Scott Chan

Okay.

Tracey Ball

Yeah. So that's probably what you're seeing.

Scott Chan

Okay. Okay. That makes sense. And maybe for Chris, I maybe missed your opening remarks, but you were talking about the loan growth and if you exclude—were you talking about higher pre-payments on the real estate portfolio this quarter?

Chris Fowler

Yes. We actually—our loan volumes in Q1 2013 were over $100 million greater than our loan volumes in the similar quarter in fiscal 2012, and that's really due to the maturity of a number of interim construction loans that had commenced in 2010. And that was just a normal maturity. The loans performed as they should, and they paid out on time.

Scott Chan

Okay. And just lastly, just I've noticed the salaries have crept up, and you've—it looks like you hired 40 people last quarter and 60 people the quarter before, and you increased your workforce by 6 percent. Is that due to the one new branch opening? Or are you been investing in other particular segments in the past few quarters?

Tracey Ball

Scott, there's a couple things going on there. One is we do have our annual salary increase that happens on the 1st of November every year. But we're also—have embarked on our major program to convert to a new banking system, which will take the next two years, and so we have been building people for that program. The costs associated with those, however, are capitalized. So you'll see the FTE go up, but it won't necessarily show up in salaries. It will show up in the cost of the system as we go forward.

Scott Chan

Okay. Thanks for that.

Operator

Your next question comes from the line of Gabriel Dechaine from Credit Suisse. Your line is open.

Gabriel Dechaine — Credit Suisse

Good morning. My first question would be for—actually before I forget, Larry, good luck in the future in retirement. It's been a pleasure dealing with you over these last few years. So back to business here, Chris, on the loan growth you talk about a good pipeline. I'm just looking at the quarter-over-quarter change in loans, and it was about $350 million, and 60 percent, over 60 percent of that growth came from real estate project loans and commercial mortgages, and those are two categories you said are slowing down. I'm just wondering what do you expect to shift over the next few quarters to keep you onside with that 10 percent or double-digit loan growth guidance.

Chris Fowler

Well, we expect our growth in this year to be actually very similar to our fiscal 2012 growth. So in fiscal 2012, our two fastest growing portfolios were commercial lending and equipment finance. So we would anticipate those based on the pipeline to be the fastest growing through the balance of this year.

Gabriel Dechaine

Is there like a seasonal trend that those weren't as growthy this quarter? Or...

Chris Fowler

No. It's not seasonal. It's just—it's timing.

Gabriel Dechaine

Okay.

Chris Fowler

I mean they get in the pipeline, and it takes time to generate the relationship and book the clients.

Gabriel Dechaine

Next one is on the margins. You talk—I get the whole liquidity, excess liquidity this quarter that exaggerated the contraction. So on a go-forward basis as this excess liquidity gets put into loans and stuff, what are we talking about here, 1 or 2 basis points of compression a quarter? Or...

Tracey Ball

We estimate it at about 3 basis points during the quarter, but of course there's so many moving parts it's really hard to know what the impact will be as we go forward. But that'd be 2, 3, somewhere in there.

Gabriel Dechaine

Okay. Now what's the—what has been the influence of competition? Because I notice your loan growth for, I haven't tracked this as closely I have to admit, but it's actually a bit slower than the commercial growth we've seen from some of the other banks. Are they just pricing stuff at rates that you don't find attractive and you're pulling back because of that or different markets, something like that? I'm just trying to understand what the competitive pressures—how bad they are.

Chris Fowler

Well, the competitive pressure is primarily in the commercial mortgage market.

Gabriel Dechaine

Okay.

Chris Fowler

And that is a pricing issue. And really when we look at the other banks in terms of them becoming more active in the commercial lending area, that's the easiest part for them to be active in...

Gabriel Dechaine

Okay.

Chris Fowler

Rather than say just general commercial banking. Commercial mortgages are very competitive and not just the banks, but the credit unions and the lifecos and pension funds are also in that market, and that's where the pricing pressure does occur.

Gabriel Dechaine

Okay. Lastly, just a couple of quick ones on the mortgages; can you explain what happened and was there a, Tracey, was there a reclass between personal loans and commercial? Looks like the way in Note 5 of the financials there was a bit of a shift out; personal loans went down versus last quarter, construction went up, if you can shed some light on that? And then you also talk about other than equipment leasing, alternative mortgages as an area for growth that will generate some NII for you. Could you give some broad strokes around what's improved in the marketplace, what you're doing to manage risk in the kind of environment we're in right now, and is it still predominantly an Ontario book?

Tracey Ball

Well, just we did do some reclassification on our balance sheet, so you're correct, and we previously included some residential mortgages in larger real estate deals, but we did reclass those. So that's—it's just a reclass issue.

Gabriel Dechaine

How does that work anyway? Like…

Tracey Ball

What I'll do, Gabriel, is I'll get back to you on that.

Gabriel Dechaine

Okay.

Tracey Ball

I don't have it in front of me.

Gabriel Dechaine

Okay.

Chris Fowler

On the Alt-A side, we do see opportunities for growth there. We've had a couple of the larger bank competitors not participate in there. We've got—our policy is adjusted for the new B2 rules—B20 rules, sorry, and we've seen some good growth on the Alt-A side. That book is predominantly Western Canada.

Gabriel Dechaine

Sorry.

Chris Fowler

And about 25 percent of it in Ontario, and certainly that's our Optimum mortgage group.

Gabriel Dechaine

Thank you.

Operator

Your next question comes from the line of Michael Goldberg from Desjardins Securities. Your line is open.

Michael Goldberg — Desjardins Securities

Before my questions, Larry, I also—I'm sure I speak for the analysts who followed Canadian Western, so I just want to congratulate you on your achievements in growing the organization over time, and good wishes for the future as you step down. So just turning to the net interest margin; I guess for half a quarter roughly you had this debenture issue outstanding were you're paying over 3 percent on it. And presumably you would have used more term deposits for funding if you hadn't done the debt issue. How much would that have increased your net interest margin? In other words, what do you figure it cost you in net interest margin to do the debenture issue?

Tracey Ball

Well, again, there's a lot of moving parts there, but I would say it's about 2 basis points.

Michael Goldberg

Okay. And also just turning to a different topic, can you discuss the game plan and progress in Canadian Direct Financial given Scotia's acquisition of ING and Royal's acquisition of ING and Royal's acquisition and run-off of ResMore and Ally?

Chris Fowler

Canadian Direct Financial we see as a great opportunity, so we started that in 2008, and we've targeted the advertising for that group mostly in Ontario. What we're looking for that group is to ramp up how we will approach the market, and we do see a market opportunity. We've had about a 35 percent increase in volume since October 31st, and it's an area we see as a great opportunity.

Michael Goldberg

What kind of margin—so if you're paying 1.9 percent in your (unintelligible), what do you invest that in notionally?

Chris Fowler

Well, it goes into our general funding on our loan portfolio. We've got—you can—as we look at the different matching of our book, we've got—the highest yielding portfolio we have is our equipment finance group that includes National Leasing. And that's in excess of 6 percent gross yield. So we've got lots of areas that we can deploy the deposits in.

Michael Goldberg

Thank you.

Operator

Your next question comes from the line of John Reucassel from BMO Capital Markets. Your line is open.

John Reucassel — BMO Capital Markets

Thank you. Just for you, Chris, I just wanted to understand, the paydowns that you experienced were mainly on the real estate project loans?

Chris Fowler

Yes. That was part of it. The other side we had a lot of paybacks in our oil and gas.

John Reucassel

Oil and gas. Okay. And those are hard to predict, is that right? Particularly in the oil and gas that could happen? Or do you have a good insight into how that's going to be paid down?

Chris Fowler

No, the oil and gas, they were companies that changed their financing arrangements. They're refinanced through other syndicates. So yeah, they're not something you can slot into your pipeline to know for repayments. The inter-construction, though, we do know when those do come up.

John Reucassel

Okay. And then—because I'm just on Page 9 of your report you talked about, the last paragraph talking about the level of growth was led by the real estate project loans and in British Columbia. So I assume those two are related. So there were good originations in real estate project loans, but there was also high paydowns? Is that what I should read into that?

Chris Fowler

That's right. Yes.

John Reucassel

Okay. Okay. Thank you clarifying. And then how are you going to—I guess for the last few quarters, and that’s not necessarily too long a time, but you talked about getting deposit growth or accelerating it, and we don't see—we see some of yet, but not a lot. So what's going to change over the next year or two, Chris, that we should start to see more deposit growth?

Chris Fowler

Well, our focus at the branch end is that we, in October, we deployed a cash management bundle. So the—what we're looking there is to approach our commercial banking clients where we have transactional business and full banking, and look at really expanding what those cash management opportunities are to give them the full range of products that they could just be doing some with us and some with other banks, and we're looking to get all that business. So we see a great opportunity for growth primarily through our commercial clientele.

John Reucassel

And how long does that take do you think? Is that sales process? Is it a year or two? Or...

Chris Fowler

It would be in that range. Yeah. It's not a—you can't flick the switch. It does take time to build that. We have a lot of relationships that we've had for many, many years solely on the lending side, so they're very well established and we need to work our way through to be on the full banking side.

John Reucassel

And what about personal deposits to the branch? Is that just not on the radar at this stage? Or are there programs under place?

Chris Fowler

Oh absolutely, and that's being very stable and increasing. It's a core part of our branch deposits today.

John Reucassel

Okay. And I too would like to say, Larry, congratulations, 25 years; unbelievable track record. I don't know if you saw the Globe and Mail called you Iron Man, so those are high praise. And, Chris, I look forward to another 25 years with you. You're going to have Methuselah's length longevity, so best of luck to both of you.

Chris Fowler

Thanks, John.

Larry Pollock

Thanks, John.

Chris Fowler

Appreciate it very much.

Operator

Your next question comes from the line of Darko Mihelic from Cormark Securities. Your line is now open.

Darko Mihelic — Cormark Securities

Great. Thank you. A couple of questions on the quarter, but maybe one conceptual first for—well, for anyone who wants to take it actually. The question is with respect to liquidity management and, Tracey, thanks for the—I guess 3 basis points or 2 is sort of the cost in the quarter. But my question is if we look back say over the last nine quarters, in six of them you would have noted that liquidity would have been a big driver or a major driver of a difference in NIM. So it seems to be something that has an impact for your bank, and so what I'm trying to struggle with is why or how it's managed?

And I imagine that from a liquidity point of view you have certain parameters that you're working with, but I'm stuck a little bit on why it fluctuates so much? And even this quarter I understand you had a debt issue, but you wouldn't have been surprised by that, so can you talk a little bit about how we should view liquidity management at CWB? Is it going to change? Are we going to see this kind of volatility in the NIM simply because of the way you manage your liquidity? And a follow-on question to that would be with respect to the upcoming Basel rules and LCR. I notice in your report you mention that it's manageable, but what I'm interested in is what is the cost of going to LCR? So maybe I'll just stop there and listen to the answers.

Tracey Ball

Okay. Thanks, Darko. So just on the Basel III, we're in a really good position to handle that. We actually just finished our Board meeting presentation by our treasurer on the impact, and essentially it won't really change how we manage our liquidity. It'll just—we'll just have to measure it in different ways, and we were quite pleased with the changes that OSFI announced, that Basel announced early in January, and that was a positive impact for us in the entire industry, so that was really, really good to see. So we don't anticipate any major changes at all because of Basel III. It still is a couple of years away.

And just in terms of liquidity, I guess we do at times raise additional liquidity for large amounts of deposits that are going to pay out. Also I believe a year ago we were a little bit concerned about what was going on in Europe, and so we do raise more liquidity. We're quite—we're still painfully aware of what happened in the markets during the crisis in 2008 and '09, and so we perhaps are more conservative than other institutions, I don't know. But I know that we're conservative, and that's really some of the things you see.

And as far as the debenture issue in December, we actually hadn't planned that. We did decide to do it on fairly short notice just to push up our total capital ratio, and yet that benefitted that transition allowance that's allowed under Basel III. So I hope that's helpful.

Darko Mihelic

It is helpful. And then I just suppose as a follow-on to that question, what I'm getting from you is that, maybe I can paraphrase, is that really you're—there's no change expected in the way you manage your liquidity and investors should just get used to the fact that any given quarter it can cause your NIM to fluctuate by 3 basis points?

Tracey Ball

Yup.

Darko Mihelic

And that's not going to change any time soon. Is that fair?

Tracey Ball

Yeah. We're not changing the way we manage liquidity. So it'll still be—it'll have an impact from quarter to quarter.

Darko Mihelic

And does that impact get exacerbated as rates rise? Or does it become less as rates rise?

Tracey Ball

Liquidity doesn't really change rates going up, but the margin itself would expand quite a bit with positive interest rate moves because you'd have all your prime based loans re-pricing right away and your deposits would be a lot slower.

Darko Mihelic

What I'm speaking to specifically is the volatility of it. Does that change as rates rise?

Tracey Ball

No.

Darko Mihelic

No?

Tracey Ball

No, it doesn't. No.

Darko Mihelic

Okay. And, Larry, it's been great, a lot of fun. Congratulations and best wishes. Thanks.

Larry Pollock

Thanks, Darko.

Operator

Your next question comes from the line of Andre Hardy from RBC Capital Markets. Your line is open.

Andre Hardy — RBC Capital Markets

Thank you. A couple clarifications on other questions, so back to the margin; in the MD&A it says that margins will fluctuate around the level of the last two quarters. Maybe I heard wrong, but I thought in answer to another question, Tracey, you said that margins would go down a couple basis points a quarter?

Tracey Ball

No, that's—well, the specific question was how much—how is margin affected by increasing the cost of funding because of the sub debt issue?

Andre Hardy

Okay.

Tracey Ball

And I said it was 2 basis points.

Andre Hardy

Okay. Sorry. I misunderstood.

Tracey Ball

Yeah.

Andre Hardy

On the loan repayments as they relate to construction projects, are the next few quarters also going to be above average in terms of repayments? Or it's going to be more normal.

Chris Fowler

It's becoming more normal. We had a significant—because there had been a slowdown of activity in the real estate markets in '09 in particular, they kind of resumed activity in 2010. We had some great growth with that, and of course those projects ramped up and now we're 18 months, two years past then, and that's when these projects are completed and closing.

Andre Hardy

Okay. Thanks. So the question I had was on Alberta auto, one of your competitors took an increase in reserves related to bodily injury in Alberta. Have you taken similar action and if not, why not? Are you seeing different things from a cost insurance standpoint?

Brian Young — Executive Vice President, President and Chief Executive Officer, Canadian Direct Insurance, Canadian Western Bank

Well, it's Brian here, Andre. We look at our reserves continually, and we did see a slight uptick in the last quarter on bodily injury, but we try to reserve to ultimate right away. Our IBNR we haven't seen any reason to be lifting the amount of IBNR that we are carrying. We think that we're well reserved, but we are going to watch what takes place in the industry over the balance of the year, and we'll make our assessments as we look at it quarter by quarter. But so far it seems to be quite manageable for us.

Andre Hardy

Okay. And lastly on the IT spend, Tracey, the 50 million I presume is a cumulative cash outlay?

Tracey Ball

Yes.

Andre Hardy

Okay. Thank you.

Operator

Your next question comes from the line of Sumit Malhotra from Macquarie Capital. Your line is open.

Sumit Malhotra — Macquarie Capital

Good afternoon. My first question is on credit quality, and to start off, it looked like there was a relatively large charge-off or write-off in the quarter, something in the neighbourhood of 12 million. Can you tell me what that related to?

Chris Fowler

Yeah. We had some commercial loans that had been impaired and we resolved and did the final write-offs. It was about five or six loans and primarily in the oil and gas market.

Sumit Malhotra

And obviously this gets charged through the specific allowance and correct me if I'm wrong here, you folks have tended to look at the allowance on more of an aggregate basis and you've provisioned at a relatively stable level, and it falls where it falls in terms of the two lines. But when I look at—I was going to say if I look specifically at the specific allowance it looks to be one of the lowest levels we've seen in quite some time. So in managing your aggregate allowance, how do you look at the distinction between the specific and the collective and does it really matter to you that the specific is at a lower level now?

Chris Fowler

Well, when we set a specific, we do it on a loan-by-loan basis. We look at the loan, we do a discounted cash flow based on our realization and expectations, and set the specific. So, where we're at this quarter, which I think is about $7 million on a $59 million gross impairment, we believe that is the right number based on the information we have today.

Sumit Malhotra

And because the gross impaired loans balance, I think it's declined for something like 11 or 12 quarters now…

Chris Fowler

Yeah.

Sumit Malhotra

Is it correct to say that you cleaned up some loans this quarter, we're likely going to see charge-offs, not at this elevated pace, I don't want to put words in your mouth, but perhaps a greater proportion of the provisions are going to be allocated to the specific going forward, and as such that should start to build back up? Is that a fair characterization of what's happening here?

Tracey Ball

Sumit, it's Tracey. What you saw in the quarter, as Chris mentioned, is we settled out several loans that have been impaired, and the specific allowance would have been set up in previous quarters, so the specifics and write-offs really are the same thing. You're getting rid of your specifics because you're writing off. So that's one thing, but we are at a very, very low level, and that's why we say that we expect fluctuations to increase because we're not going to have as many loans settling out.

And just to comment too, we don't use models to set our specifics. When you look at—we do have a model that for our general, for our collective allowance that we look at it in terms of a range and not as a specific number, but because the specifics are discrete to each loan, that's what I think we do differently than maybe some other organizations that you look at.

Sumit Malhotra

So it's not—but I guess the punch line here is you're still very comfortable with the provision range you've given us. It's not something…

Yeah.

Sumit Malhotra

We should expect to move higher, just the trend build back up on the specific?

Tracey Ball

No.

Chris Fowler

No.

Tracey Ball

No.

Sumit Malhotra

All right. That's what I expected; just wanted to make sure. On the loan growth, you've referenced a few times the paydowns in the quarter, but when I look at the growth in the quarter, it's still something like even with the paydowns and even with the mortgage sale, I think it's like 2.5 percent, so you're certainly—you're annualizing to the 10. Correct me if I'm wrong, but I mean the emphasis that you're putting on the paydowns is it to suggest that perhaps the underlying loan growth that you're seeing is a lot better than the 10 percent target you've laid out?

Chris Fowler

Well, we're very comfortable with our pipeline and the loan growth prospects in our market, so we're—just looking at the reporting, we of course have rounded it down to 2 percent for our public reporting, but it's—no, we're very comfortable with our loan growth.

Sumit Malhotra

I'm a big fan of the extra decimal, Chris, so I wanted to throw that one in for you. Last one is it came up already on the salaries and the compensation line, and it did—I realize there’s been some hirings, but it did certainly look heavier than what I was expecting, and I think we're well aware that you usually have that uptick to start the new year. Tracey, it didn't sound like, though, there's anything one-time-ish in this quarter in terms of maybe it’s the start of the year, new benefits line, anything like that. Like this is a sustainable number, I think, is the takeaway that I took from your comments. Is that right?

Tracey Ball

Yes.

Sumit Malhotra

So expect it to trend at this level. Okay.

Tracey Ball

Yeah.

Sumit Malhotra

That's helpful and to the point. Thank you for your time and, Larry, thank you for your help over the years, and best of luck in the future.

Larry Pollock

Yeah. Thank you very much, Sumit.

Operator

Your next question comes from the line of Ohad Lederer from Veritas Investment. Your line is open.

Ohad Lederer — Veritas Investments

Thank you. Just wanted to get an update or maybe refresh some data points that were talked about a couple of quarters ago. On the real estate $2 billion project loan portfolio, is the percentage that's residential construction still roughly half? And within that I think a couple of quarters ago you had talked about 200 million of high-rise condo development type loans. Are those numbers still approximately correct?

Chris Fowler

Yes. They'd be approximately correct. Yeah.

Ohad Lederer

Okay. Thank you very much.

Operator

And with no further questions in queue I'll turn the call back over to the presenter for any closing remarks.

Tracey Ball

Okay. Thank you, Sara, and thank you, everybody, that was on the phone. For any of you who may be interested, our Annual and Special Meeting will be held today at 3:00 p.m. Mountain Time, and there is a webcast link available on our website.

And thank you again for your continued interest in our CWB group, and our farewell to Larry and our hello to Chris. We look forward to reporting our 2013 second quarter results conference call on June 6th.

And as usual, any follow-up questions or comments, please call us or contact us by e-mail. Thank you.

Operator

And this concludes today's conference call. You may now disconnect.

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