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CWB.TO - Q2 2018 Canadian Western Bank Earnings Call

EVENT DATE/TIME: JUNE 07, 2018 / 4:00PM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the CWB Financial Group's Second Quarter 2018 Financial Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Matt Evans, Head of Investor Relations. Please begin.

Matt Evans - *Canadian Western Bank - Senior AVP, Strategy & IR*

Thank you, Latoya. Good morning, and welcome to our second quarter call. As Latoya mentioned, my name is Matt Evans, and I lead the Investor Relations team for CWB. Presenting to you today is Chris Fowler, CWB's President and Chief Executive Officer; and Carolyn Graham, our Executive Vice President and Chief Financial Officer. Also with us today are the other members of CWB's executive committee: Kelly Blackett, Glen Eastwood, Darrell Jones, Stephen Murphy and Bogie Ozdemir.

Before we begin, please note that the conference call graphs, quarterly results, news release and supplemental financial report are available on our Investor Relations website at cwb.com. Our forward-looking statements advisory is found on Slide 14.

I'll now turn the call over to Chris.

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Thanks, Matt. The agenda for today's call is on the second slide. I'll begin with our second quarter fiscal 2018 performance highlights and comments on the continued execution of our strategy. Carolyn will follow with detail on our financial results before we move to the question-and-answer session.

Moving to Slide 3. I'm pleased to report we closed the first half of the year with a robust second quarter, and we are well positioned for a strong second half as we continue to execute our Balanced Growth strategy. At the heart of this strategy, we have maintained our clear focus on business owners, while delivering growth across a broader geographic footprint with increased industry diversification. Alongside continuous strategic execution, this morning, we reported very strong operating performance, including a 19% increase in pretax, preprovision income, 27% growth in common shareholders net income and a 23% increase in adjusted cash per share for the second quarter last year -- from the second quarter last year. We also delivered positive operating leverage, strong credit quality, with net -- our net interest margin up 7 basis points from the same quarter last year and 9 basis points from last quarter.

Turning to Slide 4. Total loans were up 12% from the second quarter last year, with organic growth accelerating to 9% from the remaining -- and the remaining 3% coming from the asset purchase on January 31. As we expected, the asset purchase was immediately accretive and contributed $0.03 to adjusted EPS this quarter, consistent with our expectation for about $0.10 of earnings contribution in fiscal 2018. Slide 4 also illustrates continued progress against our goal to build more client relationships in Central and Eastern Canada. Clearly, we've made significant progress on this front over the past 10 years, with further success this quarter. Nearly 60% of our year-over-year loan growth was originated in Ontario, including support from the portfolio acquisition. Our geographic diversification objective is further underpinned by ongoing strong performance from established businesses with a national footprint. The combination of organic and acquired growth to over 37% increase in our outstanding loans within Central and Eastern Canada, which now account for 26% of our total loan portfolio, up from 21% 1 year ago.

The second quarter represents our strongest quarter for organic loan growth since 2016, and our pipeline of new lending opportunities is strong. We continue to expect this year to resemble fiscal 2017, where loan growth picked up in the second half. While the portfolio purchase represents another step in our strategy to increase future growth opportunities across the country, I remind you before moving on that we do expect a certain amount of runoff for this portfolio to continue over the next couple of years. Our expectations for the 2018 year-end balance is to be in the $600 million to $700 million range. And these are unchanged and consistent with what we've seen this quarter. Notwithstanding the moderate headwind to sequential loan growth represented by this runoff, we expect another year of strong overall loan growth in fiscal 2018.

Slide 5 also demonstrate success against our Balanced Growth strategy to diversify our funding sources. Total deposits increased 12% from last year, with branch-raised deposits up 2%, including very strong 24% growth of branch-raised term deposits. Branch-raised demand and notice deposit balances were down 8% from last year, partly due to competitive factors as well as an increase in relative demand for term deposits as rates have moved up. We nearly doubled the balance of outstanding securitization funding compared to 1 year ago, and increased the proportion of total funding from capital markets to 12% from 9%, with 4 successful issuances of senior deposit notes totaling $1.3 billion over the past 12 months.

Alongside continued execution against Balanced Growth objectives for loans and funding, we are working hard to deliver enhanced client experiences through a number of targeted initiatives. This quarter, we were excited to onboard our first full-service clients in Ontario through the new CWB Virtual Branch. This new channel includes a differentiated remote banking experience for business owners, with access to high-touch personalized service from experienced commercial banking relationship managers and cash management specialists. This unique approach to low bricks-and-mortar service delivery is complemented by convenient online banking options, including remote deposit capture for business, electronic signature capabilities for easy account opening, enhanced online wire transfer service, and next-generation online banking tools for businesses, which allow small business clients to house their business and personal banking on a common platform. Together, these product and service enhancements represents key steps to further enhance our client experience and support development in broader client relationships across the country.

With that, I'll turn the call over to Carolyn.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Thank you, and good afternoon. As Chris mentioned, CWB Financial Group delivered a very strong second quarter, with common shareholders net income and pretax, preprovision income up 27% and 19%, respectively, compared to the same period last year. Record total revenue was up 14%. Net interest income increased 17%, reflecting the combined benefits of 12% loan growth and a 7 basis point increase in net interest margin to 2.61%. Noninterest income decreased 8% from last year.

Trust Services fees were down $1 million due to the transfer of certain CWT accounts to successor trustees. Lower credit-related fees partly reflect the shift in organic loan growth to emphasize general commercial loans, which tend to bring lower fees compared to real estate facilities with more complex structures. Other noninterest income was up $1 million, primarily reflecting foreign exchange and dividend -- derivative-related income. Noninterest expenses were up 8% from last year, primarily due to an 8% increase in salaries and benefits. Higher people-related expenditures reflect hiring activities to support overall business growth and annual salary increments. Other expenses were up 13% due to higher employee recruitment cost and consulting fees, along with an increase in advertising expenses to support funding and business diversification strategies. Premises and equipment increased 7%, with ongoing investment in technology infrastructure to support -- to position CWB for future growth. Diluted and adjusted cash earnings per common share of $0.68 and $0.73 were up 26% and 24%, respectively, from last year.

On a year-to-date basis, on Slide 7, common shareholders net income and pretax, preprovision income were up 26% and 16%, respectively. Total revenue was up 12%, including 13% growth of net interest income and a 2% increase in noninterest income. Higher net interest income reflects 10% loan growth on an average balance basis and a 7 basis point increase in net interest margin. The increase in noninterest income was mainly driven by the first quarter gain related to the CWT strategic transactions within other noninterest income. And that was partially offset by lower Trust Service fees as a result of the CWT transactions, along with lower credit-related fees.

Turning to Slide 8. Net interest margin of 2.61% was up 7 basis points from the same quarter last year and 9 basis points from last quarter. The improvement from the first quarter amounts to a full reversal of the liquidity-related net interest margin compression we experienced on a sequential basis last quarter. Compared to last year, the increase in net interest margin primarily reflects higher asset yields, mainly due to a 75 basis point increase in the quarter's average prime rate, which more than offset higher funding costs. Net interest margin increased 9 basis points from last quarter and benefited from both higher asset yields and favorable changes in asset mix, with growth of higher-yielding loan portfolios and lower average balances of cash and securities. As expected, much of the benefit of the January prime rate increase on asset yields was offset by higher funding costs. Administered deposit rates began to rise with the third successive Bank of Canada rate increase. And this timing coincided with the typical increase in demand for broker deposits during the spring mortgage season. In addition to these factors, which we discussed last quarter, depositors also began to demonstrate a preference for longer-duration, fixed-term deposits. While this results in a better natural match to our loan book, the shift does increase our overall cost of fund slightly. And lastly, the bulk of our branch-raised deposit growth was concentrated in fixed-term product, as higher rates attracted additional deposits.

Year-to-date, net interest margin increased 7 basis points to 2.57%, mainly due to an overall increase in asset yields, partially offset by higher funding costs and changing in -- changes in funding mix. Incorporating both the acquisition-related liquidity impact on net interest margin in the first quarter, current depositor preference for longer-duration, fixed-term products and the outlook for potentially one more interest rate increase in fiscal 2018, we continue to expect up to 5 basis points of net interest margin improvement on a full year basis compared to fiscal 2017.

On Slide 9, higher total revenue and effective expense management supported positive operating leverage of 5.4% this quarter, and an improvement in our efficiency ratio to 45.4% from 47.7% last year. On a year-to-date basis, operating leverage was positive 4.6% compared to positive 0.3% last year, while our efficiency ratio improved to 45.0% from 46.9% a year ago. While we expect CWB's efficiency ratio to fluctuate at levels moderately higher than the second quarter, due to the timing of expenditures and investment to facilitate future growth, we remain committed to the disciplined control of all discretionary expenses. We expect to deliver positive operating leverage over the medium term, albeit at a considerably more moderate level compared to this quarter.

Turning to Slide 10. Overall, credit quality remains consistent with our expectations, and reflects our secured lending business model, disciplined underwriting practices and proactive loan management. The provision for credit losses represented 20 basis points of average loans this quarter compared to 25 basis points in the same period last year and 18 basis points last quarter. The provision in each of the last 4 quarters is consistent with our historical range of 18 to 23 basis points. And on a year-to-date basis, the provision was 19 basis points, down from 26 basis points a year ago.

On Slide 11, the dollar level of gross impaired loans totaled $123 million this quarter, representing 50 basis points of total loans. And that compares to $138 million or 62 basis points last year and $137 million or 57 basis points last quarter. Gross impaired loans within Alberta totaled $58 million and accounted for 47% of total impairs -- impairments. That compares to $65 million or 47% in the same period last year and $80 million or 58%

of total impairments last quarter. The relative concentration of impaired loans in Alberta continues to reflect the lagging impacts of the 2015 to 2016 regional recession and is consistent with our expectations. Having said that, conditions in Alberta continue to improve.

As we've said before, the level of gross impaired loans fluctuates as new impairments are identified and existing impaired loans are either resolved or written off, and does not directly reflect the dollar value of expected write-offs, given tangible security held in support of lending exposures. Our business model remains focused on secured mid-market commercial lending, and we have no material exposure to unsecured personal borrowings, and that includes credit cards.

Looking forward, we continue to proactively assess all accounts for signs of weakness. And this includes carefully monitoring developments within the residential housing sector. We primarily participate in housing market activities through personal mortgages and residential project financing. A mortgages are primarily originated within our branches through relationships with individuals connected to our business banking clients, with the remainder of our book comprised of alternative mortgages originated through CWB Optimum Mortgage. With the split in our total about 40% branch and 60% Optimum, both channels continue to perform well. CWB Optimum Mortgage continues to deliver strong performance with an attractive risk profile. CWB Optimum's business model targets affordably priced homes, with an average loan-to-value at initial funding of 67% this quarter on an average origination of $348,000. The average size of each outstanding mortgage is $292,000. Compared to the second quarter last year, total CWB Optimum originations were 6% lower, while the renewal rate increased to 79% from 70%. In consideration of our overall risk appetite for alternative mortgages as a proportion of total loans and the full scope of regulatory and policy changes affecting residential mortgages in general, we expect growth within CWB Optimum to slow compared to prior years, to a level resembling overall growth across the rest of the loan portfolio. Growth across our entire portfolio of residential mortgages and personal lending is expected to be in the mid- to high single digits in percentage terms this year.

Taking a closer look at our real estate project loans, our portfolio across all provinces is strong and well structured. While we do not expect changes to OSFI's Guideline B-20 to have a material impact on growth opportunities within the real estate project lending portfolio, we continue to assess the potential impact of the new measures in BC on future construction-related opportunities in that province. In general, our loan funding structure requires strong presales, supported by nonrefundable deposits, with presales representing contractual obligations to test the depth of the market for a project. While rescissions can occur at closing, the purchaser is contractually obligated to close. Ongoing monitoring of all in-progress projects confirms there has been no material evidence of account deterioration.

As we've discussed before, net growth within our real estate project loan book has slowed over the past several quarters, with much stronger growth in general, commercial and equipment finance. We continue to actively support our strong client base in the project lending space with well-structured credit facilities. However, over the past 12 months, continued growth in BC has been more than offset by the impact of successful project completions and payouts in Alberta and Ontario. We're comfortable with our overall exposure to the housing market, the protections inherent in our secured lending business model, and our proactive approach to loan management. We remain very close to our clients and we continue to monitor risks related to changing levels of activity very carefully.

Slide 12 shows our very strong capital ratios at April 30. Using a standardized approach for calculating risk-weighted assets, our common equity Tier 1 ratio was 9.4%, Tier 1 was 10.6% and our total ratio was 12.3%. At 8.0%, our Basel III leverage ratio remains very conservative.

Yesterday, our board declared a quarterly cash dividend of $0.25 per common share, up 2% or 9% -- up $0.02 or 9% from the dividend declared 1 year ago and consistent with the dividend declared last quarter.

Moving to Slide 13. With a strong first half in fiscal 2018, we are performing very well against our medium-term performance targets and are well positioned as we move into the second half of the year. We are pleased to hit our ROE target, both this quarter and on a year-to-date basis, and look forward to facilitating further improvements in this key metric through our initiatives to transition to the advanced approach for capital and risk management.

And with that, I'll turn the call back over to Matt.

Matt Evans - *Canadian Western Bank - Senior AVP, Strategy & IR*

Thank you, Carolyn. This concludes our formal presentation for today's call. And I'll ask Latoya to begin the question-and-answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Sumit Malhotra of Scotia Capital.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

I just wanted to start on loan growth and specifically mortgages. You mentioned that your Optimum portfolio -- or not even that you mentioned, we can see that the sequential growth rate in Optimum is slower but it's not what I would call slow. It's still 2% quarter-over-quarter. So should I take your comments to say that maybe the full impact of the B-20 hasn't been felt yet and you're expecting to see further deceleration in that portfolio as the year goes on? And then relatedly, your non-Optimum Mortgages, which -- I think you call those your A mortgages, that growth rate seems to be very strong in Q2. So just hoping you can confirm that for me. And maybe give a little bit of color as to what the interplay between those 2 portfolios was for you.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So Sumit, on the Optimum side, 2% a quarter, if we did deliver that for 4 quarters sequentially, that would be about 8% for the year. So 8% to 10% for us would be consistent with our expectation for the entire portfolio. So I think that's -- the Q2 growth is consistent with what we expect for the rest of the year. On the nonalternative mortgages that we raise primarily through the branch network, we have been working on initiatives in the branch to continue to grow that line. That initiative came into play about a year ago when we opened the capability to fund through the CMB and NHA MBS program, so for us that was an important step in our evolution. So it would be the outcome of that -- those enhancements for us.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

And am I right to say that, that those A mortgages or those branch mortgages, they were up something like 5% or 6% in the quarter?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

I think -- I would have to check the exact number, I don't have it right off the top of my head. But we'll come back to you on it. It doesn't sound out of whack, but I just don't have it off the top of my head.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

Okay. And then maybe relatedly, because these are obviously very important components for the banks. So your comments on margin that 5 basis points year-over-year is still a reasonable objective. In order to get there, you'd still have to have more expansion from where you are at the end of Q2. And you gave us a list of items that they could have an impact, whether it's competition, whether it's volatility and liquidity levels. Just to be clear, you're still -- I think the banks' forecast, if I look at this very specifically, would be that you are still going to have NIM expansion from where you stand right now in the back half of the year. Is that the correct read?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Yes. That would be the correct read. And we are thinking about the expectation for 1 more rate increase.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

And lastly for me is going to be around capital and specifically AIRB. Chris, we've had a number of conversations on this topic in the last few years, and just wanted to get an update from you. Your -- one of your peers suggested that they maybe delayed in the implementation of AIRB. Last we had it, you were still expecting to be calculating RW end of this measure in -- to start 2020. Is that still the goal? And maybe if you could update us on the progress in terms of the information you've been providing to us and whether there's been any kind of pushback that may delay that process?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

So our AIRB project is on track. We've deployed scorecards across our business. We're in the midst of, obviously, validating the data, making sure that we can support all of the internal processes to advance our application forward. So we are fully on track with our expectations of fiscal '20 go-live. I mean, ultimately, it is up to the regulator for that approval. But we are -- we have our teams deployed. We've got a very effective process underway right now to meet those time lines.

Operator

The next question is from Steve Theriault of Eight Capital.

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

Maybe I can start with expenses. Carolyn, efficiency ratio was just over 46% in Q1, and you said it was moving higher. Now we're in Q2 and it's gone a bit lower, which is maybe a bit unusual for seasonality reasons. But again, the direction is higher. So I guess any change in outlook? Is it reasonable to expect positive operating leverage in the back half of the year? Or I guess the alternative, should we be expecting any significant back-end loaded expense growth that will call back some of the very strong performance in half 1?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So we do expect to continue to deliver positive operating leverage but I don't expect it to be in the 4% to 5% or higher than 5% range. We do have some expenses that are a bit cyclical, including some advertising initiatives that will support business growth. So we do expect some of those will come on as the back end of the year continues. But overall, not a large or unusual chunk.

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

Okay. That's helpful. And then I wanted to ask about Alberta a little bit. Chris, you talked about loan growth being better in half 2. Maybe we can extend that to Alberta. When I look at the numbers, the last couple of quarters, sequentially at least, the Alberta loan balances have been going in the right direction. And if that continues, it looks like you could grow your Alberta balances something like -- I mean, let's say, 4% to 6% in the back half of the year. Is that reasonable? And maybe you can update us on your outlook for Alberta next half year, next year.

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Certainly, it's much more positive. And we do what we call balance scorecard within our branch network, just to get a view of what the pipeline looks like for anticipated growth. And it's absolutely much more positive. So we are seeing greater traction, and we see positive growth in our equipment finance group. And that, we've typically found to be a good bellwether of there being active contracts being let and people looking to buy equipment to support that. So it's definitely much more positive. I think we've got -- hoping something closer to getting the Kinder Morgan pipeline up and running with the recent developments, which we believe is very positive for the -- on the gas industry in Alberta. So I would say that, on balance, Alberta is certainly of a much stronger outlook than we have had in the last 4 years.

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

Okay. And then -- and last thing for me. Just to follow up on Sumit's question on Optimum. When I read the language in the MD&A, it suggests that full year lending loan growth for Optimum would be in the mid- to high single digits. So if I used, say, 7.5% relative to that guidance, and I think of what -- how it grew in the first half, which is mid-teens, simple math would suggest that back half of the year that Optimum portfolio is going to look more like 2% year-on-year growth, which would require sequential declines. But Carolyn, you said, and I think in answer to Sumit's question, that 8%, like that 2% sequential growth, I think you suggested that was sustainable. So maybe you could just flush that out a little bit more.

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Yes. No, we do believe that 2% growth is sustainable. I mean, clearly, the market has changed in the manner under which qualifications occur with the B-20 rules. Certainly, we've seen sales volumes in both Toronto and Vancouver have been impacted by it. But the big change because of the B-20 is retention rates. They're much, much higher. They're about 10% up compared to history. So that also puts these under the credits. So really from the originations and retention, the churn has actually reduced a bit. So that's a positive. So again, it's an area that we're very disciplined in underwriting each loan. It's individually adjudicated. And we continue to focus on B-20 compliance and credit quality.

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

And that retention going, I think, it was 70% to 79%.

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

That's right. Yes.

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

Is that field fully loaded or is there still upside to that into the 80s?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

I guess we'll see. But that will come into what market conditions we'll see as we move into the second half of the year. I mean, it's a short-duration portfolio, right? So it does turn. So we are looking at these credits often.

Operator

The next question is from Gabriel Dechaine of National Bank Financial.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

The margin -- just to clarify your answer to an earlier question there, I didn't quite get it, I was distracted. But are you expecting year-over-year margin expansion in each of the next 2 quarters? Because I look at the first half and we're ahead of that 5 basis points year-over-year guidance or target you've set for this. Just kind of trying to picture what's going to happen in the second half.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

I think, on average, right? I just don't have the numbers quarter-by-quarter exactly in my head. But on average, we believe, overall, for the full year of 2018, up to 5 basis points improvement from 2017. Which was quite volatile, right? It started to move with the Bank of Canada rate increases in July and September. So it was -- the improvements were back-end loaded in the second half of 2017.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Right. It would seem to be flatter for the next couple of quarters then because I actually have the numbers, 2.59 in Q3 last year and 2.63 in Q4. So I mean we're kind of in or around those levels right now.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Yes. Yes.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Okay. The retention of Optimum Mortgage is increasing. Is that the -- do you get an additional benefit there that we might see? Is it going to be material? Like, you get more pricing power, so maybe your margins are higher on renewing loans that you retain that the versus ones you have to source elsewhere to replace those? Commission costs or I mean the acquisition costs are lower. So is there any materiality to that?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

I don't know that there is anything material that I would factor in. You are right. We don't pay commission on those. We also choose the renewal, so we offer people renewable or choose not to renew, if that's our choice as well as we look at the credit and reassess. So it remains a competitive space. So whether you can gain higher spreads is still, I would say, not clear.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Chris, you're sounding awfully optimistic and bullish on the Alberta outlook there, and nice to hear. What parts of the portfolio are we seeing that growth and expect to see that growth come through, general or commercial? And what kind of businesses are increasing that activity?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Yes. So our growth is really both general, commercial and equipment finance. I mean that's where we've really put a lot of effort, particularly into the general, commercial, where we've deployed and put in place under our Balanced Growth strategy, much better hotline tools, better ways for us to provide cash management to our clients. We're really broadening our range of services. And the goal there is to build that long-term sticky client, and that's where the general and commercial is a tremendous win. And then I said earlier about EFG and our equipment finances that they are the kind of the leading indicators. So if we do expect to see more activity in the oilfield in particular, that -- and some CapEx. I mean what we haven't seen in Alberta in the last couple of years is capital expenditures. People have -- they scaled back their fleets, they prepared used equipment. So I -- we haven't seen that tap really turn on dramatically, but it's more positive than it was. And -- but we continue to focus on that.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

So energy sector-related. I mean kind of obviously for Alberta but -- and more, what, lines of credit or -- but not as much CapEx. Is that the idea?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Well, yes. The EFG would be CapEx. I mean that's typically how we grow there as people buying new equipment. So there are new loans for new equipment. On the commercial banking side, it's really -- that would be equipment lines of credit, owner-occupied real estate, be it the full-banking package.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Okay. All right. Well, that's encouraging. Then lastly, I'm wondering if maybe you can give me a sneak peek on IFRS 9 here, Carolyn. We've got that coming in a couple of quarters here. Any chance that you can give us a ballpark of transition impact on your capital ratios or anything else for that matter?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So like AIRB, our IFRS 9 project remains on track. We're still working our way through the -- all of the components, including shifting to expected loss, so the forward-looking economic forecast and conditional probabilities of default that falls from there. So nothing that we're comfortable sharing. We actually don't know what the economic conditions will look like 6 months from now, so the number today might not be the number in the future. But nothing that we're comfortable sharing at this point.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

All right. I guess not the -- so much the PCL ratio guidance, I don't think that would be realistic to expect at this stage. But you must have some idea of the capital. Is there -- do you anticipate maybe -- is it going to be incremental or will we notice it type of thing from the CapEx?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So our capital, as a standardized approach, is different than the AIRB. So if we don't have that comparison to the regulatory number to the accounting number, so our...

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Yes, yes, expected loss. Yes, all right...

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Yes. So our collective allowance today sits in Tier 2. So the only shift that there was a transition adjustment to the collective allowance was we would move between Tier 2 -- Tier 1 -- Tier 2 and CET1, sorry, would be the shifts.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

All right. There's no shortfall lineup. All right.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

That's right.

Operator

The next question is from Meny Grauman of Cormark.

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

Just wanted to get an update on BC and specifically, it sounds like when you're looking at the impact of policy changes, it looks like you're more concerned about new measures in BC than more broad B-20 revision impact. So if you could just go into that, what you're seeing in Alberta? What you're monitoring? What you're cautious of, given the new rule changes there?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Yes. So BC certainly has brought in some real estate taxation changes that if you're not a resident of BC, it can be impactful on the cost of ownership of the premises. So what we're looking at there is thinking about the different areas in which we lend and which might be more impacted. So we believe that parts of Vancouver Island and the Okanagan in BC would be more impacted by that, where you would potentially have more people that are acquiring homesick would be nonresident. So the cost of ownership goes up. We don't see that as the same issue in the Lower Mainland. There's still a tremendous in-migration into this market here. So we don't -- I mean, I think, it's definitely a potential for a portion of the market, but core Lower Mainland, we're not seeing as potentially as impacted. And as we see more impact in sort of the Okanagan and Victoria, they could be more of the second home markets. That's how we kind of think about the real estate here. So it continues to proceed well. We've got a very strong base of companies that we are the financier for interim construction, that's been very positive. Alberta, I mean, we still have a -- we've actually had good strength in that market, not a lot of growth. But our [forwards] have really managed, yes, slower market in Alberta very well. We maintain a very high-credit quality book on the development side in Alberta. So we continue just to manage. And now we think we've got a good group of clients that are very aware of what the market opportunities are. So we continue to be, obviously, very supportive of our clients. And where everybody is looking at how these different macroprudential rule changes impact the market. And I think everybody's got their eyes on it.

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

Okay. Because you said Alberta but I'm assuming you were talking about BC. And just wondering in terms of these rule changes, what kind of time frame do you need to have a more comfort in terms of the overall impact? Is it another quarter? Or will it take longer to really see the impact of these changes?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

So from a construction perspective, when we are lending into the construction market for real estate developers, we typically have very high presale requirements. And even that -- if they're going to go forward with the project, they need to test the market and show that there is that depth there by having significant presales with good deposits. So we continue to proceed. Our clients are still proceeding with projects in the Lower Mainland. It -- that hasn't been a big pullback here. As I said, the 2 areas where there is more concern because of the nature of who would be the buyers will be the Okanagan and parts of Vancouver Island.

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

Okay. And then if I could just ask about liquidity, cash and securities balance is down sequentially but still up about -- over 20% year-over-year. And you talked about the reasons in Q1 why liquidity was higher and how it would be a process to take that down. Just wondering if there's any changes there? Is there anything that is slowing down the unwinder, giving you more reasons to be cautious and to carry larger balances? Or is it just sort of -- as you indicated before, it will just take some time?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

It will take some time in comparing year-over-year. It also is factored into sort of the composition of the balance sheet. So with the impact of lower balances and notice demand, a number of those are more relationship-focused, so have a higher liquidity value. Our liquidity balances are also impacted by the timing of our capital markets. Our senior deposit notes, when the maturities are coming up, we carry liquidity on those 30 days in advance, so it just sort of depends on what our maturity cycle is there.

Operator

The next question is from Richard Roth of TD Securities.

Richard Roth - *TD Securities Equity Research - Associate*

Couple of questions on funding. First, with respect to the migration from, I guess, demand and notice deposits to fixed-term deposits. Do you expect that to continue? And if so, at a similar pace or slowing down?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So continuing to grow notice and demand is one of our key strategic objectives. So that's an area that we're paying lots of attention to. Our balances in notice demand can be a bit tricky. They can shift over time. Probably the difference between us and most of the large banks is that most of our balances there are business related. So if businesses need their cash, we can see declines like we saw this quarter. It's only anecdotal but there -- we also have had some comments from the branches that companies' drawing down and using their surplus cash could be the first sign of the economy recovering in Alberta. So perhaps they utilize their cash before they draw on their credit line. So -- but certainly, if that's not a -- that's not a strategic objective to have that trend continue.

Richard Roth - *TD Securities Equity Research - Associate*

I understand. So it would be correct to characterize, therefore, the drop this quarter is potentially chunky and sort of maybe potentially onetime in nature? Or is it something that's going to be systemic, I guess?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

We are -- we certainly hope that it is a onetime item that we're working very hard.

Richard Roth - *TD Securities Equity Research - Associate*

Yes. Got you. And then with respect to your initiatives to, I guess, raised branch deposits overall, the Virtual Branch being one of them. But you had -- you mentioned in the call that you had a couple of other things on the fly. How successful have those been, at least initial stages?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Well, certainly, to say, I mean, the Virtual Branch we just got up and running in April. So it's just the start of that. The opportunity for us to deliver more products online to our clients is one of our key focuses. And it's definitely an area where we anticipate just to gain momentum, so we would expect continuous improvement. I mean we've put in place a kind of a different front end for our clients, so we can provide many more services than we historically could. And it's really the matter of rolling that out, deploying it, creating the opportunities. And I -- we do expect it to grow. And that's really what we're focused on.

Richard Roth - *TD Securities Equity Research - Associate*

Okay. And then finally, with respect to wholesale funding. Last quarter, you guys mentioned that -- you gave us some ranges in terms of what you'd be fine with it in terms of funding mix. And you said that, I think, 15% for capital markets and 10% to 12% for -- from securitization. Is that still the case? And how are those markets looking to you guys in this quarter and going forward, as you're sort of semi new entrants into it?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So those limits or objectives, those remain in place. The markets are doing very well for us. So our securitization has almost doubled in the last year. That's primarily closing the ECN portfolio. Capital markets, we've had 4 issuances over the last 12 months, with really strong market receptivity. We've tapped 1 of our existing notes this quarter, and we're able to bring it to a total size of $0.5 billion. So that's a new landmark for us as we look to increase liquidity in our name there. So both channels are performing very well for us.

Operator

The next question is from Scott Chan of Canaccord Genuity.

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

Just in terms of the portfolio transaction that closed the last fiscal quarter, and can you quantify, Carolyn, how much that incrementally benefited the margin and the PCL ratio in the quarter?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So overall, the contribution was consistent with what we saw from an EPS perspective, about $0.03, which coincides with the $0.10 contribution for that 3 quarters of 2018. It was no more than maybe 1 basis point to NIM. As we mentioned, a bit -- it has a bit higher loss rate than the rest of our portfolio. But not -- nothing that's material. It's contributing to each of them. But as we -- it's contributing in the way that we expected.

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

Okay. Great. And just lastly, just on the FX gains in the quarter, it was just higher than the previous 4 quarters. Can you maybe just talk about what impacted the larger gain in this quarter? And should we think about that line differently going forward?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So I would view quarter 2 as a one-off anomaly. It was a -- it had to do with the balance sheet restatement and just the composition of our U.S. terms of deposits, which aren't particularly large. So it wasn't that it was transactional or client facing. So I would view it more as a one-off.

Operator

The next question is from Doug Young of Desjardins Capital Markets.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

Maybe just starting back on NIMs, Carolyn, I think last quarter you mentioned 5 to 10 basis points of expansion, and now it's more 5 basis points. And correct me if I'm wrong on that. And I know, obviously, branch-raised demand and notice deposits have declined. Is that part of the rationale for the lower end of the previous guidance? Or I know competitive factors have been mentioned. Just trying to get a sense of what's curtailing that expansion relative to what you thought last quarter?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

So last quarter, in March, we talked about 5 to 10 basis points. And our comments from the AGM in the 1st week of April, we talked about 5 to 10, but 5, what, yield sort of by then was attainable but still a challenge. I would say the thing that has been -- that has shifted over the last quarter is primarily the depositor preference for longer duration on the fixed-term side. So we like it from a managing the asset-liability gap perspective. It's a more natural fit to much of our loan portfolio. But clearly, when you have a yield curve in place, it does tick up the overall cost of our fixed-term deposits a bit. So that would primarily be the primary factor.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

Okay. And then just looking back in your notes to financial statement, I did notice, there is about a $30 million increase in business impaired loans, past due 31 to 60 days. Is that related to one particular account? I know it can be bumpy from quarter-to-quarter. Just hoping to get a little more detail, what product like -- was that related to the acquisition balance? Or was that a product line one that be related to? Any details would be helpful.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Yes. It's on the business side. It's a mix of clients. It's not one particular client that's in there. We continue to see nuances as loans move current, move 30, 60. It wouldn't -- I'm -- it's not anything that I would say is systemic at this point. It's something that we're watching. But nothing specific.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

So it's a bunch of clients, bunch of different businesses...

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Bunch of geographies.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Yes. Bunch of geographies. Bunch of portfolios.

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

It's not anything specific.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

Okay. And then just lastly, any gain in the quarter? I know the last few quarters have had some gains related to the CWT. Any gains this quarter related to that?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

There were no transfers of accounts or deposit balances or gains in this quarter. We have a couple of additional transactions to come but they won't be material at all.

Operator

The next question is from Sohrab Movahedi of BMO Capital Markets.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

Just a couple of clarification questions. Carolyn, when you are talking about the outlook for NIM, and you've talked about the depositor preference, basically, that -- for longer term causing, I guess, a bit of a pressure as far as funding costs are concerned, you are assuming that persists? Or are you assuming that the drop in demand deposit this quarter was indeed a bit chunky and anomaly and it was kind of revert back to something less than that?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

I think, as always, we are continuing to be conservative. So we are thinking about growth from the April 30 balances, but we're not necessarily anticipating, in the next 2 years, that we make up what we lost this quarter. So we'll grow from this balance but don't know that we'll get back to where we originally thought.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

Okay. So the level of the variability that is caused in your outlook for NIM from time to time, I mean, both the asset and the liability side, I suppose, are out of your control. So I'm trying to get a feel for how do you gain visibility into the 5 to 10 or 5? And why wouldn't it be 2 to 5 next quarter?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Well, I think that's why we've said up to 5 is -- rather than trying to paint to a specific number, which never seems to come to pass, just given the number that takes as you've mentioned.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

Okay. So -- but it could be flat or -- I mean, in other words, like you said, if the Bank of Canada, like -- how dependent is this on the Bank of Canada rate increase?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

I'd say that's one factor.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

Okay. Just one other -- or 2 other quickies then. In the unrealized gains schedule, I looked back, I think, a couple of years, I mean the debt securities -- other debt securities have never been in the negative or unrealized loss balance. Can you just provide a little bit of color as to what's causing that swing quarter-on-quarter?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Let me just find that.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

It's on Page 4 of your (inaudible). And I'm happy to take it off-line if it's easier.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Yes. Let's take it off-line and we'll come back. I believe it's -- there isn't any particular issuer in there. It's just the way the yield curve has moved in the composition of our portfolio. But we'll come back to you on that, Sohrab.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

Okay. And then lastly, I know there was some conversation around IFRS 9. I mean, if I kind of very -- in a very rudimentary, I guess, fashion think about where your collectives are relative to your RWA, I think it had been more in the, call it, 65 basis points. It's now closer to 62 basis points. And I'm talking about over the last year or so. Is that -- can I read into that anticipation and preparation of sort of what sort of, let's call it, reserves you will need under an IFRS 9? Or is this just coincidental that, I don't know, gee, RWA grew much faster than additions to collectives and that ratio got pulled down?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

As a standardized bank, I wouldn't read anything into that. It's really more a factor of where does our growth come from and is it in 100% risk weighted or 75% risk weighted. So I wouldn't equate that to, yes, the value of the collectives.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

Right. So if it's 100% or 75% risk weighted, it does not influence your reserve and policy?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

It -- no.

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

No.

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

It's not -- it isn't risk-sensitive the way that any AIRB risk-weighted asset calculation would be.

Operator

The next question is from Nigel D'Souza of Veritas Investment Research.

Nigel R. D'Souza - *Veritas Investment Research Corporation - Investment Analyst*

I just had a quick follow-up on the mortgage balance side. And I wanted to understand more about your mortgage growth. I see the balances on your res mortgage book is increasing sequentially by 4%, and that's quite a bit higher than what we're seeing in your peers, more of a flat book to sub-1% sequential growth rate. So I'm just trying to understand what's happening there. Are you gaining market share? Or how you've been able to navigate via, I guess, softer origination environment?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Well, as we think about our approach to the residential mortgage group, obviously, percentage growth in our book is a bit different to the very large and the much bigger peers that -- I'm not sure if you're referring to home (inaudible) versus the big banks. So I mean, percentage growth is relative to the size of the base. So clearly, if we've got -- in our branch base, if it's a smaller base. And what we've really been able to do on the branch side, and it comes back to our Balanced Growth strategy, our focus on providing better ways for us to interact with clients and with our technology deployments, we now -- as Carolyn had mentioned earlier, we now can participate in CMB and NHA MBS, that we just could not do before, and that isn't a new avenue for us. So we're able to be in the market and offer strongly underwritten mortgages but also offer rates that -- and historically, we wouldn't offer. So we continue to change our capabilities, which then we're able to find more business opportunity from it. And that's really been our core strategy, is to increase the ways that we can interact with our clients, and residential mortgages are included in that.

Nigel R. D'Souza - *Veritas Investment Research Corporation - Investment Analyst*

Got it. That was really helpful. And just a quick follow-up. I noticed that when we look at the insured versus uninsured book, the insured balances had a sizable increase, about a -- little over $100 million Q1 versus Q2. Is there something specific at play there? Or could you just provide more color on what's driving that insured mortgage balance growth in Q2?

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

Well, it's just our ability to do it. I mean, in the past, we actually sold insured mortgages because the yield didn't make any sense for us, and we couldn't really carry it based on how we were funding it internally. So now we've got the avenues that we can -- obviously, they're great products and great returns with the right funding source. And as we continue to add to our sophistication ability to run these lines of business, we are. And that's what you're seeing as success in that area.

Operator

I'm showing we have a follow-up question from Sohrab Movahedi of BMO Capital Markets.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

Just, Carolyn, do you think about a rudimentary ratio like a loan-to-deposit as something that you're trying to kind of adhere to as the brisk -- loan growth that may or may not be -- or the deposits, I guess, may or may not be keeping pace with the brisk loan growth you expect?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

It's a metric that we think about and we talk about, and I'm continually challenged. Loan-to-deposit is an interesting metric because we do want to continually look to drive funding out of the branch network and our core business network. But at the same time, part of the reason that, that ratio has stalled or come down a little is because we've had so much success on the other funding sources which aren't in the deposit number. So the securitization, the capital markets. And I believe those make our franchise stronger from a diversity-of-funding perspective. So it's one we consider but there are nuances to it.

Sohrab Movahedi - *BMO Capital Markets Equity Research - Analyst*

So you're fine to continue to fund, I'll call it, loan growth through nonrate-sensitive or noninterest -- price-sensitive sources, I guess?

Carolyn J. Graham - *Canadian Western Bank - Executive VP & CFO*

Well, it's -- I just like to have options, right? So it's -- I like to have options and things that are in our control, perhaps more than the broker market -- the broker deposit market, maybe at particular times of the year.

Christopher H. Fowler - *Canadian Western Bank - President, CEO & Director*

And just to add to that. The core strategy really is that broadening of that commercial banking footprint. And that is really deployment of more caps management offers to our clients. And the Virtual Branch that we've just got up and running in the last 60 days. So we're continuing to add more and more capabilities to how we can provide more services to our clients. So I mean, we're very focused on building that internal deposit sources, and as Carolyn said, having the choices, securitization, capital markets, demand and notice term, like, all the areas where we really are looking to gain traction, and making sure that we do by putting in place all the right technology and people and training and products.

Operator

There are no further questions at this time. I'll turn the call back over to Matt Evans for closing remarks.

Matt Evans - *Canadian Western Bank - Senior AVP, Strategy & IR*

Thank you, Latoya, and thank you all very much for your continued interest in CWB Financial Group. We look forward to reporting financial results for the third quarter of fiscal 2018 on August 30. With that, we wish you all a good afternoon.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect. Everyone, have a great day.