EDITED TRANSCRIPT

CWB Financial Group

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PRESENTATION

Operator

Good morning. My name is Leonie, and I'll be your conference Operator today. At this time, I'd like to welcome everyone to CWB's Q2 earnings conference call and webcast. 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, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press *, followed by 2. Thank you

Mr. Evans, you may begin your conference.

Matt Evans — Senior AVP, Strategy & Investor Relations, CWB Financial Group

Thank you, Leonie. Good morning, and welcome to the CWB Financial Group 2019 Second Quarter Financial Results Conference Call. As Leonie mentioned, my name is Matt Evans. I lead the Investor Relations team for CWB. Presenting to you today is Chris Fowler, President and Chief Executive Officer; and Carolyn Graham, Executive Vice President and Chief Financial Officer.

I'd like to remind listeners and webcast participants that statements about future events made on this call are forward-looking in nature and based on certain assumptions and analysis made by management. Actual results could differ materially from expectations due to various risks and uncertainties associated with their business. Please refer to our forward-looking statement advisory on Slide number 14.

I will now turn the call over to Chris.

Chris Fowler — President and Chief Executive Officer, CWB Financial Group

Thank you. The agenda for today's call is on the second slide. I'll begin with our second quarter fiscal 2019 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. We continue to execute against our balanced growth strategy and closed the first half of the year with a solid second quarter. We remain focused on broadening our relationships with our core clients, bid market business owners, and we continue to expand our client base across Canada.

Our team's hard work and continued client focus has achieved double-digit annual growth, driving total assets over $30 billion for a milestone that we've met for the first time in our history. We also achieved branch-raised deposit growth of 6 percent from last year, with very strong 3 percent growth from the prior quarter, and delivered adjusted cash earnings per share of $0.74 for the second quarter.

We continue to transform our business through an ongoing investment in core technology to further develop our differentiated full-service offering. We are broadening our capabilities to enable the strong growth expected from us by supporting our teams to deliver on CWB's reputation for proactive, personalized service, partly through development of more scalable processes.

Beginning in the coming quarter, we are thrilled to bring more awareness to our story with the launch of a refreshed brand and a new approach to marketing. This represents a key step forward as we work hard to be recognized as a disruptive force in Canadian banking, by providing a clear alternative for successful business owners across the country.

Turning to Slide 4. Total loans were up 10 percent from the second quarter last year, with further success against our balanced growth objective to build more client relationships in Central and Eastern Canada. This geographic market delivered loan growth of 14 percent, which comprised 38 percent of CWB's total lending growth.

Growth in these regions is underpinned by strong performance from CWB's businesses with a national footprint, including CWB Maxium, CWB Optimum, CWB Franchise Finance, and CWB National Leasing. Central and Eastern Canada now account for 27 percent of our total loan portfolio, up from 26 percent one year ago.

Growth in both BC and Alberta was also strong, at 9 percent and 8 percent, respectively. Business sentiment in both provinces is stable, and Alberta business owners are optimistic about the change in government, anticipating the potential benefits of lower taxes and less red tape.

At the same time, a more robust environment continues to be constrained by the lack of clarity on pipelines. Approval of the Trans Mountain Pipeline next month would clearly set the stage for a positive change in business sentiment in both provinces and across Canada. We are confident it would provide significant opportunities for our core clients and support renewed investment in our country.

Slide 4 also demonstrates successful execution against our strategy to target growth in general commercial loans. This continues to be our largest lending category at 29 percent of the portfolio and represents our growing presence across the broadest segments of Canada's economy.

Relationships with business owners in this space provides excellent opportunities to deliver our full range of products and services. We delivered very strong 14-percent growth here over the past year.

Personal loans and mortgages increased 9 percent this year and are 20 percent of overall loans. Within this category, we have minimal unsecured personal lending exposures. CWB Optimum Mortgage grew 6 percent. Alternative mortgages represent 54 percent of our personal loans and mortgages and 11 percent of CWB's total loans, unchanged from one year ago. We continue to expect residential mortgage originations to include an increased proportion of A mortgages throughout the remainder of the year. We expect the overall growth rate of residential mortgages to be in the mid to high single-digit range in full year fiscal 2019.

Real estate project loans have contracted slightly this year, with net growth in Ontario more than offset by successful project completions and payouts in Alberta and BC. This category now represents 14 percent of the loan book, down from 16 percent last year. The pace of new project developments in Greater Vancouver has moderated, while lagging impacts of the 2015 and 2016 regional recession have resulted in fewer new real estate project lending opportunities in Edmonton and Calgary.

As we move forward, we expect to continue to identify opportunities to finance well-capitalized developers on the basis of sound loan structures and acceptable presale and pre-lease levels. We monitor housing market conditions closely and remain committed to support our experienced clients in prudently structured construction-related opportunities within our targeted markets.

Slide 5 demonstrates success against our Balanced Growth strategy to diversify our funding sources. Total deposits increased 8 percent from last year, with branch-raised deposits up 6 percent. Funding from capital markets increased 11 percent from last year, while the balance of outstanding securitization funding declined. Higher amounts of outstanding securitization last year reflected success in funding the purchase of business lending assets on January 31, 2018 mainly through our securitization channels. Broker-sourced deposits as a percentage of total funding were 34 percent, 1 percent higher than last year.

As I mentioned earlier, we have developed more scalable processes to realign client-facing operations in our branches, and our efforts will continue through the remainder of 2019. These structural improvements are expected to support deposit growth through enhanced capacity to deliver on a reputation for personalized service excellence. Support for deposit-gathering capabilities also includes targeted strategies within Motive Financial, as well as continued development of the full-service grants network, including the CWB virtual branch and the opening of an Ontario branch location in 2020.

With an ongoing strategic focus on process improvement, new product and service capabilities, and a commitment to strategic pricing initiatives, we remain focused to strengthen our offering and continue to deliver for clients across our growing footprint.

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

Carolyn Graham — Executive Vice President and Chief Financial Officer, CWB Financial Group

Thank you, and good morning, everyone. As Chris mentioned, we delivered a solid second quarter. Common shareholders' net income and pretax, pre-provision income were up 2 and 4 percent, respectively, compared to the same period last year.

Modest growth in net income partly reflects the extremely strong second quarter we delivered last year, including the impact of acquisition-related revenues following the purchase of business lending assets on January 31st of 2018. Total revenue was up 7 percent, including a strong 7 percent increase in net interest income. Non-interest income was relatively unchanged from last year, as growth in credit-related and retail services fees, along with stable wealth management and trust services income, were offset by lower foreign exchange revenue, which is within the other non-interest income category.

Non-interest expenses were up 9 percent, primarily due to a 10 percent increase in salaries and benefits, driven by hiring activity to support overall business growth, execution of strategic priorities, and annual salary increments. Premises and equipment expenses increased 12 percent, primarily reflecting ongoing investment in technology infrastructure and premises to position CWB for future growth. Other expenses were up 3 percent, mainly due to higher regulatory costs and consultant fees, partially offset by a decrease in employee recruitment costs.

Diluted and adjusted cash earnings per common share of $0.71 and $0.74 were up 4 percent and 1 percent, respectively, from last year. Again, the growth rate of cash earnings partly reflects comparison with an unusually strong second quarter in 2018.

On Slide 7, looking at a year-to-date basis, common shareholders' net income and pre-tax, pre-provision income were up 5 and 7 percent, respectively. Strong earnings growth reflects an 8 percent increase in total revenue, including 10 percent growth of net interest income and a 7 percent decrease in non-interest income. Within non-interest income, growth of credit-related and retail services fees were more than offset by the impact of approximately 3 million of gains realized from the Canadian Western Trust strategic transactions recorded within other non-interest income in the first quarter last year, along with slightly lower fee income from wealth management and trust services in 2019. The change in trust services fee income mainly reflects the impact of those strategic transactions last year.

Diluted and adjusted cash earnings per common share on a year-to-date basis of $1.46 and $1.55 were up 7 and 5 percent, respectively. Compared to last year, higher net interest income reflected the combined benefits of 10 percent loan growth and a 2 basis-point increase in net interest margin to 2.63 percent. The increase in net interest margin primarily reflects improved asset yields from the higher interest rate environment, along with lower balances of cash and securities, which were more than offset by higher funding costs. The increase in funding costs was also driven by the higher interest rate environment, with a related client preference for longer fixed-term deposits.

On a year-to-date basis, net interest income was up 10 percent, reflecting 10 percent loan growth and a 5 basis-point increase in net interest margin. That increase in net interest margin primarily reflects the same factors I just noted in the quarterly comparison.

Our second quarter efficiency ratio of 46.8 percent compares to 45.4 percent last year, while operating leverage was negative 3.1 percent compared to positive 5.4 percent last year. On a year-to-date basis, the efficiency ratio of 45.6 percent compares to 45.0 percent last year, as strong growth in total revenue was more than offset by the increase in non-interest expenses.

Operating leverage on a year-to-date basis of negative 1.4 percent compares to positive 4.6 percent last year. Changes in operating leverage partly reflect the impact of higher acquisition-related revenue in the second quarter last year from the business lending assets we acquired on January 31st of 2018 and the subsequent partial runoff of that portfolio, which occurred as we expected. Operating leverage in the current period also reflects the impact within non-interest expenses of our continued investment to advance our strategic execution in both the second half of last year and this quarter.

Our strategy is focused to deliver industry-leading growth over the medium term. There is typically a lag between the timing of necessary investment and return, and quarterly volatility of operating leverage is expected. That said, we expect the rate of expense growth in the back half of this year to moderate, and we continue to expect the annual efficiency ratio to fluctuate around the average over the past three years of approximately 46 percent. We remain committed to prudently managed expenses based on expected revenue growth, and expect to deliver neutral operating leverage on a full year basis in 2019.

Turning to Slide 10. Sound overall credit quality continues to reflect our secured lending business model, disciplined underwriting practices, and proactive loan management. We continue to carefully monitor the entire loan portfolio for signs of weakness and have not identified any current or emerging systemic issues.

The provision for credit losses is estimated under IFRS 9 beginning in fiscal 2019, with the provision for fiscal 2018 estimated under IAS 39. Under IFRS 9, the second quarter for credit losses as a percentage of average loans of 23 basis points consisted of 22 basis points related to impaired loans and 1 basis point related to performing loans. This compares to 24 basis points in the first quarter this year, which was 22 basis points for impaired and 2 basis points for performing loans. And under IAS 39, the provision for credit losses represented 20 basis points in the second quarter of last year, and was entirely related to impaired loans.

On a year-to-date basis, the provision for credit losses of 24 basis points consisted of 22 basis points related to impaired loans and 2 basis points for performing loans. And this compares to 19 basis points last year under IAS 39, consisting of 18 basis points for impaired and 1 basis point related to performing loans.

Gross impaired loans at quarter-end totalled $168 million, representing 62 basis points of gross loans. That compares to $123 million or 49 basis points last year, and $136 million or 51 basis points in the prior quarter. This increase in gross impaired loans this quarter largely reflects one impairment within the general commercial category in Saskatchewan.

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 our lending exposures.

The overall loan portfolio is reviewed regularly, with credit decisions undertaken on a case-by-case basis to provide early identification of possible adverse trends. Our business model remains focused on secured mid-market commercial lending, and we have no material exposure to unsecured personal borrowing, including credit cards.

At April 30, 2019, our total allowance for credit losses, which include Stages 1, 2, and 3, was $118 million compared to $113 million last quarter. That includes $91 million of the total related to Stage 1 and 2 performing loans, compared to $90 million last quarter. At this level, our allowance for performing loans represents approximately 2.6 years of average annual loan losses over the past five years, which includes the elevated oil and gas losses in 2016.

Our steady execution on all fronts also includes progress towards our planned transition to the Advanced Internal Ratings Based approach for calculating and managing regulatory capital. Enhanced data integrity and modeling capabilities in support of risk management and stress testing are key benefits of our planned AIRB transition, in addition to improved capital management. We now expect to submit our final application and receive regulatory approval to transition to the AIRB methodology in fiscal 2020.

The slight change in timing of our final application from late fiscal 2019 to early fiscal 2020 reflects the iterative and conservative approach we've undertaken to achieve this transformational milestone, which we expect to create meaningful and lasting value for our shareholders.

With all material AIRB models now deployed into the business, our stress testing capabilities are significantly enhanced. Stress testing was performed this quarter to simulate the impact of a two-year Canadian economic recession, through a combination of GDP contraction, unemployment increases, home price declines, and lower oil prices, with the recessionary conditions also resulting in a decline in benchmark interest rates and weakening of the Canadian dollar. An additional stress test also simulated a more severe downturn, with rates of credit loss that resembled those experienced through the global financial crisis. The results of these tests confirmed our confidence that if faced with periods of macroeconomic stress, we will continue to deliver positive earnings for shareholders while maintaining financial stability, the current dividend, and a strong capital position.

Slide 12 shows our strong capital ratios at April 30th of 9.1 percent common equity Tier 1, 10.7 percent Tier 1, and 11.9 percent total capital, all calculated under the standardized methodology. Our Basal III leverage ratio, at 8.4 percent, remains very strong. With these capital levels, we are well-positioned to create value for shareholders through a range of capital deployment options consistent with our balanced growth strategy. Ongoing support and development of each of our businesses will remain a key priority, and we continue to evaluate potential strategic acquisitions.

This quarter, we amended our normal course issuer bid to provide a further 2 percent of issued and outstanding commons shares available for repurchase beyond the 1,767,000 common shares purchased and cancelled in the first quarter. While our primary focus remains to drive continued growth and support strong capital ratios, the NCIB is a prudent tool to create value for shareholders when circumstance warrant, as they did earlier this year.

Yesterday, we declared a common share dividend of $0.27, unchanged from last year and up 2 cents or 8 percent from the common share dividend we declared a year ago.

With the first half of 2019 in the books and looking ahead to the second half, we now expect that full year 2019 EPS growth may come in just shy of our medium-term performance target. We expect both ROE and operating leverage to improve through the remainder of this year. Over a three- to five-year time horizon and using the Standardized approach for regulatory capital, we remain committed to our medium-term performance targets.

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

Matt Evans

Thank you, Carolyn. That concludes our formal presentation for today's call, and I'll ask Leonie to begin the question-and-answer period.

Q&A

Operator

Thank you. Ladies and gentlemen, should you have a question, please press *, followed by 1 on your touch-tone phone. If you are using a speakerphone, please lift your handset before pressing any keys. One moment, please, for your first question.

Your first question is from Steve Theriault from Eight Capital. Steve, please go ahead.

Steve Theriault — Eight Capital

Thanks very much. A couple things for me. Just to make sure I understand, Carolyn; there's some moving parts there on the efficiency. So negative 1.4 operating leverage year-to-date. Did I hear you say neutral for the year? So second half of the year is probably in the 1 to 2 percent positive range?

Carolyn Graham

Yes.

Steve Theriault

Gets you back to flat. Okay.

Carolyn Graham

It's about flat full year.

Steve Theriault

And you talked about the stress test a little. I'm wondering if you'd be prepared to give us a little more detail. You mentioned, not so much the dramatic one, but the two-year Canadian economic recession. I'm wondering, given your secured model, can you tell us a little bit about how the credit losses perform versus that 18 to 23 percent range that you've typically talked to us about. Do you get losses materially above that range under that first scenario?

Carolyn Graham

Yeah. Great question. I think what our stress testing, using the information coming out of our AIRB models, confirmed for us was that the work that we've made to diversify the loan portfolio both geographically and by industry, over the last several years, helped support us over a two-year Canadian recession. So what we found with the credit losses was that different books experienced stress at different times, and there was a lag impact over the course of a couple of years. But if we compare the credit losses there to our historic range in the 18-to-23-basis-points period, it was only about a handful of additional basis points over the two years of the recession.

Steve Theriault

I guess, on average, like you said, they were kind of lumpy.

Carolyn Graham

Yeah. Both years probably up a handful of basis points and then starting to recover after about eight quarters

Steve Theriault

Okay. And then last thing for me. In the report to shareholders, you talk about driving strong growth in higher-yielding asset portfolios with an acceptable risk profile. Is that intended to flag that you're going out at least a little bit on the risk spectrum? Or searching for higher-yielding loans at the margin? There's obviously been, with the lack of upside to the margin with the Bank of Canada being on hold here and the preference, as you mentioned, for client deposits that are longer term, is there a bit of a shift here in terms of appetite on the credit side?

Chris Fowler

No change at all, Steve. When we talk about thatwe’re really referring to our core business plans, which includes equipment finance, which is our highest-yielding book; second would be project lending, as our second highest; and Optimum Mortgage that we continue to have a very strong return on capital from. So those are three of the very strong businesses that we’ve historically focused on and we still see those as great ways to drive growth.

Steve Theriault

Okay. Thanks. That’s it from me. Thank you.

Operator

Thank you. Your next question is from Robert Sedran form CIBC. Robert, please go ahead.

Robert Sedran — CIBC Capital Markets

Thank you. Good morning. I want to come back to the 18 to 23 basis points, Carolyn. First of all, I mean, in relatively good times for most of the footprint—I understood that it’s not so much in Alberta—you are kind of operating toward the higher end of that range. And I’m wondering if part of this is just the new accounting or if it’s something else going on from a credit perspective. And then on the same theme, just giving a sense of geographically, the Stage 1 and 2, it’s 1 basis point, 2 basis point kind of thing. Can you give a sense of ifis it by business or geography that’s driving that 1 or 2 basis points?

Carolyn Graham

Okay. On the PCL for the first six months of the year being 23, 24 basis points, there is only 1 or 2 basis points of that have come from the performing loan portfolio. So it’s primarily coming from specifics that we’re recording on particular gross impaired loans. And they continue to be sprinkled across the geography, sprinkled across portfolios, so they are individual creditor-specific situations.

On the 1 to 2 basis points for the performing loan allowance, nothing specific by geography or portfolio that jumps out at us. It's just performance of the portfolio, internal default rates, and our view of the macroeconomic conditions. So nothing systemic that we've seen in any of our books.

Robert Sedran

So is it fair to say that when you think about the loss rate on your book, as your business and geographic mix and your loan mix evolves from here, that maybe leaving the cycle out of it, maybe there's an element of this is a slightly higher loss rate business than it used to be, even in a relatively benign economic environment? Or is it just a bit of a soft patch in the credit book that we've seen in the last little while?

Carolyn Graham

I think overall, I would probably say it's more of the latter than the former.

Chris Fowler

Yeah, I would say that. I would agree with Carolyn, Rob. We've had two years of recession in Alberta, so that certainly would elevate the gross impaired loans in Alberta, which we've obviously seen good resolutions of many of those exposures. So we're comfortable that we're still in that range, even given the economic headwinds that we have seen in Alberta.

Robert Sedran

And I don't mean to make light of or to downplay the difficulty in Alberta. It's just that it's about 30-odd percent of the loan book now, and the rest of the book would feel like it's in relatively good times, that's all. But I appreciate the colour. Thank you.

Operator

Thank you. Your next question is from Sumit Malhotra from Scotiabank. Please go ahead.

Sumit Malhotra — Scotiabank

Thanks, good morning. Let me start with efficiency and some of the initiatives that are underway. So you mentioned, Chris, in your remarks, you used the term disruptive presence, and especially as far as business borrowers and entrepreneurs are concerned, and also the convenience model of CWB. So when I look at the headcount, or the complement staffing-wise, for CWB, the growth this quarter was one of the larger ones we've seen for a number of years. I don't think you're disclosing the branch count anymore. Just maybe more specifically, what are some of these initiatives underway that are bringing aboard this full-time complement? Is there more of that to come? And how, specifically, is this "disruptive" engine that you're communicating to us going to be seen in the performance of the Bank going forward?

Chris Fowler

Thanks, Sumit. TAs we looked forward – and said what are the things we need to do to create that alternative to the big banks in Canada – we have done a lot of work to restructure our business. So we put in a new banking system, T24, we're in the process of converting to AIRB, we centralized our credit support onto the branches, we're putting in a funds transfer pricing process for treasury for loans and deposits, we've put an HRIS system in to manage our staff through HR, and we have a target operating model to really focus on how it is we organize our branch and group companies for really driving business at the client. And we're focused on digital and finding ways that we can be more convenient to our clients.

So when you look at the size of the different initiatives that does drive a higher headcount. There is typically a lag between investment and return, but we've been able to generate very strong returns in every quarter. So in this particular quarter, we do have a negative operating leverage, but we've definitely got very strong processes in place to help us improve our ability to compete. And when we talk about improving our ability to compete, it is winning more business where today they're banking at the big banks. So that's really that disruption theme – our ability to really provide the right financial solutions. We're investing in our capabilities to do that well.

Sumit Malhotra

Part of that that you referenced, and it's been an area of interest for some time with the bank, is the deposit growth. So when, specifically, we look at the branch-raised deposits, demand and notice, would you suggest to us that that's one of the primary measuring sticks we should look at in terms of getting the return on the investments you're making? The ability to drive, in specific, the branch-raised portion of the low-cost deposits?

Chris Fowler

Absolutely, Sumit. It's a big win from our T24 deployment – the ability to have a very competitive cash management offer, as we think also about digital coming with CWB Motive. We have 49 percent growth on our Motive side. Funding is obviously a key for any financial institution, so as we look at the reorganizations we've done internally, I talked about our target operating model, that's getting the right people in front of our clients where we have not just a commercial lending officer, we would also have cash management officers. So we are putting all the skills at the front end to make sure, from a client perspective, we are fully competitive and able to meet the competition in the market.

Sumit Malhotra

I'll wrap up with a two-parter on AIRB, and hopefully, pretty quick. The headcount associated with the AIRB project, it sounds like, even though you're going to have a brief delay on implementation, you're getting to the later stages of this project, later innings of that, if you will. So, is it reasonable to expect that some of the headcount lift will go the other way as that project concludes? That's part A.

And then part B, maybe a bit of a strange one. If you're delayed in implementing this, are you able to do it in the middle of a fiscal year and start reporting under a different capital regime? Or will you have to wait until the end of 2020 before you start reporting under that basis?

Carolyn Graham

On the team that is supporting the AIRB journey, there is a portion that are specific to the project that may not continue, but a larger portion – we also have to have the models in production – running them on a go-forward basis. And as you know, AIRB approval requires 80 percent of your portfolios to be on the AIRB method, so we will have a few additional portfolios that still need to be modelled so there is work that will continue going forward. So some, but certainly not all of them.

On the delay perspective, the conversations that we continue to have is that we are a standardized bank until the day that we receive approval. And so that is at the regulator's discretion and could certainly be midyear, from our perspective.

Sumit Malhotra

Thanks for your time.

Chris Fowler

Thank you.

Carolyn Graham

Thanks, Sumit.

Operator

Thank you. Your next question is from Sohrab Movahedi from BMO. Please go ahead.

Sohrab Movahedi — BMO Capital Markets

Hey, thanks. Just wanted to just get maybe, Carolyn, to get you to look at the crystal ball and think a little bit further out than just 2019. Where do you think expense growth will be beyond 2019?

Carolyn Graham

That does take my crystal ball. We continue to focus on thinking first about estimated revenue growth, making sure that we live within our means from an NIE perspective, and we continue to target towards positive operating leverage. Although, like we've said, probably in the 1 percent range of positive versus not more than that. So that really hasn't changed. On an ongoing basis, and again, here, I'm thinking about a standardized institution, but if loan growth is growing at about 10 percent then revenue is growing at about the same amount. Then expenses, our projection believes, would grow slightly less than that, so we have positive operating leverage.

Sohrab Movahedi

Okay. That's helpful. And then just because loan growth is going to be, obviously, an important part of that equation, where—I mean, Chris, even absent Alberta, let's just put Alberta aside—the loan growth is still 7 percent. I mean, is that 7 percent kind of the low end that you kind of see, given the risk appetite that you have? Or do you think you could get into double digits with the risk appetite, if Alberta actually falls back into a recession?

Chris Fowler

So, if you look at our growth in 2017, we had negative loan growth in Alberta and we came in just below double digit. So I would say that your estimation is probably not unreasonable if Alberta did fall back into a recession, if that was an outcome of the current events that we're seeing. I think we had very strong growth of 10 percent in Alberta last year and we continue to be very supportive of our clients in a very prudent way, as we always are from a credit perspective. So, we continue to be focused on the verticals that we are very comfortable with. We see taking advantage of those growth opportunities. So we will prudently grow and that's the way we will continue to be focused.

Carolyn Graham

And at this point, I would say with a new government, the business sentiment in Alberta is more positive. Still a bit cautiously optimistic. We need a pipeline approval; that would certainly improve business confidence, but there has been a small shift.

Sohrab Movahedi

I understand. If I can just sneak in one last one, maybe a little bit more specific. Would you as a course of business, Chris or Carolyn, would you be lending to mortgage investment corporations? Would you have relationships with them, lending relationships with them? And if yes, which line item within the category of loans would it get absorbed in? And can you give us any colour as to how much, how big, or kind of size it for us and how much you may have grown in the past let's say year or two?

Chris Fowler

So we have lent to mortgage investment companies for 25 years. I mean, it's always been in our general commercial category. I think your question is, has B20 increased the amount of exposure there. And I would say that it's historically been a not material amount in our loan portfolio, and it really hasn't changed in the last 12 months to 24 months with the macroprudential changes that have come to the mortgage market.

Sohrab Movahedi

Thank you very much.

Chris Fowler

Thank you.

Operator

Thank you. Your next question is from Gabriel Dechaine from National Bank Financial. Please go ahead.

Gabriel Dechaine — National Bank Financial

Thanks. Good morning.

Just want to do some rapid-fire ones here. The increase in impaired loans in Saskatchewan, can you tell me what sector that was in? It's general commercial, but.

Chris Fowler

Yes. The particular loan is a retirement home.

Gabriel Dechaine

Oh, a retirement home. Okay.

Chris Fowler

Yeah.

Gabriel Dechaine

While we're on the topic of Saskatchewan, I'm thinking about canola, soybeans. Do you have much in the way of an agricultural lending portfolio?

Chris Fowler

We have zero commodity risk in agriculture. The only exposure we have in agriculture is through some equipment leasing through National Leasing.

Gabriel Dechaine

Okay. I also noticed an uptick in the equipment leasing impairments. Is that something you can shed some light on?

Carolyn Graham

So that was one loan that went over 90 days. So under IFRS 9, that is a hard stop, so it moved into impaired and has already been paid out in Q3 at no loss.

Gabriel Dechaine

Nice to hear. Your guidance on operating leverage for the full year, neutral. So that would imply, given the negative number in the first half, you'd have fairly positive outcomes in the next two quarters. Is that what you're anticipating?

Carolyn Graham

It would be more positive, yes.

Gabriel Dechaine

Okay.

Carolyn Graham

Yep. But we will see this volatility from one quarter to the next, that's not unexpected, but full year, we're expecting neutral.

Gabriel Dechaine

All right. And margins. A little uptick this quarter, and sounds like will be stable over the next two. How about in 2020? Could we see compression? Some banks are already kind of guiding to that, or at least hinting at it.

Carolyn Graham

I would say a big portion of that is depending how the economy continues to develop and whether there was a decrease. If we saw a decrease in the Bank of Canada rates, that would put pressure on our net interest margin. Barring that, so if rates hold steady we're targeting—looking at our book and the maturity profile, we are seeing about a similar NIM. So not much change going forward.

Gabriel Dechaine

So with no change at the Bank of Canada level, no change in the competitive dynamics, loan mix pretty much the same as it is today, we could have flat margins next year and avoid compression.

Carolyn Graham

Yes.

Gabriel Dechaine

Okay.

Carolyn Graham

But that's a lot of assumptions but, because there are so many puts and takes in the net interest margin.

Gabriel Dechaine

Yeah. Right. Then last one. That ECN portfolio, how big is it today? Do we know?

Carolyn Graham

In and around $400 million-ish.

Chris Fowler

Four hundred million. Yeah. It's really performed exactly as we anticipated in terms of the runoff on the book and the credit performance. So it's precisely as we anticipated.

Gabriel Dechaine

So at $400 million, does that—sometimes you look at acquisitions and the legacy is down, but then you've replaced it with new loans. Is there a way we can—

Chris Fowler

We absolutely have done new loans as well. Yeah.

Carolyn Graham

Yeah. But new loans are not characterized as ECN anymore.

Chris Fowler

Yeah.

Carolyn Graham

They just become part of our ongoing organic growth. So the original initial portfolio we acquired continues to roll.

Chris Fowler

Yeah.

Gabriel Dechaine

Would you have provided—sorry.

Chris Fowler

Yeah. The win with the purchase, Gabe, was that we did eliminate a competitor and some of the borrowers we had, particularly National Leasing, were dealing with both them and us. So we've been able to generate business in National Leasing through that category.

Gabriel Dechaine

Okay. That's all from my end. Thank you.

Chris Fowler

Great. Thank you.

Carolyn Graham

Thanks, Gabe.

Operator

Thank you. Your next question is from Richard Roth from TD Securities. Please go ahead.

Richard Roth — TD Securities

Morning.

Carolyn Graham

Morning.

Richard Roth

I have a question on your guidance. So your suggestion that you guys would come in just shy of you lower end of medium guidance for EPS, in conjunction with your NII guidance and your operating leverage guidance, suggests to me that credit losses will be a bit improved in the back half of 2019. Is that the right way to look at things?

Carolyn Graham

Yep. That would be fair.

Richard Roth

Okay. And then on the mortgage front. So your guidance is for mid to high single digits in 2019, which is roughly what you had last quarter as well in terms of guidance. What are you guys seeing in the residential mortgage market that's allowing you to take share from some of the other players who are seeing very, very weak growth, if not contractions, in that book?

Chris Fowler

Well, I would just say application volume. It's definitely slower than it's been in the past for us. We continue to be very focused on the underwriting, making sure the credit quality that we are taking on fits our risk appetite. We have moved up in improved credit quality by deploying the AIRB models in there. We're originating more on the A side than we did in the past; that's part of it as well. We didn't originate that much A mortgage in Optimum in the past, as we didn't have the capabilities to do securitization, which has now come onto our abilities since we brought in T24. So we are broadening our capabilities in the residential mortgage market, so that would be helping us in showing probably better growth than certain players in the market.

Carolyn Graham

Yeah. The growth for us has slowed compared to the same point a year ago. And for us, we're still a small market share participant in those markets, so. Yeah. There's room for us.

Richard Roth

Do you get continued momentum in that space in 2020?

Chris Fowler

Well, it's certainly our intention to participate very actively in the areas that we're very comfortable in —we'll certainly see where the economy goes — that would come back to the risk appetite in underwriting credits that we are very comfortable with. And, that will obviously impact growth. If we find the markets remain acceptable, we would anticipate reasonable growth. I mean, we always focus on prudent growth.

Richard Roth

Yeah. Thank you.

Operator

Thank you. Your next question is from Scott Chan from Canaccord Genuity. Scott, please go ahead.

Scott Chan — Canaccord Genuity

Good morning. In your MD&A, you talk about a launch for a fresh brand and a new approach to marketing beginning in the third quarter, and I was wondering if you could elaborate a bit on that. Is that like advertising-related? Or is there some other message there?

Chris Fowler

It's advertising, it's how we describe ourselves, how we make sure that the message of our approach to the market is well-known. We've got a whole program that we'll be launching mid-month in June. We're doing an internal branch launch between now and then. But it's really all about the future and really leveraging, as I mentioned on the call earlier, about all these different initiatives that we've got. We've got all sorts of program internally that really creating lots of excitement about what's next and that's the opportunity in front of us. We think we've got great growth opportunities with the investments we're making and our capabilities, and we want to reflect that in our brand and in our message to the market.

Scott Chan

Okay. Great. And just one other question. Just on the wealth management side, we've talked about this for several years now, but the organic growth seems to kind of track well below peers. So I was wondering if you could talk about maybe what's going on in that segment, organic growth opportunities, or any inorganic opportunities that you might see.

Chris Fowler

Well, wealth we still see as a very important part of our growth opportunity. We are focused on the business owner as our client and wealth is a very important part of that. The challenge we've had is a big part of our business in wealth has been in Alberta, which has been slower in this last couple of years in a recession. But as we look to the future and we want to approach wealth very in a very practical way. If we believe there's really an acquisition that makes sense, we would be certainly keen to evaluate that. Clearly, the multiples in that area have been very high, so it's certainly been a pricing challenge there. But again, it's a strategic pillar for us and we will continue to focus on the ways for us to approach the growth.

Scott Chan

Okay. Thanks for your time.

Chris Fowler

Thank you, Scott.

Carolyn Graham

Thanks.

Operator

Thank you. Your next question is from Darko Mihelic from RBC Capital Markets. Please go ahead.

Darko Mihelic — RBC Capital Markets

Hi. Thank you. Good morning. I just have a quick follow-up to your answer to Gabe's question on the equipment leasing that went 90 days and was pushed into Stage 3, and then was subsequently resolved already in Q3. Carolyn, did that have a Stage 3 provision against it that would now be reversed in Q3?

Carolyn Graham

It had no Stage 3 provision.

Darko Mihelic

Okay. So there would be no—so what about the Stage 2—I mean, what I read from your—or what I thought I heard from your commentary was it was resolved successfully. So presumably, there would have been a Stage 2 provision against it that would be reversed? Or is there nothing here that's going to be reversed in Q3? Or recovered?

Carolyn Graham

There would be no impact.

Darko Mihelic

Okay. All right.

Carolyn Graham

It wasn't a material exposure.

Darko Mihelic

Okay. Fair enough. And then, just with respect then to when I look at the impaired formations sort of the quarter over quarter, even when I back out Saskatchewan, is it fair to say, though, that the other impaired formations, ex Saskatchewan, it looks like there still was an increase. Is it related to this same equipment loan?

Carolyn Graham

That is part of it, but there are also a couple of other loans, whether we're looking at year-over-year or sequentially in the quarter, there are a handful of others sprinkled across the geography and across industries. And I'm just looking to confirm, but none of them require a Stage 3 provision.

Darko Mihelic

Okay.

Carolyn Graham

Yeah.

Darko Mihelic

And then, just lastly then, when I think about the 22 basis points or so of impaired provisioning and the 1 basis here or there, I mean, what would it take for you to move from 1 basis point to anything higher? I guess my question is really related to, should I think about the 1 basis point as effectively, as you grow your book, you're basically always going to be taking about 1 basis point just for origination's sake, and it would take a material deterioration in the outlook for a build of Stage 2 allowances. so not asking you to help me model my PCL, but in a way, I sort of am—is that a fair—is it basically 1 basis point a fair run rate.

Carolyn Graham

One basis point is probably not a bad run rate just considering regular growth in the portfolio. I think what could make that larger—and I mean, 2 would be double—but what could make that larger, I think probably two things. One would be a material deterioration in the macroeconomic forecast, material, very large. And for us, the two most material factors there are GDP and unemployment. And then the second— could be tied to that macroeconomic factor, could be tied to individual client factors — what would be a shift in clients into Stage 2, where you move from 12-month to lifetime losses.

Darko Mihelic

Right.

Carolyn Graham

But again, the stress testing that we did indicated that that would occur over a number of quarters across all portfolios.

Darko Mihelic

And many banks have told me that the migration from Stage 1 to Stage 2—I realize there's a 30-day backstop—but many of them told me that they'll migrate loans from Stage 1 to Stage 2 with just even as little as 10 to 15 days of delinquency. Is that something that you guys would consider as well? Or would you—because it sounded like you had to hit the 90-day backstop to move it into Stage 3. So is it really the 30-day delinquency, is that when you would start to really migrate loans?

Carolyn Graham

So, could be client-specific. So for any number of reasons, could be client-specific. If anything moves onto our watchlist, it absolutely moves into Stage 2, before it goes into Stage 3. And then there is a hard stop at the 30-day past due.

Darko Mihelic

I guess another way of asking it is, what is the average delinquency of the loans that are in Stage 2?

Carolyn Graham

I don't have that—we can take that offline. Yeah. I don't have that right off the top of my head, Darko.

Darko Mihelic

Okay. Thanks very much.

Carolyn Graham

Thanks.

Chris Fowler

Thanks, Darko.

Operator

Thank you. Your next question is from Doug Young from Desjardin. Please go ahead.

Doug Young — Desjardin Capital Markets

I think I can still get in a good morning here. So just wanted to go back to the FTE and the non-interest expense ratio. And I know—and Chris you mentioned a new HR system that plugs into the core banking system, I think you're changing the culture from being loan-focused to cross-sell. Is there changes in how we should—when we look at the non-interest expense and the salaries and employee benefits—is there a change in how we should think about how those expenses evolve. Is it more variable today than it would have been in the past? And is that part of what your focus is, is to make that variable? Just wanted to get a little colour on that.

Chris Fowler

I think there is some of that in there Doug, but it wouldn't be widespread across the whole FTE count. I mean, certainly, as we think about our target operating model, as we focus on the client-facing staff aspects of it there are some variable pay included in there. We've always had a short-term incentive program, so there has been some restructuring of some of those programs. But I wouldn't say, in today's world, that it's made a material change in our (unintelligible).

Doug Young

Okay. So this isn't—so the variable component, like it's not going to flex with revenue more so than it would have in the past, is essentially what I'm getting from you.

Carolyn Graham

No. It would tend to flex with our results.

Chris Fowler

Yeah.

Carolyn Graham

And on the long-term components of our incentive plans would tend to flex on our share price, would have a consideration on how those accruals move as well.

Doug Young

Okay. Okay. And then, just back to the delay on the AIRB, and I think you mentioned more conservative, iterative process. Just hoping to get a better understanding why the delay.

Carolyn Graham

I would say, it's a complicated process. It includes both the creation of the models, the deployment of the models, the use in our business across all of the portfolios that have moved to become model-enabled, and we just need to make sure that we do it right. For us, we need to be fully confident that when we submit the final application that we have met all of the requirements and that we are fully using the models across our business. So for us, it was just revisiting our timeline and our plans.

Doug Young

So no pushback from—this wasn't regulatory? This wasn't a pushback from the regulator, then?

Carolyn Graham

No. For us, the project continues to develop and we revisit our timelines every day as we know more information.

Doug Young

Yeah. And just lastly, I mean, you mentioned it, Chris, as well, the branch-raised deposits and more demand and notice deposits. It looks like a pivot from what we saw in Q3 and it looks like you've got some momentum there. You're targeting loan growth, double digits, obviously growth in branch-raised deposits would go a long way from a funding benefit for you. How confident are you, now you got the new core banking system, you're doing training, you're doing a branch launch, marketing. Where can you get branch-raised deposit growth to be relative to loan growth? And maybe more specifically, even demand and notice branch-raised deposits. Thank you.

Chris Fowler

Okay. I mean, that's a key strategic pillar for us, Doug, and it's all about putting the right capabilities in place. It's talking about the digital footprint, it's creating convenience for our clients, it's having cash management programs and products that meet the clients' requirements. To give you a percent today is kind of difficult — I can only assured you that's a key part of how we are engaging internally with how we approach our client base. So our front-end staff, we organize the structure of it, we've added a ton of capability in terms of process and product features.

So it's all about creating more horsepower there, and we are starting to see progress, and that's what we would continue to focus on. You certainly look on the digital side in Motive and the growth that we've seen there, that's very, very positive. So these are areas where, looking at every part and finding ways to improve that funding capability. So as we go forward, our goal is to continue to improve that particular to branch demand-to-notice side.

Doug Young

Okay. Would it be feasible for you to be able to fund all your branch loan growth through branch deposit growth? Is that something that you think you could actually get to? Excluding all the other businesses and other means to grow deposits, just branch loan growth and branch deposit growth, is that something feasible?

Chris Fowler

Well, certainly, it’s aspirational, Doug. In a perfect world, that’s what we would absolutely shoot for. But we have also businesses that don’t have direct funding sources, like National Leasing, CWB Maxium, Franchise Finance, these acquisitions we’ve made as well. The branch side, for sure, that is an engine room that we want to make sure that we have great relationships. And as we think about our clients, those are great solutions for them. It makes it more convenient to deal with us, and we can provide better outcomes for your clients.

Doug Young

Thank you.

Carolyn Graham

Thanks.

Operator

Thank you. Your next question is from Joo Ho Kim from Cormark Securities. Please go ahead.

Joo Ho Kim — Cormark Securities

Hi. Good afternoon, and thanks for taking my question. So my first question is on expenses, and you talked about a new approach to marketing and refreshed brands beginning third quarter. And obviously, you talked about moderation in expenses. But would the spend tied to this initiative be material? Or has the spend already happened? And if it hasn't happened, would it be material enough to contribute to sort of the quarterly volatility and operating leverage that was discussed?

Carolyn Graham

It generally, hasn't happened yet. Our prework has been included in our run rate going forward. I would say, you'll see probably an uptick in that line item, but I wouldn't say that that would contribute materially to the run rate going forward.

Joo Ho Kim

Okay. Thank you. And just lastly, I wanted to go back to residential mortgages. Residential mortgages is up pretty solid on a total basis, as well pretty solid in Ontario and BC, and you're now talking about mid to high single-digit overall growth from there. I'm just wondering what you're seeing in both Ontario and BC sort of housing market specifically right now in your book, and what is your outlook in those provinces specifically?

Chris Fowler

Well, I would say that we've seen clearly lower volumes that in prior years. But as I've said before, we're very focused on how we underwrite, who we take on as an obligor; we zero in on our risk appetite; we want to make sure we've got the attributes that make sense from a credit quality perspective. So we will continue to look at residential mortgage growth with that lens. We certainly moved up from a risk rating perspective, wanting to lower-risk lows in the Alt-A space with Optimum, and that has absolutely been the outcome of how we've approached that business, and we're happy with the results.

Clearly, the volumes in the market will depend on inmigration, interest rates, household formation, unemployment, all the different drivers of residential mortgages. So we continue to follow it closely. We believe it's an important part of our business and we'll continue to work on how we grow it.

Joo Ho Kim

Thank you.

Chris Fowler

Thank you.

Carolyn Graham

Thanks.

Operator

Thank you. Your next question is from Nigel D'Souza from Veritas Investment Research. Please go ahead.

Nigel D'Souza — Veritas Investment Research

Good afternoon and thank you for taking my question. I had just two questions for you, and the first one's on the credit side, the second is on the expense side. So on the credit side, I don't it's been touched on yet, but I wanted to point to on Page 9 of your supplement, the commercial mortgages loan category, and I noticed that had the highest year-over-year increase for gross impaired loans. And the only reason I'm bringing it up is because that book is concentrated more so in Western Canada, British Columbia and Alberta. And I was wondering if you could just provide some colour on, is there anything you're seeing in that space and any commentary to provide on where your outlook is for that specific loan category, given some softness we're seeing in those real estate markets.

Carolyn Graham

Sorry, Nigel. That was commercial mortgages?

Nigel D'Souza

Just commercial mortgages and—

Carolyn Graham

Impaired commercial mortgages?

Nigel D'Souza

Yeah. That's right. That was up to about 35 percent this quarter.

Carolyn Graham

Yeah. So the increase in the quarter is primarily one commercial mortgage located in Alberta. It requires no specific allowance and the value of the security is more than sufficient for our exposure.

Nigel D'Souza

Got it. So then just keeping with—

Carolyn Graham

So that would be it.

Nigel D’Souza

Yeah. Sorry. So just keeping on the theme of more idiosyncratic and not systemic as of right now?

Carolyn Graham

That’s right. Just not systemic.

Nigel D’Souza

Okay. And the same question, if I may, I had a follow-up for multiple questions already seen on the expense side, and just quickly if I could squeeze it in. On Page 6, many questions have already touched on the marketing expenses, but I also wanted to loop in the professional fees and services line item that’s higher as well quarter over quarter. And if I look at it last year, that line item alone with marketing built throughout the year, so you’ve already mentioned what we’re getting is more incremental increase, you expense. But if you could just provide some colour on how are those two line items going to play out for the rest of the year. Are they going to increase? And if they aren’t or if they are, what’s the offset for those? Any other line item?

Carolyn Graham

So, marketing, probably going to have to come back to you on that, Nigel, just to have a look at the details. On the professional fees, that would include consultants. Can we come back to you? Let me just get the detail. I need to get the details back up so I can come back with a fulsome response to you.

Nigel D’Souza

Yeah. We can follow up offline. I appreciate the answers and the colour. Thank you.

Carolyn Graham

No problem.

Operator

Thank you. Mr. Evans, please proceed for closing remarks.

Matt Evans

Thank you, Leonie. Thank you very much, everyone, for your continued interest in CWB Financial Group. We look forward to reporting financial results for the third quarter 2019 on August 29. And with that, I'll wish you now a good afternoon.

Operator

Ladies and gentlemen, this concludes your conference call today. We thank you for participating and ask that you please disconnect your lines.