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EDITED TRANSCRIPT

CWB Financial Group - Fourth Quarter and Fiscal 2019 Financial Results

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PRESENTATION

Operator

Good morning. My name is Joanna and I will be your conference Operator today. At this time, I'd like to welcome everyone to CWB's Financial Group Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. If you'd like to ask a question during this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, please press star, followed by two.

Thank you. Mr. Matt Evans, you may begin your conference.

Matt Evans – Vice President, Strategy and Corporate Development, CWB Financial Group

Thank you, Joanna. Good morning and welcome to our Fourth Quarter and Fiscal 2019 Financial Results Conference Call.

As Joanna said, my name is Matt Evans and I lead the Investor Relations team for CWB. Presenting to you today are Chris Fowler, CWB's President and Chief Executive Officer, and Carolyn Graham, our 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 our business. Please refer to our forward-looking statement advisory on Slide 18.

I'll now turn the call over to Chris.

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Thanks, Matt. The agenda for today's call is on the second slide. I'll comment on the continued execution of our transformational strategy, including this morning's announcement. Carolyn will follow with detail on our financial results and Fiscal 2020 outlook before we move to the question-and-answer session.

Fiscal 2019 was an exciting year for CWB Financial Group. We continued to deliver against our strategic objectives and create value for the people who choose CWB every day: our clients, our people, and our investors. We generated solid loan growth with further geographic and industry diversification. We supported that growth with a new record for annual branch raise deposit growth of $1.5 billion, generating very strong 12 percent overall growth of branch-based deposits as we continue to invest in our deposit gathering capabilities to strengthen our full-service client experience.

With ongoing profitable growth and strong capital ratios, we were also pleased to provide shareholders with an 8 percent increase to the common share dividend. Our strategy for long-term value creation is to solve for the unmet banking needs of Canadian entrepreneurs. This year we further enhanced our operating model, improved core business processes, advanced our digital strategy and invested in brand and culture. These initiatives will position us to deliver breakout growth and maximum value creation from our upcoming capital transformation. We're making strong progress on all fronts.

The growing community of business owners we serve are benefiting from the fully integrated full-service approach we provide to meet their financial needs. We will continue to empower our Business Banking, Personal Banking, Wealth Management, and Trust Services Teams to create an increasingly integrated experience. The client-centric operating model we launched this year is designed to increase collaboration across our lines of business. Our complementary business process improvement projects are designed to enable our teams to deliver for our clients more seamlessly.

And while proactive personal service and specialized expertise will remain at the core of our competitive advantage, digital capabilities will be an increasingly prominent feature of our differentiated client experience. The announcement we made this morning represents another bold step forward on this frontier.

By deepening our partnership with Temenos we are positioning ourselves to deliver seamless end-to-end digital banking experiences for our clients, the owners of small- and medium-size businesses. Temenos is the world's leader in banking software, and our journey started with the successful launch of Temenos Core Banking in 2016. It now continues with implementation of the industry-leading Temenos Infinity platform. We were the first Canadian schedule one bank to run on Temenos Core banking and we will be the first Canadian bank to offer a differentiated digital banking experience powered by Temenos Data Lake and explainable AI capabilities. We're excited to build a Temenos partnership to deliver a competitive, fully differentiated, highly personalized, world-class digital experience to our business owner clients.

This announcement provides the purposeful innovation we are fully committed to deliver to provide the proactive relationship-based client experience we are known for as we meet the rapidly changing needs of our valued clients across a full range of channels.

This year we also expect to successfully transition to the *Advanced* approach for regulatory capital and risk management. This accomplishment will represent the combination of a multiyear Enterprisewide transformation effort with contributions from nearly every CWB Team. We will enhance our capital allocation capabilities, provide a sharper review of portfolio risk and will make us more competitive on price and offering. The Advanced approach is a foundational capability for us to unleash our full potential to deliver more for clients and to grow across Canada.

Our strategy is to translate these new capabilities from digital client experience to capital deployment into strong and scalable long-term growth. For 35 years, much of our growth has come from word-of-mouth recommendations through the confidence and trust of our loyal clients. It's remarkable to think how successful we've been with limited investment in marketing, and we're looking forward to our growth potential powered by a national brand driving increased visibility and familiarity with our target clients.

We launched a new brand promise this year—Obsessed with Your Success—and we sharpened our visual identity with a contemporary new logo. We revamped our websites and brought in new expertise to engage business owners through digital and social media. Finally, we launched a new brand campaign—*We Come to You*—to show business owners the length we will go to help them succeed.

We know that our clients see us as responsive, helpful and different from the other banks. The feedback we receive on a regular basis confirms that it's our people and our culture that sets us apart. We're proud to be recognized as a Great Place to Work Canada™ and one of the Best Workplaces in Alberta™ this year.

As our transformation continues to drive significant change across CWB Financial Group, we also know that our culture is evolving to support our ambitious strategic agenda. In 2019 we introduced new core values that ground us in the qualities our clients and staff love about CWB. I'm confident that our culture will continue to be competitive and help us attract diverse talent to drive our future growth.

As we enter the new decade, there's no doubt in my mind that we are prepared well for the future. I'm proud to say that CWB is an increasingly disruptive force in Canadian financial services. We are well-positioned to take a greater share of our chosen markets and deliver long-term profitable growth in the years to come.

I'll now turn the call over to Carolyn.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Thanks, Chris. Good morning, everyone.

CWB delivered solid fourth quarter and fiscal 2019 financial performance. Fourth quarter common shareholders net income and pretax pre-provision income were up 5 percent and 3 percent respectively from the same quarter last year. Quarterly diluted and adjusted cash earnings per common share of $0.77 and $0.78 were up 7 percent and nil respectively, with the higher growth rate of diluted EPS primarily reflecting no acquisition-related fair value changes this quarter.

Fourth quarter total revenue growth was 6 percent. Net interest income was 7 percent higher with the benefit of 8 percent loan growth slightly offset by lower net interest margin. Non-interest income was consistent with the fourth quarter last year while credit quality was stable. Non-interest expenses were up 9 percent while acquisition-related fair value changes were $5 million lower and preferred share dividends were $2 million higher. On a full-year basis, common shareholders net income and pretax pre-provision income were up 7 percent and 6 percent respectively.

Solid earnings growth reflects the 7 percent increase in total revenue, stable credit quality, higher expenses from the continued investment in our strategic execution and lower acquisition-related fair value changes.

Full-year diluted and adjusted cash EPS of $3.04 and $3.15 were up 9 percent and 5 percent respectively. Total revenue growth included 8 percent growth of net interest income, benefiting from 8 percent loan growth and stable full-year net interest margin. Acquisition-related fair value changes were $12 million lower compared to 2018, while preferred share dividends were $6 million higher.

As Chris mentioned, loan growth included continued execution against our balance growth strategic objectives for further geographic and industry diversification. Central and Eastern Canada continued to lead growth by geographic market with a significant 13 percent increase, representing 42 percent of our overall loan growth this year. We expect growth in Ontario to continue to reflect ongoing contributions from our established businesses with a national footprint, as well as the planned opening of our first CWB Ontario branch premises in Mississauga this year. Our growing business presence in Ontario will also continue to benefit from capabilities centralized in our Toronto regional corporate office at 150 King Street that we officially opened last quarter.

That said, we expect progress towards our strategic goal for Ontario to represent a third of the overall portfolio to moderate somewhat compared to the significant growth rate achieved over the past several years. We expect the very high growth within CWB Maxium and CWB Franchise Finance to normalize somewhat. Growth from CWB National Leasing will likely be moderate in view of strong competition, and we expect high single-digit growth within CWB Optimum.

Looking at the rest of our footprint, growth was strong in Alberta this year at 8 percent, followed by 5 percent growth in British Columbia. Outstanding loans in Saskatchewan and Manitoba grew 4 percent and 7 percent respectively.

With respect to industry diversification, our strategically targeted general Commercial category led the way with a 15 percent increase. Personal Loans and Mortgages increased 8 percent, primarily reflecting “A” mortgage growth to leverage our securitization capabilities. Total loans within CWB Optimum were relatively unchanged from last year. Coming into 2019, we expect growth in this business to slow compared to prior years, reflecting our choice to tighten our approach in the market in response to B-20 changes and utilizing our AIRB capabilities.

However, it’s apparent that we tightened more than competing mortgage originators. With a new mortgage product for business owners launched late in Fiscal 2019, we expect to resume growth consistent with the rest of our Loan portfolio in 2020. Growth of Equipment Financing and Leasing in 2019 was strong at 9 percent overall. Commercial Mortgages increased 5 percent while Real Estate Project loans contracted $103 million.

In the normal course, we aim to deliver double-digit overall loan growth where prudent. This year, along with stable CWB Optimum balances, contractions within our Project Lending portfolio was a key factor constraining overall loan growth to the high single digits. The benefits of Project Lending growth in Alberta and Ontario were more than offset by the impact of successful completions and payouts in BC. While the pace of new project development in Greater Vancouver has moderated, authorizations related to wealth-supported projects continue and we have a strong pipeline of new lending opportunities.

Sound overall credit quality continues to reflect our secured lending business model, disciplined underwriting practices and proactive loan management. We remain confident in the strength, diversity and underwriting structure of the overall Loan portfolio.

Under IFRS 9, the fourth quarter provision for credit losses as a percentage of average loans was 19 basis points with 18 basis points for impaired loans and 1 basis point for performing loans. Under IAS 39, provisions for credit losses represented 19 basis points in the fourth quarter last year, entirely related to impaired loans. On a full-year basis, under IFRS 9, the annual provision for credit losses of 21 basis points related entirely to impaired loans. This compares to 20 basis points last year under IAS 39, consisting of 19 basis points for impaired loans and 1 basis point for performing loans.

We currently expect losses in 2020 to remain within our risk appetite and to be comparable to our historical experience. Gross impaired loans totaled $148 million compared to $138 million a year ago with both amounts representing 52 basis points of gross loans. We continue to proactively manage both impaired formations and resolutions. As we 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.

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 October 31, 2019 our total allowance for credit losses was $115 million compared to $111 million last quarter. The allowance for Stage 1 and 2 performing loans is unchanged from both last quarter and our IFRS 9 transition on November 1, 2018.

Slide 12 demonstrates our success in executing on key strategic objectives to grow and diversify our funding sources. As Chris mentioned, we delivered very strong brand-raised deposit growth of 12 percent over the past year, including 14 percent growth of demand in notice deposits. This growth was comprised about half from our banking branches, a third from Motive Financial, and the remainder of CWB Trust Services. Our very strong branch-raised deposit growth contributed to a reduction in the total balance of broker deposits compared to both last year and last quarter.

We also generated annual growth in our funding from debt capital markets with three successful senior deposit note issuances totaling $900 million, and increased debt from securitization to support originations of both Equipment Loans and Leases and Residential Mortgages.

The next slide demonstrates our solid track record of net interest income and total revenue growth over the past five years, along with the changes in net interest margin. Despite a volatile competitive operating environment we continue to win and expand client relationships, grow our business presence, and deliver steady increases in earnings. For Fiscal 2019, our net interest income was up 8 percent to a record $786 million, reflecting 8 percent loan growth and stable net interest margin, up 2.60 percent. Expectations for increases in net interest margin were tempered early in this past fiscal year when it became apparent that an anticipated Bank of Canada rate increase would not materialize.

In the end, stable net interest margin reflected the positive impacts of higher asset yields and lower average balances of cash and securities as a percentage of total average assets offset by higher funding costs and changes in funding mix.

Looking forward, we expect to deliver high single-digit growth of net interest income in Fiscal 2020 from the benefits of stronger loan growth partially offset by downward pressure on net interest margin. Our net interest margin has operated within a fairly tight range between 2.50 and 2.60 percent over the past several years, and we expect to remain around the midpoint of that range in Fiscal 2020 with the potential for quarterly volatility.

We also expect growth of non-interest income with increases across most categories, reflecting our ability to extend and deepen relationships with both new and existing clients across all business lines. The efficiency ratio of 46.5 percent compares to 45.7 percent last year, as revenue growth was outpaced by growth of expenses, reflecting our continued investment in strategic execution.

Operating leverage for the year was negative 1.8 percent compared to positive 1.9 percent last year. In 2018, revenue growth benefited from very strong loan growth, including 3 percent from a portfolio acquisition, as well as a 4 basis point improvement in net interest margin and gains from the Trust Services strategic transaction. Our annual efficiency ratio over the past three years is approximately 46 percent and we expect a consistent outcome in 2020, while delivering slightly positive operating leverage on a full-year basis. This incorporates our expectations for strong business growth supported through investment in strategic execution, along with effective control of non-interest expenses.

Notwithstanding our commitment to prudently manage expenses based on expected revenue growth, quarterly volatility of operating leverage is expected based on the timing of expenditures. With very strong capital ratios of 9.1 percent common equity Tier 1, 10.7 percent Tier 1, and 12.8 percent total capital at October 31, 2019, we're well-positioned to create value for shareholders through a range of capital deployment options.

Our Basel III leverage ratio of 8.3 percent at October 31 remains very strong. This year we repositioned CWB's capital structure to both optimize our cost of capital and support ongoing profitable growth and strategic execution. While our primary focus remains continued organic growth supported by strong capital ratios, the Normal Course Issuer Bid is a prudent tool to create value for shareholders when circumstances warrant, as they have at various points in the past year.

Yesterday, our Board declared a common share dividend of $0.28 per share, unchanged from last quarter and up $0.02 or 8 percent from the common share dividend declared in the same period last year.

As Chris discussed, our steady execution on all fronts also includes progress towards our planned transition to the *Advanced* approach for capital risk management. As we've shared before, we expect to file our final application and receive approval in Fiscal 2020. We anticipate a reduction in risk-weighted assets as calculated under AIRB approach to increase our regulatory capital ratios. However, we do not expect any other material impacts to our financial results in Fiscal 2020.

In view of the planned capital transition later in Fiscal 2020, we have discontinued our medium-term performance targets. We introduced these targets at the beginning of Fiscal 2016 and designed them to be effective over a three- to five-year period under the *Standardized* approach to calculating risk-weighted assets. We are confident our transition to the *Advanced* approach will support higher growth and profitability from our differentiated business model over the medium term. We expect to gain more certainty about the magnitude of capital available for deployment upon transition to the *Advanced* approach on approval of our final application and we expect to establish revised multiyear performance expectations, incorporating benefits of the capital transition following formal regulatory approval.

As we consider Fiscal 2020 on a stand-a-lone basis, including our strategic priorities and the potential impacts of the key performance drivers I've already discussed this morning, we expect to deliver growth of adjusted cash EPS in the mid-single digits, adjusted return on common shareholders' equity at a similar level to 2019, slightly positive operating leverage with quarterly volatility, a strong set one capital ratio and growth of common share dividends in the high single-digit range.

To conclude, we're very excited about the year ahead. We have executed our transformational strategy against a challenging backdrop over the past several years. We've created a larger addressable market and a more resilient business model to manage regional macroeconomic volatility. Going forward, we will continue to leverage focused business transformation, investment in breakthrough digital capabilities and our inclusive and diverse teams to enhance our client experience. Our strategy is designed to create tremendous value for the business owners we serve and we are confident CWB is well-positioned for breakout growth as a model-enabled Bank.

With that'll turn it back over to Matt.

Matt Evans – Vice President, Strategy and Corporate Development, CWB Financial Group

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

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the star, followed by one on your touchtone phone. You will hear a three-toned prompt acknowledging your request. Should you wish to decline from the polling process, press star, followed by two. If you're using a speakerphone, please lift the handset before pressing any keys.

Your first question is from Scott Chan from Canaccord Genuity. Please go ahead, Scott.

Scott Chan – Analyst, Canaccord Genuity

Good morning. Just looking at your 2020 targets, mid-single digit EPS growth, you talk about stronger loan growth in your assumptions. Have you backed away from that double-digit loan growth target and maybe the right number would be what you did in fiscal Q4?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Well, Scott, we aspirationally will target low double digits. I mean, that's absolutely what we focus on, but prudently delivered.

Scott Chan – Analyst, Canaccord Genuity

Just on National leasing, Carolyn, you talked about—I guess, one—what was the growth in that platform in '19? You talked about moderate growth. Does that mean low, mid-single digits?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Let us circle back with you, Scott. I just don't have the numbers right on the top of my head, so we'll come back. It'll probably be—yes, mid-single digits, yes.

Scott Chan – Analyst, Canaccord Genuity

Okay, that's fine. For 2020, okay excellent. Thank you.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Yes.

Operator

Thank you. The next question is from Meny Grauman from Cormark Securities. Please go ahead.

Meny Grauman – Analyst, Cormark Securities

Hi. Good morning. Just a few questions on the transition to AIRB. First, just if you have a little bit more clarity on the timing of approval, can you narrow it to a specific quarter? Then as a follow-on, does transition happen right after that, as soon as you get approval? Does it just switch on right away or is there a lag?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

We plan to submit early in the fiscal year, so let's say first half and probably approval in the second half of the year, so we can't really be more specific than that. The approval is not in our control.

Then the day we are approved as a model-enabled AIRB bank, we recalculate our risk-weighted assets using the new models. That happens binary; you are a *Standardized* bank up until the day you are an AIRB bank. The availability of capital to be deployed is expected to be staged over time.

Meny Grauman – Analyst, Cormark Securities

Okay. You talked about discussing with the market new medium-term targets – when do you expect to unveil that?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

We expect that to follow fairly closely after regulatory approval.

Meny Grauman – Analyst, Cormark Securities

Okay. In terms of just the expense drag coming from this transition, is there a falloff in terms of expenses right after approval; is there a spike in the lead up? If you could just maybe highlight, is there anything notable in terms of how you see expenses flowing from this particular project in 2020 specifically?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Yes. It's a number of components. There's a capital component that we've been working on over the past several years that will begin amortizing with approval. There are also portions of preparing to be a m odel-enabled bank where we have changed processes, workflows and the like, and most of those costs have been expenses as they have occurred, so some of them will continue – some of them will dissipate. Overall, you probably won't see anything that would represent a material spike or a material change in our overall NIE run rates.

Meny Grauman – Analyst, Cormark Securities

Just on the subject of expenses, you talked about the new Temenos agreement or relationship. How does that specifically impact expenses in 2020 and then beyond; what's the trajectory there in terms of the incremental expense growth?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

It's all factored into our total picture. We target loan growth in the low-double digits. We expect to be driving out total revenue growth in the high-single digits expenses to follow with slightly positive operating leverage for the year. It'll be all in the same package.

Meny Grauman – Analyst, Cormark Securities

Okay. Thank you.

Operator

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

Gabriel Dechaine – Analyst, National Bank Financial Group

Good morning, looking at your supplemental, GILs balances there—the oil and gas production loans—is nearly $20 million of impairment there; is that a re-class or is that just a new impairment?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

It's one loan, Gabe, in a syndicated structure that we don't have any anticipated loss.

Gabriel Dechaine – Analyst, National Bank Financial Group

Okay. All right. Just want to talk about the Real Estate Project loans. You said Ontario, Alberta had some advances, but those are more than offset by pay downs in BC. Then after—I'm not quite sure I made out what you're signaling there for the outlook on that particular portfolio. It's been declining for a number of quarters now; it's high margins. I just want to get a sense of your expectations.

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

The BC market was very strong in 2015 and '16. Our portfolio increased very significantly with our strong Tier 1 developers there. Those projects have worked their way through and have been paying out over the last few quarters, so that's really pressured the balances in that market. Also in the 2017, '18, '19 period there was a slowdown of new developments, so replacement projects did slow down, particularly in '18, and into '19—though, with the stabilization of the real estate market in the lower mainland, that has started to come back, so we're seeing a good pipeline of new projects coming back into play for our Tier 1 developers there.

In terms of the book itself—minus 3 percent growth over year—slight contraction but looking for fairly solid pipeline for Fiscal '20.

Gabriel Dechaine – Analyst, National Bank Financial Group

Do we say grow?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Yes, we expect growth in that portfolio in Fiscal '20.

Gabriel Dechaine – Analyst, National Bank Financial Group

All right. My last question—what's the main reason to remove medium-term targets in relation to a change in your capital model? Is there a single factor, like is it really about how much excess capital this transition may or may not create for you and how you invest that capital or what's the rationale?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

I think primarily, Gabe, it's that we believe that the combination of a number of major initiatives within our strategic execution culminate with the final application submission and approval, and that resets our ability to grow in a fairly significant manner. We just felt for us that we need more clarity around exactly what that will mean for us to be able to make medium forecasts to share with the market about the three- to five-year medium-term potential from a financial perspective.

Gabriel Dechaine – Analyst, National Bank Financial Group

Is it really about the capital flexibility then?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

I would say absolutely.

Gabriel Dechaine – Analyst, National Bank Financial Group

Okay. Thank you. Good day and Merry Christmas and all that.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Thank you, Gabe.

Operator

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

Sumit Malhorta – Analyst, Scotiabank

Good morning, guys. Just to maybe stay on those expectations for a minute, so ROE, you tell us in 2020 should be similar. Look, I think the expectations for lower growth across the sector has been prevalent for some time. But, how are you thinking about ROE after the transition occurs? It would seem like you're going to have to retain less of your earnings every quarter in order to fund your RWA growth. Are you in a position to communicate how you're thinking about ROE going forward and what your investors can look forward to from that perspective?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

I would say at this point we're comfortable sharing that we expect that one of the outcomes of the enhancements to capital and risk management that comes with AIRB approval will be the opportunity for capital deployment, initially with the approval. Some of that benefit is expected to be staged.

The second part of it is that, as you mentioned, we'll be able to grow either faster than we have in the past using organic sources of capital generation, or we will be able to add to the CET 1 capital ratio which gives us more flexibility around potential capital deployment options.

But we believe that both of those opportunities, both initially and over time, will be positive to ROE. But we don't have certainty yet that we're able to share about magnitude and timing of that.

Sumit Malhorta – Analyst, Scotiabank

All right. This is something as 2020 goes forward and we get to the end of next year you'll hopefully be in a position to update all of these numbers accordingly?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Absolutely.

Sumit Malhorta – Analyst, Scotiabank

Then for Chris, I think most likely the partnership with Temenos—I hope I'm saying that correctly—I think one of the stronger aspects for the Bank this year was the success that you had in building out the core deposit base. I know there've been periods of, let's call it, disruption in markets where your funding profile has been a source of consternation, but did show some success in that regard in 2019. This is maybe a bit of a stretch, but could you talk to us about how you're looking at this partnership and the ability to further drive your deposit growth going forward?

Maybe as you're rethinking those medium-term objectives to be reintroduced at some point, will deposit growth play a bigger role in how you communicate with the market?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Definitely. Yes. Our focus, for a number years, has been that generation of multiproduct clients. We've had a very strong history of solid loan growth in client generation through lending. Our goal and investments—in our business processes, in or core technology, our elimination of all of our legacy software—has been to ensure that we can provide full-service banking to our clients.

Our next step into the Temenos Infinity process will digitize the frontend of the Bank, provide online banking tools that are fully digital. Now, that will come in the next year. In this first year what we will get is digital on-boarding of clients, so starting with our Motive clients, later in this year. And ending, with us being able to move small- and medium-size businesses into digital on-boarding and then providing—from a cash management prospective—digital online banking.

Again, that all supports our ability to have more multiproduct clients, which then supports our deposit and funding profile. We are extremely happy with the progress we've made this year on our funding profile—we have a reduction in broker deposits—an increase in demand and notice of 12 percent. These are very positive outcomes and it's entirely on strategy that we've been focusing.

Sumit Malhorta – Analyst, Scotiabank

Last question is maybe a little bit more here and now. I was a little late getting on, so I apologize if this came up. Not only for CWB but for so many of your larger peers as well, it does seem like commercial loan growth was somewhat less robust on a sequential basis. I don't want to focus too much on one quarter with the only caveat being obviously there's been a good deal of conversation on the economic outlook and whether businesses are perhaps tapping the brakes on some project activity Canada.

As you think about—and I heard your expectations for the coming year, so maybe that's the answer—but are you seeing anything in your footprint in terms of your relationship with C&I borrowers in particular that lead you to believe that the economic backdrop is perhaps leading to less commercial loan demand than would've been the case for most of the past year?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Our best growth portfolio is our General Commercial book, which is our key one because that's our multiproduct client opportunity. It gives us that range of client growth. We had 8 percent growth in Alberta, 5 percent growth in BC, and 12 percent growth in Ontario; we feel we have good growth. Our market share [provides us] an opportunity to expand. The uncertainty about the economy in Alberta is an opportunity for us to prudently look at our market share, as we see how clients and other bank's relationships work. Often in the past we've had the opportunity pick up very strong clients in economically challenged times. If we have slower macroeconomic growth in Fiscal 2020, we'll continue to be very focused on those clients. The target of our Bank is that small- and medium-sized business —allows us to really specialize and pick the winners in that area, and we've continued to do that over the years and we have no change in our outlook for Fiscal '20.

Sumit Malhorta – Analyst, Scotiabank

Thanks for your time.

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Thank you.

Operator

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

Richard Roth – Analyst, TD Securities

Good morning. The first question, on your guidance for 2020, can you help me reconcile the difference between mid-single digit EPS growth compared to top-line growth in the high single digits and modestly positive operating leverage with flat credit losses? What's the offset?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

I think it's just the overall continued investment in the business—thinking about prudent, conservative assumptions in our base. We are anticipating ongoing challenges in net interest margin—there is a 50-50 chance of a Bank of Canada rate cut coming in 2020. There's a little bit of NIM presume coming from the implementation of IFRS 16 on leases. Then we know we have continued investments, so operating leverage we're targeting to positive, but slightly positive so not significantly positive. Then, thinking about the equity base, we saw a fairly significant movement in the amount of average equity this year coming from a recovery in unrealized losses in our security portfolio, balance in accumulated other comprehensive income. There are some factors that are not part of what factors into net earnings that then can impact ROE.

Richard Roth – Analyst, TD Securities

Okay. Yes. From the margin commentary that's already reflect in your NII guidance and I understand the investment component, but, presumably, if you have positive operating leverage with, let's say, 8 percent, 9 percent top-line growth, that should pretty much flow to the bottom line unless there's something weird going on with taxes or something else. That's where I was getting at, if there's some offset that I didn't take into consideration there.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Probably not material around taxes. We are getting a bit of benefit from the Alberta tax rate reductions, but it's probably not going to be more than a penny or something.

I think the other factor might be consistent provisions for credit losses actually implied growth in the dollar amount of provisioning given the expanding loan portfolio. The metric is stable, but the dollar amount would be higher. We can certainly work offline, Richard, and try to figure out the differences for you.

Richard Roth – Analyst, TD Securities

Yes. Okay. My other question, I guess, is related to credit losses, while we're on that topic. This year, cumulatively, it looks like your performing loan losses were almost negligible. That's in contrast to most of your peers that had pretty high bookings this year and especially this quarter. What are you guys seeing differently relative to your peers that's allowing you, from a modeling perspective, to not be forced or pushed to booking more Stage 1, Stage 2 reserves?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

If we start with macroeconomic factors—we start with an average of the large banks' public assumptions, so we are relatively consistent with them. I wouldn't say that there are differences in the macroeconomic forecasts that we start with. We use a different scenario. We don't use a set weighted average small number of scenarios, but that probably is not materially different. Then we look at our portfolio, the allocation between Stage 1 and Stage 2. Both come from finite factors, so any client who is 30 days in arrears automatically moves to Stage 2 and has lifetime credit losses estimated against it. Then I think the only underlying part of it has to be our historic credit losses and the composition of our portfolio compared to our peers.

Richard Roth – Analyst, TD Securities

Yes. That's what I was getting at. Basically, it sounds like in your modeling, when you look at your historical results, they've been better than some of the other banks, certainly—I don't exactly know what, behind the scenes, what's going on in the risk departments of other banks, but it seems to imply that your experience in downturns is better; is that fair to conclude given the difference in Stage 1, Stage 2 reserving?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Well, given that CWB is my only bank, I think I can't compare to what goes on in the other banks or risk departments. But I think about our portfolio and how it might be different, I think another factor is likely the duration. Our book has an average duration of about three years. We have a number of portfolios that amortize to zero in that time period. That means that for many of our portfolios, the difference between a 12-month loss and a lifetime loss is not that material. Even the cliff effect of moving from Stage 1 into Stage 2, the dollar impact is not that material.

Richard Roth – Analyst, TD Securities

Good. Thank you. That's very helpful. Thanks.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Thanks, Richard.

Operator

Thank you. The next question is from Marco Giurleo from CIBC. Please go ahead, Marco.

Marco Giurleo – Analyst, CIBC Capital Markets

Good morning. I had a couple of funding-related questions for Carolyn. Firstly, on the branch-raised deposits, we've seen two quarters of pretty strong growth there. I'm just curious how the funding costs compare to broker deposits, and notably on the Motive Financial side.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

I say we've had three quarters of really strong deposit growth, but won't quibble too much over that one. Overall, our branch-raised deposit funding has been somewhere in and around about a 35 basis point cheaper than broker on average.

Motive, we have held our rate on our Savvy Savings account at 2.8 for quite a while now and have had really good growth in that portfolio. That's one where we are still absolutely comfortable that the pricing of that product—

client acquisition costs. We are learning a lot about that channel. Those clients are sticky and we're really pleased with that. It fits well into the overall branch-raised deposit funding bucket that we have.

Marco Giurleo – Analyst, CIBC Capital Markets

As the funding mix shifts more to branch-raised deposits, do you expect to see a bit of an offset there for the NIM.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Certainly, that is absolutely one of the key planks in our strategic priorities, because not only are overall rates of that pool of branch-raised funding more attractive than the broker rates, they are also relationship deposits. Which allow us to move to multi-products and have the opportunity to broaden our client experience with those clients. They also tend to be more operational in nature and so there may be liquidity benefits as well to the amount of liquidity that we have to hold against them. There are a number of both strategic and operational benefits that come from the increase in the branch-raised deposit proportion to funding.

Marco Giurleo – Analyst, CIBC Capital Markets

All right. Just sticking on that topic with respect to funding mix, given the recent changes in the covered bond rule limits, just wondering how you guys view potentially tapping that market from a funding perspective.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Yes. We are actively watching the activity of some of our peers around covered bonds and RMBS as well. At this point, our view is that we are not currently originating enough volume of assets that are eligible for those vehicles to make them cost-effective for us as a funding channel at this point, but certainly it's something that's on our radar that we're watching develop and thinking about our business model.

Marco Giurleo – Analyst, CIBC Capital Markets

I see. Okay. Lastly—and apologize if you answered this already—just with respect to your NII guidance and your net interest margin guidance, are you embedding any rate cuts into those expectations?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

The current impression is a 50-50 chance of one rate cut, so that's what's built into our assumptions.

Marco Giurleo – Analyst, CIBC Capital Markets

Okay. All right. Thank you very much.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Thanks, Marco.

Operator

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

Darko Mihelic – Analyst, RBC Capital Markets

Hello. Good morning and a very sincere apology for asking the next set of questions if you've already answered them in some shape or form or fashion, but I want to run through a couple of really quick questions here so I can get to the real crux of my question.

The first question is the magnitude of capital available for deployment once you transition to the AIRB approach is uncertain. Can you speak to the level of uncertainty and what's causing the uncertainty? Is it purely that OSFI—you have no clue how much they will grant or how much will be approved? Then I have some follow-ups.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

I'm going to start. We've talked in the past that the models and the process and everything that goes into submitting the models for approval to use as a model-enabled bank are around the quantitative calculation of the pillar one risk weighted asset calculation, so working our way through that to the finalization of that with submission of our final application.

The second part is pillar two, which includes economic capital, things about concentration of the portfolio, includes our ICAAP, our Internal Capital Adequacy Assessment Process. We continue to work our way through that and that includes the establishment of what we believe are appropriate capital operating targets for us as a model-enabled bank. Then we discuss that with the regulator as part of the approval process. We've talked in the past that we expect there to be a transition to the full benefit, so we know that the maximum differential between AIRB risk-weighted assets and the *Standardized* approach, the maximum today is 75 percent of standardized, but we do expect the benefit of that to be phased in over time.

Darko Mihelic – Analyst, RBC Capital Markets

Okay. That's very helpful. Then the follow-up to that is what your intentions are. The reason why I ask that is, let's suppose it's—I don't know, pick a number—half, you're halfway there; what would your intentions be? The reason why I ask this is it really will have an impact on how I model 2021 and beyond because the way you guys write and the way I understand it is it'll free up a lot of capital. It sounds like you intend to use it for organic growth, but your intention for organic growth really matters with respect to how I'm going to view margin and so on. Is there any way you can actually answer that question?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Well, it's a difficult question to answer Darko. What we've said is as we look at capital—so, number one it changes the speed limit on the bank, right? As we think about having, say, a 10 percent reduction RWA in today's world, 10 percent growth rate starts to consume capital. Ten percent reduction RWA would actually move that growth rate to 12 percent and at 10 percent growth we would be generating positive capital. If we think about a 25 percent reduction of RWA—the current limit—that would change our growth rate to 18 percent before we would start to consume capital; and if we still grew at 10 percent we would generate about 50 basis points of capital.

It changes our flexibility quite dramatically, both organic growth, acquisition, buyback, or dividend increase. That would be the order of operations with the number one being organic growth. We would like more clients. We'd like more full-service clients. We want to improve our deposit base. We want a broader geographic footprint, so we're really focused on how we can deploy and more effectively manage capital to increase our addressable market in a broader geography.

Darko Mihelic – Analyst, RBC Capital Markets

Absolutely. I guess where I'm going with that is if you get significant reduction, the implication there is that you're on a more equal footing with the big six banks, let's say.

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Yes.

Darko Mihelic – Analyst, RBC Capital Markets

In which case you can grow faster, but you would be competing in a much more competitive environment, so I should expect your NIM over time to actually decline, but it's still probably a higher ROE loan; is that an appropriate way to think about modeling 2021 and dare I say 2022?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

I think that is a more appropriate way to think about it, Darko. It could mean that loans where the yield doesn't meet our hurdles today could meet our hurdles and our return on capital hurdles at threshold rates going forward. So you're right that might have an impact on NIM, but would benefit interest income which would benefit ROE.

Darko Mihelic – Analyst, RBC Capital Markets

Yes. Okay. Precisely. That's great. Thank you very much for that. One last question though, on credit. Despite the non-build of Stage 1 and Stage 2, I run a calculation that appears to suggest that your coverage of your LTM for your last 12 months losses are still higher than the midpoint of the big six banks. It suggests that, at least on the surface, there might be some conservatism in your reserves.

I guess the question then is if I look back at the last 12 months, is there anything you would call out that suggests there were some one offs in the provision and that in fact your conservatism is actually even higher, or do you think that the last 12 months of losses is a fair representation and your coverage of that, you're where you want to be?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Great question. I think if we look at our actual specific previsions and write-offs through Fiscal 2019, we did have a handful of larger single write-offs in the first half of the year and it normalized in the second half of the year, so not really anything I would call out on that. Our provisioning around impaired loans is absolutely consistent and unchanged from what we've always done where we look at every individual loan and we assess and determine the appropriate provision, if any, to take against them, so that absolutely hasn't changed.

The message that we take regarding the collective allowance is absolutely materially correct within the IFRS 9 accounting framework with our traditional conservative viewpoint, right. We know our portfolio. We understand that we are commercial portfolio as opposed to a largely residential portfolio, so our exposures tend to be a bit larger, so we are comfortable with the level of the models that we've built and how they are functioning.

Then we ask ourselves, how do we determine if the level of coverage is appropriate? One of the things we look at is how many years of losses do we have in the performing loan allowance? Right now with the end of the year that about $90 million represents [approximately two years of average losses] using the last five years actual losses. That includes the 2016 energy losses in that calculation and again another factor that makes us very comfortable.

Darko Mihelic – Analyst, RBC Capital Markets

Okay. Great. Thank you very much.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Thanks, Darko.

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Thanks, Darko.

Operator

Thank you. The next question is from Doug Young from Desjardins Capital Markets. Please go ahead, Doug.

Doug Young – Analyst, Desjardins Capital Markets

Good morning. I'll try to keep this quick. Just back to the guidance—and I admit this is going to go towards the capital and the AIRB conversion as well—but you're signalling mid-single digit EPS growth, but you're looking for high single-digit dividend growth in Fiscal '20. You're payout ratio, 35 percent in 2019, you've been targeting 30 percent. Are we moving towards more what the big six bank payout ratios are between 40 percent to 50 percent? Is that where we're moving towards for CWB and does the AIRB conversion let you move there a little bit easier?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

I would say we've not yet thought about really thinking about formal guidance around the dividend rate in an AIRB world because we don't have clarity yet on what it means. So can't really look out that far and comment on it. The expectation on 2020 dividend increase really assumes our same practice? It assumes that we will continue to evaluate dividends every quarter. All else being equal, we have the historic practice of every other quarter having an increase. It's really based on a no change, consistent with the past at this point.

Doug Young – Analyst, Desjardins Capital Markets

You're running above the 30 percent target and you have been for, I think, some time, so you're comfortable running there?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Yes. We're absolutely comfortable with the level that we're at currently. One of the options that's available for us on the other side of AIRB approval is to think about the common share dividend increase or common share dividends in general.

Doug Young – Analyst, Desjardins Capital Markets

I know I've asked this question before and I don't know if we can size the addressable market that the AIRB conversion provides to you. Clearly, you can go after more business, less capital intensive. Like, what is the size of that market that would fit within your threshold? Is there any way to think of that?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Well, I think it's very large. We've got a very small market share and it's also in that lower risk rated—so higher quality borrower—that today we have trouble competing with the big banks on, just given the capital. They today, as you well know, have about half the capital as we do, so from a return to capital perspective, as we price out loan opportunities, we're not competing for those larger clients. We have the opportunity to really generate many more clients; increase our market share in all the markets in which we operate.

Doug Young – Analyst, Desjardins Capital Markets

Is there any one segment or any one region where you see greater opportunity?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Well, I would say Ontario has got tremendous opportunity for us. It's the largest economy in the country. We're just opening our first branch there in the spring. We've got strong established businesses there with National Leasing, Maxium, Franchise Finance, and our Optimum Mortgage Team is there. We think Ontario has got very good opportunity for growth. BC has a solid economy. In Alberta we had 8 percent growth this year, so we'll continue to be very focused on our strong client base in Alberta as well.

We believe that all of the work we've done to transform our offer to our clients to improve their client experience with us is to generate better funding, better lending structures, better processes internally, really increase the scalability of our bank. And our next step into digital with Temenos Infinity just is the next point that allows us to just deliver more to all of those clients and, combined with AIRB and all of our internal process improvement, we just see lots of opportunity to gain market share.

Doug Young – Analyst, Desjardins Capital Markets

Just lastly, Carolyn, I missed your NIM outlook so can you just repeat that for me? Thanks.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

We've been at 2.60 full year for 2018 and 2019. When we look back over the past several years we've been operating in a range between 2.50 and 2.60, and we expect in 2020 to be around the midpoint of that range.

Doug Young – Analyst, Desjardins Capital Markets

Great. Thank you very much.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Thanks

Operator

Thank you. The next question is from Steve Theriault from Eight Capital. Please go ahead, Steve.

Stephen Theriault – Analyst, Eight Capital

Thanks. Just a couple of one cleanups. Again, on the margin, that 50 to 60 you said, is it fair to say it's more the lower end of that range if we do get a rate cut in 2020, Carolyn?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Our guidance around midpoint of that range assumes one rate cut.

Stephen Theriault – Analyst, Eight Capital

Okay. Then I wanted to ask, just around the Temenos. The digital offering you've been offering, the piloting and then offering for a while to Commercial customers—A) how has that been going and B) is that affected our enhanced by the Temenos agreement?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

We don't have digital right now, so this is a new offer. What we've delivered was a new online banking product for small business that has generated the growth of branch-raised deposits. What we'll be doing with digital is actually replacing that with a full-digital offer that includes all the cash investment services and the opportunities for us to provide even more insight into a client's business operations. It will provide better data and better ways for us to assist clients in their cash management processes.

Stephen Theriault – Analyst, Eight Capital

That very much enhances that initiative ultimately?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

It's a step-change. It's a much bigger opportunity.

Stephen Theriault – Analyst, Eight Capital

That's a 2021 conversion? Do you have a sense (cross-talking)?

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Yes. 2020 is getting the foundation in place that allows us to digitally onboard clients. 2021 is the delivery of the online banking products.

Stephen Theriault – Analyst, Eight Capital

Okay. I'll leave it there. Thanks.

Chris Fowler – President, Chief Executive Officer, CWB Financial Group

Thank you, Steve.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Thanks, Steve.

Operator

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

Nigel D'Souza – Analyst, Veritas Investment Research

Good morning. Thank you for taking my questions. I know we're running a little late on time. I just had two quick follow-ups for you. The first one, margins and capital, keeping with the theme. Carolyn, you mentioned on capital on the AIRB transition that the availability of that capital is expected to be staged over time. Is there any insight you can provide us on the cadence and timing of the capital release? In other words, did the bulk of that become available upon transition and then incremental availability past that or is it more evenly spread out, and over what time period?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

We're working on gaining certainty on that through the period between now and approval, so there's nothing specific that I can share on that today.

Nigel D'Souza – Analyst, Veritas Investment Research

Okay. Then the last quick question I have is on your margins. You mentioned, Carolyn, as well, an impact from IFRS 16, I believe. Is it possible for you to quantify what the impact might be on your margins?

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

It's one basis point, no more than two, so a factor but not the whole story certainly.

Nigel D'Souza – Analyst, Veritas Investment Research

Okay. That's all I had. Thank you for your time.

Carolyn Graham – Executive Vice President, Chief Financial Officer, CWB Financial Group

Thanks, Nigel.

Operator

Thank you. There are no further question. You may proceed.

Matt Evans – Vice President, Strategy and Corporate Development, CWB Financial Group

Thank you, Joanna. Thank you, all, very much for your continued interest in CWB Financial Group. We look forward to reporting our first quarter 2020 financial results on February 27.

With that, we wish you all a good day and all the best this holiday season.

Operator

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