CWB Financial Group

Third Quarter Fiscal 2020 Financial Results

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PRESENTATION

Operator

Good morning. My name is Colin and I will be your conference operator today.

At this time, I would like to welcome everyone to CWB Financial Group's Q3 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'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, then the number two.

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

Matt Rudd – Senior Vice President, Finance and Investor Relations, CWB Financial Group

Thanks Colin, and good morning everyone and welcome to our third quarter 2020 financial results conference call. My name is Matt Rudd and I'm the Senior Vice President, leading our Finance and Investor Relations teams.

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 CWB's business. Please refer to our forward-looking statement advisory on Slide 17.

The agenda for today's call is on the second slide. Presenting to you today are Chris Fowler, our President and Chief Executive Officer, who will provide an update on the proactive approach we have taken to assist our clients through these challenging times and to continue to execute on our transformational strategy. Carolyn Graham, our Executive Vice President and Chief Financial Officer, will follow-up with further detail on our third quarter financial results. We'll then open the lines for the question-and-answer session before Chris returns to provide his closing remarks.

I'll now turn the call over to Chris.

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

Thank you Matt, and good morning.

We delivered solid results this quarter as our teams continue to work diligently to support our clients, and prudently and proactively manage through the impact of the COVID-19 pandemic on the Canadian economy and financial markets. We also continue to execute against our strategic priorities on all fronts as we prepare for the opportunities of tomorrow.

On June 1st, we closed our strategic acquisition of T.E. Wealth and Leon Frazer & Associates, leading wealth management providers. The transaction is fully aligned with our strategic direction and will enhance our ability to provide a full suite of wealth management services with an extended geographic footprint, supporting our continued growth of strong client relationships across the country. With a significant portion of our new client base in Ontario, these businesses will help us accelerate full-service client growth, as we just opened our full-service branch in Ontario on August 4th. The Mississauga branch, in addition to two other branches we relocated this quarter feature our new client inspired design with open, adaptable and collaborative spaces that are tailored to the unique needs of our target business owner clients.

This quarter, we delivered a milestone on our digital roadmap, which will support our strategy for continued growth of branch-raised deposits. The launch of a fully digital onboarding for Motive Financial allows clients to open an account virtually and transact immediately. This will be followed by digital onboarding for the remainder of our personal banking clients in the fourth quarter of this year and expand to our business clients next year. We have not slowed on any timelines or progress on our digital transformation roadmap. We believe that the targeted capabilities our digital program delivers will augment full-service client growth across our expanding national footprint.

Each of these achievements are key steps on CWB's journey to be a disruptive force in Canadian financial services and deliver breakout growth in the years to come.

Turning to Slide 4, we were reminded by events across North America this summer that highlight the challenges people continue to face in our communities due to systemic racism. At CWB, as part of our core values, we put people first and believe that inclusion has power. So this quarter, we enacted expanded measures and support in the fight against systemic racism. We acknowledge our gaps in our own commitments, and we will tackle it with intention.

As public health measures to contain the spread of COVID-19 began to relax this quarter, we continued to provide a safe and healthy environment for our clients and our team members. Our dedicated teams remain in frequent communication with our clients to support them through the reopening of provincial economies and we have seen significant reductions in payment deferral arrangements.

As of this week, 64 percent of the deferrals, we previously granted, have returned to full scheduled payments. Under 10 percent of loan balances currently remain under some form of payment deferral, with over half of those making interest-only payments. New deferral requests have slowed to a nominal amount, and we expect continued success in working with our clients to help them resume normal payments.

We have fully triaged our loan book to find the right solutions for our clients and assess evolving risk profiles with a focus on portfolios particularly affected by the current economic challenges. The exposures we continue to pay close attention to include the hotel and restaurant sectors that represent just under 5 percent of our total loans, the office and retail real estate sector at approximately 4 percent, and the oil & gas production and oilfield service sectors that represent under 1 percent and 2 percent, respectively. We have insignificant exposure to air travel.

Our exposures within these industries remain stable, are well-diversified and supported by high-quality resilient borrowers that we have handpicked. We deeply understand their business and the individual exposures; nevertheless, we continue to carefully monitor them and the entire loan portfolio for signs of weakness, and will follow our normal practice to work closely with borrowers experiencing financial hardship.

As you can see on slide 5, our disciplined strategic execution has built a strong and stable foundation at CWB. We expect our continued focus to transform our business and invest in our digital capabilities, supported by our talented teams, will enhance our differentiated full-service client experience and position us for accelerated growth as the economy stabilizes. Thanks to our team's passion and dedication to support our clients and advance our strategic initiatives, we will be ready for the future, despite today's volatile operating environment.

We continue to expect approval to transition to the *Advanced Internal Ratings Based* approach for regulatory capital and risk management before this fiscal year-end. Utilization of the AIRB approach is expected to result in improved capital ratios that better reflect the strength of our underwriting and balance sheet. The transition to AIRB will also help us compete on a more level playing field against the large Canadian banks, and position us to deliver higher growth and profitability with an enhanced view of risk. Achievement of AIRB is a foundational capability for us and will enable us to realize our full potential across Canada.

I will now turn the call over to Carolyn, who will provide more detail on our third quarter financial performance.

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

Thank you, Chris, and good morning everyone.

As Chris mentioned, on June 1st, we closed the acquisition of the businesses of T.E. Wealth and Leon Frazer & Associates. Our financial results this quarter included two months of operations from these businesses, which contributed $6 million to wealth management non-interest income and $8 million to non-interest expenses, which included $2 million of one-time integration and acquisition costs, as well as the amortization of acquisition-related intangible assets. We continue to expect the acquisition to support adjusted earnings per common share modestly at first, with further accretion beginning in Fiscal 2022. The acquisition also increases our contribution of non-interest income to total revenue to approximately 12 percent for Fiscal 2021 with a negative impact on operating leverage in both Fiscal 2020 and 2021.

As you see on Slide 6, the impact of market disruption related to the COVID-19 global pandemic on the Canadian economy has put significant downward pressure on our financial results compared to the prior year. Our third quarter common shareholders' net income and earnings per share were lower compared to last year, reflecting an elevated estimated performing loan provision for credit losses due to an adverse shift in forward-looking economic conditions, combined with a reduction in net interest margin, reflecting the lower interest rate environment.

Our pre-tax pre-provision income was up 3 percent compared to the same quarter last year, as 4 percent revenue growth was partially offset by a 5 percent increase in adjusted non-interest expenses. We delivered an increase in net interest income as a benefit of 5 percent loan growth was largely offset by a 20 basis point decline in net interest margin. Our non-interest income was up 37 percent, primarily due to wealth management fees contributed by the acquisition, along with higher net gains on securities. The increase in non-interest expenses relate entirely to the wealth acquisition as our continued investment in our teams and technology to support overall business growth was fully offset by reduced spending on certain expenses in light of the current operating environment. Excluding the impact of the acquisition, our efficiency ratio was 45.7 percent this quarter, compared to 46.5 percent last year, and our operating leverage was positive 1.7 percent compared to negative 1.1 percent last year. We achieved this performance despite the headwinds on revenue while we maintained targeted spending to support our key strategic priorities, including our transition to AIRB and our digital transformation.

Slide 7 calculates our encouraging sequential financial performance. Net earnings rebounded strongly from the preceding quarter, primarily due to a lower estimated performing loan provision for credit losses and higher net interest income. Compared to the prior quarter, common shareholders' net income and diluted EPS increased 21 percent and 20 percent, respectively. Adjusted common shareholders' net income increased 24 percent, while adjusted EPS was up 23 percent. Our total revenue increased 6 percent compared to last quarter, primarily due to 5 percent higher net interest income, as well as 10 percent higher non-interest income that reflected increased wealth management fees from the acquisition partially offset by lower net gains on securities.

Our net interest income increased sequentially as a result of 2 percent loan growth, two additional interest earning days and a stable net interest margin that I'll discuss in a moment. Non-interest expenses were 7 percent higher, entirely due to the impact of the acquisition.

On a year-to-date basis on slide 8, pre-tax pre-provision income was up 2 percent, while our common shareholders' net income and diluted earnings per common share were down 7 percent and 6 percent, respectively. Adjusted common shareholders' net income and adjusted EPS were down 9 percent and 8 percent, respectively. The year-to-date decline in common shareholders' net income was driven by the same factors I discussed for the quarter's year-over-year comparison.

Turning to Slide 9, our third quarter net interest margin of 2.40 percent reflects a full quarter's impact of the consecutive Bank of Canada policy interest rate cuts in March. Third quarter net interest margin declined 20 basis points from one year ago and was unchanged from last quarter.

During the third quarter, the negative impact of the interest rate cuts was fully offset by lower funding costs through proactive measures to adjust the pricing of certain deposit products, balanced with maintenance of prudent levels of liquidity. Term deposit rates also trended down in the third quarter, reducing the funding costs of both branch and broker source deposits.

We expect our fourth quarter net interest margin will be roughly consistent with the current quarter. That said, our net interest margin is affected by many factors including further Bank of Canada policy rate changes, competitive deposit pricing factors, changes to the cost competitiveness or accessibility of funding channels, liquidity levels, loan growth, adjustments to loan pricing and the ability of our clients to recommence contractual payments following the completion of payment deferral periods.

Slide 10 demonstrates our continued success in executing on key strategic objectives to grow and diversify funding sources. This quarter marks our sixth consecutive quarter with a strong sequential increase in branch-raised deposits. Compared to last year, demand and notice deposits increased 34 percent and now account for 37 percent of our total funding, compared to 29 percent last year. We drove total branch-raised deposit growth of 22 percent, which resulted in a 14 percent reduction in the balance of broker deposits. Broker deposits now represent 26 percent of total funding, down from 32 percent last year.

The reduction in our reliance on the deposit broker network reflects our ongoing efforts to diversify funding sources and drive more branch-raised deposits as we generate additional full-service client relationships. I do want to emphasize that the broker deposit market remains a reliable and effective source of fixed term retail deposits, raised over a wide geographic base and has again proven to be a deep and liquid funding source. While the market disruption related to COVID-19 initially impacted the cost effectiveness of the broker deposit channel, pricing began to normalize in the third quarter in response to policy interest rate cuts and the implementation of facilities put in place by the Bank of Canada to support the liquidity of the financial system.

You'll see on Slide 11 that our total loans were up 5 percent over the past year, supported by 12 percent growth from our strategically targeted general commercial portfolio with 10 percent growth in Ontario. This very-strong general commercial loan growth reflects ongoing efforts to increase full-service relationships across our national footprint, while growth in Ontario reflects contributions from our businesses with a national footprint including CWB Maxium, CWB Franchise Finance and CWB National Leasing.

On a sequential basis, 2 percent loan growth in the third quarter was consistent with the previous quarter. New funding this quarter primarily consisted of loans that were in our pipeline prior to this period of disruption, which remained within our risk appetite and prudent underwriting guidelines. Line of credit utilization trended down during the quarter, partially offsetting new loan growth. Ontario accounted for approximately 40 percent of total growth, increasing 3 percent from last quarter, primarily driven by general commercial and real estate project loans. Looking forward, based on current conditions, we continue to expect mid-single digit loan growth for Fiscal 2020.

Turning to Slide 12, the credit quality of our portfolio and our provisioning for both, impaired and performing loans under IFRS 9 continues to reflect our secured lending business model, disciplined underwriting practices and proactive loan management, all hallmarks of our historic success. The third quarter provision for credit losses for performing loans, calculated using our past performance as well as a forward-looking view of macroeconomic factors, totaled 11 basis points. That compares to 27 basis points last quarter and a 3 basis point recovery a year ago.

At July 31, our allowance for credit losses on performing loans totaled $119 million, an increase of $8 million or 7 percent compared to the previous quarter. The third quarter provision for credit losses on performing loans reflects a shift in our macroeconomic forecasts compared to April 30, predominantly from a slightly longer recovery in the Canadian unemployment rate. We continue to calibrate the macroeconomic variables used in our IFRS 9 models to the average of the economic forecasts of the large Canadian banks.

The impact of COVID-19 on the economy and the timing of recovery continue to evolve. Our performing loan allowance for credit losses is estimated considering expectations for future economic factors, portfolio defaults or increases in the risk ratings of our performing loans. Ongoing shifts in these factors will impact the allowance balance in future quarters. The provision for credit losses on impaired loans at 22 basis points as a percentage of average loans remained stable with both the prior quarter and prior year.

The next slide shows our current and historical trends in gross impaired loans and write-offs. Gross impaired loans this quarter totaled $283 million or 95 basis points as a percentage of gross loans and remained relatively stable compared to $271 million and 93 basis points last quarter. The net increase in impaired loans from last quarter was driven primarily by the downgrade of one well-secured equipment financing borrower, partially offset by resolutions in other portfolios.

As you can see, our realized write-offs were low this quarter and have remained low through our history, even through periods of elevated levels of gross impaired loans, with the exception of a unique situation in 2016 where we were prevented by provincial regulators from realizing our security rights in our oil and gas portfolio. While the current economic challenges are unprecedented, our solid credit performance in the past in both healthy and challenged economic time reflects our prudent underwriting and secured credit model. While there remains considerable uncertainty in what lies ahead, we are confident our secured and high-quality credit portfolio provides a solid foundation as we continue to navigate this period of economic volatility.

Our strong capital ratios at July 31 appear on slide 14 with the change from last quarter primarily reflecting the 30 basis point investment for the wealth acquisition. Calculated using the standardized approach, our Common Equity Tier 1 Ratio was 8.8 percent, Tier 1 Ratio was 10.2 percent, and our Total Capital Ratio was 12.0 percent. At 8.1 percent, our Basel III leverage ratio remains very strong.

As Chris mentioned, we continue to expect regulatory approval of our formal AIRB application within Fiscal 2020. We expect this transition to boost our capital ratios, as risk-weighted assets will be calculated using more risk sensitive models.

Yesterday, our Board declared a common share dividend of $0.29 per share, consistent with the prior quarter and up $0.01 or 4 percent from the common share dividend declared one year ago.

Given the uncertainty of the economic outlook, we continue to perform multiple stress tests using our AIRB and IFRS 9 tools to simulate the impact of a more severe and prolonged period of challenging economic conditions throughout our geographic footprint. Considering the results of these stress tests and the uncertain economic outlook, we remain confident in our ability to deliver positive earnings for shareholders while we maintain financial stability, our current dividend and strong capital ratios, and very low leverage.

With that Colin, let’s open the lines for the Q&A.

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 touch-tone phone. You will hear a three-toned prompt acknowledging your request and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press star, followed by two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment for your first question.

Your first question comes from Meny Grauman of Scotiabank. Meny, please go ahead.

Meny Grauman – Analyst, Scotiabank

Hi, good morning. A question about margins first. I know that in the Q2 call, you talked about how April's NIM was down about 10 basis points from the Q2 average, so presumably, since then, the situation has gotten a lot better. So, I'm just wondering whether the margin results for Q3 surprised you and sort of what happened going from April's decline up to being flat for Q2 as a whole?

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

Yes. Primarily on the asset yield perspective, we continue to see what we had expected when we last spoke a quarter ago. Asset yields declined, reflecting the full impact for the quarter of the Bank of Canada rate drop, but we saw more positive movements on the deposit and funding side than what we had conservatively anticipated a quarter ago.

In particular, we saw movement in what we call our administered rates – so the competitive landscape began to tick down – and we proactively adjusted our rates as the market did. Then in the broker space, we started to see the rates respond to the Bank of Canada reduction quite significantly over the course of the quarter.

We were conservative at the end of last quarter and commented that there were a number of factors at play that would impact what NIM was, and they went in our favour this quarter. Looking forward, we are comfortable that Q4 should be around the same 2.40 as Q3.

Meny Grauman – Analyst, Scotiabank

Thanks for that. Then, if I could just ask about write-downs and how you foresee that evolving over time, and when do you reasonably expect to see a peak in that?

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

I'll start and then maybe Chris can chip in. If we just look at what has happened in the past, coming out of the global financial crisis, we saw gross impaired loans peak about a year after the economy turned, and so write-offs would be about that same period.

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

Yes. So, Meny, I think as we come through the summer, we've had a big reduction in our payment deferrals, people coming back online. I think there is a level of uncertainty of what the fall will bring, when expected reduction on government support programs. We're very much following our clients very closely to determine what those impacts may be. We'll continue to follow and be very close to our clients to understand impact.

I think it's a fluid situation. We're very comfortable where we sit today. We've established our performing loan allowance, we're very our confident where we sit with our specifics, and we'll continue to evaluate it.

Meny Grauman – Analyst, Scotiabank

Just on the subject of deferrals, do you have any appetite for considering extending deferrals at all? Is that in the realm of possible as you see it?

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

Well, we're triaging our loan portfolio client-by-client. We went into this process being very proactive, and did that review of our clients to see the impact of COVID on their business and we peaked at about just over 25 percent, and we're down to below 10 percent. As we look at clients coming out of deferral, we are looking at each of them individually. Some we've given say, a one-month extension on a deferral. We just haven't jumped straight to six months on clients. So, it is a very client-specific individual decision we've done, and based on the environment the client operates within, what the security coverage we have is, and to just to really be confident in our credit quality.

Meny Grauman – Analyst, Scotiabank

Thanks, Chris.

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

Thank you.

Operator

Your next question comes from Sohrab Movahedi. Please go ahead.

Sohrab Movahedi – Analyst, BMO Capital Markets

Hey, thank you. Maybe just a quick follow-up, Carolyn? You mentioned that some of your expectations around the funding last quarter proved to be too conservative relative to the administered rates and the brokerage space. Do you think you're also being as conservative in the guidance you're giving on Q4?

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

I think we're comfortable with, as we look ahead, as we look at the maturities in the broker market, we're comfortable with that with where we are. Again, there continues to be uncertainty, perhaps marginally less than the funding space with where things have moved in the last 90 days, but again, as Chris mentioned — the fall period — what happens as schools reopen across the country will sort of show what occurs in the economy.

We're comfortable and confident with that, with everything that we see today.

Sohrab Movahedi – Analyst, BMO Capital Markets

Okay, fair enough. Still sticking with that, I mean, I think you've mentioned that the new branch in Mississauga just kind of came online maybe a couple of weeks ago. If you could go through your slide 10 where you've got what's happened to the mix of funding, for example last year versus this year. If you were going to fast forward by a year, is it fair to — notwithstanding the fact that the broker term deposit example is still a very good source of funding diversification — is it conceivable that we could see another 500 basis point relative kind of reduction in the competition of broker deposits in the overall funding profile?

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

I think that would be a great outcome; I wouldn't bank on it. The piece that we're watching for in Q4 is that property taxes and corporate and personal income tax payments that usually occur earlier in the year have been deferred to August 31 and early September, so we're watching deposit balances carefully to see what occurs there. Twelve-month loan growth, about a third of our branch-raised deposit growth over the last 12 month has come in the Trust Services notice deposits. Again, part of that increase came from a movement from equities into cash, so if the equity markets normalize and investors are comfortable stepping back into the equity markets that may trend down a little over time, but we've not seen anything material happening yet.

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

I think I'll just add, Sohrab. Our intention on our branch-raised deposits really is how we are interacting with our clients. We just delivered our first product digitally with our Motive client onboarding and we are converting all the personal accounts to digital onboarding in this calendar year. Then next year, the commercial clients will be digitally onboarded. We have a lot more boats aren't going to shoot to win more deposits, and our focus is that expanded and more diversified funding base and we're just seeing great performance there.

Sohrab Movahedi – Analyst, BMO Capital Markets

Perfect. Just maybe a couple of quickies on the credit. I mean, you show I think on your Slide 12 that on total provisions, Q2 may have been maybe the peak, and you show that in 2016, I guess, it should have been the last time we saw a bit of a spike, it was around 38 basis points. I just haven't had a chance to dig it up here. Do you remember what proportion of 2016 loan book was in Alberta versus where you're at today?

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

Yes, we go back 10 years…

Sohrab Movahedi – Analyst, BMO Capital Markets

Alberta, yes, I just want—I'm just curious.

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

I think we were in the 36 percent range.

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

Yes, higher 30s, yes.

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

Yes.

Sohrab Movahedi – Analyst, BMO Capital Markets

Okay, so the composition—and, is it fair to say Chris that probably within the footprint — not that this is anything new — but Alberta is probably the one with the most precarious kind of economic outlook?

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

Well, I think the challenge in Alberta clearly is the oil and gas story, and that is a big contributor to economic growth here and it is clearly, it's slow. We still have many clients that are operating very profitably within that business, but growth is really the issue that isn't happening in that industry.

In terms of looking at what the future would be, and that's where we have seen sort of relative reduction of Alberta in our loan portfolio and the increase in Ontario and BC as percentages. So, we're still very-focused on our Alberta clients, we have many very strong ones here. We will continue to support them, but we have seen growth being stronger in other provinces.

Sohrab Movahedi – Analyst, BMO Capital Markets

That's really helpful. I guess, I just wanted to kind of really confirm I think what the numbers are showing that you are better reserved today, even with less of the footprint or of the loan book coming from probably the sensitive province anyway right now.

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

Right.

Sohrab Movahedi – Analyst, BMO Capital Markets

Versus 2016. Okay, thanks very much.

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

Thank you.

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

Thanks, Sohrab.

Operator

Your next question comes from Paul Holden from CIBC. Paul, please go ahead.

Paul Holden – Analyst, CIBC

Hi. Thanks. Good morning. Just a few questions for you, first related to those deferred loan payments and the triaging process you've gone through. I was wondering if you're willing to share more colour with us on the triage. i.e., what are the categories you put those deferred loans into and kind of what percentage of different loans fall into each of those difference buckets?

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

Paul, it's really we have account managers that lead those relationships. We have certainly asked them to be very on top of each individual client. We've got our commercial and then our retail. They've done direct callouts, so we make sure on the commercial side, we're understanding their financial reporting, how this is looking from a revenue perspective for them. The deferrals are really tied to that.

On the Retail side, we also have a team that is making direct calls to our residential mortgage borrowers, seeing where they sit, understanding what their situations are. It's really a client-by-client approach that we've taken. As reported, our reduction in deferrals is meaningful, and as we kind of look forward, there's still more reductions to come. It's working. We're positive as the economy has started to reopen that the results of the deferral I think was very timely for our clients in the economic shutdown that occurred, and as we're reopening, we're seeing ability to come back to full payment. Again, there's uncertainty in the future as we look into the fall, but we are maintaining a very close relationship with our clients.

Paul Holden – Analyst, CIBC

I'll ask it differently. Maybe in particular to the business loans that are still on deferrals, do you have a sense of what proportion of those would be impacted by ongoing shutdown, i.e. what percentage would be earning revenue, and earnings today versus those in shutdown?

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

If we look at our accounts that are in the deferral category, we also have over half of them that are paying interest. So, as much as we have deferral still in place, we have gone back to those clients, and they are maintaining interest payments current, which is certainly very positive, just not making principal payments and that as we tie it to revenue. We've identified areas that would be more COVID impacted, and we said hotel and restaurant sector, we said the office and retail real estate sector and, separately, the oil and gas both production and service. On the production side, we have no deferrals in place. But, as we look at each of those, we are working with them, and clients that are able to pay interest are, and we are working very closely to ensure that we've got a line-of-sight into their abilities to continue to move forward with their companies.

We still have none of our accounts that have come off deferral, have gone directly into watch and impaired at this point. Our arrears in that category is in the range of 1 percent. As you can imagine, it's an area of very focused activity in the Bank to be on top of our clients.

Paul Holden – Analyst, CIBC

Right, that's helpful.

The second question I want to ask is with the origination pipeline. In the MD&A you mentioned that loan growth this quarter was related to prior period origination pipeline. I'm wondering what the origination pipeline looks like today. Based on your guidance for loan growth for the year, I would get the impression, it probably suggests somewhere around 1 percent sequential growth in loans, but let me know if that's wrong or if that's right, or if I'm looking at it the right way.

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

Yes. I think, your perspective is correct. It's a challenging time to be marketing clients. Our focus has been to ensure that the clients we have today, we're meeting their needs and understanding their finance positions. Our goal with that proactivity is to create options for companies that aren't feeling that well served by their bank. So, we're definitely making sure that we're open for business, but the right business, very prudently underwritten.

Paul Holden – Analyst, CIBC

Thanks, those are the questions I had. Thank you..

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

Thank you, Paul.

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

Thanks, Paul.

Operator

Your next question comes from Steve Theriault from Eight Capital. Steve, please go ahead.

Steve Theriault – Analyst, Eight Capital

Thanks very much. Good morning everyone.

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

Good morning.

Steve Theriault – Analyst, Eight Capital

I want to start just following up on something you said, Carolyn, to Sohrab, the delay in property and corporate taxes. Kind of interested, do you normally see a seasonality there earlier in the year? Are you kind of alluding to that seasonality to get pushed out into Q4, and maybe we'll see a little bit of headwind on deposits as those get paid?

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

Well, property taxes, in Western Canada at least, are usually due at the end of June. So, we do see that has been pushed out this year. Then, personal income taxes end of April usually, now it's early September. Corporate tax for December year-ends — returns and final payments — are due six months after, so the end of June. We sometimes see at the end of June where there is a shift in deposit balances, and we factor that into our liquidity planning. We're just not quite sure what the impact will be. We're not quite sure how many depositors have deferred their payments; that was optional payment deferral. We're just remaining with strong liquidity so that we are prepared for what might come. But, it's again just part of that conservatively watching and thinking about the current environment and what that might mean for our operations as things continue to evolve.

Steve Theriault – Analyst, Eight Capital

Okay. That's helpful. Thanks. Then, did I hear you say that the wealth acquisition would negatively impact operating leverage? If I heard that right, is that like a short-term thing? Is it a statement on mix, or is it more just the integration charges on a reported basis? Maybe I misheard there, I'm not sure.

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

So, wealth has a different efficiency ratio structure than the core banking, so, overall, it will have a small impact. Right now, sort of this quarter, particularly for quarterly operating leverage, we'll see that for the next four quarters until we do a full wrap and until we have the business in the previous quarter and in the future quarter. That's why we say for Fiscal 2020 and 2021, we expect to be reporting the differential with and without wealth in the operating leverage.

Steve Theriault – Analyst, Eight Capital

That makes sense. More just the timing, and it'll roll off in due course. Okay.

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

Yes.

Steve Theriault – Analyst, Eight Capital

The last one I had was — you've got the branch in Ontario freshly opened — maybe it's a good opportunity to talk a little bit about how you're going to leverage that over time. I guess, kind of related, you're close to that AIRB approval, it sure sounds like. Are you starting to compete for more of that business that would typically be limited to some of your larger competitors, or does that need to wait? You've got the models up and running, but does that need to wait for actual approval? Is that, I guess, part of the the rationale and the strategy around the branch in Ontario?

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

Well, so AIRB is for whole balance sheet. The Ontario strategy is our diversification into that obviously very robust market. We're really happy to open. We've engaged a great team in Mississauga with some really strong people. The meaningful opportunity for us is the full-service client opportunity, and that's what we see just moving our franchise into Ontario and it really will complement the existing businesses we have there because we can now also look to provide full banking services to the customers and clients of Maxium and National Leasing and Franchise Finance. We see lots of wins for the Ontario branch, and in the future we really see the ability to grow. AIRB, I mean that will help us compete, of course, at a more level playing field with the big banks and the denominator in our return of capital will be lower, which will then allow us to look at lower risk rated clients and price them very effectively.

We see tremendous opportunities that AIRB provides us from a balance sheet perspective, from an underwriting perspective, from a pricing perspective, and from a risk management perspective. Every part of our business is touched by it, and it’s an opportunity for us to just run our bank differently. We’re looking forward to the opportunity to do that.

Steve Theriault – Analyst, Eight Capital

Looking at those lower RWA clients, that’s something that gets kick started sort of in 2021 after the formal approval?

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

Yes.

Steve Theriault – Analyst, Eight Capital

Okay. Thanks. That’s good for me. Thank you.

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

Thanks so much, Steve.

Operator

Your next question comes from Darko Mihelic of RBC. Darko, please go ahead.

Darko Mihelic – Analyst, RBC Capital Markets

Hi. Good morning.

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

Good morning.

Darko Mihelic – Analyst, RBC Capital Markets

Just a few questions here. First, I wanted to just get a sense from you, thinking about the deferral programs, but even not the deferral programs, even just outside of the deferral programs, can you give us a sense of how many of your borrowers are participating in government programs? Is there an element there of concern when those programs end? If you could just give me some rough ideas, that would be helpful.

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

As we look at the BCAP program, Business Credit Availability program, we chose to participate only in the EDC portion of that. The BDC one required administration that we didn't have embedded in our core banking system. So, we are participating in the EDC. We've got about $27 million approved there, so that I think is helpful for those clients from a liquidity perspective. We are actively looking to see where that can help clients as we look at different clients and their current financial position and what they're facing.

I don't have the data on clients that say are using wage subsidy or anything like that. But I would expect that like most companies out there, the owners and managers have looked at what is available for them in these programs that the government has put out there. But, Darko, I don't have the specific data on who's using exactly what. I just know what we've provided into the client base.

Darko Mihelic – Analyst, RBC Capital Markets

Just to be clear, Chris, it's not because you don't know, it's just you don't have the data, or is it that you actually don't know how many of your borrowers are participating in the wage subsidy program?

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

Our branches would know that, yes.

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

That would absolutely be part of the triage process.

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

For sure, that's part of the triage process. I don't have that data personally. I would say that the government programs have been very helpful in the amount of uncertainty in our economy. And I can tell you that we were on this from Day 1. We had a program called #CWBhasyourback. We reached out to all our clients, we made sure they were fully aware of all the government programs. I just don't have that in front of me right now. But, I would say that our clients, as all the banks' clients would have appropriately taken advantage of the measures that are available.

Darko Mihelic – Analyst, RBC Capital Markets

Okay. Just to dig a little deeper, I think, I've heard you say that 1 percent of those that came off deferral—is that right? One percent are sort of like a little bit behind in payments, which is not a big number, but is that the way to think about that?

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

That's in the range. Yes. None of the accounts coming off deferral have gone into watch or impaired.

Darko Mihelic – Analyst, RBC Capital Markets

Okay, but, I guess, are many of them in Stage 2?

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

The clients still on deferral, as we talked about last quarter, we have allowed to move into Stage 2, if that was where the conditional probability of default and the models moved them. About 22 percent of the loans still on deferral are in Stage 2. Of our total Stage 2 at the end of the third quarter, 85 percent of them are in Stage 2, again, because of the models, rather than because of client past due behaviour. I don't have it handy; I think it's immaterial, the ones that have come off deferral. They're not a significant contributing factor there.

Darko Mihelic – Analyst, RBC Capital Markets

Okay. The ones that have come off deferral, are they a representative sample of what's left? Or, is it possible that the remaining 2.9 [billion] have characteristics or possibly could show higher delinquency when they come off deferral in Q4?

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

I would think, Darko, it's mostly timing focused. We have a significant number coming up at the beginning of September as well that will be coming off deferral. As we went into the process of setting up deferrals, again we had that program —the direct callout program I mentioned — and spoke individually to clients, triaged their credit situation and we started with a 90-day deferral program. Primarily, they're coming off these. I think it's really affirming the underlying credit quality that we historically maintained over many years and we will continue to be very-focused on that.

Darko Mihelic – Analyst, RBC Capital Markets

Okay. I guess, Carolyn, if I can just ask you, you said 85 percent that are in Stage 2 of our—just so I get the numbers straight. Those that are in Stage 2, how many are deferred and how many aren't? Is there a way to think of it that way? I'm just curious as to what might be in Stage 2 that's actually not deferred, I guess, is effectively what I'm looking at.

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

Let us come back to you, Darko. We've got the numbers to piece it together, but let us come back to you, yes.

Darko Mihelic – Analyst, RBC Capital Markets

Sure. If I can just following up on one thing. I was having difficulty hearing you when you spoke about the revenue impact of the acquisition. I think you mentioned some sort of a proportion of net interest income versus non-interest income. I wanted to ask if the $5.9 million of non-interest income, if that's a normal representation of the kind of revenue impact.

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

That's a representation of about two months, but when we look at what the businesses have traditionally earned revenue per month, that would be indicative. The proportion that I gave at 12 percent non-interest income to total revenue, that's our projection for Fiscal 2021, when we'll have the full 12-month impact of the wealth contributing.

Darko Mihelic – Analyst, RBC Capital Markets

Perfect. Okay. That's exactly what I was looking for. Thank you for that and have a great weekend.

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

Your next question comes from Gabriel Dechaine from National Bank. Gabriel, please go ahead.

Gabriel Dechaine – Analyst, National Bank Financial

Good morning, I'll be quick. Darko asked the questions I wanted to ask. Anyway, what have I got left here? AIRB transitioning, and thanks for confirming it's going to happen in Q4, I guess, Fiscal 2020, we only got one left. Can you remind me kind of phase in we're expecting? Is that three years, the phase-in of the capital uplift?

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

As you can imagine, through the review process, we are actively working with OSFI through this and continue to discuss. So, it's not something that we are talking about publicly at this point. When we have approval, we'll share more information.

Gabriel Dechaine – Analyst, National Bank Financial

Okay. That's it for me. Thanks. Very good.

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

Thanks, Gabe.

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

Thanks, Gabe.

Operator

Your next question comes from Doug Young from Desjardin. Doug, please go ahead.

Doug Young – Analyst, Desjardin

Good morning and I apologize, I'm going to go back to the deferrals, just hopefully quickly here. Chris, it sounds like you expect this to wind down, call it in the next three months or so. Is that a fair statement?

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

Oh yes, for sure. Yes. The program is six months. The total program is six months, so yes we expect to be wound down in the next quarter.

Doug Young – Analyst, Desjardin

Do you have the LTV for the loans that are in deferral?

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

That would really vary based on the different categories they're in. I think when we look at each individual client and we determine the triaging of it and determining how it is we look at a loan deferral, I mean, it comes into what is kind of that repayment profile. Clearly, when you've got a strong LTV coming into it, it gives you more latitude in terms of not requiring principal payments. As I mentioned, about 54 percent of the deferrals are paying interest. So again, part of the triage is looking at what your security is, and as you look into a three- or four- or five- or six-month period, what impact that has on the loan horizon. We're comfortable with the structures we've put in place for the clients that have been granted payment deferrals.

Doug Young – Analyst, Desjardin

I noticed in your books that are interest in principal payments, like some of them, you're about halfway through, so your LTV would be 50 percent to 60 percent. I know there's a broad book and there's many different things that go in here, but would that be a reasonable assumption, it's in the 50 percent to 60 percent range, or is this just not something that we can get to?

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

Well, it would be hard to get to that. If we think about an equipment finance loan that might be true, when they amortize to zero over four to five years, depending on the original term. There's books of business, like our hotel business, where we start at 50 percent and it goes down from there. We have books of business that, for instance, our residential mortgage starts at 68 percent, for example, in terms of last quarter. It all depends on the client, the industry, the underwriting structure for each individual advance. Overall, as you know, a conservative lender, and we've had a very strong underwriting structure, and three months or three to six months with no payment is not a material change in the credit quality of that borrower.

Doug Young – Analyst, Desjardin

Okay, and then just on the migration, if I look at some of your notes, it looks like the performing loan PCLs, it looks like the net re-measurement there was about $12 million of performing PCLs related to that. Can you, maybe Carolyn, talk about how much of that maybe related to migration versus management overlay versus model updates? Have you updated all your PDs for all your portfolios up to date in terms of what we're seeing in the marketplace today?

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

I'll start and come back if I miss pieces of it, Doug. Our PDs for IFRS 9 are updated each quarter with the conditional probabilities of default based on the macroeconomic factors. They are updated to include the most current projections around the macro forecast. There would be some recognition of the shift between Stage 1 and Stage 2 that would be included in there. Sort of the exact nuances we could come back to you on; I don't have them top of mind.

Doug Young – Analyst, Desjardin

Yes. We can take that offline. I just wouldn't mind digging a bit into just how the migration and then the management overlay, because obviously the macro environment today is very different in Canada, is fluid and changing. I just wanted to take that offline. And then, just on allowances—sorry?

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

Yes. The only other thing I was going to say is that we continue to have a positive management overlay added on top of the risk-based calculations for the provision.

Doug Young – Analyst, Desjardin

Have you quantified what that management overlay is?

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

We have not quantified that. It's just part of our overall governance process around the provisioning.

Doug Young – Analyst, Desjardin

Okay. Then, just lastly, there's many different ways we can look at allowances and try to measure or try to quantify what that allowance is and get comfortable with that allowance. So, if I look at the total allowances over LTM net write-off, it's about 3.4. Some of your Big Six bank peers would be lower than that, some would be much higher than that. Is that a right ratio, right way to look at it? I mean, what do you look at? I know you've got all the models behind it, but from an external constituent, how would you approach that? Is that a reasonable way to think about it?

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

It's interesting. Through this, like you, we're looking at every possible metric that anyone comes up with and tries to assess, whether that is additional confirmation that adds to our comfort level with the overall provision. We also think about in particular around Stage 2, what's contributing to Stage 2? I mentioned that 85 percent of the loans that are currently in Stage 2 are in there because of the conditional probability of default and our view of macroeconomic forecasts. They tend to be better risk rate credit quality loans. So the provision per dollar of loans that are put in Stage 2 by the models tend to be less than loans that are in Stage 2 because they are past due or on our watch list, which end up with a higher risk rating, and so a higher dollar provision for every dollar of loan in Stage 2.

If we look at that composition of what is causing our Stage 2 balances, 85 percent of them this quarter are there because of the models. It's 80 percent in the second quarter. It's between 30 percent and 50 percent a year ago. And so a year ago, more of the loans in Stage 2 were there because they were past due or on the watch list, so we had more provided per dollar of loans in Stage 2 a year ago compared to today, and that makes sense looking at the underlying loans and the risk ratings on them.

Doug Young – Analyst, Desjardin

Okay. Thank you very much.

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

Thanks, Doug.

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

Thanks, Doug.

Operator

Your next question comes from Nigel D'Souza of Veritas Investment Research. Nigel, please go ahead.

Nigel D'Souza – Analyst, Veritas Investment Research

Thank you. Good morning. I just have two quick follow-up questions for you. First on deferrals, when I look at Stage 1 versus Stage 2, it looks like the bulk of the decline in deferrals were in Stage 1 loans. I understand that you're looking to that portfolio in detail and scrubbing it, but how can we interpret that Stage 1 balance currently? Do you expect the majority, where we stand today, of those loans to roll off without elevated delinquency risk? How should we think about it?

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

I guess at this point, the information is as clients reach the end of their first 90-day deferral period that for what we know now, they would behave like the ones that have rolled off already. We do have a significant bloc again, coming up the first week of September when their payment is due.

Nigel D'Souza – Analyst, Veritas Investment Research

Okay. That's really helpful. Then my last quick follow up is just on write off. You already touched on that previously, but I was hoping if you could maybe frame it relative to previous cycles. You pointed to why it was elevated in 2016. But now as you go through this cycle, we don't know what the number of impairments could potentially be. Do you expect loss rates on impairments to continually run lower than previous cycles, or what are your expectations as we pull through this?

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

I would say that's something that's very hard to predict, right? We carefully watch asset values. We think about our assets holding their value we realize our security and we go to dispose of the assets. I would say it's still early days in that process with this period of economic volatility.

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

I would just add, Nigel that just keep in mind that we are a secured lending model, so that when we look at write-offs, it is based on us having collateral behind the loans. We think the quality of our loan portfolio continues to be very strong. We've got a more diversified by geography book of business than we did in 2016 and certainly than we did in 2008, 2009, 2010. Again, we're very disciplined underwriters in terms of what we take for security, how we value it at origination of the loan, and we monitor it all closely.

It's a good question on write-offs. I think every bank will say they're on top of monitoring it and we are too. I think it's obviously crucial because ultimately that matters and we are making sure that we understand all the exposures.

Nigel D'Souza – Analyst, Veritas Investment Research

That's really, really helpful. Thank you.

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

Thank you.

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

Thanks, Nigel.

Operator

Ladies and gentlemen, as a reminder, should you have a question, please press star, followed by one.

Matt Rudd – Vice President, Finance, CWB Financial Group

Thanks, Colin. I think that's it for questions, so we'll go ahead and conclude our question-and-answer period and turn the call back over to Chris for his closing remarks.

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

Thanks Matt, and thanks everybody for your continued interest in CWB. We continue to navigate the impact of COVID-19 on the economy and execute on our solid plan to transform our bank to increase the value for our people, our clients and our investors.

Our dedicated teams have worked diligently to prepare CWB to transition to the advanced approach for capital and risk management. Leveraging the AIRB approach is expected to result in improved capital ratios that better reflect the strength of our underwriting and balance sheet, and better equip us to manage through economic downturns and allocate resources to target business segments that generate the most attractive risk adjusted returns. Transition to AIRB will also help us compete on a more level playing field against the large Canadian banks and position us to deliver higher growth and profitability with an enhanced view of risk.

We have challenged ourselves to expand our capabilities and materially strengthen and diversify our business. Every year, we have improved our processes and added new tools to expand those capabilities. We have diversified with a significantly expanded presence in Ontario and a broader base of general commercial loans and equipment financing and leasing. We've also expanded our funding sources through winning full-service client relationships to deliver very strong growth in our branch-raised deposits.

Our AIRB journey to date has provided us better tools and increased capabilities to manage credit, which will further support our reputation as a secured lender with a strong underwriting and loan management reputation. We are prudently and proactively managing our response to the impact of COVID-19 on the economy, while ensuring we are well positioned to capitalize on the tremendous opportunities in front of us. I would like to thank our staff for their passion and dedication.

Thank you, I look forward to speaking with you when we report our full-year financial results in December. With that, we wish you all a good morning. Thank you.

Operator

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