Canadian Western Bank
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PRESENTATION

Operator

Good morning. My name is Joanna and I will be your conference operator today. At this time, I would like to welcome everyone to CWB's Q4 Earnings Conference Call and Webcast. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during that time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, please press star then by two. Thank you.

Mr. Matt Rudd, you may begin your conference.

Matt Rudd — Senior Vice President, Finance & Investor Relations, Canadian Western Bank

Thank you, Joanna. Good morning, everyone, and welcome to our fourth quarter 2020 financial results conference call. My name is Matt Rudd and I'm the Senior Vice President leading our Finance and Investor Relations team.

I would 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 number 18.

The agenda for today's call is on the second slide. Presenting to you today are Chris Fowler, our President and Chief Executive Officer, and Carolyn Graham, our Executive Vice President and Chief Financial Officer. Following their presentations, we'll open the lines for the question and answer session.

I'll now turn the call over to Chris.

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Thank you, Matt, and good morning. At CWB, we will remember 2020 as a year our teams came together to support our clients and each other in an unprecedented environment. Our team's response to this situation has been truly outstanding and, thanks to their diligent efforts, we proactively supported our clients through economic uncertainty. We also made significant progress on our own strategic initiatives, including the wealth management acquisition. We also delivered another quarter of solid results in a challenging operating environment.

We entered this period of economic volatility from a position of stability and confidence due to the transformational changes we undertook over many years to strengthen and diversify our business. Our strong capital and funding base enabled us to continue to invest in our strategic priorities and support our clients when they needed us the most. At peak, we supported over 25% of our loan portfolio with payment deferrals. Since then, we have worked with our clients to resume normal payments and the percentage of outstanding loans with payment deferrals has now declined to approximately 1%. Three quarters of the clients who remain on payment deferral arrangements continue to pay the interest portion of their contractual payment. Our commitment to our clients has been prudent and we know will cement relationships for years to come.

Our robust enterprise risk management framework continues to serve us well and our credit performance remains strong in light of the economic conditions we faced this year. We are actively using the majority of our AIRB tools to manage credit risk as we navigate the current volatility. Our original timeline anticipated approval to transition to AIRB by 2020 year end. Six weeks ago, we provided an update that our approval timeline will now include completion of an AIRB parallel run while we continue to report regulatory capital under the *Standardized* approach. We will use this next period to fully embed AIRB into our operations, including our enhanced stress testing capabilities. We expect to complete our parallel run in 2021, followed by finalization of OSFI's review. We continue to expect AIRB to create long-term meaningful and lasting value for shareholders, and the shift in the expected timing of approval does not change our view.

We continue to make meaningful progress on all aspects of our strategic priorities. Strengthening our digital capabilities is a key deliverable to enhance our client experience. Earlier this year, Motive Financial launched digital onboarding so our clients can open accounts virtually and transact immediately. In November, we extended the end-to-end digital onboarding to all current and prospective personal clients.

The wealth acquisition we closed in the third quarter is a transformative step for us to become a leader in the Canadian private wealth industry. The acquisition's fiscal 2020 financial results, as well as client and team retention, have been consistent with our expectations. This quarter, we initiated a full integration of our wealth management operations to provide a differentiated private wealth experience to our clients.

We also consolidated our equipment finance and leasing businesses under common leadership to further enhance client relationships and leverage our position as a $5 billion equipment finance and leasing operation. We believe these combined initiatives will augment full-service client growth across our expanding national footprint, particularly in Ontario, and support our strategy for continued growth of lower cost sources of funding. Our expansion to meet the needs of business owners in Ontario is supported by our first full-service banking centre in Mississauga, which has surpassed all our initial performance expectations since opening this summer.

I'm very proud we've been recognized as one of Canada's Most Admired Corporate Cultures and one of the top 50 Best Workplaces in Financial Services and Insurance. Our focus is to build a positive and inclusive culture to solidify CWB as a career destination for top talent. This external recognition affirms we are on the right path.

Carolyn will provide a full update on our financial results. I'd like to highlight two pieces that stand out for me as continued demonstration that our strategy is yielding strong results: First, the 20% annual growth of branch-raised deposits, including 4% growth in Q4. This is our seventh quarter in a row with robust branch-raised deposit growth, underpinned by strong full service client growth. Second, we continue to drive strong growth in Ontario, accounting for half of our 2% quarterly loan growth and 12% for the full year. Both of these achievements mark significant progress toward our goal to become the best full-service bank for business owners in Canada and position us to deliver profitable long-term growth and enhance shareholder returns for years to come.

I will now turn the call over to Carolyn, who will provide detail on our fourth quarter financial performance and look ahead to 2021.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Thank you, Chris, and good morning, everyone.

Starting first with fiscal 2020, as you see on slide four, the impact of market disruption on the Canadian economy related to the COVID-19 global pandemic continued to put downward pressure on our financial results compared to last year. Our fourth quarter common shareholders' net income and adjusted earnings per common share were 6% and 4% lower, respectively, as revenue growth was more than offset by non-interest expense growth and an elevated provision for credit losses on performing loans.

Our pre-tax pre-provision income was up 2%, as 7% revenue growth was partially offset by a 13% increase in adjusted non-interest expenses. We delivered a 3% increase in net interest income, as the benefit of 6% loan growth was largely offset by a 10 basis point decline in net interest margin. Our non-interest income was up 54%, primarily due to the fees contributed by the wealth acquisition, along with higher net gains on securities. Non-interest expenses increased with the impact of the wealth acquisition, costs incurred related to organizational redesign initiatives, along with continued investment in our teams and technology to support overall business growth.

Organizational redesign initiatives will reduce operating costs and support accelerated delivery against our growth, digital transformation, and geographic diversification strategic priorities. They will also simplify the way we do business and improve our efficiency. Excluding the impact of the wealth acquisition and approximately $4 million of non-recurring costs related to the organizational redesign initiatives, non-interest expenses grew 2%.

The 26 basis point total provision for credit losses as a percentage of average loans was seven basis points higher than last year, reflecting a 15 basis points higher performing loan provision primarily related to the adverse shift in forward-looking economic conditions, offset by an eight basis points lower provision on impaired loans, determined on a case-by-case basis for each individual account.

As shown on slide five, compared to the third quarter, our common shareholders' net income and diluted EPS increased 2% and 3%, respectively. Adjusted common shareholders' net income and adjusted EPS each increased 1%.

Our total revenue increased 4% compared to last quarter due to 3% higher net interest income combined with 16% higher non-interest income. Our net interest income benefitted from a five basis point sequential improvement in net interest margin along with 2% loan growth, while non-interest income benefitted from the full quarter contribution of the wealth acquisition along with higher credit-related fees, partially offset by lower net gains on securities.

Non-interest expenses were 12% higher. Excluding the wealth acquisition and non-recurring costs related to organizational redesign initiatives, non-interest expenses were up 7%, primarily due to the customary seasonal expense increases we typically see in the fourth quarter combined with continued investment in technology to support overall business growth.

Our provision for credit losses on total loans of 26 basis points was seven basis points below last quarter, as a lower provision on impaired loans was partially offset by an increase in the provision on performing loans, primarily due to the continued evolution of the impact of the COVID-19 pandemic.

For the full year, pre-tax, pre-provision income increased 2%, while our common shareholders' net income and diluted EPS were down 7% and 6%, respectively. Adjusted common shareholders' net income and adjusted EPS were down 8% and 7%, respectively. The full-year decline in common shareholders' net income reflects an elevated performing loan provision for credit losses, primarily due to the significant adverse shift in forward-looking economic conditions, combined with a lower net interest margin reflecting the lower interest rate environment.

While non-interest expenses increased 8%, excluding the impact of the wealth acquisition and the non-recurring organizational redesign initiatives, non-interest expense growth was 2%. We continued to invest in our strategic priorities, but also tightly controlled our operating costs through the economic volatility this year.

As slide seven displays, we delivered revenue growth this year in a very challenging environment. Following an initial contraction of net interest margin in the second quarter as a result of the Bank of Canada's policy interest rate reductions, our net interest margin stabilized in the third quarter. And this quarter our net interest margin improved sequentially by five basis points from proactive deposit pricing changes in response to market conditions along with continued very strong branch-raised deposit growth. The NIM expansion, combined with 2% loan growth, generated 4% sequential growth in net interest income.

Looking ahead to fiscal 2021, we expect net interest margin in the range of 2.45%, relatively consistent with the fourth quarter of fiscal 2020, with the potential for quarterly volatility. As we've noted in the past, our net interest margin is affected by many factors, including further Bank of Canada policy interest rate changes, competitive deposit pricing factors, changes to the cost-effectiveness or accessibility of funding channels, liquidity levels, as well as loan growth and pricing. We expect growth of non-interest income across all categories in fiscal

2021 with the exception of net gains on securities, which are not expected to be material. Non-interest income is expected to represent approximately 12% of total revenue next year.

Slide eight reflects our success in broadening full-service client relationships across the country as we execute on key strategic objectives to grow and diversify funding sources. This quarter marks our seventh consecutive quarter with a strong sequential increase in branch-raised deposits. Demand and notice deposits increased 34% this year and now comprise 39% of total funding compared to 31% last year. We drove branch-raised deposit growth of 20%, which resulted in a 13% reduction in the outstanding balance of broker deposits, which now represent 24% of total funding, down from 29% last year. The reduction in our reliance on the 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 will note that the broker market remains a reliable and effective source of fixed-term retail deposits raised over a wide geographic base.

You'll see on slide nine that our total loans increased 6% in the past year, supported by 13% growth from our strategically targeted general commercial portfolio and 12% growth in Ontario. This very strong general commercial growth reflects ongoing efforts to increase full-service relationships across our national footprint. We also achieved further geographic diversification, with Ontario representing almost half of loan growth in both Q4 and for the year. Ontario-based loans now represent 23% of our total.

On a sequential basis, 2% loan growth in the fourth quarter was consistent with the previous quarter. Strategically targeted general commercial loans benefitted from strong growth in Ontario and commercial mortgages increased primarily due to strong new lending volumes with well-capitalized, high-quality borrowers. We continued to drive growth in residential "A" mortgages. Real estate project loans increased, primarily due to participation in syndicated facilities, partially offset by successful project completions.

Looking ahead to 2021, our continued strategic execution positions us to capture increased market share within a larger addressable market. Continued uncertainty remains in how the next six months in particular will unfold, with rising COVID-19 cases and vaccine delivery on the horizon. In the coming fiscal year, we expect to deliver mid-single-digit percentage loan growth whenever prudent, similar to this year. This includes a continued focus on originating secured loans that offer both an appropriate return and acceptable risk profile.

Turning to slide 10, the credit quality of our portfolio and our provision for both impaired and performing loans under IFRS 9 continues to reflect the secured nature of our lending portfolio, disciplined underwriting practices, and proactive loan management, all hallmarks of our historic success. The fourth quarter provision for credit losses on performing loans, calculated using our past performance as well as a forward-looking view of macroeconomic factors, totalled 16 basis points compared to one basis point last year and 11 basis points last quarter. At October 31st, our allowance for credit losses on performing loans totalled $130 million, an increase of $11 million or 9% compared to the previous quarter and $41 million or 46% compared to last year. The five basis point sequential increase in the provision on performing loans was primarily driven by an adverse shift in current and predicted borrower default rates as the impact of the COVID-19 pandemic continues to evolve. Our performing loan allowance is estimated considering expectations for future macroeconomic factors, portfolio defaults, or increases in the risk ratings of our loans. Ongoing shifts in these factors will continue to impact the allowance in future quarters.

The provision for credit losses on impaired loans, at ten basis points, declined from 18 basis points last year and 22 basis points last quarter and compares well with our five-year average of 22 basis points. Gross impaired loans at October 31st totalled $257 million, or 85 basis points of gross loans, and that’s down from $283 million, or 95 basis points last quarter. The net decrease in impaired loans from last quarter was primarily driven by full or partial resolutions all with no significant credit losses. Those resolutions included two significant Alberta-based commercial mortgage connections, a well-secured energy loan, and several equipment financing exposures. Our realized write-offs remained low this quarter and consistent with our history, even through periods of elevated levels of gross impaired loans. Our solid credit performance reflects our prudent underwriting and the secured nature of our lending portfolio.

While there continues to be significant uncertainty in what lies ahead, we remain confident in the solid foundation of our secured and high-quality credit portfolio. Based on our current outlook for the Canadian economy, as described further in our MD&A, we expect that our total provision for credit losses for fiscal 2021 will remain at elevated levels compared to 2019, but lower than the provision for credit losses we recognized for the full year of fiscal 2020. We also believe the composition of our provision for credit losses will shift and be weighted more heavily to impaired loans rather than performing loans, as fiscal 2021 progresses.

On slide 11, our dedicated teams remain in regular communication with our clients. As Chris noted, we've been successful in working with clients to resume normal payments and the percentage of outstanding loans deferring payments has declined to about 1%, with three quarters of those clients paying the interest portion of their contractual payment. Of the loans that have resumed making scheduled payments, at October 31st approximately 1% were past due and less than 1% were impaired. We continue to carefully monitor these loans and the entire portfolio for signs of weakness. We have expanded our Special Asset Management Unit to support our teams as we work proactively with borrowers experiencing financial difficulty.

On slide 12 we identify the proportion of loans categorized as Stage 2 for our estimate of expected credit loss, which now totals 34 basis points of total loans compared to 23% last quarter and 6% a year ago. There are three ways that a loan will move from Stage 1 to Stage 2. The first two relate to client-specific factors, either 30 days in arrears or on our watch list. The third factor is forward looking and model driven, based on a prediction of future downgrade in internal borrower risk rating of two or more notches since we originally funded that loan. Nearly 90% of our Stage 2 balances at October 31st are driven by our modelled expectations and only 10% by borrower-specific behaviour, consistent with last quarter. In contrast, a year ago, about half of our Stage 2 loans were driven by our models and the other half by client behaviour. We also see a lower blended loss rate in Q4 of 2020 compared to last year, as model-driven Stage 2 loans tend to have better credit quality and therefore a lower expected loss, even over their lifetime.

Looking at slide 13, our capital ratios remain strong and stable through this economic volatility. Calculated using the standardized approach, at October 31st our Common Equity Tier 1 ratio was 8.8%, Tier 1 ratio was 10.9%, and our total capital ratio was 12.6%. At 8.5%, our Basel III leverage ratio remains very strong. Our CET1 ratio is 30 basis points lower than a year ago, reflecting our wealth management acquisition, and the ratio was unchanged from July 31st. This quarter we bolstered our Tier 1 and total capital through our successful issuance of limited recourse capital notes, making us the first bank outside of the large Canadian banks to issue this Basel-compliant Tier 1 instrument.

Chris previously noted the extended AIRB timeline. Approval will provide a boost to our regulatory capital ratios due to the more risk-sensitive measurement of risk-weighted assets compared to the standardized approach. The approval extension does not change our near-term financial outlook as OSFI's current industry restrictions limit the deployment of capital through increased dividends or share buybacks. We will continue to actively use our AIRB tools to manage credit risk. These tools have enhanced our risk management and stress testing capabilities and better equip us to manage through economic downturns and allocate resources to target business segments that generate the most attractive risk-adjusted returns.

Yesterday, our Board declared a common share dividend of $0.29 per share, consistent with the prior quarter and up $0.01 or 4% from the dividend declared a year ago. Assuming the OSFI restriction remains in place, we expect to maintain our quarterly dividend at its current level through the next year.

Speaking of fiscal 2021, our overall outlook is provided on slide 14. We know that the current economic volatility will pass and our planned investment in 2021 will support continued strategic execution to ensure we are well positioned for accelerated growth when the economy rebounds. Our 2021 financial performance will reflect a balance between continued investment in our ability to deliver an unrivaled client experience and recognition that revenue growth will continue to reflect the very low interest rate environment and curtailed economic activity. We will prudently manage expenses and continue to execute on priorities aligned with our strategic direction.

Based on our expectations for a continued gradual recovery of the Canadian economy and the outlook I've already provided for several of our key performance drivers, in fiscal 2021 we expect to deliver adjusted earnings per common share and adjusted ROE relatively consistent with fiscal 2020, a strong CET1 capital ratio, and an elevated efficiency ratio compared to our historical experience as we continue to execute on our strategic priorities, including a full year contribution from our wealth acquisition. We will also expense the costs associated with operating as an AIRB bank, including amortization of our accumulated capital costs.

And with that, I'll turn it over to Chris to discuss our 2021 strategic priorities.

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Thank you, Carolyn.

The strategic investments we have made over the past 10 years support our solid results this year and have created great momentum. We have been through economic cycles before and know how to capitalize on the opportunities that emerge as the economy rebounds. In 2021, we will further optimize our business to ensure we're positioned to deliver on our future opportunities to provide unrivaled experiences to our clients.

We will continue to enhance our boutique full-service client experience with a focus to optimize client-facing interactions, leverage the synergies created with our equipment financing and leasing strategy, and enhance our wealth management offering through further integration. We will further advance our business transformation and digital capabilities to ensure we are well positioned to accommodate an expected permanent shift in client preference towards digital banking. Our success in digital onboarding personal clients in 2020 will be expanded to onboard small business and mid-market commercial clients in 2021.

We continue to replace our existing online platform with a seamless end-to-end digital banking experience for business and personal clients, complemented by our high-touch, personalized service. This will allow us to continue to diversify our business across Canada by attracting new clients both within and outside our branch footprint while further broadening our access to lower-cost funding.

Our expected transition to the AIRB methodology for regulatory capital and risk management, while delayed, will enhance our growth potential. With approval, improved risk-sensitive capital ratios will better reflect the strength of our balance sheet. Combined with the launch of our digital capabilities, AIRB will make us more competitive, support higher growth, and achieve further diversification with an enhanced view of risk. Achieving this next step will be a foundational capability to realize our full potential across Canada.

With that, operator, let’s open the lines for 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 the one on your touchtone phone. You will hear a three-tone prompt acknowledging your request. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

First question comes from Meny Grauman at Scotiabank. Please go ahead.

Meny Grauman — Analyst, Scotiabank

Hi. Good morning. First question on credit. The impaired PCL ratio came in really low this quarter. You talked about impairments increasing as we move later into 2021. Just wondering where you see that ratio peaking out in 2021.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

We've sort of looked at the overall total PCL ratio. We think it will be somewhere between where we were in 2020, at a more normal time, probably heavily skewed to impaired. So we don't have an exact number, but we expect that the majority of the PCL in 2021 will likely come on the impaired side.

Meny Grauman — Analyst, Scotiabank

Okay. And just on the issue of deposits, you keep highlighting very strong demand, branch-raised deposits, trying to disaggregate the success of your efforts versus just the broader trends that are boosting deposits across banks, so we're seeing the very strong deposit growth. Maybe the best way to ask is, just how sticky do you feel those deposits are? And as you look out to 2021, how do you see that growth progressing? Could you see a decline in deposits somewhere into 2021 if the recovery really gets going? How do you view commercial deposits as we move further into 2021, assuming the vaccine rolls out and things look better?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Great question, Meny. We looked carefully at where the growth came from in 2020. About two thirds of it came from new clients, which was very positive. We've also seen good growth in full-service client relationships, which means we're not only the lender of choice for those clients, but we also have their deposits and operating accounts and so that's very positive signs for us. Our expectations for overall branch-raised deposit growth in 2021 are not as robust as the very strong results in fiscal 2020, but still are expected to exceed loan growth.

Meny Grauman — Analyst, Scotiabank

Okay. And then just on the subject of loan growth, you talked about sort of mid-single digits. Just wondering, in terms of composition by type, do you see any change from what we saw this year in terms of strength in general commercial loans? Is there any sense that the pattern we saw in 2020 will be any different in 2021? And if you could talk sort of dynamics, as we move later into 2021 do you see anything changing in terms of where you expect the growth to come from?

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Meny, I would say that the focus we've had on building general commercial continues and the continued improvement in our capabilities, with digital front end that also is coming in 2021, will also enhance our ability to continue to support our general commercial growth. So that is really a very significant focus. We're also looking to integrate our wealth management operations as much as possible into generating more clients and a bigger portion of their wallet. So it's really lots of opportunity we see in front of us. General commercial is great. We also look at equipment finance with our one equipment strategy to pull all of our equipment finance operations under common management and we see that will create synergy, too. But that will take time as we work our way through 2021. But solid areas that we are supporting with very effective internal processes and strategy to enhance them.

Meny Grauman — Analyst, Scotiabank

In terms of the real estate project loans, do you see any material change in that in 2021?

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Well, we've got a really solid core client base in our meaningful areas of participation, Vancouver, Edmonton, Calgary, Toronto. We absolutely will continue to manage that. That's always been a very important book for us. Our borrowers have been very prudent in how they are looking at the market and determining how they take their projects forward. So, looking at that project growth, we had a decline in our BC book really with sort of a slowdown in Vancouver, but an increase in Toronto. So we are very attentive to the clients and being very prudent in our participation. But we do like the book and we'll continue to ensure that we participate in an appropriate and prudent way.

Meny Grauman — Analyst, Scotiabank

Thanks, Chris.

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Thanks, Meny.

Operator

Thank you. The next question comes from Paul Holden at CIBC. Please go ahead.

Paul Holden — Analyst, CIBC

Thank you. Good morning. I want to ask you a question on Alberta, recognizing that it's not specific to oil and gas but just the province more broadly. Are you starting to feel and see signs of improvement in Alberta given higher oil and gas prices? And I guess that's partly offset by COVID, but just wondering what you're seeing there in terms of recent trends.

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

I would say that Alberta still is in a pattern where we are looking for more signs for recovery. We have stability in certain sectors, absolutely. I think the stability of the oil price is positive, so we do see some opportunities there. We still have construction occurring with the TMX pipeline. We have construction on KXL. Now it's probably more BC. The LNG Canada is proceeding. So if we look at the core of the province, for us it is overrepresented in our gross impaired loans, but we have been stable and we have a lot of very strong clients in Alberta that we continue to support and we will continue to be very prudent and focused on how we continue to move Alberta forward.

Paul Holden — Analyst, CIBC

That's actually a good segue to my next question, which is with respect to performing allowances. Given some of the positive developments on oil prices and the likelihood we see a vaccine sooner than later, are there plausible scenarios you potentially see where maybe you're over reserved on credit right now and you could see those performing allowances reverse at some point in 2021 or 2022?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

I'd start from a position, Paul, that we are conservatively provided. I'm very comfortable with where our allowance sits on the unperforming loans and impaired. But macro forecasts that we used for Q4 still anticipate a slow recovery. So if things recovered better than that or more quickly than that or the economic impact of the second wave–which we expect to be less severe than the first – was even better than anticipated, that's always a possibility. Certainly, we started Q4 of last year, Q1 of this year, that was our allowance with a benign credit environment and expectation, so certainly when we return to that macroeconomic viewpoint we would expect that the performing loan allowance would trend up as well.

Paul Holden — Analyst, CIBC

Understand. Okay. Final one for me, and I think this is an important one to understand, is just with respect to the AIRB and this test through 2021. I guess what I need to better understand is, is it sort of a 12-month test and then we'll see where it goes from there? Or how do we view this in terms of just the longevity of running parallel systems?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

So we're starting with a parallel run. We expect that to take about a year. We continue to put the plan together of all of the different components of that to fully implement and meet the use test requirements and then we can turn it back over to OSFI to recommence their review.

Paul Holden — Analyst, CIBC

Understood. Thank you for your answers. That's it for me.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Thanks, Paul.

Operator

The next question comes from Gabriel Dechaine at National Bank. Please go ahead.

Gabriel Dechaine — Analyst, National Bank Financial

Good morning. Just a follow-up on the AIRB thing, and apologies if I missed the explanation, but earlier in the year it sounded like we were going to get it this year and now it’s delayed. Outside of COVID-related elements, I know that’s a big exception, but why was the delay taking place?

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Gabe, as we work our way through it, we are a commercially-focused bank, so we have a number of models that we are ensuring to capture the risk-sensitive nature of the businesses into which we lend. So we’re very focused in making sure that the manner into which all of our internal processes work really does identify and manage the risk to inform our ability to generate and calculate our capital levels. So what we get with the additional parallel run is just more time to prove out the risk sensitivity of the models and show their ability to capture the trends in this pandemic environment.

Gabriel Dechaine — Analyst, National Bank Financial

So fine-tuning, refining the model-type thing?

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Yeah. It’ll be, as Carolyn said, the use test. Making sure that the operation is reflective of the condition of the portfolio and, as the economy changes, that it’s captured.

Gabriel Dechaine — Analyst, National Bank Financial

Okay. The real estate project loan book, I know you addressed this earlier, and that's one where I don't think demand is so much the problem, but could supply be? And when I mean demand and supply, I'm talking about land and development land. Is that improving in any way in the next year in your view?

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

If I look at our portfolio of borrowers we have today –as I said before –, they've been very prudent in what they're deciding to take to market. They've been looking at securing locations that they believe will obviously support client demand. We really believe that our key Tier 1 borrowers are in very good position to take advantage of where this market will be. We still continue good performance in the book, but clearly, just given where the economy is at, people are just being more wary as they bring forward with new projects.

Gabriel Dechaine — Analyst, National Bank Financial

Okay. And just to wrap up on the NIM outperformance, a couple of times that's happened this year. That's great. The deposit shift, it seems to be like one of the main drivers here – correct me if I'm wrong there –because it's replacing the broker deposits in your funding structure. Can you give me a pricing differential quantification? Like for every dollar of deposit that you raise in the branch versus the brokers? Like what's the spread pickup there?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Yeah, the differential between average branch-raised for the entire bucket and broker is in and around 25 basis points.

Gabriel Dechaine — Analyst, National Bank Financial

Okay. That's pretty consistent historically, though right?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Pretty consistent historically, fixed to fixed. But as we continue to expand our notice and demand in-branch full-service client relationships, we have the opportunity to expand that differential.

Gabriel Dechaine — Analyst, National Bank Financial

And just to wrap up, how much of that growth over the past year came from the Ontario branch? I know it's just one, but it's a big province. And I guess where I'm going with that is that we expect this frothy deposit growth to slow down, but given that you've got the geographic angle here, a new geography, that you can actually maintain pretty high deposit growth rates for quite some time.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

So the branch opened in August, still in a pandemic world. The deposit growth of that one branch was from zero to a number that's not very large in our overall growth in deposits for the year. But we're pleased with the interest of clients who want to talk to us, who want to engage with the folks that we have in that branch, and we're really pleased with the first few months and what we're seeing there. So we know there's great potential for us.

Gabriel Dechaine — Analyst, National Bank Financial

All right, thanks, and an early happy holidays.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Same to you, Gabe.

Operator

Thank you. The next question comes from Sohrab Movahedi at BMO Capital Markets. Please go ahead.

Sohrab Movahedi — Analyst, BMO Capital Markets

Okay. Thank you. Just maybe two or three quick questions. Chris, throughout the footprint and different lines of business, are you seeing available loan growth that your risk appetite is having you pass up on?

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

I would say that we always have been careful on how we choose loans. We are very targeted in the areas in which we lend. The challenge we are finding right now too is even good quality ones, we're seeing a lot of pricing challenge too that we have to decide whether we participate at the yield levels that are being offered by the other banks. So I would say the answer to that would be yes, we are continuing to be selective, we're making sure that we're adhering to our risk appetite, but also a lot of internal talk on pricing discipline as well.

Sohrab Movahedi — Analyst, BMO Capital Markets

Okay. That's good. Thank you. And Carolyn, did I hear you correctly that this quarter includes about $4 million of kind of elevated expenses that you expect will go away next year?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

What we described as organizational redesign initiatives about $4 million in the fourth quarter. About half of that we expect to be reductions in our long-term run rate. The other half is being reinvested in both enhancing a number of our branches to deliver what we call in the “branch of the now experience” for our clients who still are looking to deal with us in branch and also reinvesting into our digital road map.

Sohrab Movahedi — Analyst, BMO Capital Markets

Okay. Perfect. Thank you for that clarity. And the last thing, can you just repeat what you said about your expectations for EPS and ROE next year?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

EPS and ROE roughly consistent with 2020.

Sohrab Movahedi — Analyst, BMO Capital Markets

But like how so? Are you talking about like an EPS growth or an EPS dollar?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Dollar. Yes.

Sohrab Movahedi — Analyst, BMO Capital Markets

Okay. Thank you.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Thanks, Sohrab.

Operator

Thank you. The next question comes from Darko Mihelic from RBC. Please go ahead.

Darko Mihelic — Analyst, RBC Capital Markets

Hi there and good morning. I've got a question on the Stage 2 loans. Specific to personal loans and mortgages, 61% in Stage 2, that seems high. And I realize it's a modelled result, but nevertheless, it does seem high. And so the question is, A, if you can perhaps walk me through the sort of modelling that went behind it. And then secondarily, are there any real-world ramifications for having such a high level in Stage 2? For example, one would think if you really are that concerned with that level of personal loans and mortgages, you might turn to your sales force and say, well, six out of ten of the mortgages we used to underwrite, we're not going to do now. So any help along those lines would be helpful.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

So let me start with the factors that drove that relatively high level of Stage 2 related to personal loans and mortgages, primarily due to the relatively short duration of that portfolio. About 55% of our personal loans and mortgages are comprised of the Optimum portfolio, so they tend to be one to two years in term, and the volatility that we're seeing in the macroeconomic factors–specifically unemployment and GDP, which are the two primary factors for that model– the volatility over the next 12 months. So, the Stage 2 movement is coming from the volatility in the next 12 months, which then doesn't capture the recovery that comes after that 12-month period. So that's primarily the factor that's driving the increase and the larger balance in Stage 2.

I'm going to let Chris answer the one about whether the business changes, but we've not seen a commensurate increase in past due balances related to Optimum. We've seen really good progress in them bringing their clients on payment deferral down and having those clients restart payments. So we aren't seeing indicative signs in the book to corroborate that modelled outcome in the Stage 2 balances.

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

I think that's the key. Overall in Stage 2 we have 87% of the Stage 2 balances are model-driven, and that is an interesting outcome as we are in this pandemic. It's an area that we're managing.

But coming back to our personal loans and mortgages on the Optimum side, we have been focused on how we do the underwriting and ensure that we are focusing on what we would call our Alt-A plus book where we've got key income confirmation structures, key B20 compliance stories, and a real focus on how we manage that at a low loan-to-value as well. We have had a very strong historic track record in this book. We're not seeing, from a gross impairment perspective and net charge-offs perspective, any change in that book, which historically has been on a net charge-offs of around four basis points.

So it's been a strong book. But we are continuing to monitor our underwriting. And then to Carolyn's point, the model is capturing the duration of these models in a very volatile economy.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

And then the only other piece I'd just come back and circle back on, Darko, is that this portfolio, Chris talked about our historic loss rates, the LG is very low. So having a larger proportion in Stage 2 hasn't driven out a materially higher allowance for credit losses.

Darko Mihelic — Analyst, RBC Capital Markets

I can appreciate that, and that's sort of what I thought, but what about real-world ramifications? So if I have ten mortgages coming due in January, does that mean six out of ten of them you're going to kind of do something different? Does it change any behaviours?

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Well, not necessarily, because if it goes into Stage 2 – if there's a two-notch change in the risk rating and it still could be well within our band of acceptable rating. So it's not that these are all turning into loans that you would look to not renew. So it's a function of how the model works as opposed to necessarily the choice that you would like reduce your retention rate on existing mortgages. So that's a great question.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

It's interesting. The way the model works, so theoretically, any loan that was originated in a pre-COVID world should be showing signs of pressure that potentially move it to Stage 2 just by virtue of what the macroeconomic factors have done. With those Optimum mortgages, when we revisit them on renewable and consider offering another commitment to those borrowers, these Stage 1/Stage 2 allocation starts fresh again. So the comparison of whether there's an expected two-notch downgrade starts from when we have underwritten that new loan again at renewal. So if the economy improves from there, those mortgages should be stuck firmly in Stage 1 and have little risk of moving to Stage 2 in the future.

Darko Mihelic — Analyst, RBC Capital Markets

Thank you for that. And I'm going to follow up with, it was my understanding that the Optimum portfolio, or is it not the Optimum portfolio? Now I'm getting a little confused. I have to go back and look at my notes. But for the AIRB modelling, I thought that it was the mortgage book that was in a very advanced state. Is that still true and does this have any sort of read-through for AIRB?

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

No. You're right, Optimum Mortgage and National Leasing were the two portfolios where the models were put into use first on the credit side. IFRS 9 models all came into play at the same time when we went live. So I wouldn't say there's a read through.

Darko Mihelic — Analyst, RBC Capital Markets

Okay. All right, thanks very much.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Thanks, Darko.

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Thanks, Darko

Operator

Thank you. The next question comes from Lemar Persaud at Cormark. Please go ahead.

Lemar Persaud — Analyst, Cormark Securities

Thanks. I just have a really quick point of clarification on an earlier answer. So I just want to be clear with respect to the outlook for PCL, because it's a little bit different than I would have thought. So based on where we stand today in 2021, we should expect rising impaired PCLs, but that's not necessarily going to be offset by performing releases. I just want to make sure that I'm clear on that.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Well, we expect our overall PCL to moderate down from our overall 2020 PCL rate. So we don't expect it to return to normal pre-COVID, but we do expect it to moderate down from the 2020 level. And if we look at 2019, all of our 22 basis point full year PCL was related to impaired loans and none was related to the performing loan allowance. 2020, we've seen a material portion of the PCL for 2020 going towards the performing loan allowance and the less going towards the impaired. In 2021 we expect there to be a shift over the year, so although we expect the total to be down from fiscal 2020, we do expect the impaired portion of the PCL through 2021 to be higher than it was in 2020. We expect that gross impaireds will continue to tick up. What we saw in the global financial crisis that our gross impaireds peaked a year after the economy turned, so we do expect that there will be clients that we'll be working with over the next year or two, so there would be more impaired PCLs but within a total provision that we expect to trend down from the 2020 level.

Lemar Persaud — Analyst, Cormark Securities

Okay, that's great. Thank you.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Thanks, Lemar.

Operator

Thank you. And your next question is a follow-up from Gabriel Dechaine at National Bank. Please go ahead.

Gabriel Dechaine — Analyst, National Bank Financial

Right. I just want to follow up on Sohrab's line of questioning. You said the EPS number next year will be consistent, so you did $2.93 this year in adjusted. Next year should be somewhere around that number. I'm just trying to understand that, because the way I look at it, your exit rate on margin is higher; PCL, the dollar value of PCL total next year should be lower than this year; your loan base is higher. Unless it's a big ramp-up in expenses, I'm struggling a bit with the lack of growth message.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

So we expect NIM to hold constant from Q4, but we did have four months in fiscal 2020 before interest rates fell, so we will be having the wrap on … Loan growth, as we mentioned, mid-size or mid-tier. We talked about PCLs. We do expect expenses to be higher; in 2020 as we have five months of the wealth acquisition. We will have 12 months in fiscal 2021. We have begun to expense the cost of operating as an AIRB bank and we have also begun to amortize the cumulative capital cost of that program, so that's about an $8 million increase to our run rate on NIEs for the year, so about $2 million a quarter. So our guidance around the efficiency ratio is trending a bit higher than our historical rates now.

Gabriel Dechaine — Analyst, National Bank Financial

Okay. That helps. Thank you for the clarification.

Carolyn Graham — Executive Vice President & Chief Financial Officer, Canadian Western Bank

Thanks, Gabe.

Operator

Thank you. There are no further questions at this time. I will now turn the call over to Chris Fowler for closing remarks.

Chris Fowler — President & Chief Executive Officer, Canadian Western Bank

Thank you, operator. I would like to take a moment to thank our investors for their continued support and our teams for their tremendous efforts.

As we navigate the challenges of the current environment, we continue to execute our strategy to create long-term value for our stakeholders. We have a history of strong performance and have built a solid platform to prudently accelerate our growth as opportunities arise. We appreciate your confidence in CWB and we look forward to reporting our first quarter financial results in February. With that, we wish you and your families a happy and healthy holiday season. Thank you very much.

Operator

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