Canadian Western Bank

Second Quarter 2021 Results

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PRESENTATION

Operator

Good morning, my name is Michelle, and I will be your conference Operator today. At this time, I would like to welcome everyone to CWB's Second Quarter Financial Results Conference Call and Webcast.

Now I would like to turn the call over to Mr. Patrick Gallagher. You may begin your conference.

Patrick Gallagher — Vice President, Strategy and Investor Relations, Canadian Western Bank

Good morning and welcome to our second quarter 2021 financial results conference call. My name is Patrick Gallagher and I'm the Vice President leading our Strategy 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 2. The agenda for today's call is on the third slide.

Presenting to you today are Chris Fowler, our President and Chief Executive Officer, and Matt Rudd, our Executive Vice President and Chief Financial Officer. Following the presentations, we'll open the lines for the question-and-answer session.

I'll now turn the call over to Chris, who will begin his discussion on Slide 4.

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

Thank you, Patrick and good morning. Our teams continue to deliver financial performance that surpassed our expectations this quarter. While we've benefited from a lower provision for credit losses compared to the same quarter last year, a major driver of our strong financial performance was growth in net interest income. Pre-tax pre-provision income increased 11 percent compared to the same quarter last year and we significantly increased our full year earnings per share expectations this quarter.

Our focus to support our clients by investing in our capabilities and product offering is creating solid growth opportunities for CWB, especially as the near-term economic outlook improves. We're seeing signs of a strong economic recovery that could provide additional accretive opportunities within our risk appetite to surpass our baseline loan growth expectations. To provide capital flexibility to take advantage of these potential opportunities, we plan to establish an at-the-market common equity distribution program. This program will provide a flexible and efficient tool to grow our regulatory capital base, if needed, in parallel with strong levels of loan growth to drive incremental shareholder returns.

We also continue to make strong progress on our strategic priorities, which is reflected in the growth and further diversification of our funding sources. This quarter, we increased lower cost branch-raised deposits 2 percent sequentially, which supported continued net interest margin improvement and revenue growth. Our total loans were up 3 percent compared to last quarter with robust growth across all provinces and the strongest activity in our commercial mortgage and general commercial portfolios. Within these two categories, we continued to support existing clients while also adding new full-service relationships with strong credit profiles.

Our strategic focus on geographic diversification resulted in continued general commercial loan growth in Ontario driven by effective collaboration between our Mississauga banking centre and our other lines of business that lend in Ontario. As the economy recovers, we will be well positioned to accelerate our growth and capture increased market share in the province fueled by our planned opening of a second full-service banking centre in Fiscal 2022.

Throughout the quarter, we have gained significant insights as we continue to use our AIRB tools and processes across our business and have identified opportunities for enhancements that we expect will improve our efficiency and effectiveness as an AIRB bank. We plan to implement these enhancements and expect to extend our previously communicated timeline for resubmission of our AIRB application beyond the first half of 2022 but believe this approach will result in a more favourable long-term outcome for our teams and for our investors.

We also continue to execute on the development of our digital client offering, which will provide end to end digital banking to complement our proactive relationship-based client experience. In the second half of 2021, we will commence a limited initial rollout of our virtual COO, a digital solution powered by explainable artificial intelligence. This innovative digital tool will provide small business owners with access to real time information on their financial health and relevant insights to accelerate their business growth. Our enhanced and targeted digital capabilities will enable us to continue to grow and diversify our business across Canada by winning new clients both within and outside our branch footprint, while further broadening our access to stable, lower cost funding.

This quarter, we were recognized by Great Place to Work as one of the 50 best workplaces in Canada for the second consecutive year. We're proud to be recognized as a career destination for top talent while our teams continue to make significant progress on our ambitious strategic agenda during the exceptional circumstances of the past year. There's no question that our people are core to our success and receiving this award is especially gratifying as it's based on confidential feedback from our teams.

I'll now turn the call over to Matt, who will provide greater detail on our second quarter performance and improved outlook for 2021.

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Thanks Chris and good morning everyone.

Turning to Slide 5, on a full year basis, branch-raised deposit growth of 18 percent reflects our continued focus on full-service relationships. Demand and notice deposits, which are our lowest cost source of funding, increased 34 percent compared to last year and now account for 42 percent of our total funding. We also continued to build greater funding diversity on the strength of our capital markets program with two senior deposit notes totaling $750 million issued during the quarter at historically low credit spreads. Our efforts to grow and diversify our funding sources drove a reduction in the outstanding balance of broker deposits, which now represent 21 percent of our total funding compared to 26 percent last year.

Looking at Slide 6, our total loans increased 7 percent in the past year. That was supported by robust growth across the country. Our 24 percent growth in commercial mortgages primarily reflects strong new lending volumes in British Columbia and Alberta with high quality borrowers that remain within our risk appetite. We also drove 9 percent growth in our strategically targeted general commercial portfolio, including 15 percent growth in Ontario. Total Ontario loans grew 10 percent compared to last year and now represent 23 percent of our total loans. 7 percent growth in Alberta primarily reflects general commercial loans and growth in commercial mortgages.

On a sequential basis, we delivered very strong growth in commercial mortgages. Approximately two-thirds of that growth related to strong existing CWB clients, and we've had success in maintaining the lending relationship on completed real estate construction projects. Our general commercial growth this quarter was very well balanced across numerous industries with clients with very strong credit profiles. This loan category is a strategic growth area for us as it provides excellent opportunities to increase our full-service client relationships.

As Slide 7 shows, we delivered very strong second quarter results. Our common shareholders net income increased 40 percent and pre-tax pre-provision income increased 11 percent compared to last year. That was supported by strong loan growth and higher net interest margin, despite the low interest rate environment.

Adjusted earnings per share increased by $0.24 from the same quarter last year. We did have a $0.17 contribution from a lower total provision for credit losses and that was primarily driven by a net recovery of $5 million in our estimated provision for credit losses on performing loans compared to a charge of $19 million last year. Higher net interest income compared to last year contributed $0.22 to EPS and reflected the benefit of a 13 basis point increase in net interest margin and 7 percent annual loan growth. That was partially offset by the impact of one fewer interest earning day this quarter.

Excluding the wealth acquisition, higher non-interest expenses reduced EPS by $0.10 as we continue to invest in our strategic priorities and incurred the costs associated with operating our AIRB tools and processes. We also paid the first semi-annual coupon payment on our Series 1 LRCNs during this quarter, which reduced EPS by $0.05. Lower gains on securities sold this year reduced EPS by $0.02, as in the prior year gains were higher as we rebalanced our security portfolio to reflect a significant shift in interest rates.

Our sequential earnings performance is shown on Slide 8 and reflects a 1 percent increase in total revenue despite three less interest earning days this quarter. Our common shareholders net income decreased 9 percent and pre-tax pre-provision income decreased 3 percent compared to last quarter. Adjusted EPS was reduced by $0.09 primarily due to a 5 percent increase in non-interest expenses as expected and the semi-annual LRCN coupon payment made during the quarter, both of which had a $0.05 EPS impact.

As shown on Slide 9, our net interest margin has continued to build since the third quarter last year. During the second quarter, our net interest margin increased by 6 basis points compared to the previous quarter. This reflects the positive impact of proactive deposit pricing changes that we were able to execute while also driving strong branch-raised deposit growth, and we had a one-time 2 basis point benefit associated with balance sheet management activities corresponding to a shift in our funding mix. The NIM expansion this quarter combined with 3 percent loan growth more than offset the impact of three fewer interest earning days to generate 1 percent sequential growth in net interest income.

Turning to Slide 10, the second quarter provision for credit losses on total loans of 20 basis points was up 2 basis points from last quarter. Our performing loan provision for credit losses was a recovery of 7 basis points compared to a 6 basis point recovery last quarter. Compared to the same quarter last year, the total provision for credit losses was 29 basis points lower, driven by a 34 basis point decrease in the performing loan provision for credit losses primarily due to improved macroeconomic forecasts associated with the ongoing economic recovery. Our allowance for credit losses on performing loans totaled $121 million and, as previously noted, that was a decrease of $5 million compared to the previous quarter. The forecast used in our estimation of the performing loan allowance this quarter was slightly more optimistic than the outlook we used last quarter. The credit performance of our borrowers through this quarter was stable with overall levels of delinquency that remained well below where they were just prior to the emergence of the COVID-19 pandemic.

We continue to maintain an appropriate level of performing of loan allowances for credit losses based on the current volatile economic conditions. Ongoing shifts in macroeconomic factors, changes in the level of portfolio defaults, or changes in the risk rating of our loans will continue to impact the performing loan allowance in future quarters.

At 27 basis points, our provision for credit losses on impaired loans was 3 basis points higher than last quarter and 5 basis points higher than the same quarter last year. Gross impaired loans were 95 basis points of total loans, up from 93 basis points last quarter and last year.

Our realized write-offs remain low, which has been consistent with our historical experience even through periods of elevated levels of gross impaired loan formations. Our strong credit performance reflects our prudent underwriting, the secured nature of our lending portfolio, and our disciplined management of impaired loans through to resolution while limiting realized loan losses.

Based on our current outlook for the Canadian economy, which is described further in our MD&A, we expect for the second half of Fiscal 2021 a total provision for credit losses and basis points within a range between the high 20s and low 30s, and that will be mostly attributable to impaired loan provisions for credit losses. That said, we acknowledge the current operating environment is unique, as is the path forward considering potential shifts in COVID-19 infection rates, restrictions enacted by public health authorities, and changes in government support and stimulus, which makes the expected level of impaired loans and expected losses difficult to predict.

Our capital ratios have remained relatively stable over the last year, as noted on Slide 11. Calculated using the standardized approach, our common equity Tier 1 ratio was 8.7 percent, 10 basis points lower than last quarter and 40 basis points lower than a year ago. The change from last year was primarily as a result of our wealth management acquisition. The change in this quarter was primarily as a result of our very strong loan growth. Both our Tier 1 and total capital ratios are significantly above prior year due to two LRCN issuances, and we plan to fully redeem our Series 7 preferred shares on the next redemption date available of July 31, 2021.

Yesterday our Board declared a common share dividend of $0.29 per share, consistent with the dividends declared last year and last quarter.

Looking forward on Slide 12, while we expect the trajectory of the economic recovery will be dampened in the near term, continued vaccine delivery has provided optimism for a strong economic recovery once restrictions are loosened. Under the assumption of a gradual recovery of the Canadian economy, we now expect to deliver full year 2021 percentage growth of adjusted EPS in the mid-teens, primarily as a result of stronger net interest income and lower provisions for credit losses than previously expected.

Higher net interest income is expected to be driven by stronger loan growth. We now expect to deliver loan growth in the high single digits on a full year basis in 2021. Net interest margin is expected to fluctuate around 250 basis points over the second half of the year, and that's on the assumption of relatively stable funding cost. We do expect continued branch-raised deposit growth but at a lower level than the first half of Fiscal 2021 as strong growth from expanded full-service client relationships is expected to be partially offset by declines in deposits due to increased business and consumer spending through the expected economic recovery.

With stronger net interest income growth, we expect our efficiency ratio on a full year basis to finish between 48 percent and 49 percent as we continue to make the planned investments in our strategic priorities for our clients and also including the expenditures associated with our AIRB parallel run.

As Chris mentioned earlier, we are seeing signals of a strong economic recovery that could provide additional opportunities to surpass our current loan growth expectations while remaining within our risk appetite. To provide the capital flexibility to take advantage of these potential opportunities, we plan to establish a $150 million at-the-market common equity distribution program. This program will provide a flexible and efficient tool to grow our regulatory capital base if needed in parallel with stronger levels of loan growth to drive incremental shareholder returns.

With that, Michelle, let's open the lines for Q&A.

Q & A

Operator

The first question comes from Paul Holden from CIBC. Your line is open.

Paul Holden – Analyst, CIBC

Thank you, good morning. I think there's some confusion out there regarding the ATM, which you just referred to, so it's probably worth drilling down on that a bit. Just so people understand at what level it might be used. So,I guess that's my first question and my estimates suggest that if you're growing loans at something over around 8 percent, that's kind of where you might need to tap into new equity capital. Maybe you can verify if that's a reasonable assumption or not, or what the right assumption would be.

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Yes, good morning Paul. Yes, you are absolutely within the ballpark. The level of loan growth we're expecting, that high-single digit, that's something we can deliver within our existing capital base, so we feel really good about that. The purpose of the ATM is for those situations where we look and we're starting to realize, or we are very certain that our pipelines are strong and delivering loan growth above those levels looks likely, so that's what we would be looking to use the ATM for. It would be to match it to loan growth we're generating above our current expectations in order to maintain our capital ratios in or around current levels.

Paul Holden – Analyst, CIBC

Understand. The other math I was running was just to maintain your capital levels, figuring out—let's just use the $150 million max, how much of additional loans that might correspond to? Given your current loan RWA to CET1, I figure it's roughly an 8 to 1 ratio in other words, $150 million of equity would get you roughly 1.2 billion of loans. Is that again in the right ballpark, or?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Yes, your math on that's solid. The actual RWA consumption, of course, will depend on the mix of loan growth, but expecting the current mix continuing is a reasonable assumption.

Paul Holden – Analyst, CIBC

Okay, that's great. Thank you. I guess the last point of clarification, I think I understand this one, but I think it's important to clarify. You're repaying $150 million of prefs but still planning $150 million, up to $150 million of ATM. That's not a mutually exclusive decision because there are regulatory limits, excuse me, on prefs and LRCNs, so you couldn't just simply take the prefs and not do the ATM. Is that correct?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Well, there are two independent decisions. Our call to redeem the Series 7 preferred shares is if you just look at our capital stack right now, our CET1 is 170 basis points over regulatory minimums. Our Tier 1 is 270 basis points over, our total is 240 basis points over, so the redemption of our Series 7 shares is to reset the middle and end of that stack down to what we think are more appropriate levels, also in recognition that the Series 7 prefs, they're quite expensive. The spread is 547 basis points over, so also quite expensive. We view the LRCNs we raised, they were replacement capital for these pref shares, and we were able to do that on a fairly accretive basis, so that was the thinking there. Just a bit of a timing lag between when we issued the LRCNs and then the redemption of the prefs.

Paul Holden – Analyst, CIBC

Got it, okay. I'll re-queue. Thank you.

Operator

Your next question will come from Doug Young from Desjardins. Your line is open.

Doug Young – Analyst, Desjardins

Good morning. Just maybe a further clarification on the ATM, what would your—what would you be willing to take your CET1 ratio down to before you felt you needed to tap it, or are you at that level where if it actually went down 10 basis points, you would feel compelled to kind of tap into that ATM? What's that trigger point?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Yes Doug, we're in no imminent danger or imminent risk. We like where we're sitting right now when we look at what's in front of us. We've been comfortable at this level through COVID. We've been hanging around this level. So the intent would be to maintain it in or around this range, based on what we see. If we do see a little bit of volatility around that, that's okay, and that's why we like this program. It puts us in the driver's seat, it allows us to be flexible and mindful of the loan growth that we see as it actually occurs or as it's very solidly in our pipeline. The fact we're not looking for it on an emergency or rush basis also allows us to be very thoughtful about when we're issuing, how much we issue at once, when we do it, at what price. It puts a lot of tools in our tool kit and a lot of flexibility to be very opportunistic with it, and the fact we're in a good capital position right now adds to that optionality, flexibility, and ability to be opportunistic.

Doug Young – Analyst, Desjardins

Okay, so you like where you are now, but if you started to move lower from this level, that's when you would start to click in to the ATM essentially?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

That's right, yes. If we saw a loan growth there that we were realizing that was starting to drift us lower, then yes, this would be the offset as we would look to issue the incremental shares to match up to that incremental loan growth.

Doug Young – Analyst, Desjardins

Then just further, I thought, and maybe you can correct me if I'm wrong, I went back in time in my memory here and I thought you didn't eat into your CET1, because clearly at a 7 percent loan growth this quarter, you reduced your CET1 ratio, as that was the explanation in the MD&A, but I thought that didn't occur until loan growth was in the low double digits before. I wrong on that, and has there structurally been a change in the capital, a change in how that works?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Yes, the grind on CET1 from loan growth will be dependent on where we're growing. Our growth this quarter, it was very commercial focused, and our commercial loan growth, virtually all of it attracts 100 percent risk-weighted assets. If we had a more usual mix with retail residential as a component in there, it would have been a lower grind on capital, of course. You would have noted that our retail residential continues to go backwards this quarter, so it's a case of composition of loan growth, first of all.

I think the other big factor is just the level of profitability as well. NIM is a little bit compressed, not much, considering the low interest rate environment, but it is a bit lower than what it was pre-COVID, as is our provision for credit losses a bit higher as well. We're also making strategic investments in intangible assets, which are a grind to CET1 as well, so it's the mix of all those things.

I do agree with you, though. We're now at a point where if we're generating purely commercial loan growth, we're not in that double digit or just about double digit before we consume capital. It is a little bit of a lower level.

Doug Young – Analyst, Desjardins

Okay. Then just on the AIRB conversion delay, maybe you can just flesh out a little bit more why. And then Chris, I think in your prepared remarks, you mentioned it's going to have a more favourable long term outcome. Can you unpack that? What would be that more favourable long term outcome?

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

Well, we're in a parallel run, so we're able to really evaluate how the models we've developed work, how it matches up to our business, and what we're seeing is we've got some real enhancements that will help us both in our business processes, the feedback it gives us on credit migration, credit quality, so we see some real opportunities to improve the structure of our program, and with that improvement we need some business development of course, then we have to test them and run them to make sure that they are delivering the outcomes we anticipate.

It's really just extending, but this is an event that is an operating model for the bank for the future, that we see really as important to invest the time at the outset so that we have it really in very good shape as we take it forward for that final submission to OSFI. So, we're happy with the progress. There is work to be done and we're just looking at extending what we think the submission date will be on this.

Doug Young – Analyst, Desjardins

So, would this free up more capital than it would have before?

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

Well, that would be our—that's obviously our goal, is as we think about what capital floors might come into play at the outset. Our focus is ultimately to get it to the same level as the DSIB's . Our focus is we have a very high-quality portfolio that performs very well, we like our market segment that we have really specialized in, and AIRB is a fantastic tool to really support our growth. We are going to make sure that the process under which it operates is as efficient as possible and provides us with the best capital management opportunities it can.

Doug Young – Analyst, Desjardins

Then just lastly, was this driven by yourselves or was this something that was mandated by OSFI?

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

This is our parallel run, and we have a strong team overlooking it. Of course, as you know, Carolyn Graham is now the leader of that team, and we just have lots of good insight and we're just seeing good opportunities for us.

Doug Young – Analyst, Desjardins

So, this wasn't something that OFSI said they wanted you to do, to delay?

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

No, it's not specifically anything that they've said to do. No.

Doug Young – Analyst, Desjardins

Okay, thank you.

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

Thank you.

Operator

Your next question will come from Meny Grauman from Scotiabank. Your line is open.

Meny Grauman – Analyst, Scotiabank

Hi, good morning. A question on rate sensitivity. Just trying to think through sort of the upside here. In your published sensitivity, it looks relatively low, just what one would assume based on the fact that you're so heavily skewed towards NII. Then in the MD&A, you talk about based on the current interest rate gap position, a one percentage point increase in rates would have an insignificant impact on net interest income. I'm just wondering how to understand that? Again, given your skew towards NII and just is there upside to rising rates that's not being captured in your published sensitivity, and how do you think about that?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Great question, Meny, very topical. Definitely has been a structural change in our liability profile. This is the strongest liability profile that I can see looking backwards in terms of diversity, in terms of levers at our disposal, but it is a structural change. What hasn't changed is that about 45 percent of our loans are at floating rates. What has changed is that about half of our deposits float. That used to be about 35 percent or so, so that's a structural change and that's resulted from us winning more full-service clients, and then obviously a factor of people just naturally favouring liquidity rather than term, given the interest rate environment.

Our NIM will still benefit from prime increases. That's a component of floating rates, not all of our floating products float with prime. A larger proportion of our floating rate loads are linked to prime, about 80 percent of them or so compared to deposits. Less than half of those floating rate deposits are linked to prime, but even that's much closer than it used to be. So I would say today we are less rate sensitive and I'd say we are spread sensitive at this point.

Things that will cause our NIM to move would be competition for funding, how we're able to deliver yields on our lending and any competitive factors there, how we're able to match our new funding sources to those higher levels of loan growth. Over time, people will eventually start trading back liquidity for term funding. These are factors that will influence our NIM certainly and how it plays out ultimately, and how much NIM we put to the bottom line in a rising interest rate environment, in my view, will depend on our ability to continue to win new full-service client relationships. That's where we can really win, by putting a lot of lower cost funding in to offset some of these shifting dynamics in our fixed rate products.

Overall, though, we're looking at a win to NIM as a result of rising interest rates. Prime is still accretive to NIM. We're thinking with the liability structure we have right now, we do not need the 150 basis points of Bank of Canada reductions returned to us back in the form of increases to get our NIM back to where it was pre-COVID. It is a proportion of that. We don't need 100 percent of it, and so that does speak to a lot of upside we think we can continue to drive as a result of our continued focus on winning full-service clients. That's the key for us.

You will not see that fall out of our interest rate sensitivity disclosure. That's a static balance sheet view of the world, and our strategic direction will have us be anything but static in terms of higher levels of loan growth and continued focus on lower cost branch-raised deposits.

Meny Grauman – Analyst, Scotiabank

Thanks Matt that was pretty comprehensive. Then if I can just pose another question, just in terms of gross impaired loans. The increases in two specific categories, the general commercial loans and then also on the real estate side. I'm just wondering if you could give us a little bit more detail into what's going on there? Is the increase very concentrated? Is there anything that you can sort of dig out of that in terms of themes that you see developing in terms of the build in gross impaired loans?

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

I don't think we see, in particular see themes. We anticipated as we would come through this pandemic that we would see an increase, and I think where we sit in the end of Q2 is pretty much what we said we expected in Q1 and we're in and around where we anticipated to be. We said about 30 basis points on PCL. In terms of in this particular portfolio, we've seen a little bit of movement both in the general commercial and in the commercial mortgages, and we see a couple of exposures there where we've been very conservative in our allowances.

Our goal is to run it very, very tightly. We've got a very strong team that oversees our watch and impaired loans, and we just take very specific action. We've always been very proactive in management of unsatisfactory loans, and that's not changing.

Meny Grauman – Analyst, Scotiabank

Thanks.

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

Thanks, Meny.

Operator

Your next question will come from Gabriel Dechaine from National Bank. Your line is open.

Gabriel Dechaine – Analyst, National Bank

Good morning. My first question, just a quick one on the ATM and just kind of how to conceptually view this thing. Is it sort of a bridge to AIRB transition, because the point of AIRB transition is that you could accelerate your growth and it wouldn't be as RWA intensive under that model, but you're still waiting for that conversion. Is that more or less it?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Well yes, Gabe, we are a standardized bank until we are not, and continue to manage our bank in that fashion. The ATM is about near-term growth opportunities that we're seeing build, and this is really the program to be able to take advantage of those. It's really sending a strong signal, we think, to our teams internally as well as the market that despite AIRB—That's a separate conversation. This is a case where we're not going to sit on the sidelines. If we see opportunities to participate in loans that are on strategy within our risk appetite, good full-service borrowers we've been chasing for a while and now finally have the opportunity to land them, this is a case of giving the green light to them.

Your point on AIRB, that is the whole reason we're doing it, or one of the primary reasons. It is a tool that will allow us to accommodate higher levels of loan growth without consuming capital, so that is still true. It's not a tool we have today, and it would be the most accretive path, but the path we're carving as a standardized bank is still accretive, still exciting, still delivers to the bottom line, still drives ROE, so it's a big win for us and our teams if we can deliver that loan growth.

Gabriel Dechaine – Analyst, National Bank

Okay, and the AIRB, you talk about parallel run and costs associated with that. Have you ever quantified those, and if not, could you? Also, let's say you convert and get approval in 2023 or something like that, do those costs just fall off?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Yes Gabe, we have quantified what I would call our normal run rate of costs related to the running AIRB, and that's really depreciating what was on our balance sheet that we had previously capitalized in developing the tools. It also accounts for the ongoing team that runs, develops, tweaks. Those are costs that we expect to continue at around the current run rate. It's about $2 million a quarter.

What we don't know yet with certainty, but I'm hopeful of, is that once we get AIRB and we get used to running the tools, the models are relatively stable, the depreciation won't run down, but the teams supporting the models might, so there may be opportunities to bring those costs down over time. I think temporarily, that $2 million a quarter run rate, I do think it kicks up higher as a result of some of the enhancement work we need to do over the near term here, so we could see a bit of a tick up, but we'll continue to report those costs separately as we have been the past couple quarters. It's clear that, beyond yourself, others in the market are interested and we're absolutely open to being transparent in terms of what we're spending.

Gabriel Dechaine – Analyst, National Bank

Okay, that's great. Then my last one on the deposit story, which has been great for well over a year now, it's really been a demand and notice growth story, displacing higher cost funding, and we're seeing 30 percent plus growth in those deposits. Now, walk me through the future here if we have a scenario where maybe we've hit a peak and that deposit growth decelerates, because you've hit a certain apex, maybe, and you have borrowers or clients drawing down their liquidity to invest and you also have, as you're alluding to, accelerating loan growth. What does your margin do in that type of scenario? Because it seems like that's a feasible one at this point, and it could go either direction, I guess.

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Yes, I think it's a reasonable expectation that the branch-raised deposits we've accumulated will run off. It's tough to say how much and when and the timing, but I think it's a fair assumption and it's an assumption that we've embedded within our outlook and guidance. We do believe that's the most likely path.

With the strong loan growth, we'll clearly have some decisions to make on funding. I think the natural path of what happens to our branch-raised growth is we'll likely see the cheapest sources of funding run off first, I think that stands to reason. What we replaced it with, though, we'll have some levers to pull, and we even have some levers to pull to think about driving incremental branch-raised growth.

I'd say that over the last couple of quarters for sure, we've really taken our foot off the gas from a pricing perspective. We've actually taken opportunities to continue to reduce pricing on certain products because of strength of funding coming in and new wins and other sources. That's a lever we could pull in terms of making some investments to potentially drive a higher level of branch-raised deposits to offset more of the runoff. We think without enacting those levers, we still end up, as you see in our outlook, we still end up at a positive spot in terms of branch-raised deposit growth, but this could be a tool we could use to deliver an even higher level of growth if the economics make sense.

We've also had some strong outings in the capital markets. We've opened some new securitization channels as well and have the ability to drive funding through there. So Gabe, I guess the point is through a lot of the structural work we've done to expand and deepen our funding sources, we've left ourselves with a whole lot of options, a whole lot of tools in the tool kit, a whole lot of levers to pull that if we do start seeing the runoff that we're expecting, we'll have plenty of ways that we can draw and to fund it, and we'll pick the path that we think is the most accretive to NIM, most accretive to the bottom line. It's good to have options, and we'll manage this very dynamically to ensure we're choosing the best one, depending on the pace and volume of the runoff we see.

Gabriel Dechaine – Analyst, National Bank

To put a fine point on that, the scenario I described, is that consistent with your outlook for margins staying flat at this 2.5-point level?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

That's right. We think our growth will be positive. We don't think it'll be as high as the growth we put up this quarter, so you're kind of somewhere within that range. Our expectation is that absent any runoff, we would be delivering a pretty consistent growth rate in branch-raised deposits as we put up in Q2. Q2 reflected continued growth of new full-service clients. We really didn't see a lot of runoff. There were products where we made some pricing decisions and we didn't drive growth in those products, but we also didn't see any runoff either. So I think that 2.5 percent quarterly sequential growth rate is one that we could generate without being aggressive on pricing and just through the new client wins, and then getting to somewhere between flat and that 2.5 percent level, we're probably somewhere in the midpoint based on the expected level of runoff that we see, although that's a highly uncertain prediction, of course.

Gabriel Dechaine – Analyst, National Bank

Thank you and have a great weekend.

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Thanks, Gabe.

Operator

Your next question will come from Darko Mihelic from RBC Capital Markets. Your line is open.

Darko Mihelic – Analyst, RBC Capital Markets

Hi, thank you. Good morning. Just a couple questions on the ATM and then a few on the margin.

First on the ATM, I've never seen one before, so can you just give me an idea of how mechanically it works? If I'm a shareholder of CWB, do I just wake up one morning with another share of CWB or whatever, or do you have to alert the market or how does that work?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Yes, think of it as the inverse of an NCIB. This is us just issuing new shares into the market from our treasury shares. We're in complete control in terms of how much we issue, when we issue, if we issue at all. That's a call we can make day-to-day, week-to-week. We can be very responsive, dynamic, opportunistic based on how the trading volume is occurring in that day, but not one where you would automatically as a shareholder get incremental shares landing in your book. It's one where if you're looking to put in an order to buy CWB, we would look to fill it if we're in the market to want to fill it with incremental shares issued from an ATM product.

Darko Mihelic – Analyst, RBC Capital Markets

Okay, understood. When you say $150 million, is that per year or is that per shot?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

That would be the full extent of the entire program. The way we would use it—this is not a case where we want to go out and raise $150 million and put the capital in our jeans today. This is something over the duration of a program that we'll use if and when needed, as we need it, be very thoughtful about using it, but that is the global limit of the program.

In terms of how much you potentially move each day, that is completely within your discretion as the issuer under that program. There are guardrails around how much you do and really, it's simple guidance, and I think this is guidance that should give comfort to shareholders. One of the conditions of using this program is you literally can't use it to significantly impact your share price, so by nature and by design, you use it in such a way that it's very obscured and you wouldn't necessarily even see us using it, and you shouldn't see any impact on the share price because of our ability to be really thoughtful and really not have to put the foot down on the gas from a timing perspective. We have enough of a capital buffer that we can be really strategic about when and how we use this.

Darko Mihelic – Analyst, RBC Capital Markets

Okay, that's a good explanation. I appreciate that. So, the hypothetical, if some bank came to you and said, "Hey, we've got a portfolio of $2 billion of commercial loans", you wouldn't just suddenly boom hit the button, issue that much equity, and then buy the portfolio, right? That's not what this is aimed at?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

No, no. This is an appropriate tool, we think, for situations where you're going to see variable ongoing capital consumption of relatively minor proportions. If you were looking to raise equity in a hurry for an acquisition or for any other use that you needed the equity in your jeans in a hurry, you'd be looking at a different program to raise that equity. The ATM would not be appropriate in that circumstance.

Darko Mihelic – Analyst, RBC Capital Markets

Okay, great, I understand it. The one issue or difficulty I have understanding is—to my recollection — I've never seen a Canadian bank use this kind of program before, not even you, and so it begs the question, are you running way too lean on capital? Every other Canadian bank right now has a ton of excess capital lying around.

The other question is, if we do use the program enough that you hit the $150 million, at current spreads is it actually accretive or dilutive? I'm doing some math, but I'm just wondering if you guys have done some math to help me out before I go spouting off on my math.

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Yes, appreciate it, Darko. On the first question, you're correct. To my knowledge, based on my research, I have not seen another Canadian bank do this before, neither have we. Very prevalent tool in the U.S. I think the use of an ATM product in Canada historically has not been prevalent. It's certainly increased over the last year. If you go back and look, and maybe after the call I'll flip you a note with some examples. It's really ramped up in the last year, and that's because Canadian Securities Administrators have adjusted the rules on the set-up and maintenance of an ATM program to align it with U.S. regulations. In the U.S., these are pretty common, actually. You see them in everywhere from small cap to large cap issuers, U.S. banks, including very large U.S. megabanks have used this product, so it's not necessarily a unique product to banking or banks. It's a unique product to Canadian banking, but I think that probably has something to do with how tight the rules used to be.

We'll see if it picks up, but to your point, it's a question of capital level. I think what's different for us—we've been in or around this capital level through COVID, we've been very comfortable there. I think the new change for us that we're looking at here is loan growth that appears to be a reasonable enough probability, that we liked having this in our back pocket to use if we see that higher level of loan growth materializing. It's one of those unique situations just in what might be out there from a loan growth perspective that we thought warranted an admittedly unique solution to the problem.

Darko Mihelic – Analyst, RBC Capital Markets

Okay, and on dilution, ROE, EPS…

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Accretive. If we're using this ATM product to issue shares, and that's to fund new loan growth, even at current spreads that would be accretive. It's obviously not as accretive, that if we just did the loan growth without issuing the shares, but as you run through the math, you'll see it's a proportion of that accretion but it's still accretive. It still puts dollars down to EPS, it's still accretive to ROE even at current spreads.

Darko Mihelic – Analyst, RBC Capital Markets

Okay, well let's touch base after the call. I just want to run my math by you.

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

Absolutely.

Darko Mihelic – Analyst, RBC Capital Markets

My second question is on margins. You mentioned that you don't quite need the Bank of Canada to give back or to raise rates. Can you walk through what is special now that your NIM is more sensitive to rising rates than in the past?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

I'd say our NIM is less sensitive to rising rates, and I think you can see evidence of that through what happened on the way down as interest rates declined. The usual math we had given in the past is a 25 basis point change in Bank of Canada rates might drive 3 to 5 basis points change in NIM. If you apply that math to the last year, you'd expect our NIM to be much lower than it has been.

Really the shift is us being a bit more in the driver's seat from a pricing perspective, having a greater proportion of our deposits in notice and demand, a greater proportion of our deposits in what we would call administered rates. These are deposit products where we are in control of the rate, we can make the decision in terms of how much of that market rate increase we pass onto our depositors. We can be thoughtful about that. We can make that call based on competition and demand for deposits at the time, so the big difference is we have a lot more tools in the tool kit to be able to manage and reduce the volatility in our NIM.

But I suppose the price you pay for that is that it makes you less sensitive on the way down, it likely makes us less sensitive on the way up. A lot of the NIM expansion, though, it won't directly be driven by prime interest rate increases. It'll be driven based on the spread of new lending compared to the incremental cost of deposit we need to fund that loan growth. It's a bit of a wait and see, but it's a different situation than us just sitting back and completely winning or losing on NIM as a result of prime. I think we just have more maturity and more flexibility in our funding mix today than we've had in the past.

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

And I would just add that that has entirely been our strategic direction, is to give ourselves much more of our clients' full business. We have generated many, many more new full-service clients that is giving us that boost in demand and notice, and ability to have a much stronger liability profile than we did before.

Darko Mihelic – Analyst, RBC Capital Markets

Okay, I appreciate that. That's great. Thanks very much for the colour.

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

Thanks, Darko.

Operator

Your next question comes from Cihan Tuncay from Stifel. Your line is open.

Cihan Tuncay – Analyst, Stifel

Hi everyone, good morning. Just wanted to get a little bit more colour on the digital product rollout, your recent partnership with Brim and the virtual COO product rollout with Temenos. Are you looking at getting more deeper into the payment space at all, are you looking at enhancing that digital product shelf with any other potential product and services in the future? How do you think of that, or if you can give us some more colour on where that direction is going for the product shelf there?

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

Yes, well obviously the digital delivery is key. As we think about growth, geographic diversification can be tremendously enhanced with a bigger digital footprint. The virtual COO is a set of tools that allows us to think about our client too and expand that client profile, really to – if we think about our current book, it is really mid-market commercial. We see more small business able to be accessed with the virtual COO and with that digital footprint, so the aspects of the market we're able to drive is just tremendously enhanced by our improvement in our digital capabilities.

On the payment side, we are having a switch in how we're able to facilitate ETFs with our investment in digital. Today, we've got some multiple sign-on situations that will become single. All of the ways that we think about attracting more full-service clients are enhanced with our investments in digital and our big release starts in the second half of this year with the virtual COO. And as we adopt and bring into play the different commercial banking digital capabilities, again we see lots of wins for our clients and again to attract more full-service commercial clients.

Cihan Tuncay – Analyst, Stifel

Thanks for that question. Maybe just a follow-up to that, I know it's still undergoing the rollout, as you said, but can you give us a sense of—with the pick-up you're seeing in demand deposits in particular, can you give us a sense of how much of your deposit growth is coming from digital channels?

Matt Rudd — Executive Vice President, Chief Financial Officer, Canadian Western Bank

So, at this point, Cihan, I wouldn't say it's contributing a great deal. In terms of the tools we've launched so far, it's really been on-boarding. I mean, that's been helpful and contributed, but I wouldn't call it the primary reason. I think it's all part of the package. When we go and win a full-service client, it's an element of why a client will do business with us. They'll see what we've done, they'll see what we're doing, they'll make a call based on that and other factors, so it contributes but it's hard to isolate.

In terms of the virtual COO, we're launching a pretty limited rollout of it just to release it to a select group of clients, really have them use it, contribute key insights, give us insights as to how we can best leverage,market and use this tool. In terms of near-term deposit contribution from that product. This year for instance, I would not expect it to drive a different trajectory in branch-raised deposit growth. Certainly, gets us excited about the future, but that would be a beyond this year future.

Cihan Tuncay – Analyst, Stifel

Appreciate the colour there. Maybe just on the overall inorganic growth opportunities, it sounds like with your increase in loan growth guidance, you've got a lot of organic opportunities you can target. How do you think about other avenues of growth? Be it additions to your wealth management platform, be it in other potential opportunities? How do you balance those decisions for organic versus inorganic growth opportunities from here?

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

Well right now, we're very consumed with integrating our current wealth acquisition into the bank and making sure that we've got a very strong team delivering there, and we've had great performance. We're just really happy with the progress of our wealth management teams as they've come together and integrating very effectively.

As we think about other sort of inorganic, we still like wealth as an opportunity for growth, but we're really focused on our digital, we're focused on our wealth integration, and we're focused on our AIRB projects. Clearly if there's a tremendous opportunity that we identify, we would be obviously open to that, but today we've got lots on the go. We're very happy with our progress and certainly the delivery of what we anticipate as a strong economic recovery and seeing that in loan growth that has already come through in Q2, so we just we have lots of opportunities on our plate today and we're going to be very focused on delivering on them.

Cihan Tuncay – Analyst, Stifel

Thanks very much for the colour. I'll pass it on, thanks.

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

Thank you.

Operator

This brings us to the end of our Q&A session. I will turn the call back over to Chris Fowler for closing remarks.

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

Thank you, Michelle.

Our focus on our clients by investing in our capabilities and product offering is yielding strong results now and creating growth opportunities for CWB. Each day, our teams are winning more full-service clients and as the economy recovers, we're well positioned to accelerate our growth and capture increased market share. I'm very pleased with their strong performance in the first half of the year and excited for the opportunities that exist in the back half of 2021 and beyond.

Continued vaccine delivery has provided optimism for a strong economic recovery once restrictions are relaxed, and it's possible that economic conditions could improve more rapidly or robustly than we expect. We plan to assess these opportunities prudently and support them with our ATM program to deliver solid shareholder returns.

In closing, I want to say thank you to our teams. I continue to be impressed with your efforts to advance our strategic objectives, transform our capabilities, and deliver strong financial results. Together, we are setting the stage for CWB to deliver profitable, long term growth and attractive, sustainable shareholder returns. To our investors, I appreciate your confidence in us and we are excited for the opportunities before us. We look forward to reporting third quarter financial results on August 27.

With that, we wish you all a good day and thank you very much.

Operator

Thank you everyone. This will conclude today's conference call. You may now disconnect.