FINAL TRANSCRIPT

Canadian Western Bank

Fourth Quarter Results

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PRESENTATION

Operator

Good afternoon everyone. My name is Sarah and I will be your conference operator today. At this time I'd like to welcome you all to the Canadian Western Bank fourth quarter and fiscal 2012 financial results conference call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. If you would like to ask a question during this time, simply press * then the number 1 on your telephone keypad. If you'd like to withdraw your question, please press the # key. Thank you.

I'd now like to turn the call over to our host, Ms. Tracey Ball, Executive Vice President and Chief Financial Officer. You may begin your conference.

Tracey Ball – Executive Vice President and Chief Financial Officer, Canadian Western Bank

Thank you, Sarah, and good afternoon and welcome to our 2012 fourth quarter and annual results conference call for Canadian Western Bank.

Before we begin, please note that the conference call graphs, quarterly results, news release and supplemental financial information are available on the Bank's website at CWBankGroup.com in the investor relations section. Our 2012 annual report and audited financial statements will be filed on SEDAR, and available on the Bank's website before the end of this week.

Before we begin I'll just draw your attention to our forward-looking advisory on slide 10.

The agenda for today's call is on slide 2. Joining me today are Larry Pollock, Chief Executive Officer, and Chris Fowler, President and Chief Operating Officer. Also in attendance are Executive Vice Presidents Randy Garvey and Brian Young.

First I will provide a brief summary of our fourth quarter and annual financial highlights, and then I'll turn things over to Larry for an overview of our outlook and strategy. The intent is to leave as much time as necessary for Q&A at the end of the call.

Moving to slide 3, the Bank reported solid quarterly performance that contributed to a record year for CWB Group in terms of both earnings per share and net income. Highlights in the quarter, in addition to the financial performance, which I will discuss shortly, included the opening of a second full-service branch at Winnipeg, bringing our total number of branches to 41, and subsequent to quarter end CWB's recognition as one of the 50 best employers in Canada for a seventh straight year, something we are very proud of.

Yesterday our board declared a quarterly cash dividend of $0.17 per common share, representing an increase of 6 per cent from the previous quarter, and 13 per cent from the quarterly dividend declared one year ago. The board also declared a quarterly cash dividend on our Series III preferred shares.

We achieved record results for 2012, having met or surpassed all of our minimum targets. Overall, financial performance was led by a very strong 14-per-cent loan growth that more than offset the impact of a lower-net-interest margin. Credit quality also showed improvement throughout the year as evidenced by our stable provision for credit losses. And our balance of gross impaired loans decreased for the tenth consecutive quarter, and now represents less than 50 basis points of total loans.

Fourth quarter net income available to common shareholders of $43 million was up 20 per cent over last year, and marked the Bank's 98th consecutive profitable quarter, a period spanning over 24 years. Quarterly diluted earnings per common share of $0.55 or $0.56 on a diluted cash basis increased 17 per cent and 6 per cent respectively over the fourth quarter of 2011.

Total revenues on a taxable equivalent basis increased 11 per cent over the same quarter last year to reach $133.2 million. Results were augmented by increased net gains on securities, which offset the impact of a $4 million decline in net insurance revenues. As we anticipated in our third quarter disclosure, fourth quarter claims expense was materially affected by severe weather activity in Alberta in August. Total claims related to two severe Alberta hail storms in the fourth quarter net of reinsurance and taxes amounted to more than $0.05 per common share.

Quarterly net interest margin of 2.71 per cent represented a 16-basis-point decline from the same period last year, with the difference mainly reflecting lower yields on both loans and securities, partially offset by reduced costs on fixed-term deposits and lower debenture expense.

Net interest margin was down 14 basis points from the previous quarter, reflecting unusually high interest recoveries on impaired loans in the third quarter, as well as lower loan and investment yields. While the quarter-over-quarter reduction in margin was amplified by about 8 basis points from the third quarter interest recoveries, a continuation of the current very low interest rate environment, a flat yield curve, and the impact of ongoing competitive influences, particularly in certain lending sectors, will continue to pressure our net interest margin in 2013. To give you a point of reference, for every 5 basis points increase in margins, based on our current balance sheet, equates to about $0.02 per share after tax.

Slide 4. Our annual net income available to common shareholders was $172.2 million or $2.22 per diluted common share, and both established new records increasing 15 per cent and 14 per cent respectively. Adjusted cash earnings per common share, which excludes the after-tax amortization of acquisition-related intangible assets, and the non-tax deductible change in fair value of contingent consideration, was $2.30, up 6 per cent over 2011. Record total revenues of $525.5 million represented a 9-per-cent increase. Annual net interest income was up 9 per cent as the benefit of very strong loan growth was offset by a 20-basis-point reduction in net interest margin.

Other income of $81.9 million was up 14 per cent as the combined benefit of the 2012 elimination of contingent consideration fair value changes, higher net gains on securities, and growth in credit-related fee income, more than offset the impact of lower net insurance revenues, the absence of fair value adjustments for interest rate swaps, and the expiry of a lease administration contract in early fiscal 2012.

Net gains on securities were $5.2 million higher compared to 2011. And while this is expected to remain an ongoing source of revenue, the future level of net gains is expected to be lower compared to 2012. As shown on this slide, 2012 loan growth reflected growth across all the banks' core lending portfolios other than oil and gas production loans. Growth in general, commercial loans, and equipment financing and leasing contributed the greatest dollar increases for the year at $581 million and $401 million respectively. Measured in percentage terms, the growth in these portfolios was 22 per cent and 19 per cent.

Slide 5 shows our capital ratios at October 31st under the existing Basel II standard, which remain well above both regulatory minimums and our internal targets. On a pro forma basis the all-in Basel III capital position at October 31st, 2012, using the standardized approach for calculating risk-weighted assets, shows a common equity tier-one ratio of 8.1 per cent, a tier-one ratio of 9.9 per cent, and a total ratio of 13.1 per cent. All of the pro forma Basel III ratios are above the required regulatory minimums of 7 per cent, 8.5 per cent, and 10.5 per cent respectively, which has the Bank well positioned for the fourth coming transition in 2013.

Slide 6 shows actual results compared to our fiscal 2012 minimum performance targets. As shown, we met or surpassed all of our targets and considerably out-performed the minimum goals for growth in both net income available to common shareholders and total loans. Total revenue growth of 9 per cent compared to our target of 7 per cent, while the provision for credit losses represented 19 basis points of average loans, and compared favourably the low end of our target range. The efficiency ratio of 44.8 per cent was better than our target of 46 per cent. Return on common shareholders' equity of 15 per cent met the 2012 minimum target, while return on assets exceeded the minimum target and came in at 1.08 per cent.

Our minimum performance targets established for 2013 are presented on the next slide. I'll now turn things over to Larry who will provide additional comments on our 2013 targets, as well as on our overall outlook and strategies.

Larry Pollock – Chief Executive Officer, Canadian Western Bank

Thanks, Tracey.

Our targets for 2013 confirm ongoing confidence in both our strategies and our core focus in Western Canada. But they also reflect the reality of current interest rate environment, flat yield curve, and competitive factors in certain business areas. We expect Canada will see modest economic growth next year, and believe Western Canada will continue to out-perform the rest of the country.

The volume in our pipeline for new loans remains solid, and we are targeting another year of double-digit loan growth in 2013. Growth targets for both total revenues and net income available to common shareholders of 8 per cent are slightly below our business growth expectations, reflecting our belief that margins will continue to be pressured.

As I mentioned, while the pressure largely results from the current low interest rate environment, we also continue to see heightened competition. In some areas our competitors cut pricing in order to achieve growth. We will continue to build on our commitment to invest in people, infrastructure and technology to position the Bank for sustained growth. However, we will also continue to closely monitor costs in order to maintain our efficiency ratio.

The slight reduction to our minimum target for a return of common shareholders' equity, with no change to our target for return on assets, is consistent with our expectations for sustained profitability and growth across all areas of our businesses, while also reflecting expected challenges from the current operating environment. We reduced our target range for provision for credit losses to 23 basis points of average loans from 20 to 25 basis points last year, reflecting our outlook for loan performance.

Turning to slide 8, the dollar level of gross impaired loans declined for the 10th consecutive quarter to $67 million for just 48 basis points of total loans outstanding. The lower balance of gross impaired loans reflects the success of ongoing loan realization efforts and work out programs, as well as relatively stable economic conditions in the Bank's core geographic markets.

While overall credit quality is expected to remain strong, normal experience over the course of credit cycles supports our view that gross impaired loans will likely fluctuate above the current very low level.

Our provision practices and high quality loan book have us very well positioned going forward as the balance in our combined allowance for credit losses exceeds the balance of impaired loans. Based on our current view of credit quality and results of ongoing stress tests, the collective and specific allowances remain adequate in relation to the overall loan portfolio.

Our ongoing commitment to secured lending and disciplined underwriting, combined with a positive yet cautious economic outlook in our key markets supports our view that future write-offs will remain within the Bank's range of acceptable levels. Our loan losses remain low compared to other Canadian banks and we expect this trend to continue.

Slide 9. The next slide highlights our strategic priorities for 2013. We plan to further refine our proven business models in the Bank and all of our affiliate companies with a focus on achieving continued strong growth and adding value for shareholders over the long term. This includes enhancing our business banking franchises in Western Canada while also growing in other areas to further diversify our sources of income. For certain parts of our business, Ontario represents an untapped market for us with significant future growth potential, particularly equipment financing, alternative mortgages and trust services. And we continue to evaluate opportunities in this regard. In addition to our targets for organic growth, we will also continue to evaluate potential acquisitions to further augment our market penetration and growth opportunities.

As we stated in prior periods, the objective for 2013 and beyond is to improve across each area of our organization and identify opportunities where we can further build on our competitive advantages. Although effective evaluation of our strategies will require ongoing investment in our people, infrastructure and technology, our goal is to maintain our industry-leading efficiency ratio, and we intend to manage costs very closely to achieve this. This discipline is particularly important in view of constrained revenue growth owing to margin pressures.

While we are currently well positioned for the transition to Basel III capital requirements, we need to remain mindful of the challenging job of regulators and governments as they continue their efforts to maintain effective regulatory standards without stifling economic growth by restricting the lending capacity of Canadian banks. Regulators need to ensure that Canadian banks stay on a relatively level competitive playing field with both OSFI and OSFI-regulated entities... as well as non-OSFI regulated entities, as well as global banks that may be subject to less stringent rules.

While implementing any type of major change there needs to be fulsome discussion among all parties to identify the potential for unintended consequences, and this continues to occur at the current time.

As I'd mentioned before, on an apples-to-apples basis, I believe CWB's capital levels, using the standardized approach for calculating risk-weighted assets, are very strong in comparison to other Canadian banks. This point is demonstrated through our much lower leverage based on total assets, as well as our long history of lower loan losses compared to the industry. Our relatively low dividend payout ratio also provides flexibility to support continued strong growth.

We are pleased to provide common shareholders with an increased dividend this quarter. Based on our current expectations for earnings for 2013, this announcement should keep us within our targeted payout ratio of 25 to 30 per cent of net income available to common shareholders. Our recommendation for future increases will be based on both the Bank's financial performance and any further regulatory economic developments that may arise. Overall, our objective is to remain focused on our core business and build on our *istory of achieving profitable double-digit loan growth.

We are very excited about our future in both the short and long term. The 2013 performance targets confirm our expectations for another year of record performance. While the achievement of our targets will be challenging, the future growth potential in our key areas of banking, trust insurance and wealth management is very positive.

For myself and other shareholders, I'm also very gratified that our board has chosen my successor from within the company. As everyone is aware, I will be stepping down as CWB's Chief Executive Officer at our annual meeting of shareholders in March 2013. And Chris Fowler, our current President and Chief Operating Officer, will be taking my place as the next leader of the CWB Group. I've had the pleasure of working with Chris for more than 20 years, and I know he will do a tremendous job leading our team and continuing CWB's stellar track record of performance and growth. I will remain engaged with the CWB Group for at least the next two years after that by working as a special advisor to the board and senior management. But in the meantime I'll save my formal hand off of the reins until March.

I'll now turn things back to Tracey.

Tracey Ball

Okay. Thank you, Larry.

Now that concludes our formal presentation for today's call. At this time I'll ask Sarah to begin the question-and-answer period.

Q&A

Operator

At this time I'd like to remind everyone in order to ask a question, please press * then the number 1 on your telephone keypad.

Your first question comes from Scott Chan of Canaccord Genuity. Your line is now open.

Scott Chan – Analyst, Canaccord Genuity

Good afternoon, guys.

Larry Pollock

Scott.

Scott Chan

Hi, Tracey. I just wanted to confirm the NIM statement in the presentation in terms of backing out the recoveries on the impaired loans. So the reported number is 2.71. Does that mean the adjusted was more towards 2.79?

Tracey Ball

There was about 8 basis points in the third quarter that was impaired loan interest recovery. That would be unusually high. We usually do have some, but it was 8 in the third quarter.

Scott Chan

And last year it was like a 4 bp decline, right? The unusual recovery, if I can remember. Is that…?

Larry Pollock

I think that's what we had stated was 4 would be our normal.

Tracey Ball

Yeah. Three to four would be more normal.

Scott Chan

Okay. Three, four more normal. And just on the comment on expecting that gross impaired loan interest steadily going to increase. And then when I look at your PCL target range for 2013, which is lower than 2012, can you just walk us how you kind of get to that new lower targeted range?

Larry Pollock

Of reserves? Yeah.

Scott Chan

Yeah.

Tracey Ball

Sure. Our gross impaired loans are very low right now. And we've had a lot of remedies and payouts of existing impaired loans. So at this point we're so low that any new impaired loan will actually create an increase. We don't have a big old impaired loan paying down anymore. So we don't expect losses to change at all. In fact, we expect credit quality to improve as we're definitely coming out of that cycle. We're at the bottom of the cycle. So it does make sense that our impaired loans may go up even though our provision, we're saying the range will actually go down.

Scott Chan

Okay. Okay, great. Thanks, guys.

Operator

Your next question comes from Shubha Khan of National Bank Financial. Your line is now open.

Shubha Khan – Analyst, National Bank Financial

Thanks. Good afternoon. So when I look at your 2013 performance targets, I guess implicit in your target seems to be the assumption that the NIM will be roughly flat from the Q4 level, so around 270, 271, something in that region. Is that an accurate sort of reflection of your margin expectations going forward or has it... ?

Tracey Ball

That's reasonable, Shubha. That's reasonable.

Shubha Khan

Okay. And when I look at what happened with the margin… with NIM this quarter specifically, the compression this quarter versus last quarter, Q3 that is, it looks like almost all of it was driven by the lower yield on loans, and now even adjusting for interest recoveries that you alluded to earlier, it looks like the decline was pretty severe, around 10 bps, and certainly more severe than in the previous two quarters. So can you give us a sense of how much relates to sort of competitive pressures and how much relates to the low interest rate environment and flat yield curve, et cetera? And which portfolios in particular are you seeing the most pressure?

Tracey Ball

Well I can't specifically tell you, but certainly our fixed rate loans are definitely coming down. Although in the fourth quarter the floating and fixed loans were down about 4 basis points, but the cost of fixed deposits was also down 4 basis points, so that's kind of neutral.

If you look over the year, if we go back to the first quarter our NIM was about 2.77. So comparing the first quarter of 2012 to the fourth quarter at 271 is… you can see that it's there throughout the entire year.

During the crisis we built a pretty big portfolio of commercial mortgages and also corporate loans. And we're seeing a lot of those come to maturity and re-price. And the competition for both are very strong. So we've been focusing our activity on commercial lending, equipment financing and alternative mortgages. But because those portfolios are still relatively big we do have to… we do see the margin change particularly in those sectors.

I'll see if Larry or Chris want to add anything else on the competition.

Chris Fowler – President and Chief Operating Officer, Canadian Western Bank

Well, yeah, competition is definitely keen out there, particularly in the commercial mortgage market. But we still retain very strong yields in the inter-construction market and the equipment finance market.

Shubha Khan

Okay. So I take your point on the competitive pressures. Just going back to, Tracey, what you said about the books still re-pricing, it looks… Well I mean provided that there is no material change in the interest rate environment going forward, and at what point will substantially all of the book have ref-priced to reflect the new low-interest-rate environment? I guess all I'm really asking is at what point would you expect the yield on loans to stabilize, all else being equal?

Tracey Ball

We certainly are hoping it'll stabilize shortly. But it's really hard because you have to offset it with the areas that you're growing that have much bigger margins, like our equipment financing. And then commercial lending we get a benefit there because we bring in a lot of deposits as well. So while these things are turning over, and most of the turnover should finish in 2013, you know, it'll be offset by the higher margin business that we can grow, and the ability to bring our funding costs down.

Chris Fowler

Yeah, Shubha, it's pretty difficult to bring deposit rates down from where they are today. There comes a point when people just won't deposit anymore. Maybe you're one of them.

Shubha Khan

I won't give away that secret. Thank you. I'll re-queue.

Operator

The next question comes from Gabriel Dechaine of Credit Suisse. Your line is now open.

Gabriel Dechaine – Analyst, Credit Suisse

Hey. Just a follow-up on Shubha's first question. I guess the NIM… correct me if I misinterpreted your comment, but you're saying margins, implicitly the guidance, it's going to be stable next year? I'm just wondering…

Tracey Ball

I think it's relatively stable.

Gabriel Dechaine

Why would that be the case if you're… like if the rate environment's kind of priced in or whatever, but you've got these ongoing competitive pressures in some of your bigger books that might offset the growth in ...

Larry Pollock

Yeah. Well, one answer for that is that the growth rate in our industrial portfolio and our Alt-A mortgage portfolio exceeded our overall growth significantly. So we're growing faster in the high-yielding portfolios. And so we're gaining margin there, and then we're losing it on the more competitive side, as Chris said, on the commercial mortgages. So it's really hard to determine what it's going to be, but Tracey's comment about it being… We're anticipating it being more or less flat, factoring in more competition, but stronger growth in those high yielding markets.

Gabriel Dechaine

Sorry, Alt-A and what was the other one?

Larry Pollock

And equipment financing.

Gabriel Dechaine

Okay. And that incl...

Larry Pollock

And these are two areas....

Gabriel Dechaine

Sorry. Go ahead.

Larry Pollock

... that the big five really don't… you know, our biggest competition in those areas is not the big five banks.

Gabriel Dechaine

That equipment financing includes the National Leasing, right?

Chris Fowler

Yes.

Larry Pollock

Yes.

Gabriel Dechaine

Okay. Then on the expenses also and your targets for next year, just if you got the 8-per-cent revenue growth up this year and a 46-per-cent NIX ratio, you know, that implies 10-per-cent expense growth. I'm just wondering if you're setting the bar really low or is that a realistic expectation?

Tracey Ball

Well as far as expense growth goes, you know, we're continuing to invest in all aspects of our business. We just opened a new full service branch in Winnipeg. We have other expansions that have taken place and are taking place. So we're still going to continue to prepare… you know, to be prepared for growth in the long term. But with the lower margin it's more challenging.

Gabriel Dechaine

Okay. Just a couple more here. Larry, you're usually good for some colour on… I should have asked this in the last question, but the pricing dynamics, what you're seeing in the market, you know, Canada's plus whatever, and how that's been trending in the commercial lending area.

And then also I haven't read through all the releases here, but could you tell me what your real estate construction project loan book did this quarter in terms of growth versus last quarter versus last year, and if that's started to weaken because of the tighter mortgage regulations? Net growth, I mean.

Larry Pollock

Well it's been… I'll turn it over to Chris in a sec, but it's been one of our slower growing areas over the last year. I think mainly because we concentrate our efforts in British Columbia, and that market has slowed down, although it hasn't been a catastrophe like some have predicted. But it has slowed down, and so our growth there has been… we still had decent growth. I think it was…

Chris Fowler

Nine per cent.

Larry Pollock

… 9 per cent.

Chris Fowler

Yeah, 9-per-cent growth on the construction side. We had a lot of properties that came to… there was a lot of growth in 2010, post global financial crisis, that a lot of those projects that came on then are now completing, so there's a lot being paid out, and not the same number coming in behind.

Gabriel Dechaine

Okay.

Chris Fowler

And on the… in terms of the mortgage guidelines affecting… on the... say the Alt-A side, we have adjusted our policies, and what we've seen there is some exiting lenders allowing us... or actually total volumes to increase. And so we've actually had no significant impact to the new B20 guidelines.

Gabriel Dechaine

Okay.

Larry Pollock

And frankly on the rate side, some of the rates we've seen offered on long-term mortgages will reflect on those banishment abilities being displayed today about three years from now when their boss taps them on the shoulder and says what were you thinking three years ago? Because when you take your cost of funds and add your overhead to that these numbers we're seeing in some cases are below your operating costs. So you can't make up for it in volume.

Gabriel Dechaine

Yeah but like it's buried.

Larry Pollock

That's the colour.

Gabriel Dechaine

They can bury it in big books, right?

Larry Pollock

Yeah. Oh yeah, they got big books. So, oh, yeah, that's one of the excuses we hear.

Gabriel Dechaine

All right. Okay, thanks, guys.

Operator

Your next question comes from Sumit Malhotra of Macquarie Capital Markets. Your line is now open.

Sumit Malhotra – Analyst, Macquarie Capital Markets

Good afternoon. First question is around a couple of fee income lines. First off, on insurance, you had mentioned it last quarter when we saw it from some of your competitors as well in regards to the higher claims activity as a result of inclement weather. Is there – and I apologize if this… I missed this. Is… was there any expectation that there's going to be a recurrence of this higher claims activity or should it revert to a more normalized level in Q1, notwithstanding the traditional seasonality we see in Q1?

Larry Pollock

Well Sumit, I'm leaving the Bank, but I'm going to become a meteorologist. Then I can answer that question, but… No, I'm just kidding. I'll let Brian try to answer that.

Brian Young – Executive Vice President, Canadian Western Bank

It's true that if you can tell me what the weather will be like I can give you an answer.

Sumit Malhotra

Well, sorry, it's more specific to obviously $900,000 in net insurance revenues is a lot lower than we normally see, and you guys had given us the head's up on that three months ago. So has that activity run its course?

Brian Young

Well, that really relates to the weather… the big weather storm that took place in Calgary, particularly in August, August 12th and 14th. So there was between… depending on what… the impact on the industry's $500 to $600 million. We're carrying, in terms of our deductible, we take the first $5 million. And so that really was the big change there.

Larry Pollock

Yeah, we took that one, and another one. There were two storms.

Brian Young

Three altogether in Alberta in Q4. But two of them I would consider we would take normally.

Larry Pollock

In normal course, yeah.

Brian Young

And that one kind of a $500 million event, that's considered abnormal, but there has been a number of them over the last few years. And the real question is, is are they going to continue or not? We do not plan for those. Those are sort of one-offs. So if that answers your question more in terms of seasonality, that's our expectation going forward. But every once in a while we will get hit with one.

Sumit Malhotra

No, that's understandable. I think specifically we had seen an uptick, as I said, in a couple of your counterparts that talked about that as well. So it sounds like claims related to the events you've had over the last few months, it shouldn't be this high going forward, at least related to this activity.

Brian Young

I would expect it to return to a more normalized level, both in terms of combined ratio and the loss ratio it would be a more normalized level, much like we produced in the past. And, but these events will happen once in a while.

Sumit Malhotra

And then over to Tracey. I just want to, first off, so there was another part of the fee income question, but I just want to make sure I'm understanding your net-interest margin commentary correctly. I think the interest recoveries obviously helped Q3. So some of that decline... some of the decline this quarter obviously relates to that reverting, but is it still fair to say what you would call the core decline in net interest margin this quarter was something like 10 or 12 basis points? Is that a fair characterization?

Tracey Ball

I wouldn't say it's 10, but I think the… With respect to the impaired interest over the course of last year, we... or 2012, we would have averaged 3 or 4 basis points per quarter. And then in the third quarter we had 8 basis points altogether. And so the difference this quarter is we didn't really have any. So... and I'm not sure in the future how many interest recoveries we're going to have because we basically resolved so many of our impaired loans as we go forward. So we don't anticipate seeing a lot of those increases anymore. So I would characterize the 8 basis points as being lack of impaired interest recoveries for this quarter. The rest would be relative to just the way the book is pricing down on particularly the fixed rate. But we're also getting a benefit on the fixed deposit cost coming down now as well. So I think the stability comment is really relative to the fourth quarter going forward.

Sumit Malhotra

Okay. That's helpful. And then maybe related to that and maybe not, you have a quarter where NIM is obviously softer, insurance revenue we just talked about, how do we view the gain on sale of securities line? Because you talked about this not being as much of a driver and it looked like it was going that way. But this quarter when you have a couple of factors move against you there's a large increase in the contribution from this source. So is this… how much discretion do you have over the timing of when gains get triggered? Because it certainly seems like there's a lot.

Larry Pollock

Yeah. We do have discretion, but there's something else to factor here is many of our securities are financial institutions. And under Basel III we need to carry a lot of capital – I think it's one for one – against financial institutional's investments that are over 10 per cent of our capital base. So what we've been doing is having to sell or choosing to sell, but also having to sell our preferred shares in the other banks, and our bonds held in the other banks, common shares as well, and try to find other investments. So we've been rolling out of the financials and into utilities and whatever else we can find that does not attract the same level of capital. And that's why it's been a bit lumpy. We've tried to pick our spots and when to get out.

Sumit Malhotra

And last question, just so I have an idea how you're thinking about expenses, the increase in what I'll call core expenses quarter over quarter is something like $4.5 million – yeah, $4.5 million feels right – how much of that would you attribute to normal yearend true-up seasonality in the business, and maybe getting an idea of how much discretion you have there to take some of those costs out going forward?

Tracey Ball

The first quarter would be a heavy non-interest expense quarter.

Sumit Malhotra

Yeah.

Tracey Ball

First of all, we had two very large marketing initiatives going on, one for our business banking product and one for our greater-interest GIC. And those occur in the fourth quarter, so that's definitely seasonality.

We do true up… well, we true up our bonus accruals all throughout the year, but obviously in the fourth quarter we know the most about where we're going to be at yearend. So there would have been some truing up going there. As well, we wanted to put some additional expense in to recognize our seventh year of being one of the 50 best employers in Canada, and that's where we reward our staff in a monetary way.

Also in the fourth quarter this year we spent quite a bit on training.

And then the seasonality that we get is, you know, you get a lot of people that finally, you know, clear the backlog of their expense claims in the last quarter of the year. We try to encourage them not to do that, but it still happens. And then of course in the third quarter it's the summer, so you do see a little bit of a lessening of expenses in the third quarter.

Sumit Malhotra

So the truth, as it usually is, is somewhere in the middle of the last two quarters?

Tracey Ball

Correct.

Sumit Malhotra

Thanks for your time.

Tracey Ball

You're welcome.

Larry Pollock

Thank you.

Operator

Your next question comes from John Reucassel of BMO Capital Markets. Your line is now open.

John Reucassel – Analyst, BMO Capital Markets

Thank you. Tracey, just… or Larry, back to Sumit's question on the securities gains, it looks like you sold a lot of pref shares, but you added to other debt securities or there were bigger gains there. Are these other debt securities of non-financial institutions or what are these securities?

Larry Pollock

The ones that we invested in, John? Is that what you mean?

John Reucassel

Yeah. Yeah. So your unrealized losses I think… I'm just look… on page 3, are $11.3 million. And I think there was a big jump in other debt securities.

Larry Pollock

John, those were gains.

John Reucassel

Those were what, sorry?

Larry Pollock

Those were unrealized gains.

John Reucassel

Yeah, unrealized gains. And so what are those other debt securities that you're sitting on unrealized gains on? Are they with financial institutions or not?

Tracey Ball

There'll probably be some financials in there, but it'd be mostly corporate.

John Reucassel

Mainly corporate, okay. And presumably the financials are still in the pref shared group, is that correct?

Larry Pollock

That's where most of the bulk of the investments were. Yeah.

John Reucassel

Okay. Okay.

Larry Pollock

There were some common shares too.

John Reucassel

Yeah, yeah, okay. I just wanted to clear that up. The… Larry, a lot of questions on competition and I just wanted to make sure I understand. So are you seeing competition from everywhere or are you seeing it from the non-banks? Kind of the provincially regulated institutions, for lack of a better word? And is it on pricing and terms or is it just on pricing?

Larry Pollock

Mostly pricing. But you always get covenant light deals as well, and you can usually move a client easier on covenant light than you can on pricing. But we're seeing a bit of both. And not so much from the provincially regulated institutions like ATB. I don't think we're seeing them that much, are we, Chris?

Chris Fowler

No. No. No, it definitely would be much more on the… on the big (inaudible).

Larry Pollock

Yeah.

John Reucassel

Okay. And again, just make sure, to clearly understand, that you participated in some syndications and your participation rate in those syndicates is declining because of the pricing. Is that... did I hear that right?

Larry Pollock

The fact that we don't lead the deals gives us the opportunity to cherry pick which ones we want. So we will pick a skinny price deal if it's not likely it'll draw. And we'll just sit there and collect our standby fees.

John Reucassel

Okay.

Larry Pollock

But if they are likely to draw we'll look for a higher yield on the rate.

John Reucassel

Okay.

Larry Pollock

They're still priced reasonable I think, the ones we're seeing. More so than Harry's Trucking in Lethbridge.

John Reucassel

Yeah.

Larry Pollock

Get a better rate than EnCana.

John Reucassel

Yeah. I hope for EnCana's sake. Just again, I don't… if I missed it, I apologize. The growth in loans, how much was it driven by new business and how much was driven by drawdowns?

Larry Pollock

Well it'd be mostly new business.

John Reucassel

New business, okay.

Larry Pollock

Yeah. A lot of the drawdowns, as Chris said earlier, were on the construction side, and those are actually paying out now. So they would be not quite a negative to growth, but pretty near a wash probably.

Chris Fowler

Yes.

John Reucassel

Okay. And then the last, Larry, I was interested in your comment on application of Basel or regulatory rules to OSFI institutions and non-OSFI institutions and what that means. So do I take it to mean that you're worried about provincially-regulated institutions or you're not? Or what should I interpret that to mean?

Larry Pollock

Yeah, we're worried about the non-regulated as well because they can do things that are not permitted under the Bank Act. And I can give you one example. We can't take residuals on leases larger than 10 per cent, while an unregulated financial institution or a provincially regulated one or one like Alberta Treasury Branch can. They can do more or less what they want. So those are tough to compete with, especially when you are trying to ramp up our equipment business. So...

John Reucassel

Is that new, Larry?

Larry Pollock

No.

John Reucassel

No? Okay.

Larry Pollock

That's always been there, but…

John Reucassel

But it's new because you're trying to get more into the equipment business.

Larry Pollock

Yeah. We're focusing more on that sector.

John Reucassel

Yeah. Okay. Okay, thank you very much.

Larry Pollock

Thanks, John.

Operator

Your next question comes from Brad Smith of Stonecap Securities. Your line is now open.

Brad Smith – Analyst, Stonecap Securities

Perfect. Thanks very much. Yeah, sorry, just had a general question about National Leasing. Over the last year you've closed on the ownership and you were quite excited about the growth. Can you just talk a little bit about how your outlook for that growth has changed in the last three months?

Larry Pollock

We've done a couple of things. We acquired a broker in Quebec. So we've ramped up our presence in Quebec, and I believe – I'm going from memory here – but I think our leasing assets, as it relates to National Leasing, are about 13 per cent in Quebec. So we've had some growth there.

We've also re-deployed all the people that worked on… We had a big administration contract that we lost a year or so ago. And it took quite a sizeable piece of revenue out. And our strategy has never been to just cut overhead and march on. What we tried to do is redeploy all those people into more marketing roles or supporting somebody who is in a marketing role. And we've been able to consistently, month after month, set record volumes in National Leasing by really stimulating the marketing side. And that's worked out well, in spite of new entrants in the market, like Element, and more aggressive stance by some of the others.

Brad Smith

You mention Element. Is that… I mean, has there been a change here? Because I thought at one point you had not encountered them very much.

Larry Pollock

We do on the big ticket side. But not as much as I would have thought we would. They seem to be focused on the U.S. now, so... and we're not operating in the U.S., so that won't impact us.

Brad Smith

Right. And just going back to your earlier comment about the residuals. Is that impacting the National Leasing business or your in-house equipment leasing?

Larry Pollock

No, our in-house equipment. Not National at all because they pretty well fully amortize all of their deals.

Brad Smith

Right. And so just in summary, your view, your excitement over the growth prospects at National would be the same, greater than or reduced over the last 30 months?

Larry Pollock

Well the optimism there is outstanding. So we just had our meetings with our staff, and they produced a new forecast for next year. And it's quite aggressive, and achievable at the same time. So we're very, very optimistic about the potential continued growth of National Leasing.

Brad Smith

Okay. And then one follow-up question just to shift gears a little bit with respect to your opportunity, as you mention it, in the Ontario market. I take it a significant component of that might be through your mortgage broker channel development. Can you just give us some colour as to how that has changed over the last few months?

Larry Pollock

Yeah. We have boots on the ground now in Ontario. Our mortgage reps work mainly from their homes. So we continue to expand that presence, and doing quite well. The next step would be for us to look for a point of entry for our heavy equipment people. It's a specialty area that we're extremely good at. We're probably the best in Canada. And Ontario, being about a third of the country, we can't continue to ignore that, so we're going to take a hard look at how we enter Ontario, and we have in the past looked for acquisitions there. There isn't much. We've actually attempted one or two. So we'll either try to do it through an acquisition or organic expansion. But this time next year I hope we will be up and running in the heavy equipment side in Quebec… or in Ontario, I should say.

Brad Smith

Very good. And how does the infrastructure and government finance outlook affect your view on that opportunity?

Larry Pollock

Government finance I don't think impacts us at all. I know there's some equipment financers that have focused on that area, haven't they, Chris?

Chris Fowler

Yeah. Yeah, we would be looking at not just construction; it could include construction, it could include transportation. You know, so there's different areas within the equipment finance market that we would look for the opportunities in.

Brad Smith

And it's in the private as opposed to public sector, I guess?

Chris Fowler

Oh, absolutely, yeah.

Larry Pollock

Yeah.

Chris Fowler

Yeah. Yeah.

Brad Smith

Okay, terrific. Thanks so much.

Larry Pollock

Thank you.

Operator

Again, if you would like to ask a question, please press * then 1 on your telephone keypad.

Your next question comes from Michael Goldberg of Desjardins Securities. Your line is now open.

Michael Goldberg – Analyst, Desjardins Securities

Thank you. A lot of my questions were answered already, but a couple I'd like to follow up on. First of all, ordinarily in your press release you've got more detail on the gross formation that you don't have for this quarter. So I'm looking for the number that would have been comparable to the 13,434 of gross formations in the third quarter.

Tracey Ball

Yes, hang on a second, Michael. So the gross impaired loan formations for the fourth quarter were $1,221,000.

Michael Goldberg

Okay. And also just to clarify, you indicated that most of the investment gains were coming from FIs. Do you have much of a backlog of remaining gains that you could harvest? And, you know, in the past you said that these gains can normalize out to around $1.5 million a quarter. Is that a reasonable number to still think in terms of?

Tracey Ball

Michael, the normalization for 2013 is a little bit difficult to guestimate because it really depends on what happens with the markets because we have our available-for-sale accounting would require us to also recognize unrealized losses. So I think $1.5 to $2 million a quarter in net gain is probably realistic, taking into account that we will have some losses that we will have to recognize.

Michael Goldberg

That's per quarter?

Tracey Ball

Yeah.

Michael Goldberg

Okay. And also to clarify, on the insurance, should I think of the irregular portion of the decrement to revenue as being the $5 million of limit loss that you have in the quarter?

Tracey Ball

Yes.

Larry Pollock

Yes.

Michael Goldberg

Okay. And you were also asked about getting into equipment finance in Ontario. I guess that this is over and above what you do with National Leasing. You talked in the past about potential tuck-ins for National Leasing. Could that be part of your entry also? And can you update us on what you said in the past about potential tuck-ins for National Leasing?

Larry Pollock

I can give you an example of one real live example, which I can't name, of course. But it was a small-ticket operation that we could have, had we been able to acquire it, would have put heavy-ticket people into that location, and just expanded the mandate. So you can actually have them work together. It didn't work out for us. We just won't pay too much for anything. But that's the sort of thought process that we have, Michael.

Michael Goldberg

So that's a thought process that you have for how you might get into larger tickets in addition to the smaller ticket. Is that the way to think of it?

Larry Pollock

It could work either way. If we could find a large-ticket office or a small-ticket office, we would add the opposite component to it, because the way they do their business is not a whole lot different. They are still focused on, in many cases, the same type of customer. I think our small-ticket group is now averaging around $25, $26,000, and the big ticket would be, what, north of $200 or…

Chris Fowler

About $600,000.

Larry Pollock

Six hundred thousand. Yeah. So it's quite a gap there. So our thought is that we would want to move somewhere in between there's a lot of business, move the small-ticket guys up market and the big-ticket guys down market maybe a little more.

Michael Goldberg

Thank you very much.

Chris Fowler

Thanks, Michael.

Operator

There are no further questions queued up at this time. I turn the call back over to the presenters for closing remarks.

Tracey Ball

Okay. Thanks, Sarah, and thanks to everyone for your continued interest in Canadian Western Bank Group. We look forward to reporting our 2013 first quarter results on March 7th. If you have any questions or comments, please call us or contact us by email.

Thank you again and all the best for the holiday season. Thank you.

Operator

This concludes today's conference call. You may now disconnect.

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