



FINAL TRANSCRIPT

Canadian Western Bank

Second Quarter 2013 Financial Results

Event Date/Time: June 6, 2013 — 3:00 p.m. E.T.

Length: 53 minutes

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Michael Goldberg
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PRESENTATION

Operator

Good afternoon. My name is Denise (phon), and I'll be your conference Operator today. At this time, I would like to welcome everyone to the Canadian Western Bank Second Quarter 2013 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'd 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, press the # key.

Thank you. 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

Okay. Thanks, Denise, and good afternoon, everyone, and welcome to the 2013 second quarter 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 our website at cwb.com in the Investor Relations section. I'll also draw your attention to our forward-looking statement advisory on Slide 10.

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The agenda for today's call is on Slide 2. Joining me today is our President and Chief Executive Officer, Chris Fowler, and also in attendance are Executive Vice Presidents, Randy Garvey, Brian Young, and Greg Sprung.

For today's call, I will provide a brief summary of our second quarter and year-to-date financial highlights and performance against our 2013 minimum targets. I'll then turn things over to Chris for an overview of our longer-term 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 second quarter performance, highlighted by the achievement of our 100th consecutive profitable quarter. This unique track record of consistent profitability every quarter over the past 25 years sets CWB apart from all other Schedule I banks in Canada, and we're very, very proud of this accomplishment.

We are also pleased to announce this quarter our investment and 55 percent ownership in Calgary-based McLean & Partners Wealth Management. This transaction closed in May, and we're excited to welcome the entire McLean & Partners team to our group.

Second quarter loan growth was very strong at 4 percent, and it grew 7 percent year to date and 12 percent over the past 12 months. Growth reflected good performance across almost all lending sectors, with the strongest year-over-year increases coming from our core equipment financing and leasing and general commercial portfolios. And interest margin was stable compared to the prior quarter, but continued to be constrained.

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Based on the standardized approach for calculating risk-weighted assets, the Bank's all-in Basel III ratios were 8 percent common equity Tier 1, 9.7 percent Tier 1, and 14.1 percent total capital, all well above applicable regulatory minimums and within our target high cap thresholds.

Moving to the next slide. Net income available to common shareholders of 43 million was up 8 percent over the same quarter last year, while diluted earnings per common share increased 4 percent to reach \$0.54. Adjusted cash earnings per share, which excludes the non-tax deductible change in fair value of contingent consideration and the amortization of intangible assets, was unchanged from last year at \$0.55.

The difference in growth in net income available to common shareholders and adjusted cash earnings per share is largely the result of the combined impact of an issuance of Canadian Western Bank common shares and the settlement of contingent consideration in the third quarter of 2012, both of which were related to the 2010 acquisition of National Leasing.

Quarterly total revenues of 137 million represented a 7 percent increase over the same period last year, as the positive influence of strong growth in loans and other income more than offset the impact of a 16 basis point reduction in net interest margin to 2.65 percent.

Other income of 23.4 million was up 3.1 million or 15 percent compared to the same quarter last year, reflecting increases in all categories, with the exception of a small decline in gains on securities. Based on the current market environment and the composition of the securities portfolio, we believe gains on securities will continue to provide a relatively consistent source of

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revenue for the remainder of the year. The elimination of contingent consideration fair value changes led to a 1.3 million increase in the other category of other income compared to last year.

And compared to the previous quarter, net income available to common shareholders and adjusted cash earnings per share both declined 5 percent, as the combined benefit of very strong loan growth, a stable net interest margin, and higher other income was more than offset by three fewer revenue earning days and higher non-interest expenses.

Overall, credit quality remained within expectation, and the dollar provision for credit losses represented 19 basis points of average loan compared to 18 basis points in the previous quarter and 19 basis points a year earlier.

The level of gross impaired loans remains very low in relation to total loans outstanding. This period marked the first increase in this measure since the second quarter of 2010, and more normal fluctuations are expected looking forward.

Yesterday our Board declared a quarterly cash dividend of \$0.18 per common share, representing an increase of 6 percent from the previous quarter and 13 percent compared to the quarterly dividend declared one year ago.

As a result of ongoing margin pressure and the corresponding impact on gross and total revenue, this increase in the dividend will put us at the top end of our target payout range of 25 to 30 percent of net income available to common shareholders. The Board also declared a quarterly dividend on preferred shares.

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Slide 5 shows year-to-date results compared to our fiscal 2013 targets. As shown, solid performance through the first half of the year has us well positioned in relation to the majority of our targets. The volume in the pipeline for new loans remains strong, and we are confident in our ability to achieve another year of double-digit loan growth.

Based on our positive view of overall credit quality, the annual provision for credit losses should remain at the low end of our target range of 18 to 23 basis points of average loans.

While we were pleased to see net interest margins stabilize this quarter, meaningful improvement in this measure will be difficult in the absence of interest rate increases and/or a steeping of yield curve.

The compressed net interest margin has a moderating impact on total revenue growth and challenges our profitability measures and the efficiency ratio, which Chris will speak about in a short while. The year-to-date efficiency ratio of 46.3 percent was slightly higher than our target of 46 percent or less. In consideration of expected revenues and expenditures, we believe our 2013 efficiency ratio target of 46 percent or better is attainable, but will be challenging.

One of our key objectives is to ensure expense growth is contained in consideration of expected revenue growth. That said, our focus is on adding value for shareholders over the long term, and we will continue to invest strategically in people, technology, and infrastructure to support future development and growth opportunities.

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Year-to-date return on equity and return on assets are both slightly below our minimum targets, reflecting the impact of the constrained net interest margin.

The next slide shows the historical trend of net interest margin, the spread on loans, and the prime lending interest rate. Second quarter net interest margin of 2.65 percent represented a 16 basis point decline from the same period last year, with the difference largely reflecting a reduced loan yield, partially offset by lower deposit costs.

Net interest margin was stable compared to the previous quarter and improved deposit costs, lower average liquidity, and higher yields on securities offset the impact of lower loan yields and the expense related to an increased balance of debentures outstanding.

Based on ongoing scenario modelling and stress testing, we have implemented a plan to prudently reduce liquidity levels. While lower average liquidity and other factors are expected to help offset margin pressure in future quarters, this key measure will continue to be constrained, primarily due to the prolonged low interest rate environment. Of course any increases in interest rates or a steeping of the yield curve would have a positive impact on margin.

Year-to-date net interest margin of 2.65 percent was down 14 basis points compared to the same period in 2012, reflecting the factors already noted.

I'll now turn things over to Chris.

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

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Thank you, Tracey. We've already mentioned we're very pleased to celebrate 100 consecutive profitable quarters. We're proud of what this achievement represents, and we're determined to build on this unique track record of consistent profitability and growth going forward.

To mark the accomplishment and in support of our commitment to give back to our communities, I'm also very pleased to confirm that we will donate a total of \$100,000 to children's hospitals located throughout our key geographic markets.

As Tracey mentioned, I'm going to spend a few minutes on our current business outlook by referencing some key financial metrics, then I will move to a more general discussion of our longer-term strategy.

Slide 7 shows our quarterly loan growth over the past four-and-a-half years going back to the onset of the global financial crisis. As shown, net quarterly loan growth of \$586 million was very strong, and outside of acquisitions represents the second highest dollar volume of growth in our history. Our best quarter ever was the third quarter of 2011, when we added \$683 million of net new loans.

Looking at the overall level of activity in our markets and our current pipeline for new loans, we are confident in our ability to generate—sorry, to continue to deliver double-digit loan growth. Going forward, we expect the largest growth contributions in dollar terms will continue to come from our focus on general commercial loans and equipment financing and leasing. As we

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stated in previous quarters, we expect a relatively slower level of growth in new real estate project loans, commercial mortgages, and oil and gas production loans.

Our expectation for more modest growth in real estate project loans is warranted by moderated residential real estate activity and relatively high levels of consumer debt. Intense price competition for commercial mortgages has diminished opportunities for profitable growth in this lending area.

However, we will continue to selectively grow this portfolio by accommodating existing client relationships, and participating in deals that meet our thresholds for both profitability and loan quality.

The relatively recent increase in natural gas prices from very low levels, coupled with incremental improvements in the well-documented constraints on transporting Canadian crude oil have yet to result in escalated activity in the oil and gas sector.

Turning to Slide 8. The dollar level of gross impaired loans was up slightly following 11 consecutive quarterly declines in this measure.

Total gross impaired loans of \$62 million represented 41 basis points of total loans outstanding compared to 39 basis points last quarter and 66 basis points a year earlier. Normal experience over the course of credit cycles supports our view that gross impaired loans would likely fluctuate above the very—the current very low level, but overall credit quality is expected to remain strong.

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This view is reinforced by our secured lending practices and disciplined underwriting, as well as the overall economic outlook for our key markets. Although growth in Europe remains sluggish, Canada will continue to benefit from the strengthening US economy, which appears to be moving in a number of important categories.

The combination of increasing activity in the US housing market, improving employment levels, and strengthening demand from US consumers positively influenced demand for Canadian exports. And have underpinned the continuation of comparatively stronger economic conditions in Western Canada compared to the rest of the country. Canada's economy continues to expand moderately, and we concur with the view that overall growth will pick up towards the end of the year and into 2014.

On Slide 9, Tracey has highlighted our results in relation to our 2013 performance targets. I'd like to expand on that discussion and talk about our longer-term strategic objectives and outlook. Today our objective is to continue to build a strategically important Western-based financial services franchise, and our opportunity is to continue to integrate our complementary businesses to solidify and grow our client base, increase our revenues by client, expand and diversify our deposit base, and grow both organically and through acquisition.

In keeping with these themes, we are very pleased this quarter to announce our investment in 55 percent ownership of Calgary-based McLean & Partners Wealth Management.

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McLean & Partners is complementary to our previous investment in Adroit Investment Management, and represents a continuation of our wealth management strategy.

Statistics show that a significant portion of Canada's high net worth individuals are or were business owners. And we know that our core client base in the Bank includes an abundance of wealth management prospects.

In addition to its potential to strengthen our business relationships, expanding in wealth management offers an opportunity for us to further grow and diversify revenues from non-interest sources.

Strong relationships are the foundation of our vision to be seen as crucial to our client's futures. We continue to enhance both our capacity and ability to help more clients more effectively by making meaningful strategic investments in people, technology, and infrastructure.

One of our key investments in people, in addition to increasing our complement of qualified staff to support growth, is to provide them with valued training. During the quarter, we initiated a being crucial training program to employees across all CWB branches. The program is a customized approach developed to help our employees build deeper client relationships and facilitate cross partnering within branches and across other CWB group companies. We piloted the training to a selected number of branches in the fall of 2012, and we're very pleased with the results we've seen so far.

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Work on our core banking transformation program continued during the quarter for an implementation in the first half of 2015. As we've discussed in prior periods, this is a very important project for us and will be a preliminary requirement to facilitate an eventual transition to an advanced approach for calculating risk-weighted assets.

Our financial objectives are to continue delivering industry-leading growth, strong asset quality, and increasing returns for our shareholders through both capital appreciation and dividends. Today, we are pleased to announce an increase in the quarterly dividend for common shareholders. As always, we will evaluate the dividend each quarter in consideration of our expected earnings growth and target payout ratio.

Tracey mentioned the challenges resulting from ongoing margin pressure. While the impact of very low interest rates on total revenue growth is expected to persist, we have a number of strategies and expectations that we believe will help to mitigate further pressure going forward.

First, we expect our higher yielding equipment finance and alternative mortgages portfolios to grow at a relatively stronger pace compared to the rest of our key lending sectors. On the funding side, our fixed term deposits continue to reprice at lower rates and helps to offset the impact of reduced lending yields. Ongoing growth in general commercial lending, coupled with improved product offerings in business banking, will also grow our base of branch-raised deposits.

We continue to generate strong demand and attractive pricing in the capital markets, issuing \$300 million of five-year senior deposit notes this quarter, and we expect to initiate a bearer

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deposit note program before the end of the year. This new program will enable a much better match for floating rate assets. Securing additional sources of floating rate deposits will also provide us flexibility to match a greater proportion of our core deposits to longer duration assets.

We continue to evaluate the funding potential available through securitization of various portfolios, including equipment loans and leases, residential mortgages, and commercial mortgages.

Our Internet bank, Canadian Direct Financial, surpassed \$225 million in total deposits during the quarter, and has the potential to provide a meaningful source of funding diversification and growth in the future. The benefit of strong loan growth and other income contributions will drive future revenue growth as we continue to make necessary investments in our business, while also continuing growth in non-interest expenses.

As Tracey mentioned, our 2013 target for an efficiency ratio of 46 percent or less is attainable, but will be challenging in the face of lower-than-expected net interest margins. Today, the strategic question we ask ourselves is does what got us here get us there? Here is a successful growth story built on a highly valued and recognized organizational culture where people know they're making a difference. There represents a strategically significant financial services franchise based in Western Canada.

Our core focus remains in business banking, with complementary client offerings in personal banking, equipment leasing, trust services, wealth management, and insurance. We have a strong business model that continues to deliver increasing value for our shareholders, but continual

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enhancements are necessary to meet the challenges of our current and future operating environments, including very low interest rates, competitive pressures, and questions about the future rate of economic growth.

The West remains an attractive place to live and conduct business. The four western provinces have led in economic growth in recent years, and we believe this will continue. Our Western Canadian base is a competitive strength, and as I mentioned, we remain optimistic about our pipeline for new business. At the same time, we also believe there are significant opportunities to further increase our business and geographic reach within targeted areas.

Overall, we have a very positive view of the future and are executing on our plan to produce the consistent levels of growth, profitability, and financial performance that our stakeholders have come to expect.

Thank you all very much for your time. I will now turn things back over to Tracey.

Tracey Ball

Okay. Thank you, Chris, and that concludes our formal presentation for today's call. At this time, I'll ask Denise to begin the question-and-answer period.

Q&A

Operator

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At this time, I'd like to remind everyone in order to ask a question press *, then the number 1 on your telephone keypad. We'll pause for a moment to compile the Q&A roster.

Your first question comes from Robert Sedran with CIBC. Your line is open.

Robert Sedran — CIBC

Good afternoon. Tracey, in your prepared remarks you talked about either higher rates in the short end or a steepening yield curve as being beneficial to the margin. I presume in terms of a steepening curve you're still thinking five years and in. So can you maybe explain how much that would have an impact if the curve was to steepen? Like how much steepening would we need before we'd see a positive impact on the margin? And perhaps how that would translate into the higher revenue?

Tracey Ball

So, Rob, one of the things that Chris mentioned in his remarks too was the fact that we will—or by doing the bearer deposit notes we can also move more of our core deposits out in duration. But the reality is that until the curve starts to steepen you wouldn't see a big benefit from that.

So I can't quantify it for you, but certainly that's the way that we've generated a lot of margin in the past is with, for example, a good example is in our equipment financing is because they amortize down to zero over five years, we would also look to fund that with say a three-year

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GIC, which would create a bigger spread because you're pricing your five-year loan at five-year rates. So I can't quantify it for you.

We did do a little run; just we were doing our strategic planning with our Board this morning, and we did do a run where we added 20 basis points to our number so far year to date, and it popped our revenue growth up by about 24 percent. So just 20 basis points makes a huge difference to us and it's something that we can certainly get back to with, we believe, with a more normal yield curve.

I'll also ask Randy Garvey if he wants to add anything to that.

Randy Garvey — Executive Vice President, Canadian Western Bank

No. I mean I think our portfolio is positioned to take advantage of the yield curve. So both our investment portfolio and our bond portfolio should help move us in a very positive direction with any increase in the slope of the yield curve.

Robert Sedran

And it is correct when I say that we're talking about five years and in obviously?

Randy Garvey

It is.

Robert Sedran

Okay. And, Chris, just in terms of the capital position; now that you're sitting at an 8 percent common equity Tier 1, is there reason why you'd need to run with a higher capital level? Or is this level good enough to operate from and you don't need to continue to build that ratio?

Chris Fowler

We're very comfortable at an 8 percent ratio.

Robert Sedran

Even as a longer-term target? Like this is where you plan to operate the Bank?

Chris Fowler

Well, as we model out we look at our capital generation just from normal growth and retained profits, and we see that as a good ratio. It's 100 basis points above the minimum. It works well with our ICAAP testing, so yeah, we're very comfortable.

Robert Sedran

Great. Thank you.

Operator

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

Shubha Khan — National Bank Financial

Thanks. Good afternoon. So I want to stick to the theme of the NIM as well, maybe not so much from a perspective of NIM expansion as much as NIM stabilization. So just looking at deposit

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costs, it looks like they've stabilized for the most part. The same obviously can't be said for the average loan yield, but for the most part your loan book is the shorter-term loans. So would I be correct in assuming that we are pretty close to the point where substantially all the loan book has repriced to reflect the current interest rate environment? And if so, what would be a reasonable time frame to expect the underlying loan to deposit spread to sort of stabilize?

Tracey Ball

So a lot of the loans, you're right, have repriced and there still are some more that will reprice, however. And our deposit costs do continue to go down. We're just in a process of reviewing a number of our key deposits to reduce the cost. Those aren't fixed term deposits. Those are our trust deposits, as well as our high interest savings.

We're very competitive right now. So we can still remain very competitive and bring those rates down. And as we continue to build our commercial relationships we'll also get a lot—we expect to get a higher percentage of demand accounts coming in from our commercial clients.

Shubha Khan

Okay. So the 300 basis points in net interest spread, loan to deposit spread that you're currently generating, is that a fairly sustainable level then? Or you still see some further reduction there?

Tracey Ball

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No. it's always hard to say because there's a lot of moving parts. But as Chris mentioned, we are looking to increased emphasize on our higher margin products, and as well as what I've already just mentioned on the commercial banking side is that's where you get the full relationship that brings the deposits.

We've also taken a good look at our treasury function in terms of liquidity and how we've been too conservative in modelling liquidity scenarios, and we've been able to determine that there is some ability to move there. And any benefit there won't show up until third quarter and going forward.

Shubha Khan

Okay. Just to follow on your comments with respect to liquidity there. I guess you did reduce liquidity from the previous quarter, but you're still quite a bit higher than where you've been traditionally or at least the average of the last couple of years. I think you were at around 14.5 percent of total assets in terms of liquid assets and now you're at 15.5. So is the 14.5 sort of an appropriate approximation of the target liquidity ratio? Or how should I think about that?

Tracey Ball

I think 14.5 would have been typical over the past, but we're trying to bring that down as a typical level.

Shubha Khan

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Okay. And just out of curiosity, was there any—I mean how much prepayment penalty income was there—was the contribution of prepayment penalty income to NIM this quarter?

Tracey Ball

I'll have to actually check that and get back to you. I don't have it right in front of me.

Shubha Khan

Okay. And then final question; growth in your commercial mortgage portfolio was pretty strong this quarter. I think recently you'd mentioned that the larger banks had become a lot more aggressive in terms of pricing in that segment, and that CWB was unwilling to forego—or willing to forego some lending opportunities, rather, if the pricing didn't make sense. Has the competitive environment stabilized a little bit on that front? Or did you sacrifice some margin for growth this quarter?

Chris Fowler

Well, what we do is we look at each loan individually as they come in. We see what that relationship is, and if we've got a broader relationship than just an outlet for funds, we would look to do the business.

So in the case of this quarter it would be a combination of both new business and renewals of existing that we've chosen to participate with, so they've met both our pricing standard and our quality standard.

Shubha Khan

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Okay. Thanks. I'll re-queue.

Operator

Your next question comes from Scott Chan with Canaccord Securities. Your line is open.

Scott Chan — Canaccord Securities

Good afternoon. My question is really to wealth management. And if you go back to the Adroit transaction back in late 2008, I think assets upon the acquisitions were about 1 billion and it's probably about 1 billion right now. Can you just talk about just Adroit? Because the market has improved since that point significantly, kind of what has been the trade-off in terms of kind of the existing clientele versus cross selling with CWB clients? Has there been any traction there in the last four years or five years? I'm just trying to kind of follow that up with the McLean & Partners transaction that you guys just did.

Randy Garvey

So we've seen some transaction—or some traction there. We definitely believe that there is an opportunity to increase on that traction. Adding McLean & Partners gives us a broader service offering and makes us more competitive from that perspective with a lot of the organizations that are in that space.

Scott Chan

So this is something that you're still going to run separately between the two wealth management firms?

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Randy Garvey

I mean we will look at the appropriate business model over the next six months and see what is the best way to bring that consolidated product or approach to our clients.

Scott Chan

And do you expect any other acquisitions in wealth management outside maybe high net worth looking to maybe another client segment? Or are you just looking to kind of scale the two entities you have right now?

Randy Garvey

Where we're at right now is really assessing where we are from a service offering perspective: do we have a broad enough service offering there to have a complete wealth management solution for our clients and do we have adequate geographic coverage? And I think both of those would suggest that we will continue to look for opportunities.

Scott Chan

Okay. Thanks.

Operator

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

John Reucassel — BMO Capital Markets

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Thank you. Just a question for—clarification question for Tracey; on Rob's question you mentioned a 20 basis point increase. I assume you meant 20 basis points on NIMs, not in interest rates in the prime rater (phon)?

Tracey Ball

Just on NIMs.

John Reucassel

Yeah. Okay. Okay. Great. Tracey, was there any impact—I'm sorry, was there any impact from the McLean & Partner acquisition on the CET1 ratio?

Tracey Ball

There was a bit. There's a slight deduction, but it's not material.

John Reucassel

Not material. Okay. And I guess there's a lot of questions on the net interest margins. I guess I'm just trying to understand for my sake and simplicity, if things stay the way they are today, should your net interest margins stabilize next year? Or you're still on the loan repricing you're still going to feel some pressure next year?

Tracey Ball

Well, it's—I mean it is really hard to say, John, because there are certain sectors where we would continue to see pressures, particularly in the commercial mortgages. We built that book up

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during the crisis, and now it's become extremely competitive. As you know, the other banks have said they're getting into commercial banks, and that's a target area for them.

And as Chris mentioned, we do try to keep those lulls when they represent relationships, but we do have to meet the price. On the other hand, we have our equipment financing and leasing, which is a higher margin business along with alternative mortgage, which is a higher margin business.

So we're doing many things to try and preserve margin and look for those ways to improve it. And in some cases in this flat interest rate environment you just—you can't see it because there's no opportunity to move up that yield curve. So I guess the answer is a qualified maybe.

John Reucassel

Okay. Okay. I had to ask. And then just for Chris, just when I look at the growth in your loan portfolio on Slide 3 and on the syndicated loans, I guess, or the corporate loans—the corporate lending, I assume that's mainly syndicated loans. Do those have to go through the same type of pricing hurdles that you set for commercial mortgages and everything else?

Chris Fowler

Oh absolutely they do. Yes.

John Reucassel

So the spreads, loan spreads you're getting on that, are similar to what you'd get maybe not in equipment leasing, but in other types of loans?

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Chris Fowler

They'd be similar as the commercial mortgages in spreads.

John Reucassel

Okay.

Chris Fowler

So it would be—again, we're selective on those as well, just as we are on the commercial mortgages.

John Reucassel

So the idea of participating in the syndications is to—I mean do these lead to relationships? Or is this really if you get a decent loan and there's some syndication we'll participate, otherwise we won't? Is that that simple? Or is there any conversion rate here on these corporate loans?

Chris Fowler

How it's worked sometimes is where we've had a client that's grown to the point where it's becomes syndicated, so it's sort of outgrown us in terms of us being the sole lender or the amount that we want to take of it. And the other side of it is where we participate with the other banks in a loan that makes sense to us from both a geographic and industry diversification perspective.

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So we kind of look at it from a number of different angles and make our decision based on that particular opportunity. But we keep strong relationships with all the—like all the big banks because that's typically the source of the lion's share of this business.

John Reucassel

Okay. And they're mainly Western Canadian-based institution borrowers?

Chris Fowler

Well, they'd be either Ontario or Western Canada.

John Reucassel

Okay. Okay. And then just last question is on there was a big impairment in the—looked like in the commercial real estate. Could you confirm for me is it in British Columbia or Alberta? And is it in housing?

Chris Fowler

Sorry, what was the last part of that?

John Reucassel

Is it in—what province is it in? And is it directly related to housing?

Chris Fowler

No. It's not housing. It is commercial mortgage.

John Reucassel

Commercial mortgage...

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Chris Fowler

In Alberta.

John Reucassel

Alberta. Thank you.

Chris Fowler

Yeah.

Operator

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

Brad Smith — Stonecap Securities

Thanks very much. I just had a couple questions on the personal lending side where I see the momentum or pace of growth was also very strong. Was wondering if you could talk a little bit about your thinking with respect to your broker channel mortgage initiative? And if possible, give us just some sense of order of magnitude direction of margins between the personal and the commercial lending businesses?

Chris Fowler

Our focus on the Alt-As or Optimum Mortgage group, which is based in Edmonton, and that portfolio extends from Ontario to BC, our outlook on that portfolio is for continued growth. It's been an area that the other banks from an Alt-A perspective have pulled back, so we've had more

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opportunity. And then throwing the B20 rules into the mix has also allowed us to see more volume. So we're able to do quite well on that.

In terms of the net interest margin in comparison to the commercial side, I don't have the exact percentages. It is higher and it's also a lower capital product. I mean the commercial mortgages are 100 percent risk weighted for us and the residential are 35 percent risk weighted.

Brad Smith

Just a follow-up just in terms of the direction of the net interest margin between the commercial; did it go up or down? And the personal up or down and sort of proportionately? Like did it go up 1 percent or 5 percent in personal and up or down a similar amount in commercial?

Tracey Ball

We don't really have the ability to measure it that specifically.

Brad Smith

Okay.

Tracey Ball

So we don't have a transfer pricing model that allows us to sort of measure that margin by product type. So it's more for us, it's more of a look at our lending yields versus our deposit costs and look at the different portfolios to see which are outperforming or underperforming budget or expectations.

Brad Smith

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Okay. Thanks very much.

Operator

Your next question comes from Sumit Malhotra with Macquarie. Your line is open.

Sumit Malhotra — Macquarie

Thanks. Good afternoon. My first question is just to ensure I'm thinking about your preferred shares the right way. I noticed that you were modestly active on your preferred shares NCIB. But if I look out just a little bit further, these preferred shares that you issued in early '09 are redeemable or callable by the Bank in April 2014. Could you just clarify what your intention is here? And I would say that's either for Chris or Tracey.

Chris Fowler

Right. Well, Tracey go ahead.

Tracey Ball

Well, obviously when we come up to the five-year repricing date we're going to have to make a decision whether we want to redeem them and reissue. But one of the big challenges that we have right now is that, as you would know, Sumit, is that all non-common equity capital must be NVCC. So far we have not had an NVCC issue to date.

So in the normal course of what we would look at is we would look to replace that preferred share likely with another preferred share issue because it would make sense from a

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capital point of view. But we are very anxious to see an NVCC issue, so I can't answer that question right now because it's just impossible.

Sumit Malhotra

So the level right now, that obviously I think you issued these at a somewhat pricey coupon given where you were in the market at that time. I think if you were to redeem these you would fall slightly below the Basel III Tier 1 level. Is that something—and I think I'm looking at that on a pro forma basis. I don't know how much we can press this, but would that be something you can do in the short term while you wait for that market, the NVCC pref share market, to develop in Canada?

Tracey Ball

Well, we would have a few options. But first of all, our modelling doesn't actually show us going below the 8.5 percent minimum that OSFI set. But it is—it would definitely take a nice chunk out of our Tier 1, there's no question, so if you're looking at options for Tier 1, the only other option is common equity, but it wouldn't take very much if we had to do that to augment it.

But clearly, and I'm sure you wouldn't be surprised, but we're having many discussions with OFSI on a regular basis because it's really our view that Basel III was aimed at the large AIRB banks. And this is one area, one situation that really is a challenge for us because we have to wait until that market is established. But we will do whatever we need to do that makes sense for us at the time.

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Sumit Malhotra

Well, yeah. I don't want to belabour this, but I guess my thinking was if you have paper that's out there that's paying 7.25 in after-tax dollars from a common shareholder's perspective, assuming you're okay on capital, which it looks like you are, it would make sense to get this form of funding off of your books as soon as possible and...

Tracey Ball

It's more expensive than we'd like to pay, that's for sure. And I think you've seen what two banks that have actually repriced and the pricing was good, and I think now National has come out and said that they're going to redeem an issue. Because again, they were—we're all issuing in the crisis with those high coupons on them. And as you remember, Sumit, ours was unrated, so we paid up even more.

So now that we've been rated for quite a while and we have about four or five different ratings, including the preferred share rating, it wouldn't logically make sense for us to reprice it or to reset it.

Chris Fowler

Roll it over.

Sumit Malhotra

Sorry, it wouldn't make sense to?

Tracey Ball

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To just reset it. To just let it...

Sumit Malhotra

Yeah. Okay. That's kind of along the same lines I'm thinking as well.

Tracey Ball

Debt's expensive.

Sumit Malhotra

And then my last question is around expenses. Now I think both, Chris and Tracey, you said that obviously you're mindful of the rate of expense growth, but that has to be balanced against longer-term initiatives. And I realize what with the eventual shift to AIRB, as well as some of the project and branch expansion that you're doing, that's going to cause some level of expense growth. But when you look at your comments around revenue and the challenges you're facing on the margin side, and I look at the levels of expense growth that you had at double digit or close to levels, there seems to be somewhat of a disconnect there.

So how should we think about expense trends at CWB, which don't seem like they've been stabilizing over the last couple of quarters despite a tough revenue environment? And if you disagree with that characterization, please correct me.

Chris Fowler

Well, our goal when we look at our budget and we set it for the year, we identify where we expect revenues to come in and set an efficiency ratio at 46 percent or better, our goal is to

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manage to that. And with the view that in this particular year we have moved a couple of branches, expanded them, so we have increased our expense from that perspective. So a portion of that increase in non-interest expenses is a build for the future.

We expect to see a payback from that, so expect to see increase in revenues from that investment. So it's clearly with the tighter margin on NIM, it is a challenge. And we certainly will keep our eye on that ball because it's a very important ball to keep an eye on.

Tracey Ball

Yeah. And I think it's fair to say that we don't want to make any real short-term decisions. So just as an example, maybe it would—a couple of examples I can give you that may help understand the expense growth relative to what we're trying to plan for in the future is you know we have our large banking system going on right now. And essentially we've taken a view there that it's very important to have our best people participate in that system on 100 percent full-time basis, and I don't think you'll find that surprising.

But what it does mean is that we pull those key people out of ongoing operations, and so we have to backfill. And we can't backfill with the same knowledge level because we've put all those best brains into our system and developing it.

We've also had a couple of situations in particular segments of employees at corporate office that are in high demand in Alberta in particular. So IT people are in very high demand. We've had to look at reviewing what their salaries and incentives to stay are.

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And I would also suggest that certainly over the last three years we've spent a lot of time looking at succession. And as a result of that, as you know, baby boomers are getting older, so we're identifying those younger people at our organization that are going to be the leaders for the future. And to that extent we have advanced people. We have put people into our long-term incentive program. And it does cost money, but it is the right decision to make for the long term.

Sumit Malhotra

Thanks for your time.

Tracey Ball

You're welcome.

Operator

Your next question comes from Nick Stogdill with Credit Suisse. Your line is open.

Nick Stogdill — Credit Suisse

Hi. Good afternoon. First just to follow up on the real estate impaired loan. Could you clarify that that was a single account? And would you be able to provide the LTV on the impaired commercial mortgage?

Chris Fowler

The—yeah. I don't have that off the top of my head. It was a commercial mortgage that it ran into some issues with tenants. So there's fewer tenants, so it affected their ability to make their payments, so it went impaired. So it's a very—it's not an uncommon event in the portfolio.

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We've been running these impaireds down to an extremely low level. So when you get one that ticks it up, it is just not a trend in the portfolio. And looking at Page 7 of our message to shareholders, we had—we have actually fewer impaired loans this quarter in all. So that segment is still reasonable. Our specifics in general are in great shape. We have—our total provision exceeds our gross impaired loans.

So we're very comfortable with our credit, and feel the exposures we're in and particularly those ones in the gross impaired category are manageable.

Nick Stogdill

Okay. Thank you. Just my second question on the plan to reduce liquidity levels. Could you just discuss this strategy within the context of the upcoming LCR rules? Just give a bit of colour there?

Tracey Ball

The one I'll mention is that with the changes that were made to the LCR rules in January and they're not finalized yet, but the information that was set out in January, we would—we'd always felt we would meet those ratios before the changes. And with the modifications it's not going to be a problem for us on the LCR even with putting in some I would call the nuances actually to our liquidity.

And I guess in times of tight margins or whatever, you just look at everything and say, do I really need to be this conservative? So we determined that we didn't need to, and so that's what

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we'll be implementing. But it's just a handful of support, so it's not a meaningful change in the short term.

Nick Stogdill

Okay. Thank you. And just a last question related to expenses. So over the past four quarters I noticed headcount growth has averaged about 2 percent on a sequential basis, and this makes sense given the context of the investments you're making. But I'm just wondering if we should expect a similar rate of growth going forward? Or whether you have the people on board you need for the new banking system and it'll level off a bit? So anything you could add there?

Tracey Ball

Well, what I would say is that, yes, we have. That's the headcount that has gone up. Yes. We definitely have more people.

We do have a new branch in Winnipeg; that required more people. We anticipate at the end of this year that we'll be moving into our new Edmonton main branch and that will double the size of the premises, so we would anticipate a few more people there, but mostly the holes we're trying to fill are in those revenue-generating jobs. And you don't see the results right away, but they do come in over time.

Nick Stogdill

Okay. Thank you for your time.

Operator

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Again, to ask a question, press *, 1 on your telephone keypad.

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

Michael Goldberg — Desjardins Securities

Thank you. I want to follow up on the question about the Series 3 Preferreds. Is it conceivable that you could ask the shareholders to lower the rate that you're paying as an alternative to calling those mortgages? And if you did that, would they still end up being grandfathered?

Tracey Ball

Well, that's a good question, Michael, and I'm not sure I have the answer to that. But we do have still one large shareholder of those, so that would be something worth pursuing, but we have to—myself and counsel would actually have to look at the terms of the preferred shares to determine whether we could do that or not, and we have not done that at this point.

Michael Goldberg

Because I guess it is at your option to call those shares for redemption, and I guess something's better than nothing?

Tracey Ball

That's correct.

Michael Goldberg

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Okay...

Tracey Ball

And whether they would get grandfathered or not would be something that we'd have to—if we did do something like that that would be something we'd have to get OSFI approval for.

Michael Goldberg

Okay. Given the pipeline and pace of loan growth that you've seen in the first half of the year and particularly in the second quarter, does—you have this 10 percent loan growth objective. Would it be fair to say that that now looks maybe even a little too conservative?

Chris Fowler

That's hard to say. As we look at the pipeline we're confident that we'll meet our targets. And we'll see how the—the pipeline is strong and within the projections going forward it definitely—we have a short duration portfolio that includes of course different interim construction loans that come to maturity that pay down. And we obviously experience unexpected payouts, companies are sold, loans are paid out. So we're certainly always looking to keep that pipeline at a level that keeps our loan growth positive, and certainly we're on track for our target.

Michael Goldberg

Mm-hmm.

Tracey Ball

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And, Michael, just we do comment specifically on interim real estate lending because we do know that the number of new projects is slowing for all the reasons that we read in the paper everyday pretty well. So what happens is we'll start getting more and more paybacks of existing loans as they sell out and we won't have the new product to go back on. So that's why we're cautioning on that.

So it's pretty hard to say. We've also seen in our corporate lending book we've had some pretty big paybacks just recently. And those usually come from acquisitions, and you can't guess those ahead of time.

Our equipment portfolio also pays back very quickly. So in order for them to grow they have to write a lot of business. So that's why we're not—we're comfortable with the 10 percent, but it's hard to say whether we'll be far ahead of it at any point in the next 12 months.

Michael Goldberg

Okay. And just a couple of things I'd like to clarify from your earlier comments. Would the mix of loans that you can see going forward help net interest margin?

Chris Fowler

Yeah. Our goal is to continue to grow all of our portfolio, and really focus the growth on those higher margin areas, like equipment finance and leasing and the alternative mortgage. So definitely the message internally we're providing is that we are interested in our existing business

model focusing on the business we always do where we can build the relationships, but we're particularly focused on building those higher margin portfolios.

Tracey Ball

And that also includes just general commercial banking on a relationship base because it brings with it the deposits and the fees, which also impacts margin and other income.

Michael Goldberg

Okay. And the other thing I wanted to clarify; has tightened underwriting by prime mortgage lenders would you say increased availability of Alt-A mortgages?

Chris Fowler

Yes. It definitely has increased the amount of volume we look at and the tightened requirements also come from the B20 rules.

Michael Goldberg

Thanks very much.

Operator

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

Tracey Ball

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Okay. Thank you, Denise, and thanks very much, everyone, for your continued interest in Canadian Western Bank. We look forward to reporting our 2013 third quarter results on August 29th.

If you have any follow-up questions or comments, as usual just call us or contact us by e-mail. Thank you and have a good day.

Operator

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

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