THOMSON REUTERS

EDITED TRANSCRIPT

Q3 2018 Canadian Western Bank Earnings Call

EVENT DATE/TIME: AUGUST 30, 2018 / 6:30PM GMT

CORPORATE PARTICIPANTS

Carolyn J. Graham *Canadian Western Bank - Executive VP & CFO*
Christopher H. Fowler *Canadian Western Bank - President, CEO & Director*
Matt Evans *Canadian Western Bank - Senior AVP, Strategy & IR*

CONFERENCE CALL PARTICIPANTS

Darko Mihelic *RBC Capital Markets, LLC, Research Division - Financials Analyst*
Doug Young *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*
Gabriel Dechaine *National Bank Financial, Inc., Research Division - Analyst*
Meny Grauman *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*
Nigel R. D'Souza *Veritas Investment Research Corporation - Investment Analyst*
Robert Sedran *CIBC Capital Markets, Research Division - MD & Head of Research*
Scott Chan *Canaccord Genuity Limited, Research Division - Director of Research of Financials & Financial Services Analyst*
Sohrab Movahedi *BMO Capital Markets Equity Research - Analyst*
Stephen Gordon Theriault *Eight Capital, Research Division - Principal & Co-Head of Research*
Sumit Malhotra *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to CWB's Q3 Earnings Conference Call and Webcast. (Operator Instructions) As a reminder, this conference call may be recorded.

I would now like to introduce your host for today's conference Matt Evans. Mr. Evans, you may begin.

Matt Evans ***Canadian Western Bank - Senior AVP, Strategy & IR***

Thank you, David. Good afternoon, and welcome to the CWB Financial Group 2018 Third Quarter Financial Results Conference Call. My name is Matt Evans, as David mentioned, I lead the Investor Relations team for CWB. Presenting to you today is Chris Fowler, CWB's President and Chief Executive Officer; and Carolyn Graham, our Executive Vice President and Chief Financial Officer. Also with us today are the other members of the CWB's executive committee: Kelly Blackett, Glen Eastwood, Darrell Jones, Stephen Murphy and Bogie Ozdemir.

Before we begin, please note that the conference call graphs, quarterly results, news release and supplemental financial report are available on our Investor Relations website at cwb.com.

I'd like to remind listeners and webcast participants that statements about future events made on this call are forward-looking in nature and are based on certain assumptions and analysis made by management. Actual results could differ materially from our expectations due to various material risks and uncertainties associated with CWB's business. Please refer to our forward-looking statement advisory on Slide #14.

I'll now turn the call over to Chris.

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Thanks, Matt. The agenda for today's call is on the second slide. I'll begin with our third quarter fiscal 2018 performance highlights and comment on the continued execution of our strategy. Carolyn will follow with details on our financial results before I conclude and we move to the question-and-answer session.

Turning to Slide 3. I'm pleased to report we delivered excellent performance through the first 3 quarters of fiscal 2018. We surpassed a pair of significant financial milestones for the first time this quarter, including the $25 billion total loans threshold and more than $200 million of quarterly revenue, and we are well positioned for a strong finish to the year. We're also making tremendous progress against our Balanced Growth strategy, with continued execution of transformational initiatives and strategic enhancements to our business infrastructure. This quarter, we hit key deliverables in our program to transition from the standardized to the advanced approach for credit risk and capital management as well as a related program to deliver more centralized and efficient credit support processes. We went through live -- we went live with the first phase of our program to transform our treasury infrastructure and funds transfer pricing protocols and launched our new human resource information system subsequent to quarter-end. These initiatives touch various parts of our business, and we expect the collective outcomes to improve efficiency, strengthen our competitive position and support our teams as we look to do more for our valued clients.

Continued execution reflects outstanding contributions from CWB teams across the group. I'd like to thank our people for their tremendous effort and congratulate them on their success.

Looking at our third quarter results. This morning, we reported very strong operating performance, including 11% growth of common shareholders' net income; a 10% increase in pretax, pre-provision income; and a 9% increase in adjusted cash earnings per share compared to the third quarter last year. Ongoing strong financial performance continues to reflect our focus on business owners with valuable contributions apparent across our geographic footprint. This includes significant loan growth in the Ontario market, strong growth against a stable economic backdrop in BC and continued improvement in the operating environment within Alberta.

I'd like to highlight that this quarter represented our strongest growth in Alberta in dollar terms in over 2 years and our strongest organic growth within equipment financing and leasing since 2015. As many of you know, growth in equipment financing and leasing has traditionally represented a reliable proxy for business confidence in our markets and a leading indicator for growth across the rest of our portfolio.

Finally, I'm pleased to report that our growth this quarter was once again complemented by higher net interest margin and strong credit quality, and we announced another dividend increase for common shareholders.

I'll now turn it over to Carolyn to provide more detail on our financial performance.

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Thanks, Chris, and good afternoon, everyone. As mentioned, CWB Financial Group delivered strong financial performance in the third quarter, with common shareholders' net income and pretax, pre-provision income up 11% and 10%, respectively, from the same period last year. Diluted and adjusted cash earnings per common share of $0.70 and $0.75 were both up 9%. Total revenue growth of 12% included a strong 14% increase in net interest income, reflecting the combined benefits of 12% loan growth and a 5 basis point increase in net interest margin to 2.64%. Within noninterest income, a 6% increase in Wealth Management revenues was more than offset by lower Trust Services fees, following the strategic transactions in the past year to appoint successor trustees for certain CWT accounts as well as lower credit-related fees. Overall, noninterest income declined 8% from the third quarter last year.

The decline in credit-related fees partly reflects that shift in loan growth to emphasize general commercial loans, which tend to be associated with lower fees compared to real estate project loans with more complex structures. Noninterest expenses were up 12% primarily due to a 13% increase in salaries and benefits. Higher salaries and benefits mainly reflected hiring activity to support overall business growth and ongoing enhancement of our business infrastructure as well as annual salary increments and higher incentive pay accruals compared to last year. Other expenses were up 14%, primarily due to higher regulatory costs and consultant fees along with advertising expenses to support funding and business diversification strategies. Premises and equipment expenses increased 7% with ongoing investment in technology infrastructure to position us for future growth.

On a year-to-date basis, on Slide 5, growth of common shareholders' net income and pretax, pre-provision income was very strong at 20% and 14%, respectively. Diluted and adjusted cash earnings per common share of $2.07 and $2.23 were up 19% and 18%, respectively. Very strong earnings growth reflects a 12% increase in total revenue, including 14% growth of net interest income, partially offset by a 1% decrease in noninterest income. Higher net interest income was driven by 10% loan growth on an average balance basis and a 6 basis point increase in net interest margin. The most significant changes within noninterest income reflect gains recorded in the first quarter of this year related to the Trust Services strategic transactions and the resulting lower Trust Services fee income.

On Slide 6, we can see that total loans were up 12% from the third quarter last year, with organic growth of 9% and the remaining 3% coming from the acquisition of assets on January 31. On a sequential basis, total loans were up 3%. With 10% growth from October 31 of

2017, we are confident that fiscal 2018 represents another year of double-digit expansion for CWB Financial Group. The acquired business-lending assets contributed approximately $0.04 of adjusted cash EPS in the third quarter and approximately $0.07 in the 2 quarters since closing, entirely consistent with our expectations. We now expect the 2018 year-end portfolio balance to be in the $650 million to $700 million range, which is towards the high end of our expectations when we closed with the acquisition.

Slide 6 shows our significant progress against our Balanced Growth objective to achieve further geographic diversification. The combination of organic and acquired growth drove a 35% increase in outstanding loans within Central and Eastern Canada, which now accounts for 26% of our total loan portfolio, up from 22% a year ago and about 4% 10 years ago. As of July 31, more than half of our year-over-year loan growth was originated in Ontario, including support from the acquisition and ongoing strong performance from our established businesses with a national footprint. British Columbia delivered strong year-over-year loan growth and represents 34% of our total portfolio. While the housing market in BC continues to adjust to the impacts of Guideline B-20 and provincial regulatory changes this year, the BC economy is stable, and activity within our target markets remained strong. As Chris mentioned, momentum within Alberta continues to build. With a strong quarter of new originations, Alberta now represents 32% of the loan portfolio, and our pipeline of new business opportunities is encouraging.

Slide 7 demonstrates the progress against our Balanced Growth strategy to diversify our funding sources. Total deposits increased 9% from last year and were stable compared to the prior quarter. Mainly due to competitive factors, branch-raised deposits were slightly lower compared to the third quarter last year, with a 10% decline in demand and notice balances, partially offset by 15% growth of fixed-term deposits. Operational use of funds by our clients also contributed to the decline in demand and notice deposits, more than offsetting the impact of positive trends in the conversion of single- and partial-service clients to full-service relationships. We're making good progress to increase penetration rates for key deposit products with higher funding value. These include: business savings accounts, business cash management and automated funds transfer products. And Chris will speak to our strategy to support future branch-raised deposit growth toward the end of our remarks.

Utilization of cost-effective funding from capital markets increased 62% over the past 12 months, with 6 successful issuances or reopenings of senior deposit notes totaling $1.5 billion. Further funding diversification has also been achieved through increased use of securitization, reflecting both success in funding the asset purchased this year primarily through securitization as well as increased use of the NHA MBS and Canada Mortgage Bond programs. Reliance on broker deposits as a proportion of total funding was unchanged from the third quarter last year.

Turning to Slide 8. Net interest margin of 2.64% is up 5 basis points from the same quarter last year and 3 basis points from last quarter. Compared to last year, the increase in net interest margin primarily reflects a 75 basis point increase in the average prime rate. Positive impact of prior asset yield was partially offset by higher funding costs as the rates we pay on several relationship-focused accounts have increased, and we experienced a shift in depositor preference towards longer-duration fixed-term deposits. Due to the timing of the change, the mid-July Bank of Canada interest rate increase had only a nominal impact on net interest margin this quarter. The sequential increase in net interest margin mainly reflects lower average balances of cash and securities, partially offset by a shift in the overall funding mix towards higher-cost capital market and branch-raised term deposits. The level of liquid assets held on our balance sheet is driven primarily by the structure of both assets and liabilities. Our liquidity levels reflect both our conservative liquidity risk appetite and compliance with the liquidity adequacy requirements guideline established by OFSI (sic) [OSFI]. The lower average balance of cash and securities compared to the last quarter mainly reflects reduced liquidity requirements driven by the increase in the average duration of our deposits.

Year-to-date, net interest margin increased 6 basis point to 2.59%. This change primarily reflects higher asset yields, mainly due to the increase in average prime rate of 68 basis points, partially offset by increased funding costs and the shift in funding mix towards capital markets, securitization and branch-raised term deposits.

Looking towards the end of this fiscal year, the combined positive impact of continued strategic execution and the higher interest rate environment is now expected to support approximately 5 basis points of net interest margin improvement in fiscal 2018 compared to last year. Strengthening net interest and margin along with our loan growth expectations are expected to support ongoing growth in net interest income.

On a year-to-date basis, operating leverage was positive 2.5%. On a quarterly basis, operating leverage was negative 1.4% compared to positive 0.4% in the same period last year and positive 5.4% in the previous quarter. The swing from unusually high operating leverage in the second quarter to negative operating leverage this period was mainly due to the differences in incentive pay accruals I mentioned a moment ago as well as the timing of expenditures and investments to facilitate future growth. Adjusted for the incentive pay accrual difference, third quarter operating leverage would have been positive. While the increase in expense growth this quarter was expected, we remain committed to disciplined control of all discretionary expenses and continue to expect to deliver positive operating leverage over the medium term.

Our third quarter efficiency ratio was 46%, entirely consistent with our average annual efficiency ratio over the past 3 years, and we expect the ratio to continue to fluctuate around this level.

Turning to Slide 10. Overall credit quality remained strong and consistent with our expectations. Our credit metrics continue to reflect CWB's secured lending business model, disciplined underwriting practices and proactive loan management. And I'll remind you that we have no material exposure to unsecured personal borrowing, including credit cards. The provision for credit losses represented 21 basis points of average loans this quarter compared to 20 basis points in both the same quarter last year and the prior quarter. The level of the provision in each of the last 5 quarters is consistent with our historical range of 18 to 23 basis points. And on a year-to-date basis, the provision for credit losses was 20 basis points, improving from 24 basis points a year ago.

On Slide 11, the dollar level of gross impaired loans totaled $135 million this quarter, representing 53 basis points of total loans compared to 74 basis points last year and 50 basis points in the prior quarter. Gross impaired loans within Alberta totaled $65 million and accounted for 48% of total impairments compared to 56% last year and 47% last quarter. The relative concentration of impaired loans in Alberta continues to reflect the lagging impacts of the 2015, 2016 regional recession and is consistent with our expectations. Gross impaired -- gross impairments outside of Alberta represented 40 basis points in total non-Alberta loans, relatively consistent with 38 basis points last quarter and down from 49 basis points last year. As we've said before, the level of gross impaired loans fluctuates as new impairments are identified and existing impaired loans are either resolved or written off and does not directly reflect the dollar value of expected write-offs, given tangible security held in support of our lending exposures.

Looking forward, we continue to proactively assess all accounts for signs of weakness. This includes carefully monitoring developments within the residential housing sector. We primarily participate in housing market activity through personal mortgages and residential project financing. Approximately 44% of our overall residential mortgage portfolio consists of A mortgages, with the remainder comprised of alternative mortgages originated through CWB Optimum Mortgage. A mortgages consist of residential mortgages that are eligible for bulk portfolio insurance and are primarily originated within our branches through relationships with individuals connected to our business banking clients.

Both channels continue to perform well. CWB Optimum Mortgage continues to deliver strong performance with an attractive risk profile. CWB Optimum's business model targets affordably priced home with an average loan-to-value at initial funding of 69% this quarter on an average origination of $353,000. The average size of each outstanding mortgage is $295,000. Consistent with our previously stated expectations, growth within CWB Optimum has slowed compared to prior years to a level that now resembles overall growth across the rest of the loan portfolio. This reflects both our overall risk appetite for alternative mortgages as a proportion of total loans as well as changes to OFSI's (sic) [OSFI's] Guideline B-20, which has constrained the rate of new originations. Compared to the third quarter last year, total CWB Optimum originations in dollar terms were 7% lower. Partially offsetting the slowdown in new originations, the B-20 changes have also resulted in increased renewals with existing borrowers. The renewal rate within CWB Optimum increased 78% this quarter from 70% in the third quarter last year. Our portfolio of real estate project loans across all provinces is strong and well structured. We continue to actively support our strong client base in the project lending space with well-structured credit facilities for new projects and continue to experience successful project completions and full payouts. We are comfortable with our overall exposure to the housing market, the protections inherent in our secured lending business model and our proactive approach to loan management. We're very close to our clients, and we continue to carefully monitor risks related to the changing levels of activity.

Slide 12 shows our very strong capital ratios at July 31. Using a standardized approach for calculating risk-weighted assets, our common equity Tier 1 ratio was 9.3%, Tier 1 ratio was 10.5% and the total ratio was 12.1%. And at 8.2%, our Basel III leverage ratio remains very strong.

Yesterday, our board declared a quarterly cash dividend of $0.26 per common share, and that's up $0.02 or 8% from the dividend declared 1 year ago and $0.01 or 4% higher than the dividend declared last quarter.

And with that, I'll turn it back to Chris.

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Thank you, Carolyn. CWB has delivered excellent financial performance through the first 3 quarters, and we continue to deliver against our medium-term performance targets to create long-term value for shareholders as shown on Slide 13.

We're very pleased with the progress of our Balanced Growth strategy, including ongoing success against our geographic and industry diversification objectives and further progress towards our risk and capital management transformation. On the funding side, our strategic focus to support ongoing profitable lending activity through growth and diversification of funding sources continues. This includes a goal to compete more effectively for relationship-based branch-raised deposits. Carolyn mentioned that we're already making good progress to increase penetration rates for key deposit products with attractive funding values. We're encouraged by these trends and confident that continued development of new and more effective products, along with an ongoing strategic focus on business transformation and process improvement, will enhance our client experience, strengthen our competitive position and support our growth initiatives related to branch-raised funding over the medium term.

To support strong performance against these goals, we're also working to increase our market presence with further development of digital banking capabilities and targeted marketing campaigns, and we will likely expand CWB's full-service branch network into Ontario over the medium term.

As I mentioned when I opened the call, we are well positioned for a strong finish to fiscal 2018. We continue to execute well on a number of transformational initiatives and strategic enhancements to our business infrastructure, and we have a strong pipeline of new business opportunities in front of us. Our core markets in BC, Alberta and Ontario are performing well, and I'm confident in our positive outlook heading into the final quarter of 2018 and beyond.

With that, I'll turn it back over to Matt.

Matt Evans ***Canadian Western Bank - Senior AVP, Strategy & IR***

Thanks, Chris. That concludes our formal presentation for today's call, and I'll ask David to begin the question-and-answer period.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Steve Theriault with Eight Capital.

Stephen Gordon Theriault ***Eight Capital, Research Division - Principal & Co-Head of Research***

If I could first just follow up for -- Caroline, on your comments around expenses. Operating -- you mentioned in the notes and in your comments that operating leverage was affected by incentive comp and you talked about timing. And I noticed the last couple of years, Q3 to Q4, you tend to get a bump in expenses. But in the last couple of years, we haven't seen that sort of $10 million year-on-year lift in Q3. So any help you can give us as we think about the end of the year. Is Q3 a new jumping-off point or does the incentive comp sort of moderated and some of the timing moderates and it's maybe more unusually a decline in Q4 expenses?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

So I think a couple of things, Steve. First, the incentive pay accrual difference related to both, in Q3 of 2017, we had a reduction in the accrual, just as we thought about how the year was progressing there; and then in 2018, had an increase in the accrual. So that's part of the reason why the change was a bit amplified. Looking forward to Q2 -- Q4, there are a number of expenses that tend to be always existing in the fourth quarter. We tend to do training in that quarter. We have often fall campaigns related to our clients. But I wouldn't say that there's anything particularly different that we're thinking about as we look forward into Q4.

Stephen Gordon Theriault ***Eight Capital, Research Division - Principal & Co-Head of Research***

So just the noise from the accrual will be the -- I guess, maybe something different for Q4 than is usual?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Yes, yes. That would be right.

Stephen Gordon Theriault ***Eight Capital, Research Division - Principal & Co-Head of Research***

Yes, okay. And then, in your disclosures, and you sound like you're confident you can get branch-raised deposit moving in the right direction over the medium term, but wondering, is there anything going on with -- are you considering any promotions or going on with your new virtual banking offering or improvements from your core banking system that gives you more confidence more in the near term that you can sort of stem the tide a little and reverse some of the recent trends you've seen in your branch-raised deposits.

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Our branch-raised deposits really come with our increasing capabilities. And we delivered our banking system a couple of years ago, and what we've been adding to it is greater functionality. For instance, we, just in May of this year, delivered remote deposit capture. In May, we also delivered our Virtual Branch. We are actively signing up new clients for the Virtual Branch. So as we look forward, our digital capabilities are growing, and our ability to actually meet our clients' needs are improving. So we will continue to focus on that. So we talk about medium term, but it's all happening incrementally. But it's a positive trend.

Operator

Our next question comes from Meny Grauman with Cormark Securities.

Meny Grauman ***Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research***

You noted the benefit of lower liquidity on the margin. I'm just wondering if you could isolate and quantify it in terms of the sequential impact. And then also the impact that it's had on a year-over-year basis for the margin?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Yes. Just bear with me a minute, Meny, while I look at my sheet. Sequentially, Q2 to Q3, it's probably in the range of 5-or-so basis points positive. And then that was offset by the mix of our funding. So a shift a bit away from notice and demand replaced by fixed-term deposits and then a bit in the increase in our funding costs, given that shift in deposit mix. So on its own, in the 5 basis point range.

Meny Grauman ***Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research***

5 basis points...

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

And then year-to-date, I think, was the other?

Meny Grauman ***Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research***

Yes.

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Year-to-date, it's much more muted because in the first quarter, we had higher levels of liquidity in anticipation of closing the ECN acquisition, and then lower levels this quarter. So that washes to almost no difference.

Meny Grauman ***Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research***

Okay. And then as a follow-up, I think you talked about what's driving that liquidity requirement. The lower liquidity requirement is the average duration of deposits. So I guess the question is how much more benefits can you get from this driver of the margin? Is there a sense that this is something that you can continue to benefit from and then continue to support the margin? And is it -- does that mean that you can take the average duration of your deposits even lower? And if you could quantify that somehow that would be helpful too.

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

So the average duration of our deposit book has been increasing as term deposit clients, both in our branches and through the broker network, have been interested in 3-, 4- or 5-year deposits in a way that they haven't in the last several years. And that pushes out the maturities. And the formula for liquidity is you're carrying liquidity related to both 30-day projected cash inflows and outflows and 90 days. So it's just, as things move into the 90-day window, we carry liquidity against them. So that could be depending if we had a lot of fixed-term maturities in a particular month or if we have a senior deposit notes, for example, that comes into the 90-day window. I think overall that it'll continue to be a little bit lumpy for us. I don't think we would see driving average cash and securities. Certainly, we're not managing to drive cash and securities actively lower. We're just managing within our liquidity risk appetite and the guidelines. So it'll shift a little bit. But if clients continue to have an appetite for longer-duration deposits, then this might be a new, not a starting point, but kind of a benchmark or normal.

Operator

Our next question comes from Robert Sedran with CIBC Capital Markets.

Robert Sedran ***CIBC Capital Markets, Research Division - MD & Head of Research***

Actually I just wanted follow up on Meny's question there. It sounds like the decline in liquidity is largely formulated, although I assume you also have some flexibility to keep more on the balance sheet if you wanted to. With rates continuing to rise here, presumably, you're going to see more and more demand for some longer-dated product. But it sounds like, perhaps, you may keep more liquidity than you'd have to? Or is -- did I hear that wrong?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

So our liquidity has -- we -- our internal model uses sort of 3 criteria: We look at the liquidity coverage ratio, which is the 30-day window; we look at the net stable funding ratio, which is the 90-day window; and then on top of that, we have our own umbrella liquidity horizon. So there are assumptions in our own liquidity horizon that have us carrying more liquidity, given our view of our portfolio than the OFSI (sic) [OSFI] requirements would have.

Robert Sedran ***CIBC Capital Markets, Research Division - MD & Head of Research***

And that'll become the gating principle going forward, even if you do have the ability to release more, presumably?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

It could. And as we shift from month-to-month depending on where the maturities are, which one of those 3 criteria presents the binding constraint can shift from month-to-month.

Robert Sedran ***CIBC Capital Markets, Research Division - MD & Head of Research***

Okay. And just a quick question, and it may be early, but I -- if I recall correctly, next year, you'll be moving to the IFRS 9 circus that the larger Canadian banks are on now. Any early insight into what this might mean either on a changeover basis or a run rate basis for you?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

I think, we're where our large bank friends were a year ago. We're actively working through parallel runs, continue to refine our process. But too early for me to say. This will be the transition impact on November 1 of 2018. We're actively watching the earnings volatility from quarter-to-quarter of our large bank peers. And I think we are thinking we'll be somewhere consistent with that, right. There is a pro-cyclicality built into the accounting standard that is unavoidable. But we're working hard on that implementation and getting ready for next quarter when we would share the transition impact with you.

Operator

Our next question comes from Sumit Malhotra with Scotiabank.

Sumit Malhotra ***Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services***

This is probably for Chris. If we look specifically at the loan portfolio where obviously growth has continued to accelerate this quarter, one of the items that you and I have talked over the years is just the pure yield that you're receiving on loans. And certainly, with the Bank of Canada rate hikes over the past year, that's been moving in the right direction. It did seem to flatten out in the quarter, at least on the way that we look at this. Is that reflective of some of the increased competition you're seeing in the market since everybody seems to be quite focused on the commercial portfolio? Or in your view, if that's accurate, is it just a timing issue because of that BOC rate hike coming in later in Q3?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

So competition is always a feature of the market. The growth, if you look at our book, we've got -- year-to-date growth is 20% on the commercial side and 23% on equipment finance side and lower on the project finance side. Our 2 highest-yielding portfolios are equipment financing and project financing. So with kind of that dominant growth in commercial lending, slightly lower yield there. So overall, I would say that competition is part of that flattening. The impact of the rate increase, I think, we'll see more of in Q4. And that is also based on the mix of floating to fixed. Our floating rate loans are primarily in the interim construction book. In particular, the equipment finance is primarily fixed-rate loans. So we will just -- we certainly managed to zero in on the right yields for the risk, and we'll continue to manage our process there.

Sumit Malhotra ***Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services***

Okay. Somewhat related with Optimum. I mean, if we go back, I guess, it was about a year ago this time that we started thinking a lot more about the impact of B-20 when it came in. Given your focus on the alternative space, I think you were very upfront in saying, yes, this is going to have an impact on us. Now, I mean, the numbers are lower, but at least looking at the first 3 quarters of this year, you've still had pretty consistent 3% a quarter increases in Optimum. So right to the point, do you feel that you're -- that you may have overestimated the impact on your alternative mortgage customer base because it doesn't seem like it's been a significant dropoff in terms of absolute growth levels?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

We said in the remarks about a 7% drop in the originations and the big change of course has been increase in renewals. So that's gone from 70% to 78%. So that's kept it more sticky so that portfolio -- so the growth has been -- has ended up being sort of just net 9% year-to-date. We had budgeted come in at the same rate of growth as the bank. So we actually see that being the outcome, which is a lower rate of growth, and historically, we've delivered in Optimum. So I would say a little bit constraints that B-20 has brought into this market have actually turned out as -- pretty much as we expected.

Sumit Malhotra ***Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services***

All right. Last one from me, but it's somewhere along the same lines. I mean, obviously, every quarter with this bank, we focus on that interplay between loan growth and what's happening with margin. But I guess, when we put these 2 together, where we're really trying to get to, net interest income, which is such a key driver of your top line. Looking at these various components we've discussed already on this call, so net interest margin, loan growth, core deposits, kind of looking out at your -- I'm sure you're already well into your planning for 2019. What's the net interest income outlook? Because at least in the numbers today, your net interest income growth is still 14%, 15% year-over-year. Is your expectation that even if your core deposit growth is slower to advance than you would like, is your funding profile sufficient enough to still keep net interest income growing at a level pretty close to loans?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Sorry. I'm just checking my notes and checking my detail, Rob. Yes, overall that would be a fair assumption. Sumit, sorry.

Sumit Malhotra ***Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services***

Fair assumption that net interest income and...

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

And loan growth would be relatively consistent.

Operator

Our next question comes from Gabriel Dechaine with National Bank.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***

I just want to start things off with the topic of impaired loans. Always fun. And the balances that have been coming down for a little while, and now they've picked up. I know your business is lumpy from formation standpoint, so I'm not too surprised about that. But just want to get a feel for what kind of formations you saw this quarter like 1 client, 2 clients? And then it looked like it was in the real estate project loans and the commercial mortgage portfolios. Any sense on LTVs of the accounts that went into impairment?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

So it wasn't a significant change in the formations

(technical difficulty)

quarter-to-quarter. It does in those areas you just -- you mentioned, and from an anticipation of credit loss, we feel very comfortable that those are loans that are -- have term -- become impaired. And again as we anticipate in any credit portfolio, loans become impaired and often can be resolved. So we've got a very strong team that works on these resolutions. So we don't see that as a nuance. An evolution of the portfolio, we don't see it as a real change in any systemic credit quality issues.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***

Right. Where were they? Are they in Alberta or BC or what? And what were the LTVs on the loans originally?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

It's commercial mortgages, loan-to-values, all acceptable. And it's just -- it's an area that you have -- you just -- in your credit portfolio, you can have loans that come in and out of the impaired loans bucket. And as we resolve loans, we're also adding them. But overall, as we look at where we sit with our gross impaired position, we've gone from $123 million to $135 million. We continue to have a very strong collective and coverage at 123%. So I think we feel very comfortable with the quality of our credit portfolio and the coverages with the allowances.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***

Okay. I don't want to belabor the point, your track record on these new impairments going up and loan losses not tracking is pretty good. I don't want to quote it too much. But I do want to bring to task of the branch deposit trend. So from what I -- from your description, it sounds like notice and demand, no growth, people are buying term. So customers are making the switch. You've got the same customers with the branch, and they're just switching into the term based. Is that more or less what's going on?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

There is some of that. And then we're also seeing business clients who are deploying their cash in their business.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***

Right. That should be viewed as a positive right?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Right.

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

That's right. A positive sign that the economy is -- there is a business sentiment there that's improving.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***

And then I asked you about this last quarter in relation to -- and I guess this kind of segues into the trend we're seeing in the Alberta portfolio. Last quarter, first, when where we saw a growth on a year-over-year basis in a while, and this quarter again, and it's actually a bigger growth rate. Like, what's the -- I get to about 2/3 of that growth in dollar terms coming from the commercial and equipment finance for you. What are the changes in behavior that you're seeing from your clients in Alberta now that we're on maybe not blue skies or anything like that but much better than it was a few years ago in terms of the economic environment?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

I mean it's just a more -- I think, we said in prior quarters that the economy here has been certain level of stabilization and I think more business confidence, but it's certainly not robust. There is no kind of view that there's great traction for lots of growth, but it's definitely much more stable. And we're absolutely seeing clients expanding the business. It includes adding to fleets as we got different contract opportunities. So it is positive. GDP growth is positive. It's just not the robust growth that it was in the past.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***

And then -- and just a final one here, line item that acquisition-related fair value expense. Can you remind me when -- that goes away next year right?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

So we -- that's related to the Maxium acquisition. The final date is February of 2019. So the last charge there would be in the second quarter of 2019.

Operator

Our next question comes from Nigel D'Souza with Veritas Investment Research .

Nigel R. D'Souza ***Veritas Investment Research Corporation - Investment Analyst***

I just wanted to -- first just to follow up on Gabriel's question on your gross impaired loans and the allowances as well. So when I look on Page 9 of your supp pack, just on the collective allowances, it's still fairly high, and I wonder if you have any commentary. I know, it's still a bit early. But when you transition to IFRS 9, are you expecting those collective announces to remain relatively the same and just convert to Stage 1 and 2? Or how should we think about it because right now it's still above your gross impaired loans in terms of as a percentage of gross impaired loans?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Yes. We are very comfortable with the level of collective under IAS 39. We're working carefully, as I mentioned, on our IFRS 9 transition, but we are not yet prepared to share what the transition adjustment will be. But under the current accounting standards, we remain very, very comfortable with the levels.

Nigel R. D'Souza ***Veritas Investment Research Corporation - Investment Analyst***

Okay. And then my question had to do with just your general commercial loan growth. It seems to be sequentially that was a bit soft in this quarter, and it's a bit surprising, given the strength we're seeing overall in commercial lending. I'm wondering is that driven by the one-off of the acquired portfolio you had early this year or -- and if it is, if we x that out, what would be the growth be?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Yes. It's not driven by that. The portfolio we acquired primarily resides in our equipment finance line. So the general commercial loans, so we're up 20% year-over-year. I think we've got a sales cycle in that group that is a bit longer than would be in the equipment finance side and not as lumpy as you would see in the interim construction side. So it's an area of key focus for us. It's our -- that core business own our client that we're seeking to find as a multiproduct client. So it's an area we pay very close attention to, and we continue to look for growth in that line.

Nigel R. D'Souza ***Veritas Investment Research Corporation - Investment Analyst***

Got it. So we should expect that to kind of rebound and continue the strong trend we've seen recently?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

It's an area of focus for us.

Operator

Our next question comes from Doug Young with Desjardins Capital Markets.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***

I guess my first question, bigger picture, excluding the accretion from the asset acquisition, I mean, cash EPS would have been up 3% year-over-year this quarter. I mean, loan growth was 9%. I mean, you talked about some of the moving parts, Carolyn. I mean, with some of the accretion here purposely diverted into investing in the business. Is that another way to think about? Or whether it's kind of structural changes here? Maybe, you can dig a little bit more into that.

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

I think the -- there isn't anything particular in Q3 specifically related to a change in our focus on investing in the business. That is a key part of our Balanced Growth strategy and the priorities that we have underway, the number of transformational projects that are underway as we move the strategy forward. So I don't -- there is no conscious decision in Q3. I think the -- what we saw on the expenses in Q3, particularly on a year-over-year basis, was just primarily a different view in how the years are going, which resulted in changes in the incentive accruals.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***

And have you quantified that incentive accrual? Or I guess, maybe it's in your supplement. I haven't seen it but...

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Yes. We've specifically supplemented it. If we -- but if we back it out, it would take us to a positive operating leverage for the quarter.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***

Okay. And then just on the CET1 ratio, I think you guided last quarter to it be more flat. It declined 10 basis points. What was the main driver? I mean, loan growth was obviously strong, maybe it would have gotten in the shift of mix. Or was there other adjustments that I just can't see?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

No, no other adjustments. It was primarily just strong loan growth. I don't think there was -- no, there wasn't anything significant in the deductions from the CET1.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***

Okay. And what's the -- I mean, what is the target for the -- like, what's the minimum you would take that down? Can you just remind me?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

We talk about being very strong today. We talk about our medium-term target being strong. So we're a bit over where we like to sit but haven't really put a number out there.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***

Wasn't it before like 8% to 8.2% that you talked about Chris or is it -- and if it's to change then that's fine. I can take it off-line if it's easier but...

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Yes. Well -- so we were at that level at one point. And then we have continued to post very profitable quarters. And in fiscal '16 and '17, we had slightly lower loan growth but still very profitable quarters that grew our capital resource. So obviously even very -- as Carolyn said, a very strong position on capital. So we'll continue to manage it. And yes, it has migrated higher.

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Yes. I think as we look at capital, we also consider how the bank continues to grow and develop and what makes sense to -- as for capital levels for us was the bank that we are today.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***

Okay. And then maybe just lastly. Chris, maybe, I'd misheard this, but did you mentioned that you're looking at expanding the branch network into Ontario?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Yes.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***

Is that new? Or can you talk a bit about maybe that strategy and how it fits in with your business?

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Well, it's a medium-term target. As we look at the growth, we now get 26% of our business in Ontario. From a premises perspective, we have Maxium Financial in Richmond Hill, we have the Franchise Finance in Mississauga and National Leasing is in Burlington. So we believe from a branch perspective, as we think about our continued growth there, primarily for commercial lending and equipment finance, the opportunity is definitely in front of us for Ontario presence, and we're absolutely looking at that. And that would be in addition to our Virtual Branch opportunities for digital footprint in Ontario. So we see -- it's clearly a very large amount in Canada. It's one that we participate significantly and stay, and we see other ways we can participate significantly and successfully there.

Operator

Our next question comes from Darko Mihelic with RBC Capital Markets.

Darko Mihelic ***RBC Capital Markets, LLC, Research Division - Financials Analyst***

Two questions. The first one's on the margin. I think, you mentioned that you're expecting it to be up 5 basis points over last year's total NIM. In other words, last year's NIM was around 2.56%, so that would suggest for this whole year, you want to be around 2.61%. So just if you could get clarified what that would mean for Q4? I've done my some back-on-the-envelope math. And are you assuming a rate increase in there?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

We -- your math is correct. 2.60% -- 2.56% for full year 2017, 5 basis points takes us to about 2.61%. Does assume an increase in the NIM sequentially between Q3 and Q4. It's primarily just the mid-July increase coming through and seeing the full quarterly impact of that in our portfolio.

Darko Mihelic ***RBC Capital Markets, LLC, Research Division - Financials Analyst***

Okay, that's helpful. And then just going back to the deposit discussion, Chris, and one of the questions earlier was your confidence in growing deposits through the branch. And I got -- I was a -- I have to admit, I was a little confused by your answer because I think your answer was along the lines that you've sort of increased capabilities. I think you mentioned that you have like a remote deposit capture and you had -- the Virtual Branch is now effective. And yet, when I look at your balance sheet, you've added those capabilities but your deposits have gone down. So maybe what would be helpful is maybe you can talk about -- like you give us a loan growth expectation, but you guys sort of shy away from an expectation on branch-raised deposits. Can you guys consider talking about what your growth expectations would be on the deposit side? And the reason why I ask is this, I think that from a NIM point of view, if we continue to see runoff in your branch-raised deposits, the only other outcome could be much higher funding costs and pressure on your NIM in 2019.

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

So 2 things. I can pass to Carolyn as well. But in my comments, on the capabilities, I mean my -- I added dates to that as well, right. So we just delivered the remote deposit capture in May of 2018. So literally 90 days ago. And some of the Virtual Branch just went live 90 days ago. So these all take to (inaudible). But the fact is there are new opportunities for us to add them to the deposit base with more digital capacity [creating] clients. For Western Canada, the -- we can generate a more positive front with a digital footprint. So there is many ways for us to improve deposit base (inaudible) these increased capabilities. And they are new capabilities. And our goal, obviously, is to take advantage of that to help us support the branch deposit growth.

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

And I think the only -- at this point, we haven't give -- shared expectations around branch-raised deposit growth. Certainly, our internal expectations are that we -- both sides of the balance sheet are equally important in the branch network, and we look to grow both at a similar pace. But we will think about next year whether that's information that we want to think about within expectations. Overall, as we work to continue to strengthen and diversify our overall funding sources, we're confident that net interest income will continue to grow.

Darko Mihelic ***RBC Capital Markets, LLC, Research Division - Financials Analyst***

Okay. But is that growth really related to just balance sheet growth? Or do think that's going to be a combo of balance sheet growth and some expansion in your margin?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

We're working towards a combination of both.

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

Yes. And that's a key strategic goal, Darko, that the investments we have made and our capabilities, ilk is to deliver on that. I mean it is a focus, it's an area that we absolutely have the opportunity to improve, and that's an area that we're looking to deliver on.

Operator

Our next question comes from Scott Chan with Canaccord Genuity.

Scott Chan ***Canaccord Genuity Limited, Research Division - Director of Research of Financials & Financial Services Analyst***

Chris, in your opening remarks, you talked about equipment financing, and you talked about leading indicators and business confidence. And I was just wondering, if you can elaborate on that in terms of where that business confidence is coming from in terms of maybe sectors or geographies.

Christopher H. Fowler ***Canadian Western Bank - President, CEO & Director***

So it is -- a lot of that growth has been really in all 3 of our core markets: BC, Alberta, and Ontario. I mean, Alberta has picked up. We did have 3 quarters of positive growth in Alberta, which is very strong and our best quarter yet since 2016 in equipment finance growth in Q3. And equipment finance, we have always felt, is a leading indicator, given that is pretty much where we've got clients that have obtained new contracts, and they need to expand their fleets or hover that combination of loan demand. It works, but it's been for -- historically, for us, a great indicator of pipeline strength on loan growth.

Scott Chan ***Canaccord Genuity Limited, Research Division - Director of Research of Financials & Financial Services Analyst***

Okay. And maybe for Carolyn, just on the other expenses, that was up 14% year-over-year. Now you talk about regulatory costs, higher consulting fees. And is that the thing that may persist near term? Or is that a thing that maybe you just kind of highlighted this quarter?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Regulatory costs, I would say, this quarter is probably a benchmark. And the second one? Sorry, Scott.

Unidentified Company Representative

Consultant fees.

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Consultant fees?

Scott Chan ***Canaccord Genuity Limited, Research Division - Director of Research of Financials & Financial Services Analyst***

The other is consulting?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

That's probably a little -- I guess, sort of a 3-quarter average might be a more normal run rate.

Operator

And our last question comes from Sohrab Movahedi with BMO Capital Markets.

Sohrab Movahedi ***BMO Capital Markets Equity Research - Analyst***

Carolyn, I just wanted to confirm I heard you correctly when you were talking about margins in your prepared remarks. I think you said that results were up 5 basis points year-over-year with the benefit of the prime rate increase, partially offset by rates -- higher rates on relationship accounts as well as higher funding costs. Did I hear that correctly?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Yes. So we have talked in the past about...

Sohrab Movahedi ***BMO Capital Markets Equity Research - Analyst***

What does that mean you had to pay up to keep them?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

No, that's -- as we've had incremental prime rate increases, the non-floating rate deposit -- so where we have discretion over the rates that we pay, we'd made the choice to increase those rates on particular of the accounts where -- that are important to us that our relationship based. So we felt that it was appropriate to increase those rates, and we've done that.

Sohrab Movahedi ***BMO Capital Markets Equity Research - Analyst***

Can you give a little bit more color as to where those relationship accounts are? Are they -- in which geographies? And how many of those types of relationship accounts would comprise your deposit franchise?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

So it would be across the branch footprint. Yes, it was. And we didn't raise them on particular accounts, we raised them on an entire product. So our core business savings account, our core personnel savings account, those are the 2 main accounts where we, across the board, increased the rates offered to all clients, just to be clear.

Sohrab Movahedi ***BMO Capital Markets Equity Research - Analyst***

And the reason for that was?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

The reason for that was, we -- yes, it's sort of that concept of the deposit data, right. When rates went down in 2015, we -- most of those deposit costs had hit a floor. But as we've had incremental increases in the prime rate on the way up, we felt it was appropriate to share a portion of that with our depositors

Sohrab Movahedi ***BMO Capital Markets Equity Research - Analyst***

Okay. And can you say how much of it you shared with the depositors?

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Well, the rates are on our rate sheets actually. So they would be public information. So the business savings account, we increased...

Unidentified Company Representative

20 basis points.

Carolyn J. Graham ***Canadian Western Bank - Executive VP & CFO***

Yes, I think in that 10 to 20 basis points. We can come back off-line with you, Sohrab, if you'd like.

Operator

And I'm showing no further questions in queue at this time. I would now like to turn the call back over to Matt Evans for any closing remarks.

Matt Evans ***Canadian Western Bank - Senior AVP, Strategy & IR***

Thank you, David, and thank you very much for your continued interest in CWB Financial Group. We look forward to reporting financial results for the fourth quarter and fiscal 2018 on December 6. And with that, we wish you all a good afternoon.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program, and you may all disconnect. Everyone, have a great day.