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Equitable Group Inc.

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PRESENTATION

Operator

Good morning, ladies and gentlemen. I'd like to welcome shareholders and analysts to the Equitable Second Quarter 2019 Conference Call and Webcast. Later, we will conduct a Q&A with participating analysts on the call.

Before we begin, and on behalf of our speakers today, I will refer webcast viewers to Slide 2 of the presentation, and our callers to the following information which contains the Company's caution regarding forward-looking statements.

We remind you that certain forward-looking statements will be made today, including statements regarding possible future business and growth prospects of the Company. You are cautioned that forward-looking statements involve risks and uncertainties, detailed in the Company's periodic filings with Canadian regulatory authorities. Certain material factors or assumptions were applied in making these forward-looking statements, and many factors could cause actual results or performance to differ materially from those conclusions, forecasts or projections expressed by such forward-looking statements.

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It's now my pleasure to turn the call over to Andrew Moor, President and CEO of Equitable Bank. Please proceed, Mr. Moor.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Thank you, Marcella. Good morning everyone, and welcome. I'm joined by Tim Wilson, Chief Financial Officer of the Bank.

Over the past couple of years, Equitable has positioned itself as *Canada's Challenger Bank*. At first, there was a significant aspirational element to this claim. More recently, we have turned ambition into reality by finding new ways to deliver banking services. In so doing, we've won over thousands of new customers for our now much broader business lines. In many ways, Equitable is not the same Bank we were just two years ago. We are stronger, more innovative, more diversified, and more capable of creating value for customers and shareholders than ever before.

Hitting our stride as *Canada's Challenger Bank* has created tangible momentum at every turn. At *EQ Bank*, we added 20,000 new customers over the past year, including 5,000 in Q2 itself. Our Digital team also unleashed their imagination again in the quarter, revisiting our approach to digital on-boarding. In my

view, they have created the best, most elegant on-boarding app of any digital bank in the country, and our conversion rate has soared.

I invite everyone on this call to download the EQ app and open an *EQ Bank* account. It's simple enough that you can do it while listening to me, and so fast that you can have an account in place before our call is finished. And you will benefit by being able to use the *Savings Plus Bank Account* to move money like a chequing account, to pay bills, while getting all the best elements of a savings account, including a 2.30% interest rate.

Our strength in technology development is manifesting itself in the migration of our core banking system to the cloud. We set the stage for this with significant technical advancement during the second quarter. By the time of our third quarter call, we expect to be Canada's first bank with a core banking system running in the cloud. Our new operating model will give us enormous scalability, and from a business perspective, will allow us to accelerate product development timelines to bring meaningful innovation to the Canadian financial services marketplace.

Speaking of new services, in May, we launched our reverse mortgage product with Quebec mortgage brokers, meaning now we are actively building our channels to this market across Canada's four most populous provinces.

In July, we entered into a partnership with BMO Insurance. Holders of BMO Whole Life policies can now use the new Equitable CSV Line of Credit to borrow up to 90% of the cash surrender value of their insurance policies.

This is one of several partnerships with Canada's leading insurers we've secured as a means of reaching and helping more Canadians to meet their financial needs later in life, or what we internally think of as our decumulation businesses.

Challenger Bank momentum is also propelling asset growth across the board, including at Bennington. We're getting to know the Bennington team, and it's clear that these people share our values and priorities for customer service and shareholder value creation. I've also had the opportunity to meet many of Bennington's key brokers, and the strength of these relationships has impressed me, and suggests we might find even more opportunity. It's still early, but the decision to acquire Bennington feels more and more like a good one.

The effectiveness of our strategies is also evident in our other Retail and Commercial businesses where we have long challenged industry norms for service. Combined, our assets are now approximately $31 billion, and with solid loan growth expected in the next two quarters and for the year as a whole, 2019 should be another record period of profitable expansion.

Because of shareholders, we like to think about the financial metrics as well as the strategic story. On this score, our Challenger Bank business model continues to pay off. Earnings for the quarter and year-to-date are our best ever, and our ROE, which we consider our true north, was a very satisfying 16.9% for the quarter.

Two other developments reflect the strength of the Bank: the recognition of Equitable's solid and growing franchise, and I quote, DBRS recently upgraded its outlook to "Positive" from "Stable". In assigning an improved outlook, DBRS noted the successful launch of new lending products that complement our mortgage offering and the fact that we continue to attract direct deposits through *EQ Bank* while enhancing our wholesale funding channels.

The other development worth noting is the advancement of AIRB. We recently submitted the plan to OSFI, a milestone that keeps this program on track.

We're not the same Bank we were just two years ago. We are *Canada's Challenger Bank*, with all the strength and potential that goes along with it. As our momentum has grown, so has our confidence in the future and in the Bank's ability to define a new way forward for our dividend policy. As you know, strong earnings growth has supported consistent dividend increases for 10 years, averaging above 10% per annum.

As the Bank strengthens, we recently went through a process to consider changes to our approach going forward. The conclusion of this thinking is that from now through 2024, we intend to increase dividends at a rate of 20% to 25% per annum to bring the dividends to as high as $4.00 per share five years from now. We're pleased to note that we've already acted on this new approach by increasing the September dividend to $0.33, or 22% over that paid a year ago.

I'm not going to speak in detail to our credit performance this quarter, except to say that we refined our arrears and risk modeling assumptions for our lease assets, that we remain well-reserved, and that economic data supports our view that risk in residential real estate has moderated in most markets.

With that backdrop, we expect credit loss provisions in our mortgage book to remain low in 2019. Our capital ratios did tick up in the quarter as we planned, and are now within our target range. By year-end, we expect that our CET1 ratio will return closer to the midpoint of our target range, which is 13.5%.

I'll offer a few more thoughts about the way forward, but now to Tim for his report.

Tim Wilson — Senior Vice President and Chief Financial Officer, Equitable Bank

Thanks, Andrew, and good morning everyone. On both a reported and adjusted basis, EPS was a quarterly record, and ROE moved up again. The change analysis slide in our deck illustrates the impact of various drivers of profitability, and once again, assets were the key propellant of our year-over-year earnings growth, along with an increase in NIM and a reduction in backstop facility cost.

Cost growth was a partial offset to those other factors. We invested more in operations generally, in support of our growth strategy, and incurred expenses of about a half million dollars for the migration of our core banking system to the cloud. I'll detour briefly here to highlight that the majority of the costs for our migration to the cloud will show up in the second half of 2019, one quarter later than expected. Costs in each of these last two quarters of the year should be about $1.5 million, or approximately $1 million

higher than in Q2. Costs will reduce in Q1 of 2020 as we complete the migration and decommission some of our infrastructure, which will be surplus to our needs by that time.

Turning now to NII and margin trends; Q2 reported net interest income was up 44% and 34% if adjusted for last year's write-down of upfront costs related to our backstop funding facility. The increase was due to growth in average asset balances of 23%, and improved margins, with both of those metrics benefiting from our new leasing business.

Our NIM of 1.76% was the highest it's been since Q2 2015, up 15 basis points from last year, adjusted for the write-down, and nine basis points above Q1. The year-over-year increase in NIM was primarily the result of adding Bennington's higher spread equipment leases, which had an 11 basis point positive impact, and two reductions to the size of our backstop facility, which had a seven basis point positive impact.

You will likely have seen that we successfully negotiated a two-year extension to our backstop facility in June, with the support of five of Canada's major banks, and at a lower rate. The quarterly interest expenses on our now smaller backstop will be $1.6 million lower in Q3 as compared to Q1, for a $0.28 annualized EPS benefit, and $800,000, or $0.14 lower as compared with Q2. Alongside expanding Retail and Commercial margins, the less expensive backstop should support a NIM in the range of 1.75% to 1.80% through Q4.

Before I move to costs, I'll note that PCLs were up over 2018 due to the addition of Bennington, but lower sequentially. Q2 credit performance was solid, which helped keep PCLs low, but they also include the effective changes to the loss modeling assumptions for our lease portfolio. Those assumption changes provided a $1 million, or a $0.04 EPS uplift in the quarter.

IFRS 9 will make PCLs volatile, but going forward, I would expect that in a typical quarter, total PCLs will range between $2 million and $2.5 million, most of which will relate to leases, and that estimate's notwithstanding any significant changes in the broader economic environment. Our long-term expectations remain that loss rates in the lease portfolio will range between 1.5% and 2.0%, which is well within our risk appetite.

Moving now to expenses; you will recall that our expectation for all of 2019 was that non-interest expenses would increase at a year-over-year rate between 30% and 35%. That rate of growth is elevated because of the addition of Bennington in Q1. The actual rate of year-over-year growth in total expenses in Q2 was 26%. Excluding the Bennington effect, expense growth was 10%, as we continued to invest in our capabilities and incurred insurance costs on our higher deposit balances.

That said, expenses were a bit lower than expected, due to the timing of spending on our cloud migration and *EQ Bank*'s marketing campaign. Those expense deferrals also caused our quarterly Efficiency Ratio to be 39.3%, which was slightly lower than our forecast. We expect expense growth to be higher in Q3 and Q4, largely due to the one-time cost of our cloud migration and other core banking system upgrades, as well as the *EQ Bank* marketing campaign. Overall, costs are likely to increase by about $3 million to $3.5 million each quarter, or about $6 million in total from Q2 to Q4. I'll remind you that $1.5 million of that,

per quarter, relates to our cloud migration, and will fall away in Q1 of next year. Overall, we continue to expect a 2019 annual Efficiency Ratio of between 40% and 42%.

Taking all of these items into account, we anticipate that adjusted EPS will grow between 15% and 17% in the second half of 2019, compared to 2018, and our ROE will be between 15% and 16%. This forecast is predicated on our expectation that loan growth will be between 12% and 14% for 2019, and that NIM will be at or slightly above Q2 levels for the remainder of the fiscal year.

Now, back to Andrew.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Thanks, Tim. Thinking about the big picture, Equitable now has far more choice of where to grow than ever before. Whereas in the past, our choices were limited to residential and commercial mortgage markets, we can now pursue growth across a wide variety of secured asset types, and do so with the knowledge that we have strong, diversified, and cost-effective funding sources in place to support our ambitions.

Our team is executing really well, and this is a credit to everyone here at the Bank. They're executing well at a time when the Bank has the benefit of a tailwind of broader industry forces. Open banking continues to be a theme that presents opportunity for Equitable. The endorsement of the Canadian Senate and the broadly positive views will be expected to come from the report to the Minister of Finance on open banking are encouraging developments in this area. Moreover, Minister Nav Bains' recent announcement of Canada's Digital Charter is also broadly in line with the constructive move towards open banking.

During the quarter, I had the opportunity to visit London to observe the Challenger Bank and fintech scene there, and came away with two key thoughts. Firstly, banking is changing around the world, and there is lots of opportunity in Canada to bring additional value to consumers here. And secondly, Equitable is extraordinarily well-positioned to thrive in this new world. I'm certainly excited about our prospects over the next 5 to 10 years.

As good as Equitable is today, we can be even better tomorrow. Life at Equitable is always intense, as we, as always, keep unrelenting pressure on improving our execution and customer service, while at the same time delivering new products innovation. This is certainly my expectation for the balance of 2019.

For fellow shareholders, the Bank's opportunities for value creation have never been broader, and will now include a commitment to higher dividend growth.

This concludes our prepared remarks, and now we'd like to invite your questions. Marcella, can you please open the lines to our analysts that have questions?

Q & A

Operator

Your first question comes from the line of Nikolaus Priebe. Your line is open.

Nikolaus Priebe — Analyst, BMO Capital Markets

Okay, thanks. I just wanted to start with a question on the net interest margin in the quarter. Of the factors that affected the sequential change in NIM between the first quarter of this year and the second quarter, one of the listed factors there was fair value changes on derivative instruments, which was related to the deposit portfolio. Maybe this is one for Tim, but I was just wondering if you could expand a bit on what that related to?

Tim Wilson — Senior Vice President and Chief Financial Officer, Equitable Bank

Yes, that's really some fair valuation we do on GICs, different than other fair value losses on hedging positions. It actually flows through our net interest income and our net interest margin. It was worth probably a couple hundred thousand dollars in the quarter and is embedded in the five basis points you see on the table on Page 12 of our MD&A.

Nikolaus Priebe — Analyst, BMO Capital Markets

Got it, okay. Then I also wanted to ask one on the impaired ratio. It did decline in the quarter. It looks to be mostly attributed to the leasing portfolio, and I think you made reference to that being connected to some refinements that were made in arrears and risk modeling assumptions. I was just wondering if you could give us some insight on what entailed as well?

Tim Wilson — Senior Vice President and Chief Financial Officer, Equitable Bank

Yes, sure, I'm happy to do that. You're right to point out that the decrease in the impaired balances came primarily from the lease portfolio, and there were two factors that came into play there. One is that the Bennington team has done a fantastic job of putting more emphasis on collecting the accounts that are over 90 days past due. So there was a concerted effort to bring that balance down, and they had a lot of success.

The second was some refinements to our arrears modeling. I won't get into the details; I'm happy to do that offline, but we refined the methodology we were using to measure arrears on the lease portfolio with the way we traditionally do it at Equitable, and that brought the balances down a little bit more on that portfolio.

Nikolaus Priebe — Analyst, BMO Capital Markets

Okay, got it. Maybe one last one for me before I pass the line; so I also wanted to ask about the Conventional commercial loan portfolio. It looks like principal, on a year-to-date basis, is about 2% lower than it was at the outset, and maybe that largely reflects your intent to rebuild capital organically this year. But just when I look at guidance for that Conventional commercial loan portfolio—it continues to stand at about 8% to 10% for the full year, so I'm just wondering if we should expect to see a bit of an acceleration in the growth of that portfolio in the second half of this year, relative to the first half.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Yes, I think you absolutely should. We're certainly—certainly, the way you characterized it is actually showing a pretty deep understanding of what we've been doing. That's obviously the higher risk weight density to assets, so we have been constraining growth in the first half of the year. I think about a month ago, we opened up some other lending lines, or maybe six weeks ago, so we're seeing a lot of activity in the market now and we're back in a position to grow that portfolio faster, and our guidance is based on that thinking.

So yes, our Commercial team are very busy, and we still expect to meet the ultimate kind of guidance that we provided originally.

Nikolaus Priebe — Analyst, BMO Capital Markets

Okay, great. Thanks very much.

Operator

Your next question comes from the line of Marco Giurleo. Your line is open.

Marco Giurleo — Analyst, CIBC World Markets

Hi, good morning.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Good morning, Marco.

Marco Giurleo — Analyst, CIBC World Markets

I just wanted to follow-up on the last question about the Commercial growth. You guys maintained your target, it's at 8% to 10%, so it implies pretty strong growth in the back half of the year. Can you just speak to the pipeline and factors that are driving those expectations?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Yes. We constrained making commitments on certain types of Commercial mortgages in—I think back as far as February, and held that position for about four months, so that slowed down the pipeline as we were trying to get our capital ratios back within our target range. I think in the beginning of June, we communicated to the market that we were opening those lines again, and yes, we have strong partnership relationships and we're seeing really strong traction in that market. It's quite a—these are complicated transactions which might easily take two to three months from the time we start working on them to funding, or sometimes as much as a year. But it takes time for those flows to turn into actual funded transactions, but we certainly have been operating at a pretty strong cadence for a month already, and those will turn into funding over the next month or two.

Marco Giurleo — Analyst, CIBC World Markets

All right. Are there any geographies that are seeing particular strength, or is it broad spread?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

It's actually—certainly pretty broad. While we see the housing market in Vancouver, for example, it's been fairly—on the Single Family Residential, the activity in the single-family housing market is low. We're seeing good construction, good activity in commercial real estate, including seeing sort of residential construction. Obviously, Toronto and Montreal continue to be very active. Montreal is, we'd say a bright spot in the Canadian economy, and that's translating into opportunity as well in that marketplace, where we have historically had a very strong position in Quebec, so we've got great leadership in our Quebec market. We've got great people on the ground, and we understand that market well.

But it's fairly broad, spread right across the country.

Marco Giurleo — Analyst, CIBC World Markets

All right, great. My next question is just on the margin and some of the dynamics you're seeing with respect to funding and mortgage rates. We've seen a pretty material decline in the GIC rates year-to-date, and it looks like your mortgage rates have held up pretty well. Can you just speak to the pricing environment and what you're seeing with respect to competition?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

It continues to be, I would say, constructive, in terms of pricing. I think you're always concerned about big competitors behaving in ways to sort of try and win market share. It seems that we're all trying to win market share through service, and price from time to time, and making sure that we're pricing properly for the risk of the loans we're putting out, so feeling more confident about that than I might have been feeling a year ago. I think just the dynamics of competitors is improved.

So yeah, it is translating into decent margins at this point.

Marco Giurleo — Analyst, CIBC World Markets

Is there any, I guess, deliberate decision to hold those mortgage rates while the GIC rates come off, just maybe sacrificing a little volume in the process? Could you sort of speak to that?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

I wouldn't say there's deliberate decisioning going on there. Generally, I think it's fair to say that mortgage rates require somebody to make a deliberate decision; GIC rates move much more in lockstep with market rates, as the bond market rallies and swap rates come down, then naturally the GIC market is being re-priced every day. It's a bit of a function of that, particularly when the underlying funding rates drop, we do tend to see a little bit of a gapping of spread and then, if underlying interest rates would be coming off, I would expect to see, potentially, spreads shrink for a bit until decisions are made to sort of re-price the market upwards as the spreads become narrower. We do see that dynamic, and we don't change mortgage rates daily. It's more of a decision that's made as we look at the overall market dynamics.

Marco Giurleo — Analyst, CIBC World Markets

All right, thanks. That's all for me.

Operator

Your next question comes from the line of Geoff Kwan. Your line is open.

Geoffrey Kwan — Analyst, RBC Capital Markets

Hi, good morning. Just to—I had one question. Curious to how you're finding on the residential side, the 905 area around Toronto. That was obviously an area that was pretty soft last year. Just wondering whether or not, within the various regions within the 905, is that there's comments that you've got on the different housing types, areas that you're seeing better activity, than maybe conversely, areas that may still be soft.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Certainly, my sense is that we've got good activity in the 905. A year ago, that was an area we were keeping a closer eye on. My sense is that that, along with the broader increasing activity in the GTA, is all rising together. I think from being an area of concern, we were less concerned about the risk there. The broader story in the GTA is still maintained, high levels of immigration have improved importability now that we've got interest rates dropping down, benchmark stress tests, interest rates dropping. I think it provides a constructive backdrop for the 905, as well as the 416.

Geoffrey Kwan — Analyst, RBC Capital Markets

Are there specific municipalities that are doing better than others?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Certainly. I'm sure there are, but I'm not familiar—certainly, it does not raise any concern with our group. We've generally been constructive on the 905 and the whole sort of horseshoe around Toronto right now.

Geoffrey Kwan — Analyst, RBC Capital Markets

Okay. Thank you.

Operator

Your next question comes from the line of Jeff Fenwick. Your line is open.

Jeffrey Fenwick — Analyst, Cormark Securities Inc.

Hi, good morning, everyone.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Hey, Jeff.

Jeffrey Fenwick — Analyst, Cormark Securities Inc.

I wanted to, Andrew, target my question in on the funding side here with deposits, and I know you've been making some very good headway there with *EQ Bank* and growing that contribution, but the broker deposits, or the term deposits, are still a very large majority of the total here.

If you were to look forward over the next three or four years, is there a path towards a different mix that you'd like to see things get to, to balance that out from your perspective, and how should we expect that to trend?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

I certainly think you should expect to see *EQ Bank* growing faster than the broker deposit market so that we end up with more direct customer relationships. Having said that, we're obviously growing the deposits fairly fast. I do think there's actually a more general trend in the deposits market to make it a more open and competitive market that we're going to see—it's one of the reasons why we support open banking so clearly, that the rates that you get on a CDIC deposit at Equitable Bank or *EQ Bank* are materially higher than what you might get if you walk into a typical bank branch.

That price difference seems odd to me. When you think about mortgages, for the last—and which is a space I worked in for, gosh, maybe 20 years now, the price delta between a broker and a branch today is really quite narrow. Yet, if you walk in and buy a GIC in a branch, you might easily be getting a rate that's

1.0%, 1.5% less than you would get in a more open, transparent market. There's certainly—while we're, on the one hand, trying to have great distribution and proprietary distribution for *EQ Bank*.
I'm actually feeling more confident about a more competitive, open GIC market opening that will provide that stable deposit funding.

Frankly, our deposits are ensured by CDIC, the Government of Canada. There's no reason why they really should be priced more than just—they should be priced the same as any other GIC provided by any other bank, and yet, because of distribution issues, that there is a delta there. Frankly, there's so many products that get sold, whether it's fixed income mutual funds with high MERs that provide a lower net yield to the consumer than just buying a GIC from a bank, there's lots of opportunity, for basically comparable risk. If you buy a Government of Canada bond and a mutual fund, it's already a poor investment compared to buying a GIC directly, in terms of the additional pickup you would get with essentially the same underlying credit risk to Government of Canada.

We do see, and we continue to promote the idea that people should shop around for a GIC, and obviously Equitable tries to be as easy to access in that world as we can.

Jeffrey Fenwick — Analyst, Cormark Securities Inc.

That's helpful commentary. Then, one area there you've also seen a lot of growth is with some of the partnerships you've established with the fintechs. Can you just remind us of the characteristics of those deposits there in terms of the composition, how sticky they are, and anything we should be thinking about on that front?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Yes, so these are deposits where the individual consumer has to make the decision to move the money out, so there's no broker involved, which is—there's no broker involved in the sense there's no individual that controls a book of business that could suddenly make a decision to withdraw funds from many accounts, so that is much less risky in our mind than we saw back in 2017 with—particularly with one of our competitors where brokers were making a decision to pull wholesale funds out.

Then we have institutional relationships with the fintech at the top of the house. Clearly, one of those that we've talked about quite openly is Wealthsimple, which we regard as the leading robo-advisor in the country, where we have strong institutional relationships with them. If there's cash sitting in Wealthsimple, then it's sitting as a deposit on Equitable Bank's balance sheet through that relationship account. We track the stability of that vis-à-vis the stability of our own *EQ Bank* deposits, and it looks very favourable.

Jeffrey Fenwick — Analyst, Cormark Securities Inc.

Then maybe we can turn over to the capital, uses of capital. Good to see the change in the dividend growth policy there, and you were, alongside that, building up your capital ratios. You'd mentioned, I guess earlier in the year, thinking about what are some of the options you could do as you get back into that zone for

capital. What about things like buyback activity; is that an area where you may put the focus later this year?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

I don't think we'll do that later this year. I think, all our models show that we're going to have really attractive loan growth through the end of the year, so to fund that—to provide the capital for that loan growth, plus building CET1 back up to 13.5% is going to be—and paying this new attractive dividend is going to be what we use capital for.

Going forward, NCIBs are certainly something we'd consider. I think how you should think about that is, if we have periods of softer loan growth and you see our CET1 rising above the midpoint of our target and looking like it's going to maintain that position for a while, then we might use NCIBs to bring that back down and manage our capital ratios. The difference between NCIB, in our view, than a dividend—a dividend, you commit to and you know you're going to be paying it for many years. For NCIB, it's something that one can use, you know, so incremental capital is returned to shareholders, but then also, it can be used on a targeted basis to manage your capital, it's a kind of fine-tuning of your capital.

It's certainly part of our longer-term set of tools that we have in the toolkit, we think, but I wouldn't expect to see that before the end of this year, that's for sure.

Jeffrey Fenwick — Analyst, Cormark Securities Inc.

Okay, great, that's helpful colour. Thanks. I'll re-queue.

Operator

Your next question comes from the line of Jaeme Gloyn. Your line is open.

Jaeme Gloyn — Analyst, National Bank Financial

Yes, thanks, good morning. Just want to get a little bit of clarification around the guidance for Alternative Single Family asset growth, down a little bit from the prior quarter. Just trying to square that with what looks like better underlying fundamentals for that housing market and for that segment, especially in the Toronto area.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Yes, Jaeme, I wouldn't put too much into that. We follow a process and just re-forecasting every quarter, so when you really think about it, we're comparing with our first forecast back in February with where we stand today. We've come to—I think we're down 1% in our expectations after four or five months—five months of activity, we're down 1% compared to where we thought we might have been in February, so I think it's just a bit of fine-tuning there. There's always variables that we look at. These are potentially mortgages that liquidate prior to their terms, we always got renewal rates written into it. You're thinking

about both Western Canada, which is a nice franchise for us, which is a bit softer, along with Eastern Canada. I wouldn't be surprised, frankly, if, looking on the conservative end of this but I'm not changing that, but our business is in good shape right now. Our underwriters are busy, there's good flow, we have good relationships with the brokers, and it's just simply—almost a rounding error in the spreadsheet, I would argue.

Jaeme Gloyn — Analyst, National Bank Financial

Okay, and want to just follow-up on that. You mentioned there about the geographic dynamics; you are seeing softness in the Western provinces. Maybe just speak a little bit more about what's going on, in either Vancouver and Calgary, Alberta.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

I think it's particularly Vancouver, which won't surprise anybody. Transaction volumes are down, I believe 24% year-over-year. We're not seeing any issues on the credit side, the values are staying up, default rates and arrears in Alberta have been falling over the last few months. But it continues to be a market that's been going through a bit of a softness for now. It's the nice thing about having a national business, frankly, where we're seeing the opposite. Clearly, Ontario's a core business for us, but Quebec is—our team into Quebec just did a bang-up job in the first six months and exceeded our expectations, so we're seeing that counterbalance.

Jaeme Gloyn — Analyst, National Bank Financial

Okay. Then on the Commercial mortgage side, looking at the breakdown between mortgages to corporates into small businesses, it seems like it's the corporate side that's driving a little bit of the softness here to start the first half of the year. Just, can you speak to—yes, I guess some of the dynamics between the two groups of Commercial mortgages, and, I guess, speaking to that pipeline, maybe a little bit more about what kind of corporates we're looking at versus small businesses?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Yes, that's a good observation, Jaeme. When we think about small businesses, so we're thinking about—I always talk about the storefronts on the Danforth as being the guy that's operating a restaurant on the ground floor and owns a couple of apartments above; may indeed live above it with his family. That's our small business program. Small apartment buildings, six-unit, 12-meter apartment buildings.

We try to face that market being consistent all the time, much like our Single Family business. We've been very reluctant to dial that down. We always want to be facing a broad distribution network in that area. In a reaction to wanting to build capital would not be to slow that business, because you damage the franchise value of it.

Whereas when we're dealing with large corporates, we may well be dealing with large mortgage banks that are putting huge, or significant mezzanine money in behind us, people that are working on a more

transactional—their relationships, but they understand and they have other funders they're working with all the time. It's easier for us to maintain our relationships with those people, reduce the amount of capital we're applying to the market, and yet, when we choose to step up again, step back and get the flow relatively quickly.

For many of those partnerships, we will be quite clear that if there are things that they rely on us for, or there are certain niches, even when we slow down funding, we will continue to fund those and maintain the warmth of the relationship. But we are able to kind of dial it up and down a bit, without having any long-term impact on those relationships.

Jaeme Gloyn — Analyst, National Bank Financial

Okay, and then still within the Commercial segment, looking at construction loans, a little bit of growth versus the end of the year, but quite a bit of growth if we were looking back over 2017 end of year levels. Maybe just speak to what you're seeing and the dynamics in the construction loan market, and where you expect that growth to come from going forward?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Yes, I mean, it's a core area of expertise. People, when they're building—many asset classes think of Equitable first and the construction loan business. If you're building a self-storage facility or a student residence, multi-family apartment building, we are one of the banks that get the call. We're seeing it across a broad spectrum of asset types, across many cities and across Canada, you can see there's a lot of activity, mostly major urban center driven, I would say, today. We happen to be in certain—we have some deep expertise in some areas that are extremely valuable because our clients are being active.

Jaeme Gloyn — Analyst, National Bank Financial

Okay, and last one for me. I just want to get a little bit more colour around the Bennington credit performance coming in at about 70 basis points. That's below the range that you guided to, around 1.5% to 2.0%. I'm just wondering if there's anything in particular in this quarter that you can speak to that drove a better than expected outcome, especially after the Q1 that resulted in a little bit higher than expected performance, or is it all just related to this, I guess, change in strategy to more actively collect on 90 days past due amounts?

Tim Wilson — Senior Vice President and Chief Financial Officer, Equitable Bank

Jaeme, there are three factors that come into play when you're looking at Bennington's PCLs in the quarter. The first is the increased focus that they put on collecting overdue accounts, as I mentioned earlier. They were able to bring down those impaired balances nicely, which reduced the amount of allowance we need, and caused a provision reversal.

The second relates to the macroeconomic climate. As you're aware, we do all of our loss modeling internally, and then we lay—for IFRS 9, we layer on third-party macroeconomic forecasts and look at

different scenarios. The assumptions that we are provided through that third-party improved during the quarter, which actually resulted in a net reversal of Stage 1 and Stage 2 provisions on that portfolio.

Then the third, as pointed out in our items of note, was a $1 million reversal related to changes in our approach and our loss modeling assumptions.

Jaeme Gloyn — Analyst, National Bank Financial

Okay, great. Thank you very much.

Operator

Your next question comes from the line of Graham Ryding. Your line is open.

Graham Ryding — Analyst, TD Securities

Hi, good morning. Just two questions. On the alternative business, or I guess your Retail business, originations were flat year-over-year, and we saw some other mortgage companies report some pretty strong numbers, also yesterday. Maybe you can just talk to the competitive landscape, particularly in the alternative space, and how you're feeling about that relative to your originations and your outlook?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Yes, it's a tricky one this quarter because we accelerated our reporting, so we don't actually have good data from our competitors at this point. We have some internal insight from what we hear on the street and other pieces of intelligence. We actually think we did pretty well. We think we gained share on the Alt space in Q2, which I think, as a corollary, might suggest the Alt space isn't growing as fast, perhaps, as one might have expected. But we think our teams are right there in the market in terms of service, and we think we're actually gaining share in the Alt market.

We actually believe that we may be in a period right now, so not what we'd expect in Q2, but it appears that Q3, the Alt market may be starting to grow again. I don't know what all the dynamics are there; I think that the larger big six banks are having some influence on the size of the Alt market, that's our sense, but really hard to put a finger on it.

Graham Ryding — Analyst, TD Securities

Okay. Okay, that's interesting. AIRB, could you just give us a little context on what sort of impact that could have, and can you just confirm sort of the timing of when you're hoping to officially shift?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Yes, so we're hoping to be running parallel by the middle of next year, which is the next step. It is going to be a matter of working with the regulator, make sure we've got everything in place for the following year.

Then we would expect to get a gradual migration of how they think about trusting the calculations that we've come up with, in terms of how we run the Bank. But it could be a meaningful reduction in the risk weights associated with the business.

Really, as we've always talked about, this is really about, how do we grow this Bank over the next five years, and making sure that we've got economic capital reflecting its appropriate buckets so that we're making sure that we're applying risk and putting appropriate capital against the risks in the business, which is really the quantitative methodology that AIRB brings to the table for us.

Graham Ryding — Analyst, TD Securities

Is it fair that it would be more—your Commercial business would be more sensitive to this approach and it opens up some—you could be more price-competitive and it could open up some increased volume for you if you can have a lower risk weighting on some…?

Andrew Moor — President and Chief Executive Officer, Equitable Bank

That for sure is true. One opportunity it clearly creates is, that if we're involved in a construction project for, say, a mult-ifamily residential building, today, we can be competitive on the construction financing. Once the building has fallen and the building has been fully rented out, then we continue to risk weight that 100% on the standardized approach. Under an AIRB approach, that risk weight might drop in half, for example. That building, at that point, is a much lower risk as opposed to a cash flowing building.

Yet, we can't be competitive on that funding, so having earned the trust of the customer and done all the hard work associated with that construction funding, we're not able to then provide the next solution for them. We would certainly like to be in that position, that's obviously a customer that we're—is easy for us to get to, we already deal with them, and also easy for underwriters to underwrite a building that they know intimately through that process.

I think it's also fair to say, though, that these weights in Single Family could also be significantly helped through the AIRB process. It's true to say that some of the large banks might be risk weighting residential mortgages under the AIRB approach in the around 10% risk weights, plus or minus, compared to the 35% risk weights that we put on at Equitable under the standardized approach, so quite a large delta for a third of the amount of capital in that case.

Now, we wouldn't expect to be as low as that, but we certainly would expect that our risk rates, on an AIRB approach, might be as low as 22%, 23%, compared to 35% under standardized. It's a meaningful delta on an $11 billion book.

Graham Ryding — Analyst, TD Securities

Okay, that's helpful. That's good for me. Thank you.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Thanks, Graham.

Operator

There are no further questions at this time. I turn the call back over to Mr. Moor.

Andrew Moor — President and Chief Executive Officer, Equitable Bank

Thanks, Marcella. We look forward to reporting our third quarter result this fall. Thank you for listening and enjoy the rest of your summer.

Operator

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