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EQB.TO - Q1 2020 Equitable Group Inc Earnings Call

EVENT DATE/TIME: MAY 14, 2020 / 2:00PM GMT

CORPORATE PARTICIPANTS

Andrew R. G. Moor *Equitable Group Inc. - President, CEO & Director*

Ron Tratch *Equitable Group Inc. - Senior VP & Chief Risk Officer*

Tim Wilson *Equitable Group Inc. - Senior VP & CFO*

CONFERENCE CALL PARTICIPANTS

Geoffrey Kwan *RBC Capital Markets, Research Division - Analyst*

Graham Ryding *TD Securities Equity Research - Research Analyst of Financial Services*

Jaeme Gloyn *National Bank Financial, Inc., Research Division - Analyst*

Nikolaus Priebe *BMO Capital Markets Equity Research - Former Diversified Financials (Canada) Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen. I'd like to welcome shareholders and analysts to Equitable's First Quarter 2020 Conference Call and Webcast. (Operator Instructions)

Before we begin, I'd like to refer you to Slide 2 of the presentation regarding the company's caution regarding forward-looking statements. This presentation and comments may contain forward-looking information, including statements regarding possible future business and growth prospects of the company. You are cautioned that forward-looking statements involve risks and uncertainties, including those introduced by the current global COVID-19 pandemic.

Certain material factors or assumptions were applied in making these statements and could cause results or performance to differ from forecasts or projections expressed in these statements. Equitable does not undertake to update any forward-looking statements, except in accordance with applicable securities laws. This call is being recorded for replay purposes on May 14, 2020, at 10:00 a.m. Eastern.

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

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Thank you, Amy. Good morning, everyone. And welcome. Tim Wilson, Chief Financial Officer of the bank; and Ron Tratch, Chief Risk Officer, are also participating today. While I will deliver our prepared remarks, Tim and Ron are available for Q&A. This is an extremely challenging time for Canada, and frankly, the world. Our bank, like others, exist to serve Canadians. And the critical role we play in the economy includes supporting them through this pandemic. We are committed to providing our support by living our values as Canada's Challenger Bank. We've also balanced that commitment with protecting and, where possible, strengthening the rock-solid institutional foundation we built for customers and shareholders over the decades.

Our presentation this quarter will focus on the bank's response to the pandemic, including the steps we've taken to strengthen our liquidity position. I would say our response has been well-executed in a very short time and has prepared us for new realities. We'll also touch on Q1, which was shaping up to be a good quarter for the bank based on solid growth through January and February, on plan margins and the expansion of some important Challenger Bank services.

To start, I will acknowledge this is a very fluid situation. As it's a health-driven event, we simply don't know how the pandemic and the lockdown will play out. The duration of COVID-19 will have a significant bearing on the ultimate severity of economic, financial and social impacts. I can assure you we've not downplayed risk, nor will we. In that regard, we have been transparent about the economic assumptions used to estimate our future expected losses and the broad range of stress tests we run to be comfortable with our capital levels.

While we don't know what the future will look like with reasonable certainty, understanding the various scenarios that could unfold allows us to position ourselves to manage through all of them. I will say with confidence that our bank is well positioned because of our branchless business model and purpose-built digital banking capabilities. Simply put, Canada's Challenger Bank is a great place to be in this environment, whether you're a customer, shareholder or employee.

From the outset of the pandemic, the bank has focused its actions across 3 areas: protecting our employees, serving our customers and safeguarding our business for the future. I'll address our employee base first. Not to downplay the fabulous work of our IT team, but as a digital bank with a cloud-based digital platform, it was relatively easy to move almost all members of our team to a work-from-home model. Our employees accomplished this abrupt transition over just a few days in March with very little disruption to the bank's operations. I'm extremely proud of our team's adaptability and resilience under extraordinary circumstances, circumstances made more challenging by the simultaneous increase in customer requests for assistance.

Having remote access to all the bank tools means that people of Equitable remain highly productive for our customers and partners to this day. And this will be the case going forward. We've also reinforced the support system for employees, for example, by introducing new mental health-orientated tools to help them cope with the stress of the company as a health and economic crisis of this nature. For our customers, Canada's Challenger Bank plays an important role providing a safe place to store value, and like other banks, providing capital in the economy that leads to prosperity for all.

Clearly, the unprecedented increase in unemployment is putting financial stress on many of our customers. Government programs is stepping in to provide some assistance, but there is no doubt that many Canadians are going to have to draw down their savings and will need the support of banks to see them through this difficult time. Like many of our banking peers, we are responding by offering some of our customers the opportunity to defer their loan payments if the pandemic has interrupted their employment or source of income. Through the end of April, we deferred mortgage payments for just over 14,500 customers.

Clearly, this is a new approach for us that befits the times. The way I think about this is the deferral itself represents a relatively modest increase in risk. An average LTV of 64%, an interest rate of 4.9%, the LTV on an uninsured mortgage would only increase by 0.8% over 3 months or 1.6% over 6 months of deferrals, assuming house prices don't change. We certainly expect the economy will kick back to life and employment will improve over these time frames. But nonetheless, we expect higher levels of defaults in the loan book in 2020 than we had historically experienced.

Our bank provides assistance to customers in other ways, too. EQ Bank, our digital platform, is open 24/7 as a safe and convenient way to bank, with superior interest paid on deposits, free indirect transfers and bill payments and our new international money transfer service. In Q1, we expanded the service by adding 15 new currencies. I truly believe this is the best service for sending money overseas provided by any Canadian bank. More than 110,000 Canadians now rely on EQ Bank for their banking needs. That's 34,000 more than a year ago. The rate of customer acquisitions increased markedly recently, possibly as people recognize the appeal of our all digital platform as they bank from home and also due to the great work of our marketing team.

At quarter end, the EQ Bank deposits exceeded $2.7 billion, 22% above last year, and now exceed $2.9 billion. I'm pleased to note that Celent, the international research firm, selected EQ Bank as the 2020 Winner of its Model Bank Award for Banking in the Cloud early in Q2. This shows we are in the top echelon of banks around the world that are demonstrating clear technology innovation and cloud implementation excellence. We've also broadened other key deposit services with the launch of the Equitable U.S. high interest savings account. This account provides competitive U.S. dollar cash alternative for customers and is available through our extensive network of independent investment advisers and financial planners.

As of April 30, eligible deposits held by -- in foreign currencies of CDIC member institutions such as Equitable Bank were covered for insurance. Our funding markets have been delivering all the volumes we need to maintain and grow our business. So these introductions really serve a broader purpose, diversifying our funding sources and improving the risk profile of the bank. They also support the bank's long-term growth potential, which we believe is considerable.

From a perspective of protecting our institution, we made several moves, including increasing the size of the bank's liquid asset portfolio. Although liquid assets have a negative carry, we thought this move was prudent in light of broad economic uncertainty. To be clear, we have not experienced any institution-specific liquidity stress and hold enough liquid assets to protect the bank if stress does materialize. We had approximately $600 million more of liquid assets at the end of Q1 than we did at the end of Q4. That represents 7.5% of our total assets, up from 5.5% last quarter and 7.3% last year.

In the face of the risk posed by COVID-19, we took the additional step of ensuring $622 million of mortgages as soon as CMHC expanded its insurance eligibility criteria on March 20 to further bolster our liquidity position. The insurance came into force in the first week of April and created an equivalent amount of additional liquidity. The government of Canada has moved to inject liquidity into the banking system certainly gives us added comfort with our liquidity position, and we are making use of these government programs. In March, 8 of the 9 bank members of the TSX Composite Index, including Equitable, made a draw against the Bank of Canada's new Standing Term Liquidity Facility. We also plan to increase our use of the expanded Canada Mortgage Bond program. These actions will, first and foremost, strengthen our liquidity profile, but they also provide us with funding cost benefits.

Overall, we believe we have liquidity on hand and the tools necessary to manage liquidity successfully through this pandemic. Another critical aspect of protecting the bank and mitigating risks is maintaining a strong capital position. With CET1 and Total Capital Ratios at the high end of the Canadian industry, we have a good starting point. You will note that the bank CET1 ratio of 13.5% was almost flat to the 13.6% we reported at December 31. We expect the bank's CET1 ratio to increase from here as positive earnings add to our capital base, risk-weighted asset growth slows, and we ensure single-family mortgages under available CMHC programs. For reference, the mortgage insurance we arranged on $622 million of single-family mortgages in the first week of April caused our CET1 ratio to immediately improve by 30 basis points to a pro forma 13.8% as we started the second quarter. You will see the benefits of this action flow through in Q2.

We have run a battery of stress tests and financial forecasts that suggest our capital ratios will remain within or above our target range throughout the year, even with our most severe economic assumptions that are set out in the MD&A. Last summer, Equitable announced its intention to grow its common share dividend at a rate of between 20% and 25% for each of the next 5 years. The Board has now put these planned increases on hold because of the regulatory guidance from OSFI to the banking industry as a whole. This guidance indicated that dividend increases and share buybacks of federal regulated financial institutions should be halted for the time being.

While I can't tell you when this guidance will change, I will say 2 things. First, we do not plan on decreasing our dividend. Our low payout ratio, which was 11% last year, means that we have room to maintain our dividend and still build capital organically. Second, we continue to believe that growing dividend is an important element of shareholder value creation, and we will retain the management discipline that will make this possible once the pandemic is behind us. The bottom line is that Equitable is soundly capitalized coming into this pandemic. We have taken actions to bolster our position. And we have confidence that our capital is sufficient to get us through the economic challenges ahead.

Now turning to Q1 results. We achieved portfolio growth in both our retail and commercial businesses with loans under management ahead 9% over the past year to $31.5 billion. As I've said at the outset, Q1 was shaping up to be a good one for the bank with strong productivity and successful service launches. However, estimates of future loan losses related to the economic consequences of COVID-19 had a significant negative impact on earnings. For the quarter, the bank reported net income of $29.9 million or $1.70 of EPS and a return on equity of 8.4%, all on an adjusted basis. For greater clarity, adjusted results still include the full impact of the higher credit loss provisions in the quarter.

Looking at PCL, it increased to $35.7 million as we built our credit loss reserves. These balance sheet reserves, which we refer to as our allowances, increased materially in the quarter, reflecting the deteriorating state of the economy. The increase on our allowance, which drove our higher PCLs related to performing loans, what we call our Stage 1 and Stage 2 allowances, they represent expected future losses on our performing loan portfolio. We model these expected losses based on our current book of business and macroeconomic forecasts. To ensure that our allowances reflect a range of potential outcomes as required by IFRS 9, we modeled 5 different economic scenarios and used a weighted average of those scenarios to determine the allowance. All of these forecasts are sourced from a recognized third party. In all scenarios, macro forecast deteriorated significantly, indicating a weakening in the Canadian economy and real estate markets.

We've been transparent with our assumptions and their impact on allowances. We have provided the forecast for the key variables in our MD&A as well as our slide deck, and I'm happy to take any questions you have at the end of our prepared remarks today. There is, of course, a high degree of uncertainty in forecasting at the best of times, and this is not the best of times. What we can say is that by taking into account the range of information we have today, we believe the Q1 allowance we established represents a reasonable estimate for future losses. We know some of our analysts are expressing surprise with the level of provisioning. I think that Table 14 of the MD&A is worthy of close scrutiny. What's shown is that if the economic trajectory follows our base case, we are over reserved to the extent of $9.7 million.

On Slide 11 of our deck, you'll see allowances for credit losses in each of the past 3 quarters, segmented by retail, commercial and leasing. While all allowances increased, our leasing business accounted for disproportionate share of the change. Given the risk-return profile of leasing, we do expect losses in that business to be higher than our mortgage businesses. This reflects the standard leasing industry practice of lending against the full acquisition cost of depreciable assets.

From years of superior credit performance, you know we are prudent bankers. We have always applied a rigorous approach to risk management. We lend to major urban centers where employment is diversified and where real estate markets are more liquid. Further, our mortgages is supported by first claim positions on real estate and 100% of our leases by first position claims on equivalent, meaning that we have hard assets behind virtually every one of our loans and leases. The weighted average LTV on our uninsured residential mortgage portfolio was 64% at the end of Q1, giving us some protection against a combination of high defaults and decreased house prices. As further support of our credit profile, 43% of our loan portfolio is insured. We have listed many other aspects of our approach to risk management in our MD&A, and I encourage you to take the time to read it thoroughly.

A couple of highlights are the average Beacon score for our residential borrowers was 695, up from 686 2 years ago, and small business Beacon scores averaged 740. Almost all of our uninsured commercial borrowers and a large portion of our lessees, have provided us with personal or corporate covenants against their borrowing. All of that said, as always, we adjust our underwriting criteria to manage emerging risk in the market. One tool we have used is to reduce loan to values on new loans across many of our asset types. This may reduce future loan growth and revenue growth, but will uphold the quality of the bank's asset base.

As a percentage of total loan assets, net impaired loan balances at March 31 improved to 47 basis points from 49 basis points a year ago. This is indicative of the bank entering the pandemic with a sound loan book. In dollar terms, the increase in impaired loans for Q4 reflected an $8.9 million commercial loan in Manitoba with an LTV of 64% and a $6.6 million increase in impaired equipment leases. We do not expect to realize a loan on the -- a loss on the Manitoba loan. We're also pleased that the $39 million impaired loan that we have on a multifamily property in Central Vancouver appears to be headed towards a successful resolution in Q2. We are confident that we'll come out whole.

Looking to the future, there is much uncertainty. And as noted in our MD&A, we have withdrawn our full year 2020 outlook provided back in February. It's not possible to replace that outlook with a reliable range of asset growth and NII expectations at the moment. However, it's worth noting that we believe our medium-term financial objectives are within reach in the years after we emerge from COVID-19, as we realize our vision as Canada's Challenger Bank. I know there's a lot of speculation about how our world may change as Canadians pick up new habits during the lockdown. I for one am convinced that one byproduct will be accelerated consumer adoption of digital banking and further digitization of financial services. Our award-winning digital capabilities, cloud infrastructure and ever broadening assortment of savings vehicles, provide us with a great strategic position in that environment.

Over the last few weeks, we have seen a fairly dramatic increase in new customers signing up to EQ Bank. I believe the acceleration of digitization in financial services is going to be a positive for us against an otherwise tough backdrop. And this year, we will continue to add digital capabilities to target meaningful investments in innovation and product development. To wrap up, the challenges we're all facing around COVID-19 are unprecedented. Here at Equitable, we have moved swiftly to protect our people, our customers and our institution. We are well prepared for a range of possible and extreme downside scenarios and expect to remain profitable this year. We are a strong bank with a resilient can do it culture and we will continue to be here for our customers and shareholders with an unshakable commitment to bringing better banking to Canadians. I'm grateful to our employees and our Board for their incredible efforts to date. I simply can't thank them enough. And on their behalf, I sincerely thank our customers, partners and shareholders for your ongoing confidence.

I'd like to remind you that Ron Tratch, our Chief Risk Officer; and Tim Wilson, our Chief Financial Officer, will join us in the Q&A. With that, Amy, please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question today comes from the line of Nik Priebe of BMO Capital Markets.

Nikolaus Priebe - *BMO Capital Markets Equity Research - Former Diversified Financials (Canada) Analyst*

I wanted to ask you to expand and provide a bit of color on the circumstances surrounding borrowers that have been granted payment deferrals. Presumably, there's an element that have experienced job loss or some form of reduced income. And then there might be another element that's simply being proactive and cautious because it was well-publicized that Canadian banks have become more flexible on mortgage payment terms. So can you try to help us understand what proportion of borrowers would have been simply seeking some form of short-term relief and should be back on stable footing shortly versus those who've experienced job loss?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes, Nik. So we've taken a view, and I think this is probably an experience I was talking to one of the CEOs of one of the big 6 yesterday (inaudible). And I think our feeling is that our customers are calling looking for relief, just really, for insurance. Some of them are looking for insurance. And clearly, a lot of people are quite stressed by job loss, but there is a feeling that it's been widely publicized that this relief is available and people are obviously kind of hunkering down and trying to keep capital and reserve. About half of the deferrals we've given or just over half of -- we've given a 3-month deferral. And the rest are shorter terms than that.

So the approach we've taken is not looking for much evidence of job loss or -- and if it makes sense that they were working in a restaurant and now aren't, then we'll kind of answer -- immediately move to a deferral. I think there was a starting position that some of us took around looking for evidence of actual job loss, but that became a bit of an overwhelming problem. So the approach we've taken from a customer service experience is, if in doubt, give the deferral. And we are hearing anecdotal evidence now with people -- some people coming back and saying they'd like to kind of reverse the deferral and start making payments. So it's very small in the overall scheme of things. But as people are getting used to the new environment, you're seeing a bit of that. So I think that the deferral requests are not really indicative of very much. The other thing that runs teams, Ron, you might want to just kind of go on a deep dive into where the deferral requests are coming from. You might want to talk to that a little bit.

Ron Tratch - *Equitable Group Inc. - Senior VP & Chief Risk Officer*

Sure. So we did do a very deep dive. We looked into the deferrals from a variety of different angles from geography, credit quality, business for self versus salary, et cetera, all the ways that you would normally look at our book. And per Andrew's comment that it's difficult to draw conclusions from it at this time. No matter how we look at it, the cross-section of the deferrals is largely and materially aligned with the general proportions in our portfolio. So we have the capability to look at it at a very granular level. We have. You can't really draw conclusions from it, and it's something that we'll watch very, very closely to see if variances do develop. But at this point in time, it's aligned with what Andrew suggested that a lot of people, we think, were calling in because it was there, whether they really felt they needed it or not, and I think that's borne out as evidenced in the large matching of proportionality with our book overall.

Nikolaus Priebe - *BMO Capital Markets Equity Research - Former Diversified Financials (Canada) Analyst*

Okay. That's very helpful. And then just switching gears, can I ask you to just elaborate on what you're seeing in the construction portfolio at the moment and perhaps how the LTV ratios in that segment would look?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. So ratios on the completed projects would be in around the 70% to 75%, often with a lot of presales and things. Many times we're building condos with presales, for example, supporting that business. We looked at construction, and it's almost been 2 waves. We, first of all, looked at it from the risk projects get delayed, and therefore, there are cost overruns and breakdowns in the supply chain. Our general conclusion on that at this point is there's very little risk in the portfolio associated with that. The team did a really nice job actually of segmenting that looking through that. I think our concern today would be takeouts on some of these construction loans may or may not get impaired. But generally, our feeling so far, and we -- is that we're -- our construction book is in pretty good shape. Ron, again, your team has done a great job looking at this one from different angles.

Ron Tratch - *Equitable Group Inc. - Senior VP & Chief Risk Officer*

Yes. So the only color I could really add -- or I should add to what Andrew has put out is that our construction portfolio is very heavily weighted towards multifamily and condo construction. And in the -- with respect to the condos, significant presales. So we take very little residual exposure there. Those areas have, by and large, not been impacted by work stoppages. There may be some slowdowns. But like Andrew said, the takeout may be delayed a little bit. But by and large, we feel that we've structured that portfolio in good times and it should withstand this quite well. In terms of construction projects that have experienced any type of stoppage, whether it was in Québec or Ontario, it's a very small percentage of the book, less than 10%. And in a lot of those cases, we've gone at a very granular level and have very strong sponsors behind those projects. So we feel very confident that any work stoppages will not have a material impact on the performance of that book.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

And those projects would get stand -- things like self-storage and industrial construction, those kinds of things, which we feel actually stand up pretty well.

Nikolaus Priebe - *BMO Capital Markets Equity Research - Former Diversified Financials (Canada) Analyst*

Got it. Okay. That's great. And then maybe 1 for Tim before I requeue. Just with respect to the reserve build in the quarter, I think you pointed out that about half of it was related to stage migration. I was wondering if you could just help clarify what triggered that migration and maybe what conditions will be necessary to see a reversal there?

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Yes. So that's the right observation, Nik. I would say that the stage migration was triggered mainly by the drop in the macroeconomic environment and forecast. So 2 things contribute to stage migration. One is a loan-specific factor, so a deterioration in a Beacon score and so forth. And then the other is the macro picture. It was definitely the macro picture that caused the migration this quarter. We haven't seen material changes at the portfolio level yet -- or at the loan level, sorry.

Operator

Your next question today comes from the line of Geoff Kwan of RBC Capital Market.

Geoffrey Kwan - *RBC Capital Markets, Research Division - Analyst*

I just wanted to get some, I guess, color even at a high level. On the expense growth, you talked about ratcheting that back a little bit. I'm just trying to understand how to think about the parts of your expense base that are being ratcheted back. So for example, how much -- or how are you thinking about your marketing advertising expense separately, the strategic investments that you're making to support growth. Are you kind of still going full bore on that? Or are there certain parts you might defer? And then lastly, what I'll call your other base expenses, so don't include those strategic expenses, don't include marketing and advertising.

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Okay. Thanks for the question, Geoff. So we'll answer this in 2 parts. I'll tackle the broad piece about expenses and expense growth, and I'll pass it over to Andrew to comment on strategic initiatives. So I think, generally, on expense growth, what we've said is expect expenses to stay in the zone of Q1 levels for the rest of the year. The reason is that we've pulled back on all our discretionary spending, our use of consultants, our spending on travel and entertainment and so forth. We've also committed to maintaining the employee base we have. So not engaging in layoff. But at the same time, we are -- we have put a halt to all our hiring programs for the year. So with that, again, expenses there should be relatively flat through the course of the year.

We did have a lot of discussions internally about strategic initiatives, what to prioritize or where and how to prioritize our spending, given the fact that we are putting a halt to the hiring program that we had for the year and the fact that we'll have limited resources, the fact that we're more challenged working from home and we did decide to cut back on a number of projects, but maintain the focus on the most significant strategic ones, and particularly those that are digitally oriented and customer facing. And with that, I think I'll hand it over to Andrew to talk a little bit more on that in detail.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. So we are spending a lot -- we are excited about where EQ Bank can go as probably you gathered from my opening comments. I think just to be in this -- just to reinforce, we are the only bank in Canada operating its core processing on the cloud. We -- and it's tremendous. Our customer SAT scores are fantastic in that business. We are seeing the highest levels of new sign up to EQ Bank that we've seen in a number of years as we speak.

Now challenge with spending money on marketing right now is we can't even run with the stages around close, so we can't actually run -- develop new advertising. You'll see from new digital content in market in the next couple of weeks to try and even drive customer acquisition in Ohio. We think our lifetime value of a customer in EQ Bank is over $1,000 per customer. So to the extent that we're gaining -- I think yesterday, we added more than 250 new customers. To the extent we can keep up that strong cadence there, we think it's going to be a real positive for the institution coming out of that. And just generally, we're trying to digitize more of the bank. So things like even these deferrals that Nik raised a question on earlier, we're trying to make that a digital experience so customers can come in and see where the deferral sits and that kind of thing. It's more self served.

And we said that other things will slide. So we are expecting to be in the market with covered bonds in the European issuance in the summer. Since it's impossible to even go to Europe right now, certainly very difficult, that project will get pushed probably into next year. And some of the AIRB. While we're convinced that AIRB is the right route forward for this bank, we have slowed our pace of investment in that project. We still expect to be making really good progress through the end of next year. Our capital ratios would look a lot higher under AIRB than they do under current standardized measures. So we want to be measured the same as every other big bank in the country. And so we're committed to AIRB, but that project we're investing less this year. So kind of the big picture takeaway is the customer facing digitization stuff we're continuing to invest in and sort of doubling down, not necessarily spending more because it's almost impossible to spend more, and then deemphasizing some of those longer-term strategic projects that are very difficult to execute in this environment.

Geoffrey Kwan - *RBC Capital Markets, Research Division - Analyst*

And maybe if I can just add on to your comment there around the AIRB and, I guess, halting it or kind of slowing that there. Is that driven perhaps a little bit more of just OSFI focusing on other stuff? Because I was just thinking is what that risk-reward would be to continue going down that route if it does improve your capital ratios, especially if we're in an environment of where there may be at least perceived concerns around your capital levels and perceived -- sorry, perceived levels of whether or not there might need to be a capital raise?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. I mean we certainly need to be clear. We're pretty confident. We don't need to have a capital raise and that's one of the key takeaways you should take from this presentation that we will not be forced to raise capital at a depressed stock price. And I think that I'm incredibly comfortable saying that given -- even in that worst economic scenario. I do think -- and obviously, wouldn't tell you this, but I mean, I think it's entirely reasonable to think that OSFI's team will not be ready at the end of this year to really think about migrating a bank to new AIRB standards. Every crisis brings kind of regulatory response. And I think OSFI has done a commendable job in responding appropriately to help guide the Canadian economy through this crisis. I think it's unlikely that they will have a lot of people on standby to help deal with an AIRB transition at the end of this year. So that's certainly part of our thinking to align with our regulator that is, as I say, it's not a criticism at all. It's recognizing the reality of the situation we're in. And I think, frankly, you're going to do even the kind of the -- when we stand back from this pandemic, how good are the AIRB models in actually measuring risk? I think that will be certainly one of the questions we're all asking on a global basis.

Geoffrey Kwan - *RBC Capital Markets, Research Division - Analyst*

Okay. On the payment deferrals, just expanding on that, you kind of mentioned that it aligns with the overall book. But can you provide a little bit more specificity around? Like is that based on the geographic breakdown, where, for example, Ontario, Alberta, obviously, you've got some exposure yourselves for it, but it would mimic your geographic exposure. But also, 2, is there any color you can provide on kind of the sectors of employment where you are seeing the deferrals and also maybe kind of like technical employment, in other words, self-employed.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Maybe Ron, if you could -- I think reality is it's none of those things, strangely.

Ron Tratch - *Equitable Group Inc. - Senior VP & Chief Risk Officer*

So the statement I made earlier would stand there. Part of the process that we did look at were not only business for self versus salary, but then going deeper into the industries in which those people were employed and even going down to that very low level of granularity. The same theme held true at this point that the proportions largely matched the overall composition of those respective subcategories in the portfolio.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Thinking about it intellectually, it's a very interesting environment we're in, right? We tend to think of people like airline pilots and dentists as being golden from a credit perspective. Very unusual that you see this environment where there's large-scale layoffs in these kinds of industries, whereas other people like landscapers that you wouldn't generally view as being a little bit certainly relying on individual contracts and that kind of thing. They're able to be back to work and perhaps will stand up better than some others. So it's a really interesting scenario that we're in.

Geoffrey Kwan - *RBC Capital Markets, Research Division - Analyst*

So if I understand the response rate, I'm just tossing a dynamic here, but let's say you have restaurant workers that are 5% of the portfolio, are you seeing that 5% of the deferrals or thereabouts would be coming -- the deferrals would be coming from that sector?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes, exactly. That restaurant worker would fall into a class of employment called services, and that will be the lowest subcategory we can go to where that would capture that. And yes, the composition of the percentage of that services group and the deferrals matches the percentage of the services group in the overall portfolio.

Geoffrey Kwan - *RBC Capital Markets, Research Division - Analyst*

Okay. And if I can just ask one last question. Just if you can talk about the visibility you would have on your residential mortgage book from borrowers that may have taken out additional debt, whether or not it's a second or even a third mortgage or a HELOC, that would be included kind of in their overall household debts, kind of, secured to the property?

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

We certainly haven't done that analysis recently. And I think the last time I recall doing it, probably is a good reminder. We should probably going do it again, but I think less than -- certainly less than 10%, I believe, less than 5% at second liens behind us on the single-family book.

Operator

Your next question today comes from the line of Graham Ryding of TD Securities.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

On the deferral side, so I appreciate the number that you gave, 17.9% of your loans are in deferral. Can you give us an idea of what percentage of your residential mortgage portfolio is deferred?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. So I mean, we could break that down actually between Alt and prime, too. So 24% of our single-family book is deferred. It's roughly 13% in prime and about 30% in the Alt book is -- are the numbers.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Okay. Great. And how about...

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

And by the way, not like how do I just say -- what is important is to understand is it's not moving very fast right now, like we sort of got to those numbers a few weeks ago, and it's not changing very much at this point.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Yes. That is important. Okay. And the commercial and the equipment leases, are there any notable deferrals on that side?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes, they're running at about the same as the old books are running, about 30% on the equipment side. There's a slight difference on the equipment. There are some payments being made on equipment, so less than the full amount, but almost all of those lessees -- almost all those lessees are making some kind of payment but getting payment relief.

Ron Tratch - *Equitable Group Inc. - Senior VP & Chief Risk Officer*

Andrew, perhaps we could note that the large ticket commercial book does not fall on at those percentages. Our large commercial business has been -- it's been very slow to develop. We have very few deferral requests in our large ticket business. And it could just be a factor that those take longer to develop as this thing goes on, but it's very low. So those -- the percentages at 30% are not true for our commercial business.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. In the commercial, by the way, if somebody's got a larger loan, say $5 million or $10 million loan, you don't just call in and get a deferral. That will be very much a kind of case-by-case is the deferral going to get us to the right answer. That's not -- that's much different, much more analytical approach on our front. But frankly, we haven't had that many deferral request even in the larger book.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Right. Good. Understood. Guidance on the provision for credit losses for the remainder of the year, I just want to make sure I understand the message correctly. But if the base case forecasts remain close to where they are today, that PCLs for the remainder of the year will be up on a year-over-year basis but below the large provisions that you took this quarter. Is that right?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Way below, yes, I mean, much more in line with what you've seen from us historically. So when you think about what should happen if we follow -- what's going to happen is, presumably, some of these Stage 2 loans now move into Stage 3. We actually take the provision, but then the Stage 2 provisioning comes down as those turn into real losses. And the forecast, the worst quarters, the forecast then start to roll off. That's the way the logic. It should prevail. So I think JPMorgan has actually a pretty good analogy for this. They -- when they reported, they reported certain losses and said the next quarter was going to be worse because the economic forecast had actually deteriorated between the time that they reported and the time -- so the time they ran the numbers and the time they reported. And so, really, what you go look at and say those scenarios that we've laid out in the MD&A, are those scenarios getting worse, and if they get worse, then we'll be taking more provisions. If they get better, then we'll be -- we'll actually be reversing provisions. That's the way the math works.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

And is the employment rate, really the most important metric to be tracking? The unemployment rate?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Well, HPI is very important, too, for us. And I think it's interesting. We don't have our own economist on stop, so we rely on this reputable third-party. And I think actually I got your office, TD's, HPI forecast, and I think Geoff Kwan's team at the Royals. You'll see the HPI forecast that we're using in our projections are quite a bit more negative than the larger institutions are projecting. And I think, frankly, worse than I would believe the likely outcome. Now we don't settle with those numbers. We're not -- we're -- we think rapidly about how the economist book economist. But we tend to rely on this third-party provider. So I'd be actually a little more optimistic around HPI than currently is in those forecasts. But we respect the economic outlook of our third-party data provider, and we'll live with those. The interesting if you laid up -- if you lay out the -- your own internal economist's view of HPI and ours there, I think you'll see that they're quite a bit more conservative in that projection to generate these loan losses.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Right. Okay. That's helpful. And then my last question, just on the liquidity front, why are you increasing liquidity through this period? You're presumably going to move into lower mortgage activity. Is it related to the deferrals or desire to build capital? Or is it just risk management to hold higher liquidity during this uncertain time?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. It's just -- it's that last thing. I think bankers are always concerned about liquidity, like it's -- you worry about -- and 3 things I tried to lay out. You worry about the quality of your assets and your loan book. You will worry about your capital base, you're standing on really strong foundations. And then you worry about liquidity to make sure the bank is able to settle these obligations. And I would say that we're bulletproof on liquidity and capital at this point, at least as far as I believe it, having looked at it all very carefully. And clearly, the credit quality of the loan book is going to be -- we set out the store really well, but the economics catching is going to hurt large parts of the economy. And with that, that will hurt some of our borrowers for sure.

Operator

(Operator Instructions) Your next question comes from the line of Jaeme Gloyn of National Bank Financial.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

First question is on the Bennington portfolio from the disclosures that the losses that we're taking in this quarter primarily related to pre-COVID impacts. Can you give us a bit more color as to what was occurring, maybe which industries those provisions apply to pre-COVID?

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Yes. So Jaeme, it's Tim. We did see those -- the impairment rates in that portfolio move up slightly in the first quarter from Q4. Part of an ongoing trend where it was just -- you saw, if you look at our supplementary pack, a slow migration. We're not uncomfortable with that. As we mentioned before, we price for that type of risk. Where those impairments were actually happening was across the country, across a range of industries. There wasn't one particular or even a few areas of concern that we had. It was just more a general increase.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And so in terms of the post-COVID then, I think I heard that you -- that there's 30% of that portfolio is on a reduced payment, I guess not necessarily deferred, but reduced payment platform. And just to confirm, like there's -- that's not -- the industry breakdown within the Bennington portfolio, you would have similar commentaries around the broader portfolio that, for example, retail restaurants, hospitality isn't contributing an exceedingly high amount to that number? Or is it different in this portfolio?

Ron Tratch - *Equitable Group Inc. - Senior VP & Chief Risk Officer*

So what we'd tell you today, it is largely representative of the cross-section of the portfolio. We do fully expect in that business and the leasing business as the effects of COVID are unwound with respect to restrictions, that we would see a disproportionate share in the food services portion of that portfolio and less so with respect to transportation, where things get up and running. But given this stage of the pandemic, those variances of proportion haven't been observed.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

I think a big chuck of that portfolio, by the way, is in transportation equipment. So it's long-haul trucks, local transportation, so dump trucks and that kind of thing. One of the things that's impacting long-haul transportation is just kind of the slowdown in supply chains, difficulty getting trucks back and forth across the border are causing some trucks to be sitting parked.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Right. And Tim, just going back to your comment about pricing for this risk. I think the original guidance on the acquisition was loss rates in the 1.5% to 2% range. Now with allowances approaching 5% on the overall portfolio, I'm just wondering how that type of variance plays into how you're pricing the portfolio previously and today and what kind of returns you would be generating, given this level of allowances?

Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

So you're right, Jaeme, that the guidance we did provide was 1.5% to 2% through the cycle. So we're still -- I mean an event like COVID, which we didn't expect at the time that the acquisition was announced, might take that up to the top end of the range, maybe even a little bit into the low 2% over a longer-term period. But even at those higher rates of loss, when you look at the margins we generate on the business, it is still profitable, with the exception of, obviously, the current period.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Don't forget, Jaeme, that with what we use on Stage 2, we're using lifetime losses, right, so which extend beyond the 12 months. So it may not sound logical that 5% might translate into a loss in the low 2s on an annualized basis. But that's kind of the math unwinding that you're no longer turn losses all in the first year.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Yes, fair enough. And last one on Bennington then. Given that a lot of this was related to pre-COVID, should we expect maybe not 13% provision rates, but something significantly above what we were used to seeing as COVID impacts flow through in the next quarter? Or do you feel like you've taken enough of provision as you have in the -- with the rest of the Equitable portfolio that we shouldn't see that?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. I think, Jaeme, you should expect the same philosophy whether it's spending -- whether it's a leasing asset or real estate asset. Just in terms of the kind of our modeling capability in Bennington as well, it's a little more challenging than our real estate. So I think we've probably been -- my own feeling. And you put these numbers together with a degree of caution and trying to do your best estimates as we've probably been erring towards the more conservative side on the leasing portfolio, given that uncertainty.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Great. Shifting to the net interest margin then. Can you give us a little bit of color around how lower GIC rates this year are feeding into deposit costs, maybe that's being offset by the EQ Bank deposit rates? But maybe just discuss a little bit of the push and pull on what you're seeing from deposit funding? And also where you're seeing the securitization funding costs trend given some of the dislocations there?

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Tim Wilson - *Equitable Group Inc. - Senior VP & CFO*

Yes. So I think, Jaeme, we're happy with where we see margins at the moment. GIC costs did come off -- after escalating a bit in Q1, they did come off towards the end of the quarter, and they are working in our favor at the moment. Mortgage rates have not moved from an overall mortgage top line yield perspective, haven't changed much. So we're benefiting from the downdraft in funding costs. And margins have been moving up in recent weeks. And that applies to both the securitized portfolio and the unsecuritized portfolio. So how long that will last? We don't know, but we're definitely enjoying slightly elevated margins at the moment.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Great. And in terms of -- and I apologize if this was covered in the initial remarks, but some commentary around how application volumes are trending in the 6 weeks here, April and May, post Q1.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

It's a bit of a -- in terms of mortgage applications I assume we're talking about because we...

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Yes.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

EQ Bank is hitting record volumes. But -- so on the mortgage application, I think it's a bit of a story of 2 worlds. We're seeing really strong volumes in our prime business and good margins. And in our Alt business, we've certainly seen lower flows in recent weeks. Clearly, we need to get some more activity in the real estate markets with open houses closed and a number of things make it quite difficult to buy a house as well as economic uncertainty. So I think we -- the fact that -- the reality of the health crisis where you can't actually go and walk into a house to see whether you want to buy it, unless the house is already vacant, clearly limits activity pretty significantly. And that's what we're monitoring really closely, when do we see the housing market start to move in greater volumes, where we've got true price discovery on house prices as well as more activity. So we're definitely seeing slower volumes today in the Alt business.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Are you able to put a percentage on that slowdown? Would it be something in line with what we're seeing from a housing resale activity standpoint across Canada?

Ron Tratch - *Equitable Group Inc. - Senior VP & Chief Risk Officer*

I think it's less than that, but it's meaningful.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And last one for me, just on the portfolio insurance transaction. Is that primarily or is it entirely prime mortgages? Or are you including some of the Alt-A book in that portfolio insurance transaction? And looking forward, do you anticipate executing more of these types of transactions? Or is this a onetime thing to pump capital?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

It's primarily about making sure we have liquidity reserves, not so much capital. Capital is kind of a byproduct of that, frankly. And this all came out of the Alt book. This is all -- these are all Alt mortgages, cut and short. It may be used as a tool again or may not. I would expect modest transactions, but this is probably the bigger one that we put through, just to make sure we were standing on really strong ground at the end of the quarter.

Operator

Your next question comes from the line of Graham Ryding of TD Securities.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Just on the underwriting side, have you tightened up on your loan-to-value appetite in recent weeks or months, just given the uncertainty around the direction of house prices right now?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. Yes. That was a fairly quick reaction when we understood the economic consequences of what's happening. In a general sense, we're about 5% less on LTV right across the board. And again, that really goes to price discovery in the housing markets. Clearly, if we're happy learning on certain LTV at a certain point in time and all of the indicators move to that softness in that future outlook for house prices, then a prudent thing to do is to dial back your LTVs, and you're probably at around the same risk as you were before.

Operator

Your next question comes from the line of Geoff Kwan of RBC Capital Markets.

Geoffrey Kwan - *RBC Capital Markets, Research Division - Analyst*

Just wanted to follow-up on your response around activity Q2 to date. So were you saying that on the prime side, prime and mature side of the business, that's going well, and you're seeing transactions there. But on the Alt-A side of the business, you're not seeing as much. I'm just trying to triangulate around just any sort of broader comments that you have around just housing and mortgage activity or are you talking more about specific parts of your book?

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Yes. I don't -- our prime business is -- a lot of it is relating to loans that are already seasoned, where we are providing competitive prices on renewal and bringing new loans in. So there's probably not a certain -- not an associated purchase transaction in those cases. And don't forget, we're a very small player in prime in the overall scheme of very large markets. But we have a tremendous offering for the brokers in that part of the space. So we're seeing very large volumes there. But as I say, I don't think it's associated with purchase activity.

In the Alt side of the business, typically, more than half of that is related to purchase -- underlying purchase transaction. So you can see that, that would slide down with the reduction in purchase activity. And I think it's fair to say that compared to some of our competitors, we're probably a little more cautious on credit, any of them, I mean, most of the time. And particularly in this kind of environment where there's some lack of clarity around where asset values really are, we're probably giving up a bit of share to some more aggressive players in the market.

Operator

And at this time, there are no further questions in queue. I turn the call back to Mr. Moor for any closing remarks.

Andrew R. G. Moor - *Equitable Group Inc. - President, CEO & Director*

Thank you, Amy. In light of COVID-19, we'll be hosting our Annual Meeting of Shareholders in a virtual format tomorrow at 10:00 a.m. Toronto time. The press release we issued on April 8 and our management information circular have all been -- all the details you'll need to know to participate. We hope you will be able to join us, and goodbye for now.

Operator

And this concludes today's conference call. Thank you for your participation. You may now disconnect.
