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EDITED TRANSCRIPT

EQB.TO - Q3 2015 Equitable Group Inc Earnings Call

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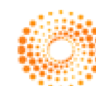

CORPORATE PARTICIPANTS

Andrew Moor *Equitable Group Inc - President & CEO*

Tim Wilson *Equitable Group Inc - CFO*

CONFERENCE CALL PARTICIPANTS

Jeff Fenwick *Cormark Securities - Analyst*

Shubha Khan *National Bank Financial - Analyst*

Graham Ryding *TD Securities - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen. And welcome to Equitable Group's third quarter 2015 conference call.

Before we begin, we would like to remind you that certain forward-looking statements may be made on this call. Including statements regarding possible future business, and growth prospects. You are cautioned that such forward-looking statements involve risks and uncertainties detailed in the Company's periodic filings with Canadian regulatory authorities.

Many factors could cause actual results or performance to be different from those expressed by such forward-looking statements. Equitable does not undertake to update any forward-looking statements made by itself or on its behalf, except in accordance with applicable securities laws.

This call is being recorded for replay purposes. It's now my pleasure to turn the call over to Andrew Moor, President and CEO of Equitable Group and Equitable Bank. Please go ahead, Mr. Moor.

Andrew Moor - *Equitable Group Inc - President & CEO*

Thank you, Nick, and good morning to everyone. Joining me is Tim Wilson, Chief Financial Officer for the Bank. For those on the phone, I would encourage you to download our regular slide deck from equitablebank.ca following our call.

Today, we will discuss the Bank's record third-quarter results and outlook for growth and performance, while also touching on the launch of EQ Bank, our mobile and online banking platform. Given that the considerable time and effort into building a future in an open market, and we're excited about its potential to add ways that we deliver excellent service to Canadian savers. I'll have more to say on this later.

First, let's turn to the third-quarter results. Equitable earned a third-quarter record CAD31.4 million or CAD1.93 per share, as we efficiently translated double-digit year-over-year growth in mortgages under management into great results for our shareholders. Those earnings, combined with the Bank's ongoing effectiveness in deploying capital, produced an ROE of 17.5%, which is right in line with the high standards of value creation Equitable has achieved over many years.

As you know, our goal is to be consistent producers of dividend growth. And while this is neither a forecast nor a promise, we aim for at least 10% dividend growth per annum. With the strong earnings growth we have achieved this year, our posted outlook and in keeping with our goal, our Board elected to increase the common share dividend by CAD0.01 to CAD0.20 on a quarterly basis with the payment on January 7.

This marks our seventh dividend increase in four years, and results in a dividend that is 11% higher than the dividend that we declared last year at this time. This demonstrates our Board's confidence in the Bank's earnings power.

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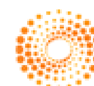

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We couldn't have accomplished any of this without our team. People development is something that our leadership team makes a priority, and I'm thrilled to tell you that our efforts have recently been recognized. Just last week, it was announced that Equitable was an Aon Hewitt Best Employer for 2016, which places us in the elite top 40 with a gold standard. The competition was judged on the basis of employee engagement, and means that our employees speak positive about Equitable to others, are committed to staying with us, and are motivated by our leaders and culture to go above and beyond to contribute to the Bank's success.

Turning to lending markets. The Bank continues to attract higher volumes, by providing outstanding service to borrowers and mortgage bank [broker] professionals. Our record third-quarter originations of CAD744 million, our Single-Family mortgage principal increased by 27% year over year to CAD6.2 billion, a new high watermark.

The 15% plus year-over-year growth in originations reflected the strong performance from most of our regional markets. This strength was enough to overcome a 43% decline in Single-Family originations in Alberta and Saskatchewan compared to last year. We expect conditions in these two provinces to remain depressed on the origination side for awhile.

The inaugural service team that you see recently predicted that Canada's housing market as a whole will cool somewhat over the next two years, and the risks are elevated. This not surprising for us. It means we need to continue focusing around building, borrowing on broker[affinity] in all regional markets, but also, and as always, to keep merging our risks prudently.

The Equitable team received more recognition from the broker community this year, as Canadian Mortgage Professional magazine awarded our sales team a gold medal to best (inaudible) our team in alternative lending. In addition, our marketing team received a silver award for best broker support.

Kim Kukulowicz, our VP of Residential Sales, and her whole team have worked hard to earn these honors, and put us in such good stead with the brokers. So my thanks go out to all of them.

With all of that and based on what we know today, we expect that year-over-year growth of the Single-Family portfolio will remain at approximately the same high level in the fourth quarter as in the third quarter. And then just below that level in 2016. I'll add some caution to that outlook by stating that comparative conditions are uncertain these days, and any changes could affect our originations and portfolio growth.

Commercial origination growth are up, this time by 22% year over year. We've discussed market conditions in our [perks] business on the past calls, and they remain unchanged. As a result, we expect our ongoing pricing discipline and the perimeters parameters to produce good results for our shareholders, even as the Commercial books remain at or slightly below the current level of CAD2.2 billion in Q4 and into next year.

I'd also like to highlight here that we are excited about recently hiring Darren Lorimer to lead our Commercial business. Darren is an experienced commercial lender, and joins Equitable with over 20 years experience at one of Canada's large banks. As we believe he will have a positive impact on our competitive position.

Turning to Securitization Financing prime mortgage growth had a very positive influence on mortgages under management, which were up 31% year over year to CAD7.5 billion. The key to this growth was our prime Single Family business. Our prime business funded CAD523 million of Single Family mortgages in Q3, up almost 38% sequentially. This number includes volumes originated directly by our internal team, and volumes sold through third-party partners. We're pleased with these early results.

Looking ahead, we believe that the level of origination and securitization activity for our prime business will increase in Q3, as we successfully expand our broker relationships and geographic coverage. As a result, prime mortgages will be the key driver of growth in overall Securitizing Financing MUM.

From an earnings perspective, we chose not to sell any I/O strips in the third quarter, as we had previously expected. And accordingly, did not benefit from any up front gains on sale. This decision was driven by the fact that many of these mortgages we originated recently are in MBS pools

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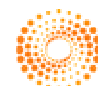

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that are retaining the strips for now to create more long-term value for our shareholders. Our intention is use I/O strip sales on the transaction that creates [e-recognition] treatment regularly in the future. And we believe that volumes will be more significant beginning in first half of 2016.

Turning to credit. The very solid underwriting standards we operate with and I described last quarter, including income verification, continue to serve us well. While another financial institution renewed from the threat of [performance] for profit or for shelter, we have made it very constant Equitable's practices in the high quality of our book.

[Entitlement] loan balances were up a bit from the last quarter, but I'm not overly concerned about the trend. The balances were exceptionally low last quarter, and just returned to levels more in line with the earlier part of the year. Another point I'd make is that there are not any large commercial exposures behind the increase.

A good metric for the high credit quality of the banks, mortgage portfolios and impairment [summersion] which reflects the level of newly recognized losses anticipated on our impaired loans. It amounts to less than 1 basis point in the quarter.

To be prudent though, we added CAD0.4 million to our collectible allowance in the quarter. As a reminder, adding to our already high collectible allowance in this way is an approach much more conservative than you'd find at other Canadian banks. This approach had a CAD0.03 negative impact on EPS.

Touching on another topic of interest, you may remember that late last year and early this year we took proactive steps to insulate the Bank from deteriorating economic conditions in Saskatchewan and Alberta. To highlight a few metrics about the quality of our portfolio in the west, the current LTV or uninsured mortgages and note promises of 67% reflecting our conservative lending stance. (Inaudible), our uninsured mortgage portfolio in Alberta and Saskatchewan, is in the major cities of Calgary, Edmonton, Saskatoon and Regina, where the economies are more diversified and [the fund] it's not solely reliant on the energy industry.

Our risk management strategy paid off to date in Alberta and Saskatchewan, and will continue to do so. It's not clear when we will see arrears uptick in those provinces, but with the jobless rate declining, Q4 or early 2016 [has some] possibilities. In with these dynamics, we believe that arrears rates of impairment versions remain low in the fourth quarter at a national level based on current economic indicators.

I'll now ask Tim to provide his report. Tim?

Tim Wilson - *Equitable Group Inc - CFO*

Thank you, Andrew.

In Q3, net interest income grew 19% year over year. The driver was 21% growth in average asset balances, which more than offset the decline in NIM. You'll recall that we expected total NIM to decrease slightly on account of a combination of factors. Including lower levels of prepayment income, the high relative growth of our Single-Family assets, and continued convergence of the growth rates in our Core Lending and Securitization Financing portfolios.

Quarter three was in line with those expectations. Core Lending NIM decreased by 7 basis points, primarily because we almost doubled the size of our lower spread liquidity portfolio. The liquidity portfolio was up due to an unusual bulge in GIC maturities and mortgage funding, which require us to keep more cash on hand.

Even though we had no trouble raising the funding for these applications, when our expected future cash outflows are high, we bulk up on our liquidity portfolio to protect us in the unlikely event of a disruption in the funding markets. We expect our liquidity portfolio to drop substantially in Q4, and for that to have a positive impact on NIM, the opposite of what we saw this quarter.

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Core Lending margins saw a benefit from us having added some new cost effective funding sources last quarter. On the other hand, Securitization Financing NIM was up by 1 basis point over last year. Thanks mainly to prepayment income, which was higher than expected and which offset the anticipated spread compression within the book.

Focusing on the quarterly trending, NIM was down due to a decline in Core Lending margins. Core Lending was down by 6 basis points, as a result of several factors, including our liquidity portfolio growth and a decline in prepayments income. Looking ahead, we expect net interest income to increase at year-over-year rates in the low to mid teens throughout 2016 due to ongoing growth from the Bank's assets, and despite a slight decrease in NIM. Consistent with our view for the past several quarters, NIM will likely decline in Q4 and next year mainly as a result of changes in our asset mix that are explained in detail in the outlook section of our MD&A.

Other income was lower in the period compared with the prior quarter and the prior year, despite an increase in mortgage administration fees. Within other income, Securitization gains were down because of the volume of mortgages that qualified for derecognition. As a reminder, we did not sell any I/O strips in Q3, but were able to derecognize some mortgages anyway. This is accounting treatment that is unique to non-prepayable multi-unit residential mortgages. We also recorded a slight loss in some derivative positions, which had an even more cramped impact on our quarter-over-quarter comparative because we recorded a gain last quarter.

Moving to non-interest expenses. We continue to make investments that build the Bank's franchise and customer service capabilities. Sequentially, expenses were relatively flat, but there were a number of puts and takes under the headline number and we provide the highlights in our MD&A. One important point to note is that expense volatility was reduced as a result of the RSU and DSU hedging programs that we put in place midway through last quarter.

On a year-over-year basis, third-quarter non-interest expenses grew by 25%. 74% of that increase was due to growth in our franchise, including hiring to support origination growth and risk management. The remaining 26% was for investments in our strategic initiatives, including systems costs, and marketing in support of our digital banking launch. We invested a total of CAD3.4 million in these strategic initiatives in the quarter. But the majority of that was capitalized, and will flow through expenses in future quarters beginning in Q4.

As you know, we were expecting to invest an extra CAD3 million to CAD5 million in marketing in the back half of 2015. We very recently chose to defer that spending to early 2016 because we think that we will be able to better reach our customers then, and will achieve better value for our money and our advertising dollars. The odds of cutting through the clutter of seasonal advertising are much lower in November and December.

Marketing investments will continue throughout 2016 to provide ongoing support for our digital initiatives, but at lower levels than in Q1. As the cost of incremental marketing should be largely offset by gain on sale revenue generated from securitized mortgages, the impact on quarterly EPS should be minimal.

Over the next five quarters, all other non-interest expenses will generally increase at rates in line with overall business growth. As a result, we expect that our efficiency ratio in Q4 will be consistent with Q3, and then increase in 2016 as a result of our strategic investments.

Our capital ratios continue to surpass minimum regulatory standards, and most industry benchmarks. We expect to continue operating above those benchmarks as we grow, including above the Basel III leverage ratio which we began to report in Q1.

Now, back to Andrew.

Andrew Moor - *Equitable Group Inc - President & CEO*

Thanks, Tim. Looking ahead, we are confident that our assets will continue to grow at healthy rates, supported by our service quality, but likely at rates a little slower than what we experienced so far in 2015. Our access to funding and our capital position are solid, and will support this growth.

Before we next report to you at the end of February, what we at Equitable anticipate the most is the launch of EQ Bank, our mobile online banking platform. This platform will take Equitable to the next level of the branchless bank. Under the leadership of Dan Dickinson, Vice President of Digital

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Banking, our digital banking team has put a tremendous amount of work into the creation of the platform and the consumer awareness campaign will kick off in the first part of 2016.

This initiative was put in place with two goals in mind. Firstly, to launch a product that delights Canadian savers and broadens our franchise. And secondly, but not as importantly, firmly diversify our sources of funding.

As this is our first foray into online banking, we are unencumbered by legacy technology and entrenched IT thinking that have be known to hamper digital launches at other banks. And because we do not have the overhead of branch networks, we can pack a lot more value into our online products to consumers, and still deliver great returns for our shareholders.

As with our savings products, our branchless business model allows us to offer a higher rate of interest to Canadian savers. This means Canadian savers who [achieved] an EQ Bank savings plus account will earn more and keep more every month. That's a huge plus.

Investor economics suggest that Canadians have about CAD420 billion in accounts earning almost zero interest. That's not good for savers who are in aggregate leaving billions of dollars a year of interest on the table compared to what they could earn by saving with EQ Bank. That's a substantial opportunity for us to bring benefit to Canadian savers. To put the plus in savings plus in other ways with unique functionality, we'll save most of those details for later for competitive reasons. But we'll share one example to give you some sense of our approach.

We've harnessed our (inaudible) consumer behavior in digital banking, hence using well known as smart savings settings. These settings allow savers to easily allocate funds to sub accounts to help them meet their specific personal goals. So for example, if you keep money aside in one sub account to pay tuition, another account to fund their patient plans and the third to save gifts. All these sub accounts are accessed from a single screen, so our clients can divide and conquer with ease. We think this capability will make a world of difference in helping Canadians focus on and achieve their savings goals. The platform has an elegant and intuitive design that consumers will find easy and quick to access and use, and is powered by a globally recognized core banking system.

But supporting EQ Bank launch saw a significant investment in the consumer awareness campaign. Remarkably, given that we have already have an CAD8 billion savings business, this is the first time in Equitable's history that we will engage in [bold] advertising campaign to support our brand. We think the investment is crucial to building consumer awareness.

Let me be very clear here. While the direct to consumer nature of EQ Bank is an new approach for Equitable and could grow in importance over time, we have no intention of returning mortgages through this channel and will always support the multi deposit broker channels that have been critical to building the Bank to where we are today.

To summarize our prepared remarks, the Bank delivered record third-quarter earnings, managed our risks effectively, and recorded very low loan losses, raised the common share dividend for the seventh time in four years; and on the strength of this high quality book and growth and diversification strategy is gearing up for another productive and profitable year in 2016.

That concludes our prepared remarks, and now we'd like to invite your questions. Nick, can you please open the line to our callers?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Jeff Fenwick at Cormark Securities.

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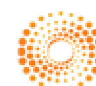

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Jeff Fenwick - *Cormark Securities - Analyst*

Hello, good morning. I just wanted to start off focusing in on the expense growth. You gave us some color there, and its been obviously trending high to higher at a pretty rapid rate and it looks like it's going to continue higher into 2016. And it's just dense I guess a little bit of the growth that you're getting from the loan book in the business here. So how should we be thinking about that a little longer term? Is there a point here through the back half of the year when that efficiency ratio can start to dip more meaningfully looking forward?

Tim Wilson - *Equitable Group Inc - CFO*

Hello, Jeff, it's Tim. Thanks for the question. I wouldn't expect it to dip within 2016. I think you'd probably have to look a little longer term than that. And remember, a lot of the investments we're making now are for the long term, so they won't pay off over the next couple quarters. I think it's probably out middle of 2017, beginning in 2018, where you'd see the efficiency ratio start to return to more normal levels. These are really important investments we're making for the Bank's future. And when we look at it over the long term, there's definitely the payback there but it is going to have that negative impact on our efficiency ratio in the near term.

Jeff Fenwick - *Cormark Securities - Analyst*

Okay. And I guess one thing. Just within that, I look at the headcount growth here. You're up over 25% year over year. How do you think about it from a risk perspective here? You're going to have, I guess you would have almost a quarter of your workforce that would be new within the last year. So what's the approach to managing that? You mentioned some of these are just to help with growth in terms of originations in underwriting, and clearly that's an area where you'd want to be well trained and monitored. So what's the approach to managing that growth?

Andrew Moor - *Equitable Group Inc - President & CEO*

I think, Jeff, that's the way to think about it. So when you think about digital banking, it's an entirely new team with a new mandate, and clearly that team comes together and builds something from scratch as a standalone entity. And isn't putting general pressure on just -- it's not like every department is growing at 25% which would clearly raise control issues.

But when you actually look at the individual department levels, while we have been adding headcount in those critical areas, underwriting and so on and Single Family, the growth is definitely manageable. We have a top notch trainer in house, we've got some on Board people so they understand our credit criteria in all the controls we have in place. So and I'm very comfortable that we've got the right control environment in place and [the timing improvement] over the last year is truly spectacular. So I think that it really positions the organization well for the future.

Jeff Fenwick - *Cormark Securities - Analyst*

Thanks. And maybe we could move on to competition. It was mentioned in passing in the disclosure and the MD&A in there. What are you seeing with respect to the competitive environment? I imagine some of the disruption we've seen this year with other competitors, it may have created an opportunity for you. Are you seeing new entrants or changes in the competitive space?

Andrew Moor - *Equitable Group Inc - President & CEO*

A little bit. And I think clearly, probably we were gaining share around this time last year without truly understanding what was behind it in terms of other issues and other (technical difficulty). I would say that we're seeing a little bit of [orension] a little bit more active in the market than we would have previously seen or B2B. So it's definitely having some impact, but generally, the competitive landscape is still continues to be the same players that we've talked about historically.

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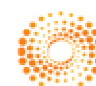

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Jeff Fenwick - *Cormark Securities - Analyst*

And then credit loss is always top of mind. I guess the thing that continues to impress me is just how low you've been able to keep the loss provisions and the charge-offs. And you mentioned -- you gave us some indication you think you should start to see it through the end of the year. I would have thought we would have seen it by now already frankly. And how do you put that in context, and think about how you stand heading into the next year and how that's going to evolve?

Andrew Moor - *Equitable Group Inc - President & CEO*

I don't think this does surprise us. Actually, I think it's so far so good with Alberta, but we're certainly not taking Alberta and Saskatchewan. But we're certainly not taking a view that the so far so good actually means very much, even when we -- even this time last year or just a bit later maybe by the middle of December when it was clear what was happening in commodity prices and when we actually dialed in our credit appetite in those provinces, we thought it might well take nine months to a year before we'd start to see things unfold. And the employment situation doesn't change that quickly, people have savings and so on. So, so far so good.

We feel like we've done what we have to do as a management team to position ourselves well for whatever comes ahead. I certainly am concerned about what Alberta might look like prior to March next year. It doesn't feel like things are moving fast enough in the market that we're going to have particular concerns by the end of the year, but I could be wrong on that. So I'm going to spend some time in the province over the next few weeks. And we continue to remain committed and it's a very important market. Alberta has its history, but it always comes back. And that is our view, that it will, and it will come back strong and we want to support our customers through what's obviously a difficult period. And so we're committed to -- we're committed to our employees in the province, and we're committed to building our franchise there. This is just a time for extra caution.

Tim Wilson - *Equitable Group Inc - CFO*

And, Jeff, I wanted to [slice] it all. I'm sorry, I'll add to that is that we've said in prior quarters, we continue to run pretty severe stress tests in our portfolio in that province. And believe that even if impaired, or sorry, even if arrears do pick up and impaired loans pick up, any losses we'd would experience are manageable for the Company.

Jeff Fenwick - *Cormark Securities - Analyst*

And I guess within that, the thing I'm trying to gauge is how quickly that can move. It seems like if it hasn't happened in a meaningful way yet, would there be a quarter where you suddenly have a big uptick? Or is this something that evolves over six or nine months? Because when I look at it from a loss provisioning perspective, it's quite meaningful to the earnings outlook obviously going forward here. And whether you get a step function change there, you suddenly have to do some catch up on the loss provision or whether it's trends into the numbers over the course of six or nine months.

Andrew Moor - *Equitable Group Inc - President & CEO*

I would expect it to be more like that nine month build. Even though I had the chance to see how the US sub prime, and I'm not suggesting by the way that's anything (inaudible). But if you look at the shape of both curves, they don't go in step function. You tend to see an increasing trajectory before you see deceleration and flattening. And I think that's just the history when you look at housing markets around the world with a (inaudible) or a correction. But I wouldn't expect to see a step function. We might see evidence of increasing deterioration, but I think once you start to see a deterioration, it will be a fairly long [burn].

I wouldn't stress, by the way, just again, I think it's always instructive. If you look at our level of collectives compared to all of our peers, we're extremely well reserved. And we made the point in the script about how much that impacts us in the short term in earnings against -- these reserves

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we're setting up without any identifiable specific loss against them. And if you'd look at and see how we compare to all of the major banks and all of the group that you generally think about in our coverage universe, we have extremely conservative provisioning in that regard.

Jeff Fenwick - *Cormark Securities - Analyst*

Okay, thank you. That's all I had.

Andrew Moor - *Equitable Group Inc - President & CEO*

Thanks, Jeff.

Operator

Our next question comes from the line of Shubha Khan at the National Bank Financial.

Shubha Khan - *National Bank Financial - Analyst*

Thanks, good morning. So I had I guess a follow-up to Jeff's question on credit quality in Alberta. Just wondering, have you made any changes or any further changes to underwriting in Alberta or Saskatchewan? And I guess in an effort to grow those loan books more selectively or more conservatively?

Andrew Moor - *Equitable Group Inc - President & CEO*

Well, I think we have -- we've talked about this in other calls. We haven't made any changes since the last call. But in December of last year, we dialed back on the loan to values generally in Saskatchewan and Alberta in our Single Family credit book. And then in February of this year, we were more selective again in dialing back in certain types of property that we were more concerned about. Probably the ones that are the most obvious, which would be the lowest value homes that tend to have more severity associated with corrections. And also the highest value where you could see some houses at the higher end that tend to be more volatile price in the housing correction. So we made those decisions in February, really anticipating exactly what's unfolded. I think what's happened, happens in fairness, completely consistent with the view we had back in December and February of last year.

And as you're probably aware, we're pretty connected with the Alberta market. I've lived there for a number of years. We have a very strong leader in the Alberta market. So I think we've done a good job in adapting to what comes to us, and we're handling all of our responsible [wares]. As I mentioned, we're very concerned about making sure that our employees are excited to be still working with Equitable and we look after our customers.

On the other hand, we obviously have [other] obligations to our shareholders and other positives as well, so trying to thread that needle and I think we've done a very good prudent job. In fact, we saw some of our competitors be much slower than us to adjust [to the new parameters], although I do believe that some of them moving to follow us around about now.

Shubha Khan - *National Bank Financial - Analyst*

Okay, sounds good. The prime Single Family business, that's been ramping quite nicely. But I guess in light of the fraud issues that surfaced at Home Capital earlier this year, I guess I'm curious as to how diversified the sources of origination are? Is the bulk of your prime Single Family business coming in from a handful of brokers let's say in Ontario, or is it from a number of brokers spread out across the country? And maybe if I could even more specific, how large is the single largest slice of the mortgage volume that is being sourced by one broker or brokerage?

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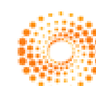

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Andrew Moor - *Equitable Group Inc - President & CEO*

In the prime space alone?

Shubha Khan - *National Bank Financial - Analyst*

In the prime space, yes.

Andrew Moor - *Equitable Group Inc - President & CEO*

So we actually, as you know we know the brokers very well and we've listened to (inaudible). So we actually went out more selectively. We're certainly happy to deal with the people on the deal within the prime business to be clear.

But in order to prove our systems and our customer service approach, we went and approached some brokers that we believed represent some really high quality business. And have chosen to make some selective arrangements with them in exchange for volume. And so I think the biggest one is to be (inaudible) quite big. So maybe 15% of our total flow is coming through one broker, who I would say we have a strong relationship of trust with, and have every belief that the quality of the book is great. So that's where we are coming from.

I think the risks come as they get slightly broader. And we're buying from -- we're also buying, as we obviously mentioned, about talking about the flow of transactions that we believe that individually dealing with brokers one by one. And then we deal with another large originator, they're buying in bulk, and they've got very good processes in place to make sure there's no issues coming through.

Shubha Khan - *National Bank Financial - Analyst*

Thank you. So no extent that any single broker or brokerage accounts for a large slice of the flow, these are longstanding relationships that you're comfortable with, and you're comfortable around the QA process as well. Is that fair to say?

Andrew Moor - *Equitable Group Inc - President & CEO*

I think that's fair to say. And I think it's fair to say that the geographies in which we are originating these mortgages are not those that were typically associated with this kind of activity.

Shubha Khan - *National Bank Financial - Analyst*

Okay. Just going on to the funding side of things. You're continuing to make progress on diversifying your sources of funding. You gave us some more color on EQ Bank, and then -- I think traction with the HISA as well.

So just wondering how that might impact the outlook for net interest margins going into 2016. Should we be looking for slightly tighter spreads on your mortgages, given your funding diversification initiatives, or how should we think about that?

Tim Wilson - *Equitable Group Inc - CFO*

Shubha, this is Tim. So we've given you guidance in the outlook section about how we expect NIM to trend next year. And as you noticed from that, there are going to be some subtle changes in the NIM within each portfolio and overall. But it's mostly driven by asset mix, rather than funding mix.

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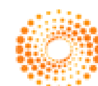

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So we've seen a little bit of benefit in NIM this year from adding those new funding sources since they are more cost effective for the Company. So that's been good news. But I think that that effect is going to level out as we proceed through 2016. And I think EQ Bank has the potential over the long term to be helpful to margins. But I think initially, the volumes won't be substantial enough to have much of an impact, at least in 2016.

Andrew Moor - *Equitable Group Inc - President & CEO*

Just to be clear, we're likely to go out with a rate that surprises you in terms of being high. And not that I wouldn't extrapolate that as the cost of funding over the long term. Don't forget, when you first launch, we have one unique advantage when we first launch is we have no balances in the accounts. So one can think of going out with a rate that grabs some attention as being a relatively low-cost promotional item, at least in the first year.

So that is our intent is to start with a rate that grabs attention, and then back off to a rate that's still attractive every day to everybody and it's a very compelling part of our marketing mix. But perhaps it isn't something that is a number that should be built into the models over the longer term or from just a pure financial modeling perspective.

Shubha Khan - *National Bank Financial - Analyst*

Okay. Final question maybe for Tim again. I guess you're contemplating IO strip sales going into 2016, and Andrew indicated that volumes will be significant as we head into next year given the amount of time Single Family that you're already originating.

Is there any additional guidance that you can give us on how significant IO strip sales could be? For example, how much of your prime Single Family going forward might you want to derecognize? Just wondering how we should be thinking about that as this becomes a more significant piece of your overall business?

Tim Wilson - *Equitable Group Inc - CFO*

Yes, it's a good question. Because we have said we're committed to a program of IO strip sales going forward. And I think the challenge is it's a tough number to forecast, primarily because the economics of mortgages that we're originating at any point in time can impact our decision to sell or not sell.

So I think Andrew highlighted that the nature of the mortgages, the economics of the particular mortgages we have originated recently have been such that it's much better for long-term value creation for us to have retained those. Rather than sell the strip on those mortgages. So with that caveat, I'll say that our broad view is when we look out over the next year or two, that when we look at the prime Single Family that we originate, we would be selling strips in roughly 50% to 75% of those volumes.

Shubha Khan - *National Bank Financial - Analyst*

Okay, that's helpful.

Tim Wilson - *Equitable Group Inc - CFO*

That's roughly the target that we have in mind, so it could vary, as I mentioned, because of those economic factors.

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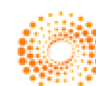

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Andrew Moor - *Equitable Group Inc - President & CEO*

Just generally speaking on a little bit behind what Tim was saying there. When interest rates are dropping, you end up having fatter strips actually than you otherwise would. So you give up more economics when you sell the strip. In a rising interest rate environment, that's less likely to be the case. So that is one of the things that impacts the relative tradeoff between for the shareholders and the strip buyer is to [now exactly have an] interest rates while we're actually originating the mortgages.

Shubha Khan - *National Bank Financial - Analyst*

Perfect, thank you.

Operator

(Operator Instructions)

We'll take our next question from the line of Graham Ryding at TD Securities.

Graham Ryding - *TD Securities - Analyst*

Good morning. Maybe I could follow on just on that interest only strip topic. Can you give us some color on your comfort on the demand for the IO strips? It sounds like it's more a decision coming from your part based on the economics that are out there right now. And so are you comfortable that when you decide to go into the market that there's enough demand to offload what you want?

Tim Wilson - *Equitable Group Inc - CFO*

Absolutely, Graham. We've said that in prior quarters, that we've developed a good network of potential investors, and believe that there's more than enough demand for this product. It's the supply question that's limiting the sales that we're doing.

Graham Ryding - *TD Securities - Analyst*

Okay. And then can you talk about the funding costs, both on the deposit base side of your business, also the prime side? Are you able to maintain your mortgage spreads right now, or is competition such that there's a spread compression?

Tim Wilson - *Equitable Group Inc - CFO*

Probably I'll answer that question in two parts. So on the broker deposit side, I think 2015 has been fabulous. There's been solid demand from the product through those channels, and the costs on the GICs, when you look at the absolute interest rate, are lower than we've experienced in other recent periods. But that channel has been performing well.

I think in terms of the funding for securitized mortgages, the MBS market hasn't behaved the way we wanted it to this year. Spreads in that market have really opened up over the course of the past six months, and as a consequence have had a negative impact on the spreads within that business. And we do mention in the outlook section of the MD&A that we expect those conditions to persist for the near term, and that to be operating with lower margins on the prime business.

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Graham Ryding - *TD Securities - Analyst*

Okay, great. And could you give us an idea of your mix? You had very strong originations on the prime side, and I understand part of it is what you originate yourselves and part is coming from a third party. Can you give us a feel for what the mix was this quarter?

Andrew Moor - *Equitable Group Inc - President & CEO*

Yes, Graham. Roughly CAD100 million or so the origination, I think it's actually in the MD&A of about CAD100 million or so was our own direct originated, and the balance was being booked through [brokers].

Graham Ryding - *TD Securities - Analyst*

So that's a step up, and CAD100 million is I think correctly is up from last quarter and year over year in a material fashion. Is that correct?

Andrew Moor - *Equitable Group Inc - President & CEO*

That's right. And I don't think we had any launches in August of last year, so clearly we're building up the platform.

Graham Ryding - *TD Securities - Analyst*

Great. And then just my last question. Tim, you mentioned that you had a lot of deposits come to maturity this quarter, and then you had to use your -- you had to increase your own liquidity to offset, but it looks like your liquidity ratio actually dropped in the quarter. Am I missing anything there, I'm feeling it makes --?

Tim Wilson - *Equitable Group Inc - CFO*

You're absolutely looking at that the right way. I think the nuance to that is what you're looking at is quarter end balances, and what impacts our margins over the quarter is the average balance. So the average Q3 versus Q2 was way up, even though the ending balance was down. And I think the ending balance reflects the drop in the liquidity portfolio that we expect going into Q4 that I mentioned in my remarks. Does that make sense?

Graham Ryding - *TD Securities - Analyst*

Yes, that makes sense. So that liquidity ratio going into the Q4 or in Q4 should be higher?

Tim Wilson - *Equitable Group Inc - CFO*

It should be -- the liquid asset ratio? The liquid asset [trails] and total assets will be lower in Q4.

Graham Ryding - *TD Securities - Analyst*

From the [5.7%] as for Q3?

Tim Wilson - *Equitable Group Inc - CFO*

Yes, it will come down a little bit off that, yes.

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Graham Ryding - *TD Securities - Analyst*

Okay.

Andrew Moor - *Equitable Group Inc - President & CEO*

We are able to projecting forward on liquidity. So we're seeing a snapshot in time at the end of the quarter that's really projecting our liquidity and is factoring in many have practiced that we anticipate coming off over the next few months.

Graham Ryding - *TD Securities - Analyst*

Okay, thank you.

Operator

Mr. Moor, there are no further questions at this time. Back to you.

Andrew Moor - *Equitable Group Inc - President & CEO*

Thanks, Nick. As there are no other questions, we look forward to reporting our full-year results in February, while the sales are little early. And since we won't be speaking to you before then, I wish you all a Happy Holidays and a positive new year. Thanks for listening and goodbye for now.

Operator

Ladies and gentlemen, we thank you for your patience. This concludes the conference call for today. We thank you for your participation. You may now disconnect your line, and have a great day.

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