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EDITED TRANSCRIPT

EQB.TO - Q3 2016 Equitable Group Inc Earnings Call

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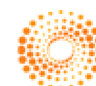

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Graham Ryding *TD Securities - Analyst*

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PRESENTATION

Operator

Good morning, ladies and gentlemen. I'd like to welcome shareholders and analysts to Equitable Group's third-quarter 2016 conference call.

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 Bank. Please go ahead, Mr. Moor.

Andrew Moor - *Equitable Group Inc. - President and CEO*

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

During today's call we'll touch on the main drivers of our record quarterly earnings performance, which provided support for our second dividend increase of the year. Our slide deck at eqbank.ca that accompanies our remarks is a valuable reference tool that I encourage you to review as part of your analysis, with the MD&A being the definitive source of information.

From an origination perspective, the quarter was Equitable's best ever, better than Q2 of this year, which was our first CAD2 billion period, and better than Q3 of last year by over CAD386 million, or 22%. Total originations were CAD2.2 billion and reflect a strong progress in all of our key business lines.

The most important contributor to our earnings is single-family alternative lending. It achieved its first ever CAD1 billion quarter, originations up 41% year over year. This primarily reflected ongoing market share gains in the broker channel, which is the result of our outstanding service quality.

Based on publicly available data, we believe we've added meaningfully to our market share since last year. And, of note, we did not materially change our pricing or risk parameters to get it. Origination increases were also supported by modest growth in the alternative market overall.

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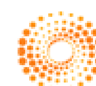

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Single-family alternative mortgage principal ended the quarter at CAD7.5 billion, up 21% from a year ago, with positive implications for earnings in the current quarter and into next year. For the second consecutive quarter since refining its approach to the market, commercial lending operations posted strong performance.

Commercial originations grew by 56% to CAD367 million, its most productive period in almost five years. There are a number of reasons for this resurgence. Most important among them is an intense focus on customer and broker service, which has caused and increase in commercial deal flow. That's good for shareholders, but so is the fact that in funding these new commercial loans we have not altered our hurdle rates, emphasis on asset quality, or in any way deviated from our policy of lending on first position mortgages only, and only to a maximum of 75% LTV. The returns from this recent growth should therefore be attractive, as always.

Commercial's a large market with many comparators, so it's always a bit hard to assess competitive intensity than our other segments. But it does feel as though there's been a more favorable competitive landscape in recent months. Commercial lending mortgage principal now stands at CAD2.7 billion,19% ahead of last year and up 9% from the June 2016 quarter.

In the prime mortgage market, internally generated mortgage originations amounted to CAD228 million, more than twice the volume we attracted a year ago. As this growth shows, we are gaining traction with our prime strategy, which is built on leveraging existing mortgage broker relationships we formed over many years from our ALT business, leverage our existing processes and technology to deliver great service, and leveraging our access to cost competitive funds provided by Equitable's MBS securitization allocation.

Securitization and financing mortgages under management were a record CAD9.7 billion at quarter end, up 31% from a year ago. This rapid rate of growth was assisted by the fact that our prime business is relatively new so there are limited maturities and runoff.

I've said it before and I'll say it again, that Equitable's success is due to the great people working incredibly hard to deliver exceptional customer service, while always employing high standards for underwriting and risk management. Recently Equitable has been recognized for having a highly engaged workforce, which is an essential ingredient for creating shareholder value and delivering all of our strategies.

I'm referring to the fact that for a second year in a row Equitable was chosen as one of Canada's top employers. And this year we graduated from the gold to the platinum category in Aon Hewitt's prestigious best employer survey. Yesterday's Canadian Business Magazine contained full details. And, as you will see Equitable ranked ahead of some very well-known companies and banks.

Of course, all of this adds up to performance for shareholders. Equitable did that once again with a diluted EPS of CAD2.16. That's a new quarterly record, 12% above last year and 5% above Q2 of this year.

While delivering these results we have continued to invest in our strategic initiatives at a cost to EPS of CAD0.19 per share. We're making these investments because they greatly enhance our brand and market position as a branchless and now digital bank, and will allow us to deliver increasing value over the long term.

On record quarterly earnings, the Bank produced an ROE of 17.2%. This is largely in line with Equitable's long-term track record and is ahead of the average performance of Canada's big six banks and our other two regional Schedule 1 banks. This return is very consistent with our shareholder value-creation approach, which is s set out in more detail in my letter to shareholders in this year's annual report.

Keeping with our goal of developing a track record as a business giving steady dividend increases, our Board increased our common dividend for the second time this year, this time by 5%, meaning the dividend to be paid on January 5, 2017 will be 10% ahead of the dividend paid in the same period last year. While paying an increased dividend we have kept our CET1 ratio high in order to provide a strong foundation for the Bank's future growth.

Moving on to credit risk, you will note that net impaired mortgage assets are CAD32.6 million, were 0.19% of the total mortgage book, down 2 basis points from a year ago. Our allowance to credit losses represented 0.2% of our total loan assets at quarter end. This is much higher than the Bank's average loss rate of 4 bps over the past 10 years, and means, in simple terms, that we are well protected.

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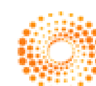

The allowance represents the amount the Bank has reserved on its balance sheet to absorb potential future losses, and shouldn't be confused with provision for credit losses. The provision for credit losses, which represents the net additions to that allowance in the current quarter that you will see on our income statement, was CAD1.2 million in the third quarter. This was up from a year ago and from Q2, but in line with the Bank's long-term norms.

Just as a reminder, this is a provision against specific loans that we take following a deep loan-by-loan analysis of our portfolio and reflects our best estimate of losses that we expect to take on impaired loans. From current economic forecasts we expect arrears rates and credit loss provisions to remain low for the remainder of 2016.

I would invite you to review our credit metrics for Alberta and Saskatchewan, which can be found in our MD&A. There you will find our early-stage delinquencies were down in the third quarter from the second quarter, an encouraging sign.

You will also see that the impaired loans in Alberta and Saskatchewan did increase by CAD2.6 million from Q2. Over the first three quarters of 2016 we have taken a total of CAD600,000 of provisions against this group of loans. I would not expect to see a material decrease in this level of impaired loans for the next few quarters.

We understand the risk in these markets, and have no desire to underplay it. We do take some encouragement from forecasts showing positive GDP growth in Alberta in the next two years. However, we still remain cautious about lending in these markets in both our single-family and commercial businesses.

Now to turn to another topic -- the new Department of Finance Mortgage Rules and the implications for our business. These changes have a lower impact on Equitable than other lenders since, they relate to insured single-family residential mortgages, which until now have been a breakeven business for Equitable. These changes may have a second order impact on our alternative business, which might even be positive. Our commercial businesses are not affected.

Since the changes have been widely reported, I won't repeat them, but rather I would start by saying that it will take some time before their full effect is felt and some time before we can be definitive about what they mean to the Bank. However, we state our preliminary view of their impact on the overall market in the MD&A and I would summarize it this way. These changes will reduce the size of the insured mortgage marketplace. As well, some buyers will simply take themselves out of the purchase market and rent or delay the process of household formation instead. This is a view shared by most lenders.

As a result, most economists are forecasting activity in housing price will be flat to slightly down next year. Although the outcome is uncertain, we agree with that view directionally. For Equitable, the likely impact is hard to judge definitively at this point and it varies across our different business lines. And prime originations could fall, but we think the market declines were mitigated by our concerted efforts to increase our nascent market share, which is less than 1% today. While success in this endeavor would be nice, it's not important in achieving our shareholder value-creation objectives.

For our alternative business, we believe the total portfolio will continue to grow at high rates even if origination growth softens due to market factors. I'm hopeful that renewal rates may be modestly higher as a result, a great job our team is doing in servicing our customers and looking after them through the renewal process in an environment where there are fewer options for mortgage insurance. Commercial will be unaffected by these changes that I mentioned.

The result of all this are two key messages. One, these interventions do not call for change in our core strategies of building shareholder value or our use of service as a competitive differentiator. Service is in fact even more important in times like this with so much uncertainty for brokers and borrowers alike. Two, and most important, these changes will likely be neutral to Equitable's earnings prospects.

I'll return with closing comments in a few minutes, but first Tim will provide his report.

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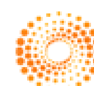

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Tim Wilson - *Equitable Group Inc. - CFO*

Thanks, Andrew. Good morning.

We experienced strong growth in assets and net interest income in the third quarter. Net interest income was an all-time quarterly record of CAD71 million, up 15% from a year ago on an increase in our average asset balance in both core lending and securitization financing.

Before I jump into the details of our performance, I wanted to highlight a point related to any outlook comments I provide. And that is, we are actively monitoring market developments and have taken the uncertainties created by recent regulatory changes into account on a best efforts basis in formulating our outlook for 2017. Competitive and consumer reactions to the changes could, of course, cause our actual results to vary from these expectations.

You may also recall that last quarter I mentioned we would refine our NIM methodology to more clearly present the economics of the underlying portfolios. In particular, securitization financing.

We made several changes. Most notably we shifted from calculating average assets and liabilities using simple period-end amounts to using daily balances, a seemingly small change, but one that moved NIM in our securitization financing business up by several basis points.

Some of the other changes resulted in expense reallocation from securitization financing to core lending. Importantly, though, our total net interest income was unchanged.

Net interest income grew at a double-digit rate because we grew average assets by 21% year over year and despite our net interest margin declining by 9 basis points over that period. The decline in NIM was as expected and occurred even though margins within our alternative single-family business have been relatively stable over the course of the whole past year.

Single-family generates the majority of the Bank's earnings, so the fact that its performance has been relatively stable is important. The reason for the overall NIM decline is the continued shift in asset mix towards our lower margin securitization financing business. NIM was impacted to a lesser degree by other factors detailed in our MD&A, including the growth in high-rate EQ Bank deposits and low margins on prime single-family assets originated at points during the year.

Sequentially, net interest income was up by 6% on 5% growth in our assets. NIM was unexpectedly up by 3 basis points relative to Q2, due to changes in our asset mix. Core lending actually grew more quickly than securitization last quarter. And within core lending, we had a surge in our higher-margin commercial assets. That team has been doing a great job of finding new business and retaining existing customers this year.

Looking to the remainder of 2016, our outlook for net interest income is for more growth, now at year-over-year rates in the mid to high teens. Asset growth continues to outpace the expectations we had earlier in the year, mainly due to our continued market share gains. Core lending and securitization financing NIMs should remain around Q3 levels.

Moving on to non-interest expenses, we recategorized these in our MD&A in the third quarter to reflect some changes we made internally in our GL. The changes will give management better visibility into our expense base as we grow, and hopefully will give investors a better look at how we spend our money.

For ease of review, we've updated our results for all comparative quarters in 2016 and 2015. And to highlight for you, one of the key differences is that we have aggregated all technology-like expenses into one category, which provides increased transparency for you, as we spend more in this area.

Current growth in the business, as well as investments in support of our key business strategies, led to an increase in non-interest expenses compared with last year. This increase was planned and designed to create long-term value for our shareholders.

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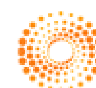

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Non-interest expenses excluding the impact of strategic investments increased by 21%, or CAD4.3 million year over year. FTE was the primary driver of this increase as our employment base increased by 20% or 90 people. These workforce additions enabled us to sustain high levels of service and risk management.

Of note, non-interest expenses before investments were flat compared to the second quarter of this year, even though we continued to add people. Higher compensation costs were offset by a reduction in consulting spend, DSU grants, and some other less material factors.

Non-interest expenses to support strategic initiatives amounted to CAD4.1 million, 180% above last year's level, and 20% higher than in the second quarter of this year. The sequential increase reflected advertising and promotion programs for EQ Bank, while the year-over-year increase reflected, among other items, the effect of expensing rather than capitalizing digital banking-related costs and higher investments for digital banking system support.

Looking forward, we expect non-interest expenses to continue increasing at year-over-year rates just below the growth rate of the Bank's assets, a lower rate than we have experienced in recent quarters, and the reason for that is two-fold. First, a material amount of recent expense growth has related to our digital banking platform. While we continue to invest heavily in EQ Bank, the rate of growth will moderate quite substantially next year. And in Q1 we actually expect to see negative growth in our digital banking expenses because of the CAD2.6 million we spent on advertising to support the launch of EQ Bank in Q1 of last year.

Secondly, we are seeing some benefits of scale economies. I want to note, however, that well over half of our costs are influenced by business volumes -- for example, the cost of our underwriting teams and our CDIC premiums. So, while we expect to continue seeing some benefits from our growing scale, I encourage you not to bake too much opportunity into your forecast.

As a result of our investments, we expect our efficiency ratio will remain in the mid-30s for the balance of 2016 and throughout 2017 -- in other words, at levels that are superior to Canada's other Schedule 1 banks. Our capital ratios at quarter end all continued to surpass minimum regulatory standards and most industry comparables. And we expect to continue operating above these benchmarks as we grow.

Related to capital, looking ahead we plan to regularly execute transactions to derecognize mortgages to the extent warranted by asset growth and our leverage ratio position. Our current view is that those volumes and the associated gains on sale will move up slightly from Q3. We will likely derecognize between CAD300 million and CAD500 million of mortgages each quarter in order to manage our leverage ratio in the face of continued high growth in our assets.

Finally, although as a subsequent event it has no impact on our Q3 results, we did become the successor issuer on CAD3.1 billion of NHA MBS pool in a transaction that closed on October 18. We press released this development, but, as a reminder, we expect it to be accretive to EPS in the range of CAD0.06 to CAD0.08 per share in Q4 and CAD0.25 to CAD0.30 per share in 2017, diminishing by approximately CAD0.10 each year through to the end of 2020. The excess spread income net of related cost is being reported as other income on our statement of operations beginning in Q4.

Now back to Andrew.

Andrew Moor - *Equitable Group Inc. - President and CEO*

Thanks, Tim. I'll finish up today with a brief update on EQ Bank, our digital bank platform launched in January.

In the first quarter deposit balances reached CAD1 billion. That's more than 5 times higher than our original full-year target. While I can't say this definitively, I suspect it's one of the best starts for an all digital bank on record. We now have some 26,000 EQ Bank customers.

While we deliberately slowed the pace a bit by adjusting the deposit rate in late August, downwards by 25 basis points, and, with that, lowered our interest expense run rate, our customer base and balances continue to grow steadily. As evident from these numbers our platform is resonating with Canadians. The digital platform is setting the stage to position Equitable in a really exciting place for Canadians increasingly looking for the

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same convenience and ease of use from their bank that they expect in so many of their other areas of their lives, from ordering a cab to buying a book.

We have an EQ Bank plan in place for 2017 that will see us adding new features and functionality which I will talk to in future quarters. We look forward to offering additional deposit products that will help us become an even more indispensable mobile bank for Canadians.

Growth of this platform will help to support our conventional, single-family and commercial business growth. I'm excited by our current pipeline in both of these businesses, that together drive the vast majority of Equitable's profitability. We believe there's lots of potential to grow at high rates through the end of 2017 and beyond.

To summarize, this was a great quarter and another year of outstanding performance for Equitable. It was a period that once again demonstrated the value of our franchise and capital allocation strategies and validated our un compromising approach to things that matter -- customer service, strong risk management and highly effective teamwork. I'm confident that Equitable will continue to thrive and that there is a significant growth and value-creation potential in all of our businesses.

That concludes our prepared remarks. And now we'd like to invite your questions. Anna, can you please open the lines to our callers?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We'll go first to Geoff Kwan with RBC Capital Markets.

Geoff Kwan - *RBC Capital Markets - Analyst*

Hi. Good morning. The first question I had was just, you made the reference on the impact on your residential insured mortgage business about, I think, roughly over half of it may not be insurable under the new rules. The two-part question within that is, as part of an offset, would you look to maybe look to purchase additional insured mortgages from third parties to make up part of that?

And then also, too, is, within those mortgages that are no longer insurable, can you talk about maybe what were the key categories that would no longer fit into it? In other words, was it more the refies or was it another aspect that the government had changed?

Andrew Moor - *Equitable Group Inc. - President and CEO*

Thanks, Geoff. Certainly we do buy, as you know, mortgages from third parties. So, we will continue to do that. That may be something of an offset.

We did a bit of a waterfall to try and break down how we get to that change. The biggest component of that was, probably, as you called out there, refinances, a significant portion of the overall market that no longer will qualify for insurance.

And then I think the other elements, which were smaller but also contributed to that, was the GDS - TDS ratios at the higher qualifying rate, the Bank of Canada qualifying rate, as well as certain properties now worth over CAD1 million that are no longer insurable, I think were the other two major components of that. It's not entirely clear to me whether that's meaningful data, by the way, in terms of how much we can no longer do, because there certainly is the opportunity for certain borrowers to restructure the arrangement, maybe borrow more of a down payment from mom and dad, or things of that nature to make behavioral changes that might actually offset some of that decline. But, if you took the portfolio as originated, that would be the impact.

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Geoff Kwan - *RBC Capital Markets - Analyst*

Okay. Thanks. And then just the other question I had was, I know it's still very early days but just wondering if you had any early observations on the impact from the government announcements, whether or not it's from the home buyer level or what you may be seeing from other competitor lenders out there.

Andrew Moor - *Equitable Group Inc. - President and CEO*

I think it's just too early for us to say, Geoff. That's why we've been not saying particularly much, really, waiting to see how it evolves. Definitely seeing slightly lower volumes in the insured space already, but not clear how it's going to evolve.

Geoff Kwan - *RBC Capital Markets - Analyst*

Okay. Great. Thank you.

Operator

Your next question comes from [Jamie Goyne] with National Bank Financial.

Jamie Goyne - *National Bank Financial - Analyst*

Good morning. First question is related to the specific provision taken in the quarter, obviously a very small number. I was just curious, though, if you could give us a little bit of color on whether that was Alberta or some other geography, and maybe some details around that.

Andrew Moor - *Equitable Group Inc. - President and CEO*

I didn't pick up the front part of that question. Could you -- would you mind?

Jamie Goyne - *National Bank Financial - Analyst*

Sorry, yes. Just to repeat that, the specific provision that was taken in the quarter, the CAD1.2 million, just a little bit of color, where, geography, or what was that related to.

Andrew Moor - *Equitable Group Inc. - President and CEO*

There were two what I would call idiosyncratic loans in there. There was a commercial loan in Eastern Canada and then there was a larger single-family loan that had some issues with valuation in the western provinces. That made up half of it in those two provisions and the rest was more broadly scattered across the portfolio.

Jamie Goyne - *National Bank Financial - Analyst*

Okay. Great.

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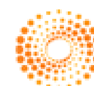

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Just in terms of the growth in the quarter or over the past year, British Columbia, it's a small piece of the portfolio but we've seen 60%-plus year-over-year growth in that province. I'm just wondering how you're thinking about the underlying risk there today and the growth going forward in BC.

Andrew Moor - *Equitable Group Inc. - President and CEO*

Certainly I think that growth this year can be somewhat misinterpreted. We were extremely cautious in BC about three years ago and only slowly came back into the market, so coming off a very slow base, a very low base. We have actually tightened some of our lending criteria in British Columbia through the summer here, some of the loan to values scaling back to reflect elevated risk. Still reasonably positive in the lending areas we are in.

Just to be clear, we're not typically in the downtown Vancouver. We are lending more in the Surreys, Richmonds, in that middle market, more affordable housing. But, no doubt, prices are elevated. I wouldn't expect that we would see significant growth in that province year over year next year in terms of originations.

Jamie Goyne - *National Bank Financial - Analyst*

Okay. Great.

And, just lastly, before I turn it to someone else, the progress on AIRB, are you able to provide us an update on where you are there? It looked like there was a brief update in the MD&A.

Andrew Moor - *Equitable Group Inc. - President and CEO*

Yes, we've been doing data discovery work. We're working with the providers of our capital engine to try and determine the gaps between the data we have in-house and what's required to drive that capital engine. I think we made some great progress there. It seems like the preliminary view I get is that those gaps are very closeable. So we're working on it, making progress.

Jamie Goyne - *National Bank Financial - Analyst*

Okay. The timing is still two to four years out, I suppose?

Andrew Moor - *Equitable Group Inc. - President and CEO*

I think that's right. Some of that's within our control, the work we do. Some of it's related to complexity around Basel even changing the rules as we go. And, of course, we have to use with the regulator and respect their time line, too.

But we still think it's the right way to go. Our basic underlying thesis here is that we can be more quantitative around risk measures and be clever about risk if we move to this kind of advanced approach. So, that's what we want to do as the institution matures and gets larger. We think there's a very good risk management reason for doing this.

Jamie Goyne - *National Bank Financial - Analyst*

Great. Thank you.

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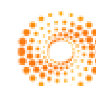

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Operator

(Operator Instructions)

Next we'll go to Graham Ryding with TD Securities.

Graham Ryding - *TD Securities - Analyst*

Hi. Good morning. Maybe to just touch on the Alberta, Saskatchewan portfolio. Big picture, where do you think we are in the cycle here in terms of your expectations for delinquencies and arrears in that portfolio going forward?

Andrew Moor - *Equitable Group Inc. - President and CEO*

As we mentioned in our prepared remarks, our early-stage delinquencies have dropped quite meaningfully quarter over quarter. So, that's encouraging in terms of new impaired formations.

I was in the market a couple weeks ago and actually spent an hour working with our head of collections there, and then working through particularly that impaired group that we showed in the MD&A loan by loan. I'd say it looks like there was plenty of equity in most of those homes, and mostly in the major urban centers, Calgary and Edmonton, modest-sized homes.

It was quite interesting to me, actually, thinking about, I had the same conversation about a year ago. A year ago it seemed that those delinquent loans were primarily coming from what you would expect -- hourly people in the oil patch had been laid off and no longer able to make their mortgage payments.

Today it seems more we've got self-employed individuals that are just generally suffering in the economy going through structuring. The typical thing you see when you get Impaireds related to family breakups may indeed be exacerbated by a tough economic situation.

I do think most of them will clean up. I don't think we're going to see much in the way of losses out of that CAD12 million group. There will be some. We already referred to CAD600,000 we've taken against them in charges.

But my sense is that most of them will work out. But given the longer process to resolve loans in Alberta, as I indicated in my remarks, I'd expect that amount to sit around for a longer period. I wouldn't be expecting that number to drop much between now and June of next year. A lot of these properties are being sold by their owners to preserve the equity and so it may work out better than that, but that's my sense of it.

Graham Ryding - *TD Securities - Analyst*

It sounds like you don't feel like the impaired bucket is necessarily going to increase going forward.

Andrew Moor - *Equitable Group Inc. - President and CEO*

I think that's right. It does seem that, if we're not at the end of the cycle, we may be getting towards the beginning of the end and we're not likely to see -- I don't feel that we're likely to see a lot of new impaired formation in that bucket.

Don't forget, we did change our lending criteria as far back as the back end of 2014 to lower LTVs, as well. So, we're feeling pretty well protected in that marketplace. I wouldn't say that Calgary is an optimistic place these days, but there is a fairly diversified economy that provides pretty good employment and, of course, that's the driver. Employment's obviously gone up significantly since the energy crisis corrected, but more recent data that I've seen seems to show a flattening off in that unemployment trend.

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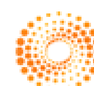

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Graham Ryding - *TD Securities - Analyst*

Okay. That's helpful color. This may be more for Tim, but Andrew feel free to -- your guidance or your outlook for core NIM, I think it could drop by 10 basis points next year. What are the factors there that are in your assumptions, given that your core NIM has actually been relatively stable over the past one to two years?

Tim Wilson - *Equitable Group Inc. - CFO*

I think we disclosed our assumptions pretty extensively in the MD&A, so I'll start by pointing you back to that. I think from a macro point of view, we view the interest rate environment as being relatively unchanged over the course of the next five quarters. And within each of our core lending businesses, single-family and commercial, we think we're going to have pretty stable NIMs there, as well.

I think the decrease really has to do with the continued shift toward single family. As we look out next year, and as discussed in the outlook, we see single family growing more quickly than commercial again, and that simple mix change causing the decrease.

Graham Ryding - *TD Securities - Analyst*

Has that mix change not been happening over the last year, yet core NIM has been relatively stable?

Tim Wilson - *Equitable Group Inc. - CFO*

It has. You're absolutely right. But there's been a bunch of offsetting effects to that, as well. Over a couple-year period we were improving the pricing on the mortgages that we were renewing. So, we did a lot of analytics around it and we think improved our margins and renewals.

We also had a number of really low-cost funding sources that we brought online. So, some of the bank funding facilities, our broker HISA account all contributed to better NIMs which offset the mix that I spoke about. Of course, EQ Bank moved in the opposite direction. But on a net-net basis, all those factors just caused NIM to stay stable.

Andrew Moor - *Equitable Group Inc. - President and CEO*

Certainly the one thing that's encouraging, to Tim's point there about the HISA, we dropped the rate on the EQ Bank deposits in August so you haven't seen a full impact on that CAD1 billion of deposits. And, actually, we also dropped the rates on our brokered HISA by 15 basis points at the beginning of October. So, none of that has been seen in these current quarterly results. So, some interesting things on the cost side of funding.

Graham Ryding - *TD Securities - Analyst*

Okay. That's helpful.

And then my last question would just be on the prime single-family side. You're still talking about decent growth on that portfolio as you figure on-balance sheet and off-balance sheet, yet you talk about 50% of your prime single-family side being affected by these mortgage regulation changes. So, is the assumption there that just your momentum and the market share gains that you're getting in that business are more than offsetting the pressure from mortgage regulation changes on that business?

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Andrew Moor - *Equitable Group Inc. - President and CEO*

I think that's our view. I would say, of all the things in our outlook this is the one that's probably got the most uncertainty around it because of the changes that have come through. So, that's the one that we worry about.

I think the good news is it doesn't really affect earnings' outlook whether we're successful or not in that assumption. I do think that some of the mono lines, the unregulated lenders that are regulated provincially with thin balance sheets will struggle here a little bit in this environment. So, maybe there's natural market share to be picked up from that group.

There are some other things that can help us here, even if the macro volumes or the volume in insured mortgages do drop as a result of the changes.

Graham Ryding - *TD Securities - Analyst*

Okay. That's helpful. Thank you.

Operator

(Operator Instructions)

We'll take our next question from Christopher Krim with Alliston Capital.

Christopher Krim - *Alliston Capital - Analyst*

Hi. Just a question on your hiring. It seems like FTEs have gone up significantly, and I know that when you grow so quickly it's hard to attract the best people. We've seen a lot of people come over to Equitable from Home Capital, and it seems like you guys have obviously been taking a lot of share from them. It seems like those people have also had dealings with Interfinance. I just wanted to get your reassurance that everything is acceptable in the underwriting with these employees that came over from Home Capital and your relationship with Interfinance.

Andrew Moor - *Equitable Group Inc. - President and CEO*

We don't deal with Interfinance, just to be clear. So, I think that's fairly straightforward. And our hiring practices are, frankly, the best in the industry. We do deep dives on everybody that we hire. A lot of them are coming from other Schedule 1 banks. So, we're basically extremely comfortable with our hiring practices.

Christopher Krim - *Alliston Capital - Analyst*

Great. If I could follow up on the securitization growth and the impact that you think the new regulations will have going forward in 2017 and 2018 on how much securitizations and derecognition that you'll be able to get.

Andrew Moor - *Equitable Group Inc. - President and CEO*

As we mentioned with the previous caller, that is the one area that's got the most uncertainty around it. Just stepping back, particularly for our US audience in terms of what finance is really trying to do here, they're trying to balance three policy objectives. One, to add stability to the housing market, while balancing that with access issues so the homeowner, the young people looking, in the household formation stage can still get access to a mortgage and the comparative element.

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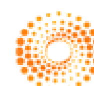

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I think what we're seeing here is a broader concern about trying to add stability to the housing market through the tightening of controls and the use of CMHC capital in that area. To some extent, they understand it will impact the competition, which I previously mentioned. So, I think for certain types of originators that are focused entirely on insured mortgages this will be challenging.

For us as a bank we sit in the middle of that a little bit. We're somewhat neutral to that because we do have balance sheets to fund these loans and don't rely just on insured mortgage books.

So, I think that's what gives us an opportunity to continue to grow in this kind of current environment. But I think it is something that I think next quarter we'll be talking about more once we've seen the impacts roll through the market and we've seen how various other competitors respond to us. As you probably realize from the statements, the earnings from derecognition are actually quite modest.

Tim, I don't know if you can share that.

Tim Wilson - *Equitable Group Inc. - CFO*

Yes, the earnings we generated in the quarter from derecognition, where we actually executed transactions deliberately to cause derecognition, were under CAD1 million. They were CAD799,000 in the quarter. Tax affected, call it CAD600,000. So, very immaterial in the overall picture.

Andrew Moor - *Equitable Group Inc. - President and CEO*

And just to speak there about that, what we think about is shareholder value in the long term. If you actually think about the PV of selling a strip to create a derecognition transaction, you're actually leaving value with the buyer of that strip. So, to some extent there's lots of interest in keeping these assets on book.

I think if you compare us to some of the other people that people might compare us with, you'll see that we've actually been growing the value of our unsold strip inventory over the last few years. We do want to execute them and do execute them in modest sizes just to maintain our leverage ratio at the right level. It's a regulatory capital management process that we're going through and that's why it makes sense from a business perspective.

Christopher Krim - *Alliston Capital - Analyst*

Thank you.

Operator

We'll take our next question from Jamie Goyne with National Bank Financial.

Jamie Goyne - *National Bank Financial - Analyst*

Just a couple more questions. I just want to follow up on, Andrew, in your prepared remarks you talked about some of the items that were driving the strong growth in uninsured; so service levels, market share gains. But you also mentioned that the market size has also increased. I was just wondering if you could maybe give us a little bit of color around your thoughts on the market size today and going forward, and whether EQB might look to take on some of these previously insurable mortgages at lower rates.

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Andrew Moor - *Equitable Group Inc. - President and CEO*

Our math says -- we do it by looking at what other companies are reporting publicly. We also have some information from some of the land registries that probably isn't available to you. But we think the alternative market grew about 11% year over year in terms of originations in Q3. So, when we're seeing 40% growth, clearly we're gaining share in that world.

And with respect to the second question, we don't see an opportunity, frankly, to price mortgages lower in order to capture mortgages that were previously insured. It's not so much a matter of the risk around that. It's really a matter of how do you fund that and put capital up. As soon as they're an uninsured mortgagee, we're putting up 35% risk weights. And we either have to fund them with deposits or with ABCP, which is a scarce resource for us.

So, our view is that maintaining a discipline around return on capital and pricing of those loans is the best for our shareholders. And we're a bit surprised by some moves we've seen in the market where people, in our view, are giving away funding and then flowing that through to the market in a way that it isn't really necessary and thereby damaging their own shareholders. There may be things that open up and we're obviously always looking at the market, but I think that where we are in our product set and pricing makes sense to us still.

Jamie Goyne - *National Bank Financial - Analyst*

Okay. Great. And then just the second question is probably more for Tim, and I'm not sure how well he can answer this. You're restricted right now, based on IFRS rules, to take larger provisions, given that there's no real deterioration or evidence of deterioration in the portfolio.

Just wondering if you have any views right now on the impact of IFRS 9, where you're able to take a little bit more of a prospective look on reserving. Is there anything in the portfolio now that maybe you would look to increase reserves? Or how do you see performance? And maybe just some high level thoughts on where you would look to establish reserves under IFRS 9.

Tim Wilson - *Equitable Group Inc. - CFO*

Yes, it's still really early days on that, so we're not really in a position to talk about the future impact. What I will say is a couple things. First is we feel very well reserved under the current regime. So, don't actually anticipate IFRS to have a substantial impact on our overall financials -- based on our early analysis, that's what I'll say.

The second I'll say is, if you benchmark us against the marketplace over the course of the past 5 to 10 years, we've been on the very conservative end of provisioning that whole way through. In periods where no other financial institution was adding meaningfully to their collective allowance. Our provision that ran through our income statement was about 80% -- 75% to 80% -- additions to the collective. We were conservative in adding to it when nobody else was.

We changed that practice a little bit this year, partly because our analytics are getting better as we head towards IFRS 9 and AIRB, and we've realized that the allowance that we had on balance sheet was more than substantial, and partly just because we realized we were a little bit out of step with overall market, which made benchmarking for investors more challenging. But the quick answer is, we feel like we're in a pretty good spot but too early to say for sure or to quantify the impact.

Jamie Goyne - *National Bank Financial - Analyst*

Okay, thank you.

Operator

That concludes today's question-and-answer session. Mr. Moor, at this time I will turn the conference back to you for closing comments.

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Andrew Moor - *Equitable Group Inc. - President and CEO*

Thank you, Hannah, and thank everybody for listening and participating. We look forward to delivering our next quarterly report in late February and to seeing our institutional investors and analysts at our first-ever Equitable Bank Investor Day next week on November 16. Thank you for listening.

Operator

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

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