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PRESENTATION

Operator

Good morning, ladies and gentlemen. I'd like to welcome shareholders and analysts to Equitable's Third Quarter 2020 Conference Call and Webcast. Later, we'll conduct a Q&A with participant analysts on the call.

Before we begin, I'd like to refer you to Slide 2 of the presentation regarding the company's caution regarding forward-looking statements. This presentation and comments may contain forward-looking information, including statements regarding possible future business and growth prospects for the company. You are cautioned that forward-looking statements involve risks and uncertainties, including those introduced by the COVID-19 pandemic. Certain material factors or assumptions were applied in the making of the statements and could cause results or performance to differ from forecasts or projections expressed by these statements. Equitable does not undertake or update any forward-looking statements except in accordance with applicable security laws.

This call is being recorded for replay purposes on November 4, 2020, at 8:30 a.m. Eastern Time.

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

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

Thank you, Marcella, and good morning, everyone. I'd like to begin by welcoming Chadwick Westlake to our quarterly analyst calls. Chadwick is an experienced banking executive who joined our management committee as Senior Vice President and Chief Financial Officer on Monday. Chadwick will introduce himself on today's call.

As a reminder, Chadwick's appointment was one piece of a broader plan to establish a streamlined management committee structure that is better organized around the way we think and act as a Challenger Bank and serving our customers and addressing the market. And into Chadwick's appointment, we create 2 new operating groups: Personal Banking, led by Mahima Poddar as SVP and Group Head, Incorporate EQ Bank, our single-family mortgage businesses, decumulation lines of business and the distribution of deposit products through the financial planning channel. Mahima has been with Equitable since 2016 and has distinguished herself in running EQ Bank, corporate development and marketing before this appointment.

Commercial Banking, led by Darren Lorimer as SVP and Group Head, includes business enterprise solutions, our specialized finance group, multifamily assured mortgage lending, the commercial finance group and Bennington. Many of you know Darren from our Investor Day a couple of years ago, and he's done a fantastic job running our commercial mortgage businesses since arriving from TD in 2015.

The [management] of the Leadership Committee are Ron Tratch, our Chief Risk Officer; Dan Dickinson, Chief Information Officer; and Jody Sperling, Chief Human Resources Officer, who is also this year's Report on Business Best Executive winner in the HR category, one of only 12 Canadians to receive this honor in recognition of her outstanding contributions to people, leadership and talent development.

Ron joins us on the call today, as does John Simoes, Vice President of Finance. John will deliver report to you this morning, while Ron will be available for Q&A.

Since the beginning of the pandemic, our team has done some really good work to serve our customers and position Equitable contributes to economic recovery and the broader societal goals of supporting home ownership and encouraging Canadians to save more during these difficult times.

By staying true to our purpose of driving change in Canadian banking to enrich people's lives as Canada's Challenger Bank, we've pivoted to put more resources to providing liquidity to customers in the assured mortgage lending market, both multiunit residential and single-family and achieved high-quality asset growth in Q3, which we expect will continue in Q4; struck a more constructive posture to underwriting in our alternative single-family business on an improved market conditions towards the end of the quarter and began Q4 with an increase in that mortgage pipeline; assisted homeowners with loan payment deferrals and found as we hoped that this support allow borrowers to resume regular payment schedules such that just 30 basis points of our loans are still on deferral; introduced new EQ Bank joint account services with more services on the way in Q4 and registered dramatic growth on both EQ Bank deposits and new account openings as Canadians unmistakably state their preference for all digital banking.

We're encouraged by improvement in business conditions since Q1 and the resilience of the housing market. Taking note of this and other externalities and having reported best ever quarterly performance yesterday, we think we're set up for a good finish to the year. We'll share our view of the future as much as we can today, while acknowledging that the pandemic has created more uncertainty than is typical in the future part of the economy.

What we can say with certainty is the advantages of an agile workforce, flexible cloud-enabled technology stack and the broad capabilities we enjoy across personal and commercial services will serve us well as we continue our challenger quest to build a better bank for all. I'm very pleased with Equitable's position within an industry where change is accelerating because of the pandemic.

Now synopsis of the Q3 performance. Diluted EPS was 35% ahead of Q3 last year on a reported basis and 41% above the level we recorded in Q2. On the strength of record earnings, return on shareholders' equity, our true north, moved to 19.8% on a reported basis, well ahead of our 10-year average of 16.8%.

Meantime, book value per common share grew 12% or $9.28 from a year ago and 5% since June 30, 2020. Based on consensus estimates, I know the strength of this performance was an upside surprise, but the reasons for it are not. Results reflected good fundamentals in the business and in the market.

Once again, employee productivity and efficiency were industry-leading, even though the vast majority of our workforce remains in work-from-home mode. Asset growth was high quality. The pivoted emphasis to ensure mortgages produced strong securitization gains, and we benefited from reduced funding costs. We expect many of these factors to prevail in Q4. Additionally, Q4, we'll see an uplift as a cost -- net of funding cost savings to ensure $687 million of single-family assets earlier this year is reduced by a further $2 million and then removed entirely in Q1 2021 with benefits accruing each quarter thereafter.

The premiums paid on that insurance, net of funding cost savings, reduced EPS by $0.09 in Q3 but give us good funding costs and capital benefits to look forward to over a period of years. Q4 financial performance will also benefit us as a result of our decision to drop rates on EQ Bank by 20 basis points at the beginning of the quarter, by strong earnings by historical standards from securitization activities.

By quarter end, positive earnings, coupled with risk-weighted asset growth, pushed the bank's CET1 ratio above the top end of our target range of 14%, up a full percentage point year-over-year and 30 basis points from June, but our CET1 in terms capital ratios are at the high end of the Canadian banking industry. Through the end of 2020, we expect those ratios to remain relatively stable as the benefit of additional retained earnings added to our capital base will be used to support increases in our risk-weighted assets.

As you know, planned dividend increases are on hold because of regulatory guidance from OSFI in the banking industry. Even so, our most recent dividend declaration was 6% above last year. Our low payout ratio, which was 9% in Q3, shows we have room to maintain our dividend.

One of the ways the banking industry has helped Canadians during the pandemic is through payment deferrals. For its part, Equitable has been proactive in working with customers in need so that they can get back to a normal payment cadence. This approach has paid dividends for customers and our bank.

At the end of October, we had just 280 accounts on active deferrals, representing 0.3% total balances. Independent economic forecast we used to establish our allowances under IFRS have improved since June 30.

On Slide 8, we included the base case of Moody's forecasts at September 30 compared to June 30 and March 31. Of the key variables tracked, all showed improvement over the next 12 months. Recall that we use a risk-weighted average of these scenarios to determine our allowances. As a result of this positive change, we reduced our allowances to performing loans categorized to stage 1 and stage 2. In Q3, we set to a modest reversal of stage 1 and stage 2 provisions in our income statement. This is accounted within our provision for credit losses as a net benefit of $2.9 million. Stage 3 provisions, which are those related repaired loans, were down by $2.9 million from the preceding quarter primarily due to a lower level of provisions required on our mortgage portfolio and a reduced level of net impaired lease formations.

If economic forecasts produced by Moody's improve and borrowers behave as expected, PCL should reduce again in future quarters with a benefit to earnings. If the economic picture unfolds in line with our base case, we will over reserve by $6.5 million.

As you know, the housing market has been resilient in the face of a broader -- of the broader economic backdrop, which will certainly have a positive impact on realized losses going forward compared to the concerns we had when the pandemic was unfolding back in March even if delinquency move up as we expect.

As I said at the outset, from the perspective of loan growth, Equitable did its part to keep the economy moving as all of the bank's retail and commercial businesses continue to provide capital for household formation and business purposes.

Total loan principal increased by $1.6 billion year-over-year. Looking deeper at this growth shows that we did make a pivot in favor of the short mortgages, both our retail and commercial businesses. We chose to provide liquidity to these segments to address the needs of Canadians for single-family homeownership and for more multi housing stock, which is to ensure supply.

For the bank, the benefit of this deployment is that all of this prime business is fully insured against credit loss, and spreads have been wider than was typically the case over the last few years. Within retail, prime single-family loans grew $1.1 billion or 17% since Q3 2019 and 2% in the quarter itself. We combined internally generated prime originations with those acquired from third parties.

I'm very pleased to note that our internal business has generated record monthly levels of prime single-family originations since May as we continue to expand our market presence with mortgage broker partners. We expect growth to continue in Q4 using this blended approach to origination.

As expected, given tighter risk tolerances, balances within our alternative single-family portfolio were down 3% year-over-year. As we subsequently moved our alternative single-family underwriting criteria closer to pre-COVID-19 parameters, as our assessment of risk in the market has changed for the better. This transition occurred later in the quarter, and we've seen a positive response from brokers and a corresponding improvement in our mortgage pipeline and originations since then.

In our commercial business, loan balances grew 9% year-over-year. There were 2 drivers. In short, multis were up by $355 million or 10% over last year, and conventional commercial grew by $342 million or 9% again due to strong originations in the multiunit residential construction sector, a more favorable competitive positions.

In response to some of the conversations I've had with investors and analysts, we've included more disclosure about our commercial book in the MD&A, and I hope you find this useful. It's harder to describe this portfolio with aggregate metrics than the single-family book. That said, having taken a deep dive into the book, the bottom line is we are feeling good about the overall credit quality and not seeing any notable uptick in problem accounts or identifying individual loans where we expect losses to arise.

We think the dynamics in the multi space are very positive. There continues to be a significant gap between tenant demand and rental apartment housing stock in many Canadian cities and, in part, recessions. And to date this year, landlords have had great success in collecting rent.

Equitable has been in the multi space for most of its 50-year existence, and that experience is serving us well. Looking ahead, we believe loan balances in the bank's established businesses will grow in the fourth quarter as well balances within our decumulation businesses, which we are confident will really hit that stride in 2021.

Not to be missed in this quarter's record performance is outstanding growth registered by EQ Bank. EQ deposits stand at $4.3 billion at quarter end, which reflects growth of $1 billion in Q3 itself. In context, it took us 4 quarters to attract our first $1 billion of EQ deposits. So this is tangible momentum.

Meanwhile, account openings increased 68% year-over-year, meaning 149,000 Canadians now rely on EQ for great digital banking services. Per month, Q3 account openings were over 3x higher than the monthly average prior to COVID-19.

These steps tell the story of a banking platform that caters perfectly to Canadian's increasing preference for all-digital banking. EQ is making the most of this environment by creating some really elegant and valuable offerings that encourage Canadians to fully embrace technology-enabled banking, Challenger Bank style.

In Q3, we introduced our joint savings plus accounts, and customers are really taking advantage of this service, which is reflected in the figures I just quoted. Setting up a joint savings plus account is entirely virtual and painless, and I really encourage all of our shareholders to give it a try if they haven't already. The EQ team has done an outstanding job of creating a simple, intuitive and fast-opening process.

Our international money transfer services also gained a lot of fans since its February launch. Again, if you haven't already, I would encourage you to try it. Once you do, I suspect you will never return to the cost of the old-fashioned approach offered by traditional institutions.

We've been successful in reducing our cost of customer acquisition to attract new accounts through programs such as refer a friend and the more effective deployment of digital marketing resources in the smart money campaign we are running during the quarter. One of the advantages our bank enjoys is our cloud-enabled technology stack, which makes it easier and faster for us to introduce products and service innovations.

We have, in fact, stepped up the pace of launches this year after moving to the cloud last year. And we are attacking our technology road map much more aggressively.

In Q4, we will infuse RSP and TFSA capabilities, and another big launch is on track for Q1 of 2021. I'm convinced that it's difficult for any investor to understand the merits of Equitable as an investment, but on setting up an account and trying some of the functionality, with the international money transfer capability being a shiny example of a great service with a wonderful customer experience. EQ Bank is a strategic asset for us that provides both an additional channel market for our bank and a platform for providing important new services.

Overall, compared to what we expected earlier in the crisis, retail and securitization funding markets have proven to be much more liquid and efficient. And GIC rates have decreased from mid-March onward at a faster pace than the relevant interest rate benchmarks. This makes funding very cost competitive.

As previously advertised, I'd now like to -- like Chadwick to introduce himself to you before John provides his report. We're really excited to welcome Chadwick, who is exceedingly well-qualified to oversee all core finance functions as well as the bank's treasury and securitization activities, corporate development and legal. Chadwick?

Chadwick Westlake

Great. Thanks very much, Andrew, and good morning, everyone. Equitable has an excellent reputation within Canadian banking. I'm excited to be here serving together with this talented team that is so focused on customers, our shareholders and the communities in which we operate.

Throughout my career, I closely watched Equitable, its rise from a small trust company into 1 of 9 publicly traded banks that are members of the S&P/TSX Composite Index is impressive. I personally don't believe Equitable gets enough credit in the capital markets for its value creation capabilities and its overall franchise value. This is a full fledged, innovative and truly differentiated bank that should be trading at a much higher multiple. Coupled with the continued growth mandate and increasing solutions for Canadians, we'll be working hard to earn a better valuation in the months ahead.

As I just officially joined as CFO on Monday this week, I won't be making substantive comments about performance this quarter. But I want to share my confidence in and excitement about the path ahead for this institution.

As for my own background, I spent nearly 2 decades with Scotiabank, lastly serving as Executive Vice President for Enterprise Productivity and Canadian Banking Finance. I gained deep experience in setting strategy and implementing bank-wide productivity improvement efforts, including growing revenue, reducing costs and driving sustainable efficiencies.

To be honest, given my previous role, I looked on with some envy as Equitable regularly reported an efficiency ratio that was much better than the big banks. This is a key advantage of branchless digital bank structure. I also served as the Chief Financial Officer for Kip Scotia's Canadian Banking division and many other roles across the bank, including credit risk, customer experience, operations, directly within business lines, corporate development and finance, among others.

I think all of this has prepared me well to take on a new challenge at a bank that truly thinks and acts differently and pursuing value creation for all stakeholders, but that is still well grounded in all the appropriate capital and risk management disciplines.

With that, for this quarter, I'll turn things over to our Vice President of Finance, John Simoes.

John Simoes

Thanks, Chadwick, and good morning, everyone. As Andrew mentioned in his opening comments, Equitable's Q3 was its best ever whether the comparison is made on an adjusted basis or reported.

Reported figures included $4.1 million of net mark-to-market gains. On an adjusted basis, net income grew 30% over last year and 44% compared to Q2. The change analysis slide in our deck quantifies the quarter-over-quarter impact of various drivers of our profitability. The largest contributors were net interest income growth and gains on securitization.

From this slide, you will note the change in operating cost of $0.11 per share. Although total operating costs increased sequentially by 3%, our efficiency ratio for the quarter was only 35.7% compared to 39.2% in the preceding quarter. This is because the increase in net interest income and gains on securitization outpaced the growth of our expenses, which is a numerator in the calculation. Expenses in Q4 should be consistent with Q3 as we continue to push forward the digitization of our bank and service offerings but in a very efficient manner.

Moving on, NII was up 8% year-over-year due to growth in our average asset balances of 12% and despite a 6 basis point decrease in NIM. As Andrew mentioned, the decrease in NIM was primarily driven by amortization of premiums paid to insure $687 million of alternative single-family mortgages in Q2, net of associated funding cost advantages and a mix shift towards prime mortgages and lower-yielding liquid assets.

NII was also affected as we kept deposit rates slightly above benchmarks in Q3. In early Q4, we moved rates down in response to the market, and this should help our earnings by $0.11 in Q4.

On a final note, the bank completed a $200 million 3-year fixed rate deposit note issuance late in the quarter and on attractive terms. It was priced at 150 basis points over government of Canada bonds and carries a coupon of 1.774%. Support for the offering came from 37 investor participants. We look forward to rewarding investor confidence with the sustained deposit note issuance program, which is part of our broader strategy of continuing to diversify our funding sources by creating products that are attractive to customers, investors and our bank.

Now back to Andrew for final comments.

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

Thanks, John. As we always do at this time of the year, we are developing our budgets for next year. This is not an easy task, given the lack of visibility afforded by the pandemic. But I can assure you our objectives will be both thoughtful and ambitious. Before they are Board approved, we obviously won't be commenting on any new goals.

Speaking of change in banking, one of the things I'd really like to see this next year is Canada finally adopting an open-banking system. Policymakers have been studying how to do this for a number of years, and it's now time for them to act. With our cloud-enabled technology stack and ability to leverage our flexible middle tier to provide and consume application programming interfaces, ours and third parties, I call ready today to bring the benefits of open banking to our customers.

Tomorrow afternoon, I will deliver the keynote address to Canada's Open Banking forum. And I will be adding Equitable's voice to this call to action.

In summary, I think we've shown pretty clearly this year the good that can be accomplished in a very short time by the Equitable team. We've contributed to small and meaningful ways to Canada's economic recovery and the recovery of customers who faced financial strife earlier in the year.

Our capital liquidity positions are strong. The improvement in business conditions is encouraging. Changes in consumer behavior in response to the pandemic favor our business model and digital foundation. And after recording all-time quarterly -- record quarterly earnings, we're ready to work hard to create even more value going forward as Canada's Challenger Bank.

This concludes our prepared remarks. Operator, can you please open the line for Q&A?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Geoff Kwan from RBC Capital.

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

I had a question with the -- I guess, it seems like a bit of being more disciplined or the pullback within the nonprime residential segment on originations. Are you seeing your competitors, especially your biggest competitor, doing the same? Or are you kind of, let's call it, willingly ceding market share?

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

Yes. I think, Geoff, as we spoke about probably the last quarter and maybe the one before that, I think we acknowledged we were losing market share, although we were deliberately ceding market share. Essentially, what we did was cut back our loan to values at the end of March, beginning of April, in the face of the pandemic to trying to protect the balance sheet and with a view that prices could be dropping.

I think with the benefit of hindsight, we were probably overly cautious, frankly. But we're prudent bankers as you know. So -- but obviously, now with the impact of much lower interest rates and the economy getting adjusted to this new normal, we're feeling a bit more confident about the credit metrics being slightly more expensive.

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

Okay. And then, I mean, if you were to update your credit loss model to only adjust for Moody's forecast as of October, I'm not sure if it's out now. Just wondering like how would that impact your Q4 loss provision. Essentially I'm just trying to understand the comment in the MD&A around the timing of potential realization of recoveries of losses if the macro environment matches your assumptions?

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

I'll let Ron deal with some of the detail there. What I can tell you is that the overlays that we apply in the IFRS 9 model effectively slow down the release of reserves. So even if we run the models with the same economic criteria, we're going to be slowly releasing reserves because of this overlay dynamic runs much more deeply in the numbers on the models and so on.

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

So thanks for the question, Geoff. Just with respect to the October forecast, it would be premature for me to comment on that. But our expectation is that it would be largely stable with the forecast that we saw in August and September as the Q3 came to a close. So we're not expecting a lot of volatility in the quarter at this point.

Now that obviously, we have to wait and see how things pan out because -- with the November and December forecast. But at this point, I think the comment I'd leave you with is relative stability at this stage.

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

Okay. And then just my last question is maybe whether or not from Equitable specifically, but just maybe broader activity in the market you're seeing so far in Q4? Are you seeing the momentum that we saw in the summer carried through into Q4? Are we starting to see cooling, whether or not it's just some of the pent-up demand is dissipating or just the regular seasonality of being in Q4?

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

I think there's still some sort of pent-up demand working its way through the market. Certainly, we would anticipate that you generally sort of see housing markets move into sort of a bit more of a seasonal lull as you approach the holidays. But of course, this year, it might be different just because so much with demand was taken out of the market in the March, April, May period. So far, demand is strong in the markets.

Operator

Cihan Tuncay from Stifel.

Cihan Tuncay - *Stifel Nicolaus Canada Inc., Research Division - Director*

Just a couple of quick questions for me. So with respect to the commentary of returning underwriting standards on the bulk book back to pre-pandemic levels, what do you expect or where do you think the potential impact on asset yields from that if even to go for that line of business?

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

Sorry, I didn't quite catch that last bit of the...

Chadwick Westlake

With the change in underwriting to the pre-pandemic level, the change in the LTV bank?

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

So (inaudible) for volume?

Chadwick Westlake

Yes.

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

So I mean we're sort of starting to hit good volumes, kind of consistent volumes of year-over-year type originations right now, sort of $300 million a month type of thing in this time of the year, which is pretty strong. And just by the way, we sort of said returning -- return to pre-pandemic kind of underwriting is a bit of a short hand. We certainly look at market segment by segment. So we're still concerned about things like commodity prices and energy produce in provinces, for example, so some of those -- we're still in a more conservative framework than we were in February.

Cihan Tuncay - *Stifel Nicolaus Canada Inc., Research Division - Director*

And what's the potential pickup in asset yields on that change in underwriting standards?

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

Well, it doesn't really change the yields on the new originations at the yields. We tend to -- haven't really moved up or down, but the spreads are good I think as you saw in the quarter, with spreads continue to be pretty strong.

Cihan Tuncay - *Stifel Nicolaus Canada Inc., Research Division - Director*

Got it. And then with that respect, as you've alluded to in your comments, Andrew, funding and deposit markets looking really good right now. We saw a sizable drop in deposit rates in the quarter. Any upcoming puts or takes to what could have a larger impact on deposit yields that you're seeing in the market right now, be it in the GICs market or as you expand your EQ Bank offering? Any commentary on that?

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

Yes, certainly, I think there might be room slowly over the next little while to eke down rates in EQ Bank, but we're not planning that right now. We like to have a very good everyday offer for all consumers. And so we're at 1.5% today in EQ Bank, which if you haven't -- don't own an account yet, I take advantage of that. But I think that will be around for a while.

Yes, you probably will see us come out with very attractive TFSA and RSP rates to try and get some traction in that product offering when we launch. Of course, we have very small balances there. So not terribly material in terms of the earnings. But we're seeing good tight spreads on the GIC -- in the GIC market, which is attractive.

And of course, the longer-term picture really on funding and the bigger win to look forward to next year is going into the covered bond market, where we expect to have funding cost about 30 basis points through GICs. And as we build that program out over a period of years, that's probably the most material thing we can do for the spreads.

Cihan Tuncay - *Stifel Nicolaus Canada Inc., Research Division - Director*

Okay. Appreciate that. And then just one last question for me. With respect to the comments around workout arrangements with borrowers that came off of deferrals, can you talk to at all? What's in that group? Like how many of those people that (inaudible) that would have gone to workout arrangement, can you -- do you have any conversations with them about -- do you advise them to sell -- just sell their home into a strong housing market? I mean, what kind of conversations are you having with that? And when you say there's been a few and far workout, is that because some people that were going to have trouble making their payments, you told them to just sell their home and they did and like does that -- how does that factor into the commentary on workout during...

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

Yes. As we mentioned in the MD&A, we're basically following the same procedures recommended by CMHC and the mortgage insurers. So in principle, if somebody's income has been disrupted but it's about to get back into good shape, and we're prepared to work with them to obviously see them through that next gap.

If so, as you mentioned, there's no prospect of income stability returning at least in the medium -- short term, medium term, then clearly preserving equity in the home may be the best answer, especially with a relatively strong housing market. So we're certainly seeing some of our customers choosing to go down that route.

We have it at very few customers. The last time I checked, about 10 different loans that moved on to interest only. So the customers, we asked them just to pay the interest on the mortgage, 10 individual homeowners. So you can see very small in the scheme of the books. And we are trying to work with our customers, obviously, who, as we all know, certain elements of the economy have been hard hit by this pandemic. So we certainly want to support them through that. But so far, the consumer seems to be in remarkably good shape.

Operator

Geoff Fenwick from Cormark Securities.

Jeffrey Michael Fenwick - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

Andrew, I wanted to start off with EQ Bank today and the growth of the deposits that you've seen that have been very strong. I'm just wondering if you could offer some commentary on your perspectives around deposit stability, meaning this is relatively new source of growth for you. It's an online platform that you've made very easy to bring in your deposits. And maybe there's a bit of a risk that they could take them out quickly if rates change. So any commentary you could offer around how that's performed, what customers have been doing as rates have changed that you're offering in the marketplace? And how we should think about that as well in terms of maybe carrying excess liquidity on your balance sheet just to manage that exposure?

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

There's a lot to unpack there, Geoff. But the -- yes, that's okay. I say that's what I expect (inaudible). So clearly, when deposits are growing fast, we tend to view a new deposit as being somewhat more flighting than established deposit. So the age of the deposit matters to us.

So to just stand back even further, our treasury team think about this issue a lot, and they hold a lot of liquidity. So one of the reasons why we're holding back liquidity on the balance sheet today is because of the assessments of our treasury team are making about exactly the area that you're talking about.

As deposits age, though, we do observe more stability in those deposits. And when we introduce other services, so the things -- some of the things I've been talking about are joint accounts, we expect to be most sticky. People are using our international money transfer service. People that are paying bills or having their payroll come into the accounts. Clearly, it's becoming a more stable part of their financial lives. So we track deposits that we regard as being more stable versus less.

We do see a feature in the market, which is, I think, quite an undesirable feature, a couple of our competitors come out with these short-term promotions. And you see some of our customers flipping money back and forth between our accounts and other customers. But that's becoming an increasingly smaller amount of the -- smaller part of our customer base. And we continue to see people become -- start to use a broader range of services, and it's becoming more of a franchise for them where they can have their core banking. And so I say, we've got our eye on it very closely. We're holding plenty of liquidity against it.

The other thing that's important to remember is that we have a $200,000 limit on each of the accounts. The vast majority of these accounts operate under CDIC limits, $100,000 CDIC limit. So we think that they're very stable from that perspective. And we would, of course, be able to use the Trust company to extend more deposit insurance if we felt that stress in the system.

Jeffrey Michael Fenwick - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

And this is becoming obviously a very strategic asset for the business, as you mentioned. I mean, when do you begin to push harder on selling loan products through to that consumer base? I mean, you've already got the customer under your roof there. How do you think about beginning to ramp that -- the offerings to that customer base?

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

Yes. I think over the next year, you'll start to see us offering products on both sides of the consumers' balance sheet. Clearly, that's where we want to go. The challenge we have today is that the -- our approach with EQ Bank is to be fantastic, digital, all-digital experience. Mortgage business is still somewhat clunky for everybody, everybody, all industry actors in terms of getting appraisals. The paperwork has to flow around it, something of a different experience. So we've been reluctant to brand those 2 things together. But as we now have got so many more customers now in EQ Bank, we're going to be biting that bullet and moving to having a sort of broader relationship on both sides of the balance sheet.

Jeffrey Michael Fenwick - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

Okay. And maybe just one more question here on expenses. I mean you've done a good job of holding the line this year and then deferring a lot of spend just as we go through this pandemic. I mean how long can you defer some of those spends on products and people? Are we at some point going to have to just see that run rate step up fairly meaningfully if you want to continue with all these growth initiatives?

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

Yes. Certainly, I think you see it sort of eke up for sure. We never permit -- I think we've talked about efficiency ratios in the 40% to 42% range over the longer term, which is still best-in-class in Canadian banking. But at those kinds of expense ratios, we expect to be able to continue to grow the franchise quite fast.

If we were just bolting down the hatches and not choosing to grow and then clearly, you could run at lower levels. But that's not how we think about it.

Operator

Stephen Boland from Raymond James.

Stephen Boland - *Raymond James Ltd., Research Division - MD & Equity Research Analyst*

Just a couple of quick questions. Andrew, you seem a lot more optimistic in terms of just the outlook for housing. But I think in the MD&A, and I apologize if this is wrong, but you've talked about modest growth for Q4. I'm not sure if that's tied to the alternative segment or overall. So is really the growth or are you really looking at 2021 as really the acceleration of getting that growth back on board?

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

Yes. I mean we will see growth in Q4 in the Oak business, it's tough to really grow. As you've observed in past years where we really see the growth is in Q2s and Q3s every year, that's when you get the seasonality flowing through in the mortgage business. Canadian's quite a wise people. They don't like to move in February when the snow is deep on the ground. So that's the seasonality that we typically observe.

Again, it might be slightly different this year just because of some of the pent-up demand. But we're not trying to build that in. But I'm feeling pretty good about the market right now. It seems to be reasonably strong without being overly effervescent to review.

Stephen Boland - *Raymond James Ltd., Research Division - MD & Equity Research Analyst*

Okay. That's good. And then just a second, I just want to go to the provision for credit losses and the recovery that you reported. I mean you set up a large provision early in the year based on economic modeling. So is that now in a position where you can and maybe this quarter, just talk about the release this quarter. If you can maybe remind me if it was tied to specific loans or the specific modeling on the economic front? So if your view on the economic modeling or if modeling is getting better, should we continue to see a portion of that large PCL kind of recover in future quarters?

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

I'll let Ron deal with the details, but I think clearly, as we indicated in the script, we do believe that if the economic scenario unfolds along line with our base case, then we do have reserves to release. And they'll then probably come in staged over a number over a period of time.

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

Yes. The only -- Andrew is right. The only comment I would add is that those numbers are modeled, and they're driven largely by economic forecast. And so we respect the forecast and the outputs that come out of those models. We do take a hard look at them to see if they believe they match up with how the things are going to unfold. But we do respect that IFRS 9 expected credit loss process.

And as we indicated, we gave some -- a little bit of a breakdown in terms of the base case scenario. And if things were to unfold under a base case, the level that would be -- we would be effectively overreserved and then similarly, if things took a turn for the worse.

But it is a modeled number. And as forecasts moderate or become more pessimistic, you could expect to see some potential changes there. It's a volatility factor that the entire industry is grappling with, but we continue to respect that process as part of the accounting framework. And we do stand behind our models and that they are, I think, largely aligned with what could transpire. But we're very comfortable with the way the book is performing practically speaking today.

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

It's really interesting, Steve, when you look at the single-family models, in particular, so we use unemployment as one of the proxies. It's one of the variables to drive the model. But if you look at the Bank of Canada monetary policy report, you'll see how the unemployment is so bifurcated in this particular recession where those with lower incomes who are not homeowners are those that are particularly bearing the brunt of unemployment, and it's really sad for that group.

Our customers, homeowners and self-employed folks are actually standing up pretty well in this. And capturing some of these nuances in our models is every recession and every event is always slightly different. So model is going to naturally -- our team is a really top-notch modeling team, but capturing all these nuances is going to be tricky for us.

Operator

Jaeme Gloyn from National Bank.

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

First off, really appreciate the extra disclosure on the commercial book. Just one follow-up on that. Mixed-use properties. Can you give us a little bit of description as to what's involved in the mixed-use properties and why those are viewed as lower risk, let's say?

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

Well, typically, they might be -- I mean, it could be a small apartment building with retail on the ground floor that we would -- as soon as you've got any kind of business within the building, then you would typically classify it mixed-use. If you think about, particularly Toronto real estate, say, all along the down 4th, where you've got 4 or 5 apartments above a storefront, that's mixed-use in our view. Well, that's what we would call mixed-use.

These have been very desirable assets, actually, as we've seen increased urbanization. You're seeing more foot traffic in those areas. Some of them are getting redeveloped into condo buildings as well. And typically, these are very attractive to investors for themselves fairly well healed. So even through this -- these small businesses are getting affected in the basement, we find that we've got owners that have got wherewithal to stand up.

And then you've got rental out of the apartment buildings. Some of the -- some of our borrowers are people that operate the businesses on the ground floor, whatever. And they tend to have very high Beacon scores. We tend to find that they're well over 700.

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

Great. Just shifting to the securitization. Gains on sale of securitized loans volumes, obviously, really high, but it looks like the gain on sale margin is pretty elevated as well, like 2 to 3x higher than what would be a normal run rate. Obviously, spreads have widened here a little bit, but maybe you can talk about that margin and the sustainability of that margin as well as volumes going forward? Like should we be thinking about gain on sale as still elevated in future quarters?

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

So as we indicated in Q4, we expect it to be -- continue to be strong in Q4. This does depend on some dynamics around allocation and the kind of mortgage bond, spreads on new loans. So we're seeing those opportunity really in the CMHC securitization area generally. I would expect that this won't prevail through all of next year. But even next year, I think we might see better gains than you would historically model for Equitable.

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

Okay. That's helpful. The -- just a couple of clarification questions to wrap up then around the TFSA and RRSP. Is that -- that will be released in 2021, and will it just be a savings product to start? Or when can we expect to see some more "sophisticated products" in those accounts?

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

So it's actually going to 2020 release. So we've got the code running now. It's a matter of putting it into production and promoting us for our customer base.

To start with, it'll be a simple GIC saving on the savings plus demand deposit product. But clearly, as we start to build deposits with that kind of longer-term investor view, TFSAs and RSPs, then I think that's the opportunity potentially to start to evolve people into slightly more sophisticated forms of wealth management going forward.

And so I think about that as being our entrée into that market. But we're starting with a fairly simple play within the product.

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

Okay. And last one is with respect to the covered bond market. Does the access to that market rely on either OSFI or other regulatory approvals before launching? And are you having discussions with those bodies today that gives you confidence you'll be able to have covered bonds in 2021?

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

No, it doesn't rely on any regulatory approvals. The -- there are already provisions, OSFI provisions has set up the capacity for covered bonds. We do believe that this is a public policy argument that there should be higher covered bond capacity for smaller institutions. We've made these arguments to regulators, and we're hopeful that they're landing in sort of fertile ground.

But our program doesn't rely -- that the economics of the program doesn't rely on that being achieved. I think there are lots -- there are lots of good reasons as to why from a public policy benefit to make the Canadian banking system more competitive, smaller institution -- and smaller institutions should have higher capacity within this framework. But I do think that, that's actually -- I'm very hopeful that will be the landed -- place where the regulators land to.

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

So is that the constraining factor then? Is that the -- I believe it's a 5.5% cap right now, but it's been expanded for -- through COVID up to, I think, 10%. Is that what's constraining your ability to tap in to covered bonds? Or is there investor demand? Or maybe explain why we shouldn't see covered bonds sooner?

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

Well, I think we would have -- if COVID hadn't hit, you would have seen covered bonds this year. So we deliberately -- first of all, our teams were dealing with a lot of other issues when COVID hit, and we were trying to work from home. I was also somewhat skeptical to be able to deal with -- to a new issue in the European buyer markets as a new entrant to the market in the middle of a pandemic. So we dialed back on the investment.

I think a judgment again with hindsight, probably we could be accessing the market around now if we've done some of the other structural things we need to do to get the program up and running. So we're basically downtimes for about 3 to 4 months in terms of actually getting the program going. Our teams are now working away on it. But then we've got year-end ahead of us and so on. So that will constrain us now to not being able to get an offering away until next year.

Operator

(Operator Instructions) And our next question comes from Graham Ryding from TD Securities.

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

So maybe I'll just start with the reserves that you released and sort of where you're sitting today. So your allowance for credit losses versus your base case assumptions, I think it's $6.5 million that you're overreserved right now. But there's some assumptions there over the next 12 months and also over the next 2 to 5 years. So how should we think about the cadence if the world plays out according to that base case assumption? Is that $6.5 million potential release more weighted towards how things play out over the next 12 months as opposed to longer than that?

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

Yes, we haven't spent a lot of time talking about that. Ron, do you...

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

Well, what I would say, that base case is the most likely case. And so that's the way that we most -- the case we most heavily weight and that the forecasting service suggests is the most likely outcome. We'll recognize that the expected credit loss that we take is over -- well, when stage 1 is over the next 12 months and then stage 2 is lifetime on the loans. And now we have a relatively short book.

So if we stayed with the base case, we would expect to see about $6.5 million less actual loss formation over about the next 18 months. But where that would be reflected is if the base case continued, I would expect that forecasts become slightly more positive to reflect that. And then our actual expected credit loss for embedded loss, recognized loss would start to be recognized in subsequent quarters. I don't know if that helps or confuses, but it is a little tricky.

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

That helps. But I guess the potential timing of this -- what you've over-reserved relative to that base case is are we looking at the next 12 months period? Or are we looking at sort of the next couple of quarters? Like that sort of timing is what I was getting at.

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

Yes. I think it's probably more likely a 12-month kind of cycle of release because as I mentioned earlier, there's a model plus there's an overlay that, in effect, slows the release of -- the effect of it is to slow the release of earnings to try not to make these things too high frequency. You tend to -- if you suddenly have a step function downward move in economic outcomes, we immediately book it. So that sort of high-frequency downward take the reserves because you don't want to be underreserved. But then there's a effectively a slowing of the release that is not quite the same. So it'll probably bleed back quarter-by-quarter rather than be suddenly seeing us release $6.5 million in 1 quarter, for example.

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

I think that's exactly what it is.

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

Perfect. Understood. One thing that's -- area that's getting a bit of attention right now is the condo market, particularly in the GTA. But you're obviously -- you're lending both on the retail side, I assume, but also on the commercial auto development side. Can you just talk to your risk appetite there? And how you're feeling generally about that space right now?

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

We don't have a lot of loans on condo construction in Toronto. It tends to be purview of the bigger banks, frankly, but still feel fairly good. If you've got the right kinds of presales, we'd still feel fairly optimistic about that. And of course, you've got to have the presales in place, which themselves reflects this change in the market.

The -- with regards to the condo market more generally, I think we've always joked that we've been negative wrong for about a couple of decades longer than we should have been. I think we still remember the early '90s strangely around Equitable on this issue.

Having said that, we got a little more constructive around over the last 2 to 3 years, I would say. But we've still been super concerned about things that might look like an Air BnB rental. So I think we've tend to avoid that sector, and frankly, we've got very low -- we're seeing very low applications in the condo sector right now. It's a very small part of the book. So I don't think we -- we're particularly concerned about how it might impact us.

We're not seeing any delinquencies over and above what we're seeing more generally in the book within our condo sector. So it feels pretty good right now.

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

Okay, got it. And my last question would just be your deposits from EQ bank, they grew very strongly, and your liquidity was elevated at the end of the quarter. Is that more of a timing issue? Or are you deliberately holding higher levels of liquidity right now? And should we expect that going forward if EQ Bank continues to grow like it is?

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

Yes. I think as we mentioned on one of the previous questions, we're holding a lot more liquidity around fairly recent growth in the EQ Bank deposits, just kind of a prudent measure. But I think we're also holding more liquidity just more generally the uncertainty, the economic conditions, again, prudence. It's costing us money, but I'd rather make sure that we don't have an issue with liquidity.

And then there's some timing issues as well at the end of the quarter. We've just recently done a deposit mode, I think which was just into the numbers. And so a combination of things, but I think you should expect us to continue to be holding relatively elevated levels of liquidity for the next little while. There may be some opportunities as we get more and more comfortable with the future outlook of the economy that we complete those down a bit because there is a negative spread on those -- on that liquidity.

Operator

Cihan Tuncay from Stifel.

Cihan Tuncay - *Stifel Nicolaus Canada Inc., Research Division - Director*

Guys, a quick follow-up question for me. Andrew, could you talk to an update on the transition to AIRB, how that's proceeding, what the potential capital release could be? And what kinds of new business that can help you win going forward?

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

So Ron is our -- is executive in charge on the AIRB program. We continue to be pushing hard on it. Ron, do you want to try and address those questions?

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

Yes. So the resources that we pulled back from the program during the pandemic to ensure that we had the business lines partly resource to deal with things are now back on the job, and we are fully reengaged to go full steam ahead in 2021. I do think it would be premature to comment on levels of capital release, I mean, and the timing of that. I mean, a lot of that rests in the hands of the regulator and the amount of time they take to review and when they approve.

In terms of new business lines, we would have to have a lot of data around those new business lines to be able to model them and achieve AIRB benefits. But I -- so -- but I am very comfortable saying that the program for the same reasons, we launched it before the pandemic and before the recent discussions around car guideline changes. It continues to make a lot of sense for us. We've spent the last couple of months mobilizing the resources to pick up the program where we slowed down and go ahead full steam throughout 2021, looking to advance it very, very materially over the course of calendar 2021 and be near to a position where we should be able to fully engage with the regulator and engage in that process.

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

And I mean, just a reminder, nothing we haven't said before that this will make us more competitive in lower-risk asset classes. So for example, cash flowing, stabilized multifamily buildings, which particularly will be more competitive in those areas. And we've -- I think we've said in previous calls that if we were being risk rate on the same basis as the DCIPs on an AIRB basis, our CET1 would be something like 19% compared to the 13% to 14%. So none of those metrics really changed in terms of our sort of longer-term view, not that we've updated them, particularly for this quarter.

Operator

There are no further questions at this time. I'll turn the call back to Andrew Moor for closing remarks.

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

Thank you so much, Marcella. We look forward to reporting Q4 in sometime around late February. In the meantime, we're always here to engage and answer your questions. And so I know Chadwick will want to get to know many of you, and goodbye for now.

Operator

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