THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

EQB.TO - Q4 2019 Equitable Group Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 25, 2020 / 1:30PM GMT

CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

Nikolaus Priebe *BMO Capital Markets Equity Research - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen. I'd like to welcome shareholders and analysts to Equitable's Fourth Quarter 2019 Conference Call and Webcast. Later, we will conduct a Q&A with participating 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 of the company. You are cautioned that forward-looking statements involve risks and uncertainties.

Certain material factors or assumptions were applied in making these statements, and could cause results or performance to differ from forecasts or projections expressed by these statements. Equitable does not undertake to update any forward-looking statements except in accordance with applicable security laws. This call is being recorded for replay purposes on February 25, 2020.

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, Megan. Good morning, everyone, and welcome. I'm joined by Tim Wilson, Chief Financial Officer of the bank. We have lots to discuss today, including record earnings, a planned step-up in investment spending to strengthen our ability to grow and provide exceptional service and our expectations for earnings and asset expansion in 2020. The fourth quarter introduction of our EQ Bank international money transfer service also deserves headline coverage. This is a groundbreaking innovation that enables our customers to instantly transfer funds in over 32 currencies through the EQ Savings Plus Account at a fraction of the cost charged by countless other banks. By a fraction, I mean, our service is up to 8x less expensive than what other banks charge. All it takes is 30 seconds and a few clicks. Whether it's India or England, money is transferred to the destination of choice instantly. While the payment mechanisms in some of the other 70 countries we cover are not quite this fast, the convenience factor of our new service is superior. It's built purposely for an interconnected world and perfect for those with children studying abroad, Canadians, with loved ones in other countries.

I'm really proud to put the EQ name on a service that exemplifies all the best qualities of entrepreneurialism, creativity and partnership to make Equitable Canada's Challenger Bank and a thoughtful contributor to better banking for all.

While the express purpose of this call is to talk about Equitable, the company, I would go so far as to say, it's impossible to really appreciate Canada's Challenger Bank without trying our international money transfer service. It's guaranteed to save your money. And a bit like a TV pitchman, I'm prepared to stand behind the claim that you're going to be delighted with our approach. And I'd be happy to take your calls if you're anything less than totally happy. Please give it a try.

Before discussing our most recent developments, an apropos of our Challenger Bank mindset, I'd like to disrupt the standard operating practice to talk about something more revealing than a single quarter performance, the bank's progress over the past decade. As business leaders, we often pledge to manage for the long term, but rarely talk about long term results. With the 2010 in our rearview mirror, I think it's the ideal time for such a reckoning to reflect back to the path, the lessons, insights that we can use to our advantage in future years. I offer my comments today in the spirit of accountability and it is my personal commitment to making the next 10 years as rewarding for our shareholders, customers and partners as the past one.

When I say rewarding, it may surprise some of you to hear that Equitable is the best-performing bank on the TSX over the last decade with a total return of 500% from January 1, 2010, to January 1, 2020. Compared to the average of the other 8 banks on the TSX Composite Index, Equitable's return was more than 300 percentage points higher and almost double that of the next closest bank. We know there are lot of drivers of total return. While managing with a long-term operational view, we made strategic decisions that had a very positive impact on these drivers.

Specifically, over the decade, we paid $120 million of dividends and increased the dividend rate 21x with average annual growth of 12% and are now committed to increasing dividends 20% to 25% per year through 2024. We retained 89% of our earnings and invested to deliver an adjusted ROE of 16.9%, 1.1 percentage points higher than the average of the other 8 banks. As a result, we grew book value 14% annually. We grew EPS by an average of 14% annually compared to 9% earnings growth for the other banks and did this while maintaining a conservative risk appetite. We maintained our status as the most efficient of all publicly traded banks in Canada due to the structural advantage of our branchless operating model by working intelligently to reduce costs and increase productivity and delivered an efficiency ratio of about 27 percentage points better than the average of the other banks. We nurtured our unique culture and advanced an agile technology platform to provide our customers with more convenient and an innovative services. And we positioned ourselves in diverse profitable segments of the market as Canada's Challenger Bank.

I recognize this is a critical analysis devoid of a description of the most significant developments that actually made this performance possible. And it doesn't tell you what we learned in the process of delivering the banking industry's best total shareholder return. So on a more personal note, here's what the past decade tells me. First, the competitive strength in banking comes from customer service, not just size. While we have grown from 183 employees to almost 900, Equitable has by far the smallest headcount of any bank in the TSX Composite. But we punch way above our weight when it comes to quality service and passion for delivering value to our customers and employee productivity. We started the last decade with a view that service would be our passion, a message that headlined our 2010 annual report. We said at that time that no matter how quickly we grow, service will always remain our strength and the cornerstone of our business. I'm really proud to say that this remains true today and will be the case 10 years hence.

Over the next decade, Equitable will continue to lead the way in developing innovative digital banking capabilities that will continue to transform the meaning of service for the better. We don't take our service embedded culture for granted, which is why we work really hard to recruit people with the right skills and attitudes and reinforce our culture at every turn. Some of the biggest strides we've made have come in the areas of people development and retention. What we've learned will help us to sustain our culture and avoid the complacency that can easily set in when things are going well.

The past decade has also proven that delivering service and gaining market share with our branches is possible in Canada, provided that we make banking better through innovation. Today, Equitable wins customers by reimagining banking concepts and services, so they are more appealing to Canadians. We then use our branchless cost structure advantage and increasingly our technology to create a differentiated value proposition. EQ Bank is a great example. In just 4 years, our award-winning digital platform has become the home of over 100,000 customers on the strengths of the value it provides to customers and continuing innovation. We started with the EQ Savings Plus Account which fundamentally altered the way Canadians bank by combining the best features of a checking and savings account, including the ability to pay bills and the ability to earn high daily rates of interest. With this platform well established, we are on an aggressive product development path with plans to add many more digital banking services.

Becoming the first in Canada to have our core banking system in the cloud allows us to increase the pace of new product launches at a low cost. It keeps us at the forefront of where banking is going in Canada as we move to an open banking environment. With our technological skills, the migration of our core banking system to cloud, our fintech partnerships and the capacity to make meaningful investments in innovation like international money transfer service, it seems to me that we occupy a pretty unique spot in the banking ecosystem.

Over the next 10 years, the onus is on us to pick spots like this that challenge outdated, expensive and often opaque banking practices. It won't be easy, but entrepreneurial was one of the traits we have nurtured over the years within our workforce and a characteristic we must continue to advance.

The past decade has also illustrated the importance of applying discipline in everything we do, especially risk management. While the 2010s were free of recession, there was certainly risks at play in the housing market and short-lived but very real disruption in the funding markets. Equitable's ability to successfully manage through these events and maintain industry low loss rates is a testament to an effective risk management framework. We've continued to refine over the decade with guidance provided by our experienced Board of Directors. It's also a reflection of our uncompromising belief in making decisions that are in the best long-term interest of the bank, our shareholders and depositors.

10 years ago, today, we operated within a strict risk appetite and never stretched in order to achieve our growth objectives. Our framework along with the broadly positive Canadian economic conditions resulted in average provision for credit loss of just 5 basis points over the decade. In contrast, the average net realized loss rate for the other 8 banks was 28 basis points.

That said, Equitable has changed and improved as a result of risk management discipline while we have greatly diversified our deposit channels. Our direct-to-consumer offerings through EQ Bank, the growth of our strategic fintech partnerships, the advancement of our deposit notes program and later this year the planned introduction of a covered bond program, make us stronger by complementing our traditional and still important brokered deposit channels. We also diversified our asset gathering operations in part by developing a set of banking solutions to serve Canadians in retirement, what we think of as our decumulation business. As the population ages, the demand for our decumulation services, including reverse mortgages and insurance-backed lines of credit will only grow.

Equitable's traditional commercial group also stands to benefit from many industry trends, including funding the construction retirement residence expected to be more than $140 billion of capital over the next 10 years, in which we have a long-standing expertise as a funder of choice.

Geographically, we expand our presence to every major city in Canada and this past year entered the leasing market through Bennington. Bennington does not stand alone in our thinking. It's an indication of where we're headed with the broader strategy of serving small business community. Despite its critical role in driving economic growth, this community is not well served by traditional financial institutions, but is served not only by Bennington, but by Equitable's Business Enterprise Solutions team. We also see opportunity to add services for small business through our digital bank.

Overall, we have more runways for asset expansion and more ways to create value in a risk managed way. In context, we grew more in the past decade than in the previous 4 decades combined. I expect the 2020s will hold more of the same. I firmly believe that we have a relative rare skill for a bank, identify market opportunities and in launching, nurturing and growing new businesses. When you look at our track record over the decade of building our alternative mortgage business from being a relatively small player to the largest in the industry measured by assets, while the launch and growth of our digital bank over the past 4 years, you can see the evidence underpins this belief.

I feel similar levels of excitement about our reverse mortgage business where we are learning by doing. Recent changes to product design and pricing are giving us traction in the market. Similarly, the team running our CSV product line is fired up and is at joy to see the enthusiasm with which they are tackling the challenge of building a new business for the bank. Commercial Lending is also gaining traction in other new growth areas through our specialized financing business. It serves the need of specialty lenders and already has over $239 million of loans outstanding. We're very encouraged by this business and its potential.

The final takeaway from the past decade is that Equitable's value creation system had stood the test of time. It is built on discipline in the form of prudent capital allocation and deployment. From a pricing discipline with our ROE calculation tools at the front line to our senior management and the Board, we are fully aligned around the goal of allocating capital to optimize long-term returns to our fellow shareholders while delivering value to our customers. I described the Equitable value creation equation in detail in our 2015 annual report, and the results over the years bear witness to its effectiveness. It is remarkable how closely this value creation approach has played out since it was published. And I would suggest you look at my CEO letter from that report as proof that our value creation story was no accident but rather good execution of our plan. As a reminder, we look to pay out a growing dividend while retaining the bulk of our earnings. We are then disciplined in deploying the retained capital to opportunities only if they exceed our return thresholds. A high and consistent ROE is evidence of the success in this approach.

To conclude this retrospective, I would say that we've come a long way in firmly establishing Equitable as Canada's Challenger Bank. In particular, we validate our core principles, one of which is to invest and spend with a long-term view. Despite growing earnings every year to the point that we earn more in Q4 than we did in all of 2010, we're not driven by short termism, and with this leadership team we never will be. This is a natural segue to 2020 and our outlook. We anticipate Equitable's earnings growth will again outpace that of the broader Canadian banking industry this year.

More specifically, we expect earnings to increase in the range of 4% to 8% as a result of loan growth of between 8% and 12%, stable margins and low provisions for credit losses, and in spite of a significant increase in planned spending, the benefit of which will not be fully realized until later years. While net interest income should increase in the range of 7% to 11% in 2020, expenses will be up between 15% and 18%. So bottom line growth will be below our 10-year average of 15%, as we absorb the short-term cost of investing an additional $30 million to $35 million in important strategic initiatives. Many of these investments are outlined in our MD&A. Most notably, we intend to increase our marketing spend for EQ Bank, launch covered bonds and make investments in our retail lending servicing. These investments will keep Equitable a leading edge of our chosen markets and drive even higher long-term shareholder value. We apply rigor to calculate the NPV of any project and believe our shareholders are best served at this view versus the timing of flows through the statements.

Even with this spending, adjusted ROE in 2020 should be between 14% and 16%. Can Equitable be the performance leader among Canadian banks in the 2020s? You can be certain that our team will sharp to work every day over the decade ahead ready to deliver value to our customers in a manner that will replicate this industry-leading performance.

Based on our fundamentals, everything we've learned, our plan for growth and investment and the changing banking environment that plays to our strengths, I know we can lead the industry again. Now I'll ask Tim to provide his report. Tim?

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

Thanks, Andrew, and good morning, everyone. To underscore the message that we manage to the long term, we introduced a new table in our MD&A that contains medium-term targets for adjusted ROE, adjusted earnings per share, dividend growth and our CET1 ratio. I think the numbers in this table illustrate that we intend to hold ourselves to a high level of performance going forward as we have in the past.

Turning briefly to Q4. Equitable delivered year-over-year earnings growth of 23% and an ROE of 15.9%, both on an adjusted basis. This was another record quarter and certainly a great way to cap another record year. Turning to Q4 asset growth. All categories were up with growth more heavily weighted towards our prime portfolio. Alternative single-family grew in the quarter, but at a slower pace than is typical for that portfolio as increased attrition offset a healthy level of originations. Attrition has increased since the middle of 2019 as other banks have adjusted to revise B-20 regulation and appear to be offering more competitive prime rates to our alternative borrowers at loan maturity. Early indications in 2020 are the growth in this portfolio is picking up momentum and we are confident as we can be at this point in the year with a 5% to 9% growth outlook provided in our MD&A.

The increase in our commercial portfolio was the result of growth in our conventional commercial and insured multi-unit residential mortgage portfolios with a good assist from Bennington. The increase occurred due to higher originations and despite an increase in attrition levels in conventional commercial. The change analysis slide in our deck quantifies the year-over-year impact of the various drivers of our profitability. And once again, asset growth was the most significant factor. From the same slide, you will note the change in operating costs of $0.67 per share since Q4 of last year. As a reminder, the addition of Bennington represented $0.27 or 40% of that increase. We also spent more in operations in support of our growth strategy, including higher marketing expenses for EQ Bank, part of which supported our international money transfer launch. The way we think about this as a management team is that the NPV of a new EQ Bank customer over the account's life is likely to be more than 5x the marginal cost of acquisition. The accounting result does not follow this economic logic with the cost of acquisition being expensed upfront, while the benefits accrue in later periods.

On our last call, I mentioned the cost related to cloud migration would be around $1.5 million in Q4. Actual cost in Q4 were $1.3 million. Migration costs are now behind us and will drop to 0 in Q1 of 2020. That said, we will spend more in 2020 on IT generally to advance our innovation agenda and more on our digital platform to prepare us for the next 10 years of growth and advancement. As you may recall, we thought our Q4 efficiency ratio would be towards the top end of our full year range of 40% to 42%. It came in at 40.6% for the quarter, in the middle of that range, and 40.2% for the year. Factoring in the expected growth of assets and the increase in spending that Andrew mentioned, our efficiency ratio likely will be at the high end of the 40% to 42% range in 2020. Even so, we expect to remain Canada's most efficient bank and by a margin.

Moving on. Q4 NII was up 32% year-over-year, mainly driven by a 17% growth in our average asset balances and a 20 basis point increase in our NIM. In general, NIM has improved since Q4 of last year as a result of adding higher spread equipment leases through Bennington, earning higher spreads in our retail and commercial lending portfolios, paying lower fees on our recently downsized and lower cost secured backstop funding facility and prepayment income. Looking at more recent margin trends, total NIM expanded by 3 basis points from Q3 to Q4 to stand at 1.78%. Q4 NIM was slightly higher than our expectations due to higher prepayment income. For 2020, our outlook suggests that NII will increase at year-over-year rate between 7% and 11%. Once again, a high level of loan growth will be the primary contributor.

In the meantime, NIM should be in the range of 1.65% to 1.75% for the full year 2020, just below the final 2 quarters of 2019. A large reason for this decline will be the mix. We expect low-margin Prime business to grow the fastest. Margins in each of our major businesses should be roughly stable. In the first 2 quarters of 2020, NIM will benefit from the reduced cost of our secured backstop funding facility. On credit performance, the Q4 PCL in our mortgage book was low and in line with our historical rates. Bennington's PCL was slightly higher than our anticipated long-term annualized loss rate of 1.5% to 2%. But as a reminder, we earn higher yields to compensate for this cost. Impaired loans at the end of 2019 were $122 million, stable with Q3, but up $84 million from 2018. This balance included $26 million of impaired equipment leases, the majority of which were added at the time of our Bennington acquisition and a $39 million commercial mortgage that defaulted in Q1 of 2019. We are still of the view that we will not realize a loss in this mortgage given its 39% LTV and the fact that the property is well situated in Vancouver.

One final item of note, we pushed our CET1 ratio up again during the quarter such that it returned to the middle of our target range of 13% to 14%. As a result of the Equitable value creation strategy that Andrew mentioned, our earnings typically add about 50 basis points to our CET1 ratio each quarter. After hitting a low of 12.9% at March 31, over the ensuing 3 quarters, we added a net of 70 basis points to it after asset growth and innovation investments, partly by deliberately restraining commercial growth through to the middle part of the year. On the strength of this ratio, we've taken to suspend the DRIP program effective yesterday. This concludes our prepared remarks. And now we'd like to invite your questions.

Megan, can you please open the line to analysts who have questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Nik Priebe with BMO Capital Markets.

Nikolaus Priebe - *BMO Capital Markets Equity Research - Analyst*

Okay. I just want to start with a pair of questions on just some of the guidance that you've established for the year ahead. It sounds like some of the investments you've planned will cause noninterest expense growth to run ahead of revenue growth, at least in the short term. Just wondering if you could provide a little context around whether you consider 2020 to be a bit of a peak spending year in that regard? And maybe just what you would consider to be a good, I suppose, long-term goal in terms of efficiency ratio for the bank?

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

Yes, I'll let Tim sort of handle a bit more the numbers sort of side. We are -- we have some stranger projects this year, for example, covered bonds, cost money to set up the program, actual expenses you develop in the program. We expect that the savings on -- we expect the cost of covered bond issuance to be through GICs -- actually through GICs but from a meaningful amount. So obviously, we're not picking up the benefit of that until we really have the assets deployed against those bonds. Similarly, I think we referred to it on the call, marketing and advertising EQ Bank is an expense in the period and then you get the benefit over many -- multiyear period. And I would emphasize we are pretty disciplined about laying out the NPVs, the cash flows from these kinds of experiences to make sure that it's actually going to deliver value for the shareholders. So I think it's likely that those kinds of -- that would guide us. They're not accounting aberrations. I wouldn't plan to try and settle the accounts or anything, but it is more around when you actually think about the economics by taking things that run through the P&L upfront and deliver benefits later. And Tim, I don't know if you can provide some more color on I don't know how you think about it too.

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

Yes. Nik, I would say, in my view, it is a peak year, not necessarily from a dollar expense point of view, but from an efficiency ratio point of view. So I think it's -- our efficiency ratio will come down from the level that we realized in 2020, hopefully over the long-term to a range of about 37% to 39%. I think that's the reasonable goal for the company. It may take a few years to get there. But the absolute dollars of expenses will likely keep growing as we grow the overall franchise and invest to support it and hire underwriters, as an example, to support the single-family portfolio.

Nikolaus Priebe - *BMO Capital Markets Equity Research - Analyst*

Got it. Okay. No, that's very helpful. And then just one other for me. There was a comment, I think, Tim, in your prepared remarks just about how some of the larger banks have been renewing alternative boards and prime products and I guess, that's caused a bit of an uptick in the attrition rate for the alternative single-family portfolio. I've always thought what kept the larger banks away from the Alt space was, I guess, in part, challenges with the income verification for self-employed as well as some other factors. So do you get the sense that the larger banks are maybe willing to accept lower, weakened business? Or I guess, I'm just looking for your read there, a little more insight on some of the competitive dynamics in that space.

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

Yes. It's certainly our sense that the competitiveness, the demand for asset is causing them to take a different view than they have historically although it's interesting. We've actually seen a sort of fairly good flood of business in the last week or so suggest that perhaps somebody from the executive team walked down to the mortgage floor to figure out what's going on. But certainly, there is -- I think, as you've heard from other bank CEOS, there's a demand to try and get more mortgages on the books. There are certainly some mortgages that we're losing to Prime A Sched I banks. And when we look back at the file and obviously we have the record of who that borrower is, it surprises us that has been taken into the Prime world. We have a Prime business ourselves, but we can't make those loans the Prime GDS, TDS kind of qualification levels. They fit well within our book, but they don't meet that sort of standard or demand that kind of pricing. But I would say these things do tend to kind of ebb and flow and so that may be the kind of, I would say that we had more of a view about this about a month ago than we do today, frankly. And today, I would say, we've got a really strong positive tone to the business, of course. It can change again. But right now, we feel like a bit of an upswing.

Operator

Your next question is from Jeff Fenwick with Cormark Securities.

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

Just, I guess, a follow-up on that competitive dynamic. As you mentioned, the banks are being aggressive there and sort of hurting you, I guess, on the attrition front. But you do have some pretty aggressive Prime single-family growth targets for this year. So what makes you feel confident you're going to be able to grow at that rate if the banks are getting more aggressive?

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

I think our Prime business is driven by entirely different dynamics. We're linked with some great brokers, lot of whom are using technology to originate loans and like us is the first choice. And I would remind you that our prime products are better than the big 6 products, in the sense they have lower break fees and people really understand the value should be coming to us rather than going to the more conventional lenders. So we're certainly making traction on that. It's still a small business for us, the Prime business, frankly. I mean it's a great business, I have a great team. It's -- until we get to the renewal cycle, 5 years down the road, it's not particularly important from the overall profitability driven by the company. Over a 5- or 10-year view, it's going to be much more positive. And it is a strongly -- it's an important business from -- building a franchise with the brokers and our brand and our reputation for service. And so that's really the focus on that side of the business. As a reminder, in the Prime business, we are price takeovers and in the old business we kind of set some of the pace there.

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

Okay. And then with respect to the uninsured business that you're doing, any thoughts here on if OSFI goes down the path of easing the stress test regs the way they're doing on the insured product, do you think that could help stoke the demand for your Alt-A business?

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

Our assessment is that it's not particularly meaningful to us. And I think, frankly, the press is overblowing the change here. I think really all that OSFI is doing is making the adjustment to what they originally intended, which is, roughly speaking, 200 basis points over contract rate where historically posted this has always been about 200 basis points of posted and for whatever reason that gap expanded. So I think some -- there seems to be some notion. They're making the right wrong move at the wrong time. But I think, actually, what they're trying to do is just get back to what they originally thought they were doing. It's a course correction and probably an appropriate one in the context.

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

And then I wanted to just dig into your medium-term EPS growth guidance that you've given us. I mean, you've set the bar for this year. And I'm trying to square where that reacceleration in EPS is going to come from when you are -- right now, it looks like you're going to run 7% to 11% increase in NII. So as we get into '21, like where is that incremental step-up in earnings going to come from? I mean, there's obviously some fall away on maybe the expense ratio dips but it seems like new products are going to be important here in terms of bringing incremental asset growth and presumably with better margins as well. So how do you kind of disaggregate where you get the incremental growth in EPS to get it up to that level?

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

I think we are, as I pointed out, seeing some good businesses that we're growing into a specialized finance group, reverse mortgages, DST, all of them have decent margins on them. I think the other question we have to ask in the longer-term is what is our capital position at these levels of growth. So we're also seeing capital grow here and we need to think about how do we redeploy that capital, and we're just going to keep the ROEs and the EPS grow up at a high level. Tim, I don't know if you have anymore.

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

Yes. And Jeff, I think the other lever we have is cost of funds. So that's a significant contributor to those higher-growth rates. On top of the new businesses that Andrew mentioned, all of which are higher than -- higher margin than our traditional mortgage business. So on cost of funds, we really have 2 developments. One is the launch of the covered bond program later this year. As we've talked about cost -- covered bonds are -- we believe will be at a lower cost of funds than deposits. And then the second lever is -- on cost of funds is EQ Bank. So we believe that over the longer term, as we introduce new products, services, functionality features to that platform, there's an opportunity to compete a little bit less on rate and sort of to bring the cost of those deposits down too.

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

And of course, looking further ahead, AIRB is very much on our plans as well and that's going to have a significant impact on capital efficiency and allow us to compete in markets that we today cannot compete in. So that will also be a driver of growth for something that we're thinking about trying to have -- this year will be a year actually sort of figuring out. I think we've got our models well-established now for AIRB. We understand the risk weights associated under the -- with the AIRB models and now looking for opportunities that will expand us beyond our current envelope.

Operator

Our next question is from Graham Ryding with TD Securities.

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

Just to follow-up on your last comment there, Andrew. When you talk about the capital efficiency from an AIRB perspective, does that imply it frees up capital to be redeployed to shareholders? Or frees up capital to increase growth on more on the commercial side of your business or equipment finance?

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

I think it will certainly do the second piece. It will improve the asset growth. And I think we'll give you more color on that, Jaeme (sic) [Graham], through the year as we start to really understand what that means in real numbers. It's possible that you could well be right that we might end up with surplus capital as well, but it will certainly open up other market opportunities. We have identified some of those already. How big those markets are and how long it will take to build a franchise in those markets is something we're still sort of working through. I wouldn't want to get too far over my skis on that, but we certainly have some more conversations to have with you about capital over the next 3 to 5 years for sure as we make that transition.

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

Okay, got it. And that sort of medium-term EPS growth target, is there something implied behind that in terms of your asset growth? Like this year, I think, you're 8% to 12%. Is that sort of a sustainable level over the medium term, but it sounds like perhaps less on the mortgage side and more on the new areas that you're pushing into? Is that a fair assessment?

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

Yes, I think we're really optimistic about the growth potential of those new areas, everything from leasing through to CSV loans with reverse mortgages in the middle. And we think those are going to be big contributors to our asset growth. So as we mentioned, asset growth is the primary -- a significant contributor to the EPS targets that we have for the medium term.

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

Okay, great. And then looking at next year, if my number is correct, it looks like your conventional commercial growth this year was 4% but your guidance next year for your conventional commercial is 8% to 12%. So what are you seeing where you anticipate growth to pick up there?

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

I think that's -- sorry, Graham, I think that more of a case of how we constrain the business last year a bit. So in the first half of the year, we were trying to actually rebuild our CET1 post the acquisition of Bennington, which as you see, we are successfully now over the middle of our target CET1 range and then became more proactive towards the commercial business through the back half of the year. And I think you see that -- we see that momentum now. We feel that momentum even as we ended -- even at the year-end, we had a lot of activity in the pipeline, and that continues as we speak. So it's not so much that we're seeing more opportunity now. It's more a matter of the last year we constrained that business to help our capital position.

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

Okay, understood. And if I could sneak one more in. Just your Alt-A business, your outlook for 2020, 5% to 9%, slightly below your sort of expectation coming into this year which was 9% to 11%. Is that a reflection of the competition, the higher levels of competition and attrition you're seeing in the Alt-A business? Or is it also a reflection of just this is a business that's getting larger and maturing and growth has to slow down eventually?

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

I mean, certainly underlying that number is seeing decent growth, good robust growth in the originations and faster expected attrition as well. So that's what leads you to that net number. Clearly, when you started to run a $11 billion book, it's harder to grow at the same kind of rates as we might have done when we were half that size a few years ago.

Operator

(Operator Instructions) Our next question is from Jaeme Gloyn with National Bank Financial.

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

Yes. First question is on the specialized financing, looks like $240 million now at the end of 2019. I think that's almost doubled. I could be wrong, but correct me on how much growth there's been in specialized financing? And then if you could detail some of the underlying assets? I believe this is a strategy that is lend to lenders. So maybe you could talk a little bit about what's going on in specialized financing?

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

Yes. So do you have the number of that?

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

Over the last couple of years, Jaeme, that portfolio has been pretty consistent in and around the 2.25% range. Maybe you and I could talk about that off-line.

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

We started with one large loan to a -- against the mortgage book, that was really what got us into this business. And that's been amortizing down, but we've actually found other types of specialized lenders to lend to. I'd say the bulk of the underlying receivables are actually mortgages. So we're basically lending to mix to provide them some level of leverage, whether it's commercial mix or residential mix. But we are open to other kinds of assets. It's a small part of the business right now, but you can imagine things like CSV loans would be something that we feel comfortable with an asset class, for example, that we're actually prepared to margin on that basis. So that's what we're thinking about. And generally, when you think about these things or loans, these are small lenders. They might have $60 million, $70 million, $100 million of loans. We might be prepared to lend $0.75 on the dollar, let's say, against that loan book with a waterfall type approach to collecting on the assets. So it feels like a pretty secure form of lending in terms of kind of overcollateralization on the underlying assets, and it's actually leading us into other areas -- other interesting areas where we might become a direct lender ourselves to some degree.

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

Okay. Next question is just around the Bennington PCL ratio this quarter, above the 1.5% to 2% guidance. I mean, there could be some fluctuations there, but maybe you can provide more color as to what drove that higher rate of provisioning this quarter? And why we should expect to see it come back down?

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

Yes. So we still believe that 1.5% to 2% is the right long-term rate. That said, with the way IFRS 9 works, as you're aware, there's going to be more volatility in our P&L. So that was part of it, just the changing assumptions behind that modeling. We did see a slight uptick in impaired loans in the fourth quarter of the year in that leasing book, but there doesn't seem to be anything systemic underlying that. It looks like there was just a temporary blip. And like we said, we still believe the long-term rate is going to be 1.5% to 2%.

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

Was that increase in impaired loans specific to any one industry?

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

No. No, it wasn't.

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

Okay. Next question around the -- there was a comment in the MD&A that strategic deposits are a lot more stable than your other source of deposits. Can you just refresh me on the rationale behind that or the explanation?

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

Yes. So typically, these -- so in general, if you approach a deposit board with a deposit product of some kind, these are open to everyone. We might be competing with other suppliers in the market for deposits. And people don't feel particularly special relationship with us. The strategic relationships though are more around when people looking to have white label products. So it's us holding the deposit underneath it. We have a much more detailed contract with the distributor that does things like control their ability to move deposits fast from us, controls the way that people behave around this and aligns us much more closely. And so we see evidence that those are much more stable types of deposits than the more general corporate market that we go into.

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

Okay. And can you just remind me, is this -- is there a handful of strategic deposit relationships or partnerships? Or are we talking like several dozen?

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

No, it's a very small number.

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

Very small number. Okay. And last one for me, and this kind of goes to the medium-term objectives and I think you started to allude to it a little bit. But if I look out 3, 4 years from now in trying to achieve the CET1 ratio target of 13% to 14%, given the amount of internal capital generation that's coming off these businesses based on the guidance, I mean, there has to be some form of share buyback built into those forecasts. So is that a key component of driving EPS growth in the, let's say, 3, 4, 5 years as we get out that far? Or is share buyback something that could be coming, I mean, as early as 2020 to help drive that EPS growth?

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

Tim, to get your complete system forecast, how did you derive them?

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

I mean, I think, Jaeme, the primary contributor to the EPS growth over the medium-term is going to be the factors we outlined earlier, mainly continued growth in our assets, stable margins, low losses and improving cost of funds.

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

But I do think that we will be having conversations with you about share buybacks over the next few years. I think you probably were right on point, Jaeme, around how we need to be thinking about this because what we're trying to do is find opportunities in the market that will see growth through assets. But clearly, our view is not to hold on to capital -- shareholders capital they can deploy elsewhere more attractively. So if we see ourselves building excess capital, then that will certainly be part of the dialogue that we have. It's a conversation that we haven't yet had with the Board, and you'll see that the general move around sort of capital is -- we're starting to head in that direction just by suspending the DRIP this quarter is an indication of where we feel about where we are with -- about with capital as we sit.

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

Okay. So I guess the takeaway here would be that 2020 is probably a little bit early to be having these conversations?

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

Yes, I think so. I mean, it's probably time -- good time to be having these conversations about what the future might look like, but it's probably not a year that you should expect us to be making any -- to be having the conversation with you trying to understand market's perspective, our choices as we did last year with the dividend increase. And I thought it was very good feedback we got from our shareholders in order to allow us to make appropriate decisions. And I wouldn't be surprised to see us having some of those conversations this year.

Operator

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

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

Well, thanks, Megan. In signing off, I offer my thanks to every member of the Equitable family, business partners included, especially our employees, for making 2019 a milestone year for growth, expansion of our business, profitability and service. I also thank our customers and shareholders for your continued confidence and trust. 2020 will mark Equitable's 50th anniversary and we're determined to make it one for the record books. For those on the line, webcast, including our analysts, we very much appreciate your time today and look forward to reporting our first results of the new decade on April 28. Goodbye for now.

Operator

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

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.