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PRESENTATION

Operator

Welcome to EQB's earnings call for the second quarter of 2023 on Wednesday, August 2, 2023. At this time, you are in a listen-only mode Later, we'll conduct a Q&A session for analysts. Instructions will be provided at that time. It's now my pleasure to turn the call over to David Lee, Senior Manager of Investor Relations for EQB, please go ahead.

David Lee

Thanks, Colin. Your hosts today are Andrew Moore, President and Chief Executive Officer; and Chadwick Westlake, Chief Financial Officer. For those on the phone lines only, we encourage you to log on to our webcast as well to review our accompanying quarterly investor presentation. The presentation included on Slide 2, EQB's caution regarding forward-looking statements as well as the use of non-IFRS measures on this call. All figures referenced today are adjusted or applicable or otherwise noted.

Now my pleasure to turn the call over to Andrew.

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

Thanks, David, and good morning, everyone. As this year and decade prove Equitable is consistently put in great numbers on the board. Through effective execution of long-term strategies, those numbers include Q2 earnings of $115.5 million, an all-time quarterly record and ROE of 18.3%, which adds to EQB's status as the Canadian banking industry leader in shareholder value creation.

We regularly assess the 10-year total shareholder return of all Canadian and S&P 500 banks. This week, EQB is on top, and it certainly is nice to see us outperforming all of the leaders on Wall Street and Canada's largest banks on this important outcome for shareholders. We do not take this performance for granted. This also comes why we firmly believe a wide discount remains in the value of our bank for investors --reminds us that we must stay true to our capital allocation, branchless business model and Challenger Bank approach and all fronts, we can be positioned to continuous return trend for the next 10 years and beyond, outperforming our industry in a very meaningful way.

Another figure that delights me is 543,000, the number of Canadians now relying on Canada's Challenger Bank to deliver our mission of changing banking to enrich people's lives. We're making a concerted effort to grow and engage our customer base through innovative value-enhancing services. Those efforts are working, but also an institutional responds to challenges. During this time with higher interest rates, our processes and monitoring activities are keeping our credit book in good shape. Chadwick will speak to results and the progress of our Concentra Bank integration plan.

On my part, I'll discuss conditions in our priority markets, updated increased 2023 earnings guidance, innovations to watch for and a comment on a regulatory development. First, market conditions. As expected, the 10 bank of policy interest rate increases totaling 4.75% since March of 2022, and the resulting slowdown in the housing market reduced single-form family mortgage application volumes compared to prior periods.

At the same time, loans are staying on our books for longer and renewals are stronger as more customers opt to remain in their homes. The housing market has gone through a correction, and prices are now showing signs of improvement. At the very least, there seems to be a floor under house prices that gives us more confidence in our credit outlook for that part of the book. With growth of 3% through June, we now expect the bank's conventional personal lending portfolio to grow 5% to 8% for the 10 months ended October 31. We will provide our 2024 outlook when we report our Q4 results in December.

And now I can share that we expect higher growth next year, a reasonable assumption given the housing market's fundamentals fueled by population growth, sub-pent-up demand caused by current housing market conditions and presumably by then, more stability in interest rates.

In commercial, our priority market is multifamily, including affordable housing, where demand for CMHC insured products is strong. From a risk perspective, we like our positioning as over 2/3 of our commercial loans under management are CMHC insured. I encourage you to review past disclosures, which will help you get very comfortable with our commercial lending activities.

With growth of 5% through the first half of 2023, we now expect the conventional commercial portfolio to expand 8% to 12% for the 10-month fiscal reporting period without degradation in our risk profile.

Growth will be faster in insured lending, where we are protected from credit loss by the government of (inaudible).

Turning to liquidity and funding market, it appears the fallout from U.S. bank failures earlier in the year continues to be contained. Structurally, it's evident that Canada enjoys an advantage over the U.S. While U.S. money market funds for mechanisms to deposit funds directly with the Federal Reserve taking liquidity out of the banking system. In Canada, money really only moves between banks is an important difference.

For our bank, total deposit growth was 37% year-over-year with ample liquidity on the balance sheet, a well-positioned liability structure and access to liquidity to fund the operations of the bank, our foundation is strong.

Moving to earnings guidance. We're aligning our financial results calendar to improve our reporting comparisons to Canadian bank peers. 2023 fiscal year will end on October 31, covering only 10 months on a onetime basis. To make it easier to track progress in the Q2 MD&A, we provide guidance for the 10 months reporting period ending with a 4-month Q4 as well as 12 months guidance as a relative checkpoint if we had not been changing fiscal years. Not to be lost in the recap, we raised guidance for EPS, ROE and book value per share growth. As the slide in our deck at the table in our MD&A show, through June, we are performing well ahead of original guidance, including adjusted EPS growth of 20%, 7% year-to-date versus original calendar guidance of 10% to 15%. This momentum gives us confidence to increase expectations. Our next carding report is set for December 7, and we'll publish our regular detailed annual guidance for next year at that time. I believe we are the Canadian bank with the most upside of the industry, and we are investing in ways that are adding value for our customers and momentum for Equitable.

The recent introduction of the EQ Bank card now in the hands of 75,000 Canadians who have used it in 140 countries, last month's addition of the mobile wallet to hold that card and benefits from the launch of EQ Bank services in Quebec are all having their desired effect on customer expansion and engagement. At the end of the quarter, customer growth had increased 31% year-over-year. As of today, over 375,000 Canadians now have EQ Bank accounts. As a result of adding the value and functionality to make the EQ Bank platform capable of serving Canadians everyday banking needs, we experienced a good increase in the potential customers to deposit payroll in EQ Bank, a sign of trust and belief that's evident in our customer satisfaction visions. Daily transactions also illustrate that customers increasingly see EQ Bank as a sold alternative to traditional bank checking accounts.

In late July, we had another reason to make bank with Equitable by introducing the market's first all-digital first home savings account product to the EQ Bank platform. The EQ FHSA -- savings account is a tax-deductible way for customers to accumulate a down payment for a home purchase much faster than rival banks because of our high everyday deposit fit rates and 0 fees -- the EQ FHSA is completely free and there's no need to visit a branch to start an account. In just 2 weeks since launch, customers have opened more than 2,400 EQ Bank FHSAs.

(inaudible) to the EQ team for working through CRA reporting requirements to get this product to market and to the Concentra team for introducing it to credit unions through our Concentra Bank Partner Portal. 80 credit unions have already signed up to participate a great start. While generally, we're working hard to increase EQB's presence in the credit union system throughout reach activities, including our attendance at the World Credit Union conference in Vancouver. At the conference last week, I came away with a reinforced view that there is tremendous opportunity to work closely with credit unions to build value for all, and we're actively pursuing a number of initiatives to make that happen.

Progress in our reverse mortgage business also has been positive. This fall, you will see a more prominent advertising message to drive enhanced consumer awareness of our differentiated reverse mortgage solutions.

Around the world, we see the difficulties large banks have in serving small business effectively, but Canada being no exception to that general reality. We're on the cusp of changing that too as we put the final touches on our first EQ Bank, small business account. The start is will be a minimal viable product on desktop and then a mobile app. It promises to be a game changer for business owners due to the digital experience, elimination of bank fees and good interest on deposits in the accounts. I'm really excited about this one. A final thought on the regulatory development.

Open recently proposed changes to capital at to address risks related to variable rate mortgages. EQB has no exposure to these increased capital requirements because we stopped offering berms 12 years ago, a move to adjustable rate mortgages or ARMs, which can adjust payment to keep amortization of the original terms.

The financial institutions are always risks to address, and we are diligently ensuring that our bank is prudently managed to navigate the challenging economic environment. We are feeling confident and I think just a baby so in EQ's positioning as Canada's Challenger Bank. 23% year-over-year dividend increase we announced is delivering on the commitment we have made to shareholders and a reflection of the strength of the bank's place in the market.

Now over to you, Chadwick.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Thanks, Andrew. I'll brief as Q2 and year-to-date results demonstrate how well EQB is performing the guidance despite the economic backdrop. With year-to-date ROE now at 17.5%, and our outlook for the rest of 2023, we're well positioned to achieve our goals with momentum into fiscal 2024. Q2 reflects the second consecutive quarter of full results from Concentra Bank. In this short time, what we believe to be true about the value we could create with this acquisition is translating well. We've set a target to achieve annualized cost savings of $30 million within 18 to 24 months post-closing. This has been achieved ahead of schedule. This progress is reflected in our strong earnings momentum ahead of guidance year-to-date. -- our efficiency ratio closer to historical trending at 42.8%, a 2.6 percentage point improvement from Q1. This is also particularly strong given the prior efficiency ratio of Concentra was nearly 70%.

We continue to invest in the Concentra technology migration, but the adjustments in the quarter further narrowed, which you see between reported and adjusted figures. In general, I would call primary financial metrics for this integration complete. We are winning in service delivered to our new customers from Concentra and the credit union partners we serve and the technology work will continue in the year ahead.

In Q2, the most notable adjustments to our reported results included $3.4 million pretax related to integration costs, down from $4.7 million last quarter. We also made a couple of other adjustments, including removing the onetime $28 million noninterest revenue benefit from a strategic investment that I'll speak more about in a moment. Today, I'll complement Andrew's comments with a few key focus areas: margin funding, noninterest revenue, credit performance; and lastly, rounding out 2023 guidance.

First, margin. This remains a distinct competitive advantage that was proven again in Q2. 1.99%, NIM expanded 7 bps from Q1 and 18 bps year-over-year. This trend is even higher than target with growth across our conventional loan portfolios and yields on those portfolios growing at a faster rate than our diverse funding costs, plus higher sequential prepayment income. You'll recall that prepayment income accelerated during the pandemic and dropped off when rates started climbing. Over the past couple of quarters, we're trending back towards a more normalized level.

The strong net interest margin led to a 6% increase in net interest income over Q1 and a 50% expansion year-over-year, including the benefit of Concentra. We're getting to expect to lift from our long-term efforts to diversify and strengthen sources of low-cost funding. Retail and securitization funding markets continue to be liquid and efficient for our strategy. In terms of stability, 95% of our deposits continue to either be term or insured. Our match funding focus and approach to hedging are serving us well.

Beyond direct deposits, our funding stack contains a variety of wholesale options, including $1.7 billion of covered bonds, $1.9 billion of deposit notes, $2.2 billion of credit union deposits and $102 million of strategic corporate and institutional partnerships. (inaudible) union deposits declined sequentially aligned to seasonal expectations for the segment, consistent with past patterns at Concentra Bank.

I said last quarter that you should expect to see us in the market for a fourth covered bond issuance in Europe, and we delivered that in Q2 with a successful EUR 300 million offering at 52 bps over the euro mid-swap rate, which translates to CDOR plus 68 bps. We will remain a regular issue of covered bonds in Europe as we see opportunity to add margin tailwind with a strategically important funding source. Our capacity for issuance expanded with Concentra Bank and other synergy.

We talked in the past about the low deposit beta largely attributed to EQ Bank. This continues to translate on our margins while giving our customers a great deal, including competitive everyday savings rates and a host of no fee banking services. Sequential growth of 9% in EQ customer accounts, 35% growth in transactions and a steady record high 51% engagement score through the first 6 months of the year demonstrate our expanding franchise value. We are focused, in particular, on growing EQ Bank customers, and this is trending extremely well on a daily basis.

Deposits are below our prior targets, but that's the outcome of steering away from short-term competitor promotions and instead focusing on leveraging all of our various funding levers while yielding the long-term value of the bank with a customer lifetime value to acquisition cost ratio of at least 7x to 10x. We now expect EQ deposit growth of 5% to 10% for the 10-month period ending in October with an uplift from our new FHSA more to come after small business launches in EQ Bank.

To complete the revenue picture, noninterest revenue increased 18% over Q1 and more than doubled year-over-year. Reflecting our strategy, noninterest revenue accounted for 12% of total revenue compared to more mid- to high single-digit historical trending. The way to think about this deliberate noninterest revenue growth anchors back to our 2022 Investor Day when we outlined our plan to increase this to at least 12% to 15%, which is well on track. If anything, we'll be targeting a higher amount over time.

This quarter, you can see strength in fee-based income that increased 7% compared to Q1 and 84% over last year due to the addition of Concentra as well as strength in securitization income, which increased another 12% sequentially. We had a sharp increase year-over-year with higher activity in our insured multi-unit residential business.

Now in terms of the onetime gain of $28 million, we started separating out a line for strategic investments with noninterest revenue in our MD&A back in 2021 to isolate noncore games. These are proprietary investments that from time to time include FinTech-related mark-to-market changes and also a time special dividends from common share-based investments. To ensure a more consistent revenue line comparison, we removed this revenue from adjusted results.

Now to credit risk trending. PCL was $13 million, an increase of $7 million from Q1 when we had a $2.3 million recovery from one commercial loan. The increase reflected portfolio growth, modest changes in macro forecasts and normal course loss recognition. Net ACO was 20 bps compared to 19 bps at March 31, 2023. This is in line with our expectations given lending portfolio growth and economic conditions. The way to think about the 1 basis point net PCL increase quarter-over-quarter is that about 2/3 is related to shifting macroeconomic variables and 1/3 is due to an increase in our gross impaired assets.

Changes in macroeconomic forecasts really impacted our Stage 1 and Stage 2 allowances where we deploy complex risk models to forecast future losses on our performing loans. These losses may or may not materialize depending on whether customers behave as expected and economic forecasts unfold as anticipated.

The $2.3 million increase in Stage 3 allowances is where a credit event, such as a loan not making a payment in 90 days, has triggered a need for a specific allowance that's determined on a loan-by-loan basis. Of the 13 million PCL booked in the quarter, just over 50% is related to equipment financing where the high loan yields reflect this risk. And as a reminder, on our lending portfolios, nearly 100% is secured, over 51% is insured. The average LTV for our single-family uninsured portfolio was 63% in Q2 compared to 65% in Q1. We don't offer single-family variable rate mortgages. Commercial office represents less than 1% of our total lending and over 2/3 of all commercial lending is insured against credit losses. We are holding to our consistent risk management framework.

As expected and communicated previously, impaired loans have continued to increase, but we continue to not expect to lose money on these impairments. Due to growth of the portfolio and the fact that we are at a different point in the credit cycle, our gross impaired loans increased $76.4 million or 49% quarter-over-quarter to $233.3 million, but about 2/3 of that amount relates to 2 commercial loans, and we are fully provisioned for any expected losses.

Moving on, and as Andrew said, we have presented guidance for the 10 months ending October 31 and from what would have been 12 months if we were not changing to our fiscal 2024 reporting year as of November 1 this year. Our refined and higher guidance reflects excellent performance for the first 2 quarters. I'll repeat that we will not be reporting Q3 results with this change. Our next reporting will be for the 4 months ending October 31. As every month is different, we needed to recut guidance to account for November and December this year, moving into our 2024 fiscal reporting calendar. The change from a calendar to a fiscal year will make EQB more directly comparable to publicly traded Canadian bank peers. For the relative 12-month period, in the MD&A, we outlined that we would have expected diluted EPS growth to increase to 18% to 21%, up from 12% to 15%, pre-provision pretax growth of 30% to 35%, up from 25% to 35% and book value per share growth of 14% to 16%, up from 12% to 15%. The corresponding 10-month period measures are also in the MD&A. We expect CET1 for the 10 months to remain in line with our original guidance of 13% plus and no change in our 20% to 25% dividend growth guidance. We expect stability in our net interest margin.

Guidance for the 10 months also reflects our expectations for expense levels. Now that we're achieving cost synergies with Concentra and planned investments in people, process and technology. While we plan to increase investment spending related to exciting new campaigns in the works, we expect efficiency within this range, but we're going to rank ROE as the North Star priority metric.

To sum up, our best quarter ever, more great and purpose-driven solutions introduced for Canadians with the best service of all banks and a lot of momentum ahead for a challenger story as we aim to continue to reduce the significant discount in our share price, while at the same time, expand our track record of delivering the best long-term shareholder return of all cures. Now we'd be pleased to take your questions. Colin, if you can please open the line for our analysts.

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, we'll now conduct a question-and-answer session. (Operator Instructions) One moment for your first question. Okay. And your first question comes from Meny Grauman from Scotiabank.

Meny Grauman - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

First question, maybe on credit Chadwick, you highlighted the equipment finance business as a source of some of the impaired loan provisions this quarter. I'm just hoping you could give us a little bit more color in terms of what's going on there? Is it a few specific loans? Anything you can give us in terms of what's driving the increase that we're seeing this quarter in that portfolio specifically?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes. Thanks, Benny, for the question. So I think as we've always talked before, where we would expect to see credit losses and we price the credit losses is in our equipment finance business. I generally think about our real estate businesses as lending that we lend to not lose money effectively the odd time we get the idiosyncratic loss, but that's why over the last 12 or 15 years, I think our average losses in our real estate businesses is 1% -- 1 basis point per annum. So extraordinarily low. We do end up with the odd tell the story in front of investors a house slip-down at lift. And so we changed our policies and stop learning on houses that might fall out cliffs and that's an effort to reduce that 1 basis point.

But to go back to your question to on equipment finance, we do price for loss. We're lending on a faster depreciating asset, lending to start-up businesses, which goes right to our purpose of helping people kind of build wealth. But with the new to people say, starting up a trucking company or may have 2 or 3 trucks where they're looking to buy another truck. Over the last couple of years, frankly, we've done much better than we would expect in this business. This is a business we've only been in since 2018. And over the last couple of years, we're running roughly speaking, the earnings of this business is like 2x our purchase -- sorry, a PE of 2 basically on a purchase price. So we are seeing credit losses back to more normalized levels. I'd say what you're observing in that area are falling secondhand equipment values as supply chains get trained up. So a year or 2 ago, the price of secondhand drugs and trailers were high in a shortage of -- and supply chains were constrained. So freight lines were able to higher rates. And to the extent we had defaults, we could get very good recovery values. Clearly, that situation has normalized.

Now the good news is we actually tightened our credit stance about 12 months ago. And the typical lease goes into default after about 20 months to 25 months. So it looks like we actually kind of got ahead of this issue and it is diversified across sort of large pool of what I would mostly transportation equipment is really where we're seeing these defaults and losses. But I do think that there -- I don't know what they peaked, but they certainly -- I don't expect to see in future quarters an increasing trend in a meaningful way of this kind of loss increasing? And if you sort of take a stand-alone for you, even with these costs running through the P&L of the lease the equipment leasing business is still a very attractive business for us. To have a short question that I may have (inaudible) I think it's important to have the background there.

Meny Grauman - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

I wanted to switch gears, Andrew. In your remarks, you gave us a little bit of insight into the outlook for growth or loan growth next year. And I think you referenced it, but I just wanted to clarify in terms of what kind of rate outlook is that based on? Is that assuming the Bank of Canada stays at 5%. What's the rate assumption as you look ahead into next year?

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

As we've always been consistent no, we don't think we have any insight in forecasting rates. So we just use what's the implied market implied rates from the forward market. So I think the jury is out as to whether the bank has one more 25 bps move. I think we probably my comments are not particularly sensitive to that one more move, but that we would -- if we start to see more than one rate increase upwards, that might take my comments off the table a bit and starting to see The Bank of Canada move into an easing cycle perhaps in the first, second quarter of next year. I think that would be the context of which you're making those remarks.

Meny Grauman - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

Got it. And I wanted to ask about the revised guidance, specifically the ROE. So year-to-date, ROE, 17.5%. So it makes sense that you're taking the guidance up. But I guess the question is, so you're taking it from 15% plus to 16% plus, given year-to-date performance, there's room presumably to take that guidance up even higher. So I'm just trying to understand your thinking there. Is there any sort of message we can read into that in the context of 17.5% year-to-date potentially signaling that you do expect a little bit of a moderation here in terms of the ROE going forward?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes. No, we'd expect a consistent trend. It's sort of the nuances of where we're at year-over-year. You got the Concentra portfolio. We had different earnings picture. Obviously, last year as well in Q1 and Q2. But for ROE, I think we're just being thoughtful about where the market goes earlier over the next 4 months. And I still expect us to see us at the higher end of the range. But at a minimum, we want to move up the floor to provide some comfort, but I would expect some consistency.

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

I think just to add on to that. I think our approach is generally to be sort of relatively conservative in our approach to stance, whether it's a 1% difference. A few things can move to change either way, obviously, a 16%-plus ROE is a very credible outcome by any standard.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

That was kind of the -- as you see that consistently, too, right, it's part of why I think you might have seen in our guidance as well. So we've obviously given that 12-month and 10-month view to the guidance. But it's also just the nature of remember, for some of these pictures of 10 months versus 1 month. So EPS on a relative basis may look a little lower, but that's just again, we can earn as much in 10 months. And again, if you look at the year-over-year, what happened in Q2 last year. So the earnings picture is very different now on a year-over-year basis, and Concentra kind of changes the delta. So I think net-net, you should see the guidance is quite positive across the board.

Operator

Your next question comes from Geoff Juan from RBC Capital Markets.

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

I had a question on the Alta part of your business. It just -- it appears that despite having the higher mortgage rates that we've seen and also relative to prime borrowers and also perceived higher credit risk profile. How would you explain why your Alta borrowers so far haven't seemed to have issues renewing the mortgages at these significantly higher mortgage rates?

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

Certainly, a very encouraging thing is when you look at the performance of those borrowers within our book that are self-employed. So they seem to be a pretty resourceful bunch, I mean that's certainly my high degree of respect for that kind of part of the economy. And I think it's fair to say that they probably still got -- they've got more reserves and more capital available to support mortgage payments that probably is even clear to us in the underwriting and look at typical self-employed person if they are having increased mortgage payment shock in this kind of environment, they're able to take on an extra contract or whatever it is to get the extra income, work an extra day in the week to get that extra income. And so I think that's what we're seeing observing the entrepreneurial community is pretty good at adapting to these changes in the economy. And -- that's what I would mostly put it down to.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

If I may just add, too, Geoff. So remember, again, we don't able these as (inaudible). Again, these are single-family uninsured with -- and you can think about a residential mortgage underwriting policy is pretty consistent with the D-SIBs, but we are underwriting, right? We're investing more to underwrite and understand these customers in a different way other borrows, and that's why we've also framed that very carefully. And then hence, the quality of that borrower is higher and you see that consistency in our Beacon scores, the LTVs, the markets where we're lending. So again, just the framing on how to think about these borrowers, they are on quality.

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

I think the other dimension is sort of the character relevance of the 5 Cs of credit that we already think about, which is many of our customers have first-generation Canadians around to in (inaudible)or in the pride of ownership and the effort that people go to, to maintain that home to bring up their family and so on is very high. So we see that as aligned with their values is helping keep the mortgage current, and so we're much aligned with them in that world.

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

Okay. And just my second question was the adjusted efficiency ratio was just under 43% in Q2. Just wondering, bigger picture, as you pursue your growth as we get through the Concentra integration, where do you see that adjusted efficiency ratio going over the medium term?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes. It's -- I'd say -- again, I'll say it again, I don't want to be a broken record, but the main one we're going to focus on is ROE every day of the week, and efficiency, the way to think about it is it's probably within this ballpark, but it's going to be plus/minus on the quarter as we particularly think of some of our investments in EQ Bank and this inflection point that we're at. But in general, if we were historically in that kind of 42% range, it's still in that ballpark, plus/minus, but our priority will be the ROE, to be honest.

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

Yes. And just to sort of follow on that, so what any one area that I'm very interested and believe we've underinvested in the past is marketing. So that running at the doses during the hockey playoffs really seem to change the mindset of consumers about the -- the bank proposition. And we're working on something that might find really compelling in that area that I think would really sort of changed the mindset with a different demographic. So we may choose assuming that comes to fruition. we're not there yet. We haven't got lined up what we want to do yet, but I'm hopeful that we would have a good opportunity, good NPV in terms of advertising and marketing in the upcoming quarter and probably through the next quarter and that really could change our brand proposition, but that will create some short-term expenses that would have a negative impact on the efficiency ratio.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes. Kind of the other way to think about it Geoff, we'll continue -- we've said in the past, we'll continue to think about it on an annualized around trying to keep that operating leverage flat to positive. But to Andrew's point, right, it doesn't mean you won't see a quarter at, say, 44%, you won't see a quarter at 42%, plus/minus as we make some of these smart investments that that will pay off in the top line, too.

Operator

Your next question comes from Lemar Persaud from Cormac.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

I want to turn to Concentra here. You achieved those synergies well ahead of target. So the velocity is faster than expected. But what about the magnitude of the cost savings? So can you maybe talk about any additional synergies you may have identified above and beyond, I think it was the $30 million you referenced.

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

I don't give you a big picture, and then Chad will give you the numbers. But I think generally, we're feeling good about having achieved cost savings faster and they're likely to be better than we had hoped. But I would say there's more complexity under the hood around sort of unwinding systems and that kind of thing. So fully resolving all those issues will take a little longer than we might have expected going in. I think we did great diligence on that. So I feel really good about the big picture, but there's a lot of complexity in the technical stacks and banks, as you know, you all know and that will probably take a little bit more refit of our team, probably not so meaningfully to our outside investors, but certainly iterative energy required just to solve that alone.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes, I'd say if you think back to the -- as we look at this as a business case investment or is how do we deploy capital? I'd say the top line is coming in stronger than expected. So we've retained more business, and we're growing more business, as Andrew noted, with our credit union partners that includes loan syndication opportunities, more credit and services and there's some more referral business, including as you think about even equipment financing and how we're partnering with that distribution channel and offering our products. So those have been positive upsides, including the -- how we've retained those funding sources. And then you think of an additional synergy level, for example, even the credit rating increase that we received that had positive tailwind as well for our interest expenses.

And then you think of the covered bond issuance we just did that we were able to also pursue this year because of the additional capacity because of consensus, that's another plus side. And then when you look at the cost side in general, Lemar, if we were saying $30 million, I won't necessarily give a precise figure, but we -- I would say we will overdeliver that on an annualized basis and by over, I'd say, comfortably stand by well over 10% that we overdelivered on an annualized basis. So all that with the way we're going as these numbers become more integrated, all that's reflected in our updated guidance. And that's why our guidance has also increased in addition to the other core portfolio growth. Does that answer your question?

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

Yes. Yes, it does. I mean the consent is clearly evolving better than I think any of us were expecting on this to really kind of understand all the moving parts here. Some of them are easier to understand than others, to be honest with you. Just moving along that, just on noninterest revenues, Chadwick. I think you might have mentioned this in your opening remarks, but I probably missed it. But why are we excluding the gain on strategic investments in your adjusted results? Like we don't usually see those kind of reverse out of adjusted. So wondering why that was the case this quarter? And then what can we expect that moving forward?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes, it was the magnitude of it. So we -- you're right, you have seen those in the strategic investment line in the past -- plus/minus a couple of million here and there. But when we think of consistency and transparency on the core business for our investors, we didn't think it was appropriate to show that through the adjusted results, especially when you look forward a year and look back, it could be a little bit confusing. So it's certainly there reported. Importantly, for our investors, it's there on the book value either way. But for cleanliness of reporting on a go-forward basis, we made the prudent choice, I think, to exclude that from the adjusted side as a noncore game. It's kind of that simple to post.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

Is there kind of a hurdle rate, like, let's say it's over $10 million, we're going to see it adjusted. But if it's less than, then it will be included in the adjusted results. Like is there like a hard line in the sand on that or no?

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

Hardline maybe something we need to think about to actually sort of set the expectations with you because otherwise you can get a bit noisy, but... I think that's a good suggestion that you have there, and we might choose to adopt.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

Okay. And then Yes, that would be helpful. If you could just communicate that to you. And then just sticking with noninterest income, that's 7% sequential loan growth in fees and other income. It seems that there's some reclass benefits in there from gains on loans and investments. So maybe could you talk a little bit about what the -- let's call it, the core underlying growth figure would have been? Because that 7% sequential in fees and other income seems a bit higher than I would expect. I typically think of that line as being more stable. So maybe you could help me understand that a little better?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

So that would be -- the fees would be core. So we've had -- so remember, there's a lot of things built into (inaudible) right? So we have the credit services. We have Concentra Trust. We have EQ Bank payment solutions. We have actually quite a few fee categories that come in there. So a lot of that is core, where you could see sometimes in some quarters, you could see some very light volatilities depending on -- even on our trust business, when you see certain estate fall ins, some of those businesses, the newer businesses for us can be a little bit more lumpy. But I'd say that is core fee-based growth, including even new things we offer, including on the payment side and EQ Bank and some of the prepaid solutions and including what we do with Black Hawk, but there are some great new solutions.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

So then let me try this. With that $14.5 million this quarter, is that an appropriate starting point to think about the fees and other income line? -- going forward?

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

I think don't forget there is securitization income in that number, right?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

It's all part of the $6.1 million. So it's kind of plus/minus, yes. That's -- it's a fair starting point, Lemar. And I know it's -- you're trying to get to a new clean baseline because this is only the second full quarter with Concentra, but kind of plus/minus for the fee side.

Operator

Your next question comes from Etienne Rickard from BMO Capital Markets.

Etienne Ricard - *BMO Capital Markets Equity Research - Analyst*

On EQ Bank, you're expecting deposit growth to be in the high single digits this year, which essentially implies that EQ Bank as a percentage of your mix should stay relatively flat. Now I understand it's a balancing act -- on one hand, you're offering -- offering the attractive rates and growing deposits. But on the other hand, also leveraging that platform for NIM expansion. Looking part, how do you think about balancing those 2 given we're in a higher and arguably more competitive deposit market today relative to a year or maybe 2 years ago?

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

Yes. I'm not convinced we're in a higher competitive scenario, frankly. Our proposition is very clear. You got a great reg with EQ Bank every day, every year, we're consistent on that. Our competitors, the primary 2 competitors, we think of in that space tend to come up with these short-term rate specials that the day because of the inverted yield curve, various other factors, they're coming up with some pretty high rates. Now you only get that money for -- you only get that high rate for 90 days or whatever the particular promotion is -- and we're not really interested in chasing and competing with that. There's no real way for us to do that other than the breakup around promise to our existing customers. So it is a subtle thing. What we're trying -- what we believe we're doing well having, we believe, fantastic success is showing that the innovation we're bringing to Canadian Banking has really makes EQ Banks the place to deposit your money.

For example, if you take your EQ Bank card on Europe to Europe with you to draw money at the ATM, you're likely to end up with 3% more cash in your jeans after drawing money out of an ATM than you would otherwise. So it's these kinds of valuated compared to any other bank can (inaudible) have correct if I challenge anybody, the EQ Bank card is the magic card to take our vacation. So that's where we're trying to drive the value prop. And as we say, if we sneak up rates, we will see faster deposit growth little bit of expensive NIM, but also potentially kind of a rolling up brand promise. So really we're trying to present the full value of the platform. I think you will see over the next little while, some enhancement and rate for those people that are super-engaged with us. And of course, from a risk management perspective, we want this to be -- we believe, first of all, there is a huge value in the account for this being somebody's everyday account every day bank account. But clearly, from a risk perspective, to the extent that we're part of households kind of key financial metrics, it reduces the liquidity risk to us and the risk of runoff, which is an important part of our consideration set. So clearly, we could grow EQ Bank faster if we increase rates and so on, and it would be a huge source of liquidity if we did that. I see it as a huge safety valve. That option is always open to us as a management team. But I think we're sort of going -- thinking our way through quite nicely, right, now kind of growing at a good clip. -- but not choosing to participate in some of some activity in the market.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

And if I may say, too, just again, I'll bring you back to what we said earlier. The one key metric we're tracking is customer growth, right? So what we still believe to be sure we're making a difference and we're growing the franchise value, and you see that in the 31% customer growth year-over-year and the amount of growth sequentially. We're literally still adding hundreds a day. So as we think about the rate environment, the products and services coming on, we do believe we could increase the deposit levels with those customers that we're bringing on as the time is right and as we add more products and services. And then again, you see the momentum to points like the HSA and as we add small business. So it's how you think about the overall economics of the business are evolving and maturing.

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

Yes. Just we can be long winded our answers today. But the other thing to think about is the value of the term deposits inside EQ Bank you do get great rates on term deposits in general, you should deal with EQ Bank rather than deal with the deposit brokers to get a term deposit, we're generally going to always beat the term deposit market. So it's an extremely attractive platform to come in from that perspective. Even then because we're able to not pay as much in commissions for the deposit brokers. This represents a funding cost saving compared to going through brokered deposits that really only plays out over a multiyear period. So somebody buys a 5-year GIC through EQ Bank today, we might be saving 20 basis points a year over the next 5 years, and that will show up as increased NIM over that 5-year horizon compared to raising a broker deposit.

Etienne Ricard - *BMO Capital Markets Equity Research - Analyst*

Andrew, that was my next question. Actually, what do you see as the optimal balance between turn and demand deposits at EQ Bank? And how should investors think about the resulting economics?

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

Certainly, the resulting economics are much higher to the extent we have demand deposits, but of course, there's an offsetting riskiness around demand deposits, which I understand and worry about. Just to reiterate, we only allowed a bond deposit up to $200,000 in that platform. That's why we've been lobbying for higher CDIC rates. We want -- those are very -- those are in the obscene things we believe we at very stable demand deposits. I mean this 50-50 split between demand and term is something I feel very comfortable with. Frankly, I don't think we've cracked the marketing out of people coming to us just to buy GICs. We don't think most people come into us looking for the savings account and then we are able to cross-sell a deposit to them. I do believe that our message around this is the best place in Canada by a GIC is something we need to get out there more as a loud voice and if we were able to do that, then don't be certainly very comfortable with the amount term relative share of increased vis-a-vis demand.

Operator

Your next question comes from Graham Ryding from TD Securities.

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

Just wanted to start with your guidance and maybe what's implied for NIM with your revised guidance. Is it fair to say that if NIM stays at this level, that there's upside to your guidance? Or are there some other offsets perhaps baked into your outlook?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes. No, it's fair. Graham expect some consistency and then the margin to achieve that guidance. So that's -- I'd say it's -- we're not implying a lot of expansion in the NIM from there, the short way to think about it.

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

Okay. So NIM as the expansion this year has been very strong. What would you be expecting as we sort of look into 2024 or even 2025, if we do see interest rates start to come back down in line with sort of consensus forecast, what does that do to your NIM going forward?

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

It's hard to know Graham because the markets are dynamic and how we have to compete and change mortgage rates is unknown to see how competitors behave. In general, I would say that what I've observed over the last 20 years in the industry is that if anything, is rates in a falling rate environment, NIMs tend to expand a little bit with mortgage books with mortgage lenders. When rates are going up, people are somewhat reluctant to increase less manage rates here, we will post our rates every -- we think about it every week or 2. As rates go up, people are reluctant to increase rates market share. Similarly, when rates are dropping, people don't feel the incentive to be the sort of market leader to drop rates to maintain their market share. So you do tend to see a slight sort of stickiness in that environment and then NIMs expanding.

But I would add the provides that all depends on sort of competitor response and exactly what's happening in the market of a lot of things, but in general, dropping rates are good for those.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes. It's just -- it's kind of -- you get that consistency at the product level, right? And the NIM changes or as the product mix changes. So hopefully, that helps.

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

But we haven't been seeing that dynamic this year for your NIM. So what is it? Is it the evolving portfolio mix? Is it higher prepayment income? What are the key factors that are driving your NIM expansion this year as rates are going up?

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

I think 2 things. I mean, I think on the mortgage books, you are seeing that the payment income normalizing. So in an increasing rate environment than where you've got low coupon mortgages as rates increase, you tend to see the prepayment land individual loan will be reduced because it's a on an interest rate differential basis. So that interest rate differential falls in a rising rate environment and therefore, the prepayment is lower as the mortgages reset to higher rates, senator the mortgage on our prepayment becomes higher again, so you'll see that normalize. I think the other big factor for us is the deposit beta on EQ Bank, frankly. So it's not really related to mortgage pricing. It's really more related to EQ Bank and frankly, the skills in our treasury team is setting up the balance sheet to go through this kind of environment.

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

And then my last question would just be around the -- some color around the increase in the arrears that you saw this quarter, in particular, I guess, on the commercial side, I noticed that your Stage 3 provisioning had very little in there for commercial specifically. Maybe just some color on why you feel like your allowances of, I think, around 30 million in commercial are sufficient for the current level of arrears?

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

Yes. I mean, it's really a matter of looking at the loan by loan basis. The nice thing about commercial is you can say very actually a single family to, frankly, but commercial you can look at these larger loans and analyze where you are on a basis, what's your resolution plan. And certainly, 2 of them have looked at in detail and their reload LTVs, the resolution might be message and so it takes some time. In fact, I think in both cases, 2 larger loans were involved with the EQ Bank and some of it with the same borrowers. And they think that will resolve attractively, but they are -- the asset coverage is pretty good.

Operator

Your next question comes from Jaeme Gloyn from National Bank Financial.

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

Sticking with the NIM theme. I just wanted to get a bit of an update, I guess, on the covered bond programs and success this quarter. What type of cadence would you be expecting in size? Like I assume that demand remains strong from investors on that front. So I just wanted to get a sense as to how you see that funding structure building over the next several quarters?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes, sure. Thanks for the question, James. It's -- that certainly remains our lowest source cost of wholesale funding. We believe in the strategic value of the program, especially having gone into Europe for that program. We would -- we have, I'd say, plenty of capacity left at a minimum, we want to be in the market once a year. You could still even see at some point of reopening trade, moving some -- moving, say, one of our other issuances to euro benchmark of EUR 500 million. But going forward, consistency, at least once a year and growing to probably more like a CAD 3 billion plus program as our assets grow. And then the last issue you'll note, we had about 70 new investors, great investor appetite, really healthy marketing and the overall program continues to grow.

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

I guess, why not more than once a year?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

How you manage your capacity, right? So we are still capped at 5.5% of assets. We would hope that, that changes at some point to reflect the balance sheet growth. So you have to be thoughtful about how issuance could come up for renewal, so they're often 3-year term. So how they come up for renewal and how you manage your balance sheet and your issuance capability, it is important to be in the market at least once a year.

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

I think the other thing, James, just to look again is this whole risk management overlay. The covered bond market seems to has been resilient for the last 40 years. So hopefully, it will be resilient for the time to support everybody on this call. And so to have some covered bond capacity available in a tight equity market. This is something that I see as a very valuable thing to kind of have sitting on the shelf. So we would never want to be completely Max, we would want to have a lever to pull to be able to go into that market.

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

Okay. And as I think about the NIM going forward, I hear the guidance is consistent or I guess, flat for the rest of this year into next year. I'm wondering why there wouldn't be more NIM upside to be expected in the upcoming quarters, at least this expanded Q4 quarter as mortgage prices or mortgage yields that are rolling off or repricing now still at significantly higher rates, I would assume. So my view is that there would still be some NIM upside here in the next couple of quarters as that mortgage yield repricing is higher and faster than deposit costs or overall funding costs are. So I'm just want to get a little bit more color from you guys as to why you wouldn't expect more NIM upside here near term?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Well, there could be. So what we're saying we would expect for some consistency. But you got to even think of the nuances, right? When you think of margin, we said this last quarter, too. So things like normalization of prepayment income as rates change with that prepayment pattern continue or not. And every $1 million there is a better basis point you can almost assume as well. And then there's a lot of variables here. So we're saying, yes, you should expect consistency, but it could expand from here. Andrew, how are you thinking...

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

Well, the other thing course is just mix. I don't think we -- it's pretty hard to communicate the impact of NIM that mix of aggregate NIM. So our NIMs at the business line level are very consistent. But as we see a mix change because we have lower risk weights on residential mortgages, we have lower NIM on them, and they still produce great ROEs. So as we see the single-family mortgage -- single-family market expanded at a faster rate, which is our expectation, that puts a little bit of pressure on name at the top of the house at the business unit level, it's great.

So I think we always try to have a little bit of reserve to kind of think about the impact of product mix. And clearly, we don't want to make the guidance so complicated sort of assuming this product mix and then we'll do this or that. So there is room. I think. I think the general sense that we have an optimism we'll be able to at least deliver on what we promised and perhaps some upside. I think is the right way to think about it.

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

Yes. And I mean, conventional loans growing faster than residential loans or personal loans should support that NIM upside as well, at least that's -- the guidance for the rest of this year looks...

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

Exactly... I'm not expecting much in the way of -- do expect to see insured single family, for example, expand faster than other past book that actually helps them. So you're right on, that's exactly -- you're thinking about it right, for sure.

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

Okay. Good. Shifting to the credit side of the story. Someone touched on the commercial side, but I wanted to focus more on the personal loan side and delinquency rates jumping up, still low levels, obviously, when we're talking about these delinquency rates, but the direction is obviously unfavorable. So -- and we're kind of at a level now on personal loan delinquency rates that are higher than 2019. So I just wanted to get a little bit more color from you guys on what you're seeing with those delinquency rates. Is there any characteristics or themes in those personal loans that you're seeing that is driving higher delinquencies?

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

Not really. I'm still pretty relaxed about it, frankly. I do think you end up -- you end up sometimes with this kind of -- I suspect that high mortgage shock is encouraging some people to sell the house and preserve the equity and with different types of accommodation and so on. So there might be a little bit of a churn in the book as a result of that. And sometimes you have observed in the past, and I don't know whether this is true this time is that when people sort of actually sold the house, know they're going to pay the mortgage off out of the house proceeds, they intend to maybe not make that last month or 2 payments done it's going to quickly resolve. So I think that could be one of the underlying features in cost other end was exactly when people would most likely be active in the housing market moving once the kids are out of school. So there may be a little bit of that there. I mean, these as you say, though, are still very much within kind of historical norms. So -- but yes, definitely some challenges to some people are for sure, interest rate shock and what the bank ends done and how people might be listening to the Chairman of the Feder have not been concerned interest rate rises. And then we've -- we set market to change the perspective is causing some interest rate shock from people. But I would say the general big picture is it's blazing the other way, how well people have been able to take these interest rate shocks in the trade.

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

Okay. And just sort of following on that interest rate shock, I guess, if I look at the remeasurement of allowance for credit losses, a pretty big driver of, say, Stage 1 and Stage 2 increases. Normally, I would attribute that to deteriorating macro assumptions, but it seems your macro assumptions are actually improving. And so that would indicate that this is being driven by changes in credit risk. And so is it that interest rate shock that you're baking in and overlaying some more risk attached to that? Or are there some other factors here that are playing into that increase in remeasurement in stage 1 and stage 2 allowances?

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

There's a bunch of pack there, maybe probably Chad could give you more color off-line, frankly, that the impact of the models are not just the sort of instantaneous changes in forecasts, there's some time effects about how those changes flow through the models. So that's creating a little bit of -- even though the forecasts are changing in a positive way, still putting a bit more the models lead us to put more away going forward get into the newest pretty technically complicated. I think that's probably the big driver. And then we are -- we do play expert judgment to put some overlays in place here. And so that's kind of how we always -- that's the other days are done with the technical driver and again, (inaudible) you more feelings on that.

Operator

There are no further questions at this time. I'll turn it back to Mr. Moor for closing remarks.

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

Thank you, Cal. That's a great voice to conclude the call on. Before we leave you today, I want to thank my fellow Challengers for living our purpose of driving change in Canadian banking to rich people's lives. More than ever, Canadian has been a bank that works for them and ours does. We look forward to our next analyst call in early December. In the meantime, please keep an eye up for new innovations coming your way from Canada's Challenger Bank. I'll be sure to avail yourself of the opportunity to have less take and more make any for any of those -- any of you traveling to Europe in the next few weeks, I would encourage you to take the EQ Bank card with you. Enjoy your summer. Thank you for participating, and have a great day.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.