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Laurentian Bank

First Quarter 2016 Results Q&A

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PRESENTATION

François Desjardins

This is François Desjardins. During the conference call, apologies again, but we were surprised that there were no questions, but also we could not see anybody on the call having any questions, and we just learned afterwards that you were there. So my most sincere apologies.

I know that you all have to run, so just for clarity's sake what we're going to do in this unusual situation is record the call locally and post the questions and answers on the website as soon as possible after the call so that this is disclosed publicly as it should be.

I would just go one at a time and ask for your questions. Maybe I can start with Meny, who's been waiting for a long time.

Q&A

Meny Grauman

Thank you very much. I just wanted to ask about the losses coming from the AFS book, are there any changes contemplated to mitigate losses going forward? Or how do you view what's going on in that book specifically and the impact on capital?

François Desjardins

You're asking about the losses in the investment book. I'll ask François Laurin to answer that question.

François Laurin

We realized a loss of $3.1 million before taxes related to our preferred shared portfolio, and this is a portfolio that's held for the long term. We proactively manage it and we don't expect to trade this portfolio a lot so we're comfortable with the portfolio at this point.

Meny Grauman

Okay. And you realized some losses, but then there's other unrealized losses that are coming through OCI that are hitting capital. Is that right?

François Laurin

Yes. The portion that hits capital is mostly the unrealized portion.

Meny Grauman

And that's being driven by preferred shares, generally. Is that right?

François Laurin

Yes.

Meny Grauman

And I'm wondering, is there a point there where you have to realize losses, coming from a downgrading of the outlook for that. And I'm wondering if there is something there that could trigger the rest of the book to hit the income statement, just given the slide in the preferred share market?

François Laurin

There's no single concern on any of the portfolio securities owned, but typically in the past, we've recorded a loss in the P&L when there's a downgrade in the security. But at this point we're not seeing any of that ahead of us.

Meny Grauman

And if I could just ask on the loan growth, particularly the mortgage growth at B2B. Very strong. So when something is good, it's good, but definitely there's people that see some risk in that kind of growth, and I'm wondering what's your response to the view that maybe this is just too fast given the kind of environment we're in right now in terms of the leverage of households and just the overall broad economic uncertainty that it's just too fast and mistakes can happen in that kind of situation.

François Desjardins

Thank you for your question. I'll ask Deborah Rose to give her comments and maybe some additional comments from Susan Kudzman about general risk.

Deborah Rose —

Thank you. The growth year over year for B2B was very large or has been very large at 45 percent. However, that significant rate was in part due to the fact that we had a relaunch of our mortgage business back in late 2014. So now we're more in a steady growth pattern. So in the low double digits is where we are now. We feel very comfortable with that and expect that trend to continue.

Susan Kudzman

We have sound underwriting practices in general at the bank and at B2B, as evidenced by our strong credit performance at historically low rates. The credit quality of B2B Bank's particular portfolios remains good. The Alt-A in the portfolio is aimed at high net worth, immigrants, self-employed people where we verify the ability to pay. And loan loss provisions could increase a bit because the growth is there, but the risk reward remains very positive.

Meny Grauman

Credit's been a very good news story for a long time. Is there any part of your book where credit is surprisingly good? Is there anything that you scratch your head at? Or is it really as expected across the portfolios?

Susan Kudzman

Again, this is Susan. As I mentioned earlier, 12 basis points is even lower than our historically good record. We do have very strong underwriting practices. I'm repeating myself, but the numbers continue to be there, and it's really reflective of our business practices. Having said this, it is not a level that we expect to sustain, particularly with the forecast we have in growth and the change in the business mix as we move towards more commercial. So we're comfortable with the credit quality. The credit quality of the portfolios remain very good, but we do expect modest increases as time goes by.

Meny Grauman

Thank you very much.

François Desjardins

I'll take questions from BMO next.

Sohrab Movahedi

Thank you. Just had a quickie on this statement: higher risk-weighted assets due to strong—sorry. Growth in risk-weighted assets due to a reduction in the value of collateral against investment loans. What does that mean?

François Desjardins

I'll ask François Laurin to explain.

François Laurin

Typically, there is collateral for investment loans put against those loans, and when the market value of that collateral goes down it increases the amount of risk-weighted assets we need to set aside for those same loans at the time. So it varies with the market value. It has no bearing on the credit itself, but it's just a mechanical modelling that occurs with that collateral.

Sohrab Movahedi

Okay. So this is volatility caused in your capital levels because of market movements?

François Laurin

That's exactly it.

Sohrab Movahedi

Okay. And this has got nothing to do with the discussion around the AFS you were having earlier? This has to do with loans made as part of the—these are the margin loans?

François Laurin

They're not margin loans. They're loans based on the credit capacity of the borrower, but on top of that there's collateral supporting the portfolio of investments.

Sohrab Movahedi

Okay. So the collateral value has gone down, but you still feel comfortable that there has been no deterioration in the credit quality of the borrower.

François Laurin

As my colleague, Susan, explained earlier, we applied our credit ratings and policies against those loans for the purpose of the loan losses provision as well. And so our numbers reflect that exercise as well.

Sohrab Movahedi

Okay. And if I can just sneak in one other one. I think you mentioned that you obviously listed some reasons for why the margins were sequentially lower, but I think I heard you say that you expect pressures on margins to persist. What I would like to get a feel from you, if you can help us out, is persist in so far as where we were in Q1 ‘16 - we’re stable there, or is there a pressure that it could go down further from the 1.78 margin in Q1 ’16?

François Desjardins

François, again.

François Laurin

Well, given the low interest rate environment we see continued pressure, clearly from the market. However, we are clearly proactively managing our product portfolio in order to maximize our product mix. So we could expect a slight decrease in the NIM until the end of the year given all those factors. Yet many things could change; we don’t know what the Bank of Canada will decide in the next few weeks and what the market will bear as well as what pricing will be in the market.

Sohrab Movahedi

Okay. Thank you very much.

François Laurin

You’re welcome.

François Desjardins

Thanks again. I can call on the CIBC next.

Koki Akala

Thanks. Just a quick one maybe on expenses, the efficiency ratio came down quite hefty this quarter. Just thinking about as we move forward in the year and some of the investments that you spoke about on the investor day, where can we maybe see that ratio progressing over the next few quarters?

François Desjardins

Maybe I can take that one myself. I think that what we've been talking about in terms of our objectives has been to really aim at the four-year targets that we've already discussed and that is where we should be.

I will tell you that internally becoming a simpler bank also means focused investments and a culture of investments versus expenses. So I think that is a reflection of what you're seeing now; the results are positive. I would think that over the course of the next few quarters we should maintain this good discipline. It can probably vary a little bit over time, but that's where we should stand.

Koki Akala

Okay. Great. Thank you.

François Desjardins

Sumit. How are you?

Sumit Malhotra

Good. Thanks. On Slide 15, just wanted to ask about the pension item that affected capital. So this individual item of the 28 basis point in the list of the three, how much was related to the pension approximately?

François Laurin

The pension? About 12.

Sumit Malhotra

About 12. So when we think about this going forward, long-term rates Government of Canada 30-year bond yields have fallen further since the end of the first quarter. So I just want to understand mechanically how does this work? Is it that the discount rate gets reset every time bond yields fall? Is this a deficit position that now becomes a larger present value that's being reduced? I want to get a gauge as to whether this is something we need to be sensitive to going forward for the balance of the year.

François Desjardins

I would like Susan Kudzman to make some comments on this.

Susan Kudzman

What's important to know here is that our pension plan is hedged; we've made good progress on our hedge. So as you very well understand, when discount rates are reduced, liabilities go up, but in our case it's hedged so the matching assets go up also.

In this case there was a very mechanical reason for a big portion of the 12 points. On the hedged portion there is an actuarial method for determining the discount rate that was affected by two long corporate bonds that were rerated, bringing a big spread, a very unusual spread happening this one time that affects anybody that has a defined benefit pension plan. So it's not just the movements of the curve but this individual event that affected the curve in a very unusual fashion. So usually we would be a little less prone to movements in the curve than any others that are less hedged.

Sumit Malhotra

And let's maybe get to the bottom line of this. For François Desjardins: Q4, your CET1 was 7.62 percent, and you decided to raise capital. You're not that far away from where you were then, and that's after having sent some shares out the door already. So how much confidence should we have here that the capital is okay for you to manage your growth plan from this level?

François Desjardins

Well, with respect to the common share issue in December, what I had stated, and which is still true, is that we wanted in increase capital to fuel organic growth and potential small portfolio acquisitions. That hasn't changed. The unfortunate part is that, regarding the CET1 ratio of now 7.7, is that external factors that were out of the Bank's control accounted for 28 bps of the reduction that we've seen.

More importantly, though, is the organic growth self-generating of capital? And the answer to that is yes. I'd like to add that with respect to what we can control, we're doing a good job. We earned our way through the market-related weakness, and our adjusted net income increased by 8 percent year over year. NII is strong, up 7 percent year over year. Expenses are down. Efficiency ratio we've talked about, and we're growing our targeted portfolios within an environment where our credit quality remains good and where we have no direct exposure to oil.

So looking forward, to your second follow-up question which you might add is to what level would you think about reissuing common equity. And the answer to that is we have no plans to do that. We would take other measures to manage capital if we had to deal with a reducing capital ratio, but for the moment what we're looking forward to is organic growth that is self-generating of capital, and what we're looking forward to is to rebuild our capital ratio to a higher level than what we have at the 7.7 mark now.

Sumit Malhotra

All right. And one more I want to make sure I understand. So the actual—the realized losses that were taken that affected the treasury and financial market operations line, those were preferred shares, I believe it was mentioned, that were sold.

François Laurin

Mostly, yes. Preferred shares.

Sumit Malhotra

And was there anything that triggered that sale? Or was it a decision on the part of the Bank that we’re exiting this position? Or was there some event that made it mandatory that this position be written off?

François Laurin

Well, at least once a year, there's a rebalancing of the portfolio by the manager that rebalances and then that creates some sales. And then also we have guidelines internally in terms of risk and value at risk that we want to maintain. So that may create some sales at some point as well. So the combination of those two created some sales in the portfolio.

Sumit Malhotra

All right. Thanks.

François Laurin

You're welcome.

Shubha Khan

It's Shubha here on the line. Thanks for taking the question. So first question, maybe a follow- up to Sumit's question on the securities losses, you mentioned that you sort of right-sized or restructured the portfolio or sold down certain exposures. Are you comfortable with the make-up of the portfolio now such that any further losses will be primarily impairments rather than realized losses? Is that a good way to look at it?

François Laurin

I can't predict what the market will do, but obviously, it's a portfolio that's marked to market for the purpose of capital ratios, and it was a difficult January. So far the market has been better since the end of the quarter, but are we comfortable? The manager was comfortable, we were comfortable, and we have no concern with any single exposure and there's no concentration in that portfolio. But the market has not been very friendly on that side.

Shubha Khan

Okay. Understood. And then just going back to the regulatory capital question, you talked about 28-basis-point impact from, I guess, market movements or unfavourable market movements. Do you foresee any need to perhaps, in order to preserve capital, to throttle growth in commercial lending or in alternative mortgages, given how taxing they are on risk weightings? Or do you think the balance sheet will allow growth in those portfolios to perhaps continue at the pace that we've seen over the past year or so?

François Desjardins

Well, beyond the fact that our growth in our core growth engines that normally self-generate capital—capital is one of the key drivers of the Bank and we manage it proactively. We're continuously projecting and monitoring our internal capital generation, market conditions, and regulatory issues, as well as any other opportunities that may present themselves.

Shubha Khan

Okay. Perhaps one last question on the NIM, then. And, François Laurin, I understood your comments on margin pressure perhaps persisting, but if I were to take that interpretation one step further, would it be fair as to say that any continued growth in higher-margin business loans or Alt-A mortgages and any seasonally high prepayments and any possible drawdown of liquidity levels would not be sufficient offsets to the margin pressure we're seeing from lower interest rates? Is that a fair interpretation of your comments?

François Laurin

Well, there are many factors that could impact NIM, so it's not just one factor. But clearly the mix has a major impact on the NIM, and so that's why we want to be very proactive in managing our portfolio to maximize the product mix of this portfolio. We proactively manage capital and we do the same for our products to maximize the return on our products as well as maximize the return for the shareholders.

Shubha Khan

Perfect. Appreciate your answers.

François Laurin

Thank you.

François Desjardins

Is there anyone left on the line that has additional questions for us?

Therefore, thank you very much for joining us at this part two of the conference call. We will be posting either the text or the recording of this call on our website. Thank you very much, and apologies again for the mishap.

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