Conference Call
Fourth Quarter 2019
Financial Results

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LAURENTIAN BANK
FINANCIAL GROUP

Caution Regarding Forward-Looking Statements

In this document and in other documents filed with Canadian regulatory authorities or in other communications, we may, from time to time, make written or oral forward-looking statements within the meaning of applicable securities legislation. Forward-looking statements may include, but are not limited to, statements regarding our business plan and financial objectives including statements contained in our 2019 Annual Report under the heading "Outlook". The forward-looking statements contained in this document are used to assist readers in obtaining a better understanding of our financial position and the results of operations as at and for the periods ended on the dates presented and may not be appropriate for other purposes. Forward-looking statements typically are identified with words or phrases such as believe, estimate, forecast, project, expect, anticipate, plan, goal, target, may, should, could, would, will, intend or the negative of these terms, variations thereof or similar terminology.

By their very nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties, both general and specific in nature. There is significant risk that the predictions, forecasts, projections or conclusions will prove to be inaccurate, that our assumptions may not be correct, and that actual results may differ materially from such predictions, forecasts, projections or conclusions.

We caution readers against placing undue reliance on forward-looking statements, as a number of factors, many of which are beyond our control and the effects of which can be difficult to predict, could cause our actual results to differ materially from the targets, plans, objectives, expectations, forecasts, estimates and intentions expressed in such forward-looking statements.

The future outcomes that relate to forward-looking statements may be influenced by many factors, including but not limited to: general economic and market conditions; changes in government monetary, fiscal or economic policies; changes in currency and interest rates; legislative and regulatory developments, including tax legislation and interpretation; critical accounting estimates and the effect of changes to accounting standards, rules and interpretations on these estimates; changes in competition; modifications to credit ratings; scarcity of human resources; developments with respect to labour relations; information technology and cyber security; developments in the technological environment; environmental risk including changes to global environmental policy and the effects of climate change; the possible effects of global conflicts and terrorism, natural disasters, public health emergencies, disruptions to public infrastructure and other catastrophic events; our ability to execute our strategic plans including the reorganization of our retail branches, the modernization of our core banking system and implementation of the Advanced Internal Ratings-Based (AIRB) Approach to credit risk, as well as our ability to anticipate and effectively manage risks arising from the foregoing.

We further caution that the foregoing list of factors is not exhaustive. Other factors and risks could adversely affect our results. For more information on the risks, uncertainties and assumptions that would cause our actual results to differ from current expectations, please also refer to the "Risk Appetite and Risk Management Framework" section of our 2019 Annual Report, as well as to other public filings available at www.sedar.com.

We do not undertake to update any forward-looking statements, whether oral or written, made by us or on our behalf, except to the extent required by securities regulations.

NON-GAAP MEASURES

Management uses both generally accepted accounting principles (GAAP) and non-GAAP measures to assess the Bank's performance. Results prepared in accordance with GAAP are referred to as "reported" results. Non-GAAP measures presented throughout this document are referred to as "adjusted" measures and exclude amounts designated as adjusting items. Adjusting items relate to restructuring plans and to business combinations and have been designated as such as management does not believe they are indicative of underlying business performance. Non-GAAP measures are considered useful to readers in obtaining a better understanding of how management analyzes the Bank's results and in assessing underlying business performance and related trends. Non-GAAP measures do not have any standardized meaning prescribed by GAAP and are unlikely to be comparable to any similar measures presented by other issuers.

Operator

Welcome to the Laurentian Bank Financial Group conference call. Please note that this call is being recorded. I would now like to turn the meeting over to Ms. Susan Cohen. Please go ahead, Ms. Cohen.

Susan Cohen, Director, Investor Relations

Good morning and thank you for joining us.

Today's review of fourth quarter and fiscal 2019 results will be presented by François Desjardins, President and CEO, and François Laurin, Executive Vice President & CFO. All documents pertaining to the quarter, including the Press Release, Investor Presentation, and Supplementary Financial Information, as well as the 2019 Annual Report can be found on our website in the Investor Center.

Following our formal comments, the senior management team will be available to answer questions after which François Desjardins will offer some closing remarks.

Before we begin, let me remind you that during this conference call, forward-looking statements may be made, and it is possible that actual results may differ materially from those projected in such statements. For the complete cautionary note regarding forward-looking statements, please refer to our press release or to Slide 2 of the presentation.

It is now my pleasure to turn the call over to François Desjardins.

François Desjardins, President and Chief Executive Officer

Thank you, Susan and good morning everyone.

STRATEGIC FOUNDATIONAL CHANGE

2019 was a busy year for us and we made a lot of progress on our strategic plan. The most significant event of the year was the establishment of a new labour relations environment. Underpinning this new environment was a redefined bargaining unit and the ratification of a new collective agreement. This is a strategic foundational change as it significantly improves our ability to serve customers and allows us to implement process efficiencies. Now, the bargaining unit covers customer-facing positions almost exclusively, and no new positions can be added. As well, the agreement emphasizes individual performance instead of tenure and job security.

But this strategic achievement came at a cost - the cost of having to allocate a lot of resources towards building a business continuity plan, carrying a higher level of liquidity, slowed growth in mortgages and personal loans, and having to spend more on everything related to labor negotiations. All of this impacted our 2019 financial performance. However, these consequences – albeit temporary - are considered worthwhile to achieve an enduring positive shift towards a culture of performance throughout the organization.

FINANCIALLY STRONG

While 2019 was a year when profitability was below what we are aiming for. Growth in loans to business customers was strong at 9% and was driven by Inventory and Equipment Financing, as well as by Real Estate Financing. We continued to optimize our loan portfolio mix which contributed to an improvement in net interest margins. Credit quality remained solid and capital was strong.

However, some of these strengths were offset by lower capital markets revenues which also impacted our financial performance. This was primarily due to reduced capital markets activity levels given volatile market conditions and a weak investment banking environment in Canada, consistent with what we are seeing across the industry.

TRANSFORMATIVE ACHIEVEMENTS

In 2015, it was with our eyes wide-open, that we embarked on a transformative journey that would take this organization into the next decade and beyond. We are more than halfway there. Our first accomplishments: retooling and retraining our team members; rethinking and refocusing our organization – contributed to making our foundations stronger than ever before. Moreover, we are preparing for simpler and higher-value, convenience-driven products and preparing for tomorrow's customer today.
In 2019 we also:

- became the largest bank in Canada to have changed our main banking system;
- converted our Quebec-based network to 100% Advice Financial Clinics;
- and launched a fully digital offering for Canadians.

Let me elaborate on these foundational achievements.
In 2019, we implemented the foundation of our new core banking system - Temenos T24 - which allowed us to enter the digital era. With this system in place, we migrated all B2B Bank products and most of our loans to business customers to this new platform. The initiative is 75% complete and we are preparing for the migration of all remaining accounts. This is a true win as we are now able to build our future personal banking product suite.

At the more than 80 Financial Clinics, personal and business customers are encouraged to seek the advice of financial professionals and build long-term relationships. We are having real conversations with customers about their goals and how we can help in achieving them.

In the last quarter of 2019, we launched a fully digital offering to Canadians to meet their everyday personal banking needs, first through Advisors and Brokers and then direct to customers through LBC Digital. Anyone can now open, with straight through, on-the-spot processing - chequing, high interest savings and GIC accounts - using their mobile devices.

Digital is important on multiple fronts: it gives current customers access to a renewed and modern mobile-first banking experience, it allows for immediate and effective communication, it extends the reach of our Group to attract and serve new customers from coast to coast and finally, it lays the foundation for more products, services, and growth.

STRONGER FUNDAMENTALS THAN EVER BEFORE

With the spotlight on transformation, we sometimes overlook some of our core strengths that set us apart. We are a diversified bank, with multiple business units and distribution channels, that targets specialized niches. We operate across Canada and have a presence in the U.S. through inventory and equipment financing.

Our capital is strong and at year-end, the CET1 ratio stood at 9.0%, a full 1.4% higher than the 2015 level. Our funding is diversified and strong. Moreover, 98% of our loans are secured by real estate or investments, and our provision for credit losses are about one third of the industry level. Finally, we are the only Canadian mid-sized bank to have two investment grade ratings.

Across all channels in the Personal segment – Financial Clinics, Advisors and Brokers and Digital Direct to Customers – this year's focus will be on the customer experience and growth, specifically in personal lending and investment products. To enhance the customer experience, digital teams are working towards adding functionality, transactions and products to the platform and promoting our offer to Canadians from coast to coast. For Financial Clinics, teams will focus on migrating all current personal customers to the new core banking platform so that, at the end of 2020, they will have access to modern digital interfaces. Once this is completed, we will be able to gradually decommission our legacy systems, putting an end to the operating costs associated with maintaining them.

One of our growth engines has been, and continues to be, our Business Services unit. In the last four years, assets have grown by over 60%, from $8 billion to $13 billion. This is a direct reflection of our solid expertise and the strong relationships we have built in Real Estate Financing, Equipment and Inventory Financing and in Commercial Banking. Furthermore, the investments we made in Equipment and Inventory Financing are paying off and we will make additional investments in its infrastructure to expand our U.S. operations. We will also upgrade customer-facing technology to improve the business customer experience.

We are committed to harnessing more opportunities in the institutional segment and we have set plans in motion to do just that, beginning with the appointment of new leadership in Capital Markets. We believe this will contribute to driving performance in 2020 and in the years that follow.

As we evolve into a digital environment, we will continue to work on improving and automating our processes, enhancing controls and adapting practices. We will also maintain discipline, rigor and continuous improvement around cybersecurity, data security and privacy because our utmost responsibility is to protect our customers' personal information.

LOOKING FORWARD

I am pleased to report that the heavy lifting is coming to an end. As we look forward, 2020 will be the year when we complete major initiatives and focus on growth so that we are well-positioned to achieve our medium-term objectives. As we do every year at this time, we are introducing our objectives for 2022, as presented on slide 7. Our medium-term financial objectives are delayed by a year as the difficult union negotiations impacted our timeline. Francois Laurin will soon provide additional detail. I would like to add that 2020 will set the stage for 2021 - our 175th anniversary – and the beginning of a new era for our Group.

The Board has reaffirmed its confidence and has approved an increase in the quarterly common share dividend of $0.01 to $0.67 per share.

In conclusion, banking has changed, and so have we. We are building a better and different banking experience – and we are starting to see the positive, tangible results of our efforts. It has been a long road, but we are making every decision count for all of our stakeholders.

And now, I would like to turn the floor over to François to provide a more in-depth review of our fourth quarter and 2019 financial results.

François…

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

Thank you, François.

Good morning everyone.

I would like to begin by turning to slide 11 which highlights the Bank's financial performance. Adjusted EPS in the fourth quarter and 2019 were $1.05 and $4.26, compared to $1.22 and $5.51 a year earlier and adjusted ROE over the same periods were 7.8% and 7.9% compared to 9.0% and 10.5%. The 2019 results were impacted by costs related to labour relations, specifically, a higher liquidity cost of $7 million on an annual basis, higher other expenses including those related to legal and security of $3 million on an annual basis, as well as the impact of curtailing growth in residential mortgages and personal loans. Another important factor contributing to the year-over-year decline in profitability, for both the quarter and the full year, was lower other income and specifically, lower capital market-related revenues.

As outlined on slide 12, reported earnings for the fourth quarter included adjusting items totalling $6.6 million after tax or $0.15 per share. For 2019, adjusting items totalled $20.5 million after tax or $0.49 per share. The restructuring charge mainly related to the optimization of our Financial Clinic operations and the related streamlining of certain back-office and corporate functions.

Turning to slide 13, total revenue for the fourth quarter of 2019 was $241.6 million, 6% lower than a year earlier. Net interest income was relatively unchanged and other income declined by $14.3 million in the fourth quarter of 2019 compared to a year earlier.

On a sequential basis, total revenue declined by 1% as net interest income was slightly lower. NII in the third quarter of 2019 benefited from seasonal mortgage prepayments while the fourth quarter was impacted by a lower average volume.

Total revenue for the year declined by 7% or by $74.9 million. Net interest income decreased by 3% mainly due to the lower level of loans, partially offset by the lower liquidity cost and the change in business mix. Other income decreased by 16% or by $55.4 million. Lower capital market-related income accounted for half of the decline.

Net interest margin, shown on slide 14, was 1.84% in the fourth quarter of 2019. This was seven basis points higher than a year earlier due to the greater proportion of higher-margin loans to business customers and a reduction in liquidity following the ratification of the collective agreement. Compared to the third quarter of 2019, net interest margin declined by 1 basis point due to seasonally higher mortgage prepayments.

Other income, as presented on Slide 15, totaled $68.4 million in the fourth quarter of 2019 and decreased by $14.3 million year-over-year. This is largely due to the decline in capital market-related revenues of $11.1 million and is mostly explained by the $3.8 million loss resulting from a revaluation of trading securities which equals five cents per share on a net basis, and $4.9 million of gains on available-for-sale securities in 2018 of which no such gains were realized in 2019, in part, as a result of the adoption of IFRS 9, as well as $2.0 million lower lending fees as the mix is changing toward lower fee but higher margin business which is reflected in net interest income.

Sequentially, other income was relatively unchanged, with the trading inventory loss offset by improvements in brokerage operations.

Other income for 2019 was lower by $55.4 million and as mentioned earlier, half of the decline was related to lower capital market related revenues. This reduction included the impact of lower activity levels resulting from market volatility, $7.6 million of gains on available-for-sale securities in 2018 of which no such gains were realized in 2019, in part, as a result of the adoption of IFRS 9, and a $3.8 million loss resulting from a revaluation of trading securities. Other income was also impacted by lower lending fees and service charges. I would like to mention that since year-end, trading activity has improved, and the investment banking pipeline is strong.

Slide 16 presents adjusted non-interest expenses that in the fourth quarter were relatively unchanged from a year earlier. Salaries and employee benefits decreased by $3.0 million mainly due to lower performance-based compensation, a favourable adjustment to pension cost, and lower headcount, and was partially offset by an increase in other non-interest expenses of $2.3 million mainly related to the launch of our new digital offering. Compared to the third quarter of 2019, adjusted non-interest expenses decreased by more than $600,000, essentially for the same reasons. Adjusted non-interest expenses were well controlled in 2019.

The adjusted efficiency ratio stood at 71.2% in the fourth quarter of 2019 and 72.3% for the whole year which reflected lower revenues.

Slide 17 presents our well diversified sources of funding. Deposits totalled $25.7 billion at the end of 2019, $1.0 billion lower than at the end of the third quarter of 2019 and $2.4 billion lower than at the end of 2018. The decrease in deposits was a result of a reduction in liquidity aligned with the lower level of loans and the ratification of the collective agreement mid-year. We also increased our funding through securitization which, on a net basis, was up by $1.1 billion over the year and by $935 million during the quarter. In the fourth quarter we securitized residential mortgages and finance lease receivables and earlier in the year, we also securitized investment loans. Going forward, we expect that deposits gathered through our digital offering will further diversify our funding sources.

Turning to Slide 18, the CET1 ratio of 9.0% is presented under the Standardized approach and highlights our strong capital position.

Our diversified loan portfolio is shown on Slide 20. Loans to business customers increased to 38% of the portfolio from 35% a year earlier. The proportion of residential mortgages declined by 1% to 48%, reflecting our focus on higher-yielding commercial loans. The proportion of personal loans declined by 2% to 14% as a result of the reduction in the investment loan portfolio as consumers deleverage. In 2020, we expect double digit growth in loans to business customers and a gradual resumption of growth in residential mortgages and personal loans.

Slide 21 provides a deep dive into our residential mortgage portfolio. We are maintaining our strategy to seek profitable niches, such as the high end of the Alt-A business. At October 31, 2019, our Alt-A portfolio totalled $1.1 billion and represented 7% of the total mortgage book and 3% of the total loan portfolio. This portfolio remains well diversified, with mortgage loans in the GTA representing about 20% of the portfolio and the GVA accounting for 4%, and is high quality as evidenced by very low loss ratios.

Slide 22 highlights our commercial loan portfolio which is pan-Canadian with a US presence. It is well diversified and is positioned for sustainable profitable growth.

Turning to slide 23, in the fourth quarter of 2019, the provision for credit losses was $12.6 million compared to $17.6 million a year earlier, which included a loss of $10.0 million related to a single syndicated commercial loan. In 2019, the provision for credit losses amounted to $44.4 million, essentially unchanged compared to 2018, as higher commercial losses were offset by lower personal losses. Lower 2019 personal losses are mainly explained by releases of Stage 1 and 2 provisions for personal loans and, to a lesser extent, residential mortgages, as a result of volume reductions in those portfolios. Similarly, there was an increase in stage 1 and 2 provisions for commercial loans due to portfolio growth. Overall, our commercial credit portfolio remains strong at an 18-basis point loss ratio. For the bank as a whole, the loss ratios for the fourth quarter and for the full year were 15 basis points and 13 basis points respectively. On an annual basis, we continue to expect the loss ratio to trend slightly higher as the loan portfolio mix evolves. However, we expect increases to be more than offset by higher revenues.

Slide 24 highlights that net and gross impaired loan ratios decreased sequentially and year over year as the underlying credit quality of the portfolios remains good. The Bank remains comfortably provisioned considering that the loan portfolio is well collateralized.

This quarter, as presented on slide 25, we are providing an initial view of the impact of adopting IFRS 16, Leases which is being implemented effective November 1, 2019. The decrease in shareholders' equity at IFRS 16 transition is not expected to exceed $8.5 million. The adoption of IFRS 16 is expected to decrease the CET1 ratio by up to 10 basis points. With respect to our income statement, the impact of IFRS 16 in 2020 is not projected to be material. Depreciation and amortization will increase by about $20 million but will be offset by lower rental cost. As well, net interest margin is expected to be negatively impacted by about 2 basis points.

Finally, I would like to return to our updated medium-term objectives that François mentioned earlier and can be found on Slide 7.

Our 2022 financial objectives are unchanged from our 2021 objectives. Our timeline to achieve them has been extended by a year given the labor situation that prevailed during the first half of 2019. Our 2022 ROE objective is to narrow the gap with the major Canadian banks to 250 basis points and the gap should gradually close when we adopt the AIRB approach to credit risk in 2022. We continue to target an efficiency ratio of below 63% and positive operating leverage. Lastly, we will work towards an adjusted EPS growth rate of 5 to 10% annually over the medium-term.

With respect to our growth objectives, Business Services has been and will continue to be a growth engine for the Bank. For that reason, as we move our targets from 2021 to 2022, we are increasing our objective for loans to business customers to $17.5 billion from $16.0 billion as we continue to expect double-digit growth. Furthermore, given the foundation that we have built with our Financial Clinics and our digital offering, we have the opportunity to attract new customers, in addition to our existing customers, and to cross sell products to them. For that reason, we believe that a better measure of our success is to target growth in loans to personal customers, which includes residential mortgage loans and personal loans. We expect this portfolio to grow to $22.5 billion by the end of 2022. Lastly, in line with our expected asset growth and the optimization of our funding sources, we are targeting deposits from clients to increase to $26 billion by the end of 2022.

In 2020, we expect EPS growth to resume and be skewed to the second half of the year to reach the lower end of our medium-term EPS objective. Revenues should improve, particularly those related to capital markets, and net interest margin should increase by a few basis points as our loan portfolio continues to evolve towards higher margin loans to business customers. For the year, our efficiency ratio is expected to be slightly lower than the level in 2019. The first quarter of 2020 should be relatively in line with the fourth quarter level as it is expected to be impacted by seasonally higher stock-based compensation and higher payroll charges, while the ratio should be lower in the second half of the year as we realize the remaining cost savings from lower headcount and the synergies of back-office and corporate functions. Provision for credit losses should be slightly higher than in 2019 as our portfolio mix evolves and should be more than offset by higher revenues. We also expect that our tax rate will move towards the high teens in 2020 as a result of changes introduced in the 2018 Canadian federal budget that will impact future income earned on foreign reinsurance operations by about $5 million annually.

We remain as committed as ever to execute our strategic plan and achieve the objectives that we have set.

Thank you for your attention and I will now turn the call back to Susan.

Susan Cohen, Director, Investor Relations

At this point, I would like to turn the call over to the conference operator for the question and answer session. Angela?

Operator

Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. And we will pause for just a moment to allow everyone an opportunity to signal for questions. And your first question comes from Marco Giurleo of CIBC. Please go ahead.

Marco Giurleo, CIBC

Good morning.

François Desjardins, President and Chief Executive Officer

Good morning.

Marco Giurleo, CIBC

My first question is for François Desjardins. In your prepared remarks, you mentioned making investments to expand your US platform. So, I'm just wondering what do you envision the capital implications might be for that and if you could expand on the just overall US strategy?

François Desjardins, President and Chief Executive Officer

For sure. Thank you for the questions. Probably a little simpler of an answer than you're expecting. Basically, we have to move our people in Georgia to a bigger location because they've outgrown their current space and we're changing out some of the technology to help them with their organic growth plans.

From an expansion perspective, we're still on track with loans to business customers as part of the general business services unit growth but maintaining our businesses in the US to equipment and inventory finance.

Marco Giurleo, CIBC

All right. And if we were to focus on domestic commercial growth, could you tell us what the growth of the business has been this past year?

François Desjardins, President and Chief Executive Officer

For business services or for growth as a whole?

Marco Giurleo, CIBC

Just your commercial growth ex-Northpoint?

François Desjardins, President and Chief Executive Officer

I'll ask Stéphane Therrien to comment on it.

Stéphane Therrien, Executive Vice President, Personal & Commercial Banking

Yeah. Thanks for the question. The loan to business customer was up 9% adjusting for the portfolio sale that we've done in Q1. That portfolio sales were $105 million. Going forward, we expect that the business services will remain a solid growth engine. We continue to expect double-digit growth in 2020, mainly driven by inventory finance, equipment finance and real estate loan construction financing.

Marco Giurleo, CIBC

Okay. And my last question is just on AIRB implementation. You mentioned – I believe, François Laurin mentioned that you would get a lift in 2022. So, did the implementation timeline there get extended by a year as well alongside your financial targets?

François Desjardins, President and Chief Executive Officer

No. We mentioned a couple of quarters ago that we were extending that timeline. But from that revised timeline, we have not extended it any further. It's still being implemented in 2022 with benefits '22, '23, '24.

Marco Giurleo, CIBC

I see. All right, thank you.

François Desjardins, President and Chief Executive Officer

Thank you.

Operator

And if you find that your question has been answered, you may remove yourself from the queue by pressing star two. We will now take our next question from Meny Grauman of Cormark Securities. Please go ahead.

Meny Grauman, Cormark Securities

Hi, good morning. Just wanted a little bit more detail on the loss from the revaluation of trading securities. If you could give any more detail on what that situation was, and whether there's still a risk of more of this kind of revaluation to come in Q1?

François Desjardins, President and Chief Executive Officer

I'll ask François Laurin to answer that.

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

Yes, Meny. This loss is really a one-time non-recurring loss related to a specific position in the trading portfolio, revalued in the quarter. We really don't expect this to reoccur, and we're not discussing the specifics.

Meny Grauman, Cormark Securities

Can you say this was equity or fixed income?

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

No.

Meny Grauman, Cormark Securities

Okay. And then just want to understand better on maybe a more detailed basis quarter-by-quarter, how you expect the evolution of specifically the deposit growth to evolve in 2020? So, basically, at what point do you expect deposits from clients to actually start growing sequentially?

François Desjardins, President and Chief Executive Officer

Well, we have diversified sources of funds, which is a real strength of the bank, right? So, that includes deposits. In 2019, deposits were lower, but what was really a reduction in liquidity following the ratification of the new collective agreement and a reduction in assets and an increase in securitization activities to optimize our funding mix.

We are pleased that now we have three channels to gather deposits from clients. Financial clinics, where there has been relatively stability over time, stability from clients despite the fact that we've been merging more than a third of our network. Of course, advisors and brokers are our second source. And recently, we've added a digital source with our pan-Canadian launch of LBC Digital. So, we really believe that our deposit taking abilities is actually quite strong.

Meny Grauman, Cormark Securities

Okay. Maybe what I'm trying to get at in part is just trying to understand how customers have reacted to the transition on the branch side. So, I'm wondering if there's any metrics you can share with us in terms of number of clients that you've lost over this period, or if you can kind of isolate the deposits that are specifically going through the branch, maybe NPS scores, anything to get a sense of how you're tracking client reception to the changes that you made?

François Desjardins, President and Chief Executive Officer

I'll ask Stéphane Therrien to answer that.

Stéphane Therrien, Executive Vice President, Personal & Commercial Banking

Thanks for the question. The three key metrics that we're following, and we'll still be following, obviously, and you mentioned this one is the customer satisfaction through NPS. The second one that we'll follow will be the efficiency ratio of our network. And the third one would be the overall growth of our balance sheet.

Including in the overall growth of our balance sheet, François just mentioned that we're pleased with where our deposit level has evolved through the years. So, going forward, we feel that the customers that are with us right now are happy with our transformation as illustrated by the results that we have.

Meny Grauman, Cormark Securities

Can you give us some sense of how many customers you've lost over this transition period through the branches?

Stéphane Therrien, Executive Vice President, Personal & Commercial Banking

In any given year, we win and lose some customers. We cannot necessarily make link between the transformation and the loss of some customers. More importantly is that we believe that we're following the customer trends and their new behaviors, and we're confident that we'll attract new customers going forward.

Meny Grauman, Cormark Securities

Thank you.

Operator

And your next question will come from the line of Sumit Malhotra from Scotia Bank. Please go ahead.

Sumit Malhotra, Scotia Bank

Thanks. Good morning. A couple questions to start on credit quality. So, first off, your gross impaired loans balance in the quarter did decline decently. I think it's down 12% as you noted in the prepared remarks. I know this information is flowing to the annual. So, just hoping you give me a little bit of detail there because that's a good performance. Was it some recoveries that you enjoyed, was it write-offs, was it a combination? Just I have another follow-up on credit, but just wanted to get some information on the $20 million plus decline in the GIL valves?

François Desjardins, President and Chief Executive Officer

I'll ask Liam to comment.

William Mason, Executive Vice President and Chief Risk Officer

Sure. We've seen a couple of moving elements. Overall, in terms of gross impaired, though, I would note that in residential mortgage though, we've got GILs decreasing sequentially. We have the $26 million in terms of changes. One way was driven by IFRS 9 elements. So, they're still seeing some noise arising from that. We also have one or two situations that were – in 2018 that were resolved that were one-offs. Overall, we're happy with our underwriting standards in the portfolio. We expect our strong PCLs and GILs to remain.

Sumit Malhotra, Scotia Bank

And then, Liam, to stay with you, we've had this conversation a couple times this year. Obviously, the market is still getting familiar with the transition to the new accounting for provisioning and maybe especially with you folks, given that we just got four quarters of history. This is the first quarter that you moved to add the provisions in the non-impaired or the stage one and stage two buckets. I know this can be somewhat detailed. But just curious as you did this year-end review after three quarters of releases, what prompted the increase? And I apologize if you've discussed this and I missed it earlier. I was a little bit late getting on.

William Mason, Executive Vice President and Chief Risk Officer

Yeah, I would – Sumit, I'd start by pointing you to slide 23 in the presentation, where François Laurin has laid out of our evolution overall in terms of PCLs. I would note that notwithstanding that we do have the methodology shift, IAS 39 to IFRS 9. 2018 results, as you noted, were under the old standards.

We're relatively stable year-on-year overall in terms of our provisions. There are some moving parts. As our commercial loan portfolio is seasoned, we're going to be stabilizing as that rate will be shaking out as our portfolio has been growing dramatically. And also, some shifts in the residential mortgage as that portfolio shrunk a little bit in terms of size. So, we've got moving parts due to higher volumes in commercial and seasoning of it. We have some timing differences, but overall the PCLs are really relatively stable.

I would note, though, as we've indicated in the past from a run rate perspective, we do expect PCLs to tick up commensurate with an increase in revenues and would note the comments that François Laurin made around our loss ratios.

Sumit Malhotra, Scotia Bank

Am I correct in stating when you provide PCL targets or forecasts and what you're expecting for the coming year, you're – you do so with an anticipation that the non-impaired portfolio will not have any contribution? You're basing your outlook on the impaired book only.

William Mason, Executive Vice President and Chief Risk Officer

We're basing our outlook on the overall portfolio. Obviously, when you think about the ECL methodology, you have an expected base case, you have an extreme case, and you have a benign case. Our overall forecast is based on the expected case. As you know with the IFRS 9 methodology, as you change your expectations from an economic condition standpoint, you re-baseline your expectations from PCL accordingly.

Sumit Malhotra, Scotia Bank

Okay. Last one for me is going to be for François Desjardins. You've spoken in here about your – rolling your targets forward a year. And I think the big one from the time you took the role was focused around the – narrowing the ROE differential with the industry. We've got a few guys left to report, but I think on a full year basis, ROE for the sector is going to be around 15.5%, and on your adjusted measure, you've come in at 8%. So, to get that gap narrowed to your objective, there's a lot of work to be done. Just – so that's stating the obvious. We think to 2020, as these moving parts that you've talked about start to align, what's a reasonable objective in terms of ROE expansion in your mind off of the 8% level you're at right now? Is narrowing the gap with the industry going to be something that's going to take until closer to the timeframe, or do you expect to see meaningful progress in terms of ROE expansion for your bank, in particular, forgetting about the industry in 2020?

François Desjardins, President and Chief Executive Officer

Thanks for the question. I think that the ultimate goal is still the same. Obviously, with the new labor relations environment, we can now focus on growth and efficiency, which has driven our ROE down, as you know. So, our target is to reach a 250 ROE gap by 2022. From where we are now, the road to better performance starts with efficiency and growth, and that's really fueled by the things that we've already done.

Flexibility of new labor relations environment was not easy but done. Completion of the core banking initiative, 75% there. Growth in higher yielding assets, it's good on the business services side. Our focus on 2020 on the personal side. Opportunities to attract new customers and generate additional cross-selling synergies from digital offering just launched and recently transformed 100% advice activities. All of this stuff drives the future. And, of course, lastly, IRB, which benefits would start partially in 2022.

The confidence I have to achieve this plan comes to me because I feel that 2020 ends the period of heavy-lifting in investments and gets us back to growth. Might sound like a large gap to fill, but I am more confident than ever that this is the road that needed to be taken to get there with winds in our faces sometimes in the last few years, as you know, but this is what needs to get done.

For 2020, I would say that we'll focus on execution, growth and profitability as we work towards those medium-term targets, but we do expect that financially 2020 will be better than 2019, skewed towards the second half of the year.

Sumit Malhotra, Scotia Bank

Well, I appreciate you taking us through the journey. But I think you said it from a 750 basis point gap this year to 250 basis points in three years, does sound like a lot of work. So, I think along the way, you'll appreciate the fact that it's good to have some signposts on the way to 2022, and that's what we're hoping for. But I think I hear you. You think it will be better next year, and we'll look forward to that.

François Desjardins, President and Chief Executive Officer

I do. And as François said maybe earlier, I think that towards 2020 François and I will disclose some shorter based wins in terms of what's happening on digital, what's happening on customers so that you can see some of the progress that we're making on growth.

Sumit Malhotra, Scotia Bank

I appreciate that. Thank you for your time.

François Desjardins, President and Chief Executive Officer

You're welcome.

William Mason, Executive Vice President and Chief Risk Officer

Thank you, Sumit.

Operator

We'll now take our next question from Richard Roth of TD Securities. Please go ahead

Richard Roth, TD Securities

Hi guys. Question on your main target performance and particularly the loans to personal customers' target. I guess previously you had it, specifically you're dealing with mortgages rather than total personal loans. But if I back into what the implied mortgage growth rate is, given this change in disclosure, it seems to imply that you've taken down your mortgage growth expectations in the sense that you're not expecting to see as quick of a rebound in growth rate in mortgages. Is that the correct interpretation?

François Desjardins, President and Chief Executive Officer

Partially. We're focusing on financial health and offering the right product to the customer is important. We always want to build relationships with our customers, not offer just one product. Now that we've built a foundation for our financial clinics and our digital offering, we can attract new customers and offer a full suite of products to them. Obviously, personal loans that are not mortgages have different profitability levels as well. This should include credit cards, personal loans, RSP, TFSA, investment lending. So, offering the full suite of products is really the reflection of why we changed our targets to include personal loans. But you're right.

On the mortgage side, we did in the last few quarters indicate that previous objectives might be too high, given that we want to focus on profitable growth, not just growth for the sake of growth. We are, though, thinking that mortgage book growth in 2020 will resume and hit our targets that we've outlined today.

Richard Roth, TD Securities

Okay. And then on the commercial front, it seems like when you rolled out a year, you're baking in almost 9-10% growth rate on top of 2021's original target. But the last couple of quarters, we've seen pretty tepid growth on the commercial front. What are you seeing right now that's caused commercial loan growth to have been relatively slow? And what are you expecting to see in the future that's having you bake in, call it, high single-digit, low double-digit growth going forward?

François Desjardins, President and Chief Executive Officer

I'll ask the Stéphane Therrien to comment on growth.

Stéphane Therrien, Executive Vice President, Personal & Commercial Banking

Yeah, the – our three growth engines in commercial will be – will continue to be inventory finance, equipment finance and real estate, as I've said before. One of them, mainly inventory finance growth, is skewed to the Q1 and Q2. So, it's normal that you've seen a bit less growth in the last two quarters. But we're confident, and we have all the data to be confident that 2020 will be a double-digit growth in these three businesses and globally in business services.

Richard Roth, TD Securities

Okay, thank you.

François Desjardins, President and Chief Executive Officer

You're welcome.

Operator

And your next question will come from the line of Scott Chan of Canaccord Genuity. Please go ahead.

Scott Chan, Canaccord Genuity

Good morning. Just on the capital market side, you called out the trading loss. But with a new leadership team in there, is there any change in the strategy of that segment going forward?

François Desjardins, President and Chief Executive Officer

We're thrilled to have Kelsey Gunderson leading this business now. He brings a vast amount of capital markets experience and a strong network to our organization. Kelsey, would you mind sharing a few thoughts?

Kelsey Gunderson, Executive Vice President, Capital Markets

Sure. Thanks François. Well, I should point out that my tenure here is currently only measured in weeks, so it hasn't been a long time. But so far, I've been impressed by both the structure of the capital markets business as well as the people that are here, but really also around the opportunity. I do think there's room to grow this business here by doing things like aligning our capital markets group maybe a little better with the rest of the enterprise, and really build on our strengths, which everyone should know are largely with our small and mid-cap issuers, our fixed income business here and our Québec-based groups as well.

But I wouldn't expect to see a dramatic change in strategy or business mix in the near-term. Over time, we'll continue to prudently and in a measured way evolve this platform along with the rest of the bank.

Scott Chan, Canaccord Genuity

Okay, thanks. And just on your Alt-A book, I just haven't seen it. How has the growth been in that portfolio? And kind of what's the outlook there as your peers are growing a lot faster than the market within that segment?

François Desjardins, President and Chief Executive Officer

Well, we are introducing new products, including the Alt-A mortgage product for business for some clients amongst others, which we expect to contribute to increasing volumes. We believe that growth is achievable given that we are operating below our historical ability to grow mortgages. As to your question comparing to others, well, from a profitability and growth perspective, the main elements impacting our profitability and growth in 2019 were really the efforts that are associated with the labor relations situation.

So, loans to business customers growth has been strong. We're changing the business mix there, and we're pleased with that progress. But for mortgages and personal lending, labor relations was the distraction and slowed down growth. Now that that's behind us, we're working to stabilize our portfolios and resume growth.

If I might add as well, we're a diversified bank with multiple business units and distribution channels with targets in specialized niches. This bank is a bank where the capital is strong, and the CET1, as you know, is at 9%. I think that investing that capital in growth and the rest of the investments that we need to make in 2020 will be our focus for next year.

Scott Chan, Canaccord Genuity

And just lastly, just a clarification question. In your prepared remarks, you talked about NIM getting impacted by 2 bps next year. Was that from IFRS 16 coming in?

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

Yes, it is. Overall, despite that 2 bps negative impact, we expect NIM to grow compared to the level we have today from the business mix going forward.

Scott Chan, Canaccord Genuity

And is that NIM impact, is that in fiscal Q1 2020?

François Laurin, Executive Vice President, Finance, Treasury and Chief Financial Officer

Yeah, starting Q1.

Scott Chan, Canaccord Genuity

Okay, thank you very much

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

You're welcome.

Operator

And your next question will come from the line of Darko Mihelic of RBC Capital Markets. Please go ahead.

Darko Mihelic, RBC Capital Markets

Hi. Thank you. Good morning. I have a few questions.

François Desjardins, President and Chief Executive Officer

Hello Darko.

Darko Mihelic, RBC Capital Markets

Hi. Just a few questions here. First, starting with the other income, and I'm looking at your supplemental, and I wanted to understand a little bit better the reclassification or the sort of the change in the way you're presenting these items. And in particular, I am interested in the income loss from financial instruments. Presumably that trading loss was in there. But what I'm interested in is a few things on that line. The first is just getting back to your commentary on that trading loss. You mentioned that you did not expect it to reoccur. Is that because the position is gone? And secondly, is that – was this a proprietary position? And third, what is it that I should look at that would drive this line item going forward?

François Desjardins, President and Chief Executive Officer

François?

François Laurin, Executive Vice President, Finance, Treasury, and chief Financial Officer

Okay. First, it's clearly a non-recurring. And the items that were affecting that are basically very low now in the books. So, that's why we feel very comfortable that it's not going to recur going forward. Regarding the capital market, we – part of the reduction is the reduction you had year-over-year, mostly half of it is because of the volatility and the softness we've had during the year. Part of it is the loss we mentioned. And the other one is the IFRS 9 – the gains that we had and recorded in 2018 that we didn't have in 2019 because of this change in classification of the portfolio from an IFRS 9 point of view.

So, what you should see going forward from this level on, if you go from Q-to-Q, Q3 – Q4 would have been better than Q3 on that line, if it was not for that 3.8%. So, we feel that the pipeline and the activities we see will take that time from where we are to Q3 level to move forward up and positive going forward in 2020, Darko.

Darko Mihelic, RBC Capital Markets

So, I should consider that's some sort of a trading line. Is that a fair way to characterize it? And what is driving the trading? Is it pure – I guess, where I'm going with this is, is proprietary trading a significant component of that line item?

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

It's all trading that occurs in the dealer, not just proprietary.

Darko Mihelic, RBC Capital Markets

Okay, thank you. And then a question for you on the expense side. Firstly, when we look at your expenses, and I know we often try to avoid looking at restructuring. But what we do know is an awful lot of restructuring charges every quarter at Laurentian Bank for quite some time now. Is this going to stop anytime soon, or do you anticipate that we will continue to have restructuring charges every quarter going forward?

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

Well, the restructuring charges – we should expect some in 2020 because we still continue the optimization of the financial clinics and other initiatives to improve efficiency. However, in 2021, we expect those charges to be lower as we're part of the transformation plan, as we – François mentioned, the heavy-lifting will come to an end. So, obviously, as we go forward, we should expect that number and those charges to be lower and in time eventually disappear, but not for the immediate future.

Darko Mihelic, RBC Capital Markets

Okay. And then lastly on the expense side. I'm trying to gauge, I mean, one of the things that I'd like to look at is performance-based compensation or variable comp. And I tend to try and want to model that sort of as a percentage of revenues. Is now – I mean, when I look at it, it kind of looks like it's averaged in here around this level as a percent of revenue. Should I think of that – first, is that an okay way to think of it, and is that how you guys like to think of your performance-based comp going forward? And if so, what is the appropriate level? It came in around 5.5% this quarter, and it's generally been between that and around 6-6.5%. Is that an okay way to think about that line item or should this change going forward because of the way you're changing your bank?

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

I think there are different compensation programs in the organization, Darko, so making an average is not perfect. Clearly, you've got a higher compensation level from a dealer perspective than from the bank's perspective. We could take it offline. But I would suggest to go to past quarters as a better indication of performance-based percentages because of the reduced profitability we have in this quarter compared to previous ones, I would use, in your calculation, previous quarters, if that's clear.

Darko Mihelic, RBC Capital Markets

Okay. I might come back to you on that. I do have one last question which is on credit quality. And really what this is, is I'm referring to your annual report. When you guys provide a view of your stage one and stage two allowance for credit losses, as if everything was in stage one and all banks do this. And what I noticed in your case is the PCL will come up to around $49 million, and I'd like to think of that as a sort of a 12-month expected credit loss. So, in a roundabout way, that's kind of what we should expect for 2020 in terms of losses. Do you think that that's an okay way to think of it, in which case – I mean, I'd just like to hear your thoughts on it, and maybe I'll just leave it there, but I might have a follow-up.

François Desjardins, President and Chief Executive Officer

Liam?

William Mason, Executive Vice President and Chief Risk Officer

Yeah. I think it's one way to look at it. Thank you for your question. But rather look in terms of our run rate on PCLs and our expectation around PCLs. And as François indicated, run rate overall at 13 basis points, commercial, 18, we expect an uptick in terms of basis points and sort of run rate now in around $12 million a quarter. I'd rather base it on that.

Darko Mihelic, RBC Capital Markets

Okay. All right, that's good. Thank you.

François Desjardins, President and Chief Executive Officer

You're welcome.

Operator

Your next question comes from Gabriel Dechaine of National Bank Financial. Please go ahead.

Gabriel Dechaine, National Bank Financial

Good morning. I mean we're running a little short of time here. So, slide 17 or page 17 of the supplement that shows in personal loans, the migration of stage one and stage two. Stage 1 is a negative number. Stage two is a positive number. Is that really migration from – to lifetime expected loss in a particular category?

François Desjardins, President and Chief Executive Officer

Liam, again.

William Mason, Executive Vice President and Chief Risk Officer

Yeah. Thank you for your question, Gabriel. IFRS 9 has brought some volatility to our numbers, normal course variation, but also within personal loans, we've seen some timing differences on recovery actions that have shifted some of the elements between quarters. So, I would tend to look at the year-on-year results for personal loans, and once we get some of the noise out, this should stabilize.

Gabriel Dechaine, National Bank Financial

So, it wasn't a particular category suddenly looking shakier and you're moving that on –

William Mason, Executive Vice President and Chief Risk Officer

It wasn't a particular shift, no

Gabriel Dechaine, National Bank Financial

Speaking of the credit, I'm just wondering if you can give some intra-quarter, I guess, move on the US impaired loan balances. You gave the annual figure of over $16 million of US impaired loans and 9% of the total. We don't know how that shifted from Q3. I know it went up from $8 million in Q4 of last year, but was there any migration there or impairments, I should say during the quarter?

François Desjardins, President and Chief Executive Officer

Liam, I'll ask you to answer that too.

William Mason, Executive Vice President and Chief Risk Officer

Sure. That's really driven by a methodology shift more than anything else. We have been evolving our methodology with regard to our US ECLs, and that's a methodology shift.

Gabriel Dechaine, National Bank Financial

Okay.

William Mason, Executive Vice President and Chief Risk Officer

Yeah, sorry, one further comment. Obviously, in addition, you've got the growth in the portfolio, which is affecting those numbers.

Gabriel Dechaine, National Bank Financial

Okay. ROE gap, back to that one as well. I'll ask this in just kind of a different way. But what kind of rate environment do you need to get the rate differential to tighten substantially versus the peer group? What kind of – what's embedded in your model – in your internal model there?

François Desjardins, President and Chief Executive Officer

I'll ask François to answer.

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

So far, what we have in our model is one rate decrease in 2020, and we don't go beyond that for now.

Gabriel Dechaine, National Bank Financial

Okay. Thanks a lot. Have a good day.

François Desjardins, President and Chief Executive Officer

Thank you, Gabriel.

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

Thank you, Gabriel.

Operator

And your next question will come from the line of Doug Young of Desjardins Capital Markets. Please go ahead.

Doug Young, Desjardins Capital

Good morning. I'll keep this really quick. Just first you mentioned decommissioning of the legacy systems at the end of fiscal '20. So, fiscal '21 is when you get the benefit of that. Can you quantify what the savings will be?

François Desjardins, President and Chief Executive Officer

I'll ask Deborah Rose to answer that.

Deborah Rose, Executive Vice President and Chief Operating Officer

Sure. We expect the extra cost associated with operating two parallel core banking systems should be eliminated gradually through 2021, which is factored into our objective of 63% efficiency ratio in 2022.

François Desjardins, President and Chief Executive Officer

If I could ask Stéphane also to talk about those benefits from a client perspective.

Stéphane Therrien, Executive Vice President, Personal & Commercial Banking

Yeah. As soon as our employees have been made aware that the retail network is moving toward that system, everybody is really excited about the opportunity to present this new online banking experience to all our customers by year-end.

Doug Young, Desjardins Capital

And so can you – is there a way to quantify, like is it $3 million, $5 million annual cost to operate the two systems, like is there any quantification you can provide?

François Desjardins, President and Chief Executive Officer

François?

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

Thank you, François, and thank you, Doug. No, we don't provide quantification. It's part of the elements to make it to reach our 63% efficiency ratio in 2022.

François Desjardins, President and Chief Executive Officer

Obviously, if I might add to the questions that were asked earlier about bridging the gap, there's a lot of moving parts here, right? And the confidence level of the team here is when you add them all up, right, simplified products, core banking ending, heavy-lifting ending. So, the gap is still large, obviously. But as we're finishing up these things and focusing on growth, adding them all up, it is what gives us the confidence that we can reach these targets by 2022.

Doug Young, Desjardins Capital

And just lastly the restructuring charge back to Darko's question, like I know they're going to continue through fiscal '20. I know in fiscal '18, it was $5 million, in fiscal '19, it was $6.2 million. Are these – is this a reasonable goalpost for what we should think about in terms of restructuring charges for fiscal '20, or should it be starting to dwindle below the $5 million in fiscal '18?

François Desjardins, President and Chief Executive Officer

François?

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

In 2020, this should be the range, high single-digit below $10 million, between $5 million and $10 million, Doug. That's what we anticipate.

Doug Young, Desjardins Capital

Between $5 million and $10 million?

François Laurin, Executive Vice President, Finance, Treasury, and Chief Financial Officer

Yeah.

Doug Young, Desjardins Capital

Okay, thank you.

François Desjardins, President and Chief Executive Officer

You're welcome.

Operator

And there are no further questions at this time. I would now like to hand the call back over to Mr François Desjardins for closing remarks.

François Desjardins, President and Chief Executive Officer

While 2019 was a year where profitability did not meet our expectations, we established a new labor relations environment, converted to 100% Advice Financial Clinics and launched a fully digital offering. These were no small feats. And when combined with the improving loan mix towards loans to business customers, our expanding geographic footprint and our renewed culture of performance, we really are building something great. We are confident that value creation is well underway as we continue to focus on execution, growth and profitability.

I will now turn the call back to Susan.

Susan Cohen, Director, Investor Relations

Thank you for joining us today. Should you have any further questions, our contact information is included at the end of the presentation. We look forward to speaking with you again at our first quarter 2020 conference call on February 28.

Operator

And this concludes today's call. We thank you for your participation. You may now disconnect your lines and have a wonderful day everyone.