First Quarter Results 2018 Conference call

February 28, 2018

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 include, but are not limited to, statements regarding our business plan and financial objectives including statements contained in our 2017 Annual Report under the headings "Outlook" and "Off-Balance Sheet Arrangements - Securitization Activities". 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 use the conditional, as well as words such as prospect, believe, estimate, forecast, project, expect, anticipate, plan, may, should, could and would, or the negative of these terms, variations thereof or similar terminology.

By their very nature, forward-looking statements are based on assumptions and involve inherent risks and uncertainties, both general and specific in nature. It is therefore possible that the forecasts, projections and other forward-looking statements will not be achieved or will prove to be inaccurate. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we can give no assurances that these expectations will prove to be correct. Certain important assumptions by us in making forward-looking statements include, but are not limited to: our ability to execute our transformation plan and strategy; the expectation of regulatory stability; the continued favourable economic conditions; our ability to maintain sufficient liquidity and capital resources; the absence of material unfavorable changes in competition, market conditions or in government monetary, fiscal and economic policies; the maintenance of credit ratings and our assumption that the in-depth review of the branch-underwritten mortgages described under the heading "Off-Balance Sheet Arrangements - Securitization Activities - Review of Mortgage Portfolios" of our 2017 Annual Report and in this document, will reveal a level of ineligible loans with documentation issues in line with the level discovered through the limited sample audit. See also "How the Bank Will Measure its Performance - Key assumptions supporting the Bank's medium-term objectives" in our 2017 Annual Report.

We caution readers against placing undue reliance on forward-looking statements when making decisions, as the actual results could differ considerably from the opinions, plans, objectives, expectations, forecasts, estimates and intentions expressed in such forward-looking statements due to various material factors. Among other things, these factors include: changes in capital market conditions, changes in government monetary, fiscal and economic policies, changes in interest rates, inflation levels and general economic conditions, legislative and regulatory developments, changes in competition, modifications to credit ratings, levels of branch-underwritten ineligible loans with documentation issues being in excess of levels identified during sample file audits or other related assumptions pertaining to the conduit requirements, scarcity of human resources, developments with respect to labour relations, as well as developments in the technological environment. Furthermore, these factors include the ability to execute our transformation plan and in particular the successful reorganization of retail branches, the modernization of the core banking system and the adoption of the Advanced Internal Ratings-Based Approach to credit risk (the AIRB Approach).

With respect to the anticipated benefits from the acquisition of Northpoint Commercial Finance ("NCF") and statements with regards to this transaction being accretive to earnings, such factors also include, but are not limited to: the ability to promptly and effectively integrate the businesses, reputational risks and the reaction of our and NCF's customers to the transaction; the failure to realize, in the timeframe anticipated or at all, the anticipated benefits and synergies of the acquisition of NCF; our limited experience in the U.S. market and in inventory financing; and diversion of management time on acquisition-related issues.

With respect to the anticipated benefits from the acquisition of CIT Canada and statements with regards to this transaction being accretive to earnings, such factors also include, but are not limited to: the ability to realize synergies in the anticipated time frame, the ability to promptly and effectively integrate the businesses, and diversion of management time on integration-related issues.

We further caution that the foregoing list of factors is not exhaustive. 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” on page 44 of our Management's Discussion and Analysis as contained in our 2017 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 certain non-GAAP measures to assess the Bank's performance. The Bank's non-GAAP measures presented throughout this document exclude the effect of certain amounts designated as adjusting items due to their nature or significance. These 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

Good day and bonjour, and welcome to the Laurentian Bank Financial Group First Quarter 2018 Results conference call. Today's conference is being recorded, and at this time I would like to send the conference over to Susan Cohen, Director Investor Relations. Please go ahead ma'am.

Susan Cohen, Director, Investor Relations

Good morning, and thank you for joining us. Today's review of the First Quarter 2018 results will be presented by François Desjardins, President and CEO; and François Laurin, Executive Vice President and CFO. All documents pertaining to the quarter, including Laurentian Bank Financial Group's news release, investor presentation and financial supplement, can be found on the website in the Investor Centre. Following our formal comments, the senior management team will be available to answer questions. Before we begin, let me remind you, during the conference call, forward-looking statements being 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 [inaudible] presentation. It is now my pleasure to turn this call over to François Desjardins.

PREPARED REMARKS

François Desjardins, President and Chief Executive Officer

Thank you Susan, and good morning everyone. Our organisation posted good results in the first quarter. On an adjusted basis, net income was up 20% from a year ago, and ROE stood at 11.5. We improved our efficiency ratio by 250 basis points compared to a year ago. With respect to our capital, as you know, we had two years of significant asset growth. Given that our CET1 ratio target range is 7.9 to 8.3 and that we have been tracking towards the lower end of this target, we elected to replace the preferred share issue that we redeemed with a common share issue, and run the business at the higher end of this range.

This provides flexibility to execute the transformation plan and to pursue profitable growth. We achieved double-digit year-over-year growth, as loans to businesses were up 22%, with the acquisition of Northpoint accounting for about half of that growth. Residential mortgage loans through independent brokers and advisors were up 19%. We are also pleased with our deposit growth, which is up 10% from a year earlier. Before speaking about the progress that we are making on our transformation plan, I would like to give an update on the mortgage securitisation issue that was discussed during our fourth quarter call, and is presented on slides six and seven.

As a reminder, we are referring to the two residential mortgage securitisation programs that B2B Bank and retail services branch network use, and the two types of situations that were identified for these programmes, specifically ineligible loans with documentation issues, and loans that were inadvertently insured and sold. First, let me say that our mortgage book is performing very well from a credit perspective, and we are confident that the credit decisions that we make are the right ones. Our organisation has a long history of being a conservative lender, as evidenced by its low loan loss ratio.

So where are we now? Since November 1st we have been implementing improved processes for the adjudication of new mortgage loans. We continue to monitor and adjust these processes in order to achieve the level of quality that we have set for ourselves. Moreover, the implementation of the new B20 guidelines is also leading to further changes in our procedures. We are making good progress towards the resolution of the situation with the third party purchaser, or TPP. In regards to B2B Bank underwritten mortgages sold to the TPP, as we previously disclosed, we repurchased 90 million of mortgages, of which 89 million had documentation issues and one million were inadvertently sold.

Furthermore, the TPP completed a confirmatory audit, and no further repurchases are required. As well, 17 million out of the 40 million cash reserve that was deposited with the TPP will be returned to the Bank. The remainder will be kept by the TPP as additional credit enhancement and will be remitted to the Bank over time, as the mortgages amortise. Consequently, I am pleased to say that this situation is resolved.

In regards to the retail services branch underwritten mortgages sold to the TPP, as previously disclosed, we repurchased 90 million of inadvertently sold mortgages in the first quarter.

Again, I am pleased to say that that situation is resolved. Also in Retail Services, we are in the process of conducting an internal review of about 1,900 mortgages. This review is expected to be completed by the end of the second quarter, at which time the TPP will perform a confirmatory audit. As we previously mentioned, we conducted a limited sample review and, through extrapolation of the entire portfolio, we estimated about 124 million of ineligible loans with documentation issues that may need to be repurchased. A definitive amount will be determined upon completion of this review. As we previously indicated, we provided a 61 million cash reserve deposit, the release of which is subject to the repurchase of ineligible loans and a confirmatory audit.

I would like to reiterate that our 2018 funding plan does not rely on the securitisation program, but nevertheless we will look forward to the confirmatory audit and having this programme available to us. With respect to the CMHC securitisation programme that was referred to as the “other” third party purchaser, we had previously disclosed that we had identified 88 million of inadvertently insured and sold mortgages. These were repurchased in the second quarter. As well, after discussions with CMHC, we are not required to perform a full review of the mortgages sold to CMHC nor make material repurchases.

We continue to work with this party on reviewing and ensuring solid controls are in place, in addition to our continued engagement in the normal course audits by CMHC from time to time. I am pleased to report that this securitisation programme remains available, and we continue to securitise mortgage loans. As you can see on the summary table on slide seven, we have made progress towards the resolution of this issue, and have settled and repurchased 268 million of the 392 million of estimated total ineligible loans. It is understandable that this issue has been our focus over the past few months and will remain a priority until we are satisfied with our processes and elevated governance.

The situation also reaffirms the need for our transformation into a simpler and more automated bank. Building a strong foundation is integral to our transformation plan, and essential to future growth plans. The very positive past two years have also seen more than their share of economic challenges, market disruption and new regulatory requirements. For us this means that, to continue progressing, 2018 will be a pivotal year of investment in our businesses, people, processes and technologies that aim at ensuring disciplined growth by strengthening the foundation and simplifying the organisation. Last quarter we had reset our midterm growth targets, as we continue to focus on sustainable and profitable growth. Moving forward, we will continue to concentrate on target niches and, as the bank transforms, we will continue to review our activities and determine areas and portfolios that we will grow or maintain, as well as areas that we need to fix or access.

This means that we can make decisions on non-strategic portfolios, so that we may focus on niches where we can win. As a result, our net loan growth is expected to be in the low single digits in 2018, with growth skewed to ‘19 and ‘20. Our move from traditional to digital banking – the crux of our transformation plan – is highly dependent on us simplifying procedures, going paperless, improving our IT capabilities, digitising processes and so on. The first phase of our initiative to replace our core banking system is on track. In the first quarter we installed the backbone of the new Temenos T24 core banking system and started migrating B2B Bank products to this new platform.

In the coming months, we will continue to migrate B2B Bank and Business Services products. As I have previously mentioned, the core banking system migration continues through the end of 2019, so until we can retire old systems, we must operate two separate core banking systems, and technology teams to support them. As a result of our investments in this new platform, B2B Bank will be launching a fully digital suite of banking products. The plan calls for a progressive rollout, focusing on transactional and deposit products, in 2018, followed by lending products in early 2019. In preparation for this rollout, we have concluded an arrangement to be part of the exchange network. Prior to this arrangement, B2B Bank and Laurentian Bank clients had access to about 300 full-service ATMs in Quebec. Now they will have access to 3,600 full service ATMs across Canada.

As well, we are investing in, and wish to adopt, the AIRB approach in 2020 pending regulatory approval, for which we also need to simplify product suites, streamline processes and elevate our governance. To this end, on an organisational basis we continue to invest and enhance regulatory and compliance frameworks, to better manage our risks.

Lastly, an important pillar of our transformation plan is improving the profitability of retail services. This should be achieved through a combination of efficiency gains and revenue growth. We have already made great progress on efficiency, notably with the merger of 46 branches, most of which were done last year. Our plan is to continue optimising our branch network and invest in our advisory force and customer experience. Nevertheless, on the labour relations front, we are currently in the process of negotiating a collective agreement to replace the one that expired on December 31st 2017. This agreement covers approximately 1,400 employees, who work mostly in retail services. Given the uncertainty on this front, we are reviewing the pace of the retail services transformation. All these factors will impact the efficiency ratio over the next few quarters, and we are making the prudent decision to maintain higher liquidity levels.

As we had previously mentioned, the improvement and efficiency was not expected to be linear, and there could be bumps in the road, but ultimately it does not change our strategic directions, nor our 2020 nor 2022 targets. In fact, our investments and strategy contribute towards building a solid foundation that supports our mission and our objectives. We are committed to becoming a renewed financial institution that is there to help customers improve their financial health by combining the value of human advice, the ease of doing business and the convenience of digital transactions.

In closing, I would like to announce that, starting May 1st, François Laurin will become Executive Vice President, Finance, Treasury, Capital Markets, and CFO. This change comes as Michel Trudeau has decided to take his well-earned retirement at the end of April. Michel has had a very accomplished career, of which the past 15 years has been at the helm of our capital market segment, and President to CEO of Laurentian Bank Securities. I would not only like to thank him for a significant contribution to the organisation, but for his friendship along the way. Michel will not be leaving the organisation, as he will be staying on as vice chair of the Board of Directors of Laurentian Bank Securities. I would like to express my sincere gratitude and appreciation to Michel Trudeau and congratulate François Laurin, and wish him well on his expanded role. And now, François Laurin will provide details on our first quarter results. François?

François Laurin, Executive Vice President and Chief Financial Officer

Thank you François, good morning everyone. I would like to begin by turning to slide 12, which highlights the Bank's good core financial performance. Adjusted net income in the first quarter of 2018 grew 20%, compared to a year earlier. Adjusted APS was $1.49, up 4% over the same period. First quarter APS was impacted by the common share issuances, which increased the average number of outstanding shares by 16% compared to a year ago. Adjusted ROE was 11.5%, and while lower than the previous quarter, reflects a strong capital base which positions us very well in an evolving environment.

As outlined on slide 13, reported earnings for the first quarter were affected by adjusted items totalling $3.5 million after tax, or 9 cents per share, and are largely related to business combinations. The drivers of our performance are presented on slide 14. Total revenue in the first quarter of 2018 amounted to $267 million, an increase of 10% compared to a year earlier. Net interest income rose by 16%, mainly due to the strong volume growth in the commercial loan portfolio, both organic and from acquisitions, and the higher margins earned, particularly on the acquired loans. Other income was relatively unchanged from a year earlier. Net interest margin, shown on slide 15, was 1.77%. The main factors contributing to the 11 basis points year-over-year increase was growth in commercial loans, including the acquisition of Northpoint with corresponding higher margins, and to a lesser extent rising interest rates. Sequentially the margin was up two basis points, reflecting a positive impact of a higher level of commercial loans, as well as higher interest rates, and was partially offset by higher liquidity.

While average earning assets rose 9% year over year, reflecting 19% organic growth in residential mortgage loans through independent brokers and advisors, and 22% growth in loans, to business customers, it remained relatively unchanged from the prior quarter. Other income, as presented on slide 16, totalled $88.4 million, relatively stable from a year ago. Favourable market performance positively impacted income from mutual funds. As well, fees and commissions on loans and deposits increased, mainly driven by higher lending fees due to the acquisition of Northpoint. These increases were partly upset by a decrease in income from brokerage operations, mostly related to lower fixed-income activities.

Compared to last quarter, the category of other income fell by 4% when the fourth quarter of 2017 included a contribution of $5.9 million from the gain on the sale of the bank's participation in Verico Financial Group. Slide 17 highlights that adjusted non-interest expenses rose by 6% year over year. This increase was mainly the result of the acquisition of Northpoint, regular salary increases, and higher professional fees to support our transformation. Our adjusted efficiency ratio of 64.8% improved by 260 basis points compared to a year ago. While the efficiency ratio has been ahead of our 2020 target for the past two quarters, the investments required as the bank transforms, including parallel IT systems for the next several quarters, is expected to exert some pressure on expenses. However, an efficiency ratio of below 65% on a sustainable basis by 2020 remains our objective.

Slide 18 highlights our well-diversified sources of funds. In the first quarter of 2018, the bank continued to optimise its funding mix. Deposits stood at $29.4 billion, up 10% compared to a year earlier. Total deposit source through independent brokers, and advisors grew by 11%, and institutional deposit growth was also very strong. While we have reduced our footprint by close to a third, our branch source deposits have experienced minimal attrition. I would like to add that our liquidity positions continue to be strong and well above our internal and regulatory requirements, through highly rated government securities.

Slide 19 presents the CET1 ratio under the standardised approach of 8.6% at January 31st 2018. Taking into consideration the recent share issues, our capital ratios are very strong and support the bank's transformation plan.

Our diversified loan portfolio is highlighted on slide 21. Loans to business customers have increased to 34% of the portfolio from 30% a year ago, and residential mortgages remain relatively unchanged at around 50%. Within the residential mortgage portfolio, Alt-A mortgages total $1.5 billion and represent 8% of the total mortgage book and 4% of the total loan portfolio. As well, mortgages in the GTA represent about 22% of the portfolio, and the GVA accounts for 4%. LTVs remain low, and credit scores remain high.

Turning to slide 24, credit quality remained good. The provision for credit losses at $12 million was $3 million higher than a year ago, reflecting the evolution of the business mix and growth in the loan portfolio. The loss ratio was 13 basis points in the first quarter of 2018, compared to 11 basis points a year earlier. 97% of our loan book is collateralised, and the underlying credit quality of the portfolios continues to be good.

Impaired loans are shown on slide 25. Gross impaired loans rose by 15% compared to last year, and include the impact of the evolution of overall growth in the loan portfolio. The net impaired loan ratio stood at 31 basis points, and we remain well provisioned. We continue to expect that, over the medium term, the loss ratio will gradually move higher to reflect our changing business mix. Nonetheless, with our current portfolio mix and conservative provisioning, we expect that the loss ratio will remain below other Canadian banks.

Turning to slide 27, we continue to gradually progress towards 2020 midterm growth targets and financial objectives. To conclude, we're pleased with the core earnings performance in the first quarter of 2018. We are also confident that our transformation plan and the strategic initiatives that we are implementing will lead to sustainable profitability and create long-term value for our shareholders. Thank you for your attention, and I will now turn the call back to Susan.

QUESTION AND ANSWER

Susan Cohen, Director, Investor Relations

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

Operator

Thank you. If 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 a few moments to allow everyone an opportunity to signal for questions.

We will go ahead with our first question from Nick Stogdill from Credit Suisse. Please go ahead.

Nick Stogdill, Credit Suisse

Hi good morning, my question's on the funding. Can you clarify, I think I heard you say that you are expecting the securitisation programme to open up to you after the review is completed, is that right?

François Desjardins, President and Chief Executive Officer

Thank you for your question. I will ask Susan Kudzman to answer that, please.

Susan Kudzman, Executive Vice President and Chief Risk Officer

Yes, hello. Yes, you are right. As was disclosed, we have already dealt with the CMHC conduit as well as the B2B mortgages in what we call the third party purchaser conduit. So after – we expect that a successful confirmatory audit of our new processes and procedures, as well as an audit of the internal review of the branch network mortgages in this conduit, should be complete towards the end of Q2 2018, and that the conduit will reopen. I would also like to remind you that the credit remains good throughout this whole period, and we continue to expect so.

Nick Stogdill, Credit Suisse

Okay. And then, related to that, when you look at your deposit profile in the MD&A, it shows your demand and notice are down, and we're seeing double-digit increases in your one to three, and three to five year term deposits. So clearly by going to the term market, that comes with additional costs. Maybe you could walk us through your outlook for deposit growth. Should we expect more growth in the longer-term deposits versus the notice and demand?

François Desjardins, President and Chief Executive Officer

I will ask François Laurin to speak to that.

François Laurin, Executive Vice President and Chief Financial Officer

Thank you. Clearly we expect growth in the term deposits, it is a very good source for us of funding. Basically, half the market in that term deposits are in the one-year basis, and 50% in the two to five. So we're basically aiming at keeping a healthy market share in all those segments, but you can expect that we will be along the curve where the market is.

Nick Stogdill, Credit Suisse

Have you adjusted pricing at all in the two to five year to spur that growth?

François Laurin, Executive Vice President and Chief Financial Officer

Basically we follow the market, and with the increase in rates, the deposits – the term deposit rates have increased slightly. We haven't kept up with the increase in rates overall that we had in the markets from over the last nine months, but they did actually increase a bit.

Nick Stogdill, Credit Suisse

Okay, thank you. And just one more, you called it the lower mortgage originations in Q1 2018. Could you potentially give us a bit more colour on how much you think is coming from B20 versus how much is the intentional slowdown? And have you made any pricing changes to your mortgage products over the last few months?

François Desjardins, President and Chief Executive Officer

François Desjardins here. We have reset our midterm growth targets in Q4 last year, and we expect to grow mortgages through independent brokers and advisors by about $1.4 billion, that means from 8.6 to $10 billion by 2020. So of course this growth target is at a slower pace than what we had in previous years. Yes, new regulations have had an impact, not only B20 but other implementations of regulations, but B20 did have increased sales before the holidays as people were trying to beat the deadline, and since the holidays we have seen a slowdown, I think, industry-wide. It is still too early to tell how this will settle and how the market will evolve.

You know, B20 is one thing, but there's rates and also market sentiment around pricing in certain areas of the country, so we'll have to see how customer behaviour adapts to this regulation. For Retail Services, as a reminder, we have halted referrals to the branches from mortgage brokers late last year so that our Retail Services advisers may concentrate on advice, meaning investments, deposits and more regular business versus one-off mortgage products. And lastly, one of the priorities for the bank is to change the mix slowly towards Business Services, so growth in that area, specifically in niches where we can win, we will grow at a faster pace than our mortgage business.

On that note, can I ask Stéphane Therrien to just give an update on Northpoint and CIT?

Stéphane Therrien, Executive Vice President, Personal and Commercial Banking President & CEO of LBC Financial Services

Yes, thank you François. We are really happy about these two acquisitions, they are performing as planned. These two acquisitions are bringing to the bank higher-margin loans, and we expect these two businesses to continue to grow at double digits. The guidance that we gave in Business Services, it is $14 billion by 2020. This will include, as I have just mentioned, growing these two latest high-margin business at double digits. We will maintain a single-digit growth other businesses, and strategically we will look at the existing certain areas where we feel we cannot win, going forward possible volume. So doing these three things will optimise our capital and will permit us to reach our goal of $14 billion by 2020.

François Laurin, Executive Vice President and Chief Financial Officer

Nick, François Laurin here. I would just like to complement the answer I provided you earlier. Marginally the cost of funding increased from the GIC slightly, but our NIM was not negatively impacted, because overall our NIM was not impacted.

Nick Stogdill, Credit Suisse

Thank you.

Operator

We will now take our next question from Gabriel Dechaine of National Bank Financial, please go ahead.

Gabriel Dechaine, National Bank Financial

Good morning, just a clarification on Nick's question there. You're saying that, when the audit is complete with the third party purchaser, you expect that that funding channel will reopen.

François Desjardins, President and Chief Executive Officer

Susan Kudzman again.

Susan Kudzman, Executive Vice President and Chief Risk Officer

Yes we do, that is the understanding. We have not planned for it in our funding plan, but we do expect after the confirmatory audit by the third party purchaser of our review of the branch network mortgages in the conduit, and as well as our new processes and procedures, we do expect that to be complete by the end of Q2.

Gabriel Dechaine, National Bank Financial

Okay. Then, on a branch deposit, they have been steadily going down, and your commentary on that is that the client and branch, core branch deposits in line with your expectations. What does that mean? Like, when do you expect it to, you know, bottom out, and do you expect the branch deposits to grow at some point? I believe last year you were expecting it to kind of stop declining, but it hasn't.

François Desjardins, President and Chief Executive Officer

I will ask Stéphane Therrien to give an update on retail transformation, including the deposits.

Stéphane Therrien, Executive Vice President, Personal and Commercial Banking President & CEO of LBC Financial Services

Thanks for your question. Just we made some strategic decisions in terms of our footprint. Remind you that our footprint decreased by 32, roughly 33% in the last two years, and our deposits, we expected that our deposits will go down, but not obviously as severely as our footprint, and this is exactly what happened. Our deposit level compared to a year ago is way lower than the percentage of decrease in terms of our footprint. Going forward, yes, we expect with our new advice that we are giving to our customers, in the way that we are now treating our customers in terms of advice-only branches, that our deposit levels will go up.

François Desjardins, President and Chief Executive Officer

If I may add, Gabriel, on that, I also mentioned in my prepared remarks that we are investing and that B2B Bank will be launching its digital offering in the second half of 2018, and focusing on transactional products and deposit products, thus adding to the ability to increase the breadth of funding of the bank.

Gabriel Dechaine, National Bank Financial

Okay, like a high-interest savings account, or some sort, I guess?

François Desjardins, President and Chief Executive Officer

High-yield savings, GICs, transactional accounts, but – but you know, the important part here is the automated nature of the products, so we're really going fully digital on this.

Gabriel Dechaine, National Bank Financial

Okay. And then – that's great, thanks. Some clarification, I guess these are expense items here. And I didn't quite catch it in your comments. The retail transformation – something about that being on a hold? And then – I apologise, I was distracted, but there's some pressure on the NIX ratio that you're expecting over the next – next little while? And is this the elevated initiative spending that's tied to the B2B initiative?

François Desjardins, President and Chief Executive Officer

Well, I think a little bit all-encompassing, right? In my remarks, you know, 2018, as we discussed late last year, is an investment year for the bank where we're going to be investing in our people and processes and technologies. There's some improvements that are being made across the banks, but the big-ticket items of course are the core banking system, for which the implementation is 2018 and 2019, and is going well. And core banking lays the foundation for the digital offering, which is launched first through B2B.

From a retail perspective, retail is an important pillar of our transformation plan, and I've said in previous calls that we needed to really work on efficiency, in regards to retail, though we are currently negotiating a renewed collective agreement and consequently we do have to review a little bit the pace of the transformation in this sector. Overall, this combined with AIRB investments for which we're still looking forward to in 2020 and getting the benefits in the years after that, it's still on track but we're making those investments as well.

So overall, from an efficiency perspective, we will see some pressure on the efficiency, and we are making the prudent decision to hold some higher liquidity to give us this flexibility. As we have previously mentioned as well, efficiency is not supposed to be linear, right? We're aiming for below 65% in 2020. That was the guidance that we said last time. And there will be some bumps in the road. But nevertheless, we're really excited about the progress that we've been making on the transformation plan. All of these things are required for us to create sustainable improvements in efficiency and overall performance. To date, you know, building a new, strong equipment finance platform with the acquisitions of CIT, for example, and Northpoint. We're seeing revenue growth both in B2B Bank and Business Services, are all things that work for us. So we're thinking that the investments that we're making in 2018 are well worth it to get to our targets and objectives of 2020.

Gabriel Dechaine, National Bank Financial

All right. Appreciate that. I guess my underlying question, and the communication of the strategy, that makes sense. I just wonder how you view this – the challenges in your mortgage book as affecting it. Is it a curveball that's coming at you that, you know, does affect your funding plan? Because all of the sudden you've got a third-party purchaser that's not there temporarily. The expense, you've got some initiative spending that you want to advance the – your transformation plan, keep that on track, but then at the same time you've got to step up investment in control, underwriting systems, and whatever else IT system-related to make sure that these problems don't reoccur – recur. I'm wondering, do you view them as a bump in the road, or is this something that will be more noticeable this year? That fallout from that issue, I mean.

François Desjardins, President and Chief Executive Officer

I think, from a growth perspective, this issue has no material impact at all on our growth. We had already reset our targets to a lower pace and of course we're having fallout from regulation and B20, as we have previously discussed. Obviously we're taking this opportunity as a learning opportunity for the bank. You've heard me in multiple calls talk about simplifying the bank, automating the bank, working on processes, working on governance. Obviously this issue with the securitisation conduit, we're seeing this as an issue to resolve and to put behind us to get back to the plan and – and move forward.

Obviously, for the moment it remains our – our highest priority, because, you know, having any unknown in the market is never good, but as we've discussed in my comments and Susan's comments, we've made really good progress in the last quarter, and we're looking forward to resolving this in the next quarter. And of course we're putting in place processes that are enhanced so that these issues don't reoccur ever again.

Gabriel Dechaine, National Bank Financial

Okay, thank you.

Operator

And your next question comes from the line of Meny Grauman of Cormark Securities. Please go ahead.

Meny Grauman, Cormark Securities

Hi, good morning. François, as you go through this mortgage issue, I'm curious what the lessons you draw from it are for the organisation and – and maybe even for yourself. Thank you.

François Desjardins, President and Chief Executive Officer

Well, that's a great question. I – I must admit that for the organisation is that – well, first of all, the securitisation conduit that we're talking about here is about $2 billion, so it is a relatively small portion of the funding of the entire bank. But for the organisation as a whole, respecting the criteria of securitisation conduits to the letter is something that obviously we missed on, and that means that simplifying our bank and having a more simple and automated bank is still the way to go. It reaffirms the need for our bank to transform, more than anything else. It reaffirms the need for us to move forward more than anything else. For myself, of course, you know, no CEO ever wants to go through these issues, and I must say that, you know, the executive team here and the different teams in credit and processes that have been working on this issue have been doing a great job at – and taking this very seriously.

You know, in hindsight, could we have seen this coming? Obviously now we're getting into hindsight is 20/20, but overall the plan remains the plan, and that's the best comment I could give.

Meny Grauman, Cormark Securities

Thank you, that's really helpful. And just as a follow-up, I was wondering what you would say to people – and you definitely come across this, you know, some people say, 'Why not do a broader review of your mortgage underwriting, and – and just look at a much larger swathe of mortgages?' Understanding that you're identifying a specific problem in that channel, but why not just go through a bigger piece of the mortgage pie – maybe all the mortgages – and have full comfort that the underwriting was done properly, that everything is – is up to the perfect standards that you expect?

François Desjardins, President and Chief Executive Officer

Well, first – and I'll ask Susan Kudzman to chime in here – but first, we are running with excellent credit quality overall, and we have been from in a historical fashion. This is a securitisation eligibility issue, and not all securitisation conduits have the same criteria. And of course this is a miss for this conduit, and that is resolved by buying back the loans that are not eligible. The third part is, regardless of loans being destined to be in securitisation conduits or not, we are increasing governance across the board so that all new business is subject to enhanced quality control. So we will be paying more attention to the business overall as businesses – loans renew and business comes in. Susan, you want to add on that?

Susan Kudzman, Executive Vice President and Chief Risk Officer

François has covered it well. Just to remind you that, you know, we take this very seriously, and in the current environment we understand the consequences. However, this is not a credit issue. Our credit remains well below the industry. We are comfortable with the risk appetite of these loans, and it was an issue related to eligibility for conduits. We've been working with both of the conduits and have made tremendous progress. One of the conduits, the situation has been dealt with and we're getting to the end. So, to your question, you know, we are comfortable with the credit of these loans, of the entire book, as well as the loans. To address the situation we've been repurchasing them, so we have them back on our books and are comfortable with the credit and these loans.

Meny Grauman, Cormark Securities

Thank you very much. That's helpful.

François Desjardins, President and Chief Executive Officer

You're welcome.

Operator

Your next question comes from the line of Sumit Malhotra of Scotia Capital. Please go ahead.

Sumit Malhotra, Scotia Global Banking and Markets

Thanks. Good morning.

François Desjardins, President and Chief Executive Officer

Hello, Sumit.

Sumit Malhotra, Scotia Global Banking and Markets

Hi, good morning. First question is just going to be on your comments on liquidity. I thought you were tying that in with some of the discussion regarding the negotiation with the union, and then you – you were stating that – I think it was as a result of that you were planning on holding extra liquidity? Could you just clarify that for me, and, if that is the reason, how are those two factors related in your mind?

François Desjardins, President and Chief Executive Officer

Thanks for the question. Not specifically, Sumit, in regards to the – the labour situation, but as an overall, right? So, you know, in my prepared remarks I talked about, you know, core banking, digital bank investments, AIRB. There's a lot of change going on in the organisation and now, of course, on top of that, after, you know, some disclosure that you've seen about the certification movements, and now recently a vote taking place, you know, we're now in the negotiation process with our union and this is, of course, going to have some impacts on what we can do or can't do in the retail services area during the negotiation process. So it brings some uncertainty there. And we're just acting prudently. It's not more than that. I think it's a prudent thing to do to have increased liquidity when we're going through a significant amount of change.

Sumit Malhotra, Scotia Global Banking and Markets

And just thinking about what this means from a numbers perspective, you've had the net interest margin move higher the last couple of quarters, chiefly due to the acquisition. You've mentioned the rate hikes as well. So looking forward from here, does the increase in liquidity – is it going to be sufficient or significant enough to stem the NIM expansion? Do you feel NIM stabilises from here, or does it actually step back because of the higher level of liquidity?

François Desjardins, President and Chief Executive Officer

I'll ask François Laurin to give you some colour on that.

François Laurin, Executive Vice President and Chief Financial Officer

Sumit, we still believe there is going to be expansion in the NIM because we haven't had the full year of Northpoint in our numbers. So as we move forward, we'll have – compared to last year, we've seen expansion. But part of that expansion will be contracted by whatever level of liquidity we might hold higher than what we had before by a few basis points.

Sumit Malhotra, Scotia Global Banking and Markets

Yeah, I meant more from where you are now. Obviously this is the first full quarter.

François Laurin, Executive Vice President and Chief Financial Officer

Yeah, we still expect – from the 1.77, we expect expansion still.

Sumit Malhotra, Scotia Global Banking and Markets

Okay, that's clear.

François Laurin, Executive Vice President and Chief Financial Officer

Slight – slight – we expect a slight expansion, given what I mentioned about Northpoint and benefiting from the increased interest rates that have been implemented in the last few months.

Sumit Malhotra, Scotia Global Banking and Markets

Thanks for that. Second question is going to be on revenue, and specifically some of your fee income lines. These are lines I feel like, at least from my perspective, I don't ask you too much about. There was a conversation earlier, and we've heard it for a few calls now, about the softer trend in what I'm going to call your core deposits. And can I link the deposit decline over the last year to some of the trends we're seeing in things like deposit service charges, lending fees? These are usually more stable items, and they have been trending downwards for Laurentian. I'll direct it to you, François. Do you think this relates to what's happening with your core deposit base and some of the branch closings that you enacted over the past year, year and a half?

François Desjardins, President and Chief Executive Officer

Yeah. I'm guessing you're meaning François D here, right?

Sumit Malhotra, Scotia Global Banking and Markets

That's right, that's right.

François Desjardins, President and Chief Executive Officer

No, or I would say, partially. What's – and I'll ask Stéphane to again give some colour on the results of our branch mergers, but there was an expectation, you know, closing – merging one third of the branches of course was going to have some reduction on deposits, and that has been going as planned. But some of these lines are just up and downs of fees that we charge on new loans or self-directed fees or other line items that may vary from time to time. Stéphane?

Stéphane Therrien, Executive Vice President, Personal and Commercial Banking President & CEO of LBC Financial Services

Yes, there's an ensemble of things that happened at the same time. As François just mentioned, there's a reduction of the footprint by 33%. Obviously that had an impact on the deposits. Also partially, as François mentioned, on fee revenue. The other thing is that there is a movement through what we're doing right now that our clients are using more and more electronic services versus cashier, for example. So – so there's a lot of factors going on at the same time. That being said, what's good is that we've been able and we're making progress and we improved the efficiency ratio in retail overall.

Sumit Malhotra, Scotia Global Banking and Markets

Last one is going to be for François Desjardins again, and it just goes to the – the conversation around capital adequacy. We've had a lot of discussions over the years on what the right level of capital is for Laurentian. You know, for a period of time it did seem like you were comfortable operating as long as you were above, I think we had discussed 7.75. Obviously, as you discussed at the outset of the call, you've made the decision to replace the prefs that you redeemed with common, which at least was a little bit surprising to me, given that previous discussion. What changed in your mind as far as management of the CET1 ratio and adequacy, and you know, was this a shift that was aided in part by regulatory discussions, or did you have a new line of thinking as to where common equity needs to be for Laurentian?

François Desjardins, President and Chief Executive Officer

Well, two parts, and thanks for the question. Yeah. You know, the right level of capital for the bank is always calculated with the risk appetite, which we review over time. And of course, even from my first day as a CEO, where the capital ratio was just a ratio, it was around 7.4. We calculated the risk appetite to be insufficient and raised capital to the 7.8 mark. Further evaluations of that gave us a range, right? An operating range that now stands at 7.9 to 8.3. And why we are – we have a range is because of different aspects, whether it be just monthly fluctuations of paying out dividends or investments in core banking, for which we need to deduct the capital as soon as it's spent, or the other way around. You know, we need to have an operating margin so that we don't hit the bottom of the range.

So in the first two years of our transformation plan, we experienced really strong growth in assets, as you know, and we were ahead of plan. So as we ended up looking at what we needed, strategically looking at the business mix, which we know as we're pushing more loans into Business Services, common sense will tell us that this range will slowly go up as Business Services takes a higher proportion of the overall business of the bank. But what we did after the holidays is really take a look at the opportunity we had in the market to rebuild. We were at the bottom of the range. So sure, we can take our time and rebuild this, but it takes several quarters to do this, and we were uncomfortable with that, so we took the opportunity to go and replace the preferred share issue of $100 million with a new common share issue, strengthening both tier one and CET1 ratios.

Obviously, with the green shoe being fully exercised, it takes us slightly above our operating range, but quite frankly I don't mind this buffer. I think it gives us extra operational flexibility, and as I've said in my previous comments, this is a big year for us. Just for transformation alone, we're implementing many changes. So having that extra buffer, I don't see this as a negative at all.

Sumit Malhotra, Scotia Global Banking and Markets

And just for clarity while I wrap it up, 8.2 to 8.5 on CET1 is the new range that investors should think about Laurentian managing the ratio going forward?

François Desjardins, President and Chief Executive Officer

The risk appetite calculated is 7.9 to 8.3, and our guidance for the next few quarters is that we'll be operating at the higher end of this range, even slightly higher for the next several quarters.

Sumit Malhotra, Scotia Global Banking and Markets

That's very clear. Thank you for your time.

François Desjardins, President and Chief Executive Officer

Thank you.

Operator

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

Doug Young, Desjardins Securities

Hi, good morning. Just you've been crystal clear, I think, that expenses are going to bounce around. I just want to put a finer point on that topic. François, maybe can you elaborate in terms of how much additional costs will flow through the P&L from running two platforms?

François Desjardins, President and Chief Executive Officer

We haven't disclosed that, for the reason of not disclosing yearly targets. We gave our midterm targets, you know, in Q4. And of course the question back then was you're aiming at below 65% efficiency ratio, you're already there, so what do you do for the next three years? So obviously, you know, the answer is it's not going to be a straight line. And the answer to the question is, you know, is it going to be a massive amount of pressure? No, but we want to be clear that 2018 is an investment year, and there will be some pressure on expenses. And that pressure on expenses is going to translate on, you know, slight pressure on performance. But we're absorbing this investment cost within our operational capacity, which I think is something that will eventually disappear. Running two core banking systems at the same time with two teams obviously is more expensive than running one. So as soon as we can retire those systems, it does give almost an immediate benefit.

Doug Young, Desjardins Securities

So the new core banking system came live Q1, is that correct?

François Desjardins, President and Chief Executive Officer

Correct. A portion of it, right? So the foundation became live, and we started migrating certain products of B2B Bank. Other products of B2B Bank will be flowed onto the new banking system in the next – in the next few quarters. So, Doug, can you still hear us?

Doug Young, Desjardins Securities

I still hear you. Yeah.

François Desjardins, President and Chief Executive Officer

Okay, sorry. Good, you're there. In the next few quarters, and so will products from business services. The end of the –

Doug Young, Desjardins Securities

I don't know where that's from.

François Desjardins, President and Chief Executive Officer

The end of the quarter – sorry, the end of the programme is mid to late 2019, where retail services products all go into the core banking platform, and that's where we expect some really nice efficiency gains there and cost reductions.

Doug Young, Desjardins Securities

And have you disclosed or will you disclose how much you've capitalised for the new core banking system?

François Desjardins, President and Chief Executive Officer

François?

François Laurin, Executive Vice President and Chief Financial Officer

It will be part of our capitalisation costs once we do them and we disclose them, but basically we said that the – the majority of our capital expenditures in the plan were coming from two major projects, the core banking and the AIRB. But that's the extent –

Doug Young, Desjardins Securities

But you haven't disclosed – you haven't disclosed the amount that you've capitalised. Okay. And then I can't imagine the AIRB cost – you're just saying that there is cost there – is it incrementally increasing significantly? I wouldn't imagine it would change drastically. And the same on the retail. Is this just, you know, you may not get further cost savings from the retail side, but incrementally we shouldn't see an increase, should we?

François Laurin, Executive Vice President and Chief Financial Officer

From the AIRB programme, of course, you know, systems that are not implemented yet don't hit the operational lines, so that will just hit progressively as systems come on. But the cost of teams that are working on the implementation of different proportions, procedures, models, you know, putting that together, is hitting the lines of costs as we speak. And of course we're not getting the benefit of that until AIRB is live. So, you know, but as a reminder, why we're doing this is that better managing our capital requires better processes, documentation, data. And the benefit of that as calculated and disclosed previously is around 200bps of improvement in ROE as we move from standard methodology to advanced methodology. So it's well worth the investments that we're making, both in technology and in process.

Doug Young, Desjardins Securities

Okay. Just lastly, on page 12 of this – the – it shows individual provisions, $7 million. I mean, that's down significantly. I think that's your specifics. Just wanted a little bit more details as to were there recoveries in there, was there something else? Just hoping for a little bit more colour.

François Desjardins, President and Chief Executive Officer

Doug, you're in the MD&A?

Doug Young, Desjardins Securities

No, in the financial supplement package on page 12 under the provisions for credit losses. The $7 million versus $6,969last quarter and 2.8 last year

François Desjardins, President and Chief Executive Officer

Hold on a second. We're just going to flip to your line here, sir.

Doug Young, Desjardins Securities

I'm sorry, it was $7,000, not $7 million. But... And I – we can take it offline if it's easier.

François Desjardins, President and Chief Executive Officer

Yeah, maybe we should get back to you on the line.

François Laurin, Executive Vice President and Chief Financial Officer

Can we take it offline, Doug, and come back to you on this?

Doug Young, Desjardins Securities

Yeah, that's fine. Yeah, that's fine. Thank you.

François Desjardins, President and Chief Executive Officer

You're welcome.

Operator

And your next question comes from Marco Giurleo from CIBC. Please go ahead.

Marco Giurleo, CIBC World Markets

Good morning.

François Desjardins, President and Chief Executive Officer

Good morning, Marco.

Marco Giurleo, CIBC World Markets

Morning. My first question is on acquisitions. Over the past two years you've made a couple of material acquisitions, so first on the progress of those acquired entities, do you still envision 4% EPS accretion for each of them?

François Desjardins, President and Chief Executive Officer

I'll ask François Laurin to answer.

François Laurin, Executive Vice President and Chief Financial Officer

Yes, we do. CIT we said this year and Northpoint next year, and we're still holding to that.

Marco Giurleo, CIBC World Markets

All right. So we should see the 4% EPS accretion plus whatever organic growth you generate.

François Laurin, Executive Vice President and Chief Financial Officer

From that – from those two acquisitions, yes.

Marco Giurleo, CIBC World Markets

All right, great. And could you also touch on your acquisition appetite going forward?

François Desjardins, President and Chief Executive Officer

I certainly will. We obviously always look at acquisitions on a regular basis, and – but we do have criteria and targets, and it really does have to be a good cultural fit. You know, enhancing our current product line, or, as we did with CIT and Northpoint, you know, leveraging things that we want to be in or where we can win. The challenge for 2018 and 2019, of course, is that you can't really do big acquisitions at the same time as you're doing core banking implementations, and those two things really don't go hand in hand. You want to be successful on your core banking implementations, and that's really where we're focusing on. So, you know, our appetite short term is curtailed because of that. We're also being cognisant that a lot of the modelling and a lot of the work that has to be done for AIRB has to be reviewed over time. We need to have the historical data of these portfolios, so we have to be careful what we would put into the portfolios. I would say that in – from an appetite perspective, we'll get hungrier once some of these big-ticket initiatives are behind us.

Marco Giurleo, CIBC World Markets

Excellent, thank you.

François Desjardins, President and Chief Executive Officer

You're welcome.

Operator

Your next question comes from the line of Scott Chan of Canaccord Genuity. Please go ahead.

Scott Chan, Canaccord Genuity

Good morning.

François Desjardins, President and Chief Executive Officer

Good morning.

Scott Chan, Canaccord Genuity

François, maybe a bit – maybe, big picture, your ROE has been trending down and I expect it to probably go down a bit more before it goes higher. You know, kind of regarding your target on attaining an ROE within 300 bps with the big six banks by 2022, is that still a reasonable target or medium-term target considering the challenges paused short term?

François Desjardins, President and Chief Executive Officer

Yes, Our current evaluation of the implementation of the plans and the efficiency gains that have to happen with the investments that we're making in '18 and '19 take us there. You know, we're willing to make these investments because that's the payoff.

Scott Chan, Canaccord Genuity

Okay, and earlier you commented on mortgages, but I think that was more directed towards conventional. Maybe you can just update us on the Alt-A book, and kind of expectations over the next few years there, and kind of impact on B20.

François Desjardins, President and Chief Executive Officer

Sorry, I just wanted to make sure I said the right thing. Our midterm targets are 2020, right, so we're making investments in '18 and '19 to get to there. Your question on the Alt A book?

Scott Chan, Canaccord Genuity

Yeah.

François Desjardins, President and Chief Executive Officer

Is the percentage –

Scott Chan, Canaccord Genuity

Just in terms of like what to expect in terms of that book going forward. I think earlier the commentary was directed more towards the conventional mortgages. Just wanted to see if that kind of growth rate would kind of be more higher than your traditional book.

François Desjardins, President and Chief Executive Officer

Overall, the mortgage growth rates, I have already expressed that during this call, so low single-digit growth rates on mortgages from brokers and advisers, but please take into account that the bank stopped the referral program to the branch network, so overall residential mortgages is going to be impacted by that. As far as the split between the different types of mortgages, you know, one of the big trends that we're seeing is regulation impacting insured mortgages, so we're seeing less of that, and we're seeing more of the non-insured traditional mortgages. The percentage of Alt business coming in has remained relatively stable, so not a big change there.

Scott Chan, Canaccord Genuity

And just lastly, just a clarification question, in your supplemental on page 13, just on your HELOC portfolios, it seems like the percentages in Quebec and Ontario flipped sequentially, like Ontario is now 68% of the portfolio versus 17% last quarter, and Quebec is vice versa. Is that kind of a – is that kind of a misstatement, or was that related to something else?

François Laurin: Can we get back offline, Scott, with those particular details?

Scott Chan, Canaccord Genuity

Yeah, sure.

François Laurin, Executive Vice President and Chief Financial Officer

I will be happy to do this.

Scott Chan, Canaccord Genuity

Okay, appreciated, thank you.

François Desjardins, President and Chief Executive Officer

Thank you Scott.

Operator

And your next question will come from the line of Sohrab Movahedi of BMO Capital Markets, please go ahead.

Sohrab Movahedi, BMO Capital Markets

Okay, thank you, I know it's been a full hour, so I'll try and be very quick here. The – François, what would have been organic expense growth absent Northpoint?

François Desjardins, President and Chief Executive Officer

I'll ask Francois Laurin.

François Laurin, Executive Vice President and Chief Financial Officer

I'll have to get back to you with specifics, Sohrab.

Sohrab Movahedi, BMO Capital Markets

Okay, and when you think about the expense or the investment program through '18 and '19, I guess, is that somewhat revenue-dependent, or you know, once you press the switch, those expenses are coming at you regardless of the revenue environment?

François Laurin, Executive Vice President and Chief Financial Officer

The – a lot of the expenses that we're seeing happen to us before revenue is generated from them. So we see a – some of the work that has to be done in IRB, core banking, digital, can be amortised, you know from a systems work perspective, but a lot of it can't, so those have to go into the expense lines without any revenues being generated from them. Of course, we're not doing this for nothing, so we'll be, you know, eager to see the success on the digital bank launch later this year and grow that business. We're also – of course, we've made some investments already with CIT and Northpoint, so, you know, we're expecting to see some good business that way too. And as Stephane mentioned earlier, you know, some of the things that we're looking at as well is continuing to look at our portfolios to see are there things that we want to get out of too, which might have some short-term impact on the top line. But, you know, I'd rather spend my liquidity and capital on higher-margin products and in industries and product lines where I can win and be successful and relevant than to leave them just hanging. I think that's the best summary I can give you at this point.

Sohrab Movahedi, BMO Capital Markets

Okay, so maybe let me just take – come at it slightly differently. I mean, you have had a very noticeable improvement in your expense to revenue ratio, let's say, over the last, I don't know, eight or 10 quarters, from let's say somewhere within the 70s, all the way down to where you're at this quarter. I guess you've made it crystal clear that these things are not going to be – this is not going to continue to go down, it will actually kind of fluctuate up and down. Can you put a bit of a range around it? Is it going to be 65 this quarter plus, you know – plus, you know, 100 to 200 basis points, or could it go back to 70 basis points, or 70%, sorry?

François Desjardins, President and Chief Executive Officer

It's really an excellent question, Sohrab, but I wouldn't want to send you down the path of giving you disclosure that is more than – than this, right? We're aiming for below 65 in 2020, we're at 65 now. So we're going to have some pressure, it's not going to be massive pressure, both on efficiency ratio and on – and of course on performance, but there will be some pressure.

Sohrab Movahedi, BMO Capital Markets

Okay, and one last question, and I apologise. I think you answered this question, but I don't know if I got the full gist of it. I think you said you've adjusted your risk appetite ultimately and will be running with a higher, you know, capital ratio over the next, you know, the next few quarters anyway. Was the commensurate offset to the, you know, to a more conservative risk appetite willing to live with a lower ROE?

François Desjardins, President and Chief Executive Officer

No, I'll just repeat the answer. We review the risk appetite on a regular basis, and that's independent of the performance. It's really just driven by mathematical calculation of total risk. The risk appetite when I first came in as CEO, we had a capital, a CET1 capital ratio of 7.4. We recalculated our risk appetite and it gave us a number of 7.8, and because of transformation, you can't run at 7.8, you have to give yourself a margin of operational – an operational margin here. So the risk appetite that we're running at since last year is 7.9 to 8.3. The decision to run at the higher end of this ratio came as a reaction to, you know, two really big years of asset growth. And as we were running at the lower end of this ratio, we saw the opportunity. We had a pref share issue that was coming up, so we decided to replace that with the common share issue, and that – both effects our tier 1 and the CET1 ratio. So now we're running at the upper end of the range, actually a little bit above our range, because as we issued common shares, our green shoe was fully exercised, and now we're standing at around 8.6.

And the last comment that I made for the question is, "Well are you going to be at that range?" and the answer is yes. I think that having a higher capital buffer gives us an added operational flexibility. There's a lot of stuff going on – core banking, etcetera – that eats up, you know, capital as soon as you spend it. So we're being prudent on that, and if short term it has some impacts on ROE, obviously, it might have a small impact, but we believe that is the prudent thing to do, and is required to get us through this transformation.

Sohrab Movahedi, BMO Capital Markets

Thank you.

François Desjardins, President and Chief Executive Officer

Susan, do you want to add something on this?

Susan Kudzman, Executive Vice President and Chief Risk Officer

Yeah, maybe just to add a point that, you know, of course our risk appetite, as we've mentioned before, is something that we review regularly, and we do expect the performance out of the level of risk that we take. So as François has said, we're just reiterating that our risk appetite determines an operating range, and the performance that comes out of that at 7.9 to 8.3, and that we'll be running for – with an extra buffer for the reasons he explained for a little while. It doesn't change our midterm target.

François Desjardins, President and Chief Executive Officer

The last thing that I might add on that is that although it doesn't have an immediate impact on the risk appetite, moving the mix of the business from retail products towards business services does slightly impact the risk appetite, you know, by a bp or two over time. But of course as you're moving that business, the revenue is generated proportionately, right, so there should be an expectation that the risk range itself in the next years might move by a bp once in a while.

Sohrab Movahedi, BMO Capital Markets

That's very helpful, yeah, that's very helpful, thank you. I'm just trying to figure out at what rate you're going to be accreting book value here. That's all. I appreciate that, thank you.

François Laurin, Executive Vice President and Chief Financial Officer

Sohrab, François Laurin here, I have got the answer for you. So, Sohrab, are you still there?

Sohrab Movahedi, BMO Capital Markets

Yeah, I'm still here.

François Laurin, Executive Vice President and Chief Financial Officer

Okay, so I guess your question was the – out of the increase in non-interest expenses, how much comes from the acquisition?

Sohrab Movahedi, BMO Capital Markets

Yeah, I think you said that adjusted no-interest expenses are up 6% year-over-year, and I just wanted to know would it have been ex-Northpoint, yeah.

François Laurin, Executive Vice President and Chief Financial Officer

Short of 2%.

Sohrab Movahedi, BMO Capital Markets

Less than 2%.

François Laurin, Executive Vice President and Chief Financial Officer

Yeah.

Sohrab Movahedi, BMO Capital Markets

Thank you.

François Laurin, Executive Vice President and Chief Financial Officer

You're welcome.

Operator

And the next question comes from the line of Richard Roth of TD Securities, please go ahead.

Richard Roth, TD Securities

Good morning, I'll be prompt. With respect to the commentary about there being a bump in the efficiency – bump in the efficiency ratio over time, between the employment matters you're dealing with, and the parallel system, and the core banking system implementation, which of those two do you see as being a higher risk, or a greater chance of causing one of those bumps?

François Desjardins, President and Chief Executive Officer

It's a great question that of course we have to ask ourselves. But, you know, honestly, management cannot look at any given item in isolation, right? When we're talking about, you know, different costs, or – these might happen at different schedules or times, and I think that what we're trying to make sure that the market understands is that of course we are in a negotiation with the union, this we don't control fully the process, it takes two to tango. So, you know, at what speed this will get to resolution is bringing some uncertainty, and of course then, you know, what we can do in retail services and at what time. Well, it's hard for us to make decisions when we don't know the rules of the game. So, bottom line, you know, there are some costs, and we had already said in previous calls that 2018 would be an investment year for us, but this is, you know, a new wrinkle, I guess, to add to the mix.

Richard Roth, TD Securities

Thanks, I realise this is a sensitive issue, but would you give some sort of bookend in terms of what the potential impacts of the employment matter could be? And I mean not just from a dollar value perspective because maybe you can't do that, but maybe from a timing perspective, like what sort of delay on this or a transformational plan, worst case if this thing, you know, carries on.

François Desjardins, President and Chief Executive Officer

Unfortunately no, I wish I could. But just from reasons that have to do with negotiations themselves, we can't disclose much on this because we can't negotiate in public.

Richard Roth, TD Securities

Right.

François Desjardins, President and Chief Executive Officer

And so talking about any issue in regards to time or money or etcetera, we have to do this at the negotiating table, and we'll have to get back to you when that resolves.

Richard Roth, TD Securities

Sure, I totally understand that, and then one final thing, with respect to the core banking system implementation, do you expect additional costs if they arise to be sort of consistent and linear in fashion, or is there going to be a step function where, you know, one quarter there's, like, a large expense? It's just booked because that happens to be the quarter when costs were incurred.

François Desjardins, President and Chief Executive Officer

Well, the impact on capital occurs as soon as the amounts are spent, so every month, there's a hit on the capital side. But from hitting the expense side, it really happens when the systems are turned on, so we already have a partial hit in our run rates right now, because we turned on the foundation and a part of the B2B services. We'll have probably later in the year when we turn on business services in B2B another bump there, and when we turn on retail services, another bump there which is in 2019. But you know, as much as I want to be transparent with you, this is all the things being equal, right, so delays can happen, movements of time can happen. This is a large-scale project, so, you know, what we've said is going to be over time within these two years. I'm trying to give you a little bit more colour but, you know, take it with a huge grain of salt.

Richard Roth, TD Securities

Okay, thank you.

Operator

And this now concludes our Q&A session, I would like to hand it back over to Susan Cohen for closing remarks.

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. Our second quarter of 2018 conference call will be held on May 30th, and we look forward to speaking with you then. Have a good day.

Operator

And this concludes today's call. Thank you for your participation, you may now disconnect your lines, and have a wonderful day.