Third Quarter Results 2018 Conference Call

September 4, 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 and in our Third Quarter 2018 Report to Shareholders 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 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 estimates and statements regarding our business plan and financial objectives including statements contained in our 2017 Annual Report under the heading "Outlook".

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, 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 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).

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

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 the third quarter of 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 Report to Shareholders, investor presentation and financial supplement 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.

Francois Desjardins, President and Chief Executive Officer

Thank you, Susan. Good morning everyone.

My formal remarks today will focus on the following 4 items: The mortgage loan portfolio review, appointments to the executive team, our strategic objectives and finally, financial performance for the quarter.

I am pleased to announce that we have completed the mortgage loan portfolio review and have resolved the situation with both the TPP and CMHC. With sincere thanks to the teams involved, this matter was resolved within the guidance that was given last quarter.

As you know, this review garnered some media attention. Everyone at Laurentian felt it was important to put this issue behind us as quickly as possible and allow current and potential shareholders to have the same level of confidence in our organization and our plan that the team, Management and the Board have.

Certainly, the events of the last 9 months have been hard on the team. But this has been a tremendous learning experience and in the end, makes us stronger and more determined than ever.

Turning to talent, we continue to attract experienced and seasoned executives to the team.

First, we hired Liam Mason as our Chief Risk Officer. Formerly from CIBC, Liam brings extensive risk management experience to the Group. He has also served as Managing Director, Bank Supervision with OSFI for the past 2 years.

To further reinforce the team that is already in place, Liam has brought on additional bench strength with John Penhale, formerly of TD Bank and CIBC, who will serve as Senior Vice President, Integrated Risk Management.

I would also like to announce that Vania Artinian has been appointed Senior Vice President, Internal Audit. With a distinguished career at State Street, Royal Bank and Genworth, Vania will bring a disciplined approach to improving the effectiveness of our governance and controls.

We promoted Deborah Rose to the position of COO of Laurentian Bank Financial Group, recognizing her 25 years of experience and accomplishments within the financial services industry, of which 7 have been at B2B Bank. Deborah will oversee the Group's activities relating to administration, technology and operations, and lead our largest initiatives.

Craig Backman has joined the team as our new Executive Vice President of Personal Digital Banking. Craig comes to us from a long career in the consumer product and financial services industries, most recently in charge of digital strategy across the Canadian business lines at TD Bank. At LBCFG, Craig will be responsible for digital retail banking product development and distribution across Canada, advancing the work begun by Deborah.

As you can see, we said we were going to build strong foundations, and we mean it.

Moving to strategic objectives - as you know, the industry continues to evolve, and so our need to move swiftly to becoming a renewed financial institution remains a priority. Our commitment to being different and better - to delivering value to our customers - has not wavered.

We have made progress on several fronts: simplifying product lines, making inroads into equipment and inventory financing, the new Montreal corporate office and the move to the Advanced Internal Ratings Based approach to credit risk.

We have made good progress on the implementation of the new core banking system and are just weeks away from the implementation that will see all B2B Bank and most of Business Services products onboarded.

Our new core banking system will soon enable the launch of digital products… and transactional digital banking products require mobile devices, not necessarily branches.

As you know, since 2004, we have limited our direct-to-client development to our branches in Quebec. This is changing. We are a pan-Canadian bank and it's time that we grow our consumer base outside of Quebec.

B2B Bank will be launching transactional digital banking products through the independent advisor network, and in parallel, Laurentian Bank will be gradually launching the same products directly to consumers across Canada.

As for Quebec Branch Retail Services, we will continue the migration of branches towards advice-only financial centers and increase the total number of financial advisors. But as you know, unionized employees have been without a contract since December and we are in negotiations with very slow progress. Until we know the outcome of ongoing labour discussions, we must delay investment decisions in technology and real estate for this sector, including the migration of accounts onto the new core banking platform.

I will conclude my remarks with a word on our quarterly results. From my perspective, this quarter's results are below what we are aiming for. Obviously, I would prefer to report better financial performance but all things considered, I am happy with the progress we are making. We made decisions that allowed us to manage through the mortgage loan portfolio review, which is now behind us, strengthen the team and reinforce foundations. In short, we are making investments in the right places to support future growth.

Now, it's back to the plan. Changes to customer behaviors are either an opportunity or a challenge for all banks, and we must be prepared. We are continuing to make investments to ensure competitiveness in this changing financial landscape, which in turn, will improve efficiency and profitability on a sustainable basis and build long-term shareholder value. But, as I have said on previous calls, Management is being prudent.

We are maintaining a healthy level of liquidity and capital. We continue to manage the balance sheet conservatively and regularly review our risk profile and have concluded that a CET1 ratio of 8.3 to 8.7% is the right level to target to withstand market volatility, continue to increase loans to business customers in the bank mix and pursue our strategic objectives. All this puts pressure on short-term performance, but ultimately, ensures the financial strength of this organization.

I will now invite François Laurin to provide a more in-depth review of the financial results for the third quarter and, following the Q&A session, I will return to offer some closing remarks.

François…

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

Thank you, François.

Good morning everyone.

At the end of May, we announced that the mortgage situation with the TPP was resolved and as François mentioned, today we can say the same regarding CMHC. Specifically, in the third quarter we identified and repurchased mortgage loans totalling $135 million that were inadvertently portfolio insured and sold into CMHC's securitization programs as highlighted on slide 12. The amount was in line with our estimate of $125 to $150 million that we reported at the end of the second quarter. CMHC insurance on the inadvertently portfolio insured mortgage loans was concurrently cancelled and as a result, a one-time charge of $1.5 million was included in other non-interest expenses in the third quarter of 2018. CMHC will release the $20 million cash reserve deposit previously made by the Bank in the fourth quarter. CMHC's securitization program remains available and the Bank has been securitizing mortgage loans, as usual, during 2018.

I would now like to discuss the Bank's core financial performance beginning on slide 14. Results reflect our investment in people, processes and technology and our actions to strengthen the Bank's financial foundation, including maintaining high liquidity and strong capital which position us well to deliver our strategic objectives. Adjusted net income in the third quarter of 2018 declined by 1% compared to a year earlier. Adjusted EPS was $1.34, down 18% over the same period. Sequentially, adjusted EPS declined by 9%. Adjusted ROE was 10.0%, and while lower than a year earlier, it reflects a strong capital base.

As outlined on slide 15, reported earnings for the third quarter were affected by adjusting items totalling $4.5 million after tax or $0.11 per share, and are largely related to business combinations.

The drivers of our performance are presented on slide 16. Total revenue in the third quarter of 2018 increased to $260.7 million, up 5% compared to a year earlier. Net interest income rose by 12% mainly due to strong volume growth from the acquisition of Northpoint, and the higher margins earned, particularly on the acquired loans. Other income decreased by 7%.

Net interest margin, shown on slide 17, was 1.77%. The main factors contributing to the 14 basis point year-over-year increase was the larger proportion of higher yielding loans to business customers, including the acquisition of Northpoint, with corresponding higher margins, and recent increases in the prime rate that were partly offset by the higher level of liquid assets. Sequentially, the margin was down by 5 basis points, largely reflecting the higher level of liquid assets. As previously mentioned, 2018 and 2019 are important years of investment in our strategic plan and we expect to maintain a high level of liquidity over this period. Considering all of these factors, we expect a modest improvement in NIM over the next few quarters.

Average earning assets rose 3% year-over-year reflecting 14% growth in loans to business customers and a level of residential mortgage loans through independent brokers and advisors that was relatively stable from a year earlier. Residential mortgage loans through the branch network were 10% lower than a year earlier, largely reflecting the decision last November to no longer accept referrals from the broker network. As well, personal loans were down 10% over the same period, mainly due to lower investment loan balances, reflecting consumer behavior to accelerate repayment following strong capital market performance. Over the past 6 months, we have also been managing asset growth more tightly to optimize the profitability of the product mix and the related risk-weighed exposures.

Other income, as presented on Slide 18, totaled $83.7 million, down 7% from a year ago. The decline was primarily driven by lower service charges as clients continue to modify their banking behavior and as we simplify our product offering. As well, income from brokerage operations declined due to a lower level of activity. Sequentially, other income was up slightly. There was improvement in lending fees reflecting higher activity in the commercial loan portfolios, higher income from treasury and financial markets due to better results from treasury operations and higher income from brokerage operations relating to a rebound in fixed income activities. In the second quarter of 2018, we recognized a $5.3 million gain from the sale of the agricultural loan portfolio.

Slide 19 highlights that adjusted non-interest expenses rose by 12% year-over-year. This increase was due to the acquisition of Northpoint, regular salary increases, and higher technology costs related to running two core-banking platforms. As well, other non-interest expenses increased, resulting from a variety of items which are also highlighted on Slide 19. We anticipate that the ongoing costs will remain at a similar level over the next few quarters.

Our adjusted efficiency ratio of 69.7% was 410 basis points higher than a year ago. As discussed on previous conference calls, we expect that over the next few quarters, this ratio will remain volatile and high. However, as we make progress on our strategic initiatives, this ratio is expected to improve.

Slide 20 highlights our well diversified sources of funds. Deposits stood at $29.1 billion, up 3% compared to a year earlier. Total deposits sourced through independent brokers and advisors grew by 10% and amounted to $15.1 billion. While we have reduced our footprint by close to a third, our Branch sourced deposits have been relatively stable over the past 2 quarters and have experienced low attrition over the past year. Debt related to securitization at $7.8 billion decreased by $636 million compared to a year earlier mainly due to maturities of Canada Mortgage Bonds and the repurchase of mortgage loans resulting from the mortgage loan portfolio review.

Slide 21 demonstrates the success of our strategies to increase our non-redeemable broker-sourced GIC's over the past 2 and a half years - a higher quality term funding source - while reducing our exposure to more volatile broker-sourced high interest investment accounts.

With respect to liquidity, our positions continue to be strong and well above our internal and regulatory requirements. Furthermore, slide 22 highlights the high-quality composition of our liquidity portfolio. Almost 90% is invested in low risk – highly rated liquid assets, such as Canadian Government, Provincial and Municipal securities, as well as in cash. We expect to maintain a healthy level of liquidity over the next few quarters.

Slide 23 presents the CET1 ratio, under the Standardized Approach, of 8.8% at July 31, 2018. Our capital ratios are strong and support the Bank's strategic plan.

Our diversified loan portfolio is highlighted on Slides 25 to 27. Loans to business customers have increased to 35% of the portfolio from 31% a year ago and residential mortgage loans remain relatively unchanged at 50%. Within the residential mortgage loan portfolio, Alt-A mortgages total $1.4 billion and represent 8% of the total residential mortgage loan book and 4% of the total loan portfolio. As well, residential mortgage loans in the GTA represent about 22% of the residential mortgage loan portfolio and the GVA accounts for 4%, equal to last quarter. LTV's remain low and credit scores remain high.

Turning to slide 28, credit quality remains strong. The provision for credit losses at $4.9 million compared to $6.4 million a year ago. The loss ratio was 5 basis points in the third quarter of 2018, compared to 7 basis points a year earlier. Ninety seven percent of our loan book is collateralized and the underlying credit quality of the portfolios continues to be excellent. The Bank will adopt IFRS 9 on November 1, 2018 and we will provide some insight at year-end.

Impaired loans are shown on Slide 29. The gross impaired loan ratio stood at 45 basis points, two basis points higher than the previous quarter. However, credit quality of the underlying portfolios remains strong. The net impaired loan ratio stood at 37 basis points and we remain adequately 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 lending practices, we expect that the loss ratio will remain below other Canadian banks.

To conclude, we are building a solid foundation to pursue our plan which will allow us to deliver 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.

Susan Cohen, Director, Investor Relations

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

Operator

If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speaker phone, 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'll pause just for a moment to allow everyone an opportunity to signal for question. Their first question will come from the line of Richard Roth of TD Securities, please go ahead.

Richard Roth, TD Securities

Hi, first question on expenses. What are the exact details around that $1.5 million write-off? Like, what exactly does that relate to?

Francois Desjardins, President and Chief Executive Officer

I'll ask Francois to answer, to give some colour.

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

Thank you, it's related to the cancellation of insurance from the mortgage loan portfolio. So, those inadvertently insured loans, we stopped the insurance and we had an amount of insured premiums paid, not amortised in the books that we have to take as a onetime charge.

Richard Roth, TD Securities

Okay, understood. And then, you also mentioned in your commentary that there was an increase in deposit insurance. Historically, I mean, these are typically small enough not to mention. Was there a specific reason you guys mentioned it this quarter?

Francois Desjardins, President and Chief Executive Officer

Yes, Francois.

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

Yes, the higher deposit insurance cost is related to an increase in premiums and deposit volume growth that we incurred, starting this quarter.

Richard Roth, TD Securities

Okay. So, it's just entirely driven by higher deposit levels rather than anything else?

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

And the premium as well.

Richard Roth, TD Securities

The premium went up, okay. And then, you mentioned in your commentary that you anticipate ongoing costs to remain at a similar level over the next few quarters. Of the cost you had this quarter, which ones are not ongoing? So, the write-off is one of them. But are there any others that are baked in that would not be ongoing?

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

No, basically, Richard – basically that's right, given, you knock off that $1.5 million, the rest is basically the level we expect to sustain for the next few quarters.

Richard Roth, TD Securities

With respect to capital, I know that your move in your range is fairly substantial, I guess 4 %. Now that the mortgage thing is concluded, what sort of drove you to increase your CET1 capital range, like what's the catalyst for that?

Francois Desjardins, President and Chief Executive Officer

The biggest – it's Francois – the biggest catalyst is the move towards business services customers. We have indicated in fact that maintaining a strong capital position, so we can withstand market volatility, continue to increase loans to business customers and to pursue our plan. I think that from the beginning of my tenure, we indicated that one of our objectives was the change the mix of the bank slightly and gradually towards more of the business customers and that drove the changes in the CET1 range targets that we had this quarter and previous years.

Richard Roth, TD Securities

Okay, thank you for that.

Francois Desjardins, President and Chief Executive Officer

You're welcome.

Operator

We'll go ahead with our next question from Scott Chan of Canaccord Genuity, please go ahead.

Scott Chan, Canaccord Genuity

Good morning. Maybe just a follow up on new target ratio on the capital side. With your earnings outlook probably impacted near term, and your payout ratio at the high end of your range right now and also the increased capital range, has that affected the dividend growth that LB has historically done every other quarter? Or how do we think about that in terms of the new capital ratios?

Francois Desjardins, President and Chief Executive Officer

I think you should think about it as, we do. You know, the Board of Directors and management review our dividend rate very quarter. The dividend yield is key to our investors, and we're aware of that. So, as we're making these reviews and decisions, we're considering that 2018 and 2019 are investment years, where expenses are going to be slightly higher. And therefore, performance is going to be under pressure. But we are thinking about rewarding the patient investors that we have and hopefully have more.

Scott Chan, Canaccord Genuity

And then when I think about forward-looking growth on your portfolio, you've scaled back mortgages and personal loans. So, how do we view the overall growth, say, over the next year and how does commercial still play into that in terms of the outlook there?

Francois Desjardins, President and Chief Executive Officer

We're still working towards our 2020 growth target and as you may recall last Q4, because we were so far in advance of our mortgage target, we decided to scale those back and really focus on loans to business customers. As expected, growth is higher for business customers and slower in residential mortgages. And as we move forward, that will continue to be the case. We want to concentrate on target niches and profitable growth. We're also reviewing our activities in certain areas for those where we want to grow and maintain and those where we want to fix or exit.. For example, last quarter, we exited the agriculture portfolio. This should result in a net growth of low single digits in 2019, for growth overall in loans, and low double-digit growth in loans to businesses in same period.

Scott Chan, Canaccord Genuity

That's very helpful, thank you very much.

Francois Desjardins, President and Chief Executive Officer

You're welcome.

Operator

And your next question will come from Gabriel Dechaine of National Bank, Please go ahead.

Gabriel Dechaine, National Bank Financial

I just want to follow up on the rationale for the higher core, tier one target range. So, what I'm hearing is you're kind of bracing yourself for market volatility and then you want to have higher capital ratios as you push further, I guess, into commercial lending as… What else changed? I mean, just last quarter or the quarter before, we were content with 7.9% to 8.2 % and all of a sudden, we're higher than that. I mean, it seems sudden, not like the commercial lending game[?].

Francois Desjardins, President and Chief Executive Officer

I don't think that it's sudden. I think that we've been moving our target range slowly, but steadily as the loan portfolio is moving. And of course, you have to move the range before you get the loans in as well. So, if we're looking for more loan to business customers in 2019, we have to make that adjustment beforehand. But, you're right. I mean, I can read the news and so can investors. And I think that we've been managing the bank and the capital well over the last period. And I think that investors want to be safe and secure in investing in Laurentian. And I think that having a high level of capital – a healthy capital position and for that matter, a high or healthy level of liquidity, reassures us and the market that we can withstand the market volatility and continue with our plan in terms of the growth.

Gabriel Dechaine, National Bank Financial

Okay. Well, speaking of these commercial borrowers, can you tell me what the organic growth was, or can we carve out the Northpoint on a year-over-year basis? I want to know what the Northpoint ex that agriculture loan sell-off was.

Francois Desjardins, President and Chief Executive Officer

I'll ask Stéphane Therrien to comment on – generally on business services growth.

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

Year to date, our growth has been 14% as you mentioned, including Northpoint. It would have been 8% organically without Northpoint.

Gabriel Dechaine, National Bank Financial

And that 8% is I guess understated, given the sale of that ag portfolio?

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

Yes, slightly.

Gabriel Dechaine, National Bank Financial

Okay. And then if I look at the trend in the commercial – sorry, the mortgage book, the personal loan book which has been shrinking for quite some time now, the pressure is on the fee income from your branch transformation. And then what you're saying about expenses being elevated for a few quarters, what does that imply about your efficiency ratio into 2019, not just Q4. Are we looking at maybe a similar year next year to this year and then a hockey stick type 2020, when you push through to get to65%.? Is that kind of the progress you have in mind now?

Francois Desjardins, President and Chief Executive Officer

I think I'll step back a little bit and comment on how the group is working. One of the things that's important in the plan that we operate in each market where we can win. And try not to be everything to everyone. This has been true on the business services side, B2B bank side, it has been true on the commercial side, it has been true from Laurentian Bank Security side.

The sector that I'd like to see some more progress on is our retail branch network. And that, we've made some great strides there in terms of managing the size of the network and managing the expenses down. But you can't shrink yourself to greatness. So, what we need to do is to move out of the branch network and towards financial advice and increase the number of financial advisors and other advice-type jobs to generate more customers and more revenue. And towards guidance for 2019, I'll just make a general summary here.

We're going to see some better growth organically from loans to business customers, specifically in inventory financing, in equipment financing, in loans to commercial customers as a whole, specifically real estate financing, construction lending. I think we're going to see a little bit better growth than this quarter on mortgage size as we're going to be aiming for low single-digit growth and aiming for our 2020 target. I think that we're seeing some really interesting developments in terms of investments that we're making in the core banking and the digital offering. I think that from a digital perspective, being able to grow deposits directly from end consumers across Canada, is something that the digital is giving us. It's an opportunity to further diversify our funding sources.

And of course, in my comments I said before, healthy levels of liquidity and capital are going to put some pressure short-term performance, and we expect that for the next few quarters. But really what we'd like to see some progress on is on the retail services branch network side. And then we need some clarity on the labour discussions to be able to give you some more guidance there.

Gabriel Dechaine: Okay. And then actually touching on my final question here, because you do mention that on page seven of the report to shareholders – how the union negotiations are going and it's forcing you to review the pace of the conversion to advice-only branches. So, what is the implication there? What are you saying? Just trying to understand that.

Francois Desjardins, President and Chief Executive Officer

Well, from the beginning of the plan, we had spoken about really making a general migration of the branch network towards advice. As you know, customers are not really going to branches as they were in 1980s or 1970s. A great majority of transactions, 94% of them are made online, in ATMs, etc. So, we have to move the physical attributes of the branches and also the people that work there and what they do. And because a large portion of our branch network is under the collective bargaining agreements, we've been trying to get some clarity on the labour front for the last two and a half years. And as I said, the collective agreement has been expired for the last nine months. So, we had hoped that this would be behind us by now and it still isn't. So, for the moment, before putting more money and investments into technology and real estate, we'd like to know what the rules are.

Gabriel Dechaine, National Bank Financial

Okay, I appreciate the colour you've provided. Thanks.

Francois Desjardins, President and Chief Executive Officer

Very welcome.

Operator

We'll go ahead with our next question from Darko Mihelic from RBC Capital Markets, please go ahead.

Darko Mihelic, RBC Capital Markets

Hi, thank you. On that note, when you accrue for expenses, are you accruing as per the past collective bargaining agreement or are you accruing at slightly higher amount?

Francois Desjardins, President and Chief Executive Officer

I'd like Francois Laurin to answer that.

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

Good morning Darko. We accrue for the past collective agreement.

Darko Mihelic, RBC Capital Markets

Well, I'm just curious, so right now you have –

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

Darko?

Darko Mihelic, RBC Capital Markets

Hello, hi. Can you hear me?

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

Yeah.

Darko Mihelic, RBC Capital Markets

So in essence – sure. So, my question is with respect to your compensation expense that is currently – that you're running, is that based on the previous collective bargaining agreement, in other words the costs? I guess, where I'm going with this is if you hash out a new agreement –

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

We accrue what we currently pay the employees according to the current agreement which is still in place - with the one that expired at the end of 2017.

Darko Mihelic, RBC Capital Markets

And if a new collective bargaining agreement is put forward, is it not retroactive to December of 2017?

Francois Desjardins, President and Chief Executive Officer

Usually, from our financial perspective, it is not.

Darko Mihelic, RBC Capital Markets

Okay. And my second question then is you mentioned in your shareholders report that you're carrying higher liquidity for market volatility. But you're the only bank to actually mention that. And other banks actually are reducing the liquidity requirements. So, what specific volatility are you seeing in the market place that would require you to carry extra liquidity?

Francois Desjardins, President and Chief Executive Officer

I think that we chose market volatility, those terms well to encompass whatever you would like. I can't really talk to one specific item, but I think that we have ongoing labour discussions. I think that they read the news, same as you. I think that even some of the smaller players have had some incidents in 2017. All that goes to wanting us to put ourselves in a stronger financial position and reassure investors that they're investing in something that they can feel is safe, right? We run Laurentian Bank in a conservative fashion and I'm just reading the environment here. I think that that is the safe thing to do. Francois, do you want to add a couple of thoughts on that?

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

Sure. I would add to this, given the regulatory environment over the past year or so and the execution of our plan – we want to make sure that we have strong liquidity and capital to execute our plan going forward.

Darko Mihelic, RBC Capital Markets

Okay, thank you. And then just one last question, if I may. I guess the question that comes to mind is now that you've gone through some of this branch let's call it optimisation, the question comes to mind is have you lost customers? We can see the balances are barely down. But what I'm interested in understanding is whether your customer accounts on the deposit side is actually up or down.

Francois Desjardins, President and Chief Executive Officer

I think I'll ask Stéphane Therrien to comment on this?

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

Thanks for your question. No, we have not experienced material client attrition, nothing major. And going forward, as Francois mentioned, we expect that the focus on advice will result in attracting new clients.

Francois Desjardins, President and Chief Executive Officer

I think I would add to that, Darko, that one of the things that we chose to do last year is to stop the referrals of mortgage brokers into the branch network. You know, from a customer perspective, from a profitability perspective and from a customer cross-selling perspective, we prefer that our financial advice in the branches focus on investments and deposits, and to provide financial advice instead of being the tail end of a mono line type of commoditised product, like residential mortgages..

Darko Mihelic, RBC Capital Markets

Okay. Yeah, that makes sense. Thank you.

Operator

The next question comes from the Sohrab Movahedi from BMO Capital Markets. Please go ahead.

Sohrab Movahedi, BMO Capital Markets

Thank you. Just wanted to clarify a couple of things here. To talk about higher liquidity, are you factoring in the cash collateral that's coming back in? Like, in other words, when that comes in, does the liquidity level even go back higher, or will that be able to be repurposed, if I've asked the question correctly here?

Francois Desjardins, President and Chief Executive Officer

I'll ask Francois to comment on that.

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

The short answer is no, Sohrab.

Sohrab Movahedi, BMO Capital Markets

So, it will come in and be additive to the liquidity level?

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

No, it doesn't have a material impact.

Sohrab Movahedi, BMO Capital Markets

So you – I mean, you have some liquidity that is sitting with some counterparties. When you're targeting your liquidity levels, are you assuming that money is coming back or are you excluding that? And if that money then comes back, does it put you in an excess liquidity position relative to the targets you've set for yourself? Or do you factor that in and it would continue to remain at higher liquidity levels?

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

We monitor and we proactively manage the liquidity level, given our requirements including all the requirements that we have going forward.

Sohrab Movahedi, BMO Capital Markets

Okay. So, this will be additive. When they come back to the bank, your liquidity is going even higher.

Francois Desjardins, President and Chief Executive Officer

Sohrab, no. Are you specifically talking about the $20 million that's coming back from CMHC?

Sohrab Movahedi, BMO Capital Markets

Yeah.

Francois Desjardins, President and Chief Executive Officer

Yeah, clearly. It's $20 million, it's inconsequential on a $46 billion bank. So, the target liquidity levels that we're having from a higher liquidity position is much, much higher than the $20 million comeback.

Sohrab Movahedi, BMO Capital Markets

Okay. Then Francois, I guess, the other Francois, – let's just quickly touch on ROE as well then because one of the targets for the bank has been to narrow the ROE gap to the group. Certainly by moving the capital targets higher, the hurdle becomes, I guess, a bit more difficult. So, have you revisited your ROE aspirations for the next 12 to 18 months, basically given the outlook on expenses and, I don't know, the variety of ongoing initiative that you have as you look to invest in the bank?

Francois Desjardins, President and Chief Executive Officer

As I mentioned last quarter, there are some headwinds here. But we're still working towards our 2020 target in growth and in performance. We will renew those in Q4, as we do on a yearly basis. But for the moment, we're still working towards those targets. The investments that we're making today are going to pay off. We're making these investment on a seven-year basis. Just some of the investments that we're making today and have been making, for example, the AIRB. Well, the IRB pays off because we're, slowly but surely, strengthening our foundations, our processes, our data gathering, our models, etc. Of course, these things cost more money in the short-term. But we've become a better bank. And in the end, from a financial perspective, we make better financial decisions, for sure. And investments show up as well in how we manage capital and we've said to the market that this would have a 200 basis points relief on capital and about 200 basis points of increase on ROE.

When we're talking about the gap with the majors, without AIRB, that gap would be very difficult to get done. So, this is a very important initiative for us. And it accounts for 200 basis points plus of the gap, so, we're looking forward to that.

There are other investments that are, from an efficiency perspective, very important as well. So, the short answer is, we're on the path. This last nine months has been more difficult because the mortgage loan portfolio review has been distracting for us. I'm happy to say that today, this is behind us so that we can fully concentrate on making the moves that we need to make to get us to the right place. But the only thing where I believe we need to have more clarity is on our labour relations front because we do need to have a higher level of customers and growth coming from retail services than what we had. We've done the work from an efficiency perspective. But as I said before, you can't shrink yourself to greatness. I think that advice for our customers is good. We need to increase the number of people that help our customers with financial help. And we're hoping that we will get some clarity so I could give you some better guidance on that front over the next quarters.

Sohrab Movahedi, BMO Capital Markets

Okay. And just one last one for me, Francois, when you and the management team and the board reviewed or revised up the target range for the capital ratio, notwithstanding everything you just said as far as the AIRB conversion and what have you, did you leave room for further revision upwards in short order? Or was that deemed to be sufficient with a – I don't know, six quarter timeframe?

Francois Desjardins, President and Chief Executive Officer

You should expect this to be good for that timeframe, yes.

Sohrab Movahedi, BMO Capital Markets

Thank you.

Francois Desjardins, President and Chief Executive Officer

Welcome.

Operator

Your next question will come from a line of Meny Grauman of Cormark Securitites, please go ahead.

Meny Grauman, Cormark Securities

Hi, good afternoon. Just another question on the labour issues. Just wondering about a timeline or some sort of deadline or – the real motivation here is at what point does the delay on the labour front at least push off some of your 2020 targets. Where do you have to get to in this for it to start to have a meaningful impact in terms of just not being able to reach some of those 2020 targets?

Francois Desjardins, President and Chief Executive Officer

I'll ask Denis Pinsonneault, our Head of Corporate Human Resources to give you the technical answer on dates. And then I'll come back and give some comments on objectives.

Denis Pinsonneault, Senior Vice President, Human Resources

Thank you, Francois. As you may know, the collective agreement expired at the end of 2017. We've had several meetings with the union starting in September, 2017. We're now at a stage of meeting in the presence of a conciliator.. Some of these meetings are scheduled in September. And the situation is that some changes are to be made and the collective agreement in order for the retail services to fully implement their plan and improve their performance. So, that's the process as we speak and we still expect both parties to negotiate a good faith.

Francois Desjardins, President and Chief Executive Officer

I think from a timeline perspective, my answer would be two years ago, when we started the plan, the employees really got behind the plan. And then I think there are a lot of retail services employees that are really dedicated to making this happen. And I'm not commenting on this in any other fashion than to just state it to you that – you can't get improvement in efficiency ratios when you have a great number of your staff that's doing transactions that most customers don't want or need anymore. And so we need to be able to fix that. And right now that process is slow. So, we would like to get some more clarity on it. So, I don't know what the timeline is on this or deadline. I've been told to be patient.

Meny Grauman, Cormark Securities

Thanks for that. And then if I can just ask on the margin, you talked about still expecting modest increase in margin. So, just wondering whether we've already seen the impact of the most recent Bank of Canada rate hike in your net interest margin. And when you present that guidance of modest increase in margins going forward, what are you assuming in terms of future rate hikes?

Francois Desjardins, President and Chief Executive Officer

Francois.

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

Thank you. Short-term, clearly yes, part of the increase has already started to reflect itself and gradually will reflect itself fully. We expect that over the next two quarters a couple of points in the NIM coming from our proactivity of managing our business and some additional expansion coming from potential increase in interest rates in the next year.

Meny Grauman, Cormark Securities

Thank you.

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

You're welcome.

Operator

Your next question comes from the line of Robert Sedran of CIBC Capital Markets, please go ahead.

Robert Sedran, CIBC Capital Markets

Hi, good morning. Just wanted to follow up on the question of the collective bargaining and it sounds like there's discussions or schedules and all that. There's no prospect of work action in the next little while, is there? Like this is going to continue to be more of a negotiation under the old collective agreement rather than something that could create some disruption in the platform?

Francois Desjardins, President and Chief Executive Officer

Most parties have indicated that they would not expect stoppages going forward. They both stated that they would work to avoid any work conflict if possible. Of course, it's always something that both parties have an option to do. But that is not the way we see it today.

Robert Sedran, CIBC Capital Markets

Okay, thank you. I wanted to ask a follow-up on the margin question. I guess it's for Francois Laurin. When you think about sequentially, I gather – and the explanation is the greater liquidity on the balance sheet is the reason the margin was down. But with the business mix shift toward commercial – even sequentially, towards commercial and away from residential mortgage a little bit, I might have otherwise expected the margin to be up. So, are there some other moving parts in there?

Francois Laurin, Executive Vice President, Finance, Treasury and Capital Markets, and Chief Financial Officer

The major part would be from liquidity. As you remember, last year in Q4, we had basically Northpoint for the full quarter. So, it's going to be like-for-like this year. So, there might be a small increase as we move and optimize our portfolio and focus onprofitable growth in the way we are growing our lending assets. But those are the two elements. But that's why we're saying a few basis points in the quarters to come.

Robert Sedran, CIBC Capital Markets

Okay. And just one last point of clarification, Francois Desjardins. You mentioned that – I think it was Sohrab's question – for the next several quarters, that range is fine. But when you think about the transition in the business, you think about the AIRB world, is it right to assume that, as you think about the bank the way you want it to be, even this current range probably ends up migrating higher over time as you become more of a loans to business rather than loans to retail?

Francois Desjardins, President and Chief Executive Officer

Well, it's really comparing apples and oranges, right, because whatever the range is, understand the methodology which we are on today and whatever range is required under a bank's AIRB methodology is really two different types of ranges. And RWAs under AIRB are calculated differently. So, the best way to look at it is, all things being equal, whatever the range you are at from a standard perspective, what a shift to AIRB does is recalculate the RWA in such a fashion downwards because you're doing a better job at evaluating our own risks and credit risk. And we know that Laurentian is a conservative lender. This is evident by quarter over quarter, us telling you that our provisions are low and about the third of the industry. So, that does have a quite a bit of an impact when you move AIRB. Our calculation today is about 200 basis points of capital that's released over time. And when you take that in, then you can use that from a growth perspective or deploy it in any way you want because your regulatory requirements are different. So, the answer I gave earlier is, I think we're good. As we move more towards the loans to business customers with the range that we put out, we are at the higher end of the range there. I think that we want to keep comfortable in that position. But I don't expect in the near future to have it going higher to get to 2020.

Robert Sedran, CIBC Capital Markets

That's helpful, thank you.

Francois Desjardins, President and Chief Executive Officer

You're welcome.

Operator

And once again ladies and gentlemen, if you have any additional questions at this time please press star one on your telephone key pad. Again, if you have any additional questions at this time please press star one. And we will go ahead with the next question from Gabriel Dechaine from National Bank. Please go ahead.

Gabriel Dechaine, National Bank Financial

Hi, just sort of a follow up on the credit performance this quarter. We did see a pretty big reversal out of the collective and you acknowledge that your PCL ratio is going to trend higher. Just want to get a sense of any – I guess the goal posts here, where do you think we're going to be – what range do you have in mind for the PCL ratio?

Francois Desjardins, President and Chief Executive Officer

William.

William Mason, Executive Vice President, and Chief Risk Officer

Yes, Gabriel, thank you for your question. We think going forward, it would be back in the range of $10-12 million run rate.

Gabriel Dechaine, National Bank Financial

$10-12 million?

William Mason, Executive Vice President, and Chief Risk Officer

Yeah, against the 4.9 that we reported in Q3.

Gabriel Dechaine, National Bank Financial

Okay. Thank you for that.

Francois Desjardins, President and Chief Executive Officer

You're welcome.

Operator