Conference Call
Second Quarter 2019
Financial Results

May 30, 2019

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 2018 Annual Report under the heading “Outlook”. The forward-looking statements contained in this document are used to assist readers in obtaining a better understanding of our financial position and the results of operations as at and for the periods ended on the dates presented and may not be appropriate for other purposes. Forward-looking statements typically 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 2018 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 the Retail Services operations, 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” section of our 2018 Annual Report, as well as to other public filings available at www.sedar.com.

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

NON-GAAP MEASURES

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

Operator

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

Susan Cohen, Director, Investor Relations

Good morning and thank you for joining us.

Today's review of the second quarter of 2019 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 our website in the Investor Center.

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

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

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

François Desjardins, President and Chief Executive Officer

Thank you, Susan and good morning everyone.

The road to becoming a better and different bank - one that is relevant to today's customers and one that delivers higher performance than historically - is an exciting and challenging one.

I am pleased to report that during the last quarter, we made significant progress on key initiatives of our strategic plan that will propel our organisation in the coming months and years.

There is no doubt in my mind that the most significant achievement in the second quarter was signing a new collective agreement for our Quebec-based retail operations, where eighty one percent of members voted in favour. This strategically changes the business going forward.

In the last three years, we made great strides towards advancing strategic initiatives, such as simplifying our product and services offer in our branches, optimizing our branch network, implementing a new core banking platform and acquiring 2 operations – Northpoint Commercial Finance and the Canadian activities of CIT - which are generating excellent growth and profitability.

But as we have previously mentioned, to continue to evolve and be successful in our transformation we needed to address efficiency and relevancy, and to do that, we needed a renewed collective agreement that would support performance, efficiency and growth, be relevant to market conditions and adapt to our evolving industry.

We identified two goals that were critical - and we achieved them both.

First, the Canadian Industrial Relations Board understood the importance of this organisation's transformation to move forward and therefore accepted the redefinition of the bargaining unit so that it is limited to specific existing positions, mainly client-facing positions in our branch network, in the province of Quebec. This is important, as the previous bargaining unit had a much broader reach in terms of positions.

Second, working conditions in the new agreement promote a modern culture of performance. We now have working conditions that are comparable to those offered by our competition and this is key in being able to attract new talent who want to be hired, assessed and promoted based on their qualifications and performance. This also means that it gives us a lot more flexibility to carry out our activities in the most efficient and scalable manner. For example, in the new collective agreement, job security was eliminated and consequently, we have gained the ability to outsource or automate our administrative activities.

As a result, we have begun to put into place the staff reductions that we mentioned in February. We have also gained the ability to streamline our internal operations and eliminate duplication of activities – something that we could not do before the new collective agreement. For example, in April, we optimized Retail Services back office, credit and collections functions internally and through outsourcing agreements to generate efficiencies of scale.

Although the total number of unionised employees is lower today than when we started our strategic plan, the percentage of client-facing professional positions is increasing. It is our wish, as we have stated all along, that we see growth in the number of financial advisors and other revenue generating positions.

Let there be no mistake, negotiating this agreement was difficult as it required time, energy and most importantly resolve, as it impacted the organisation's strategy, growth and financial results in the last several quarters. This quarter's performance continues to be impacted by transformation related investments and costs related to labour relations which can now be reduced.

But, this new-found flexibility will not only drive efficiencies, but also reset how this organisation can move forward.

The immediate positive impact is that we no longer have to incur the incremental expenses associated with a potential work conflict. This means that we are reducing the liquidity to more normal levels, reducing the expenses on legal matters and other labour related costs and re-tasking members to more productive priorities.

Last quarter, we indicated that on an annual basis, carrying the appropriate level of liquidity would improve net interest income by $7 million, reducing legal and labor related expenses would cut non-interest expenses by $3 million and lowering the headcount would reduce expenses by $15-$20 million. We remain on track to deliver these results gradually over the next 9 months.

With this milestone behind us, Retail Operations in Quebec can turn its complete attention to growth and performance, as our branch network is streamlined and staff are engaged and eager to succeed in the pursuit of our mission.

Moreover, the entire organisation can resume its full focus on our priorities of growth and performance. To this end, we have begun the process of resetting the strategic plan implementation schedule and I would like to provide updates on four key elements.

First, we had previously stated that we would postpone Core Banking Phase 2, which converts all remaining assets and liabilities from the old core banking system to the new one. With the current momentum in our retail operations, we intend to accelerate the implementation of the core banking initiative relating to branch operations. The target for completion is December 2020, at which time, 100% of all products will have been migrated from the old banking platform to our new core banking platform. As of 2021, the extra costs associated with operating two parallel core banking systems should be gradually eliminated, contributing to an improving efficiency ratio.

Second, we've said from day one that our new core banking platform would broaden opportunities in the digital space. On that front, we are making progress towards the launch of our digital banking products. Our digital offer is now in pilot mode and we are planning to launch our hassle-free banking products to independent advisors and brokers in the fall, and direct to customer across Canada at the end of the year. These digital products are expected to be available to new customers in our branches in early 2020.

Third, from a growth perspective, we are continuing to focus on loans to business customers with an emphasis on equipment and inventory financing, as well as real estate financing, as we work closely with our partners and build stronger client relationships. With respect to retail activities conducted through our branches, independent advisors and our digital offering - we will be focussing on improving the overall customer experience and helping our clients improve their financial health. Providing sound financial advice to our clients should result in growth in basic banking accounts, deposits, mutual funds, mortgages, personal loans and credit cards.

Fourth, with a sharp focus on core banking, our digital offer, balance sheet growth and efficiency gains, we will be slowing down the AIRB initiative by 12-18 months. Correspondingly, we are now planning the AIRB implementation between the end of 2021 and the first half of 2022, subject to regulatory approval, with benefits to be realized in 2022 and beyond. We still believe strongly in this initiative and its positive impacts on the organisation, but wish to prioritize growth and efficiency initiatives that have a more immediate impact on results.

I would be remiss if I did not mention that in the quarter, the Group achieved strong growth in loans to business customers, maintained solid credit quality and increased its revenues from Capital Market related activities. We are looking forward to better results.

This has been an important quarter for us from a foundational perspective. We delivered a new collective agreement which strategically changes the business for us moving forward. I would like to express my gratitude to the team that made this happen and sincerely thank customers and shareholders for their patience and commitment to the brand and to our Bank.

I have said before that the road to becoming a better and different bank is sometimes a bumpy one. As I look forward, I do see a clearer road ahead.

With the progress we are making towards reaching our strategic objectives, the Board has reaffirmed its confidence and has approved an increase in the quarterly common share dividend of one cent to $0.66 per share.

I will now turn the floor over to François Laurin to provide a more in depth review of our financial results for the second quarter of 2019.

François…

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

Thank you, François.

Good morning everyone.

I would like to begin by turning to slide 11 which highlights the Bank's financial performance. Adjusted net income of $48.7 million, EPS of $1.08 and ROE of 8.3% in the second quarter of 2019 were lower year-over-year but improved sequentially.

Reported earnings for the second quarter, as outlined on slide 12, were affected by adjusting items totalling $5.4 million after tax or $0.13 per share, and are related to restructuring charges and business combinations. As shown on Slide 13, costs related to restructuring measures totaled $11.7 million and mainly included severance charges to optimize the Retail Services operation and streamline certain back-office and corporate functions that were announced last quarter. These charges were partly offset by a $4.8 million curtailment gain on pension plans and other post-employment benefits obligations and reversals of other provisions amounting to $3.5 million, resulting in a net restructuring charge of $3.4 million.

The drivers of our performance begin on slide 14. Total revenue in the second quarter of 2019 amounted to $239.9 million, a decrease of 8% compared to a year earlier and 1% compared to the first quarter of 2019.

Net interest income decreased by $12.5 million compared to a year earlier and was impacted by lower year-over-year loan volumes and higher liquidity levels, partly offset by higher margins on loans to business customers. As previously mentioned, $800 million of non-strategic commercial loans were sold over the past year in order to optimize capital allocation. As well, during most of the quarter, we were carrying higher levels of liquidity given the potential for a work conflict. While this was the prudent thing to do, it negatively impacted net interest income and margins. With the new collective agreement signed at the very end of March, we have begun to gradually decrease the level of liquid assets which, as we mentioned last quarter, is expected to increase net interest income by $7 million annually, with benefits starting in the third quarter of 2019. Sequentially, the decline in net interest income was mainly due to the negative impact of three fewer days in the quarter.

As shown on Slide 15, NIM decreased to 1.77% in the second quarter of 2019, down 5 basis points year-over-year. The higher level of lower-yielding assets accounted for 3 basis points or - most of the decline. Sequentially, NIM declined by 3 basis points mainly as a result of higher liquidity and lower volumes. As we reduce liquidity to normal levels and continue to implement our strategic plan to evolve the bank mix towards higher margin commercial loans, we expect NIM to gradually increase over the remainder of the year. As at April 30, 2019, commercial loans accounted for 37% of our loan portfolio, compared to 34% a year earlier, residential mortgage loans accounted for 48% compared to 50% and personal loans accounted for 15% compared to 16%.

Other income, as presented on Slide 16, totaled $75.3 million, and decreased by $7.5 million from a year ago. Of note is that in the second quarter of 2018, other income included a $5.3 million net gain on the sale of our agricultural commercial loan portfolio. Sequentially, other income increased by $5.6 million. The second quarter of 2019 benefited from stronger capital market related revenues which was mostly driven by higher gains on inventory held for brokerage activities and to a lesser extent, higher revenues from trading activities.

Slide 17 highlights adjusted non-interest expenses of $176.3 million, which rose by $7.2 million year-over-year. Salaries and employee benefits decreased by $1.1 million compared to a year ago, mainly as a result of lower salaries from a reduced headcount. Higher share-based compensation was more than offset by lower salaries, in addition to fewer days in the second quarter, which resulted in the $1.6 million quarter over quarter improvement. As we continue to streamline operations over the next few quarters, we expect to gradually attain the $15 to $20 million cost savings that we indicated in February. These savings should be fully realized towards the end of the first quarter of 2020 once we have completed the transition.

Premises and technology costs increased by $2.6 million year-over-year as higher technology costs to run concurrent core-banking platforms and to enhance IT service levels and security, as well as higher amortization expense for the completed Phase 1 of the core-banking system were only partly offset by lower rent expenses following the move to our new Montreal corporate office. Similar factors explain the $1.5 million sequential increase. By the second quarter of 2021, the extra costs associated with operating two parallel core banking systems should be eliminated.

Other adjusted non-interest expenses of $35.2 million increased by $5.6 million compared to the second quarter of 2018. Higher regulatory expenses, including costs related to deposit insurance, new IFRS standards implementations, anti-money laundering, regulatory compliance management, as well as higher professional fees and labour relation costs related to the new collective agreement contributed to the increase. Sequentially, other adjusted non-interest expenses declined by $2.9 million due to various items including lower costs for services provided by third parties and favorable adjustments to sales taxes.

The adjusted efficiency ratio was 73.5% in the second quarter of 2019. As mentioned in previous periods, this ratio is expected to remain high over the next few quarters as the Bank invests in its transformation.

However, the investments that we are making, in addition to the measures that we announced last quarter, are expected to contribute to improving efficiency as we work towards our objective of 63% in 2021.

Slide 18 highlights our well diversified sources of funds. In the second quarter of 2019, deposits declined by 4% quarter-over-quarter, driven by lower broker-sourced deposits. This was in line with the reduced level of liquid assets, given that the new collective agreement was signed which eliminated the risk of a potential work conflict. Retail branch deposits were relatively unchanged. Year-over-year, deposits fell by 8%, mainly due to lower broker-sourced deposits, and were in line with the reduction in liquidity and loans.

I would like to add that our liquidity position continues to be strong and well above our internal and regulatory requirements and that our liquidity portfolio is largely highly rated government securities.

Slide 19 presents the CET1 ratio, under the Standardized Approach, of 9.0% at April 30, 2019 and highlights our strong capital position which provides flexibility for the Bank to continue to invest in its transformation and to support growth.

Turning to Slide 21, while total loans were essentially unchanged sequentially and stood at $34.1 billion, the mix continues to evolve. Residential mortgage loans declined 2% quarter-over-quarter as we focus on higher-yielding loans to business customers, which increased by 3% over the same period. We remain on track for double digit growth in loans to business customers in 2019. Growth in residential mortgages is expected to gradually resume over the next few quarters as Quebec Retail Services, and the organization as a whole, refocuses on this priority.

Slide 22 provides a deep dive into our residential mortgage loan portfolio, where we have slowed down growth as we refocused on loans to Business Service customers. We are maintaining our strategy to seek profitable niches, such as the high end of Alt-A business. As at April 30, 2019, our Alt-A portfolio totalled $1.3 billion and continues to represent 8% of the total mortgage book and 4% of the total loan portfolio. Within the overall residential mortgage portfolio, mortgages in the GTA represent about 21% of the portfolio and the GVA accounts for 4%. Overall, this portfolio is high quality as evidenced by very low loss ratios and low LTV's as well as high credit scores.

Slide 23 highlights our commercial loan portfolio which is pan-Canadian with a US presence. It is well diversified, has a track record of strong credit quality and is positioned for sustainable profitable growth.

Turning to slide 24, credit quality remained good. The provision for credit losses amounted to $9.2 million and was $0.3 million lower than a year ago, and $1.3 million lower than in the first quarter of 2019 when a $4.5 million provision was taken against a single syndicated commercial exposure. At this point, we believe the provision against that exposure is adequate. The loss ratio of 11 basis points in the second quarter of 2019 continues to reflect the good underlying credit quality of the portfolio.

Impaired loans are shown on Slide 25. Gross impaired loans increased by 1% sequentially and the net impaired loan ratio stood at 42 basis points, unchanged from the previous quarter. 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, conservative provisioning and a portfolio that is 97% collateralized, we expect that the loss ratio will remain below other Canadian banks.

Turning to Slide 26, we continue to work towards our 2021 medium-term growth targets and financial objectives.

To conclude, we are confident that our transformation plan and the strategic initiatives that we are implementing, along with the renewed collective agreement 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.

Susan Cohen, Director, Investor Relations

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

Operator

Thank you. If you'd 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. Once again, please press star one to ask a question. We'll take our first question from Doug Young with Desjardins Capital. Please go ahead.

Doug Young, Desjardins Capital

Hi, good morning. Just on expenses, I think you've been crystal clear on the expense saves from the headcount, and lower legal costs. But I just want to be clear, is this expected and you've been clear on when they're going to come through. Is this expected to hit the bottom line or is this going to be invested because you've also talked about investing back in the business? So, that's just question one.

François Desjardins, President and Chief Executive Officer

I'll ask François Laurin to answer that.

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

Good morning, Doug. It would hit the bottom line. Those numbers are pre-tax on the bottom line.

Doug Young, Desjardins Capital

Okay, so hit the bottom line. Second just on the AIRB conversion process being slowed down, and I think you've talked about why. Is this -- was this all internally driven or was this at all a pushback from the regulator I guess is my question?

François Desjardins, President and Chief Executive Officer

Completely internally driven.

Doug Young, Desjardins Capital

Okay. And then third, and this might serve to be best discussed offline. But I was just flipping through your notes to the financial statements and note seven in particular. And it shows the reconciliation of allowances for IFRS 9 by the stages. And just one item caught my eye. And It would appear you're setting up allowances for newly originated loans under stage two, which I guess just seems odd to me.

But maybe there's a terminology differential that I -- between you and the other banks because it doesn't seem like any of the other banks are doing so. So anyways, it just was one item that kind of caught my eye. I don't know if there is any explanation. And again, if it's easier to take this offline, we can do so.

François Desjardins, President and Chief Executive Officer

Yeah, maybe we could. I will ask Liam Mason to maybe say one word or two. And we can take it offline and get back to you with details.

William Mason, Executive Vice President and chief Risk Officer

Yeah, so in terms of the technical aspects, I am happy to follow offline. I would say the following with regard to our ECL stage changes. On the commercial side, no trend or major change there. It's just normal variation, relatively small numbers. But then on the personal loan side of the ECL changes, there are two offsetting factors.

One is we had some loan repayments where we're releasing provisions. And the other is that we have a slight uptick in the impaired loans, again within variation. So minor changes in the ECL stages. I wouldn't have any concern there.

Doug Young, Desjardins Capital

Yeah, it's just more of the origination side. But as -- yeah again we can kind of take that offline. And then maybe just lastly just if you can François you can talk a little bit about just taxes. Because I mean it was abnormally low. Can you kind of dig through like it was 8%, I think you've guided to 20%. Like what should we think -- be thinking about from a tax perspective?

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

Yeah, so going forward for the rest of the year we should expect mid to high teens and 20% starting 2020. It's just a combination of the mix of the profitable business, the origination of the profit in the structure. And a favourable adjustment related to insurance. Yeah, go ahead.

Doug Young, Desjardins Capital

No, I was just saying, is there anything -- like was there any gains in the quarter that came through? Like it's just the quantum difference between 8 and the high teens or 20%. So just that seems pretty significant.

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

There is a $1.5 million positive adjustment that accounts for maybe 3% of the tax rate there. So, adjusted 12 point something, 12.5%, roughly 3% added for that one adjustment.

Doug Young, Desjardins Capital

So, it's more mid to high teens going forward kind of range? Okay, thank you.

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

For the rest of the year.

Doug Young, Desjardins Capital

Rest of the year, okay. Thank you.

Operator

If you find that your question has been answered, you may remove yourself from the queue by pressing star two. We'll take our next question from Marco Giurleo with CIBC. Please go ahead.

Marco Giurleo, CIBC

Hi, good morning.

François Desjardins, President and Chief Executive Officer

Good morning, Marco.

Marco Giurleo, CIBC

Morning. I just want to follow up on Doug's expense question. Last quarter you provided a guidance of about $180 million per quarter. I am just wondering, does that still hold through the remainder of the year? And just curious on the trajectory of the expense line heading into 2020 just given the launch of the digital that you mentioned that's going to take place in this fall and also the extension of your AIRB? Just a lot of moving parts there, so just wondering if you could provide some clarification.

François Desjardins, President and Chief Executive Officer

I will ask François Laurin to answer that.

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

Marco, basically as a recap, so the signing of the collective agreement allowed us to reduce those costs over the next months. When we add the liquidity, the current administrative costs and the measures we are taking, they amount to $25 million to 30 million pre-tax on an annual basis of the bottom line.

That's expected to improve the efficiency ratio of 300 to 500 basis points in early 2020. So basically, till then, in this quarter we're at $176M. And we should remain at that similar exact level for the rest of the year.

Marco Giurleo, CIBC

Alright, that’s clear. And just on your digital offering, I was hoping François Desjardins, I was hoping you could just elaborate on what that offering entails? And do you see this as something that could potentially drive an inflection in your mortgage and deposit growth?

François Desjardins, President and Chief Executive Officer

I will ask Craig to give some further details. But as we've said previously the direct-to-consumer deposits, this drive towards digital answers many things. It answers relevancy to our current customer retail base. It answers cross-selling opportunities to our current B2B Bank. Customers said that they did not have access to checking accounts or transaction accounts and credit cards.

And it does also answer and open up new funding capabilities as we're taking Laurentian Bank brand back to the Canadian space. This is important in terms of our funding growth strategies. And I’ll ask Craig to give some details.

Craig Backman, Executive Vice President, personal Digital Banking

So, we're really excited to be launching digital. Our focus as we launch this fall will be on deposit products. And we really have two main steps that are going to be in the launch. The first one we'll be launching through our strong relationships with independent brokers and advisors in the B2B channel.

We will launch that this fall. And second, we're going to be taking digital across Canada under the Laurentian branding. And we are targeting that at the end of the year. And finally, we have some work that we're going to do through retail in our branches in early 2020. We see real advantages by focusing on deposits first.

And by getting out with a differentiated experience that we know our customers and brokers and advisors are going to really love. And it significantly increases our top target audience in our geographical presence. And it's really an important step in our transformation plan.

Doug Young, Desjardins Capital

Alright, great. Thanks. That's it for me.

François Desjardins, President and Chief Executive Officer

Thanks Marco.

Operator

We will take our next question from Gabriel Dechaine with National Bank Financial. Please go ahead.

François Desjardins, President and Chief Executive Officer

Morning Gabriel.

Gabriel Dechaine, National Bank Financial

Good morning. Just want to ask about the -- a quick one on the union contract, just the timing. I know it matures or expires on December 31st, 2021. That's a four-year contract I guess it would be?

François Desjardins, President and Chief Executive Officer

That's right. It's a four-year contract retroactive to the expiration of the contract that was in place, yeah.

Gabriel Dechaine, National Bank Financial

Yes, there's a little -- maybe just a technical thing. But why is it shorter than the last one and the prior one?

François Desjardins, President and Chief Executive Officer

Typical labor contracts are three years, four years. The last one was a particularly long one. And in this environment, I would say that it's going much longer than what we have in place would be nonsense. This industry is moving fast. And we need to be able to open up our contracts regularly. If I might add to this.

As I said in my prepared remarks, the contract is one thing. But also one of the wins for us is the resetting of the bargaining unit. The bargaining unit is unionized. The contract is what are the conditions. And what we've done on the bargaining unit is really curtails that to specific positions in the -- mostly in the branch network - customer-facing positions.

And this gives us an ability to outsource the administrative work, and get some real efficiencies from that. As I mentioned also we've been able to eliminate job security as part of the working conditions which also enables us to do the same thing. And more importantly to employees, working conditions evolve. Employees want to be recognized for their performance.

They want to be recognized for what they do every day. And we really need to move this contract forward and to a modern state. So, we thought long and hard to get this where we needed to be. So, that we can attract and retain and measure performance and recognize unionized employees just as well as the competition would. And that's where we are now.

Gabriel Dechaine, National Bank Financial

Okay, thanks for that. My other question is on the business itself, the loan book. It seems like the growth is coming from commercial and Northpoint is a big part of that. But the Canadian business mortgages and personal loans, they've been -- those balances have been declining for a number of quarters now.

I'm just wondering where you see that -- sorry, I'm just wondering where you see the loan balances kind of settling out considering you are making investments in digital offering, and ways to stay relevant with your customer base?

François Desjardins, President and Chief Executive Officer

You are right. Although total loans have not been increasing, RWA has been stable. Loans to business customers have grown 3% sequentially. That is the focus of the organization and we protected that business as we focused on higher yield loans. And I think that we've accomplished this despite the fact that over the last 12 months we've been optimizing that portfolio, selling non-strategic commercial loans.

Loans to retail customers, both B2B and the branch network have been impacted by several elements including the union negotiations. Now that this is behind us, we can focus on growth and performance. Our teams are eager to get back to work. And we expect to stabilize these portfolios and then begin to grow specifically our mortgage portfolio in the second half of 2019.

Gabriel Dechaine, National Bank Financial

So, there's no -- it might be more of a function of having allocated resources into the union situation? And now that that's done, you are going to move resources back to growing the loan book. And both in the mortgages and maybe personal lending as well, you're going to start to see an increase?

François Desjardins, President and Chief Executive Officer

Well as we mentioned in the last quarter, the negotiations with the union have been difficult. And we needed to manage and put together a business continuity plan, that had not only human resources dedicated to it, but also financial. We significantly increased our liquidity positions to way in excess of normal levels.

We are holding our capital high. And we put human resources into plans to continue operations in case of the labor conflict. This does unfocus the organization. So, we're really happy that we can put this behind us finally. This had been a long haul. But I think it was worth it. Quite frankly that again we needed to change this agreement.

To be able to fix Laurentian Bank, we said from the start in 2016 to fix the bank, we need to fix retail. And fixing retail needs to have a collective agreement that's modern, and that allows us to serve our customers the way that they want us to serve them. Eliminate things like job security and getting a collective agreement that promotes a cultural performance is not only good for the bank.

It's good for the employees. It's good for the customers. And I truly believe that strategically for years to come, way beyond the current collective agreement, this significantly and strategically changes the way that we operate.

Gabriel Dechaine, National Bank Financial

And then last one on the provisioning. We've seen some reversals out of stage one and two, particularly in the personal loan book. I suspect that because the loan book has been declining, correct me if I'm wrong there. And then if that's the case, then we should see that trend reverse as the growth resumes?

François Desjardins, President and Chief Executive Officer

I will ask Liam Mason to comment on that.

William Mason, Executive Vice President and chief Risk Officer

Yeah, good morning, Gabriel. I think that's correct. I mean the other thing I note in terms of the ECL agreement is obviously insured loans are now included. And that change is also reflected in the ECL numbers. But as I mentioned to Doug’s question, some loan repayment is driving that loan provision. But we expect that to tick back up with the growth as you mentioned.

Gabriel Dechaine, National Bank Financial

Alright, thank you.

Operator

We will take our next question from Sohrab Movahedi with BMO Capital Markets. Please go ahead.

Sohrab Movahedi, BMO Capital Markets

Thank you. François, I know obviously, lots on the goal over the last few years. And especially in the last year or so, you have some financial targets out there. The focus is on 2021. You've made some kind of trade-off decisions internally, one of which is to delay the AIRB implementation.

And I wonder how does that factor into the ROE targets that you had set for the bank, closing the gap over there? And presumably with the delay, the gap closing or narrowing to the group is going to be pushed out a little bit. And if you could just share with us what was the thought process in that regard when you made the internal decision to delay the AIRB implementation?

François Desjardins, President and Chief Executive Officer

Sure. I think that the outcome of the negotiations with the collective agreement forces us, gives us the opportunity to relook at the sequence of the strategic initiatives. It is still very much our plan to meet the 2021 targets. The three-year targets that we set out for ourselves, I think that there was a small part of that that I discussed last quarter that was AIRB related.

But I think that we will make that up with efficiency and growth. It is still our plan to bridge the gap completely with the industry average. But that will happen a year or so later than planned. Over the past several quarters these negotiations have been a real distraction. And as I mentioned in the previous questions, it has impacted growth plans and financials.

But from where we're now, the road to better performance starts with efficiency and growth. And focusing on things like core banking, getting all the flexibility out of the collective agreement, having growth in higher-yield assets is really going to fuel better short-term performance. AIRB, we still absolutely believe that in this project, and its benefits.

But it is a project in which it allows us to better manage our loan portfolios and better manage ultimately our capital. What we're focusing on right now is the business. The relevant business, the efficiency of the business, the customers, getting rid of old core banking platforms. And I think that that is a better bang for the buck in the next 12 to 24 months.

And after which the cherry on the cake will be AIRB which will -- still our calculations today tell us that it's an improvement of about 200 basis points of capital and translated into when we deploy 200 basis points of ROE. So, the goal is still there, may be a year out more than we thought. But from this point, I am thinking that it is right call to push this one out or to slow it down a little bit. So, that we can really have some wins later this year and in 2020-2021.

Sohrab Movahedi, BMO Capital Markets

Okay. So then maybe just quickly for Liam. Liam, where do you see the RWA to kind -- the total asset density kind of trending towards with the expected portfolio mix shifts under the standardized approach?

William Mason, Executive Vice President and chief Risk Officer

In terms of the sort of clarification on your questions are where we see RWA trending under standardized? I mean, we feel we're --

Sohrab Movahedi, BMO Capital Markets

Yeah, I mean like where RWA to asset ratios are right now? And given the portfolio mix shifts that you're talking about, more commercial. Maybe a little bit more higher-yielding stuff. Just trying to kind of get a feel for the next call it 12 to 18 months? Where do we see those RWA to asset trends trending really to try and figure out what under the standardized approach you see the capital requirements of that loan growth being?

William Mason, Executive Vice President and chief Risk Officer

I had made two comments. One is I think from a capital standpoint, we are adequately capitalized to support that growth. And we have the capital. But secondly as François laid out, we have initiatives we're undertaking right now to grow those RWAs, both in the commercial side wherever we had a historical emphasis. But also in retail as we turn our attention to that given the success with closing the labor agreement.

Sohrab Movahedi, BMO Capital Markets

So where do you see the ratio going?

William Mason, Executive Vice President and chief Risk Officer

I would see it increasing. I don't want to talk about forward-looking magnitude. But I would see an improvement and an increase in it.

Sohrab Movahedi, BMO Capital Markets

Sorry. I just want to be crystal clear. When you say an improvement, you see the business becoming less capital-intensive from an RWA growth perspective or more capital-intensive?

William Mason, Executive Vice President and chief Risk Officer

I expect the business to grow our RWA base and to utilize the available capital.

Sohrab Movahedi, BMO Capital Markets

Thank you.

Operator

We'll take our next question from Scott Chan with Canaccord Genuity. Please go ahead.

Scott Chan, Canaccord Genuity

Good morning. Just going back to expenses, I appreciate the guidance for the next two quarters of $176 million. Looking at the fiscal 2020, with your cost savings and your annualized savings, is it reasonable to assume that the run rate would be lower in the next two quarters or higher? I am just trying to get a sense of looking out beyond 2019?

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

Sorry Scott, I didn't get the qualification in the next two quarters.

Scott Chan, Canaccord Genuity

Sorry?

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

I didn't get the qualification you put in your question for the next two quarters?

Scott Chan, Canaccord Genuity

Yeah, in the prior response you talked about $176 million of adjusted non-interest expenses over the next two quarters. And I'm just wondering in fiscal 2020 how would that compare with all the initiatives offset by some of the cost savings that you kind of announced?

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

Well, in the prepared remarks basically we said that we would achieve a $15 million to $20 million savings that would hit the expenses on an annual basis. So overall the level of expenses would be reduced by that $15 million to $20 million.

Scott Chan, Canaccord Genuity

Okay, so –

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

So, split this over four quarters, so that's $6 million to $7 million per quarter from the run rate we have now. But we've achieved $176 million to $180 million this year, less the $6 to $7 M.

Scott Chan, Canaccord Genuity

Okay. But for 2020 is there -- do you have any kind of guidance on that run rate total number?

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

No, at this point we're focusing on the efficiency ratio to improve it. We said that this would improve it by 300 to 500 basis points. And the target is to reach 63% by 2021 and improving the existing 73% today.

Scott Chan, Canaccord Genuity

Okay, fair enough. And just lastly, just on the commercial growth in the guidance of 10% for this year. Maybe you can elaborate on some of the areas where you're seeing good growth on that platform?

François Desjardins, President and Chief Executive Officer

I will ask Stephane Therrien to comment on that.

Stéphane Therrien, Executive Vice President, Personal & Commercial Banking

Thanks for the question. I mean our guidance is still to grow by over 10% this year. Our three growth engines for this year will be equipment finance, inventory finance with Northpoint, and real-estate financing.

Scott Chan, Canaccord Genuity

Equipment financing, real-estate financing and I missed the second one?

Stéphane Therrien, Executive Vice President, Personal & Commercial Banking

Northpoint inventory financing.

Scott Chan, Canaccord Genuity

Oh Northpoint. Okay, thank you.

Operator

We'll take our next question from Meny Grauman with Cormark Securities. Please go ahead.

François Desjardins, President and Chief Executive Officer

Hello, Meny.

Meny Grauman, Cormark Securities

Hi, good morning. I would like to go back to the collective agreement. I mean it sounds like a fantastic agreement for you. And just given how contentious it was, it just sounds a little surprising. I'm just wondering it sounds like you got everything you wanted. So, I want to ask what kind of concessions did the workers get? And how did you manage to after so much negotiations basically get this deal that seems like you basically came out ahead on every point?

François Desjardins, President and Chief Executive Officer

Of course, I can't go into details like that. But let me say just one thing. Our employees are behind this plan. Our non-unionized employees and our unionized employees are behind this plan. And the people that are working at our branches, the people that are our financial advisers, the people that are talking to our customers everyday voted for this plan, 81%.

And that's a very strong focus. Negotiating with union representatives is never easy. And having people understand the need for transformation when things pretty much stayed stable for a long time took us a lot I got to say. But I think that now this is behind us. And I think that the employees win from this just as much as the bank does. And I'll leave it at that.

Meny Grauman, Cormark Securities

Just a follow-up if you can? In terms of just what kind of concessions did workers get, are there any key points that you can highlight for us?

François Desjardins, President and Chief Executive Officer

The concessions that we made is to pay them adequately to support mobility, to treat them with performance. And to not recognize anything else than performance when we're making decisions, and the ability to manage our team.

The move to a core culture of performance in a modern age, employees want their colleagues and themselves to move forward. It is not something that some might think. But for the most part, I think that employees wanted that. And they voted for it.

Meny Grauman, Cormark Securities

That sounds good. Thank you very much.

Operator

We'll take our next question from Sumit Malhotra with Scotia Bank. Please go ahead.

Sumit Malhotra, Scotia Bank

Thank you. Good morning. I'll start with François Desjardins. Just with the rate of change that the bank has been demonstrating for a couple of years now, I'm kind of curious to hear from you. How do you think your market share in your home province and some of your key products have been impacted?

And maybe more than just around numbers, in terms of some of the customer service or customer perception studies that I'm sure you and third parties conduct. Do you feel that the ranking or how Laurentian is regarded by its clients has been negatively impacted by the rate of change?

François Desjardins, President and Chief Executive Officer

I think there's a difference. Thank you for the question. I love talking about customers. I think that the first thing is that there is a difference between general public perception, and what each customer perceives about the services that they're getting from their bank. And when we polled, there was a recent poll about the advisor base in Québec.

We actually polled quite favorably in the level of trust that our customers have for our financial advisors. I would say that if you visit our branches and talk to our clients, one by one, I think that there's a pretty good response from the clients. Where we need to go though is to broadcast that and make changes for years to come.

So, where we need to go is to offer digital products, so that we can attract a new clientele and deliver on new needs that are coming from customers. And I don't think that this is really union negotiation base. This is something that I spoke about in 2016 as something that was critical for us to move forward.

From a negotiation perspective, I would say that yeah, there has been some impacts on the market. Not just on our customers, the market sentiment in general. But you know what, I said from the start - this is going to be a bumpy road. It certainly has been. But if I'm looking forward from this point, I see a better future.

Just going back and being able to grow our advisor base in terms of numbers, being able to deliver on the promises we made, and ultimately being able to deliver a relevant bank is what we set our sights on. And that's what we will do. And this is -- it has to translate into profitability in the end and shareholder value.

That's the goal, so one into the other. So, a little bit of a setback, I would say a hard one in those last twelve months. But you have to have some results here. And that's what this management team has done.

Sumit Malhotra, Scotia Bank

Well, that's a good answer. We ask a lot of questions about the numbers. And I'm going to do that in a second as well. But I'm just -- it's interesting to hear you talk about where the positioning of the bank within your market has trended. And hopefully, we'll get to the numbers now.

Because I think that's where we want to see it. There's been a few questions about efficiency. And some of the comments that you gentlemen have provided in terms of both expenses, and then how you think the liquidity will translate. I guess more specifically here, so your efficiency ratio in the first half of this year is around 74%.

And if you were to put some of these moving parts together, like even last year which I think you would say was not where you want to be. You were closer to a 67 number. Like as you think about this repositioning of some of the expenses that you've endured, what would be a more reasonable near term objective for efficiencies?

Getting back to 70 in short order is something that you can achieve? Or is there still too much going on from an investment perspective for that to be realistic?

François Desjardins, President and Chief Executive Officer

I think that the best answer that I can give you is really we had to relook at, are we still holding our own in terms of our three-year 2021 targets? And we are, and that's 63%. I know that's a little bit of ways away. You'd like to have some more short guidance. But in terms of numbers, that's where we are.

I would say that if I look just at expenses in three different buckets, let's look at the cost of the labor relations alone is about $10 million, right? And $7 million on liquidity, $3 million on labor-related costs. This is something that we try to encourage that we can back out of. And that's what you should expect.

We identified that we were going to have some cost reductions last quarter. We're moving towards that. The agreement helps us in that regard. Not only from the cost perspective, but efficiency in general of processes. We're looking at $15 million to $20 million pre-tax over the next nine months. Both of these buckets will hit the bottom line.

Getting the growth back and the deals back to growth is just shifting expenses, not necessarily increasing them. It's shifting expenses from people that are doing one thing to another, and getting teams back and focused on growth initiatives. So, we expect to get some top line impacts as we turn these portfolios around, mostly on the retail side.

And the other bucket of course that we can't forget is that we've been running two core banking systems and operating it pretty inefficiently as we went through this. Now that the negotiations are over, we can finish what we started, get the core banking done, move the cost out of the organization. And that should be a 2021 deliverable.

So, you should see a gradual improvement. And that's why we believe that the 63% number, that won't be a straight line, is what we are aiming for. But you'll see improvement as the next quarters happen. You'll see some improvement in 2020 from what I just described. And core banking, we'll see that further improvement in 2021. All things being equal, it gets us to the 63% efficiency ratio. So, that's as good as I can get.

Sumit Malhotra, Scotia Bank

And thank you for that. And we'll unpack some of these afterwards. I think the last one just in and around the AIRB. I think for the standardized bank there has been a long journey to get to this. And it looks like it's delayed. I think if I got you right, you're now hoping 2022 is the time you get there?

François Desjardins, President and Chief Executive Officer

Actually, for the implementation, yes. And then the benefits starting 2022. So, the day that it's implemented is 2021 and then the start of benefits in 2022 is where we are. So about 12 to 18 months delayed from the dates that we have.

Sumit Malhotra, Scotia Bank

Yeah. And I think the question from -- for maybe this is the last one for François Laurin would be, we've seen this from the sector broadly of late is that as more of the growth in the loan portfolio shifts to commercial or corporate lending. It's clearly having a negative impact on the ability of some banks to grow capital.

You've communicated this going back to the investor Day when you laid out some of these targets that the aggregate business portfolio was going to be a bigger piece of the pie for Laurentian going forward so to speak. So, François Laurin, for capital is it fair to think that roughly in and around 9% is going to be a level from which we don't see much growth because of the higher density of the lending that you're moving towards? And that's a question right there. Is like 9% a level that we probably don't see much growth from in your view?

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

In our view, we're still aiming to get to our $16 billion of commercial loans by 2021. And as Liam said earlier, 9% is at the -- it's outside the high end of our ratio of the risk appetite which we stated was at between 8.3 to 8.7%. So, it's higher than the 8.7%. So, the intent were in years of investment.

But with the capital ratio at that level, we don't see this as hindering our growth in the commercial loans for the foreseeable future, no. The short answer is we don't see this as an impediment. So, it might vary from 9. But we always said we wanted to be at the high end during our period of investment. But that doesn't mean necessarily staying at 9% itself. And if we are at between 8.7 and 9, it still gives us room for growing the portfolio.

Sumit Malhotra, Scotia Bank

Thanks for your time, guys.

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

You are welcome.

Operator

Once again if you'd like to ask a question, please press star one. We will take our next question from Richard Roth with TD Securities. Please go ahead.

Richard Roth, TD Securities

Good morning, a question on liquidities. I guess is it safe to assume that by next quarter, the balance would have normalized down to back to normal run rate levels, or would it take longer than a quarter?

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

No, you're right. Clearly in Q3 that we're currently in, we should have and we will keep normal liquidity balances on our books. You should see this by the end of Q3 publication results.

Richard Roth, TD Securities

Okay. So, then that would sort of lead me to assume that you should -- we should see a bit of a rebound in margins in Q3, and maybe hitting run rate in Q4. What's a reasonable run rate there? I think previous guidance from you guys was that you could see margins pick up a little bit given your business mix shift towards commercial. Is that still the case?

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

Well what we see is we were at 1.77 basis points this quarter. And it's mainly the reduction from previous quarter because of liquidity. So as the liquidity returns to a lower level, you should expect that we're bouncing back to the level we had in Q1 over the short term which was 180.

Richard Roth, TD Securities

So, you're expecting no more incremental expansion versus Q1?

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

Well, at this point no. To get back to the level of Q1 would be what we're seeing at this point. We're not going to stop there. But that's what we see at this point in the short term.

Richard Roth, TD Securities

Okay because my expectation given the difference in margins between let's say your retail book and your commercial book, wouldn't we have expected margins to continue the upward climb? It's like what's sort of hampering them, let me put it that way?

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

No, it's a combination of different factors, Richard. But we're three basis points behind in this quarter. The majority of it is the liquidity. So, that's why as a target we aim at, at least 1.80%. Obviously, the trend going forward is to move higher than 1.80 over the next few quarters, beyond the next immediate quarters. But the immediate quarter is more like around 180.

Operator

It appears there are no further questions at this time. Mr. François Desjardins, I'd like to turn the conference back to you for any additional or closing remarks.

François Desjardins, President and Chief Executive Officer

Thank you all. With the negotiation of the collective agreement behind us, the whole organization can resume its full focus on growth and performance. We're really eager to continue making progress on strategic initiatives, the core banking platform, the soon-to-be launched digital offer and the transformation to advice-only branches.

We're building a solid foundation for our bank and a solid foundation for creating shareholder value. I sincerely mean what I said just a few minutes ago. The road to becoming a better and different bank is exciting and challenging. But as I now look forward, I do see a clearer road ahead. Thanks, everyone. And I will now turn it back -- the call back to Susan.

Susan Cohen, Director, Investor Relations

Thank you for joining us today. Should you have any further questions, our contact information is included at the end of the presentation. Our third quarter of 2019 conference call will be held on August 29th. And we look forward to speaking with you then. Have a good day.

Operator

The conference has now ended. Please disconnect your lines at this time. Thank you you're your participation.