CIBC Q2 2020 Earnings Conference Call

May 28, 2020

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Hratch Panossian

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Management Discussion Section

Operator

Good morning. Welcome to the CIBC Quarterly Financial Results Call. Please be advised that this call is being recorded.

I would like to turn the meeting over to Geoff Weiss, Senior Vice-President, Investor Relations. Please go ahead, Geoff.

Geoff Weiss, Senior Vice-President, Investor Relations & Performance Measurement

Thank you and good morning. We will begin this morning's presentation with opening remarks from Victor Dodig, our President and Chief Executive Officer. Following Victor, Hratch Panossian, our Chief Financial Officer, will review our operating results. Shawn Beber, our Chief Risk Officer, will close out the prepared remarks with the risk management update.

We're also joined in the room by CIBC's business leaders, including Harry Culham, Laura Dottori-Attanasio, and Jon Hountalas, as well as Mike Capatides who has joined us remotely from the US. They will be available to take questions following the prepared remarks.

As noted on slide 2 of our investor presentation, our comments may contain forward-looking statements, which involve assumptions that have inherent risks and uncertainties. Actual results may differ materially.

With that, I will now turn the meeting over to Victor.

Victor G. Dodig, President and Chief Executive Officer

Thank you Geoff and good morning. I hope everyone joining us on the call, including your families and colleagues, are well. And to those in the front lines providing essential services for healthcare and economic recovery, we'd like to thank you for your courage and for your dedication.

I'd like to begin the call by underscoring three essential factors that guide our thinking about our bank in the current environment and as we look to the future. First, we're well-positioned to balance the short-term actions necessary to successfully navigate the current challenges, as well as advance our long-term strategy. We continue to make strategic investments now to position us for success, as we enter the recovery period and beyond.

Second, our investments over the past several years to modernize and simplify our bank have allowed us to mobilize early and to respond quickly to the pandemic in support of our clients, our team members and the communities we serve. Third, whether you're building client relationships or managing a public health crisis, your success often rests on your people and their leadership. Our CIBC team has stepped up in remarkable ways over the past several months and it has reinforced that we have a singularly connected team that is bringing a relentless focus on our clients.

For our bank, we are leaning in to support our clients at a time when they need our help more than ever, while also ensuring the well-being of our team. Since mid-March, we've enabled over 75% of our employees to work remotely, tripling the number from a few months ago. We've also taken significant actions to ensure the well-being of our team members required to work on-site, as they support our clients and keep our operations running smoothly.

For our clients, we have helped over 0.5 million personal, business and corporate clients facing financial hardships including payment deferrals on loans, mortgages and other credit products, as well as reduced interest rates on credit cards. And we're directly supporting government stimulus programs that have been launched for individuals and businesses in both Canada and the United States.

In addition, our industry-leading mobile banking platform and online capabilities have served us well, as more of our clients adopt digital channels to perform their day-to-day banking. This level of digital engagement will become entrenched behavior and the new normal in a post-COVID world. We're well-positioned for that new normal and we'll continue to invest in digital to advance our lead.

Now, it's important to provide some context on why these numbers and these measures are important. We've consistently acted with the long-term in mind when it comes to client relationships. That's been a driver of our strategy and our investments in recent years. As I've said before, this is our moment of truth on that journey where we've executed decisively on our long-term vision in the midst of a crisis.

When we needed to be reactive to meet the urgent need for financial relief among clients, we made it as easy as possible for them to get help such as creating a simple online form to request a payment deferral and building a seamless application process for the Canada Emergency Business Account loans in Canada and the Paycheck Protection Program in the United States. We've also taken every opportunity to be proactive, particularly in light of the sharp increase in the need for advice. Our team has called hundreds and thousands of clients offering advice or just checking in to ensure their banking is in order.

We were the first bank to institute a you're next policy to serve seniors and persons with disabilities in our banking centers. We also proactively extended payment relief to clients who we identified as needing short-term support, and we've been highly visible with our commercial and corporate clients helping them navigate these challenging markets. These are investments in the bank we're building as one connected team at CIBC. It's a long-term effort, but we're seeing continued signs of progress.

Earlier this month, J.D. Power released their 2020 Canadian Retail Banking Satisfaction Study for the big five banks and CIBC moved up another rank to third this year. That has been a consistent trend for us. We knew when we set out to improve our client experience scores that it would take time, but our progress has been steady and our unwavering commitment to our clients is being recognized.

In addition to helping our clients through this crisis, we continue to support the communities where we live and work. We've increased donations to charities that directly support those most at risk. And more recently, we announced the bursary fund to support the education of the next generation of healthcare workers.

Now with that context, I will review the highlights of our second quarter results. While our results for the quarter were stable on a pre-provision basis, the changes in the economic backdrop that began in March had a material impact on our provision for credit losses. Pre-provision earnings of CAD 1.9 billion reflect the resilience of our core business despite these challenging times. Including the impact of the CAD 1.4 billion provision for credit losses, adjusted earnings were CAD 441 million, resulting in earnings per share of CAD 0.94. Our balance sheet remains strong and it's underpinned by a solid capital position with the CET1 ratio of 11.3%.

Looking at our business units, COVID-19 has significantly impacted consumer behavior which materially affected our results. In Personal and Business Banking, transaction volumes across payment products have declined significantly since social distancing protocols were implemented. These trends negatively impacted fee revenue this quarter. And notwithstanding the macro challenges, we continue to see improving trends and volume growth across our core products, including mortgages and deposits.

Our North American Commercial and Corporate Banking businesses saw a credit utilization increase early in the quarter, as clients secured liquidity for their businesses. With a large portion of these draws retained, both loan and deposit volume growth accelerated during the quarter. In Wealth Management, market deteriorations that occurred largely in March reduced fees as well as retail mutual fund net sales. And in Capital Markets, market volatility drove higher trading activity as we supported our clients. And while new equity issuance slowed, we had a record quarter in debt issuance and there continues to be a strong pipeline for both government and municipal paper.

In closing, before I hand it over to Hratch and Shawn for their remarks, I want to leave you with a few key messages. Our core franchise is strong. And while our economic headwinds are likely to be here for the near term, our client focus and our well-diversified business will allow us to get back to pre-COVID levels of profitability as the recovery takes hold.

In addition, while there are many unknowns related to the pandemic, its effect on the economy and the path to recovery, what is certain is that our strong capital liquidity will allow us to withstand ongoing stress, while continuing to support our clients and protect our dividend for our shareholders.

And finally, disruption creates opportunity. We are continuing to invest for the long term, with an eye towards strength in technology and innovation, as well as in building relationships so that we emerge on the other side as a stronger bank. We've already fast tracked some of our investments in technology to support digital engagement as well as working remotely, and we will continue to review other areas of our business to adapt and develop competitive advantages in this new normal environment. We have a talented leadership team who, along with our entire CIBC team, has stepped up to the challenge.

And with that, I’ll turn the call over to Hratch, for a detailed review of our financial results. Over to you Hratch.

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Thank you, Victor. Good morning, everyone, and hope you're all doing well. Starting on slide 9, for the second quarter of 2020 we reported earnings of CAD 392 million and diluted earnings per share of CAD 0.83. Adjusting for the CAD 49 million after-tax item of note reflected in the appendix, we delivered net earnings of CAD 441 million and earnings per share of CAD 0.94.

Our results this quarter are net of a CAD 1.4 billion provision for credit losses, which captures the full impact of the economic circumstances we anticipated as of the end of the quarter. Provisions were primarily driven by a substantial increase in our allowance for performing loans reflecting potential credit losses, as the economic impact of COVID-19 continues to unfold. Shawn will speak to credit provisions in more detail in his remarks momentarily.

Pre-provision earnings of CAD 1.9 billion were relatively stable from the prior year. While COVID-19 impacts presented headwinds in the quarter, our core underlying business performance remained solid, reflecting the resilience of our diversified franchise and continued progress against our strategy over the last year. Revenues of CAD 4.6 billion were up 1% year-over-year driven by a 13% increase in net interest income, as continued growth in client balances and stable margin across our bank more than offset the COVID-related headwinds.

In contrast, non-interest income was down 13% as a result of reduced transactional activity by our clients and disruption in Capital Markets due to COVID-19. Adjusted expenses of CAD 2.6 billion were down 2% sequentially and reflect the actions we have taken to contain expense growth, while accelerating some investments to respond to COVID-19 and modernize our bank. We will continue to prioritize selective investments to address the challenges presented during this crisis and to position our bank for growth in the post-crisis period.

Overall, net of our ongoing efficiency initiatives, we continue to expect more moderate expense growth in the second half of the year as compared to the first. This quarter highlighted the strength and resilience of our balance sheet. As shown on slide 10, we entered this crisis in a strong position and have maintained that strength. During the quarter we supported our clients with our balance sheet, absorbing material increase in credit allowance and maintained our dividend, while continuing to build our book value, capital and liquidity position.

Our CET1 ratio remained stable at 11.3% excluding performing provisions, internal capital generation and implementation of the internal model method for counterparty credit risk benefit of capital this quarter. These items were largely offset by an increase in RWA deployed in support of our clients. The impact of provisions on performing loans was mostly offset by associated changes in capital deductions and the CET1 add back per OSFI's transitional arrangement. Our ending capital position provides us with a buffer of approximately CAD 6 billion in capital or over CAD 65 billion in RWA relative to the 9% regulatory minimum.

This represents a 30% increase from current credit RWA levels, which is significantly beyond internal credit migration estimates even in severe downside scenarios. Our liquidity ratios were also strong, improving throughout the quarter as we preemptively built up our liquidity reserves. Our average liquidity coverage ratio for the quarter improved to 131% as a result of strong deposit growth and our continued access to funding markets throughout the quarter. Going forward, our resilient balance sheet positions us well to absorb any future stress or market disruption, while continuing to support our clients and our dividend as the impact of COVID-19 unfolds.

Slide 11 reflects our Personal and Business Banking results. Net income for the quarter was CAD 204 million, down 64% from last year due to a higher provision for credit losses and revenue headwinds related to COVID-19. Revenues of CAD 2.1 billion decreased 2% year-over-year due to pressure on fee income in the current environment. Net interest income was stable year-over-year, as growth in client balances was offset by the impact of lending accommodation to support clients experiencing financial hardships.

Non-interest income for the quarter was down 9% due to significantly lower transaction activity, particularly in payments and deposits, due to the ongoing social distancing measures across Canada. Net interest margin of 244 basis points for the quarter was down 3 bps from last year and 7 basis points sequentially, largely due to the impact of the prime BA compression and COVID-related interest relief this quarter. Going forward, if rates are unchanged from current levels, we expect NIMs to experience gradual pressure, as we continue to absorb the impact of the recent changes in the yield curve.

Expenses of CAD 1.1 billion were up 2% year-over-year, but down sequentially, as we reallocated resources through the quarter to react to COVID-19, while optimizing our cost base. We are continuing investments to further advance our leading mobile and digital capabilities, but have reduced investments in our physical footprint and other initiatives from the prior year. We will balance our level of investment through the back half of the year guided by changes in market conditions as they evolve.

Slide 12 shows the results of our Canadian Commercial Banking and Wealth Management business, where our core business performed well driven by continued growth in client balances. Net income for the quarter was CAD 206 million, down 37% from a year ago due to the higher provision for credit losses. Pre-provision earnings were stable with underlying revenue growth of 3% and a 5% increase in non-interest expenses.

Commercial banking revenues were up 3% from a year ago benefiting from continued volume growth and favorable rates offset in part by lower advisory fees. Deposit and lending balances were up 13% and 9% respectively as we saw balanced portfolio growth throughout the year and continued supporting our clients with incremental credit needs in the quarter.

Wealth management revenues were up 3%, primarily driven by higher fee-based assets and trading volumes in our full service brokerage business due to the market volatility in the quarter. The 5% increase in expenses reflects higher revenue base variable compensation and hiring of client facing roles over the course of 2019. We are continuing to invest in our digital capabilities to support our clients and our teams over the remainder of 2020, but expect expense growth to moderate.

Turning to slide 13. US Commercial Banking and Wealth Management results reflect continued growth in our US client franchise and market share gains. Net income for the quarter was CAD 35 million, down 80% from the prior year due to the higher credit provisions. Pre-provision earnings growth continued to be strong at 16% year-over-year in Canadian dollars or 12% in local currency.

Revenues were up 11% or 7% in US dollar terms over the last year. Double-digit volume growth and higher asset management fees more than offset headwinds related to the significant decline in rates over the last year and a mark-to-market loss in the discontinued CMBS business due to the market disruption this quarter.

Average loans grew 22% from a year ago in US dollars, reflecting continued momentum in client development and our advancement of loans as a part of the Paycheck Protection Program later in the quarter. Deposits outpaced loans growing 24% from a year ago as new and existing clients continue to entrust us with their cash management and investment needs.

Net interest margin was 305 basis points, up 3 basis points sequentially and down 27 basis points from a year ago. The modest NIM improvement this quarter was helped by reductions in deposit pricing that followed the Federal Reserve rate cuts, while LIBOR declines lagged through the end of the quarter, while there can be some quarterly volatility of prolonged low rate environment and in particular the recent downward trend in LIBOR with pressured core margins downgrades going forward.

Non-interest expense growth of 6% from the prior year was impacted by FX translation. The constant dollar increase of 2% reflects our continued growth investments in this business net of the impact of our efficiency initiatives and a significant reduction in travel and business development expenses.

Slide 14 covers Capital Markets result. This quarter, we stood by our corporate and institutional clients through the market disruption, generating strong revenues despite the impact of significant dislocation in some markets. Net income of CAD 137 million was down 52% from a year ago driven by a higher provision for credit losses.

Pre-provision earnings were up 6% over the years due to the continued growth of core revenues, offset by expense growth related to the strategic investments to expand our platforms. Revenues of CAD 824 million were up 9% from a year ago, mainly due to the higher client trading activity and interest rates and foreign exchange, growth in corporate banking and higher debt underwriting. The performance of these businesses more than offset lower equity derivatives revenues, valuation adjustments driven by a wider funding and credit spreads, and reduced market activity in advisory and equity underwriting.

Average loans were up 21% as we supported our clients through this crisis, providing incremental access to funding and financial flexibility as a part of our lending accommodation. Non-interest expenses were up 12% from a year ago, primarily driven by higher spend on ongoing growth initiatives, particularly in the US and expenses associated with higher trading volumes.

Finally, slide 15 reflects the results of the corporate and other business units. Net loss for the quarter was CAD 141 million compared with net income of CAD 5 million for the prior year, driven by lower revenues and higher PCL, while strong expense management provided an offset.

Lower FCIB revenues were impacted by write downs and debt securities and declines in rates as a result of the COVID-19 pandemic. Treasury revenues were also lower this quarter, primarily due to the impact of the increased level and cost of our liquidity reserves.

As mentioned previously, we anticipate completing the sale of our controlling interest in FCIB subject to regulatory approval and we'll provide updated guidance for this segment at that time.

And with that, I will turn the call over to Shawn.

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

Thank you, Hratch, and good morning. Before turning to our provisions, I'd like to provide a few high-level thoughts on our credit portfolios in the context of the current economic situation.

First, our portfolios have performed well heading into this crisis. Nearly two-thirds of our outstanding loans are to consumers, the majority of which are mortgages with our uninsured mortgages having an average loan to value of 53%. The balance of our portfolio is in business and government lending with an average risk rating for the portfolio equivalent to a BBB+.

Second, given the unprecedented dislocation that has occurred since we last reported our results to you, we have performed various analysis and exercise judgment to determine our provision for credit losses this quarter, particularly with respect to the provision for performing loans.

And third, we have also provided incremental disclosure this quarter, to help you better understand select industry exposures.

While acknowledging the uncertainty and the path forward for the global economy, if our current economic estimates materialize close to forecast, we would not expect to see notable increases in performing allowances from here. With that context, turning to slide 18, the total provision for credit losses of CAD 1.4 billion were higher quarter-over-quarter mainly due to performing loan loss provisions driven by unfavorable changes to the macroeconomic outlook that informs our forward-looking indicators reflecting the impact of the COVID-19 pandemic.

For impaired loans, the provision this quarter was CAD 343 million, up CAD 99 million from the prior quarter, mainly due to a few impairments in Canadian Commercial Banking and the oil and gas sector within our Capital Markets business. Given the current environment, we have provided additional information this quarter on the composition of allowance, and our provision on the following slide.

Turning to slide 19, allowance for credit losses grew by 59% to CAD 3.3 billion this quarter, with our coverage ratio to gross loans increasing from 51 basis points to 78 basis points. On our performing provision of CAD 1.1 billion this quarter, we have provided more details on the bottom-left of the slide. The first column represents our model provisions, which incorporates revisions to the forward-looking indicators, along with changes to the case weightings based on input from our economics division.

We made a number of further adjustments to reflect the circumstances this quarter, that netted to a reduction of CAD 122 million, which I'll now describe. We adjust in certain forward-looking indicators used in the model to reflect the benefits of government relief programs on our consumer and business and government portfolios, that we do not believe our models would have otherwise captured.

The outcome of these adjustments materially reduced our model provision. In addition, we performed a bottom-up review on select segments of our portfolios. We applied qualitative factors to these portfolios for the impacts we believe were not captured in our model-driven provisions, including additional future credit migrations.

This bottom-up review resulted in our recognizing additional performing provisions, which offset a majority of the adjustments we have made to reflect the benefits of the government support. As I mentioned, the net results of these adjustments is a reduction of our model provision by CAD 122 million, which is reflected in the second bar in the chart.

Lastly, we had other portfolio movements, including credit migrations and parameter updates, so that is CAD 136 million to the provision. All in, this resulted in a total provision on performing loans of just under CAD 1.1 billion for the quarter.

On slide 20, we provided incremental disclosure on our wholesale exposure to oil and gas which represents 2.5% of our total loan portfolio with 54% in exploration and production subsector. Our total allowance for credit loss coverage for this segment was four times our current impairments this quarter.

Looking at the oil provinces from a retail perspective with 87% of our retail loans being secured and are uninsured mortgage portfolio in these provinces having a loan to value of 67%, we remain comfortable with our overall exposure.

Slides 21 and 22 provide details on select industries in vulnerable sectors that have been particularly impacted by the various protection measures put in place as a result of the pandemic. These include industries in leisure and entertainment, retail, as well as certain asset classes within our commercial real estate portfolio.

38% of leisure and entertainment exposure and 50% of retail exposure were investment grade at the end of this quarter. For commercial real estate, 71% of our Canadian portfolio and 42% of the US portfolio were investment grade.

We have introduced relief programs for our corporate and commercial clients experiencing hardship in addition to support programs offered by governments to provide assistance as they navigate through this difficult time.

The next slide provides an overview of our gross impaired loans. Gross impaired dollars were up in both consumer loans and business and government loans, mainly due to COVID-19 and continued pressure on oil prices.

The increase in consumer loans was mainly driven by marginally higher impairments in our Canadian mortgage portfolio. Given the moderate average loan-to-value ratio of this portfolio, we do not expect this increase in gross impaired balances to translate into material losses. In addition, the increase in formations this quarter was mainly driven by loans in our Canadian Commercial Banking segment along with higher impairments in the oil and gas sector.

Slide 24 shows the net write-offs and 90-plus day delinquency rates of our Canadian consumer portfolios. At this stage, our write-offs continue to remain relatively stable other than seasonal trends within our credit card portfolio. We do expect consumer write-offs to increase late in the second half of 2020, once deferral programs that were put in place in Q2 end. At which point, we will likely see a resumption of delinquency and write-off trends.

The overall Canadian consumer late-stage delinquency rate was up this quarter with a higher rate in residential mortgages and a lower rate in credit cards. As I mentioned earlier, we do not expect the increase in mortgage delinquencies to translate into material losses. The decrease in credit cards was mainly due to the client relief programs instituted in Q2, which prevented certain clients from becoming increasingly delinquent during the quarter, resulting in fewer accounts flowing to late-stage delinquency.

Excluding the benefit of payment deferrals, the delinquency rate on credit cards would have been 115 basis points versus 66 basis points shown in the chart. We have included this adjustment in our provisions for

performing loans to account for the anticipated increase in delinquencies and potential write-offs in future quarters.

On slide 25, we've shown our trading revenue and VaR distribution throughout the quarter. Given market volatility in Q2, VaR increased throughout March and April peaking at CAD 22 million near the end of March.

We also experienced 14 negative trading days in March and April. These were mainly driven by losses and equity derivatives, precious metals and the impact of negative oil pricing. This is in the context of volatility this quarter, that in many respects, was more significant than during the 2008, 2009 financial crisis. I would also note that much of these mark-to-market losses were recouped in April as markets rebounded.

In closing, I'd like to reiterate the extraordinary economic backdrop this quarter. As I noted in my opening remarks, assuming our forecasts remain unchanged, we would not expect to see further material increases in performing allowances this year.

Having said that, none of us know how long this crisis will last or how effective the government's support and relief programs will be in acting as a mitigant to potential losses. We remain comfortable that our prudent underwriting approach has positioned us well to manage through this period, while continuing to support our clients.

Operator, I'll now turn the call back to you for questions.

Question and Answer Section

Operator

Thank you. And the first question is from John Aiken with Barclays. Please go ahead.

John Charles Robert Aiken, Analyst, Barclays Capital Canada, Inc.

Good morning. Hratch, you mentioned, in terms of the sale of FirstCaribbean that you're expecting to go forward. My understanding though is that there's potential price adjustments based on book value. Do you see any impact on the pricing on this deal, because of what happened in FirstCaribbean this quarter? Or alternatively, is there any impact on the timing that you expect the deal to close?

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Sure. Thank you, John, and good morning. I would say on the price adjustment side, we had made references before to the way the agreement is structured. So, any changes in book value, as mentioned in our disclosures would flow through to that. But that doesn't mean there is a price adjustment, so the agreement is as it is, it just reflects changes in the book value between agreement and close.

And so that would happen as normal course. However, I'll say on the economics that that structure actually guarantees us that the economics with that respect stay the same. So, we've looked at and recalculated the impact of the close and you'll see as this goes on our capital side, we still anticipate 40 basis points roughly benefit when we close that transaction.

And in terms of timing, as we've disclosed again, we are working through regulatory approval processes and that's what is between now and close. And so, obviously, the COVID-19 situation and shutdown of certain government bodies including regulators and the workload can impact that, but we still are anticipating later this calendar year.

John Charles Robert Aiken, Analyst, Barclays Capital Canada, Inc.

Thanks for the color, Hratch. I will re-queue.

Operator

Thank you. The next question is from Ebrahim Poonawala from Bank of America Securities. Please go ahead.

Ebrahim H. Poonawala, Analyst, BofA Securities, Inc.

Good morning. I guess just a question following up on Shawn on your comments around performing PCLs. If you can just give us some clarity around – my senses, performance PCLs and the model is very sensitive to the unemployment outlook. If you can talk to just in what you're baking in with regards to unemployment as we look out I guess first half of 2021 in the housing market, that would be helpful?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

Sure, Ebrahim. So, we've used – working with our economics department, we've taken the various scenarios, weighted them, and then run our modeling exercise. So, I'd say our base case is more reflective of a U-shaped pattern. So, big contraction in GDP and rising unemployment fairly quickly, then as the economy reopens, recovering begins, and it's sort of quickly at first, but then we're sort of forecasting a more gradual emergence from there, where GDP doesn't get back to say end of 2019 levels until late 2021 or early 2022, with unemployment coming back after that.

From a house price perspective, we've modeled in, think about it as sort of a little more than 6% to 7% price drops over the next two years and then some recovery in the following year.

Ebrahim H. Poonawala, Analyst, BofA Securities, Inc.

Got it. And just on that, so you mentioned this was probably the high watermark actually the macro change on performing PCLs. Do you feel the same way about just total PCLs? Or do you think that impairment and credit migration could actually push absolute PCL levels higher than what we saw in 2Q as you move later in the year?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

Yeah, so, as I said, we – based on our view of the forecast and the various analyses that we've done which includes bottom up analysis on impacted sectors, if things play out the way we've modeled them and based on the risks as we understand them today, we wouldn't expect to add any material amount to allowances.

Now in terms of the impaired provisions, what we would expect to see – again, as things play out is, some level of credit migration and ultimately perhaps some cycling of those performing provisions into impaired provisions, but net not having that allowance number move up materially.

Ebrahim H. Poonawala, Analyst, BofA Securities, Inc.

Got it. Thank you.

Operator

Thank you. Your next question is from Gabriel Dechaine from National Bank Financial. Please go ahead.

Gabriel Dechaine, Analyst, National Bank Financial, Inc.

Good morning. I just want to ask about the deferrals and interesting that you put the proactive and reactive descriptions in the card portfolio. That kind of hints at the needs versus accommodation or tactical use of these deferral programs by some borrowers, I'm wondering if you talk about it across the whole book and especially on the tactical, because if those numbers are quite high, it can give us comfort in how these deferral numbers are going to decline over the next few quarters and results in a much lower impaired loan number?

Victor G. Dodig, President and Chief Executive Officer

Good morning, Gabriel. It's Victor here. I wanted to just comment on that, I'm going to hand it off to Laura, where the largest number of deferrals occurred in our Canadian Personal and Business Bank. At the outset of this pandemic, it was clear to us, based on the inbound calls and based on the economics that we saw out there, that clients are feeling anxiety and hardship, some with real financial hardship, some with perceived financial hardship. And we wanted to deal with them as expeditiously as possible. So, we dealt with that on mortgages. We set up a digital form and made it very easy.

We, on credit cards, decided that there was a group of clients that we wanted to offer relief to on a proactive basis based on their real hardship, because alleviation of hardship means alleviation of hardship. And that's what we set out to do for those clients, while at the same time recognizing that there are clients that we needed to open the lines for request to – for alleviation. And that was the reactive group.

In our Commercial Bank and our Corporate Bank, we also work with our clients on the deferral basis and/or to negotiate new lines of business. So, we are highly and actively engaged. I think your question specifically relates to the proactive piece. I'll hand it off to Laura to speak to that.

Laura L. Dottori-Attanasio, Senior Executive Vice-President and Group Head, Personal and Business Banking, Canada

Sure. Good morning, Gabriel and thanks Victor. So, Victor said really our number one priority during the crisis was to help our clients. So, you would have likely seen if you're following the news that we were actually first out of the gate with all the announcement of the various deferral programs including dropping interest rates.

And I do want to point out that during the pandemic there was a national poll of Canadians that ranked us as number one among the big six banks for our handling of COVID. And so that that I point out, because it was really important for us, because we pride ourselves on doing the right thing. So, it was a deliberate decision that we made at the beginning of the crisis.

And as Victor pointed out what we wanted to do here was really find a way to provide cash flow relief to the clients that we thought might needed the most. So, there were those that came in and asked as Victor points out and the ones we felt might also need it where we had seen say they had missed a payment or been late with a payment. So, it was really trying to help these clients, because that's what we're supposed to do during these times, during their period of I would say very high stress that avoided a lot of delays with calls into our call centers. And most importantly we knew these folks would benefit.

So, just some stats for you, which I know we had a slide that show them. But on mortgages the 108,000 deferrals we did that represented 18% of overall mortgage outstanding. On the card side it was about 7% for those who asked for it, and 9% for the proactive one. So, totaling 16%.

And what I think I should point out to you is what we're seeing with our clients, they've been acting incredibly responsibly during these times. So we've seen them cut back on purchasing, they haven't increased their debt levels, actually, in fact, utilization rates both on secured and unsecured lines have trended downwards. And of

the folks that we offered proactive relief to, I would tell you that just under 60% of them still chose to make a voluntary payment on their cards. So I think that just speaks to the response – sorry, how Canadians are acting responsibly during these times. So does that answer your question, Gabriel?

Gabriel Dechaine, Analyst, National Bank Financial, Inc.

I guess it's – if you can tell me like 80% of these deferrals are people that are just taking a payment holiday, or a sort of their situation and then I'd expect those to get back to performing and paying by when the six-month period has elapsed?

Laura L. Dottori-Attanasio, Senior Executive Vice-President and Group Head, Personal and Business Banking, Canada

Yeah, well for mortgages, most of our client we offered six months deferrals too. On the card side, it was two to three months of, if you will, deferral and lower interest rates that they received. So I think you're – well, comfort comes from of that segment of population where we proactively deferred, as I said just under 60% of those folks made voluntary payments on their cards.

Gabriel Dechaine, Analyst, National Bank Financial, Inc.

Okay. My next question on capital, and Hratch, I think you were talking about the your – you mentioned credit migration. A bank yesterday gave some sensitivity on migration that if everything was downgraded a notch there would be 100 basis points or whatever hit the capital ratio. Just to kind of give a stress scenario, I was wondering if you have anything of that nature?

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Yes, I'll take that Gabriel. Good morning, it's Hratch. So, yes, I can give you a little bit more color on that. So, as I mentioned our capital is resilient and we expect it to remain resilient to cover migration. So, we've got – this quarter you'll see if you go into the supp packs we only had about 5 basis points of CET1 worth of migration, but we do expect that to come over time.

When I look at our portfolios, if I look at let's say the wholesale and I gave similar numbers to what was discussed yesterday. For our wholesale book, which is not just corporate sort of overall wholesale book, we anticipate that we would have approximately if you just look at the RWA impact from migrations, it would be about 80 basis points to CET1. But you've got to keep in mind that there is also on top of that potential increases in the ECL, which would come through. And so, you put that all in about 100 basis points over several quarters.

Now, that I should point out is a very, very significant scenario to see the whole book downgraded one notch. And we are starting from a very strong place with a portfolio that is very strongly positioned. Just to give you some numbers on our corporate sort of sovereign book as of Q2 of our exposures, 82% almost had a PD of under 0.5%, so I think that's a great starting point and we can absorb from there.

In terms of what we actually expect, we've done a number of forecasts and what I'll leave you with is absent credit migration, we think our capital is stable. At this point in time, hard to tell what's going to happen, but we do expect some credit migration. But we think that level of credit migration will be sort of in our expected case within that sort of 40 basis points. And then outside cases that we're seeing, still well into the 10%, I would say, above potentially, sort of, that 10.5% level. And then in a very, very severe stress, based on the numbers I just gave you, you see that we still have, as I mentioned in my remarks, significant buffer to that regulatory minimum.

Gabriel Dechaine, Analyst, National Bank Financial, Inc.

Yeah. All right. Thank you for the thorough response everyone.

Operator

Thank you. The next question is from Scott Chan from Canaccord Genuity. Please go ahead.

Scott Chan, Analyst, Canaccord Genuity

Good morning. Laura, I was wondering if you could offer any update on client behavior trends post quarter? In terms of what you're seeing on the mortgage origination side or personal or card side would be helpful? Thanks.

Laura L. Dottori-Attanasio, Senior Executive Vice-President and Group Head, Personal and Business Banking, Canada

Sure. Good morning, Scott. Well, I'd tell you post quarter does feel better than what we went through during the quarter. That said, I'd still expect to see, I'd say, slower demand for credit and that's just reflecting the new reality that we're in. Let's see. We're seeing, I'd say, deposits, balances, those continued to increase, that feels good.

On the mortgage side, pre-crisis, I'd say we were feeling good in that, as you've probably seen, we reversed that declining growth trend and are now on a positive trajectory. That said, still not good enough in terms of where we'd like to be, but we were trending in the right direction. I'd tell you, sort of, post-quarter-end, we are seeing some of those applications drop off, which I think is normal given the circumstances.

But on the credit card side, for as much as we saw a big drop-off, particularly in April in terms of purchase volumes and new applications, we are actually seeing a much improved pipeline as it relates to number of applications coming in including purchase volumes that have come up. And so, feels a lot better. That said, I think we're going to see slower demand, if you will, for credit on a go-forward basis. Does that answer your question?

Scott Chan, Analyst, Canaccord Genuity

Yes, it does. Thanks. And just for Shawn, just to follow-up on your scenario analysis, I guess, response on performing loans on the allowances. For the housing prices, when you say 6% to 7% over two years, is that over two years or is that 6% to 7% each year?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

No, over the two years.

Scott Chan, Analyst, Canaccord Genuity

Over the two years. And when you find the weight to the different scenarios, can you quantify the weight for us?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

I don't think we've historically disclosed that. We didn't move a bit towards our upside case, but that was more of a reflection relative to prior quarters. But that was more a reflection of the fact that our base case now reflects more of a recessionary environment.

Scott Chan, Analyst, Canaccord Genuity

Okay. Got it. Thank you very much.

Operator

Thank you. Your next question is from Steve Theriault from Eight Capital. Please go ahead.

Steve Theriault, Analyst, Eight Capital Partners

Thanks very much. Victor, in your opening remarks, you talked about looking forward to getting back to pre-COVID levels of profitability. That's been a big question. It hasn't always been the case. Obviously, last cycle put pressure on ROEs. Can you just maybe elaborate a bit on your confidence there and talk about some of the risks of that outcome?

Victor G. Dodig, President and Chief Executive Officer

Good morning, Steve. I think we all generally know where we are today in the economy. I think the stimulus – just to provide a broader macro context, my views and our collective views here at CIBC are that the stimulus from the various government programs in both Canada and United States are helping and will help demand recover as we come out of this.

Clearly, some sectors will perform better than others. The discretionary economy; travel, entertainment, leisure, the ones that you constantly hear about are the ones that are going to have a longer period of recovery. Our economists tell us that GDP will contract in the high single-digits this year, both Canada and United States and will likely rebound next year. Various letters of the alphabet are used to describe the recovery. I always say there's no letter in the alphabet that will describe it. Let's just kind of take it quarter by quarter.

In terms of my comments that we will return to pre-COVID levels, there's a number of things that we're going to have to do. We're going to have to continue to win market share and develop deeper client relationships within clients across all of our businesses. And I think you're seeing that in our businesses. There's obviously pockets of improvements that we have in our portfolio that we need to work on. We need to continue to transform our cost base and we announced that last quarter, and we will continue with that program to transform our bank and to try and get our efficiency ratio to a normal level.

If we do what we can do to improve the performance of our portfolio and the economic recovery does take root, which I believe ultimately it will, there's a tremendous amount of stimulus in the market globally that's happening. We will see that growth come back, it may take to 2021, it may take to early 2022 before you see a robustness back in the banking sector again, assuming that the healthcare crisis is behind us.

So, I know that we have a good plan. We are going to continue to execute against that plan. I think quarter after quarter, you will see the resilience in our business results that on a relative basis we will hold our own and try to improve versus our competitors as best as possible.

Steve Theriault, Analyst, Eight Capital Partners

Okay. Thanks a lot Victor. Second question for Hratch, I think the margin was up 3 basis points in the US. You talked about a decline going forward Hratch. Can you put some numbers around that either some numbers around that or the timing with which it will take for margins to kind of settle out all else equal post rate cuts?

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Sure. Thank you. So, it's a little tough right now to put numbers around it because A) as I mentioned in my remarks, we do expect some volatility over the next few quarters. And so, if you look at for example the Paycheck Protection Program and how that plays out and there seem to be potentially extensions to that. So that will, when it's on balance sheet skew things to some extent in the short-term. But to give you the longer term trends as we've spoken about before we do anticipate that business to be more stable now than it's been before because we have hedged that balance sheet fairly significantly. But directionally I would say LIBOR going down you would see some modest pressure over the long-term.

And I think once the noise of the PPP program clears out, you will see the impact fairly quickly come in for the LIBOR changes that we've seen now and then stabilize from there if we don't see any changes going forward. So what you see in our disclosures, I'll give you may be a bit of extra color, you see that 25 basis point disclosure, the rates we have now which is a lot more than what we had before, because of some of the deposit floors. I would say within that number there is probably a sort of somewhere in the neighborhood of CAD 15 million for the US. And so, you can go back and see how much rates have moved by. It was substantially less than that, what we had said before, right, for shocks. And I think with that, you could triangulate to a number that still stands.

Steve Theriault, Analyst, Eight Capital Partners

Great. Thanks for that.

Operator

Thank you. The next question is from Meny Grauman from Cormark Securities. Please go ahead.

Meny Grauman, Analyst, Cormark Securities, Inc.

Hi. Good morning. A follow-up – following-up on Steve's question, Victor, in terms of thinking about the future, I'm wondering – you referenced a lot to digital investments and taking advantage of the current opportunity to do that. But I'm wondering what about potentially the golden opportunity of more dramatically reducing the branch footprint? Is this something that's considered – should be considered in your view?

Victor G. Dodig, President and Chief Executive Officer

Okay. How are you doing, Meny? Nice to hear your voice. So, a couple of things I'd say about our physical footprint. We've, kind of, gone in a period of a journey of transformation in terms of modernizing the footprint, where we're moving transactions out of our banking centers and moving advice into our banking centers. And that's a trend that, I think, you will continue to see.

I believe that now, our transactional levels, 91% or 92% of transactions are conducted either via an ATM, your tablet or your online banking – online banking platform, which is all encouraging, we see that going to 95%. But our belief over time is that people and people interaction, whether it's through some sort of safer distance measures or not, are going to be an important part of the banking equation.

So, while banking centers may drop in terms of overall numbers and they become smarter and lighter in terms of footprint, I think they'll be an important part of our value proposition, particularly in the Canadian marketplace over time. You'll see some shrinkage, but they'll play an important role in building those client relationships.

The other thing I'd add is that shrinking the number of banking centers doesn't necessarily improve your profitability that dramatically. What improves your profitability dramatically is your ability to attract the client

relationships we wish to attract and make sure they're deep and meaningful relationships, so that you can see those numbers flow through both our ROA and our ROE and that we can generate the healthy capital that we believe we will generate through our business model going forward.

Meny Grauman, Analyst, Cormark Securities, Inc.

Thanks for that. And while we're talking about the future, I thought I'd ask about taxes and the questions, the inevitability of tax increases as we search to pay for all of this government spending. And maybe even further than that, at what point should we get or what point do you get concerned that the government is – government debts or public debt is just getting out of control?

Victor G. Dodig, President and Chief Executive Officer

Well, look, as citizens, we should always be concerned about what is the right level of debt to share the burden and making sure that our countries are strong in Canada, United States and other countries we operate in. I'm not going to talk about whether tax increases or our taxes increase – tax increases will happen or not. What I will say is that what matters most is economic growth and policies that stimulate growth, so that the economy can slowly retire the debt that's been incurred from this. We have the benefit of low interest rates that help. But all policies need to point to growth as we move into the recovery period.

There's obviously a recovery period, there's going to be a reconstruction period both for our bank as we continue to accelerate our transformation and our country as we move to a more modern economy. And I think this pandemic has opened our eyes to the ability to move swiftly in that regard.

And the only thing I would continue to advocate all our government leaders to focus on is growth, because that will raise the standard of living for everybody involved. And that's what we continue to advocate for. We continue to talk – engage with policymakers to make sure that our GDP can get up to a robust enough level so that our standard of living continues to improve for all Canadians and Americans.

Meny Grauman, Analyst, Cormark Securities, Inc.

Thanks for that, Victor.

Operator

Thank you. The next question is from Sumit Malhotra from Scotiabank. Please go ahead.

Sumit Malhotra, Analyst, Scotia Capital, Inc.

Thank you. Good morning. First question is for Hratch and it's going to go to your capital slide on page 10. So, the lower capital deduction and ECL transition, from what I've seen, the transition piece was 10 basis points. On the capital deduction, I was looking at the disclosure in the supplement and it looks like it's the removal of the shortfall that had previously been running in the CAD 500 million-CAD 600 million range that's provided that boost to capital. Just thinking about this technically, Hratch, you or the bank booked CAD 2.2 billion in performing provisions this quarter.

Simplistically, does that give you a buffer in the neighborhood of CAD 1.5 billion now on this line that would have to be worked through in the model before this deduction could reemerge? I don't know if I'm phrasing this as well as I want to, but hopefully what I'm getting at here, just kind of curious as to whether this deduction could reemerge as clearly it was a benefit to capital this quarter?

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Yes. Good day, good morning, Sumit, I hope you're well. Let me give you some color on that, and maybe I'll tie in the ECL transition piece as well just to give you a sense of how this is likely to move going forward. So, as I'm sure you're aware, that's the capital shortfall or the capital deduction that was there for the shortfall in any differences between what's in our allowances and expected loss and what's in our regulatory capital model that's an expected loss. And it was there to just ensure that you're holding either allowance or capital for the full spectrum of losses right between expected and the unexpected losses for the capital framework.

So we at the time go – before going to this crisis had about a CAD 550 million kind of delta there, which was a deduction. And so what you saw is as we increased the performing provision and this is mostly a stage 1 and 2 as we've talked about the CAD 1.1-ish billion, that does not have an impact on the regulatory expected loss which only moves as kind of the ratings move and downgrade.

So we went through, actually, when you have to go after tax and there are some more complicated math there and what qualifies and doesn't, but net-net we actually went from a shortfall to a surplus. And then what OSFI did with the ECL transition framework essentially is, it made to some extent that sort of – that dynamic symmetric. So when you are in a surplus now, you also get to add it back to CET1 which you didn't get to before.

So where that sort of lands you now is going forward, what you'll see that will impact capital mostly there might be some noise still, because it's not a 100% offset, right as you're stage 1 and 2 moves up or down. But what will really impact capital is how your regulatory expected loss changes. And that will be driven by migrations. And so that's why in the comments we talked about migration. So I would at this point say, we – I would not be looking at as a shortfall, but I would be looking at some migrations forward.

Sumit Malhotra, Analyst, Scotia Capital, Inc.

And that is more a reflection of what we've been discussing for a lot of this call, the trends in the underlying portfolio, effectively the higher expected loss provision you took this quarter was the trigger that moved you from this deduction to now being flat from a capital perspective at least as far as that line is concerned?

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Correct. You can almost think of it, Sumit, as that the impact of what flew through P&L this quarter, right, was basically already taken in capital and reserve for.

Sumit Malhotra, Analyst, Scotia Capital, Inc.

Got you. I might follow-up with you on that to make sure I'm thinking about this, but we'll do that later. Hopefully, more to the point question for Laura and it has to do with credit cards at CIBC. I think this is a applicable both to your current role and your previous one. We all know that credit cards are a smaller portion of the loan portfolio for commerce than they were 12 years ago when we were going through the last downturn. But the composition of that book has changed as well with some of the shifts you've made over that time, specifically moving to less single product customers.

When I look back in the archives, the loss rate on the card portfolio or at least the provisioning rate, got up to 7%, 8% at the worst employment levels in 2009. Laura, do you think the composition of the book has changed such that you expect loss rates will be lower for the bank in that product than was the case in the previous downturn?

Laura L. Dottori-Attanasio, Senior Executive Vice-President and Group Head, Personal and Business Banking, Canada

Well, the composition has changed and that we have spent time over the years really deepening our client relationship. So, they're not sort of single product clients. And history has shown us that we always do better from a loss perspective when we have a deeper relationship. And we've also done a great job over the years with our risk team in terms of being much better from credit adjudication perspective. So all of that, I would tell you, has contributed to our loss rate coming down as much as it has.

That said, I don't want to call things. We're in unprecedented times. Who knows how bad and how ugly things can continue to get. That said, I – again, because in a stable environment we've managed to really bring down the loss rate, I would hope and would expect it wouldn't go up to that same rate just based upon all of the good work that was done, as I said, in risk management in terms of how we adjudicate; and with the teams over the years, how they've really deepened those client relationships. So, we should do much better sort of this round than we would have years ago.

Does that answer your...

Sumit Malhotra, Analyst, Scotia Capital, Inc.

I appreciate that. Yeah. That's very good. I appreciate your time and thanks again.

Operator

Thank you. The next question is from Sohrab Movahedi from BMO Capital Markets. Please go ahead.

Sohrab Movahedi, Analyst, BMO Capital Markets Corp. (Canada)

Thank you. Actually if I can just follow-up on that, Laura. One of the things you said was that the demand for credit is going to be a little bit slower, certainly mortgages. Maybe just to turn Sumit's question on its head, is there a risk that you may have to get back into single product relationship in cards as you push for growth in Canadian Personal and Small Business Banking?

Laura L. Dottori-Attanasio, Senior Executive Vice-President and Group Head, Personal and Business Banking, Canada

Hey, Sohrab. Well, I wouldn't call that a risk in that – a natural part of growth, you have to start somewhere with someone. And so, that can be entry-level relationship, you start with a credit card. We do see some stuff in the industry that shows that clients might also be migrating to a bit of single product. But that said, regardless of the product we start with, whether that's a transactional account that we open, a credit card or a mortgage, I would tell you our goal is full client service. So it's how do we franchise that client, so that we have a real and deeper relationship with them.

So I wouldn't say that we don't want to have, if you will, just a credit card. That might well be how we start off our relationship, but do know that the goal will always be to deepen the relationship so that we have deeper client relationships which just goes to not only help us on the revenue generation front, but it helps us a lot form a risk mitigation front as well, and it allows us to offer even better service to our clients because we just know them that much better. So, all around win-win, but it's okay to start with just one product. Does that answer your questions?

Sohrab Movahedi, Analyst, BMO Capital Markets Corp. (Canada)

Yeah. That's helpful. That's helpful. And if I can just quickly ask Shawn, maybe a bit of an unfair question, Shawn, I don't know. But when you have arrived at the allowances and the required provisions, are you in a position to comment on kind of vintage analysis?

Is there any reason to believe maybe some of the outsized growth in mortgages in prior years may have kind of yielded higher allowance requirements now or the growth in PrivateBancorp – since the PrivateBancorp acquisition? Is there any reasons – have you done any vintage work to suggest there's anything peculiar about vintages that may have driven higher reserve requirements, credit reserve requirements?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

No. Sohrab, I wouldn't attribute it to vintage as an issue. I mean, our credit adjudication standards have not been relaxed since – I'll speak first to The PrivateBank acquisition. We haven't relaxed that, we've been growing. And I'll turn it over to Mike shortly to make a few comments about that business. And on the mortgage side as well, I don't think we've been changing our standards there in terms of our growth. But I'll pass it to Mike, and then maybe Laura can speak to the mortgage piece.

Michael G. Capatides, Senior Executive Vice-President and Group Head, U.S. Region; President and Chief Executive Officer, CIBC Bank USA

Sure. Thanks, Shawn. I'd like to remind everyone on the comments we made before at the time of the acquisition of The PrivateBank is that, one of the incredible positives we found at that bank was the credit culture. And so, it was seamless in terms of a vintage analysis in terms of the loans and the clients that were brought on the books and how we moved forward.

So, I would say pretty emphatically that you're just not going to see any type of negative vintage analysis in terms of loans that we inherited through the merger, loans that we've put on the books the last couple years and in fact going forward. It's a very consistent credit quality.

Having said all that, we are in unprecedented times. Some of our clients and areas in – for example, in our specialty lending areas are doing well for the time being. That's healthcare, construction and engineering, insurance. Some are more challenged like retail and hospitality, where we have a relatively limited exposure. But for the most part, these sentiments are reflected for the time being in our relatively normal course provision on impaired loans.

And I'll just end by saying, consistent with the credit discussion we've just had, we are actually seeing a fair bit of good growth even in the midst of what we're going through over the course of the last couple of months and the last couple of weeks, as deals in our pipeline are closing and our investments in additional people and capabilities are continuing to bring us new clients.

So, hopefully that gives you a little bit of color. I'll hand it over to Laura.

Laura L. Dottori-Attanasio, Senior Executive Vice-President and Group Head, Personal and Business Banking, Canada

Yeah. Thanks, Cap. Look, just having sat in the risk chair for so long, I did want to add in that that vintage of clients that you were referring to earlier with regards to mortgages, again having been in the risk chair when a lot of that origination happened, I can tell you that I did follow all of the vintages very closely and still continue to, given I sat in the chair when we did those adjudications and maybe it's just to reiterate what Shawn was alluding to.

But when we look at that vintage relative to the others, most important takeaway for you is that there aren't any differences in performance. And in fact, for some of the special programs that we did during that time like our foreign income programs, not only did they track, I would say, in line with that overall delinquency profile, but they have somewhat of a lower loan-to-value. So, nothing to be concerned about.

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

And the last thing I would...

Sohrab Movahedi, Analyst, BMO Capital Markets Corp. (Canada)

Excellent.

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

...just mention is, we're not seeing impairments coming through. You would have seen in the numbers a small uptick in the US commercial portfolio. So we're not seeing those issues now at this point – in this point of the cycle.

Sohrab Movahedi, Analyst, BMO Capital Markets Corp. (Canada)

Okay. Thank you. Congrats on getting that capital ratio back to top of the class.

Operator

Thank you.

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

Thank you.

Operator

The next question is from Doug Young from Desjardins Capital Markets. Please go ahead.

Doug Young, Analyst, Desjardins Capital Markets

Good morning. Shawn, just back on slide 19 bottom left when you talked about just the progression of the performing loan PCL, the CAD 122 million and the CAD 136 million. The CAD 136 million looks like it does include credit migration. I'm hoping you can just maybe break that out, I mean how much of that CAD 136 million relates to credit migration. And then talk about just the methodology and the thought process; and if you can quantify that credit migration that you're assuming in that number?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

Okay. So in terms of – we saw some credit migration over the course of the quarter. Most of that would have been in the oil and gas sector. Obviously, it's been under some stress in that period. In fact, from an impairment perspective, that's where essentially all of the capital markets' impairments came from this quarter. In terms of the composition of the CAD 136 million, it'd be less than CAD 100 million would be a function of credit migration.

It's still early in the cycle for at least – since the pandemic onset to see that migration coming through. Obviously, our provisions are reflecting our views about that, but we would expect that migration to be realized in coming quarters. So, hopefully that answers your question.

Doug Young, Analyst, Desjardins Capital Markets

Yeah. Sorry. This is just many banks in many days. But that migration that you're baking in here, that is just what you're seeing so far in the quarter, or are you anticipating some further migration in that number?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

Yeah. So, that was this quarters. And so, we would expect to see further credit migration over the coming quarters which is reflected to some degree, as you look at our provision build and what we're sort of looking out forward how we expect things to sort of materialize over coming quarters.

Doug Young, Analyst, Desjardins Capital Markets

Yeah. And then that minus CAD 122 million and positive CAD 136 million, that's just – essentially that's a management overlay to some degree. Is that the way to think or is there – or can you spike out how much of this increase is the management overlay?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

Sorry. Not the CAD 136 million; the CAD 136 million is parameters and actual experienced migration. The CAD 122 million is the net of all of the various adjustments that we made to reflect government support, bottom up analysis across various portfolios that we think are particularly impacted by COVID-19. So, that netted to that CAD 122 million number. But there was a decent amount of travel, positive and negative, to ultimately get to that number relative to sort of the original CAD 1.55 billion on the left side.

Doug Young, Analyst, Desjardins Capital Markets

And then just second, Hratch, the ability to add back the excess allowance over regulatory ECL and the CET1, that is new I take it because I didn't think you were able to do it before. So correct me if I'm wrong. And is that something that's temporary, or is that something that will – will it go away at some point in time in the future, or is that something that's permanent?

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Yeah. So, it is new. It was one of the changes announced by OSFI as we were sort of going through this. And I can't speak to its permanence, but it was introduced at this point in time as was sort of the drop in the buffer – the countercyclical buffer to enable banks to support clients. And so, that's its purpose as stated at this point. But I can't again speak to what happens in the future and what the regulators may do with that.

What I will speak to is, from our perspective, we are continuing to watch the portfolio migrations. And as I said, we do feel pretty strongly with that trajectory forward. So, that for us represented that sort of 10 basis points now, if you will, and sort of we do see – as we see those migration numbers that I reference with portfolio deterioration, part of it is that add back going away, and then going back to Sumit's question, right, you're starting to get into the territory of taking a deduction again.

But as I kind of said to Sumit, I wouldn't focus on all the noise and which of the driver that is underneath it. It's just as downgrades happen, RWAs will go up and the ECLs will go up. And both of those items together are

included in the 100 basis point-ish number for the wholesale book I gave you. And it is significantly lower than that if you get a one band on our entire retail portfolio on top of that.

So even with all of that combined, which I'm sure you can appreciate, is a very significant threat. And at that point, we would not be relying on any sort of add backs here. I think you would see our capital ratio well above that regulatory minimum.

Doug Young, Analyst, Desjardins Capital Markets

Perfect. And so, just the benefit from that add back is 10 basis points, is that...

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

That's correct.

Doug Young, Analyst, Desjardins Capital Markets

Yeah. Okay. Perfect. Thank you very much.

Operator

Thank you. The next question is from Mario Mendonca from TD Securities. Please go ahead.

Mario Mendonca, Analyst, TD Securities, Inc.

Good morning. Shawn, your opening comments sounded a little different from an answer you gave before. Maybe just help me understand what you're getting at. You said in your opening comments that you expected no material change in the performing loan allowance going forward; and then in response to one of the questions I think you said you expect no change in the total allowance going forward. Can you be more specific, which one are you referring to?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

So, we don't expect to add to our performing allowance going forward. If things play out the way we anticipate them to then this would be where the allowance level would be. And then you would migrate from Stage 1, Stage 2 into Stage 3 impaired over time as things play out. So we wouldn't expect, for instance, to take significant incremental provisions in coming quarters as a function of increasing our ECL. We believe we've reflected at least our current view in our CAD 3.3 billion in allowances.

Mario Mendonca, Analyst, TD Securities, Inc.

Yeah. That's clear. One other thing. I've struggled during this reporting season to understand the extent to which banks take into account migration or anticipated migration in establishing their PCLs, the performing loan PCLs. And what I'm getting at is, when a bank revises the unemployment number materially higher, by definition they have to assume there is migration into – like, there's got to be downgrades and there's got to be defaults. So, it just seems logical to me that migration has already contemplated when you change your forward-looking indicators. Am I not thinking about this correctly?

Shawn Beber, Senior Executive Vice-President and Chief Risk Officer

Yeah. So the way I think you should be thinking about it is, I talked about in my prepared remarks about the judgment we exercise in looking at a bottom-up analysis across various sectors in the portfolio. The analysis that was done there used a number of different tools, stress testing, et cetera, to get a view as to – because we

can't rewrite the book of real time at the end of the quarter, to get a view around, well, what would migration potentially look like and come up with a view around that to then determine some level of judgment overlay to add to the provision. So we've done that in the best way we can based on the understanding of the risks as we understand them today.

So, that's where you would see that anticipatory migration analysis come from, at least the way we've done it. The other element of the adjustments was all the government support which goes the other way, and we've – including – in that bottom-up analysis, as we thought about it, we also consider at least how that government support would play in that more bottom-up type analysis. But that's how we've come to our number. But what you don't see like there's no – you'll see it from a capital model perspective other than the impact of the PCL, the migration in terms of RWA will happen over time in the future based on the experience.

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Yeah. So maybe, Mario, I'll jump in with the accounting side a little bit. So, you're right in that IFRS 9 basically requires us to determine, right, how much of the portfolio is Stage 1, how much has significant to credit deterioration, so at Stage 2, and then a whole one year or a lifetime as appropriate for each of those. So, to do that you have to have a good view of what's in Stage 1 and what's in Stage 2 today.

And that's where Shawn described all the analysis that we did to do that because we couldn't take, for example, the larger portfolios like commercial and so forth and one by one re-rate every client in the quarter. But the analysis that team did on the risk side really estimated that for what we think would have been migrated and that's captured in our overlays. And the models capture some of that future migration particular on the retail side driven by SLIs. But on the commercial corporate side, it really captures where we think the book would have been as of this quarter.

Mario Mendonca, Analyst, TD Securities, Inc.

Yeah. I think that took me a long way toward understanding it. Thank you.

Operator

Thank you. The next question is from Darko Mihelic from RBC Capital Markets. Please go ahead.

Darko Mihelic, Analyst, RBC Capital Markets

Hi. Thank you. Thank you for extending the call to actually get to my question. I promise it's an easy one. Quarter-over-quarter it looks like your credit risk, RWA, increased at least of the big six banks. And I'll just oppose this against TD which reported today as well. Your credit risk RWAs is up 4% quarter-over-quarter and TDs is up 10%. Now, one of the things that I know in your capital supplemental, this is on page 5, is you guys use some sort of client relief and government support programs to mitigate the increase in RWA; and TD makes no mention of that. So, I wonder how much did that helped you contain the RWA this quarter, if you can quantify that.

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Hi, Darko. It's Hratch. Good morning and you're welcome on extending the call. So, I think you're referring to the capital page, as you said, page 5 in the pillar 3 pack. I want to make it very clear that we did not get any capital benefit from the programs. And so, whether it's the deferrals that we provided or the government programs, we did not – we followed the guidance on both of those. And so, whether you look at our provision

that Shawn spoke about or you look at the capital and RWA sort of impact to that, we did not take any benefit from that.

And so, what you're seeing, if you're referring to some of the changes here, there was some changes that went to the negative side on credit quality as some of the migrations happened that Shawn mentioned, and you see that that 9.05% number there on asset quality, that's netted off. Against that, there is a number of sort of improvements on the retail side, mainly utilization. So what you actually saw is utilization rates dropped. As Laura referenced earlier, just the way the capital models work, that provide some credit benefit which netted off against the corporate commercial that went the other way.

But what you see here is that migrations that may have happened in terms of the delinquency buckets were sort of frozen, as was the guidance provided by OSFI on this. But that doesn't necessarily mean that there was capital benefit derived from that. And as Laura mentioned, a lot of those clients, particularly on the retail side, are still making payments and are de-levering which is providing a bit of a positive from a capital calculation perspective.

But as that portfolio comes out and starts, so either back to payments or if it does deteriorate then we expect there'll be sum of both, right, as there is for the portfolio that hasn't gotten any accommodation. Some people will face challenges through this crisis and some won't, but all of that will get reflected as we experience it.

Darko Mihelic, Analyst, RBC Capital Markets

I guess what I'm confused by is, it says here in Q2 2020, credit migrations were mitigated by CIBC client relief and government support programs. So, I don't understand – I mean, the verbiage seems to suggest that there was mitigation. But you're suggesting that there wasn't? Is that how I should read into that?

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Yeah. So Darko, what that would have done is, that refers to, had we not provided that relief maybe some folks would have had some cash flow trouble and they would have moved down delinquency buckets and then similar with some businesses. But what we've done is, we have frozen the status – and again, this was the guidance provided, so we had sort of largely frozen the status of folks where they were. And we have not assumed just – essentially what we've done, right, not assumed just because they have elected to take the payment holiday that that means that they cannot make payments and their credit has deteriorated.

But we have looked at all of the other factors that would have potentially driven deterioration. So on the retail side, credit scores, utilizations, all of that stuff that service still goes into the models and it gets calculated. And so, it goes on the provision, again, I'll state that because it is important. So thank you for bringing it up.

Provisions and capital, we were very deliberate as per the guidance if a company or an individual would have deteriorated regardless of deferral or no deferral, we would have reflected that. And if they took it to defer a loan, we are not going to assume they deteriorated; we're going to look at the underlying credit quality.

Darko Mihelic, Analyst, RBC Capital Markets

Okay. All right. Thank you. So it's possible that other banks are also doing it. They just haven't explicitly printed that into their supp-packs. I guess, it's another way to think of this as well, right?

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

I don’t really know the answer to that, Darko.

Darko Mihelic, Analyst, RBC Capital Markets

Yeah. I'm just trying to understand why your credit risk RWA is simply – I mean it's an understatement to say that quarter-over-quarter the world changed. And we're seeing significant credit risk RWA inflation, but yours is just so small relative to everybody else. So that's why I was curious.

Hratch Panossian, Senior Executive Vice-President and Chief Financial Officer

Yeah. Again, I don't want to speak to the other banks, Darko, but from what I remember glancing through some of the supp-packs there was, if you look at the credit quality, some folks actually saw a net credit quality improvement in their CET1 ratios and RWA reduction. We saw net deterioration, right? So, that was a 5-basis point drag to CET1 and that's that 9.05% you see here on a net basis.

Darko Mihelic, Analyst, RBC Capital Markets

Yeah. Okay. Thanks very much. Very helpful.

Operator

Thank you. There are no further questions at this time. I'll turn the call back over to you, Victor.

Victor G. Dodig, President and Chief Executive Officer

Thank you, operator; and thank you, all of you, for your very detailed questions. Before we end this call, I wanted to thank our incredible CIBC team. Thank you for your dedication and relentless focus on helping our clients achieve their ambitions during these very difficult times. Our immediate focus has been on providing our clients with the relief they need to deal with the short-term impacts of the pandemic, and I think we made that very clear both in the remarks as well as the answers to your questions.

We're committed to standing with our clients and the communities we serve throughout this recovery phase. We know it'll take time and resolve to get our economy and our clients back on their feet. We as a bank have risen to the challenge, and we're going to continue to do so as we fully support our clients in what I know will be an economic recovery ahead of us. So thank you and take care, everyone.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time. And thank you for your participation.