CIBC Q4 2019 Earnings Conference Call

Dec 5, 2019

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Management Discussion Section

Operator

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

I would now 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 & Enterprise Transformation

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. Laura Dottori-Attanasio, our Chief Risk Officer, will close our prepared remarks with the risk management update.

We're also joined in the room by CIBC's business leaders, including Mike Capatides, Harry Culham, Jon Hountalas and Christina Kramer. 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 Dodig, President, Chief Executive Officer

Thank you Geoff and good morning everyone. This morning CIBC reported fourth quarter adjusted earnings of CAD 1.3 billion. Our core businesses delivered pre-provision earnings growth of 4%. However a higher provision for credit losses this quarter affected our bottom line results.

On a full-year basis, we recorded pre-provision earnings of CAD 8.1 billion, up 5% from last year. While provisions have increased, we remain confident in the quality of our loan portfolio going forward. Laura will provide further context on our credit portfolio in her comments. More broadly, we concluded the year with a strong capital position of 11.6%. This provides us with the flexibility to invest in our core businesses for long-term growth, as well as return capital to our shareholders.

We leverage this capital strength by repurchasing 1 million common shares and increasing our common shares and increasing quarterly dividend payment by 5%. We continue to make progress in delivering a modern relationship banking value proposition for our clients, and we remain focused on four key levers: building a strong, client-focused franchise; diversifying and accelerating our earnings growth; optimizing our operational efficiency; and maintaining capital and balance sheet discipline. In 2019, we made steady progress on all of these levers and furthered our capabilities as a bank that can compete and win where it matters most on the strength and quality of our client relationships.

In Personal and Small Business Banking, volume growth and higher margins drove a modest improvement in pre-provision earnings. While our 2019 financial performance did not meet our expectations, our ongoing focus on investing in our people and technology and deepening client relationships will have a positive impact on our growth going forward.

We're pleased with the key indicators that a long-term strategy to modernize and transform our business is working. We continue to earn recognition as a leader in mobile and online banking. We've significantly improved our client experience scores and the J.D. Power Retail Banking Study and Ipsos Customer Service Index. Our credit card portfolio is market leading and well-positioned for growth, providing value and choice to our clients. We have seen strong results from our Aventura card lineup, and we continue to innovate with new features like Pace It, which allows CIBC clients to make installment payments on larger purchases at a lower rate of interest.

We have modernized our banking center network with more than 200 locations across Canada, now transformed to emphasize advice-based conversations with our clients, while leveraging technology to manage routine transactions. And we have invested in better meeting the needs of entrepreneurs, including the launch of CIBC Smart Banking for Business. A first of its kind banking platform in Canada designed to help businesses integrate their banking, accounting and payroll functionality.

Our Canadian Commercial Banking and Wealth Management business delivered strong and balanced growth in both loans and deposits, driven by the addition of talent to help meet the unique needs of our diverse clients as well as building on opportunities across our bank on both sides of the border. Our team is delivering growth through referrals, something we're able to do because we're building a highly connected team, culture and platform made for this purpose, making us more agile in how we collaborate across our bank to earn our clients full relationship.

Within Wealth Management, our clients have embraced our competitively positioned CIBC Smart Investment Solutions, a portfolio that blends active and passive investment strategies which generated net sales of CAD 1.7 billion, enabling us to attract long-term investment dollars, while supporting earnings growth.

In the US, we reported very strong earnings growth of 22%, driven by strong connectivity across teams and borders. We achieved a significant milestone early in the year with The Private Bank acquisition becoming accretive to earnings well ahead of expectations, further validating the strategic and financial benefits of our investment. We're growing our US business through a combination of deepening existing relationships in verticals we know well and by selectively entering new markets. We now have offices in 27 US cities and we're building momentum in banking the private economy.

We also continue to extend our US Private Wealth Management capabilities with the recent acquisition of Lowenhaupt Global Advisors, a leading family office in St. Louis in New York. With this acquisition and our ongoing client development efforts, we grew assets under administration by more than 12% this year.

In our Capital Markets business, we delivered solid underlying results with pre-provision earnings in line with a strong fiscal 2018, despite a slower issuance market. The resilience of our performance reflects the strength of our client relationships as CIBC ranked number 1 and number 2 for the year in equity and corporate debt underwriting, respectively. We also continue to hold leadership positions in syndicated loan, advisory services, equity trading as well as commodities and foreign exchange.

This year, we also committed to CAD 150 billion in environmental and sustainable financing by 2027, underscoring our focus on enabling sustainable growth and helping make Canada and North America global leaders in environmental stewardship. In the US, we expanded our Chicago team and completed the acquisition of Cleary Gull, which added to our investment banking capabilities to serve middle-market clients.

Post quarter end, we announced an agreement to sell a significant portion of our stake in CIBC FirstCaribbean to GMP Financial Group, for approximately $800 million, while retaining a 24.9% stake in the business upon closing. With this transaction, we expect to improve CIBC's common Tier 1 equity capital ratio by over 40 basis points on closing and free up capital to reinvest in our core businesses.

Looking ahead to 2020, rate cuts, rate uncertainty and a global economic slowdown are driving moderate GDP growth expectations of under 2% for the North American economy. Against this backdrop, we expect to see low digit single earnings growth next year.

In Personal and Small Business Banking, we're encouraged by the signs of progress we're taking hold in our business results. Looking forward, we will continue to lead with advice to help our clients achieve their ambitions. We'll add mortgage advisors to support more conversations with clients about homeownership, and we'll build on our strengthening cards with a continued focus on our Aventura portfolio and our participation in Air Canada's new loyalty program in 2020.

In our Canadian Commercial Banking and Wealth Management platform, we will build on our momentum from 2019, as we continue to grow a strong private economy bank that focuses on making our clients' ambitions a reality. Our US Commercial and Wealth business will continue to capitalize on organic growth opportunities to deepen relationships in our core markets in the year ahead and build out our presence in new markets that we've entered. And in Capital Markets, we will continue to accelerate revenue growth through increased connectivity across our bank in both Canada and the US. Core business performance has been strong in Capital Markets and we expect that to continue in fiscal 2020.

Across CIBC, we will continue to simplify and streamline our operations, optimizing our efficiency, and changing our cost structure. This will enable us to make strategic investments in tools, talent and technology that will support our growth. We will focus on deploying our capital to organic growth opportunities across our businesses as well as returning capital to our shareholders in the form of dividend increases in line with earnings growth and share repurchases.

Now with that, let me turn the call over to our CFO, Hratch Panossian, to review our financial results in greater detail. Over to you.

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Thank you Victor and good morning everyone. My presentation will refer to the slides that are posted on our website starting with slide 6.

This morning, we reported earnings of CAD 1.2 billion and diluted earnings per share of CAD 2.58 for the fourth quarter of 2019. Adjusting for items of note detailed in the Appendix of this presentation, net income for the quarter was CAD 1.3 billion, and earnings per share of CAD 2.84 was down 5% year-over-year. Overall, our pre-provision earnings growth of 4% was more than offset by increased provision for credit losses in the quarter.

Revenues of CAD 4.7 billion were up 4% year-over-year reflecting solid margin and volume growth across our client franchise. Expenses grew in line with revenues as we continue to balance strategic investments across our bank with prudent expense management. Provision for credit losses of CAD 402 million was up sequentially and compared with the prior year. Laura will speak to this in more detail in her remarks.

Turning to slide 7, our capital position strengthened to 11.6% in the quarter, up from the 11.4% last quarter and comfortably above our target range. Including the impact of the announced reduction in our stake in CIBC FirstCaribbean, our pro forma CET1 ratio was approximately 12%. Internal capital generation of 27 basis points this quarter was partially offset by the impact of higher risk-weighted assets, due to strong organic growth, model updates and the impact of share buybacks. RWA has increased by CAD 3 billion in the quarter, reflecting largely credit growth across portfolios in our business partly offset by a decrease in market risks in our Capital Markets business.

This quarter, we also bought back 1 million common shares as part of our ongoing normal course issuer bid, which had an impact of 5 basis points on CET1. Going forward, we expect continued balance sheet strength, but anticipate quarterly CET1 increases to be more modest than what we experienced this quarter, as we grow our business organically and return capital to shareholders at a more accelerated pace. The balance of my presentation will be focused on adjusted results which excludes items of note.

Let me now turn to the performance of our business units starting on slide 8. Slide 8 reflects our Personal and Small Business Banking results, where we continued to see improved growth in funds managed and return to quarter-over-quarter growth in residential and secured lending balances. Net income of CAD 603 million was down 10% from last year as continued investments in the business outpaced revenue growth and we experienced higher provision for credit losses.

Revenue of CAD 2.2 billion increased 1% year-over-year driven by underlying NII growth of 3% as a result of expanded margins and deposit volume growth, partially offset by lower fee income. Net interest margin was 253 basis points in the quarter, down 2 basis points sequentially due to competitive pricing, but up 8 basis points from last year primarily due to the benefit of favorable rates.

Non-interest expenses of CAD 1.2 billion were up 5% from the prior year, as we continued to invest in modernizing our bank's infrastructure, distribution channels and products. As we've noted before, while there are some quarterly volatility and expenses due to timing of initiatives, our full-year expense growth for the segment of 3% is in line with our previous guidance.

Slide 9 shows the results of our Canadian Commercial Banking and Wealth Management business. Net income for the quarter was CAD 307 million, down 8% from a year ago due to a CAD 73 million increase in provision for credit losses, primarily due to one notable impairment. We continued to see strong operating growth in this business. Pre-provision earnings were up 7% from a year-ago, driven by revenue growth of 4% against the 2% increase in non-interest expenses primarily associated with strategic initiatives including our continued hiring and client facing roles.

Commercial Banking revenues were up 8% as we continued to gain share on both sides of the balance sheet with particular strength in deposits. Deposit and lending balances were up 14% and 12% respectively from the same period last year.

Wealth Management revenues were up 2% primarily driven by strong volume growth in our private banking business and higher fee-based assets in our brokerage business. AUM balances grew 11% year-over-year from growth in our mutual fund and institutional businesses, while AUA balances grew 7%. Net interest margin remained relatively stable in this business at 310 basis points, down 1 basis point year-over-year and 2 basis points sequentially, driven in part by unfavorable rates and modest pricing compression in the Commercial Banking Business.

Slide 10 shows the results of our US Commercial Banking and Wealth Management business. Net income for the quarter was CAD 191 million, up CAD 52 million or 37% from the year prior. In addition to pre-provision earnings growth of 14%, the business benefited from particularly strong credit performance this quarter, which resulted in a CAD 23 million reduction in provision for credit losses over the prior years. Revenues were up 11% from the prior year, driven by double-digit volume growth and higher asset management fees, more than offsetting the impact of lower interest rates.

Average loans grew $4.3 billion or 18% from a year ago, reflecting our continued momentum in client development. The growth in loans was driven by increases in both the Commercial Real Estate and C&I portfolios, while the Institutional Real Estate portfolio continues to remain relatively flat. Average deposits grew $3.9 billion, or 21% from a year ago, reflecting strong organic growth from new clients and other deposit initiatives. Net interest margin was 293 basis points, down 25 basis points sequentially and 31 basis points from a year ago.

As noted last quarter, our NIM benefited from certain nonrecurring items, which contributed 7 basis points to our Q3 margin. The balance of the decrease quarter-over-quarter was largely due to the impact of falling rates related to the three recent Fed cuts.

We also continue to grow our US Private Wealth business. AUM was up 15% over the prior year, driven by organic growth helped by tighter integration with our Commercial and Private Banking businesses. Non-interest expenses increased 8% from the prior year, reflecting continued but moderating investments in head count, infrastructure and marketing expenses to support growth. As with last year, we anticipated a seasonal expense increase in Q1 related to the accrual of incentive and benefit costs, but expect full year expense growth in 2020 to come in below the levels we experienced for this past year.

Turning to Capital Markets on slide 11, net income of CAD 226 million for the quarter was down CAD 7 million, or 3%, from a year ago as pre-provision earnings growth of 19% was offset by CAD 49 million higher provision for credit losses. Revenues this quarter were CAD 735 million, up CAD 86 million or 13% from the prior year. This reflects strong performance across the business with higher trading activity broadly across all products, strategic growth in Corporate Banking and higher underwriting activity.

Our differentiated Capital Markets business continues to generate strong returns and stable revenues supported by our growth momentum in the US and our growing revenue streams from its connectivity with our other business units. Noninterest expenses of CAD 386 million were up CAD 30 million, or 8% from a year ago, primarily driven by higher performance-related compensation and higher spend on growth and enterprise initiatives.

Finally, slide 12 reflects the results of the Corporate and Other business units. Net loss for the quarter was CAD 18 million compared with a loss of CAD 11 million for the prior year. These results reflect strong performance in FCIB and disciplined expense management balanced against our ongoing investment in enterprise-wide strategic initiatives. We anticipate the announced sale of a portion of our stake in FCIB to close in the second half of 2020, and we will continue to recognize income from the FCIB in the normal course until then.

Let me now turn to slide 13, which summarizes our full-year 2019 results. On a full-year basis, net income of CAD 5.4 billion and earnings per share of CAD 11.92 were both down 2% year-over-year. A record pre-provision earnings of CAD 8.1 billion, were up 5% from the prior year, underpinned by revenue growth across each of our businesses and positive operating leverage. We maintained a return of equity of 15.4% for the year, ahead of our 15% target and we finished the year with a strong balance sheet and CET1 ratio of 11.6%.

Heading into fiscal 2020, we remain confident in our ability to continue delivering value to our clients, and we are well-positioned to build momentum and earnings growth through 2020. And with that, I will turn the call over to Laura.

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Right. Thank you Hratch and good morning. So let me start with the review of our credit performance in the fourth quarter.

Turning to slide 15, provisions for impaired loans increased to CAD 330 million, representing a provision rate of 33 basis points. This increase was driven mainly by our business and government portfolios and was largely as a result of one fraud-related impairment that amounted to CAD 52 million in our Canadian Commercial Bank. Our provisions on performing increased to CAD 72 million this quarter. CAD 40 million of the move relates to changes in our forward-looking indicators, including our scenario weightings which were adjusted towards the downside. The remainder of the increase is related to credit migration mainly in our business and government portfolios.

The next slide provides an overview of our gross impaired loans, which increased to 47 basis points. The increase was mostly driven by our business and government loans as I mentioned earlier. Slide 17 shows the net write-off rates of our Canadian consumer portfolios. The increase in net write-offs over the course of fiscal 2019 was primarily driven by our unsecured lines of credit. Notwithstanding the slight increase, write-offs continued to perform within our risk tolerance and in line with consumer insolvency trends that we are seeing in Canada.

Slide 18 provides the 90-plus day delinquency rates of our Canadian consumer portfolios. Our delinquency rates have moved up this past quarter. The increase is mainly in insured mortgages and secured lines of credit within personal lending that have conservative collateral coverage. As such, we do not expect them to translate into notable losses. Increases are primarily from the Alberta region which is experiencing more challenging economic conditions and higher unemployment rates.

Page 19 summarizes our credit performance on a full-year basis. Our key metrics such as write-off, delinquency rates and loan impairment continue to remain well within our risk appetite. Provisions on impaired loans ended the year within expectation at 29 basis points and that's despite some distinct impairments during 2019. When we account for this, I would expect our provisions on impaired loans to remain relatively flat in 2020, when compared with 2019.

And with regards to provisions on performing loans, they migrated higher this year primarily as a result of changes to our forward-looking indicators and scenario weights. More specifically, we slightly shifted the scenario weighting to the downside along with the more temperate outlook for unemployment and WTI prices. That said, to the extent our economic outlook remains stable, we would expect moves and provisions on performing to be more modest in 2020 than they were in 2019.

To conclude, we continue to have solid underwriting standards and credit policies, a strong team of experts along with a proactive management of accounts, and I continue to have a strong degree of comfort with the quality and resiliency of our credit portfolios and with our credit outlook for 2020.

With that, I'll turn the call back to the operator for questions.

Question and Answer Section

Operator

Thank you. The first question is from Gabriel Dechaine with National Bank Financial. Please go ahead.

Gabriel Dechaine, Analyst, National Bank Financial

Hi. Good morning. Just want to ask first about the US margin, you mentioned the three Fed rate hikes. Is there any reason why the drop was sharper this quarter than it was in Q3? Is it just a lagged effect, just jumped out at me? And then sorry, where do you expect that to be in Q1 in 2020?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Yeah. Thanks. Thank you, Gabriel. It's Hratch. So, addressing the NIM in the quarter, I think first starting with the 7 basis points onetime help that we had in the Q3 quarter, so I think that creates a bit of noise. And then in this quarter, I would say, we have a couple of basis points of onetime negatives. So those things combined I think skewed the quarter-over-quarter picture a little bit.

So, I think for the rest of it as you look at the combined margin change over the latter half that represents the bulk of the impact in our business due to the recent changes in yield curve and the Fed cuts. And the reason it presents that way with the bulk in the quarter is really the pricing dynamic of our book. And so, as our assets are repriced with LIBOR and we continue to reprice our deposits on a negotiated basis with clients, that effort is still underway.

Despite the pressure on NIM though, I'll note NII was up 7% year-over-year this quarter, due to our strong volume growth.

Gabriel Dechaine, Analyst, National Bank Financial

Yeah.

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

And in terms of looking at that forward, we do largely anticipate it stabilizing here, given where LIBOR is at this point, maybe a slight downward pressure from here, but largely stabilizing. And with that, we feel confident between the stabilizing margin and the continued growth in volume that we'll continue to see good NII growth.

Gabriel Dechaine, Analyst, National Bank Financial

So a couple basis points down over the next few quarters?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Yeah. I'd say something in that neighborhood. Generally flat.

Gabriel Dechaine, Analyst, National Bank Financial

Okay. Then on the credit, I just want to better understand the guidance, Laura that you were giving. A full-year loss on impaired loans, loss rate on impaired loans was 29 basis points. So are you saying you're expecting that to be stable in 2020? I keep hearing the word normalization from banks and I'm just wondering if that means now we're actually going to move higher.

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

So, yes. What I did say is that when we account for the unusual items that took place during 2019, that I do expect our provisions on impaired loans to remain flat when I compare them to 2019. So, thinking out to 2020. So there would be some if you will normalization in the numbers. So increased impairs but offset by some of the one-off items such that we remain flat or expected to remain flat on a year-over-year basis.

Gabriel Dechaine, Analyst, National Bank Financial

Okay. And then just last one. How does – like this trend of higher provision is going to – you talked about a lot. How does it affect your risk appetite? I'm thinking about cards, which you know is a battleground and that's only going to intensify to the midpoint of 2020. Unsecured personal lending has been a growth area for a few banks the last number of years. How does all of this change your appetite looking forward?

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Well, it doesn't change our appetite when we look forward. As I mentioned in my prepared remarks, we continue to have strong underwriting standards that will continue to apply and we're very proactive in terms of how we manage our account base. And while we are seeing some rise in our delinquency numbers and write-offs all within risk appetite. As I said, we're seeing some increases in insolvencies across Canada, some softness in Alberta, but nothing of concern. And I think that's why you're hearing everyone talk about the term of normalization if you will. Recall we've come off of some really low loan losses in history. And I think this is just a bit of a return to normal. So, don't see anything of concern.

Gabriel Dechaine, Analyst, National Bank Financial

Thank you for that.

Operator

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

Scott Chan, Analyst, Canaccord Genuity Corp.

Good morning. Could you remind me how much the annual impact is on first quarter being on an annualized basis and in fact it is factored into your fiscal 2020 EPS guidance of low single digits?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Yeah. Thanks. It's Hratch. I'll take that. So, we see a CIB impact as more of a later 2020 and 2021 impact, so it's not in the numbers that we're speaking of. And as we've mentioned before, we expect that transaction to close somewhere towards the end of the year, depending on the regulatory processes. So it's not a 2020 impact.

For 2021 going forward, the way we would think about it is that we see the impact of the reduction in earnings that we realize off of our FCIB position, netted off against some income we have from the loan. And then in terms of the net of that, we haven't talked about the specific numbers, but generally when we do the math, the capital that we'll be freeing up in the transaction, if deployed towards the buyback programs and net-net we think that generally neutralizes the impact to EPS, so that's the way we would guide to it.

Scott Chan, Analyst, Canaccord Genuity Corp.

Okay. And just on the Canadian Personal and Small Business Banking side, I saw that premium was up 8 bps year-over-year, but I didn't see the sequential number. I don't know if you have that and perhaps an outlook on that – on the margin for that in fiscal 2020?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Yeah, sure. So the sequential was down 2 basis points on the Canadian PSBB business. And that really was the net of some pressure on margins on certain products as we got into Q4, but still some continued momentum from favorable rates on the repricing of our tractors. And so, going forward at this point with our expectation and what seems to be generally in line with market's expectation for rates in Canada, it's looking like stable with maybe slight negative margin pressure in that business, but generally a full-year 2019 to full-year 2020 in the same neighborhood.

Scott Chan, Analyst, Canaccord Genuity Corp.

Okay. Thank you very much.

Operator

Thank you. The next question is from with Eight Capital. Please go ahead.

Steve Theriault, Analyst, Eight Capital

Thanks very much. I want to ask a question on mortgages for Christina. Christina, can you talk about your outlook for mortgage growth in 2020, and specifically do you have a better sense of when you get back to market levels of growth seeing some improvement this quarter here?

Christina Kramer, Senior Executive Vice-President and Group Head, Personal and Small Business Banking, Canada

Thank you, Steve. While we have some more work to do to get back to market level growth. We're pleased with what we're seeing and what we're delivering in the market, so we expect improvement in our performance. As you may be aware, this quarter we saw growth as Hratch mentioned and that growth came across our banking centers and our mobile mortgage advisor teams, and that comes after a period of flat growth, the quarter prior and several quarters of decline prior to that. We see continued strong retention rates and our pipeline remains improved on a year-over-year basis. So with all of that, we expect that market growth we will improve our growth rates and it may take some time as we get to market level growth rates.

Steve Theriault, Analyst, Eight Capital

Is that foreseeable in 2020 or is it difficult to say at this stage?

Christina Kramer, Senior Executive Vice-President and Group Head, Personal and Small Business Banking, Canada

It's difficult to say, but our objective is to continue to improve. And based on what we're seeing, we're confident that we will see that.

Steve Theriault, Analyst, Eight Capital

Okay. Thanks for that. And I had one quick question. Just about one of the unusual, the interest income settlement on tax matters, wondering if is that related to the CRE reassessments of the total return swap activity from a few years back? Can you help me with that Hratch?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Sorry about that. Can you repeat the questions?

Steve Theriault, Analyst, Eight Capital

One of the unusuals this quarter was, it was called interest income settlement on certain tax matters. I was wondering if that's linked back to the CRE's reassessment of some of the total return swap activities that was going on...

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Yeah. No. So a portion of that was related to the Enron settlement, that we had announced and then a few other pieces, but nothing to do with that other file.

Steve Theriault, Analyst, Eight Capital

And also the increase in legal provisions? Was that related at all to the provision in the Canadian Bank or is that something else?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

So, we won't speak to specifically the matters underlying that or some ongoing legal matters that were provision for before and this is an increase to that provision.

Steve Theriault, Analyst, Eight Capital

Okay. Thank you.

Operator

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

Meny Grauman, Analyst, Cormark Securities, Inc.

Hi. Good morning. It's come up before, but definitely relevant today. Just trying to get a better sense of how to forecast provisions on performing loans and specifically the forward-looking indicators and I ask it specifically because I mean I don't think we've seen any other updates to this quarter from other banks and I appreciate you can't speak to peers, but it stands out from that perspective, and also just given even the Bank of Canada's statement yesterday. So I'm just wondering if you could give us anymore guidance here?

How much leeway do you have when you're making these kinds of updates? Was this an update that could have been made? Like – can you defer it to a quarter or two? How does those mechanics work? And is there anything that you can point to give us a better sense of when these types of adjustments are going to be made?

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Sure Meny. It's Laura. So, I'll take that one. So a lot of it – again hard to compare all of the banks, but it really depends on where our starting point was back when we first implemented IFRS 9. And so from there, really it's formulaic in that every quarter we have an economic outlook that gets updated and that's what tends to drive a portion of this number. So for us this quarter, the biggest impact with the FLI as I've mentioned in my prepared remarks was around the forward-looking indicators, and the scenario weights.

So, essentially what we did is, we increased the probability weight to the downside scenario, and equally decreased the weight of the upside scenario. And so from an economic outlook perspective, that was to reflect increased uncertainty in the macro environment. So that change if you will accounted for about half of the move. The rest of it came from revised forecast to certain factors as I mentioned, one of those was unemployment and the other one was WTI. So, again it's really how we update our economic outlook on a quarterly basis. So hopefully that clarifies, and as I said in my prepared remarks, when we look forward into 2020, so to the extent our economic outlook remains stable, we'd expect that the provisions on performing would come in at a more modest level than they have this year.

Does that help you?

Meny Grauman, Analyst, Cormark Securities, Inc.

Yeah. I mean – I guess, it seems like very small changes in sort of economic outlooks lead to relatively large changes in updates to the forward-looking indicators when it comes to performing loans. Is that correct? Like is there – the sensitivities is would you say is relatively high to small changes? That's what it seems is going on.

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Yeah. That's right. And I think as we've always talked about IFRS 9 with that comes volatility that you'd expect to see on a quarter-over-quarter basis. Now, we do always have the ability to overlay our expert credit judgment, which we do on occasion, but for a lot smaller amounts for us here at CIBC, this is primarily formulaic driven.

Meny Grauman, Analyst, Cormark Securities, Inc.

Thank you.

Operator

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

Mario Mendonca, Analyst, TD Securities, Inc.

Good morning. Just one sort of detailed question first. The net interest income in the Corporate segment, it seems elevated. Now, I understand that a big portion of that, Hratch, is the CAD 67 million interest settlement. But even adjusting for that, it does look somewhat elevated. My suspicion is that that's offset somewhere else perhaps in other revenue or non-interest income? Can you help me think through that? Is that the right way to look at it?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Yeah. Thanks, Mario. So you're right in that large part of that NII is related to that CAD 67 million of interest income. Outside of that I would say we have the – continued performance of FCIB, as well as within Treasury we had some good performance this quarter that would drive that. But generally, no other specific items to point out there.

Mario Mendonca, Analyst, TD Securities, Inc.

And so there is no natural offset there like in non-interest income being maybe a little light in that division. Is there any sort of logical offset or is it just good treasury performance this quarter that you'd highlight for us?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

No, not really. I think it's those factors of those key pieces of NII being – performing well.

Mario Mendonca, Analyst, TD Securities, Inc.

Okay. And then just broadly on expenses. I thought I heard you say something to the effect of expense growth should be lower in 2020 than it was in 2019. Now, you may have been referring specifically to a segment. So if it was a segment, could you offer a more broad outlook on expense growth in 2020?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Yeah. Sure. And that comment was specific to the US business, Mario. As we've continued to invest in that business. Mike has talked about that in the past, both in terms of the back end capabilities as well as the front line. So any particularly more color on that, I'll let Mike take it if you want. In terms of total bank guidance, the back half of the year, we've been guiding to that 4% or 5% range and that's where we've been. And our goal overall is to manage the business over the long-term for positive operating leverage and improved efficiency over time.

So we're pleased to have done that both in Q4 as well as full year this year. Going forward, we think as we're seeing currently the revenue environment and the expenses that drives as well as the investments that we will continue to make. We think that half is still the right range to target for 2020. And again long term, we're managing positive operating leverage here and there'll be some quarterly volatility in that and you may have some negative operating leverage. But we think at this point with the revenue we're seeing, that's the right expense level for us.

Mario Mendonca, Analyst, TD Securities, Inc.

4% to 5% then. Thank you for that.

Operator

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

Doug Young, Analyst, Desjardins Capital Markets

Hi. Good morning. Just back to you, Laura, just on the credit side. When you gave your guidance for impaired loans of being – PCL rate being flat year-over-year you talked about – yeah, excluding unusual items. Can you talk a bit about what you define as being some of the unusual credit items that came through in fiscal 2019?

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Yeah. For myself the more unusual items would have been those that we mentioned that took place this quarter. So items that are really not representative, if you will of the strength of the overall loan books. The unusual items we had this year that would have gone straight to stage 3 and not transited sort of through the stage 2 provisioning.

Doug Young, Analyst, Desjardins Capital Markets

And that would have been the fraud in Canadian Commercial and that was the CAD 52 million I believe in PCL, is that correct?

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

That's right. And you'll recall, we spoke of one in the utility sector earlier on in the year. So those would form, if you will, the bulk of what I see is isolated events.

Doug Young, Analyst, Desjardins Capital Markets

Okay. And then your performing loan PCL for the year was about 4 basis points. But you're essentially saying between, yeah, it's going to be less than that essentially is what you're anticipating, absent any changes or looking indicators or your models and scenario weights essentially.

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

That's right.

Doug Young, Analyst, Desjardins Capital Markets

Okay. And then, Victor, you mentioned in your comments change of cost structure and I don't want to take it out of context. But what I'd like to know is, do you think big changes need to be made to your cost structure? And if so – do you anticipate having to take a restructuring charge to reset your cost structure?

Victor Dodig, President, Chief Executive Officer

So, Doug, good morning. It's a good question. I think it's important to kind of provide broader context on our cost transformation over the years. If you look at the last couple of years, we've made progress on simplifying our bank and improving efficiency in a number of ways. And we use that through a combination of restructuring charges in 2016, and importantly normal course efficiency gains and with that focus on cost transformation. Our mix ratio had improved from where it was in 2016 at 58% to 55.6% today. Our goal was to get to 55%, some of the revenue softness that we had got in the way. So, we're at 55.6% and we're fairly pleased with those results.

As we go forward, we'll continue down the same path. And we believe we have further opportunities to simplify our operations and create efficiency. And while we prefer to execute this gradually over the normal course, we continue to review all our options. And that could potentially require a charge down the line in order to accelerate our progress. We've got a target of 52% by 2022. That was based on the old revenue environment. I think a more realistic mix target for 2022 based on the macroeconomic factors that we see out there is in the 53.5% to 54% range and we need to work diligently to get there.

Doug Young, Analyst, Desjardins Capital Markets

So not relating to that, what would be the pivot point where you think some drastic change has to be made? Is that just what the revenue environment is just not turning the way that you anticipate? Is there any sense that you can give us?

Victor Dodig, President, Chief Executive Officer

I won't look at it as pivot points, Doug. We kind of look at it as an ongoing transformation and we're sort of halfway through the cost transformation at CIBC. We've made really good progress and there's more progress to make.

Doug Young, Analyst, Desjardins Capital Markets

Okay. Thank you very much.

Operator

Thank you. The next question is from Sumit Malhotra with Scotia Capital. Please go ahead.

Sumit Malhotra, Analyst, Scotiabank Global Banking and Markets

Thanks. Good morning. I want to just start with Laura and a couple of things with credit. On the Canadian Commercial fraud situation, looking at your all bank numbers here, your charge-offs weren't really that different than they've been running out here, I've got a lot of paper on my desk. So I think it was in the neighborhood of $234 million a quarter. So is your provision for this situation – is it resolved that this is something that you're not going to collect or is there any possibility this comes back? Because obviously there's a big delta between what you provision and what you charged off in Q4.

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Yeah. Hi, Sumit. You're right. The provision level can always change over time because it really depends on how the situation evolves. At this point in time, we're provisioned at 49 cents on the dollar. I think we're adequately provisioned at this point in time. But the story will play out. But at this point in time, it feels like we're adequately provisioned.

Sumit Malhotra, Analyst, Scotiabank Global Banking and Markets

And just a couple more for you. I think Doug was getting at this too. So, if we look at the full year PCL ratio for the bank, I think it's around 33 basis points this year. And you referenced a couple of things, whether it's the fraud, whether it's PG&E earlier in the year. I mean, look, further we go in the cycle these things are going to happen. When you couple that with the movements in your underlying parameters or methodology, when you think total PCL for CIBC in 2020, the bank has at times in the past given us some indication. Relative to that 33 basis points on a total level, what do you think is an appropriate range investors should be thinking about?

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Well, as I talked to and I break it down into two amounts because as you can appreciate, the provisions on impaired feels a little easier, if you will to predict. So barring unforeseen events, my expectation, as I said is that we remain relatively flat. So we came in at 29 basis points for the year, as they said, which was within guidance that we provided last year. I would expect us to remain flat next year. And with regards to provisions on performing, as you said, they were up 4 basis points and I would expect, again unless things change in terms of our economic outlook, that the increase would be more modest than before.

Sumit Malhotra, Analyst, Scotiabank Global Banking and Markets

And last one for you. There's been some volatility in the Canadian consumer bankruptcy and solvency proposals that we've seen in the last number of months, which seems to be at odds with the jobs data in Canada and some of the underlying credit metrics we've seen from the banks. Did that play any part at all in the parameters update you enacted and any comment from you especially given the larger credit card portfolio of the bank as to how you're thinking about that situation with respect to your consumer book?

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

I'm actually feeling very comfortable with our consumer book, and our credit cards are actually, I'd say performing in line with expectation. We did see a bit of increase in delinquency rate sort of quarter-over-quarter, but that was really seasonality where we see delinquencies normalizing after usually low summer numbers. What we're seeing here and maybe if I look at it in two parts. So on the delinquencies, the bulk of the uptick was really in our insured mortgages and secured lines of credit and that was mainly driven by the softness that we saw in Alberta. So from that perspective, all of those loans are really well collateralized, so losses would be very low if they ever materialize. But if you look at our net write-offs where we're seeing the bulk of the increases there is really in our unsecured lines of credit and that would be in line with the broader trend that we're seeing in Canada where we've seen consumer insolvencies up.

I guess, I'd just point out that even with that increase in the personal lending segment, when you look at it from a year-over-year basis it's a CAD 9 million increase, CAD 15 million from a quarter-over-quarter basis. So nothing of great concern. And in our provisions for performing, there was some delinquency migration in that number. But as you saw on the – I think it was slide 15, it was a very small amount. Does that answer your question?

Sumit Malhotra, Analyst, Scotiabank Global Banking and Markets

That's help – that's very good. Thank you for that. Last question and just very quickly for Hratch. I think ex of the accounting are IFRS changes, next quarter pro forma in capital you're about 11.8%, one of the better numbers in the group, I believe. You answered the question on FCIB saying that you could neutralize the EPS impact by buying back more stock. Is that something you're suggesting will occur as that transaction closes or given your pro forma visibility is that uptick in buyback activity that you're referencing something that the bank is thinking about prior to the close of that transaction?

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Sure. Thanks Sumit. I'll take that one, but we're going to have to move on after this.

Sumit Malhotra, Analyst, Scotiabank Global Banking and Markets

Absolutely.

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

So – on the capital line. So, I think we have slightly different numbers than you on Q1. And as we've disclosed the IFRS impact for us is a bit smaller than what the peer group has disclosed. But leaving that noise aside in Q1 as I mentioned in my remarks, we do expect capital generation forward to continue to be net positive, maybe a bit more modest than this quarter because of some of the one-time helps we had this quarter, but still net positive and we feel pretty good about that. And even before the close and having the capital in the door on FCIB, we feel strong about our capital trajectory. And with that we anticipate accelerating the buyback activity in advance of that. So, as I said in the remarks again going forward from here, we anticipated to be more active than we have been in the past.

Sumit Malhotra, Analyst, Scotiabank Global Banking and Markets

We'll compare numbers after. Thanks for your help.

Hratch Panossian, Senior Executive Vice President & Chief Financial Officer

Thanks, Sumit.

Operator

Thank you. The next question is from Nigel D'Souza with Veritas Investment Research. Please go ahead.

Nigel D'Souza, Analyst, Veritas Investment Research Corp.

Hi. My questions have actually been asked and answered. Thank you.

Operator

Thank you. The next question is from Mike Rizvanovic with Credit Suisse. Please go ahead.

Mike Rizvanovic, Analyst, Credit Suisse Securities (Canada), Inc

Hi. Good morning. I just want to go back to Laura on the provisioning on performing loans. So if you could just help me understand, but your guidance for a lower number in 2020 is a bit confusing to me, just based on the fact that you're discussing more downside risk. It seems like you're a bit more negative than you would have been last quarter or even at the beginning of the year. Can you just sort of help me understand that dynamic?

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Yeah. Well maybe I'll start with provisions on performing. So, those are forward looking. And so, I would say that that takes into account that downside. My expectation, again at this point in time would be that our economic outlook at this point remain stable. So in that regard, that's why I expect provisions on performing to come in lower in 2020 than they did this year. That's with regards to provisions on performing.

With regards to provision on impaired loans, just in keeping with a bit more downside on the horizon, I do expect impaired provisions to increase in 2020 relative to 2019. But essentially what I've done is, I've taken into account the unique events of 2019 that we spoke of and I assume that those likely won't represent. And when I took all that into account is how I get to flat in my expectations for provisions on impaired in 2020 relative to 2019.

Does that help?

Mike Rizvanovic, Analyst, Credit Suisse Securities (Canada), Inc

Yeah. Yeah. It helps. Is it fair to say that as you add loans in 2020 you would be provisioning slightly more on the performing? Is that fair on those new loans just given your more negative outlook?

Laura L. Dottori-Attanasio, Senior Executive Vice President & Chief Risk Officer

Well, I'm not sure that that's the way I would look at it. I mean the provisions on performing take into account the economic outlook and during the year they'll take into account credit migration. So, yeah, I guess there'll be some of that in there. But even with that I still expect that provisions on performing when we look forward to come in less than what we had in 2019.

Mike Rizvanovic, Analyst, Credit Suisse Securities (Canada), Inc

Okay. That's helpful. Thanks. And then just one quick one for Christina. Just wanted to get your thoughts on how you think about the trade-off between getting your growth back up towards industry peer levels with the margin. Are you going to look to maybe protect the margin and maybe this is a longer process than was originally anticipated or how do you think about that trade-off?

Christina Kramer, Senior Executive Vice-President and Group Head, Personal and Small Business Banking, Canada

So, it isn't a mortgage strategy trade-off, it's really about our focus on our clients and growing with our clients and the markets that we serve them in across Canada. So, as we continue to see opportunity to continue to help clients with their home ambitions, we expect there's opportunity for growth in this space. And it will also then contribute to our relationship strategy because home ownership is a great moment for us to help Canadians with broader goals and their financial planning goals beyond that. So, when we look at the margin question, it's really about how do we build a longer term relationship with our clients and will compete in the market at the rates we'll need to compete in.

Mike Rizvanovic, Analyst, Credit Suisse Securities (Canada), Inc

So is it fair to look at that catch up as maybe more of a 2021 story, just given the sizable differential that you currently have?

Christina Kramer, Senior Executive Vice-President and Group Head, Personal and Small Business Banking, Canada

We'll see growth in this segment of the business in mortgage space and the portfolio over the course of the year. And I say that because we're seeing it in Q4 and that's been improving for a couple of quarters now and the growth will continue over that course of our business and by the end of the year will position us well for 2021 as well.

Mike Rizvanovic, Analyst, Credit Suisse Securities (Canada), Inc

Okay. Thanks very much.

Operator

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

Sohrab Movahedi, Analyst, BMO Capital Markets (Canada)

Okay. Quick question for Jon Hountalas. Jon, if I look at just the Commercial Banking component of Canadian Commercial and Wealth, the margins in that business are down every quarter this year anyway. Can you just talk to me, to us, I guess a little bit about the dynamics there between volume growth and margin compression as you look into 2020?

Jon Hountalas, Senior Executive Vice-President and Group Head, Commercial Banking and Wealth Management, Canada

Thank you for the question. So, our model has been pretty consistent, and we don't compete on rates at all. Has the marketing gotten a little kind of more aggressive? Yes, but nothing material. A lot of the compression you see is just rate impact. So, we haven't seen big client compression, and whatever has existed has been more on the deposit than the loan side. Going forward, I don't see – again from client-pricing perspective, I don't see big deterioration, so could it move a basis point? A couple of basis points perhaps, but nothing material.

Sohrab Movahedi, Analyst, BMO Capital Markets (Canada)

But the direction now are generally low or down I should say?

Jon Hountalas, Senior Executive Vice-President and Group Head, Commercial Banking and Wealth Management, Canada

I mean, client pricing, I don't think will be going up. So, again we're running a relationship bank. We will compete in the market. We don't lead on price, but we win business, win our good clients, and win the relationship clients.

Sohrab Movahedi, Analyst, BMO Capital Markets (Canada)

Okay. And then maybe just a couple of quickies here. Hratch, you or Victor, I guess, I mean, we've talked about the capital ratios now on pro forma and potential for buyback. But generally speaking, is there a kind of level that you're going to try and run the bank with the capital ratio level? Is it 11.5%? Is it low 11s? Is it high 11s? Can you give us kind of yardstick on that?

Victor Dodig, President, Chief Executive Officer

Good morning Sohrab. It's Victor here. So we've done a good job in building up a very robust capital level on a pro forma basis at 12%. We think about running the bank at 11% and 11.5% range, being the comfortable range for us. We're clearly at 11.6% today, just to remind you of our capital priorities going forward, and I try to do this every quarter. We have four. The first one is to invest in our businesses or organic growth. We have been investing and that's reflected in our expense growth, with an over-indexing in our Commercial Banking and Wealth Management businesses in addition to our Canadian Personal Banking business.

Share buybacks are an important component of them. I think Hratch has been clear. We bought back 1 million shares last quarter. We do intend to accelerate the pace of share repurchases given our current capital level. With respect to dividends, we target the midpoint of our 40% to 50% range on an adjusted basis or slightly above that. We plan to grow our dividends as in line with our earnings. And the last one on inorganic investments and I think we've been quite clear that we're selective. We're in no rush. We're investing in our business organically. You can see the growth in the US, it's quite robust. With the expansion in the markets, our bias is really toward tuck-ins at most for the foreseeable future.

Sohrab Movahedi, Analyst, BMO Capital Markets (Canada)

That's excellent. Do you think you will rethink the dividend policy from a semi-annual to an annual just to give a bit more flexibility given some of the kind of lack of transparency or visibility I guess into the outlook or you think there's no need for that?

Victor Dodig, President, Chief Executive Officer

At this point in time, there's no need to rethink it. We may. We're really focused on improving the performance of our businesses. We did not deliver what we wanted to deliver to our shareholders and we're focused on getting the bank back to earnings growth in 2020. That's the primary preoccupation of the leadership team.

Sohrab Movahedi, Analyst, BMO Capital Markets (Canada)

Thank you very much.

Operator

Thank you. This will conclude today's question-and-answer session. I would now like to turn the meeting over to Victor.

Victor Dodig, President, Chief Executive Officer

Thank you operator. So we said in 2015 that we were going to succeed by building CIBC into a client-focused bank and we've made clear progress in that regards. This year we continue to improve our client experience numbers across our Canadian Retail business. We drove robust top line growth in Commercial Banking, delivered strong results in our US businesses and continued the transformation of our Capital Markets franchise into a connected business that's driving high quality earnings consistently for our bank. We are firm in our belief that we're on the right path. And as I look to 2020, I'm confident that we're well-positioned to deliver value to our clients and team and growth to our shareholders.

Just before I wrap up, I'd like to thank Kevin Glass for his contributions to our bank over the past 11 years. He's been quiet during this call, but he has been beside a microphone in case you did have a question for him. Kevin has been a tremendous leader and an important part of our team and we wish him the very best as he starts his retirement at the end of the year. And on behalf of our board and executive leadership team, I want to thank our entire CIBC team for your continued dedication to making our clients' ambitions a reality and to our shareholders for your continued support.

Have a wonderful holiday season everyone and we'll talk to you in the New Year.

Operator

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