CIBC Q2 2023 Earnings Conference Call

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Forward Looking Information

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Corporate Participants

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Harry Kenneth Culham

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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 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, everyone. We will begin this morning's presentation with opening remarks from Victor Dodig, our President and Chief Executive Officer; followed by Hratch Panossian, our Chief Financial Officer; and Frank Guse, our Chief Risk Officer. Also on the call today are a number of our group heads, including Shawn Beber, US region; Harry Culham, Capital Markets and Direct Financial Services; and Jon Hountalas, Canadian Banking. They are all available to take questions following the prepared remarks.

For those participating on the Q&A, given you have a hard stop to get to another presentation at 8:30, please limit your questions to one so we can allow as many of you as possible to participate. We will make ourselves accessible after the call for questions or follow-ups.

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

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

Victor G. Dodig, President and Chief Executive Officer

Thank you, Geoff, and good morning, everyone. I'll start our call today with an overview of our second quarter performance, followed by insights on the current financial sector dynamics as well as CIBC's resilience as we navigate a fluid economic environment.

This morning, we announced adjusted second quarter revenue of CAD 5.7 billion, which is up 6% from the prior year. Our strong performance is a testament to our client-focused strategy and the hard work of our CIBC team members to create value for all of our stakeholders.

During the quarter, we continued to leverage past investments while moderating expense growth. Expenses of CAD 3.2 billion were down 1% sequentially and up 7% year-over-year, and this is within the previous guidance that we've provided you. Pre-provision pre-tax earnings of CAD 2.5 billion were up 6% from the prior year, while net income of CAD 1.6 billion was 2% lower as impaired credit provisions continued to normalize, again, as expected.

We are vigilant in our risk management and continue to closely monitor our asset classes and client segments for signs of stress, taking proactive steps to address potential exposures. Broadly speaking, our loan portfolio continues to perform well in an evolving economic environment. We're comfortable with what we're seeing, despite market-wide challenges in certain pockets of commercial real estate, particularly in the US office sector.

Overall, our portfolio is prudent and disciplined lending standards, with conservative caps on loan-to-value ratios and good debt service coverage. Now, Frank will provide additional details on our portfolio in a few minutes.

Earnings per share were CAD 1.70 this quarter, and we have announced a CAD 0.02 dividend increase to our common shareholders. Going forward, we will adopt an annual review of our dividend payment instead of the semi-annual pattern of the past. We will review our dividend on our fourth quarter earnings call and annually thereafter. We intend to continue increasing dividends in line with earnings growth, while maintaining a dividend payout ratio of between 40% and 50% over the long term. Our capital position remains strong with a CET1 ratio of 11.9%. I'll have further comments on our capital and liquidity following comments on our core businesses.

So I'll turn to the core businesses now. First, our Canadian consumer franchise. Our investments here are deepening client relationships, they're driving strong client acquisition and robust volume growth. Over the last 12 months, net personal client acquisition totaled approximately 500,000 net new clients to our bank. We're pleased that the progress we're making franchising co-brand cardholders who've also joined our bank last year. To date, these clients have brought over CAD 3 billion of incremental funds managed to CIBC beyond their credit card balances.

Our North American Commercial Banking and Wealth Management businesses continued to see year-over-year loan growth in the 9% to 10% range, albeit at a slower pace than prior quarters, again, something we expected. Not surprisingly, client sentiment is more cautious as macroeconomic headwinds weigh on the near-term investment outlook. Given the environment, we're focusing on supporting our clients and helping them navigate this period of increased volatility, something that the CIBC does through the ups and downs of the economic cycle. We remain thoughtful and maintain a disciplined and prudent approach to capital deployment.

In Wealth Management, while challenging market conditions tempered client activity during the quarter, our unique structure of Commercial Banking and Wealth Management teams working together will continue to drive strong referral activity to serve both the business and personal needs of the entrepreneurs we serve within our bank.

In Capital Markets, our franchise continued to deliver top line growth despite a slower underwriting environment. In line with our strategic objectives in this business, we continue to grow our revenues in the United States and play a leadership role in sustainable financing. This quarter, Direct Financial Services reported strong results as currency conversion activity increased with travel recovery and Simplii Financial benefited from higher deposit margins.

So, now let me spend a moment on the current banking sector environment. In recent months, isolated challenges emerged for several banks outside of Canada. Over the past several years, armed with lessons learned and the resolve to be a more durable bank for our stakeholders, we've been executing on our long-term strategy to build a strong and resilient bank that CIBC is today. We have a strong, well-capitalized balance sheet, and we have the capabilities required to generate capital on an ongoing basis while also supporting our growth. We continue to build on our capital position this quarter, and at 11.9%, our CET1 ratio is now approximately CAD 3 billion above the current regulatory requirement.

We also have a sustainable funding strategy that's underpinned by a well-diversified, high-quality client deposit franchise and supplemented by wholesale funding that's purposefully constructed across investor types, across geographies, across currency maturities and across funding instruments. Helped by our stable funding base, we ended the quarter with a liquidity coverage ratio of 124%, including CAD 177 billion in high-quality liquid assets, which represents a CAD 34 billion of surplus over our cash outflow obligations under a 30-day stress scenario.

Also embedded in our strategy and our approach to doing business is our commitment to enable a more secure, equitable and sustainable future. We continue to make good progress on our ESG initiatives across the spectrum this quarter. We were recognized as one of Canada's Best Diversity Employers for the 13th consecutive year, and we ranked number one in Canada for gender equality by Equileap for the third consecutive year. These recognitions are testaments to the work we're driving – doing to drive positive change, and we're committed to continuing our efforts using our resources and our technology investments for good.

In closing, while the near-term macroeconomic environment remains challenging, I think we all see that with expected headwinds to economic growth and geopolitical instabilities, we have the strength to weather periods of uncertainty in the near term, and importantly, the right strategy to drive solid results over the long term.

And with that, I'd like to pass the call over to Hratch for a detailed review of our financial results. Hratch?

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

Thank you, Victor, and good morning, everyone. Thank you for joining us. Our bank delivered solid results for the second quarter of 2023, supported by the embedded growth momentum from our past strategic investments which is helping offset the impact of a more challenging environment. Diluted earnings per share were CAD 1.76 for the quarter, up 9% year-over-year. Excluding items of note, we generated adjusted EPS of CAD 1.70 and ROE of 13.9%. And despite the disruptions faced by the broader banking industry during the quarter, our balance sheet remained resilient as we strengthened our capital ratios and maintained excess liquidity.

The balance of my presentation will refer to adjusted results, which exclude items of note, starting with slide 9. Adjusted net income of CAD 1.6 billion for the quarter was down 2% from the prior year, driven primarily by higher credit provisions largely in our US portfolio. While provisions for credit losses continue the anticipated normalization, our overall credit quality remains strong, as Frank will cover in further detail.

Revenues of CAD 5.7 billion and pre-provision pre-tax earnings of CAD 2.5 billion were up 6% from a year ago, benefiting from balance sheet growth across all our businesses, resilient margins and higher fee income. Expenses were up 7% from the prior year and down 1% sequentially for the second consecutive quarter.

Slide 10 highlights the drivers of net interest income, which was up 3% from the prior year. And excluding trading, NII was up 10% as a result of continued loan and deposit growth. Total bank NIM, excluding trading was largely stable over the quarter, benefiting from strong margin expansion in our P&C businesses offset by lower margins in the US and Capital Markets. Canadian P&C NIM of 257 basis points was up 9 basis points sequentially and 19 basis points over the same period in 2022. Deposit margins continue to expand in this business supported by higher rates, partly offset by pressure on asset margins, most notably mortgages.

NIM in our US segment was 341 basis points, up 2 basis points year-over-year and down 13 basis points from the prior quarter. While deposits in our US bank have been stable over the year, the segment's NIM this quarter was impacted by recent deposit trends across the industry and the lag in rate resets on loans. As we've communicated previously, we manage our balance sheet to protect margins and deliver sustainable NII outperformance over the medium term. As a result, we continue to expect modest upward momentum in NIM, excluding trading, which will support ongoing NII growth.

Slide 11 provides further disclosure on balance sheet growth and margins. Loan balances averaged CAD 535 billion in the quarter, an increase of 9% from the prior year, supported by all businesses. Client deposit growth outpaced loans over the same period, increasing 10% to an average balance of CAD 520 billion. While we continue to see a shift from non-interest-bearing to interest-bearing deposit, betas on notice and demand deposits are performing well and have been supportive of overall margin stability. We have a strong deposit franchise across our bank, which supports balanced stability and profitable growth.

We continue to be focused on growing funds managed with an emphasis on stable client deposits and lending in key client segments with strong risk-adjusted returns.

Turning to slide 12. Non-interest income of CAD 2.5 billion was up 10% from the prior year, supported by growth in trading income, which moderated this quarter from a very strong Q1. Excluding trading, market-related fees continued to see some pressure, down 1% year-over-year and sequentially. Offsetting this, transaction-related fees were up 4% year-over-year, driven by strong card and credit fees, while sequential declines were mainly related to less days in the quarter.

Turning to slide 13. Expenses were up 7% from a year ago, largely due to higher employee compensation, the impact of inflation and our focused strategic investments to deepen our capabilities in high-growth segments, build our future differentiators and to simplify our bank. These investments accounted for approximately half the expense growth over the last year, and they are already delivering results. Specifically, client acquisition in key segments, robust revenue growth, positive employee engagement scores, and strong client satisfaction.

As previously communicated, we continue to take proactive steps to manage our expense base. By maintaining steady strategic investment in priority areas while continuing to realize opportunities for efficiency improvements in everything we do. As we have demonstrated, this will result in relatively stable quarterly expenses in the short term, fiscal 2023 expense growth of mid-single digits, and positive operating leverage over the medium term.

Turning to slide 14. Our capital position improved 26 basis points sequentially, driven by strong organic generation and share issuances, partially offset by RWA growth. As we had telegraphed, the net impact of the Basel III reforms was modest, contributing a few basis points. We are confident that our CET1 ratio will continue trending higher, ending 2023 above 12% as we've previously guided.

Despite the disruption in funding markets during the quarter, our liquidity position remained well above minimum regulatory requirements throughout the quarter. Our average LCR was 124% and we ended the quarter significantly higher than that. We expect to maintain modestly higher liquidity in the short term given the uncertain environment.

Starting on slide 15, we highlight our strategic business unit results. Personal and Business Banking net income was CAD 643 million, up 11% from the prior year and 8% sequentially, driven by robust revenue momentum. Revenue of CAD 2.3 billion was up 7% year-over-year, helped by strong deposit margins and volume growth. On a sequential basis, revenue was up 1% driven by expanding margins, which more than offset the impact of the shorter quarter.

Expenses of CAD 1.3 billion were up 8% from the same period last year, driven by employee count and compensation changes as well as expenses related to the co-brand credit card portfolio, which was acquired partway through the second quarter last year.

Moving on to slide 16. Net income in Canadian Commercial Banking and Wealth Management was CAD 452 million. Pre-provision pre-tax earnings of CAD 663 million were up 2% from a year ago. And pre-tax pre-provision earnings growth benefited from 15% revenue growth in Commercial Banking, partially offset by 6% revenue decline in Wealth Management due to the negative impact of markets.

Expenses increased 3% from a year ago, mainly due to higher employee costs, partially offset by lower performance-based compensation. Net income of US $50 million in US Commercial Banking and Wealth Management was down 67% from the prior year, most notably due to higher credit provisions. Revenues were up 2% over the same period, driven by an 11% increase in net interest income supported by higher volumes, partially offset by 15% market-related decline in non-interest income. Expenses were 4% higher year-over-year due to ongoing investments in people and technology, offset by variable expenses. While we anticipate continued investment in this segment, we expect expense growth to moderate through fiscal 2023 and operating leverage to improve.

Turning to slide 18 and our Capital Markets business. Net income of CAD 497 million was down 8% year-over-year from a very strong quarter last year. Revenues of CAD 1.4 billion were up 3% over the prior year, supported by Direct Financial Services growth of 34% largely due to deposit margin expansion in Simplii. This was largely offset by lower trading revenues and underwriting activity due to market conditions. Expenses of CAD 664 million were up 12% compared to the prior year, largely due to investments in our team and infrastructure to support key initiatives.

Slide 19 reflects the results of our Corporate and Other business unit. Net loss of CAD 33 million was CAD 104 million better than the prior year and CAD 14 million better than the prior quarter. Revenues of CAD 76 million were up CAD 53 million from a year ago, driven largely by our International Banking business and higher revenues from strategic investments. Expenses were down 5% from the prior year and 6% sequentially. We maintain our medium-term guidance of CAD 75 million to CAD 125 million quarterly loss in this segment, including the cost of maintaining elevated liquidity reserves.

In closing, this quarter's results underscore the benefits of our client-focused strategy, our disciplined approach to resource allocation, and the resilience of the CIBC franchise in the face of market headwinds. Recent industry events have demonstrated the value of our diversified business, conservative risk posture and strong, stable balance sheet. These strengths position us well to deliver long-term sustainable value for all our stakeholders through periods of disruption. As we've done this quarter, we will continue to manage through the current macro uncertainties proactively by emphasizing margins and efficiency to deliver near-term results without sacrificing the long term.

With that, let me turn the call over to Frank.

Frank Guse, Senior Executive Vice-President and Chief Risk Officer

Thank you, Hratch, and good morning, everyone. In Q2, our retail and business and government portfolios continued to show resilience. While uncertainty remains on the macroeconomic outlook, as expected, we continue to see a normalization of credit conditions to pre-pandemic levels.

Turning to slide 22. Our total provision for credit losses was CAD 438 million in Q2, compared with CAD 295 million last quarter. The provision on impaired loans was CAD 379 million, up CAD 120 million quarter-over-quarter. We experienced higher impaired provisions in both retail and business and government loans this quarter.

In retail, write-offs trended higher as expected, reflective of delinquencies returning towards pre-pandemic levels. In business and government loans, high impaired provisions were mainly attributable to office exposures in the US institutional real estate book. The provision on performing loans was CAD 59 million in Q2, reflective of changes in forward-looking indicators for our retail portfolios. This was more than offset by changes to our economic outlook and credit migration in the US commercial portfolio.

Turning to slide 23. Our allowance remains prudent given the economic backdrop. The overall increase this quarter is mainly driven by our revisions to the economic outlook. We remain comfortable with our allowance coverage overall, which are also above pre-pandemic levels.

Slide 24 focuses on our lending portfolio mix. Consistent with previous quarters, our portfolio reflects strong credit quality. Our total loan balances were CAD 538 billion of which 55% is real estate secured lending. Our variable rate mortgage portfolio accounts for a little over one-third of our mortgage portfolio and shows strong credit quality and performance.

The average loan-to-value for our uninsured mortgage portfolio was 53%, up from 46% a year ago as we have seen a continued house price softening in most markets. Recent trends seem to indicate a stabilization in major markets, and we would expect loan-to-value ratios to improve in the quarters ahead. The overall business and government portion of the portfolio has an average risk weighting equivalent to a strong BBB, which has remained steady and continues to perform well.

Slide 25 details our gross impaired loans. Overall balances were up in Q2, mainly driven by business and government loans. New formations were also up in Q2. On the new formations this quarter, CAD 370 million is related to our US commercial real estate business.

Slide 26 details the net write-off and 90-plus day delinquency rates of our Canadian consumer portfolios. As communicated in prior quarters, we continue to expect write-offs and delinquencies to revert towards pre-pandemic levels. The overall delinquency and write-off movements in retail this quarter are well in line with our expectations.

Slide 27 provides an overview of our Canadian real estate secured personal lending portfolio. Our overall late-stage delinquency rates continue to remain low and stable compared with pre-pandemic levels. The mortgage portfolio continues to show resilience to interest rate increases with renewal metrics that are stable. Our non-amortizing portion of the variable rate mortgage portfolio has meaningfully improved quarter-over-quarter from CAD 52 billion down to CAD 44 billion.

Our clients are adjusting to higher interest rates by taking proactive steps to address their variable rate mortgage payment shortfalls. Around 75% of the reduction this quarter is driven by clients voluntarily increasing contractual fixed payments for the remaining terms with the balance of clients renewing or converting to fixed rate mortgages. We will continue to work closely with our clients as we closely monitor interest rate and market developments.

Slide 28 covers details of our commercial real estate exposures in both Canada and the US. 69% of our Canadian portfolio and 58% of our US portfolio are investment-grade at quarter end. We have prudent lending standards for our commercial real estate exposures in both countries with the strategic focus remaining on clients where we can develop and maintain long-term relationships. Our exposures in these two regions remain well diversified and continue to perform well notwithstanding the pressure we are seeing within the US office portfolio.

On slide 29, I'd like to provide some additional details on our US office exposure. The US office portfolio represents 1% of our total loan book and comprises 21% of our overall US commercial real estate, and that is down from 26% in 2019. Over 50% of the portfolio consists of Class A properties. We have a dedicated team of experienced commercial real estate professionals who are actively and proactively managing and monitoring the portfolio. Remain comfortable with provisions at this time, but the US commercial real estate market continues to evolve, and we are very focused on working with our clients.

In closing, our performance is still within our expectations and remain stronger than pre-pandemic levels. Our credit portfolio quality and coverage continued to remain robust. Communicated in the prior quarters, we are seeing impaired provisions for credit losses gradually increase. We remain comfortable with our guidance on overall losses in the 25 basis point to 30 basis point range. Depending on prevailing market conditions in the second half of the year, we could expect to trend to the high end of this range. As the economic conditions evolve, we will continue to proactively work with our clients.

And I will now turn back – the call back to the operator.

Question and Answer Section

Operator

Thank you. [Operator Instructions] Our first question is from Ebrahim Poonawala from Bank of America. Please go ahead.

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

Hi. Good morning. I guess maybe a question for you, Hratch. Look, just going back to the slide 10 around the margin breakdown both in Canada and the US. Obviously, your Canadian NIM, it feels bucked the trend relative to what we've seen from peers. So just talk to us about the three components you outlined there. One, what's unique? I appreciate you've been hedging the balance sheet a little bit more differently than some of the peers. So talk to us when we think about your margin, one, outlook on deposit margin both in the US and Canada? And then is there something differentiating with regards to your hedging strategy that should lead to more better margin resiliency relative to what we've heard from peers? Thank you.

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

Yeah. Thank you, Ebrahim, for the question. Generally, we're very pleased with our margin and NII performance. It has been materializing according to the guidance that we provided in our expectations largely. We do emphasize stability of margins, as we've said before. And so as the environment changes, and it has changed. It mutes the impact of that to margins. And so to backtrack for a second, we've grown our NII 10% year-over-year. We guided to stable NIMs across the overall bank in the first half of the year with some upwards momentum in the back half. And we still expect that, and that is because of our balance sheet. We know the factors that impact the balance sheet. We know how we're hedging it. We're controlling the things that we can control.

And on the margin, the deposit trends are the big ones, I would say at this point that are a little bit different, both in Canada and the US, we're expecting more intense shift from non-interest-bearing to interest-bearing interim over the back half. But again, the impact of that, as I said in my remarks, is largely muted because we are seeing strong margins. And in some areas, we've actually been able to pull some pricing levers in addition to hedging in the businesses in order to emphasize margins in the short term on the deposit side.

So just to give you a little bit more in each of those businesses. So in the Canadian P&C side, we benefit a few basis points a quarter from our hedging strategy and higher rates that continues to be a case. Even though there is some volatility in rates curve forwards, which suggest, we're still going to have 300 basis points plus in the five-year swap range and what's rolling off and off our book is in the 100 basis points to 150 basis points range for the foreseeable future, actually similar levels in the US. So both US and Canada will benefit from rising rates coming into deposits.

In Canada, I think what you saw this quarter is the pressure from the asset margins we were seeing, and that's largely from the mortgages. It moderated a bit. And so the margin expansion deposits were being offset more in the past by mortgages, and we're seeing that subside a little bit. In the US, to cover the deposits in the US a little bit, we are still seeing the benefit from interest rates. There was several basis points positive from the interest rates this quarter, but that shift in mix and the decline in volumes and deposits more than offset that this quarter. Going forward, we're expecting deposits to be more stable and that mix shifts to be less of a factor. And so we will see upwards momentum in our expectation on deposits.

And then on the loan side, the negative 5 basis points you see that, largely this quarter that was affected by, it takes some time for loans to reset after the two Fed increases and the SOFR rates to reset on the loans, right? So, that we will see as well revert. So net-net, in both businesses, I would expect some upwards momentum. And what that will do at the total bank level towards the end of the year, we're still expecting single-digits increase from last Q4 to this Q4. I'd probably peg it in the high 160s total bank ex-trading.

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

Perfect. Thank you so much.

Operator

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

Gabriel Dechaine, Analyst, National Bank Financial

Hi. Good morning. Yeah, along that line of questioning. I just wonder about your liquidity coverage ratio, I've never asked about that, but it went down 10 points sequentially and you're now at the low end of the group. Is that where you want to be if – what would you need to see to maybe bring that back up? Or what was the motivation to bring it down? Because just in my simple way of viewing things, if you have to bring it up, you have to bring on extra liquidity and on the margin story we're hearing now could change?

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

Yeah. Thanks, Gabe, for the question. It's a good question, certainly on all of our minds this quarter. And so first thing I'd start with is averages don't tell the story of quarters. And so this quarter's average versus last quarter's average sort of hides the path that we've been on, and I mentioned some of this in my remarks. But just to give you a bit of the background, recall in Q1, we were talking about higher liquidity levels than we would usually operate at. We like operating in the mid-20s in a normal benign environment, mid-120s that is, and so we were working our way down.

Gabriel Dechaine, Analyst, National Bank Financial

Okay.

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

So where we ended the quarter and where we started the second quarter was not the mid-130s, which was last quarter's average. And then we faced a disruption, and we're actually very pleased and this, I think, shows the stability of our balance sheet. Even though we entered the quarter in the 120s, we had the disruption in the markets for a couple of weeks, a week of complete shutdown of the markets on the funding side and then slowly opening back up. We maintained the resilience and only a few points of LCR is what we dropped during that time, and we were still well above the 100% level, as I said in my remarks.

And then once the markets opened up, we had anticipated a riskier environment, and so we brought that LCR back up. And so as I said in my remarks, we ended the quarter significantly higher than that. Mid-130s again is where I would say we are at this point in time. And as I said in my remarks, in this environment, we're probably going to keep it that way, 5 basis points to 10 basis points higher than our normal operating level because of the risk in the environment. And yes, there will be a cost to that, and I referenced that in my remarks as well in the Corporate and Other segment. We expect that CAD 75 million to CAD 125 million loss per quarter range. And part of that is higher cost of liquidity that we've already done the liquidity and the funding, the higher cost isn't fully reflected this quarter, will get reflected next quarter and beyond.

Victor G. Dodig, President and Chief Executive Officer

Yeah. And Gabriel, just to add on to Hratch's comments. The other thing that underpins all of that is we're staying close to our clients. We have exceptional client relationships. We're diversified across geographies and businesses, and all our channels are open, and they continue to see largely positive inflows from clients.

The second thing is we have an exceptional treasury team. So the spot ended up much higher, as Hratch noted, because we also watch our costs. When the markets open up, we fill up our tanks, so we make sure we have the liquidity in place for the bank overall. It's a highly connected function between treasury and our client functions. We work really well together, which is why we're exceptionally pleased with how we ended the quarter.

Gabriel Dechaine, Analyst, National Bank Financial

Oh, thanks. And Victor, thanks for grabbing the mic there, because my next question was for you. I get asked pretty regularly from investors, mostly in the US about Canadian banks becoming more opportunistic on acquisitions in the US given the depressed valuations, disruption and all that stuff. And there are a few other banks that, like, would probably rule out at the moment because of various factors.

CIBC, I would say maybe there's a possibility there. It's been a long time since your last acquisition, and that being the main reason. And – but you've been preaching more of the organic growth strategy in the US for the past couple of years. I'm just wondering if you've got any shift in mindset there at all with regards to M&A in the US?

Victor G. Dodig, President and Chief Executive Officer

I think the disruption in the US banking market is in its early innings. And when I said it's early innings, you realized that the game will last nine innings. This is probably the third inning, so our focus continues to be on organic growth across our franchise. This last 12 months, we've attracted over 0.5 million clients in our Canadian franchise through our Personal Bank and our Direct Financial Services business.

Our goal now, Gabriel, is we've made significant investments in our business. Our entire management team is shifting to harvesting those investments, making sure you can see the depth and richness of those client relationships, both in the Canadian market and in every business we operate in, including the US. Having said that, you keep your antenna up and see how the baseball game evolves here. And like I said, I think we're in the early innings, so the most important thing is harvest our investments, continue to demonstrate operational resilience in periods of volatility, and deliver for your shareholders on a consistent basis quarter after quarter.

Gabriel Dechaine, Analyst, National Bank Financial

Maybe use the hockey analogy since we're Canadian...

Victor G. Dodig, President and Chief Executive Officer

...use the hockey analogy, too. Well, can you use many – we'll talk later about sports analogies, but thank you for your questions.

Gabriel Dechaine, Analyst, National Bank Financial

You bet bye.

Operator

Thank you. Our following question is from Meny Grauman from Scotiabank. Please go ahead.

Meny Grauman, Analyst, Scotiabank

Hi. Good morning. I just wanted to dig a little bit deeper into differences between the Canadian and US office market and just better understand what accounts for those differences as you see them? How do you explain those differences? So maybe that's the first question there.

Frank Guse, Senior Executive Vice President and Chief Risk Officer

Yeah. Thank you for the question, Meny. I think most of it is indeed driven by differences in the market and how the markets are structured and that would relate to levels of recourse that you would see in those different markets, and that would also be reflected in our lending portfolios. You would see, if you – particularly you go into office sector, you would see differences in the ownership structures between those two markets. And again, that would be reflected in our lending portfolios as well.

I would say where you don't see a difference for us is in our underwriting and lending standards that we have very consistent across both markets. And as I said in my prepared remarks, taking a very prudent approach to the sector in both. And as I said, we've taken a bottoms-up approach. We have been through our Canadian portfolio on the office side. We have been through our US side, while we do expect the US office sector to remain somewhat elevated from an impaired perspective, we do not see any signs of stress in our Canadian book.

Meny Grauman, Analyst, Scotiabank

Because what I was getting at was one might think that there was just more of a timing difference rather than a more substantive difference in terms of when we'll see sort of some of the pressures that you're seeing in the US come through to Canada. But I guess, paraphrasing you, you're saying that, that's not your view?

Frank Guse, Senior Executive Vice President and Chief Risk Officer

We have – as I said, we have taken a very proactive approach. We are through a bottoms-up loan-by-loan review of the files. I wouldn't attribute it to timing. One difference that I can call out, we do see a somewhat front-loaded maturity profile in our US businesses. So far, we have seen 24% of the entire office book renewing in the first half of the calendar year. We expect close to another 30% renewing in the second half of the calendar year. That is a little bit more, but then again, we have done a loan-by-loan review regardless of maturity profiles. And I wouldn't attribute it to timing. We do not foresee any major stress in our Canadian books.

Meny Grauman, Analyst, Scotiabank

Thanks for that. And then just as a follow-up, I wanted to ask about the performing recovery in the Canadian Personal & Business Banking segment. It just stands out to me as a little odd, so I wanted to understand it better. What's driving that? I wouldn't have expected to see that just given the kind of conservatism that we're talking about broadly that the bank's conservative posture here, so if you could just help me understand that line in particular?

Frank Guse, Senior Executive Vice President and Chief Risk Officer

Sure, Meny. I would say a lot of that is relative to our starting points. If you recall, we started increasing our performing allowances early last year with updates to our economic outlook and specifically in retail, where we have taken a more pessimistic view early on. I wouldn't say we are now having a more optimistic view. We probably have a little less pessimistic outlook on the retail side, and that is driven by both forward-looking indicators, but it's also driven by the resilience that we are actually seeing in our books.

And when we say well in line, it's actually coming in better than expected. If you look into delinquencies, if you look into impairments, if you look into losses that we are actually taking, data point I would throw out is, year-over-year, we still added CAD 70 million in provisions on the performing side for retail. And if you compare it to Q1 2020, so pre-pandemic, our performing allowances are 60% higher still, and continue to remain very, very comfortable and well, not conservative, but prudent in that regard.

Meny Grauman, Analyst, Scotiabank

Thank you.

Operator

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

Mario Mendonca, Analyst, TD Securities

Good morning. Hratch can you help me reconcile a couple things that you talked about, the overall bank margin likely trending a little higher. And I think you gave us some, like, a nice clear explanation as to why. But I'd like to think about that in the context of the increase in your LCR. Taking the LCR from, say, 124% to 134% or like the mid-130s-percent as you said, that does imply a lot of – like a fairly meaningful increase in your high-quality liquid assets, which sort of tells me that the bank has done a fair bit of funding in the wholesale market to support that LCR.

So where I'm struggling is how do you get overall margin expansion with deposits competition a lot higher, the shift to higher cost wholesale funding or higher wholesale funding costs, the increase in the LCR, how do you get to a higher margin in an environment where everything seems to be pushing in the other direction?

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

Yeah. Thanks, Mario, for the question. And so you are right, we were very active in the funding markets after the markets open back up and as Victor said, that in combination with our deposit franchise, both in terms of stability of balances and frankly, as I referenced in my remarks, with the pricing discipline we've had, that helps the overall cost of liabilities actually stay fairly contained despite some of those mix shifts. And we provided that extra disclosure on our balance sheet and the cost of liabilities, and you'll see that.

If you look at the demand category, I would say it's probably on the margin better than our modeled betas is what we're seeing when you look at – on the right side of slide 11 there. Our demand notice deposits have gone from 20 basis points to 93 basis points average cost, that dynamic will continue. And so we do believe that, that will help the bank, and that's the few basis points a quarter upside momentum as I mentioned.

On the asset side, there's still some uncertainty on mortgages, margins keep moving around and so forth. But overall, we do anticipate a lot of that is behind us. And so net-net, that will contribute to the bank's increased margins going forward. And on the funding side, particularly, yes, that's a significant amount of HQLA, but not that significant in the context of over CAD 500 billion of client deposits, of which about half is behaving with characteristics that are helping us on the pricing side, right? So we feel pretty confident in that upwards momentum despite the shift.

And we do think the demand notice side is probably going to be more stable from here versus some of what we've seen so far in the year because there's a lot of the incentive, if you will, that there was as yields went up and GICs and CDs had better opportunities for clients and interest-bearing opportunities versus non-interest-bearing, that spread grew as interest rates went up, that's starting to stabilize. And so we do think the mix side will stabilize as well.

And like I said in my remarks, and Victor emphasized it, we've got a very strong deposit franchise. We've got broad relationships with these clients and that helps us on the pricing side, and we'll continue to emphasize our margins while doing what's right for our clients.

Mario Mendonca, Analyst, TD Securities

Okay. Let's flip over to commercial real estate. There is – I see in the disclosure here that 58% of the exposure is investment-grade. Of course, that means 42% is below investment-grade. Can you talk about what proportion was investment-grade, let's say, a year ago, six months ago, how has that changed? Has it gone from investment-grade like up 75% down to 58%? Help me think through how much that's changed?

Frank Guse, Senior Executive Vice President and Chief Risk Officer

I would say, Mario, it's very stable. We have seen some downward migration. But I would say on the balance, it has remained very stable, and that is reflected both in our CRE disclosures, but it would also hold true for the entire business and government portfolio. We may have seen a number of downgrades. As we talked about, we have seen a number of impairments, but on the balance and across all sectors that we're showing on the slide, the portfolio actually has remained very stable. And yes, we have seen those downgrades. I wouldn't say that number has meaningfully changed.

Mario Mendonca, Analyst, TD Securities

So it was still around that sort of 60% range of investment-grade in commercial real estate about a year ago?

Victor G. Dodig, President and Chief Executive Officer

Yeah. Mario, if you actually look at the slides where we show commercial real estate in previous quarters, you'll see similar numbers.

Mario Mendonca, Analyst, TD Securities

Okay. Thank you.

Operator

Thank you. The following question is from Lemar Persaud from Cormark Securities. Please go ahead.

Lemar Persaud, Analyst, Cormark Securities, Inc.

Yeah. Maybe sticking with Frank there. I appreciate the disclosure on the US office portfolio. So if we flip over that slide, maybe – could you maybe talk to what the average LTV would be today if that portfolio was mark-to-market because it looks like the LTV given is at origination? So that 60% I'm referring to?

Frank Guse, Senior Executive Vice President and Chief Risk Officer

Yeah. Lemar, you're right, it is the at origination LTV. Assessing LTVs in the office sector, specifically, given how fluid it is, is a very hard task at the moment, there is not a lot of market comparables out there. Some of the market comparables you would look at are probably way too low and finding a bottom. As I said, we have taken a very proactive and prudent approach. We looked at LTVs from a cap rate perspective. What I would say is averages would be very misleading to give out here. It is a loan-by-loan, and it is a file-by-file, asset-by-asset review and it's very hard to give you a precise number here. I would say, well, it's very hard to give you a precise number here.

Victor G. Dodig, President and Chief Executive Officer

Again, Lemar and all our sell-side analysts and investors, it's important to recognize a couple of things. One is our office sector loan portfolio consists of 2% of our overall loan portfolio at CIBC, roughly half and half between Canada and the United States. It's all originated 60% loan to value. We see what's happening in the market. I would anchor it in the 25 basis points to 30 basis point risk for impaired guidance that Frank has provided, so we feel comfortable we're at. We recognize the volatility. We'll manage through it. We'll get through this. And I'm convinced that values are surfacing and investors will start showing up to snap up these properties, and people will start coming back to the office more. This is not going to be a steady state. Things will turn around, and we will manage through this.

Lemar Persaud, Analyst, Cormark Securities, Inc.

I appreciate that. And maybe if I could try just a little bit differently and just probe a little deeper here. As I read more and more about commercial real estate and office specifically, the more I realize it's actually based on the specific building itself. So I'm going to ask this very directly, Frank, maybe you could provide some guidance on how you see losses evolving on this portfolio specifically? Now, I appreciate the guidance on the 25 basis points to 30 basis points and potentially towards the higher end of that range. But just specifically, if you could just give me some color on that, that would be very helpful.

Frank Guse, Senior Executive Vice President and Chief Risk Officer

Yeah, sure. And as you said, it is asset by asset, and it is a very different answer for different assets that we are seeing. What I would say specifically, and as Victor said, specifically to the US sector, which is about 1% of our total loan portfolio, we should expect losses to remain elevated. They could be a little higher in the next coming quarters, but they will moderate over time, in line with our maturity profile in early 2024, and that's specific to our US portfolio. We are not seeing anything similar in our Canadian portfolios, so we feel very confident. And then again, overall, that 25 basis points to 30 basis point range is something we will continue to give as guidance, even including some of the impairments and stress we are seeing in US office.

Lemar Persaud, Analyst, Cormark Securities, Inc.

Appreciate the time.

Operator

Thank you. A following question is from Joo Ho Kim from Credit Suisse. Please go ahead.

Joo Ho Kim, Analyst, Credit Suisse Securities (Canada)

Hi. Good morning. Not to beat the dead horse, but just wanted to square up on the US office exposure as well. And correct me if I'm wrong here, but I think some of the performing build from the US this quarter was due to the worsened outlook in the CRE sector specifically. And correct me if I'm wrong, but is there any way you could kind of give us a sense of what the allowances are backing that about, call it, CAD 4 billion of US office CRE. I appreciate the disclosure of the historical losses, but we wanted to get a sense of how prudent or conservative the allowances were there?

Frank Guse, Senior Executive Vice President and Chief Risk Officer

Yeah. So what I would say is a lot of the performing build, you would have seen this quarter is allocated to the US portfolio. A lot of the previous build would also be allocated to the US office portfolio. At this point, I cannot give you a precise number on the performing coverage that we have. But what I would say is we feel a very prudent coverage at this point in time, and we feel very comfortable with that coverage for what we expect on the portfolio.

Joo Ho Kim, Analyst, Credit Suisse Securities (Canada)

Thank you. That's it for me.

Operator

Thank you. The following question is from John Aiken from Barclays. Please go ahead.

John Charles Robert Aiken, Analyst, Barclays Capital Canada

Good morning. Victor, I wanted to dive in a little bit more about the move to an annual dividend increase. Was this something – is this a move that just gives you another six months of capital under your belt? And is this something that was raised by the management team to the board? Or was this actually a board action?

Victor G. Dodig, President and Chief Executive Officer

Our dividend actions are always recommended by the management team to the board. We're effectively just trying to simplify everything, John. So our yield is high, our target payout ratio is at the high end, the consistencies you should get from what we're going to do going forward. Aside from the annual change is that we will grow our dividends as earnings grow. Our plan is to grow earnings and to be within that 40% to 50% payout range. At times, you can be outside it, but I would expect over the cycle, we'll work our way to the middle again. We're at the high end right now. That's the only thing you should read into it.

Our capital generation plan, just as I touched on capital, our plan as a leadership team is to generate capital organically. We are able to do that. Obviously, we're going to do that in the 10 basis point to 15 basis point range, probably more like 10 basis point over the short to medium term. We have our DRIP in place, which generates about 10 basis points, and we can always strategically reposition our balance sheet to free up more capital. As Hratch said, our goal at the end of the fourth quarter is to be north of 12%. We're very pleased with the capital levels that we're at today, particularly given that we've settled all this litigation of the deep past and are working our way to north of 12% by the end of this year.

John Charles Robert Aiken, Analyst, Barclays Capital Canada

Great. Thanks, Victor.

Operator

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

Scott Chan, Analyst, Canaccord Genuity Corp.

Good morning. For Jon, on the Canadian side, Wealth and Asset Management. Can you kind of qualitatively comment on the flows that you're seeing and how that is interconnected with the bank? And then maybe more specifically, can you comment on CIBC's like high interest ETF product now that OSFI is starting to look at a bit more closely?

Jon Hountalas, Senior Executive Vice President & Group Head-Canadian Banking

So let me start with the flow question. On the Asset Management side, I mean, the whole industry is in redemption, right, and we're number three. So we target number three or number two, that's where we'd like to be. So good results, but we need more constructive markets to really show our stuff. On the Wood Gundy side, that's probably where the Commercial Wealth referrals work best because it's more high end, that's working very well. Our flows are good, second best on record. Again, it's lower this year than last. There's less M&A in the commercial bank, so you're seeing less Wealth flows overall.

Victor G. Dodig, President and Chief Executive Officer

I'm also just going to add to Jon's comments. So we look at – our leadership team looks at two things. What does our money in profile look like? What does our money out profile look like? And we seek to compete, obviously, with the peer group that we're competing against day after day, but also manage margins. So the shift that we've seen under Jon's leadership is to shift to both competing but also managing margins so that we can expand margins, which very much ties to the NIM narrative that Hratch shared with you earlier.

We've made some significant investments on the money in side when it comes to mutual funds. Our digital financial planning platform is seeing real results. We are going to be rolling out e-documentation for investments, so our financial advisors in our Imperial Service can get on a virtual call with a financial planner, to a digital financial plan and invest with e-documentation within a very short period of time for our clients, taking the friction out of investing with the bank.

In terms of our deposit products, our checking accounts are really well positioned in terms of pricing in the marketplace. We did really well in terms of term deposit market share growth early last year, and we're pleased with that, so we're not chasing a trend. We identified the trend and did the right thing for our clients and our Direct Financial Services platform Simplii is well positioned to get those clients, especially students and newcomers, where we've seen a robust growth in our market share and our market position to further grow deposits.

Scott Chan, Analyst, Canaccord Genuity Corp.

Okay. Thank you very much.

Operator

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

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

Thank you. Good morning. Two quick follow-up questions for you. The first was on the PCL reversal in Canadian Banking this quarter. Just trying to get a sense of the rationale behind it, because coming out of the pandemic, you have substantial excess allowances and you applied a management overlay to retain those allowances despite an improving macroeconomic outlook. And now we're in a more challenging environment, perhaps on the precipice of recession, why not apply that management overlay again and retain those allowances instead of releasing them to earnings?

Frank Guse, Senior Executive Vice President and Chief Risk Officer

Yeah. Thank you, Nigel, for the question. I mean ultimately, GDP and unemployment have changed to a less pessimistic outlook. Our coverage ratios remain very healthy, and we are constantly applying management overlays and looking at expert credit judgment along the way. Ultimately, we have to and we did disclose what we feel comfortable with, and that is in our results and disclosures this quarter.

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

Okay. And then my second question, when I look at the FDIC bid summary for Silicon Valley Bank, it looks like CIBC did put a bid in there. Is that right? And Victor mentioned that it's early innings, but it looks like you took a swing on the first bid. So just trying to understand the rationale behind that bid?

Shawn Beber, Senior Executive Vice-President and Group Head, US Region; President and CEO, CIBC Bank USA

Hey, Nigel, it's Shawn. Thanks for the question. Look, as Victor said, we always have our antenna up. We watch for what kind of developments are going on in the market, and so to the extent we see opportunity that aligns with our strategy, we'll certainly look at those opportunities.

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

That you bid on – any comment on the bid, is it just the Wealth Business or...

Victor G. Dodig, President and Chief Executive Officer

Nigel, we're not going to comment on anything specifically, like we keep our antenna up. Anything that we do has got to be accretive to the capital in a short period of time. That's how we think about things, right? So the most accretive way to build capital is to invest organically right now, that is really the focus. I think Shawn feels very much that way, so that's all I would say right now.

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

All right. That's it. Thank you.

Operator

Thank you. Our following question is from Sohrab Movahedi from BMO Capital Markets. Please go ahead.

Sohrab Movahedi, Analyst, BMO Capital Markets

Okay. I just wanted to see if – maybe a little bit early to do this, but I wanted to see if you could look beyond the next couple of quarters, Victor, Hratch. I mean, I think you guys have talked about it being a bit of a challenging operating environment. Maybe reserves are going to have to go up, maybe revenues are going to slow down. I'm just curious to get a sense of how much that's within your control here? I'm thinking expenses and risk taking. Just can you give me a sense of your posture right now, whether or not you think you need to tap on the brakes harder on either one of them looking into next year?

Victor G. Dodig, President and Chief Executive Officer

It's a good question. So I'll start off, Sohrab, my colleagues can chime in as they see fit. There's a couple of things I'd note and stress once again. Last year, we saw some robust growth at our bank and a lot of it was tied to the investments that we're making across our franchise. And we've always said, and we've always guided that once that economic environment starts to shift, we're going to shift our investment posture, and we're going to take our expense growth down to a more normalized level.

So I think that from a revenue standpoint, you're going to see a world of normalization. When it comes to NIMs, you're going to see a world of normalization. When it comes to volumes from an expense standpoint, you're going to see the CIBC team continue to deliver expenses in the mid-single-digit range and continue to be relatively flat sequentially over the short term as we work through this economic environment and harvest the investments that we've made.

I think from a provisioning standpoint, Frank has been very clear in terms of what our stance is. So this environment is normalizing and we are well prepared to deal with that normalizing environment. We've built the franchise that we have today purposefully with the client base that we have and the client base that's growing in a world that's normalizing. So that, in general, is how I see ourselves positioned.

Sohrab Movahedi, Analyst, BMO Capital Markets

And no need – I mean just for crystal clarity, it's going to be a tough revenue environment. You're not going to be adjusting your risk appetite necessarily more aggressive or more conservative. Is that a fair statement?

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

Yeah. Sohrab, I'll jump in. I think on the risk appetite, that's a fair statement. And in terms of appetite on the investment side as well, I don't think we need to adjust beyond what Victor said. We do understand that the environment is normalizing. Cost of credit will go up, revenues may slow down. We're controlling the things we can control. We've shown you what we're doing with expenses. And the only thing I would add is our investments were well worth making.

We said at Investor Day that we would have over CAD 2 billion going into 2024, 2025 of pre-tax pre-provision earnings from those. We have over CAD 1 billion of contribution this year is what we're forecasting from those investments, which is ahead of plan. And what we've done is we've – we don't want to get there on our expenses by not investing in the business. That's why I said in my remarks, we're continuing to invest at a steady level. We're focusing that investment in key areas where we have a good return, so we're making some trade-offs, and on the flip side, we're trying to take out expenses and you see our disclosures on that. We're creating efficiency, and we want to do more of that going forward.

Sohrab Movahedi, Analyst, BMO Capital Markets

Perfect. Thank you very much.

Victor G. Dodig, President and Chief Executive Officer

Okay. I think all of you going to bolt before I make my closing remarks. I might as well start now. I want to thank you all for joining today. So to wrap up, a couple of things. Despite the market volatility you're seeing, our leadership team, those who spoke on the call today and those are around the table this morning is delivering solid results. We delivered them this quarter. We plan on doing that going forward. We're going to control what we can control by being highly disciplined in both our capital allocation and how we manage our expenses while still investing as Hratch just said now in strategic areas for future growth.

CIBC has a resilient, well diversified business model. We're well positioned in this current challenging environment with a strong balance sheet that can withstand any potential short-term headwinds. We're also executing on our strategic priorities. We're leveraging our market advantages to deliver more for our clients, and we're bringing more clients to our platform. We're managing CIBC with thoughtfulness and with agility to optimize margins and to optimize efficiency during this very unique period and maintain an unwavering focus on creating value for all of you, our investors.

I want to thank our CIBC team for their continued dedication to helping our clients realize their ambitions day in and day out. Their collective efforts are really essential to building the resilient relationship-oriented bank we have today. And again, I want to thank you all for your continued support, your insightful questions, and we hope that we answered all of them to your satisfaction and look forward to seeing you next quarter and speaking between now and then. Thank you.

Operator

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