CIBC Q2 2022 Earnings Conference Call

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Management Discussion Section

Operator

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

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

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

Thank you and good morning. We will begin this morning's presentation with opening remarks from Victor Dodig, our President and CEO; followed by Hratch Panossian, our Chief Financial Officer; and Shawn Beber, our Chief Risk Officer. Also on the call today are a number of our group heads, including Mike Capatides, US Commercial Banking and Wealth Management; Harry Culham, Capital Markets; Laura Dottori-Attanasio, Canadian Personal and Business Banking; and Jon Hountalas from our Canadian Commercial Banking and Wealth Management. They are all available to take questions following the prepared remarks.

During the Q&A, with a hard stop at 8:30, we ask that you limit your questions to one. As noted 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 meeting over to Victor.

Victor G. Dodig, President and Chief Executive Officer

Thank you, Geoff, and good morning, everyone. I'd like to open the call with a few comments on the macroeconomic environment, followed by a summary of our second-quarter results.

So, there's no doubt we're all in a very fluid environment. First and foremost, our thoughts are with those who have been affected by the war in Ukraine. Beyond its human impact, the conflict has exacerbated COVID-related supply chain disruptions and contributed to inflationary pressures around the globe. Central banks around the globe are responding by raising interest rates to cool inflationary pressures, which is leading concerns to an economic slowdown. Now, during times like this, our unrelenting support for our clients together with our diversified business model, our strong balance sheet, and our prudent risk will drive consistent and sustainable performance for CIBC.

You can see this resilience in our financial performance. Against this macroeconomic backdrop, we reported solid results this quarter, underpinned by our strategic focus on investing for profitable and enduring growth. Revenue was up 9% over last year, driven by broad-based loan and deposit growth, higher fee income, and strong client base trading activity.

Adjusted earnings of CAD 1.7 billion or CAD 1.77 per share were down modestly from the prior year as we were starting to see a normalization in provisions for credit losses. We also reported an adjusted ROE of 15.2% and a CET1 ratio of 11.7%, well above the 10.5% minimum requirement. Having delivered solid financial performance on behalf of our shareholders in the first half of the year, today we also announced the CAD 0.025 increase to our common share dividend to CAD 0.83 per share while maintaining our payout ratio target of between 40% and 50%. Note that the dividend also reflects the previously announced two-for-one stock split that took effect earlier this month.

Well, turning to our business results. Our Canadian consumer businesses demonstrated continued strength during the quarter with growth on both sides of the balance sheet. Excluding contributions from our Costco Mastercard acquisition, card purchase volumes were up 22% from a year ago most notably in discretionary

spending such as on hotel, entertainment, restaurant expenses, as well as for transportation services as the economic reopening took hold.

During the second quarter, we also completed our acquisition of the Costco credit card portfolio in Canada, adding one-third to our total purchase volumes. We're very pleased to welcome more than 2 million new clients to CIBC. Early performance of the portfolio has been positive. New account acquisition, purchase volumes, and balanced growth are all tracking ahead of expectations. We have initiatives in place to deepen relationships with our newly onboarded clients and look forward to reporting on our progress to you in the quarters ahead.

We also continue to build relationships with our existing CIBC clients by making investments for the future. Post quarter-end, we launched CIBC Smart Start, a no-banking – a no-fee banking and no-fee self-directed trading solution to help Canadians up to the age of 25 get a head start on their financial journey. Better said, if you're under 25, you bank for free, and you trade for free at our bank. We're the first among the major Canadian banks to offer this, and we believe it'll further our momentum in new client acquisition. This program simplifies our existing offerings for youth and students by providing a market-leading solution to this cohort. Over the last 12 months, we've seen a 32% growth in our student population, and the new offering will further support this segment.

In North American Commercial Banking and Wealth Management, loan demand increased on both sides of the border, fueled by our existing client base to support their existing – increased working capital requirements and from new client relationships. In Wealth Management, volatile markets driven by geopolitical concerns dampened asset growth to single digits in Canada, with a slight decline in the US, and this compares to double-digit growth in both regions last quarter. Now, in spite of this market volatility, we continue to deliver solid net flows across our wealth businesses in both regions.

In Capital Markets, our focus on supporting clients through volatile markets generated strong trading revenue. As well, our direct financial services business continued to benefit from volume growth in both Simplii Financial and our currency conversion business associated with our International Student Pay and international student banking offers. Overall, each of our businesses contributed to solid results.

Now, we're proud to be recognized this quarter by Mediacorp Canada who named CIBC as one of Canada's best diversity employers for the 12th consecutive year; and by Equileap who ranked CIBC the number-one gender equality employer in Canada for the second consecutive year. At CIBC, culture matters. Providing an inclusive environment to attract and retain talent with differing ideas and insights is a cornerstone of our bank's culture. By having a team that reflects our clients and communities, we can better deliver on our purpose of making our clients' ambitions a reality.

Now, looking ahead, we're well positioned to continue to deliver for our shareholders. In an environment that's increasingly fluid, one thing remains unwavering: our focus on what we can control. As we did at the outset of COVID, we will continue to demonstrate our resilience as we adapt to the changing economic environment with an emphasis on agility and an emphasis on stewardship. Today, CIBC is a bank with a streamlined and increasingly digitized infrastructure. Our collaborative culture and client-first strategy will enable us to drive profitable growth over the short, over the medium, and over the long term. You're going to hear more about our strategy, our capabilities, and our vision for the future and have the opportunity to connect with our leadership team more directly at our upcoming Investor Day.

And now, with that, let me turn the call over to Hratch to review our second-quarter results in more detail. Over to you, Hratch.

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

Thank you, Victor, and good morning, everyone. Our CIBC team continued to deliver solid growth and profitability this quarter, fueled by the disciplined deployment of balance sheet resources and targeted investments against our client-focused strategy.

Diluted earnings per share was CAD 1.62, and excluding the items of note detailed in the appendix of this presentation, adjusted EPS was CAD 1.77. Pre-tax pre-provision earnings growth momentum remained strong, while pre-provision – provisions for credit losses against performing loans trended higher due to a more pessimistic economic outlook and the initial IFRS 9 expected credit loss against the Costco credit card portfolio treated as an item of note. Shawn will cover credit provisions in further detail later in our presentation.

The balance of my presentation will refer to adjusted results which exclude items of note, starting with slide 8. Net income of CAD 1.7 billion was comparable to the prior year, and ROE remained above our 15% target. Pre-provision pre-tax earnings of CAD 2.3 billion were up 7% from the prior year, and revenues of CAD 5.4 billion were up 9% supported by broad-based volume growth, stable margin, robust trading and fee income. Expenses were up 1% sequentially or 11% from the prior year, largely due to continued investments, inflationary headwinds, and performance-based compensation across our business.

Diving into revenue further, slide 9 highlights the key drivers of net interest income. Excluding trading, NII was up 13% from last year due to robust growth in funds managed on both sides of the balance sheet. We anticipate NII growth to remain strong in the back half of the year, benefiting from continued volume growth and the interest rate outlook embedded in the forward curve. Total bank NIM was up 1 basis point sequentially and, underlying this, Canadian Personal and Commercial Banking NIM was up 2 basis points, benefiting from the impact of the Costco credit card portfolio and rising interest rates, partly offset by changes in mix and competitive pricing. P&C NIM is positioned to continue improving on the back of rising interest rates and growth in higher-margin unsecured lending. Consistent with our prior guidance, NIM in our US segment was down 6 basis points over the last quarter, primarily due to lower nonrecurring items including prepayment income.

Slide 10 provides an overview of our go-forward sensitivity to interest rates. We continue to be positioned to benefit significantly from rising rates.

Turning to slide 11, noninterest income of CAD 2.3 billion was up 5% from the prior year. Market-related fees were up 6%, helped by strong growth in trading revenues, particularly in interest rates, foreign exchange, and equities. Conversely, lower underwriting and advisory fees were impacted by a more modest industry issuance and deal volume. Transaction-related fees were up 9% from the prior year, benefiting from credit as well as deposit and payment fees.

Turning to slide 12, expenses were up 11% over the prior year, or 9% excluding higher performance-based compensation driven by strategic initiatives, most notably, the Costco credit card program and investments in our US platform, as well as the impact of inflation on baseline operating expenses. While inflationary pressures have been more elevated than originally anticipated, we continue to target neutral, positive operating leverage for the fiscal 2022.

Over the last several quarters, we've successfully deployed excess balance sheet resources towards organic growth across our franchise, but our capital and liquidity position remains strong as highlighted on slide 13. We ended the quarter with a CET1 ratio of 11.7%, down approximately 50 basis points from the prior quarter, driven largely by the closing of the Costco credit card portfolio and the impact of market volatility in the quarter on both the value – fair value of [ph] CI securities (00:11:36) and market-related RWAs. We expect capital ratios to be more stable going forward as internal capital generation funds, organic growth and return of capital to shareholders.

Turning on slide 14, we highlight our strategic business unit results. Net income in Canadian Personal and Business Banking for the quarter was CAD 577 million, down 4% from a year ago, driven by higher provisions for credit losses. Pre-provision, pre-tax earnings of CAD 962 million were up 9% from the prior year, reflecting share gains as we continue to grow our consumer and business franchise.

Revenues of CAD 2.1 billion were up 10% from the same quarter last year due to broad-based volume growth, including the Costco card portfolio and higher fee income, partially offset by margin pressure, particularly in mortgages. We have added some incremental disclosure on this page, highlighting the diversified nature of our revenue growth, which is supported broadly by contributions across our Canadian franchise.

Expenses of CAD 1.2 billion were up 3% sequentially and 11% from the same quarter last year, which included a onetime recovery as highlighted in my remarks at the time. The remaining growth was largely driven by higher strategic investments and employee-related expenses.

Moving on to slide 15, net income in Canadian Commercial and Wealth Management was CAD 480 million, up 20% from a year ago. Pre-provision, pre-tax earnings of CAD 648 million were up 23% from a year ago, benefiting from strong volume growth in constructive markets.

Commercial Banking revenue was up 24%, supported by robust double-digit loan and deposit growth, which is expected to moderate going forward. Wealth Management revenue was up 9%, primarily driven by higher fee-based assets, which benefited from net sales and market appreciation over the last year. And increased expenses were in large part due to higher revenue performance and investments in strategic initiatives.

Net income in U.S. Commercial and Wealth was $152 million in US dollars, down 17% from the prior year, driven by higher credit provisions. Pre-provision, pre-tax earnings of $228 million were up 2% over the same period.

We continue to execute on our plans to scale our US business organically by simultaneously investing in our client base to drive revenue growth, as well as our operational and risk management infrastructure in order to keep pace with the scale of the business and support our long-term growth ambitions.

Revenues were up 10% over the prior year, supported by strong growth in average loans and deposits and fee income. Expenses were up 1% sequentially and 18% from the prior year, largely due to our ongoing investments in client-facing capabilities and infrastructure across our US operations. We expect expense growth to moderate in fiscal 2023 as we complete the ongoing foundational investments towards the next phase of our organic growth.

Slide 17 speaks to our diversified Capital Markets business. Net income of CAD 540 million was up 9% from the prior year, while pre-provision pre-tax earnings of CAD 724 million were up 10%. Revenues of CAD 1.3 billion were up 10%, driven by strong performance from global markets, corporate banking and direct financial services, partially offset by lower investment banking revenue, as both originations and advisory activity was more muted year-over-year. Expenses were up 10% as well, driven by employee-related compensation and continued investment in support of our strategic growth.

Slide 18 reflects the results of our Corporate and Other segment. Net loss of CAD 137 million in the quarter compared to a net loss of CAD 60 million in the same quarter last year. The decline in profitability in the segment was largely related to Treasury, driven by increased funding issuance as well as significant market volatility and rapid increase in credit spreads experienced in the quarter. We anticipate losses in this segment to remain elevated in the short term if the current market conditions persist.

To close, our second quarter results demonstrate continued momentum across all of our businesses, notwithstanding a more uncertain operating environment. Our balance sheet continues to provide us with significant flexibility to deploy capital in support of our clients to fuel organic growth and enhance shareholder returns. Thanks to our client-focused strategy, diverse business mix, and disciplined approach to capital

allocation across our client franchise, we are well positioned to respond to a changing operating environment in order to continue delivering growth and solid profitability.

With that, I'll turn the call over to Shawn.

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

Thank you, Hratch, and good morning. Our credit performance was strong this quarter and our portfolios are performing well. We have continued to support our clients, while proactively managing our underwriting activity in response to the evolving environment. And we remain comfortable with our risk levels and coverages.

As Victor mentioned, in the second quarter of 2022, we also closed our acquisition of the Costco credit card portfolio, which is reflected in our Q2 results. It's a very high-quality portfolio, and credit quality and performance has been in line or slightly better than our expectations.

Slide 21 details our provision for credit losses on both a reported and an adjusted basis. Our reported PCL was CAD 303 million in Q2, compared with the provision of CAD 75 million last quarter. Excluding the performing allowance related to the Costco credit card acquisition, which is treated as an item of note, our adjusted PCL was CAD 209 million in Q2.

Provision on impaired loans was CAD 196 million in Q2. Impaired provisions were up in Canadian Personal and Business Banking due to the impact of rising interest rates on our modeled stage 3 allowance and higher write-offs as clients have begun reverting to pre-pandemic spending patterns. This is aligned with our expectation and net credit losses continue to perform better than pre-pandemic.

Provisions in business and government loans were up this quarter due to slightly higher impairments and fewer reversals. The adjusted provision for our performing portfolio was CAD 13 million this quarter, reflecting some deterioration in our forward-looking indicators from last quarter. We're pleased with the continued strong performance of our portfolios.

Turning to slide 22, our allowance coverage ratio was down a net 3 basis points quarter-over-quarter, mainly attributable to our portfolio growth and impaired allowance release, partially offset by the build in allowances associated with the Costco portfolio acquisition. Our allowance dollars were flat quarter-over-quarter. We continue to be comfortable with our coverage ratios, which remain above pre-pandemic levels.

Slide 23 details our lending portfolio mix. Consistent with previous quarters, our portfolio reflects good diversification and strong overall credit quality.

Against the backdrop of an evolving mortgage market, with respect to our mortgage portfolio, I'd make a few observations. The average loan to value for our uninsured mortgage portfolio has been trending down over the past several quarters and is currently 46%. The majority of originations over the last two years, including this past quarter, have been with our higher credit quality clients who have deep and balanced banking relationships with us. The loan to values of new originations has trended down over time from 70% in Q2 of 2020 to 65% in Q2 of 2022.

Client credit scores have been favorable, deposit balances have increased, as have client incomes, and debt service metrics have remained stable over the past year. We're pleased with our origination activity and the strength of our portfolio.

And turning to our business and government portfolio, the average risk rating has been stable, remains equivalent to a BBB and continues to perform well.

Slide 24 details our gross impaired loans. Overall gross impaired balances were down in Q2. Retail impaired balances were down slightly, while the business and government portfolio experienced a larger decrease due

to higher write-offs. New formations remained stable and low from a historical perspective, and both the gross impaired loan ratio and new formations remain lower than our pre-pandemic run rate.

Slide 25 illustrates the net write-off and 90-plus day delinquency rates of our Canadian consumer portfolios. Net write-off dollars trended higher in Q2, as expected, as clients have begun reverting to pre-pandemic spending patterns. The new Costco card portfolio also contributed a small amount to the write-off dollar increase this quarter, in line with our expectations.

Overall, retail 90-plus days delinquency rate remained relatively flat in Q2, with a decrease in residential mortgages, partially offset by a slight increase in personal lending and the impact of the Costco card acquisition.

In closing, we continue to see strong overall performance. We expect a return to more normalized credit losses over time. The performance year-to-date has been favorable. We are, of course, monitoring closely for potential impacts from the pandemic, the inflation and rate environment, and broader geopolitical developments that could affect our outlook.

I'll now turn the call back to the operator.

Question and Answer Section

Operator

Thank you. We will now take questions from the phone lines. [Operator Instructions] And the first question is from Ebrahim Poonawala from Bank of America. Please go ahead.

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

Hey. Good morning. I guess maybe just sticking with expenses, Hratch, if we could talk through the breakdown that you provide on slide 12 in terms of the makeup of the expense growth this quarter.

As we look into the back half, remind us how we should think about either operating leverage or year-over-year expense growth. And also talk to us about the flexibility to pull back on expense spend, particularly as we look out into next year. On the one hand, inflationary pressures are going to probably push expenses higher.

Just give us a sense of like how we think about expenses in the back half of the year. And as we think about 2023, I realize you are not going to give any guidance, but just talk to us around investment spend versus areas to kind of pull back if you need to.

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

Thank you, Ebrahim, for the question and happy to provide some color. And we'll certainly get a lot more into our 2023 plans in Investor Day in a couple of weeks here.

But as context, I'll remind everyone how we've spoken about our investments and increases in our expenses and our targets from a financial performance perspective, which have not changed. We continue to target over time pre-provision earnings growth and positive operating leverage, and we continue to believe that we have the abilities to our strategy and our capital allocation approaches to make adjustments in order to respond to the environment and deliver that.

And so, as I look at this year, we had promised 5% to 10% pre-provision earnings growth and positive operating leverage. We talked last quarter about the fact that there is some puts and takes, but we felt overall pretty good about being able to deliver that. In fact, on the pre-provision side, to some extent, we feel we will deliver more than what we had expected to deliver.

And so we're staying in the course in terms of our approach. But we are aware of a lot of the things that you're talking about. We look at the environment and on this chart here I'll highlight, we've got the inflation impact and the normalization of the environment impact. And that sort of half-ish of that 5% operating cost increase, there's been probably about 1% more pressure there than we had expected.

But against that, we have had successes in our efficiencies, which have been, in some cases, outperforming our expectations. We have looked at our strategic investments and paced them to some extent. And so we've already been reacting, and we have the ability to react through the rest of the year.

Now I will point out in our strategic investments, you'll see two big buckets. We've highlighted Costco, and that's been ramping up over several quarters now as we're preparing to bring that program on and we had a partial impact of those expenses this quarter. We'll have the full impact next quarter. And after that, that will start plateauing.

Our investments in the US franchise, which again has been ramping up, but we see that plateauing towards the end of this year. And so, overall, we will continue investing at a high level, but that accelerated investment and the step-up and the increase in expenses that that was causing us, there'll be some room for that to moderate.

And so I would expect going into the back half of the year and to next year, some of that moderation. We have levers to pull again to move that around by a couple of percent if we need to, obviously, for this year. Every day that passes, there is less and less of that lever. But net-net, I think we'll be able to offset some of the headwinds and we'll be able to deliver a better pre-provision earnings result than what we expected in that range. And we are still striving for that positive operating leverage, right, right side of neutral for this year.

Victor G. Dodig, President and Chief Executive Officer

And Ebrahim, just to build on Hratch's remarks, this is all consistent with what we've telegraphed to our investors. We are investing to grow, grow client franchise with enduring value. And you see that in terms of our market-leading revenue growth, our market-leading pre-provision growth, our strategic and focused way of growing market share profitably by deepening client relationships, our improving client experience scores. So all of these investments, and I look at them as investments, are delivering growth above market and above our peer group.

And I think that's the most important thing to note here is the linkage between what we've telegraphed, what we've done, what we've delivered, and what we will continue to deliver going forward.

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

Got it. Thank you.

Operator

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

Scott Chan, Analyst, Canaccord Genuity Corp.

Oh. Thank you. Good morning. And then, Hratch, maybe just a technical question on the sup, if you look at slide 8, there's another large gain on the FI. I think it was like CAD 286 million, similar to last quarter. Just maybe some context around that and maybe some guidance on if that is going to kind of persist going forward or should that moderate towards historical standards?

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

Sorry. It was a bit muffled in the beginning, so we didn't hear the beginning part of your question.

Scott Chan, Analyst, Canaccord Genuity Corp

Oh. Just on the supplemental, I think it's slide 8, there was larger gain of CAD 286 million on the financial instruments. I'm just wondering what that was. Did you get a large gain last quarter as well? And that's certainly a lot higher than historical standards.

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

Yeah. Nothing that I would highlight with that respect. That would be something on an ongoing basis.

Scott Chan, Analyst, Canaccord Genuity Corp

Okay. And maybe just on mortgages, you talked about margin pressure. Is that due to competition mostly?

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

Yeah. We are seeing – and Laura can jump in here from a business perspective. But we did – I referenced some of the pressure on margins and there is some of that pressure on the mortgages, as we said, on the PBB side.

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

Yeah. Hi, Scott. Yeah, we did see a lot of, I'm going to say, inflow margin compression and the whole industry has seen that. I'd say the market's been incredibly competitive and our economic environment did see our funding costs, I'd say, rise faster than client rates.

So, our expectation when it comes to mortgage inflow spreads is that we expect them to slowly improve when we enter the back half of the year. And that's as we see sort of the increased pricing work its way through the system.

I think you've seen we've taken a market leadership position in raising prices over the last few months when it comes to mortgage pricing. So we're working hard to restore, I'd say, more sustainable margins.

So, as we get through the back half of this year, we should see some of that margin compression start to come off in the mortgage book.

Scott Chan, Analyst, Canaccord Genuity Corp

Okay.

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

And maybe if I – sorry if I jump in on your question, I think you had the wrong slide reference. I think you're referring to slide 6 and you're referring to the [ph] fair value P&L (00:28:21). That's just related to the trading revenue. And so the strong trading revenues coming through the other income typically come in in that line. So you saw last quarter strong trading revenues reflected there and this quarter, the strong trading revenues.

Scott Chan, Analyst, Canaccord Genuity Corp

Okay. Thanks, Hratch. Thanks Laura.

Operator

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

Meny Grauman, Analyst, Scotia Capital, Inc.

Hi. Good morning. Just a question on cards. First, just in terms of numbers. The card fee line down sequentially. Is that just seasonality or is there something else there driving that?

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

Good Morning, Meny.

Meny Grauman, Analyst, Scotia Capital, Inc.

Hi. Good morning.

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

I'll take that. So on cards, we're actually seeing, I'd say, continued improvements in purchase volumes. So when I exclude Costco, we're actually up almost 30% year-over-year, and I think we're up about 30% from 2019 levels.

So we have seen, I'm going to say, full recovery, if you will, in the categories that are travel, hotel, entertainment. So everything is good. If you're looking at quarter-over-quarter where you see, if you will, things coming down a bit, that's really just seasonality. But when we go back over the years and look at quarter-over-quarter seasonal decreases, this has actually been one of our better quarters. So we're feeling pretty good about our card performance.

What I would say, though, is that our interest-bearing balances, those did remain flat on a year-over-year basis and again, they were also down a bit quarter-over-quarter. That's all seasonality. And I do think, as I've mentioned in previous calls, it's going to take some time before those increased purchase volumes translate into revolving balanced growth.

But it is coming. And when it does, I would say that we are very well positioned for growth just given, again, the strong value propositions of the cards that we have out there. We've been leading the market on new account sales in cards, excluding Costco. And as of March, we now have the Costco card portfolio and the new account growth on that.

It's still early days. It's been well, well, well above expectations. So I think things are looking good for us on a go-forward basis.

Meny Grauman, Analyst, Scotia Capital, Inc.

Thanks for that. And your comments is a good segue. The second part of my question was just about thinking about the card spending versus borrowing, what that tells you about the health of the consumer?

Obviously, everyone's worried about recession, downside risks, but when you look at that, just wondering if there's any – do you see any signs of stress there or – actually, when I look at it, it tells me the opposite story. So just wondering on the perspective there in terms of the health of the consumer as you see it through the lens of your card book.

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

Yeah. We're feeling really good about the, I'd say, the health of the consumer. We're seeing – again, we saw it through the pandemic. We continue to see, I would say, very prudent client behavior.

When we look at our – whether it's cards or other unsecured lines and we look at utilization rates, if you will, things are actually much better than they were pre-pandemic. And so, utilization rates are down, I want to say, about 20% when we look at our unsecured lines or even HELOC. So if we go back to pre-pandemic, 2019 compared to today, and so we see people using less. And then our cards business, our revolve rates from 2019, they're down, call it, 7% to 10%.

So we're seeing very prudent behavior when it comes to how people are managing their debt and how they're making payments on their credit cards. So very, very pleased with the performance that we're seeing from our clients.

Victor G. Dodig, President and Chief Executive Officer

And very well positioned strategically for growth going forward. What we've built and what's happened here with our card portfolio is a market-leading portfolio, Meny. You look at the travel card portfolio, the non-travel card portfolio, and CIBC has the best card portfolio in the marketplace.

The 2 million-plus newly onboarded clients from Costco, most of them don't bank with us, and a large majority are affluent and a significant minority are small business owners. Both of those will contribute to increased growth going forward. And that's why the message about investing for the future is an important narrative for us that differentiates us from the rest of the marketplace.

We're one of the few banks in North America that are investing and growing at the top end of the market, and a lot of that is due to these investments in the card portfolio, our US business, Innovation Banking, the list goes on. And that's why we're confident going forward that we're going to be able to continue to deliver market-leading growth.

Meny Grauman, Analyst, Scotia Capital, Inc.

Okay. Thank you very much [indiscernible] (00:33:34).

Operator

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

Gabriel Dechaine, Analyst, National Bank Financial, Inc.

Hi. Good morning. My question is for Shawn. I mean, the change in provisions there caused by the additions to performing, excluding the Costco stuff, I mean, looks driven mainly by adjustments to your economic indicator – forward-looking indicators. I'm seeing more conservative versus last quarter Canadian GDP, US GDP forecast, and the Canadian housing price index. Is there any one of these factors that's much more influential than the others, just to kind of get a sense of GDP in Canada and US, more important than the housing price forecast?

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

Great question, Gabriel. Thanks for the question. You're right, the FLI are what have driven the performing build, excluding the Costco acquisition this quarter. We're very pleased with the performance from an impaired loss perspective on the portfolio.

Given the deterioration in the FLI quarter-on-quarter, it sort of resulted in a flattish small build. But the more significant – in the context of this quarter, the more significant item is the debt service ratio change, which is reflective of the higher interest rate environment and some of those knock-on impacts. And so, that's really one of the more influential ones this quarter.

The GDP deterioration in the growth forecast impacted some of the business units as well. But I'd say DSR was one of the more sensitive ones this quarter.

Gabriel Dechaine, Analyst, National Bank Financial, Inc.

[ph] Where do – is that just why you don't list then these (00:35:23)...

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

Yeah. It’s in Note 6.

Gabriel Dechaine, Analyst, National Bank Financial, Inc.

Oh, okay.

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

Yeah. Yeah.

Gabriel Dechaine, Analyst, National Bank Financial, Inc.

I'll take a look. Thank you.

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

Okay.

Operator

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

Mario Mendonca, Analyst, TD Securities, Inc.

Good morning. Shawn, can you help me understand – and I think you described it, but I think I could do with a better understanding of the increase in impaired PCLs in the Canadian Personal and Business, I didn't see any deterioration in delinquencies or formations. Is that increase predominantly Costco or is there something else going on there?

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

No, it's – remember that the impaired losses also have a modeled component to them. And so, when the FLI and again, the debt service coverage for both personal and for mortgages, when that change occurred in the forecast, that has a knock-on impact both from a performing perspective, but also from a impaired loss perspective for those portfolios. So that's what you're seeing. More than half of the build in the PBB result was a reflection of the modeled FLIs.

Mario Mendonca, Analyst, TD Securities, Inc.

And Costco would be the modest portion then.

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

Yeah.

Mario Mendonca, Analyst, TD Securities, Inc.

So, I don't expect you to comment on other banks, but CIBC is the only one where I saw this play out. In no case did I see this play out for any other bank. Is it just all the banks have their own sort of models and sensitivities and we shouldn't expect it to match quarter-to-quarter?

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

Yeah. I can't really comment on the other banks. We've built our models. We obviously follow IFRS 9 based on our interpretation and understanding of it. When we've inputted our FLI, we have generated the result that you've seen. So you could see variability quarter-on-quarter.

We've also had significant growth in the portfolio, so that also impacts the performing provision. We've had some release. You all have seen in Capital Markets, there was a release that related specifically to oil and gas given the improved outlook for – well, the improved results and outlook.

But from quarter-to-quarter, as we've talked about, as the macroeconomic environment deteriorates, we may see build. And if it improves, then we could see releases. But quarter-on-quarter, we had a modest deterioration and so that came to our results.

Mario Mendonca, Analyst, TD Securities, Inc.

Okay then, a broad question then probably for Victor or Hratch. All our banks have used their capital to grow in different ways. Some are doing it through acquisitions. It's clear that CIBC, the process has been to grow RWA organically. But it would appear to me that with the capital ratio tracking back a little now and your guidance, that it should maybe remain stable going forward. Would I be correct in suggesting that the bank will manage the RWA a little bit more or manage that growth a little more closely? By that, I mean, we may not see RWA growth at the same pace we've seen in the past.

Victor G. Dodig, President and Chief Executive Officer

Mario, good morning. It's a good question. I'd highlight a couple of things. One, you're absolutely right that our focus is on organic growth, and that's why you see that reflected in every single business unit that we run. You see growth, and it's client-focused growth. If you lift the hood on that growth, there are deep, meaningful client relationships from Personal Banking right through to Capital Markets. At 11.7%, we feel very good about where we're at. We have the cushion to deal with any market volatility that may come to all the banks in the banking sector, and it allows us the room to continue to grow.

You may have seen the peak in terms of high growth rates, but we will continue to pace to be at the top end of the market, win client relationships, win profitable market share going forward. You'll see some Basel-related changes next year that will add to capital and that will give us continued – excess capital to continue to grow and deploy that capital through the various avenues that we've articulated in the past. So, we feel good about our strategy of organic growth. We feel good about our level of capital. And we feel good about our level to continue to grow at the top end of the market, do it profitably, and do it sensibly.

And, Hratch, I don't know if you'd like to add anything to that.

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

As Victor covered, this was a deliberate strategy, Mario. So, maybe the only thing I'll add, right, as a reminder, as we were coming out of the pandemic with peak levels of capital and liquidity, we had telegraphed that we made a conscious decision to deploy that capital for growth organically. We've also communicated the reason we did that – and we will talk a lot more about that in Investor Day – is we've done good M&A in the past, and we believe we can continue the good M&A. But organic growth returns are always superior, particularly in the short term. And as long as we have good opportunities to grow organically, we feel that is a better use of capital than any other avenue we have, including returning capital to shareholders.

We are focused on generating tangible value and growing tangible value for our shareholders, and that is the best lever we have. And so, we've leaned on it, and so we've deliberately been bringing down our excess capital position through organic deployment. To your point, that continued this quarter, right? Take out some of the market volatility which will be [ph] back and (00:40:03) forward, take out Costco which is a onetime, you'll see that we drew down on capital even on an organic basis, and that was deliberate and planned. At the levels we are now, as Victor said, we feel comfortable there's still buffer, but from this point on, I would expect a more

balanced, where as I said in my remarks, generation will be offset by the deployment and the return of capital. So, we'll be generally around these levels; plus or minus is what we expect on capital.

But that still allows us with that level of capital deployment given the investments we've made so far. And some of the investments we've made now will allow us to grow more capital-light growth. On the back of those, Costco is a good example. We have RWAs against that portfolio, but now there's a lot of franchising opportunities that will be more capital-light. And so, that's what allows us to now continue to grow, have the revenue and pre-provision earnings momentum, but keep capital more flat from here.

Mario Mendonca, Analyst, TD Securities, Inc.

That’s clear. Thank you.

Operator

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

Lemar Persaud, Analyst, Cormark Securities

Thanks. My question's for Shawn. Maybe just coming back to the response to Gabriel's question on the debt service ratios impacting the performing build this quarter. Should we expect additional builds if interest rates continue to move higher just because, as you're aware, consensus estimates for Bank of Canada interest rates, they still contemplate a number of further rate hikes throughout the course of 2022 and 2023 [ph] so is there (00:42:34)?

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

Good morning, Lemar. So, the FLI contemplate a rising rate environment, so they're forward-looking. So, we've built into the forecast that raising – that rising rate environment. I'd say we've captured our current view of it; maybe an extra 25-basis-point move in the outer quarters. But we've reflected our view of what that rising rate environment is going to be. So, unless that outlook changes materially, then wouldn't expect to see additional builds just as a function of that.

Lemar Persaud, Analyst, Cormark Securities

Okay. That's great. Okay, thanks, guys.

Operator

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

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

Shawn, you're – I guess you're on the spot today. I'm just going to come back to you. I just want to – I hear you on the IFRS and the forward leading indicators and the models and one of those tools that I guess management teams use, but as the Chief Risk Officer, when you stand back and you think about qualitatively the outlook, the quality of the portfolio, and the growth that the bank has been delivering, do you feel adequately reserved?

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

Good morning, Sohrab. It's a great question. I'd say, yes, the portfolio continues to perform well. When we look across the various businesses, when we look across the growth that we've achieved across our retail and our business and government portfolios, we're very comfortable with the underwriting that we've had in place. I

think it positions us well. As you know, the way the models work, if there's a deterioration, we set it – we have the results from last quarter. We reflect the change in the economic outlook and then reflect that in our performing provisions.

And so, this quarter, as I said, you wound up with a flattish performing provision, but feel very good about our portfolio and the road ahead. We don't see near-term stresses. We've seen some. We've talked about this in prior quarters. We expect to see some normalization of those loss rates over time as things get to some level of sort of pre-pandemic activity. I expect that sort of over the coming several quarters, but frankly, there's – the uncertainty out there, I think, is reflected in the performing provision. We feel good about our allowance coverages which remain strong.

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

And just as a kind of addendum to that, you – I think you mentioned the GDP growth forecast as one of the forward leading indicators to higher rates. And I think the debt service ratio. Is it fair to say that there was a countervailing balance here because of unemployment rate, and that – is that yet another area that I guess it become a net negative here, or you – how should I think about how you have factored unemployment rate outlooks I suppose into – in your thinking?

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

Yeah. So, again – yeah, in Note 6, we disclosed our forecast for the unemployment rate. There have been small changes there, but we will continue to factor that into the analysis going forward as one of the – it's certainly one of the FLIs. As I was saying earlier, the debt service coverage was a particularly impactful one this quarter on the performing.

Operator

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

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

Thank you. Good morning. I had a follow-up again on your allowances for performing loans, and I wanted to tackle it a different way. When I look at your disclosure on stage 2 loans, based on my math, for personal and credit card loans, you have about 20% of both portfolios sitting in stage 2, and that's relative to stage 2 loans running at about 10% prior to the pandemic. So, I'm trying to get a sense of what's the rationale for about 20% of that portfolio being in stage 2 and what's preventing the migration of those loans into – back into stage 1?

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

So, as you recall, we had builds over the course of 2020. We started from a coverage perspective on our performing balances at 35 basis points. We're now at 45 basis points after having released provisions over the course of time. To the extent – as the environment continues to improve, then we would expect to see some of that migration happen. But as I said, with the FLIs moving the way they have – we're watching that migration closely – it's still reflective of our – of the overall performing build.

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

So, trying to get an understanding here because these two loans represent a significant increase in credit risk. So, should we interpret that as your [ph] extra credit (00:47:52) judgment that 20% of your personal credit card portfolio is exhibiting a significant increase in credit risk [ph] was vulnerable (00:48:00) to a significant increase of credit risk?

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

Well, it did – we did recognize that over the course of 2020. And to the extent that we continue to look at those portfolios and in some areas continue to exercise that same judgment, we're watching for that -- those indications of continued positive migration. And you could see that coming through in subsequent quarters. But it's really a reflection of the build over the course of 2020.

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

And I assume that's the same rationale for your mortgage book with the 6% in stage 2 versus closer to 3% pre-pandemic?

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

Correct.

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

Okay, great. That's it from me. Thank you.

Operator

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

Doug Young, Analyst, Desjardins Capital Markets

Hi. Can you hear me?

Victor G. Dodig, President and Chief Executive Officer

Yes.

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

We can hear you, Doug.

Doug Young, Analyst, Desjardins Capital Markets

Okay. Perfect. Just on the commercial loan growth, obviously very strong in Canada and the US, an area that I think you obviously in the team has been quite focused on. I'm just more curious, what are you hearing from businesses? Because it does seem counter to what the feeling out there, and I've had this question from many people about what you feel when you read the paper every day. And more importantly, so – well, that's one part of it. And then at what level of growth should we expect this to normalize, or is this a level of growth that you think you can continue to drive over the coming year?

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

Good morning and thank you for the question. It's Jon Hountalas. I'll start and then pass it over to my colleague, Mike. So, last quarter when we – I was asked the question about confidence in the environment. I classified business confidence is very strong. And today, three months later, it's still strong. It's a nudge down for sure, but people are still feeling good. Demand for product is there. Price increases continue to get passed on. Labor remains a challenge. Supply chain is hit and miss. Some people tell me it's getting better. Some people, worse. But, overall, people remain confident. So, in terms of Canada and growth, I mean, this quarter

was particularly strong. I think we were 6% quarter-over-quarter in loan growth. I don't think you'll see that. I think you'll see us go back to our normal, healthy historical rates, low double digits, and I think we'll outperform the market.

Mike, I'll pass it to you.

Michael G. Capatides, Senior Executive Vice-President and Group Head-US Region, President & Chief Executive Office CIBC Bank USA, USA

Thank you, Jon. So, it's more of the same in our commercial book and with our clients in the US. As Jon just described, our clients remain confident. They're a bit more cautious as they – and they're dealing with, as you mentioned, supply chain issues, employee shortages, and inflation. But they're focused on growth. They're borrowing to rebuild our inventories, and that's reflected in our revolver utilization, getting back up to more historical levels. And on the real estate side, they're building to meet housing demands in the US. So, for our commercial clients, we can describe the sentiment as good, as confident.

And what they're telling us mostly, if you had to sum it up, is that demand and revenue is not an issue for them. They're experiencing margin compression. That's a bit of concern, but they're still looking at growth. Like, Jon, in the US, we see this very healthy growth that we had in the US, which on a spot basis got to 18% year-over-year. We see that moderating, but we still expect to see growth in the – in a double-digit range moving forward.

Doug Young, Analyst, Desjardins Capital Markets

And just a quick follow-up and maybe for Canada and the US, is there a particular sector where you're doing particularly well or sectors that you're taking more market share?

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

This is Jon. In Canada, about 40% of our growth has come from real estate. 15% has come from Innovation Banking. We'll talk a little bit about that on Investor Day. That's been a focus for us, and I think we're doing very well there. And the rest is very broad-based by industry and by geography. Mike?

Michael G. Capatides, Senior Executive Vice-President and Group Head-US Region, President & Chief Executive Office CIBC Bank USA, USA

A little bit different in the US and a bit of a reversal from prior quarters. Our C&I portfolio and businesses and customers led the way on growth the past couple quarters and this past quarter in particular. We've also seen a fair number of payoffs in the real estate area, but it's reflective of our growth at our strategy in the US where our network of offices around the country where we've brought in new teams, new bankers, new products, they're all coming on line. And a lot of that's on the C&I side, and we expect that to continue going forward as part of the investment in organic growth that both Victor and Hratch mentioned earlier. Put simply, it's working.

Doug Young, Analyst, Desjardins Capital Markets

Thank you.

Operator

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

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

You get rewarded for complying with the rules here. Harry, Capital Markets, I mean, I think loan growth there, we keep on looking at it elsewhere, but Europe, I think 30%-plus in loans in the Capital Markets segment. Trading revenue at a record level. What are you doing differently there and how sustainable is this?

Harry Kenneth Culham, Senior Executive Vice-President and Group Head, Capital Markets, Canada

Oh, thanks very much for the question. Good morning. So, it's more of the same. I'll be honest. We are – we have a well-diversified franchise. In terms of the loan growth, it is very well diversified across our corporate franchise, across our institutional client franchise, which would include insurance companies, asset managers, pension plans, private capital on both sides of the border. As I think I mentioned last quarter, we expect to see lending growth taper off throughout the year. And in fact, quarter-over-quarter growth on average balances was 8%, down from 10% last quarter. But more importantly, we're seeing growth across the platform. We're seeing very, very good results with our trading businesses. Quite often, in the less capital-intensive businesses such as foreign exchange, we saw a 26% increase year-over-year in our trading revenues.

The team's working extremely well to deliver Capital Markets' products across our franchise, including our commercial wealth and retail clients. So, we've seen revenue growth in the US of around 30% year-over-year and double-digit growth servicing nontraditional clients I just mentioned. So, really it's all coming together delivering for our franchise across our bank the Capital Markets' product suite. So, we're quite optimistic on the outlook. The pipeline is quite strong. The environment is the environment. But we're standing with our clients. It is a cycle-tested business. So, I'm optimistic that given the strength of the pipeline that we can continue to deliver on that CAD 600 million plus [ph] PPBT (00:55:42) earnings growth.

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

Thank you.

Victor G. Dodig, President and Chief Executive Officer

And, Sohrab, just to build on Harry's comments, our Capital Markets business is another point of distinction from our bank relative to our peer group. Not only is our strength in Canada notable, our growth in the US notable, but CAD 1 in every CAD 4 in revenue in the Capital Markets business comes connected to our overall bank and retail, wealth management, and commercial banking and other retail banking partnerships that we have outside our country through our direct financial services business. Again, something that we'll highlight more deeply at Investor Day. Thank you.

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

Thank you.

Operator

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

Victor G. Dodig, President and Chief Executive Officer

Thank you very much, operator, and thank you for your great questions. I wanted to just close off by taking this opportunity to thank our 45,000 CIBC team members who play a critical role in bringing purpose to life for ourselves and for our clients each and every day. And to our shareholders and to all our sell-side analysts, thank you for your continued support and for your good questions. And we will speak with you in a couple of

weeks at our Investor Day where you'll learn more about our bank, and you get to spend more face time with our leadership team. Look forward to seeing you then. Have a good day.

Operator

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