SCOTIABANK

Q4 2022 EARNINGS CONFERENCE CALL

NOVEMBER 29, 2022

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Additional information relating to the Bank, including the Bank's Annual Information Form, can be located on the SEDAR website at www.sedar.com and on the EDGAR section of the SEC's website at www.sec.gov.

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PRESENTATION

John McCartney – The Bank of Nova Scotia – SVP of IR

Good morning, and welcome to Scotiabank's 2022 Fourth Quarter Results Presentation. My name is John McCartney. I'm Head of Investor Relations here at the bank. Presenting to you this morning are Brian Porter, Scotiabank's President and Chief Executive Officer; Raj Viswanathan, our Chief Financial Officer; and Phil Thomas, our Chief Risk Officer. Following our comments, we'll be glad to take your questions.

Also present to take questions are the following Scotiabank executives: Dan Rees from Canadian Banking; Glenn Gowland from Global Wealth Management; Ignacio Deschamps from International Banking and Jake Lawrence from Global Banking and Markets.

Before we start, on behalf of those speaking today, I refer you to Slide 2 of our presentation, which contains Scotiabank's caution regarding forward-looking statements. With that, I will now turn the call over to Brian.

Brian Johnston Porter - The Bank of Nova Scotia - President, CEO & Director

Thank you, John, and good morning, everyone. I will begin with a review of the bank's performance and progress over the course of fiscal 2022, after which Raj will review the financial year in more detail. Phil Thomas, our Chief Risk Officer, will review risk performance. We will be pleased to then take your questions.

Given that this will be my last quarterly call as CEO, I will close off with a few final remarks. The 2022 fiscal year was indeed a year in which the diversification of our businesses by both product and geography allowed us to continue to deliver strong all bank results. Despite heightened market volatility and rapid monetary response to deal with elevated inflation, across our operating geographies. Each of our businesses performed well.

The bank delivered adjusted earnings of $10.8 billion in fiscal 2022 or $8.50 per share, a healthy 8% increase over 2021 and a strong 15.6% all bank return on equity, both exceeding our medium-term financial targets.

Our common equity Tier 1 capital position at 11.5% has us well positioned to continue to support organic growth initiatives while continuing to return capital to our shareholders. Loan growth was robust, up 15% with deposit growth of a commensurate 15%, which is a result of concentrated efforts and strategies to strengthen our core deposit franchise.

As Phil will detail, we continue to observe very strong credit metrics across our portfolios despite the inflationary pressures that have been a reality for businesses and households alike over the course of the past year.

Our full year PCL ratio was well within our guidance of 25 basis points provided at this time last year. Strong underlying fundamentals and our higher-quality secured exposures have us confident that we will deliver against our previously provided expectations in the coming year.

Specific to Q4 results, adjusted earnings of $2.6 billion or $2.06 per share represented a solid finish to the year. Canadian Banking delivered earnings of $4.8 billion, a very strong 15% increase over the prior year and more notable progress against strategic initiatives in support of future growth. Our Business Bank, which includes our commercial, small business and Roynat franchises, delivered another strong year in 2022. This business has been a key driver of Canadian bank performance, and we are particularly pleased with the important role that our team has played in helping commercial clients expand their businesses post the pandemic and the strong funding profile that this business provides the bank.

This year's launch of Scene+ is another example of our ongoing efforts to further deliver value to our retail customers. The addition of Empire Company to the partnership and the inclusion of its brands, including Sobeys and IGA to the program, have added flexibility to earn and redeem points on everyday grocery in addition to banking, entertainment, dining and travel.

The Scene+ relaunch has resulted in more than 1.2 million new members joining the program, which now totals over 11.2 million Canadians. And we continue to see strong performance at Tangerine, Canada's leading digital bank. Tangerine grew deposits by over $4 billion this year and continues to grow assets through a focused strategy to become an everyday bank of choice for value-oriented Canadian consumers.

Our Global Wealth business showed strong resilience in fiscal 2022, generating earnings of $1.6 billion despite the revenue impact of softer financial markets on fees, in the asset management business. Expenses continue to be well managed. Market share gains and strong investment results in dynamic funds provided some offset to the AUM impact of lower fixed income and equity markets during the course of the year.

On the advisory side of our business, double-digit growth led to record results in each of our private banking, ScotiaMcLeod and Private Investment Council channels. We continue this year to build and introduce new digital tools and platforms to enhance the customer investment experience, including Scotia Smart Investor and Scotia Smart Money Advice Plus, as well as a new generation of our iTrade mobile app.

Our Global Banking and Markets business had a solid finish to the year in Q4, resulting in earnings of $1.9 billion for the fiscal year, down a respectable 8% year-over-year in a very challenging period of market conditions.

Our GBM business in Latin America reported in the International Banking segment continued to show strong momentum, delivering record Q4 and annual earnings contribution of $232 million and $809 million, respectively.

And rounding out our GBM strategy, our business in the United States has also grown significantly with earnings up 11% in the fiscal year. Our international business delivered significantly improved fiscal 2022 earnings of $2.4 billion, up 37% from the prior year, a result of stronger loan volumes, expanding margins and impressive expense management, while also benefiting from a lower tax rate.

Our ID retail businesses performed well and continued to benefit from the efficiencies that resulted from our continued efforts to further digitize our platform. Our Caribbean businesses performed well, delivering earnings in the quarter of $110 million, up 42% year-over-year and has been the Caribbean unit is back to a more normalized level of contribution.

Our results this year clearly reflect solid contributions across our businesses and the ability to absorb periods of volatility as evidenced by the challenging conditions faced by our market-sensitive businesses in recent quarters. Turning to our outlook. Global Growth prospects have clearly been impacted by the central banks for on inflation, and affected our various operating geographies in different ways and at a different pace.

Central banks in Canada and the United States appear to be nearing the end of their tightening cycles as inflation finally appears to be slowing. In Canada, the economic growth is moderating, but economic levels of activity remained robust.

The strength of our labor market and strong balance sheets, along with robust commodity prices, are providing a counterbalance to the impact of a less planned European and Asian economic environment. In the Pacific Alliance countries, growth is moderating from its recent pace that's seen over the past year.

Central banks in our key Latin American economies have responded early and aggressively to inflation with orthodox monetary policy. And despite this, we have not seen any meaningful reduction in capital sources in the region. We are confident that this decisive action will allow most central banks to hit terminal rates soon and allow others to ease during fiscal 2023.

The bank continues to be recognized for industry excellence throughout our footprint. We were again recognized as Bank of the Year in Canada for the third year in a row, an investment bank of the year for the Americas by the banker and Best Bank in Canada by Euroline. Fiscal 2022 was also a year of great progress on our commitments to the environment and the communities in which we live and work. We have now normalized a total of $96 billion of climate-related financing, up from $58 billion last year, putting us well on track to achieve targets communicated in our inaugural Net-Zero Pathways Report published earlier this year.

Since launching ScotiaRISE, our $500 million 10-year community investment commitment, we have partnered with more than 200 nonprofit organizations and made more than $60 million in community investments globally, creating opportunity for hundreds of thousands of people in communities where we live and work.

And our Scotiabank Women's initiative continues to grow. Our capital deployed to women owned and women-led businesses grew to $5.6 billion, against our target to reach $10 billion by 2025.

And finally, one of my proudest moments as CEO. Just last month, we were recognized as 1 of the top 25 World Best Workplaces by Great Place to Work Institute, the only Canadian headquartered company and the only bank to be recognized in the field.

Overall, we are very pleased with our financial results and progress on many strategic growth initiatives over the course of the past year. And with that, I'll turn the call over to Raj.

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Thank you, Brian, and good morning, everyone. This quarter's net income was impacted by certain adjusting items of $504 million after tax or $0.43 of EPS at above 2 basis points on our common equity Tier 1 ratio that was recorded in the other segment. This consisted of a $66 million restructuring charge relating to the realignment of certain GBM businesses in Asia and ongoing technology modernization, $98 million of support costs relating to the expansion of our Scene+ loyalty program and a $340 million currency-related loss resulting from the sale of investments in associates in Venezuela and Thailand, as well as the wind-down of operations in India and Malaysia.

All my comments on the bank and the other segment that will follow will be after adjusting for these items. So starting on Slide 5, on fiscal 2022 performance. The bank ended the year with adjusted diluted earnings per share of $8.50 and a return on equity of 15.6%, both exceeding our medium-term objectives.

Revenue was up 2% and expenses increased 3%, resulting in negative operating leverage for the year. Our business lines, particularly our P&C businesses, has had strong performance. Canadian Banking earnings increased 15%, while International Banking earnings increased 37% on constant currency basis.

Global Wealth Management earnings of $1.6 billion were down a modest 1% year-over-year as higher net interest income and brokerage revenues were offset by lower mutual fund fees, driven primarily by market conditions and higher volume-related expenses.

Global Banking and Markets reported earnings of $1.9 billion, down 8% compared to fiscal 2021. Solid business banking performance, including strong loan growth momentum, was offset by weaker capital markets performance in which the industry faced challenging market conditions.

The bank's earnings in 2023 are expected to benefit from higher interest income and noninterest revenue, but be impacted by higher funding costs, higher expenses, normalizing provisions for credit losses relating to the end of performing along its releases and a higher tax rate in both Canada and certain international countries. Once rates stabilize, the bank is expected to benefit from asset repricing, resulting in net interest margin expansion.

The bank's capital and liquidity position is expected to remain strong in 2023. I'll now review the performance for the quarter on Slide 6.

The bank reported solid quarterly adjusted earnings of $2.6 billion and diluted earnings per share of $2.06 and the return on equity was 15%. All bank pretax pre-provision profit increased 2% year-over-year, impacted by the other segment as the pretax pre-provision profit of the 4 business lines in aggregate increased 7% as detailed on Slide 25.

Revenues were up 4% year-over-year as an increase in net interest income of 10% more than offset a decline in noninterest revenue of 3%, mainly driven by lower wealth management revenues lower unrealized gains on nontrading derivatives and lower income from associated corporations. The net interest margin declined 4 basis points quarter-over-quarter, mainly driven by the increase in funding costs due to the velocity of administrate increases. The impact of the Canadian Banking net interest margin of 3 basis points was partially offset by the 13 basis points expansion in the International Banking, which benefited from asset repricing.

The PCL ratio was 28 basis points for the quarter, up 6 basis points from last quarter. Year-over-year adjusted expenses increased by 6%, driven by higher personnel costs and performance-based compensation and spend to support business growth.

The productivity ratio closed 53.7% this quarter, while the whole year operating leverage was negative 1.1%. Slide 7 provides an evolution of the common equity Tier 1 ratio over the quarter as well as the cordless changes in risk-weighted assets.

The bank reported a common equity Tier 1 ratio of 11.5%, up 10 basis points from last quarter, primarily from strong earnings net of dividends that accreted 21 basis points. Risk-weighted assets grew $9.6 billion in the quarter, mostly related to foreign exchange. Excluding the impact of FX, loan growth was $6.1 billion. Combined with positive migration, the CET1 ratio benefited 2 basis points.

The impact of higher rates on the bond portfolio held for liquidity purposes and fair value through OCI had a 14 basis points impact on the CET1 ratio this quarter. Our priority remains to deploy capital to support organic growth initiatives in each business line while prudently managing capital in the face of a less certain economic outlook. Turning now to the business line results beginning on Slide 8.

Canadian Banking reported earnings of $1.2 billion, a decrease of 5% year-over-year, while pretax pre-provision profit grew 10% year-over-year, driven by revenue growth of 11%. Net interest income increased 13%, as loan and deposit growth continued, while the net interest margin declined 3 basis points since Q3 as lower spreads in particular, the prime SEDAR compression, the lag on fixed rate asset repricing and lower mortgage prepayments were partially offset by higher deposit spreads.

As expected, Quarter-over-quarter mortgages grew a modest 1%, but increased 11% compared to the prior year. Business loans grew a strong 25% compared to last year. Deposit growth during the quarter was strong at 7% year-over-year, driven by an 8% increase in personal deposits and a 6% increase in nonpersonal.

Noninterest income increased by 3%, due primarily to higher banking revenue and foreign exchange fees, partially offset by lower mutual fund distribution fees. Expenses increased 12% year-over-year, driven by higher technology and personnel costs to support business growth.

The segment generated positive operating leverage for the year of 1.5%. The PCL ratio was 15 basis points, an increase of 6 basis points compared to the prior quarter or 25 basis points compared to the prior year. Medium banking revenue growth is expected to be driven by deposit and loan growth with stable margins while mortgage growth is expected to decelerate.

The segment will maintain strong expense discipline to generate positive operating leverage. 2023 earnings are expected to be impacted by normalization in provision for credit losses and a higher tax rate.

Turning now to Global Wealth Management on Slide 9. Earnings of $368 million declined 6% year-over-year. Revenue declined 4% due primarily to lower fee income driven by lower assets under management and high trade volumes, partially offset by higher interest income driven by strong loan growth and improved margins.

Expenses declined 3%, driven by lower volume-related expenses, while the productivity ratio this quarter was 61.2%. The wealth business line has generated positive operating leverage in 10 of the last 12 quarters and adjusting for performance fees generated operating leverage of positive 0.8% in the full fiscal year.

Assets under management decreased 10% to $311 billion, while assets under administration decreased 3% to $580 billion, primarily due to market depreciation. Despite a challenging market environment, we continue to be ranked #2 by assets in the Canadian retail mutual fund industry.

Investment returns have been strong across co-share global asset management with 72% of assets in the top 2 quartiles over a 5-year period as of October. Dynamic Funds is ranked #3 among independent asset managers with 87% of assets in the top 2 quartiles over a 5-year period. We also saw strong growth in our key international markets with double-digit earnings growth across the Pacific Alliance Wealth Management businesses.

Global Wealth Management expects modest revenue growth, and we'll continue to invest in the business while remaining focused on managing expense growth in line with revenue growth. Earnings are expected to remain stable in 2023, reflecting the slowing economic backdrop and a higher statutory tax rate.

Turning to Slide 10. Global Banking and Markets generated earnings of $484 million, down 4% compared to the prior year, but up 28% compared to the prior quarter. Business were driven by strong loan and deposit growth as loans grew 31% year-over-year while deposits grew 12%. Revenue increased 15% as net interest income grew 35%, driven by strong volume growth and expanding margins.

Noninterest income grew 6%, as higher banking revenues was partially offset by weaker primary and secondary markets. Capital Markets revenue was down 9% from last year. However, it rebounded 19% from the prior quarter.

Expenses were up 18% year-over-year, due mainly to personal costs and technology costs to support business development and the negative impact of foreign policy translation. GBM Latin America, which is reported as part of International Banking, reported record earnings of $232 million, up 29% year-over-year with particularly strong results from Chile and Brazil.

Global Banking and Markets expects to deliver earnings growth in 2023. Through the Americas strategy, the segment continues to deepen client relationships while also adding new clients. Capital Markets results are expected to improve, driven by more favorable market conditions and increased levels of client activity.

The segment plans to deliver on disciplined expense management that is expected to result in positive operating leverage to more than offset any increase in provision for credit losses.

Slide 11 highlights this quarter's strong international banking results. My comments that follow are on an adjusted and constant dollar basis. The segment reported net income of $650 million, up 25% year-over-year. Pretax pre-provision profit grew 9% year-over-year with the Pacific Alliance growing 6% and Corrugated Central America up 18%.

Year-over-year, loans up 12%, with commercial loans also up 12% and mortgages up 16%, while personal loans and credit cards grew 9%. Revenue was up 8% year-over-year, driven by higher net interest margin, strong capital markets and banking fees and partially offset by lower gains in investment securities.

Quarter-over-quarter, the net interest margin improved a strong 13 basis points. Assets repriced faster to offset the increase in funding costs and impacts from changes in deposit mix. Provision for credit losses ratio decreased year-over-year by 2 basis points to 89 basis points.

Noninterest expenses increased 7% year-over-year, driven by business growth and inflationary impacts, partially offset by the benefit from efficiency initiatives executed last year. The tax rate of 13.6% for the quarter and 18.9% for the year benefited primarily from higher inflation benefits in Mexico and Chile.

With lower inflation expectations in 2023, the tax rate is expected to return to more normal levels starting in Q1 2023. The segment generated positive operating leverage of 1.8% for the whole year.

Revenues in the International Bank are expected to benefit from loan growth and modest net interest margin expansion as a result of the expected stabilization of interest rates and potential rate reductions in the second half of 2023.

Expenses are expected to grow in line with revenue, supported by strong digital progress to deliver positive operating leverage. Earnings are expected to be impacted by normalizing provision for credit losses and a higher tax rate. Now turning to the other segment. We reported an adjusted net loss of $100 million compared to a loss of $35 million in the prior year.

Year-over-year, the change was a result of higher funding costs resulting from higher interest rates and asset liability management activities. With that, I'll turn the call to Phil to discuss risk.

Philip M. Thomas - The Bank of Nova Scotia - Chief Risk Officer

Thank you, Raj. Good morning, everyone. For fiscal 2022, the bank reported an all-bank PCL of 19 basis points, well within our guidance of 25 basis points.

As we look to 2023, we remain confident that our PCL ratio will be in the mid-30s basis point range. This is driven by 3 key factors: a higher quality customer mix; A more stable and predictable portfolio driven by a higher level of secured lending; and our strong credit and underwriting fundamentals, which position us well for macroeconomic uncertainty. I will now highlight some of the trends we are seeing for the quarter across our portfolios.

Despite higher interest rates and inflation, our customers' financial health remains resilient. Canadian retail deposits, on average, are 13% higher than they were in February 2020. And delinquency of 90-plus days for Canadian retail has been stable at 15 basis points for the last 3 quarters and roughly half of the pre-pandemic ratio.

We remain confident in our Canadian market. After 6 rate hikes by the Bank of Canada this year, our Canadian variable rate mortgage customers continue to maintain high liquidity with approximately 36% higher balances in their deposit accounts compared to fixed rate customers.

Our uninsured mortgage portfolio will average LTV of 49% and average FICO scores of 799. In International Banking, our retail portfolio remains 72% secured versus 65% to pre-pandemic. High-quality rated customers also remain at 96% of originations. Portfolio delinquency of 90-plus days increased marginally this quarter by 8 basis points, in line with slowing economic growth but remain well below pre-pandemic levels.

Finally, in Business Banking, we have observed upgrades across the portfolio due to customer performance. Credit quality and liquidity levels remain strong. While Business Banking gross impaired loans are up slightly quarter-over-quarter. They are primarily driven by foreign exchange fluctuations and 1 account in International Banking.

Now turning to PCL on Slide 15. PCLs this quarter were $529 million. This increase in our PCL ratio this quarter to 28 basis points, reflects normalizing trends and forward-looking indicators. The increase from last quarter was mainly driven by Stage 3 PCLs up $105 million as delinquency levels rose modestly, primarily in international retail and GBM, though remaining well within our expectations and well below pre-pandemic levels.

Year-over-year, performing PCLs were up, driven by a less favorable macroeconomic forecast and strong portfolio growth. We continue to be focused on high-quality credit originations and diversification across markets as we look to fiscal year '23.

Our current allowances for credit losses this quarter were $5.5 billion, up $204 million quarter-over-quarter or an ACL ratio of 71 basis points. Nonperforming ACL increased slightly this quarter as we saw small increases in deal formations and net write-offs primarily driven by international retail and commercial.

Total ACL coverage represents about 12 quarters of net write-offs, almost double our pre-pandemic levels. While current macroeconomic -- and while the current macroeconomic environment continues to be uncertain, we remain prudent in building allowances in response to these changing conditions.

Our coverage reflects the quality of our portfolio, strong credit practices and changes to business mix. Looking ahead to fiscal 2023, we expect strong credit performance to continue. While pressure from inflation and interest rates will continue to be a factor. We believe our efforts to derisk our portfolios have positioned us well to manage economic uncertainties. For these reasons, our earlier outlook of PCL ratios in the mid-30s basis point range remains unchanged.

And finally, I would like to congratulate Brian and thank Brian on behalf of all Scotiabankers globally for his 41 years of service and leadership. Thank you, Brian.

Brian Johnston Porter - The Bank of Nova Scotia - President, CEO & Director

Thank you.

Philip M. Thomas - The Bank of Nova Scotia - Chief Risk Officer

I will now turn the call over to John for Q&A.

John McCartney – The Bank of Nova Scotia – SVP of IR

Thanks, Phil. We'll now be pleased to take your questions. Please limit your question to 1 and then rejoin the queue to allow everyone the opportunity to participate in the call. Operator, can we have the first question on the phone, please?

QUESTIONS AND ANSWERS

Operator

Our first question is from Ebrahim Poonawala from Bank of America.

Ebrahim Huseini Poonawala - BofA Securities, Research Division - MD of United States Equity Research & Head of North American Banks Research

Good morning. So I guess maybe, Raj, for you on the net interest margin. If we can just break down in terms of the outlook for the margin consolidated versus the Canadian and the international banking NIM. You gave some color earlier. But what happens to the 3 net interest margins in a world where Bank of Canada, the Central Banks are hiking rates. And do we actually need rate cuts in Canada for the Canadian bank NIM to stop going lower?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Yes. Thanks, Ebrahim, and good morning. I'm not going to forecast margin quarter-by-quarter, and I'll ask Dan or Ignacio to comment on the specific business line margins. But I would call out 4 important factors and I think our net interest margin evolution over the next 2 years, '23, '24 lots of changes that are happening.

Trajectory of central bank industry changes, definitely, is going to be a factor of our margin reaction at the all bank level. The schedule of assets repricing, that's actually quite well underway both in IP as well as starting to do in the Canadian Banking business segment. And thus we expect it to accelerate. Changes in business mix as the bank expects to generate less low-margin mortgages. The business has slowed as I said in my prepared remarks in the Canadian bank and, of course, deposit margin behaviors. So these factors have always been a key for the net interest margin evolution for this bank, and I think it will be key to how it's going to evolve in 2023 and into 2024 as well. Dan, do you want to say something with the Canadian banking margin or a...

Daniel Llewellyn Rees - The Bank of Nova Scotia - Group Head of Canadian Banking

Ebrahim, it's Dan here. I would just say that we expect margin in the Canadian bank to build above the Q4 levels as they look at the full year of next year. Certainly, the change in business mix has an impact. And of course, the speed of loan repricing is underway through the course of this quarter, and we expect that to expand into next year.

The composition of deposits is important to bear in mind here. Obviously, as we grow our business banking book, there's a fair portion of non-maturity deposits in there for which the deposit NIM has been a tailwind this quarter, and we expect that to continue for the next couple of quarters. And I think our emphasis on deposits may well have been overshadowed in the front half of the year where we saw strong mortgage growth. Clearly, in the last 2 quarters, you've seen deposit growth rates in Canadian Banking equal or beat loan growth rates and in Q4 and balances deposits grew faster than loans. So that emphasis on a balanced balance sheet will continue in '23, and that should help NIM.

Ignacio Deschamps - The Bank of Nova Scotia – Group Head of International Banking & Digital Transformation

And Ebrahim, in terms - Good Morning, -- in terms of International Banking, NIM was up 13 bps in the quarter, and this was driven by the Caribbean and Central America, while in the Pacific Alliance countries, where Central Banks moderated the pace of interest rate increases, NIM stabilized compared to last quarter.

In the Caribbean, we have 50% of our balances are U.S. dollars. NIM increased 38 bps in the quarter, driven by the benefit of higher Fed rates. And in the Pacific Alliance countries, NIM increased 3 bps in the quarter with assets repricing faster than liabilities. I would say Central banks in the Pacific Alliance countries took proactive measures in advance of the Fed to increase interest rate. The tightening six cycle is ending, and it is likely there will be some of the first countries to start a reduction trend in 2023, starting with Chile.

Ebrahim Huseini Poonawala - BofA Securities, Research Division - MD of United States Equity Research & Head of North American Banks Research

But just 1 follow-up on that, Dan. Why is the Canadian NIM not going higher $112 billion of variable rate mortgages? Is the spread compression offsetting the increase in benchmark rates or am I missing something?

Daniel Llewellyn Rees - The Bank of Nova Scotia - Group Head of Canadian Banking

Look, there's just a lot of moving parts, Ebrahim. Certainly, we did see in Q4 the movement to fixed in mortgages occur as we have been indicating for some time. So that would have been a component. The movement out of low pay deposits into term as consumers were anxious about equity markets, and that would have been a component.

There's a lot of moving parts in margin, where we ended in Q4 is about where we expected. We gave back some of the expansion you saw in Q2 and Q3, and we expect to be growing through the course of next year in the aggregate.

Ebrahim Huseini Poonawala - BofA Securities, Research Division - MD of United States Equity Research & Head of North American Banks Research

Got it. And Brian, congratulations on your retirement and good luck.

Brian Johnston Porter - The Bank of Nova Scotia - President, CEO & Director

Thank you, Ebrahim.

Operator

Our following question is from Paul Holden from CIBC.

Paul David Holden - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research

So there's a lot of questions popping up around variable rate mortgages. And obviously, Scotia is 1 of 2 banks that offer variable payment, variable rate mortgages and you addressed it a bit in your prepared remarks, but wondering if you can dive down a little bit deeper just in terms of how those higher interest payments are impacting consumer behavior if at all, sort of give us a flavor maybe for what proportion of converted to fixed payments or again, any kind of pressure or payment behavior you're seeing?

Daniel Llewellyn Rees - The Bank of Nova Scotia - Group Head of Canadian Banking

Sure, Paul. It's Dan here. I'll start and maybe Phil could add if he would like. We really appreciate the question. We believe strongly that a variable rate mortgage should have a payment that varies. We are not seeing credit pressure in that category during Q4, full stop.

We are certainly preparing for and are having lots of conversations about cash flow management at the customer level. But big picture, the creditworthiness of the variable customer is higher than fixed. And as Phil would have mentioned in his remarks, deposit balances are substantially higher. And as we look at the liquidity position of checking and savings accounts combined in the variable customer balances that are with us, we see well over a year worth of excess liquidity to absorb payment increases of $200, $300, $400 per month. So we're not concerned about the credit side of the mortgage position.

And on the other hand, we're not seeing tremendous pressure on payment levels. In other words, credit card balances expanded this quarter, as you will have seen, and our personal deposits are holding in on the nonmaturity side. So from a consumer behavior standpoint, the variable customer is in good shape.

I think our proportion of mix there is not showing up in the credit line, and we're confident with the transparent structure and the conversations with -- that we're having with customers to date.

The final thing I would say is on a big picture basis, strategically, we've been focused in the mortgage business at cross-selling into the deposits. We've been doing that year-on-year now for the last 3 years, 50% of our mortgage holders have a deposit account with us. And within the first 6 months of opening variable rate mortgage customers now have 3 or more products, so already into there, health and strength is good, and we're comfortable with our position, as we said last quarter.

Philip M. Thomas - The Bank of Nova Scotia - Chief Risk Officer

Just to add to that, and then Dan will have comments that will be consistent with mine as it relates to the credit performance. But just speaking in generally, we're not seeing any signs to stress across our portfolios, whether in retail or in our business banking segments right now. And we continue to monitor, as Dan mentioned, we've made significant investments in our ability to looking and see how our consumers are behaving and the type of performance they have both in retail and in business banking.

And we're not seeing any signs of liquidity pressures in our business banking book. And certainly, we're seeing the health of the Canadian consumer considerably stronger than they were pre-pandemic and holding. And so -- and from a credit perspective, we're quite comfortable with how these folks are performing right now.

And maybe just to add to that, I think it's also important as we look forward, employment or rather unemployment continues to be strong in Canada, and this is all this predeterminant of as we hit sort of bumpier times, but we're not seeing any changes to that. And certainly, we're also seeing wage increases consistently across our customer base as well, particularly for those customers that do participate in the variable rate mortgage program.

Operator

The following question is from Doug Young from Desjardin Capital Markets.

Doug Young - Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst

I just wanted to go back to the Canadian banking NIM discussion, and I'm not sure if this is for Dan or for Raj, but there's an interplay between Corporate and Treasury and Canadian Bank. And maybe I can just ask it this way. If the other or the treasury costs in corporate were actually allocated out to the divisions are allocated back to banking. Would that NIM decline this quarter had been worse, no different or better? And can you talk a bit about that?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Yes, sure. I'll start, Doug, and see if I can help you with that. Transfer pricing is a factor and that -- So what I want you to know is that doesn't apply only to the Canadian bank, whatever is in the other segment. Transfer pricing generally from an asset repricing perspective will track to that.

Deposit transfer pricing happens quicker, because very simply put, the deposit rate tracks what would be the wholesale funding rate from a transfer pricing perspective, while the asset transfer pricing will happen as assets reprice in the business line, and that's to ensure that the business line NIM is consistent. This is not inconsistent with what other banks do. So I wouldn't attribute it only to the Canadian bank. It's just a nuance when you have significant rate changes, it's up or down, how it manifests itself in our bank and the other segment. That's the comment I'd make.

But I would suggest that you take it up to the higher level, just look at it from an all-bank perspective, net interest margin. And if you understand the reasons why it moved up or down in any particular quarter, I think generally will be in...

Doug Young - Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst

Okay. So the squeeze between the deposit costs went up faster than the asset repricing is actually being captured within the other segments. I think we've talked about this before. And I guess the way they really kind of just high level, just thinking about to track the all-bank, that's what you're suggesting?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Yes, that's what I'm saying, Doug. I think it's easier. And at the all-bank NIM compression is the simple way to think about it is our funding costs have grown quicker. And when assets cash, you shouldn't see that. But what happened in IB this quarter.

Operator

Our following question is from Gabriel Dechaine from National Bank Financial.

Gabriel Dechaine - National Bank Financial, Inc., Research Division - Analyst

Brian, best of luck in your retirement, not that you need it, but it's engaging with you in the past 9 years plus. My question is on Canadian Banking margin. We talked about asset yields or spreads that are tightening. I suspect that mortgages spread dynamic in that business, plus the impact of prepayment income probably of the client? And then just some question, it could be a quick yes or no answer. Is there any thought to or progress towards converting the RWAs in the International segment to the AIRB model.

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

I'll take the second one first, and then I'll start on the Canadian Bank NIM and I'm sure Dan will have more to say. No, we're not looking to move any of those portfolio any time soon. I think that's a short answer.

On the Canadian Banking NIM, what -- there's a couple of nuances in this quarter. So we called it out in the disclosure on the movement. One is the timing of prime SEDAR. And that's always going to be a factor not necessarily for Scotiabank, but for the other banks because the price of prime and then the SEDAR moves in advance, particularly in a rising environment. So that should normalize next quarter once prime catches up, which happened in the last week of October.

Mortgage prepayment, yes, when rates go up, you expect to see less prepayment happening, and that's what we're seeing in the Canadian bank's net interest margin. And like Dan talked a little bit earlier, that margin will continue to modestly expand in line with how the assets start to reprice and which variant business mix changes will happen in the Canadian bank as the mortgage volume growth will slow down in '23 compared to what we saw in '22.

Gabriel Dechaine - National Bank Financial, Inc., Research Division - Analyst

Right. No quantification of prepayment income?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

We haven't quantified it before. I don't think it's substantial. But if you back end through the NIM that disclosure will probably be within the ballpark.

Operator

The following question is from Mario Mendonca from TD Securities.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

So Raj, just get started first with going back to Ebrahim's opening question. He asked for whether the all-bank margin could only improve once rates decline. And the reason I want to go back to this is your disclosure indicates that the bank is positioned for falling rates. Higher rates lead to lower NII, lower rates lead to higher NII. So can we interpret from your disclosure that the all-bank margin can only improve once rates start to fall? Or is that too simple an interpretation?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

I'd look at it 2 ways. Directionally, you're right, Mario. Yes, we will benefit from falling rates. The balance sheet is positioned that way. One of the key factors which applies now is the pace of asset repricing. And depending on how fast that reprices, the benefit will be higher than what we show in that disclosure, but directionally, you're right based on this portion.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Okay. Different type of question then. This is probably the most frequently asked question through this last quarter. And it relates to debt service costs. We can all appreciate that unemployment is an important aspect of the Stage 1, Stage 2 performing loan provisions. But debt service costs and debt service ratios clearly are going materially higher. Could you talk about how that factors into your performing loan provisions and whether it's really just a matter of time before all the banks have to start building performing loan reserves for their mortgage book.

Philip M. Thomas - The Bank of Nova Scotia - Chief Risk Officer

Yes, I'll start. I'll -- happy to take that, it's Phil here. Thanks for the question. I go back to some of the comments I made in my prepared remarks and my comments from a few minutes ago. While TDSRs have been increasing just because of the cost of the mortgage, we're not seeing any sort of reciprocal stress.

And as I said, most of our customers still are maintaining high levels of liquidity in their portfolio -- in their deposit accounts. So for example, our average customer is up 13% versus pre-pandemic in terms of the level of liquidity.

FICO scores continue to improve up to 799 basis points, 800 plus, 840 with customers with HELOC. And so what we've seen actually is positive credit migration over the last quarter or so. And so as we're looking at performing loans and we look at our forward-looking indicators, there's some built in pessimistic scenarios for macroeconomic. But what we're seeing more importantly is the credit change in quality is actually a tailwind for us from a performing loan perspective. And I think that's important to note as you're looking forward. So I would be less focused on TDSRs, and I'd be more focused on health for the consumer quality of the portfolio, sort of the shift in the dynamic within the macroeconomic that we're seeing today, which is positive.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Okay. Final question then. Did the bank talk about how you managed to get securities gains in the quarter in a rising rate environment. I was a little surprised because over the last few quarters, we haven't seen any. And then this quarter, a nice meeting number. Could you help me think through that?

Rajagopal Viswanathan - The Bank of Nova Scotia - Group Head & CFO

Sure, Mario. As you know, investment gains will be lumpy, right, in any quarter and in any year. The first 3 quarters of this year, I think we had $1 million, if I remember my numbers right.

We didn't have any opportunities, but we continue to roll those because these are high-quality liquid assets. We hold it for liquidity purposes. And depending on when we invest and when we think it has reached economic value to the maximum, and we don't think that it's going to raise in value, so to speak, because of interest rate changes, we monetize it.

We just had the opportunity to do it in some of the securities, debt securities. This quarter, that's what you're seeing. Like I said, it will be lumpy. It all depends on the time at which we put on these securities and how much value it has gain based on rising rates, falling rates, all these are factors. It's a large portfolio.

Operator

Our following question is from Scott Chan from Canaccord Genuity.

Scott Chan - Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst

I'll kind of switch to capital banking, more specifically on the business banking side. Revenues went up a lot year-over-year, driven by corporate loans, both on a quarter-to-quarter and year-over-year basis. So my question is like what driving that robust growth in this segment if you could perhaps provide a little bit of an outlook. And if that did contribute to the higher personnel costs in the quarter?

Brian Johnston Porter - The Bank of Nova Scotia - President, CEO & Director

Great. Thanks for the question, Scott. So there's a few things in that question. First thing I'd say is we're very focused on our existing clients and adding in new clients. And that's been core to that loan growth that you're seeing in the business.

A big part of that loan growth is happening in the U.S. where we're focused on the Americas strategy. And I think that's important to note because we've talked about that several times.

Q3 was a very quiet DCM quarter. Not a lot of activity happening. So we saw a lot of clients come into banks for its facilities. We're going to see that monetize as we move into 2023. So we're quite confident, we're being there for our clients. We're putting out balance sheet, and we're doing it on both sides. The deposit line continues to grow, and we have an LDR in the business below 1, which is positive, I'd say.

In terms of performance costs in the quarter, Q3 was an air pocket for the capital markets industry. And what we saw happen was a step back in the performance cost for the year. That stepped up ahead when we delivered what we felt was a pretty solid Q4. Does that help you answer your question, Scott?

Scott Chan - Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst

Yes. That's very helpful.

Operator

Our following question is from Darko Mihelic from RBC Capital Markets.

Darko Mihelic - RBC Capital Markets, Research Division - MD & Equity Analyst

And Brian also, best of luck in retirement. I just wanted to dig, Dan, a little bit deeper into the mortgage question. You mentioned in your remarks that or in response to 1 question that there was a shift from variable to fixed.

But when I look at Slide 35, I don't see a change quarter-over-quarter. And there was a lot of rate increases that just recently happened. So my question on the portfolio for mortgage is really given to a couple of different areas. First and foremost, if there is a shift happening from the existing variable rate mortgage portfolio to fixed. Could it be that originations are heavily variable rate mortgage related, and therefore, you don't see an overall shift in the portfolio? Are you in fact suggesting to customers to continue to go down the variable rate mortgage as a preferred vehicle, especially since you think rates are going down?

And lastly, with respect to the average loan to value, for the whole portfolio, I see it rising a little bit. You have a very heavy concentration in Ontario, where house prices are falling. So maybe you can speak to what you're seeing there on loan to values of the portfolio and where you think that's headed over the next couple of quarters, please?

Daniel Llewellyn Rees - The Bank of Nova Scotia - Group Head of Canadian Banking

Sure, Darko. There's a lot there, and I am sensitive I think RBC's called at 9. So I'll make this brief and we can do a follow-up in detail if you like.

My comments around shift to fix was new business flows during the fourth quarter as opposed to I think the slide you're referencing is a photograph of the stock in the portfolio. We are not on the front foot with regards to devising customers strongly into or out of variable effects. We work with the customer based on their unique situation.

Often, you're seeing renewals come forward. And therefore, I think our view is balanced there, whether it's by channel or by turn. So the movement out of variable into fix did begin to happen in Q3 that continued in Q4 as expected. In terms of outlook on LTVS, I wouldn't say we're over-indexed in Ontario necessarily. I would say we're slightly under-indexed in Quebec versus the rest of the marketplace.

Clearly, as house prices have deflated over the last number of months, the emphasis on loan to value at origination will be maintained at, call it, Phil Thomas' credit risk standard. As the book comes in for renewal, where we are concerned about any consumer situation, we will reappraise the value of the home and decide whether we want to renew on that basis.

We are not leaning into high LTV, high TDSR, long amortization. Our credit situations in the mortgage book, we believe very strongly that immigration, employment, wages, shortage of housing will be constructed for the housing market once we get through this price adjustment period. And as margins return as the prime SEDAR compression dissipates.

Operator

Our following question is from Sohrab Movahedi from BMO Capital Markets.

Sohrab Movahedi - BMO Capital Markets Equity Research - Banks Analyst

And Brian, congratulations on a very illustrious career. I have just maybe a quick clarifying question. I think you've talked about normalization, I'll call it, on the PCL into the mid-30s. Can you just talk a little bit more detail on that? What sort of an unemployment rate does that assume? Where is that performing versus nonperforming? And how does it kind of -- which line items or business segments or geographies would you say you're kind of, I guess, over earning in right now on that line? So would just be adding to performance in mortgages in Canada, or is it nonperformers and business lending in LatAm? Or just if you could give me a little bit more color as to how we get to that new clarities and what sort of assumptions there will be?

Brian Johnston Porter - The Bank of Nova Scotia - President, CEO & Director

Sure. Not a quick question, then I'm happy to maybe answer it and you and I can maybe spend a little bit of time together offline. But I'd go back to -- we -- if you look at where we were a year plus ago, this bank has done a tremendous amount of work to derisk our portfolios. And so as we head into '23, a new normalized run rate is sort of in that mid-30s basis point range.

I would say the mid-9s basis point range for International Banking. And so we continue to grow our mortgage book in international, continue to put on more secured lending. Our focus has primarily been on affluence for the higher-end segment. And as I mentioned in my remarks, 96% of our originations and IP are sort of that higher credit quality segment now. And so we're really -- as we normalize, it's sort of a new normal incentive. The portfolios have really shifted.

Again, higher -- big focus on high investment grade at corporate and commercial lending. And so as I look out into next year, I'm confident in the guidance. And we'll continue to work very, very closely with Dan and Nacho and Jake and James and others to make sure that we have that focus on higher quality credit moving into the year.

I would also say that this bank has made a significant amount of investment in the collections. And we have -- and we've built collections hubs. We've invested in technology. We've invested in analytics, and so we're doing a lot of preemptive phone calls to customers who we may see had a bit of stress. And so both from a quality of the process that we have in place to help our customers and from a collections perspective, we're feeling pretty good as we go out to next year.

Sohrab Movahedi - BMO Capital Markets Equity Research - Banks Analyst

What's the unemployment rate in Canada behind the 30 basis point?

Brian Johnston Porter - The Bank of Nova Scotia - President, CEO & Director

Yes, it would be. Yes, obviously, we stress test our portfolios on a regular basis every day. And we have a number of stress scenarios for unemployment that we put into the stress scenarios. And I'm happy to maybe spend a little bit of time with you offline, we can go into those.

Sohrab Movahedi - BMO Capital Markets Equity Research - Banks Analyst

Okay. But the mid-30 basis points, you don't -- is it not based on an unemployment rate?

Brian Johnston Porter - The Bank of Nova Scotia - President, CEO & Director

It would be based on a whole bunch of different factors, including unemployment, our outlook, how we're thinking about our portfolios, what is performing, what are we looking at for nonperforming, where are we focused on in terms of growth of assets.

Operator

It's all the time we have for questions. I would now like to turn the meeting back over to Mr. Porter.

Brian Johnston Porter - The Bank of Nova Scotia - President, CEO & Director

Thank you very much. I wanted to extend my sincere thanks to the analyst community for your ongoing coverage of the bank and to our investors for your continued support of the bank.

I'm extremely proud of our team of over 90,000 Scotiabankers for their tireless efforts to put our customers first. And I have every confidence that Scott Thomson and the entire leadership team will continue to build on the strong foundation we have established and the many successes we had achieved over the past decade. Together, we have built an enduring resilient institution that continues to champion Canadian values around the world. It has been the privilege of my lifetime to serve as CEO of the storied institution. And I have every confidence that the bank's best days are yet to come.

And I wanted to wish you and yours all the very best for the upcoming holiday season and beyond. Thank you very much.

Operator

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