# SCOTIABANK

# Q3 2023 EARNINGS CONFERENCE CALL

# AUGUST 29, 2023

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Additional information relating to the Bank can be located on the SEDAR+ website at www.sedarplus.ca 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 2023 Third Quarter Results Presentation. My name is John McCartney. I'm Head of Investor Relations here at Scotiabank.

Presenting to you this morning are Scott Thomson, Scotiabank's President and CEO; 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; Glen Gowland from Global Wealth Management, Francisco Aristeguieta from International Banking; and Jake Lawrence from Global Banking and Markets.

Before we start and on behalf of those speaking today, I will 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 Scott.

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**Scott Thomson - The Bank of Nova Scotia – President & CEO**

Thank you, John, and good morning, everyone. We appreciate you joining us today. The bank reported Q3 adjusted earnings of $2.2 billion or $1.73 per share, up 2% sequentially. The Pretax pre-provision earnings of $3.5 billion were up 5% compared to the prior quarter. The bank's Q3 results reflect both the resilient performance of our retail and commercial businesses and modest improvement in our market-sensitive capital markets and wealth businesses.

Although the operating environment has stabilized following the Q2 market dislocation, deposit migration to term products and Central Bank rate increases continue to increase our funding costs. Importantly, we strengthened our capital, liquidity and deposit metrics as we prepare the bank for our next phase of profitable, sustainable growth. We continued to build capital this quarter, resulting in a common equity Tier 1 capital ratio of 12.7%. Our liquidity coverage ratio was a strong 133% at quarter end, up from 122% in the prior year. Deposits once again outpaced loan growth in the period, from a sustained focus on deposit growth initiatives across our businesses, improving our loan-to-deposit ratio.

Year-over-year deposits increased by 9% or approximately $55 billion. On a sequential basis, deposits grew in our Canadian Banking and International Banking franchises. Lending volumes in the quarter reflect a more cautious environment from both a household confidence and business investment perspective as seen in activity levels across our various segments and geographies. The impact of these macroeconomic realities coupled with a more selective and deliberate approach to new originations has resulted in a moderation of our loan growth. Expense growth was flat to last quarter and will be a priority as we strive to achieve our medium-term objective of delivering positive operating leverage. Disciplined expense management has always been a core competency of our bank.

The higher for longer interest rate environment that has played out across our operating geographies has already and will continue to impact consumer health. Through our advanced data and analytics, we are closely monitoring customer behavior and have observed a very rational and responsible shift in spending as households manage through this period of reduced discretionary income. In our core international banking markets, where the interest rate tightening cycle has led most other global economies, we are seeing the impact of recessionary conditions, which are reflected in our elevated provisions. With the Chilean economy, for example, now in a recession, its Central Bank cut rates with a 100 basis point policy rate decrease in late July and additional rate cuts are expected in the near term. Overall, we remain confident that the investment grade bias to our corporate and commercial portfolios, coupled with our conservative underwriting standards, has the bank very well positioned to manage through this phase of the rate cycle.

We continue to build performing allowances and improve our ACL coverage as the longer-term macroeconomic outlook continues to be uncertain. From a business line performance perspective, I was particularly encouraged by our revenue-led pre-tax pre-provision growth in each of Canadian Banking and International Banking, both up year-over-year and quarter-over-quarter. GBM and wealth both showed positive trends as market volatility stabilized. In our Canadian Banking business, as expected, profitability was impacted by higher provisions, however, we saw healthy net interest margin expansion supported by another quarter of double-digit deposit growth. Our Scene+ loyalty program reached 14 million members in the quarter and has been a strong contributor to new primary client relationships and deeper product penetration with existing customers. Just this month, Home Hardware was added to the Scene+ program, providing members the opportunity to earn and redeem Scene+ points at one of Canada's largest home improvement retailers. The Scene+ program was an important driver of the strong growth this quarter in Canadian Banking deposits and clients who use us as their primary bank for day-to-day payments through credit cards.

Our Tangerine franchise is performing well from a deposit gathering and profitability perspective and is increasingly focused on deepening client relationships through card and wealth management cross-sell. Importantly, over 80% of our Tangerine deposit flows in Q3 originated from digitally engaged multiproduct clients, and once again, the business delivered double-digit revenue and earnings growth on a year-over-year basis. International Banking delivered solid performance against a challenging economic backdrop with strong revenue growth and good expense control. Earnings were impacted by higher provisions and a normalizing tax rate. Our Mexico business continues to show great momentum, delivering 16% pre-tax pre-provision growth year-over-year and a return on equity of 25%. We are well positioned to strategically support both local and multinational clients in Mexico as a wave of supply chain-related foreign direct investment drives outsized industrial activity and economic growth.

Global Wealth Management earnings grew 4% from the prior quarter, strong relative investment performance and continued momentum in our international wealth business tempered the impact of a negative industry investment fund flows. Global Banking and Markets delivered solid results on stronger capital markets activity in conjunction with moderating loan growth as the business continues efforts to optimize capital allocation with a focus on return metrics. Inclusive of continued strong results in GBM LatAm, GBM delivered earnings of $748 million, up 31% year-over-year and 11% sequentially, driven largely by growth in our fee and client underwriting and advisory business. In summary, results across our businesses reflect the bank's ability to generate solid earnings through a period of economic uncertainty and transition.

Our results also reflect early actions in support of the priority initiatives I have previously outlined: primary client growth, purposeful capital allocation and excellence in operating efficiency. Growing client primacy is critical to delivering on our strategy, which means bringing the entire bank to our clients to earn core relationships. In each of our business lines, we are evaluating our approach to relationship building and our opportunity for relationship deepening. We will look to prioritize markets where we have scale opportunity and target client segments where we have the product capability and connectivity to be a lead financial services provider. Allocating capital to the businesses where we have the highest return through a disciplined approach will result in profitable growth for the bank. Operational excellence will entail continuing to digitize and streamline the way we do business to create efficiency across our bank. We want to make it easier to do business with us through continued digitization, simplified internal processes and enhanced client interactions. We are committed to ongoing productivity initiatives and a collaborative culture that positions us to win for our shareholders, colleagues and communities.

In closing, I would like to welcome Jacqui Allard, who joins us next week as our Deputy Head, Global Wealth Management and will assume leadership of that business early next year. Jacqui will work closely through a transition period with Glen Gowland, who has done a fantastic job building our wealth business to scale in recent years. I look forward to having Glen Gowland work closely with me on strategic initiatives across the organization in his new role as a Vice Chair of the bank. And finally, I wanted to acknowledge the devastating wildfires in the Northwest Territories and my home province of British Columbia. I want all our employees and clients to know that we're thinking of them and are here to support. We have made a donation to the Canadian Red Cross, the United Way Northwest Territories and the Kelowna firefighters to support relief and recovery efforts, and we are raising additional funds through our branches across Canada. We remain focused on the safety of our employees and ensuring we're here to support our clients during this difficult time.

With that, I will turn the call over to Raj for a more detailed review of our financials.

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

Thank you, Scott, and good morning, everyone. All my comments that follow will be on an adjusted basis for the usual acquisition-related costs. I'll begin with a review of the performance for the quarter on Slide 5.

The bank reported quarterly adjusted earnings of $2.2 billion and diluted EPS of $1.73. Return on equity was 12.2%. All bank pre-tax pre-provision profit decreased 2% year-over-year but increased 5% quarter-over-quarter. Year-over-year, the decline was driven mainly by higher funding costs, which is recorded in the other segment and lower wealth management results driven by challenging market conditions. Net interest income was $4.6 billion, down 2% year-over-year as loan growth and the positive impact of foreign currency translation were offset by lower margins. The net interest margin declined 12 basis points year-over-year and 3 basis points quarter-over-quarter, mostly from higher funding costs due to central bank rate increases. Recall, given the increased probability for rates to remain higher for longer, last quarter, we modified our interest rate positioning while remaining positioned to benefit meaningfully from declining interest rates.

For the second quarter in a row, deposit growth outpaced loan growth, resulting in a loan-to-deposit ratio of 114%, an improvement of approximately 140 basis points quarter-over-quarter. Noninterest income was $3.5 billion, up 12% year-over-year, mainly due to higher banking revenues, trading-related revenues in fixed income and equities, underwriting and advisory fees and wealth management revenues. The PCL ratio was 42 basis points this quarter, of which 4 basis points was performing PCLs. Phil will cover PCL in more detail later. Quarter-over-quarter expenses were flat or down 1% excluding the unfavorable impact of on currency translation, driven by lower share and performance-based compensation and employee benefits, partly offset by the 3 additional days in the quarter. Expenses increased 9% year-over-year or 5%, excluding the unfavorable impact of foreign currency translation, reflecting growth in staffing-related costs, technology costs, amortization and advertising and business development. The productivity ratio was 56.1% this quarter, an improvement of 140 basis points quarter-over-quarter as revenue growth outpaced expenses. Year-to-date operating leverage was negative 7.4%. The effective tax rate was 18.4% this quarter compared to 18.9% a year ago, driven by higher income in lower tax rate jurisdictions and higher tax-exempt income in the quarter, partly offset by lower inflationary adjustments in International Banking.

Turning to Slide 6. This slide provides an evolution of the Common Equity Tier 1 ratio over the quarter as well as the quarter's changes in risk-weighted assets. The bank reported a Common Equity Tier 1 ratio of 12.7%, an increase of approximately 40 basis points. Net internal capital generation was strong at 37 basis points, including a lower risk-weighted asset number. Under the dividend reinvestment plan, the bank issued 7 million shares that contributed 11 basis points. Risk-weighted assets were $439.8 billion during the quarter, a decrease of approximately $11.3 billion from the previous quarter. Lower business loan growth, a reduction in the capital floor add-on of approximately $7 billion and the benefits from the inaugural synthetic risk transfer transaction reduced the risk-weighted asset during the quarter. The bank's capital ratios are expected to continue to grow in Q4. In addition, the bank's liquidity coverage ratio or LCR improved 200 basis points quarter-over-quarter to 133% this quarter and was significantly up from 122% last year.

Turning now to the business line results beginning on Slide 7. Canadian Banking reported earnings of $1.1 billion, a decrease of 13% year-over-year due to higher provision for credit losses and noninterest expenses. Pre-tax pre-provision profit grew 2% year-over-year as revenue growth of 3% was partly offset by expense growth of 5%. Pre-tax pre-provision profit increased a strong 5% quarter-over-quarter. Net interest income increased 4% year-over-year as deposits grew a strong 11% and earning assets grew a modest 3%. Quarter-over-

quarter margin expanded by 5 basis points due primarily to higher deposit margins. Average loans and acceptances grew 3% year-over-year. We saw continued growth in our higher-yielding portfolios as business loans grew 13%, personal loans grew 4%, and credit cards increased 17%. This was offset by a decline of 1% in residential mortgage balances. Average loan balance was in line with last quarter as the decline in mortgage balances was offset by growth in business, personal and credit cards. We continue to see strong deposit growth, with average deposits again up 11% year-over-year and 2% quarter-over-quarter. Year-over-year, personal deposits grew 13% and primarily in term products and nonpersonal deposits increased 6%. The loan-to-deposit ratio has improved to 129% from 139% last year in this segment. Noninterest income was down 1% year-over-year, driven by lower cards revenue and reduced income from associated corporations. Expenses increased 5% year-over-year, primarily due to higher personnel costs from increased client-facing staff and inflationary adjustments. Quarter-over-quarter expenses were down a modest 1%. The PCL ratio was 27 basis points, an increase of 7 basis points quarter-over-quarter.

Turning now to Global Wealth Management on Slide 8. Earnings of $373 million declined 3% year-over-year primarily due to Canadian wealth being down 7%. International wealth earnings grew a strong 26% year-over-year. Earnings grew 4% quarter-over-quarter in spite of difficult market conditions. Revenue grew 2% year-over-year and 3% quarter-over-quarter due primarily to higher mutual fund and brokerage revenues. Expenses were up 6% year-over-year from expansion of revenue-generating sales-force and 3% quarter-over-quarter driven by higher volumes. Assets under management increased 4% year-over-year to $331 billion as market appreciation was partly offset by net redemptions. Assets under administration increased 9% over the same period to $631 billion from both market appreciation and higher net sales. While investment funds in Canada remain in net redemptions, Scotia Global Asset Management investment results continue to perform well against their benchmarks, and the bank maintained its #2 ranking in investment funds in Canada. International Wealth generated earnings of $60 million driven by higher net interest income and business volume growth. International Wealth Management AUA grew 21% year-over-year to $130 billion.

Turning to Slide 9, Global Banking and Markets, generated earnings of $434 million up 15% year-over-year. Revenues grew 17% year-over-year, outpacing expense growth of 16%. Capital markets revenue was up 41% year-over-year as FICC grew 52% and global equities grew 28%. Business Banking revenues grew 2% and the loans grew 13% year-over-year. Net interest income was down 17% year-over-year, as a result of lower corporate lending and deposit margins and lower loan fees. Noninterest income grew $259 million or 35% year-over-year, primarily due to higher underwriting and advisory fees and growth in trading-related revenue in fixed income and equities. Expenses were up a modest 1% quarter-over-quarter, mainly from higher performance-based compensation and salaries. On a year-over-year basis, expenses were up 16% due mainly to higher personnel costs and technology investments, both related to business growth. The provision for credit losses was a recovery of $6 million driven by Stage 3 recoveries. The U.S. business generated earnings of $217 million this quarter. GBM Latin America, which is reported as part of International Banking had another strong quarter, reporting earnings of $314 million up 64% year-over-year, driven by Mexico, Chile and Brazil.

Moving to Slide 10 for a review of International Banking. My comments that follow are on an adjusted and constant dollar basis. The segment reported net income of $635 million, down 8% year-over-year. However, pre-tax pre-provision profit grew a strong 11%. The Pacific Alliance was up 10% with strong growth in Mexico of 16% and 19% growth in Caribbean and Central America. Revenue was up 8% year-over-year, driven by good loan growth, higher net interest margin and strong capital markets and corporate banking revenues in Mexico and Chile. Year-over-year, loan growth moderated at 5%. Mortgages were up 10%. Personal loans and credit cards grew 3%, and business banking was up 3%. Deposits grew a strong 8% year-over-year and 1% quarter-over-quarter, reducing the loan-to-deposit ratio by approximately 400 basis points year-over-year. Net interest margin expanded 15 basis points year-over-year. The margin was down 2 basis points quarter-over-quarter, mostly from lower inflation benefits in Chile and Uruguay. The provision for credit losses was 118 basis points or $516 million, up 15 basis points from last quarter. On a quarter-over-quarter basis, expenses were down 1% due to lower salaries and employee benefits. On a year-over-year basis, noninterest expenses were up 5%, driven mainly by the inflationary impacts on personnel costs. The tax rate of 22.9% for the quarter increased from 20.7% in the prior quarter due to lower inflationary adjustments in Chile and Mexico.

Turning to Slide 11. The Other segment reported an adjusted net loss attributable to equity holders of $299 million, an improvement of $24 million compared to the prior quarter. Quarter-over-quarter, higher funding costs mainly driven by continued rate increases, were more than offset by higher income from liquid assets and lower expenses. I'll now turn the call over to Phil to discuss risk.

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

Thank you, Raj, and good morning, everyone. While we continue to operate in an environment of heightened uncertainty, we believe our business is well positioned to navigate this successfully. PCLs in Q3 were $819 million, up $110 million quarter-over-quarter, translating to a PCL ratio of 42 basis points. Our PCL ratio reflects 4 basis points of performing allowance build, reflecting the continued uncertain macroeconomic outlook. The fifth consecutive quarter of performing allowance build contributes to our balance sheet strength, with a total ACL coverage now at 78 basis points. Stage 3 PCL also increased, with nonperforming provisions of $738 million, up $117 million quarter-over-quarter. The largest increase was in Chile and Colombia unsecured retail, where the economies continue to slow. In Canada, despite two additional rate increases in Q3, variable rate mortgage customers remain resilient. These customers have adjusted quickly with spending down 15% year-over-year, driven by reductions in discretionary areas. We remain comfortable in our retail, commercial and corporate customers' ability to manage through this credit cycle.

Moving to international retail. Our secured balances remained stable at 73% of total loans for the third consecutive quarter. While inflation is beginning to ease, the absolute levels and price pressures on consumers remain high. This erosion of purchasing power is impacting the financial health of consumers in the Pacific Alliance. In particular, in Chile, this is compounded by a gradual rise in unemployment given the decline in economic activity. Overall, 90+ day delinquency increased 8 basis points quarter-over-quarter, within expectations. In Q3, the International Banking retail PCL ratio was 215 basis points compared to [184] (corrected by company after the call) basis points in Q2.

Turning to business banking. This portfolio continues to perform well. The segment reported PCLs of 18 basis points, down from 21 basis points in Q2. International Commercial was stable quarter-over-quarter, while we had a small release in GBM driven by a recovery on 1 account. In Canada, we built performing allowances being cautious on macroeconomic outlook and headwinds facing commercial real estate. Our global commercial real estate portfolio is $66.2 billion, down 1% quarter-over-quarter, representing approximately 8% of our loan portfolio. We remain focused on undersupplied asset classes with 72% of our CRE exposure in residential and industrial. Office exposure represents less than 1% of our total loans, and we have built performing allowances as the longer-term impact of flexible work remains uncertain. We continue to proactively manage maturities and credit events.

Moving to Slide 13. Gross impaired loans were up 3 basis points quarter-over-quarter to 70 basis points, but remain below pre-pandemic levels. GILs were primarily driven by new formations in retail, and specifically in Chile and Colombia. Business Banking GILs were relatively unchanged this quarter. Canadian commercial GILs increased quarter-over-quarter. However, GBM and international commercial GILs were lower.

Moving to Slide 14. Canadian Banking reported PCLs of $307 million. The PCL ratio of 27 basis points reflects a performing build of 4 basis points. The quarter-over-quarter increase was due to continued uncertain macroeconomic outlook, a performing build in commercial and higher impairments in Canadian Commercial and prime auto. International Banking PCLs were $516 million, translating to a PCL ratio of 118 basis points. The quarter-over-quarter increase was primarily due to retail driven by delinquency and net write-offs mainly in Chile and Colombia. In international, ACL coverage is now at 218 basis points, up 9 basis points quarter-over-quarter. We continue to build prudent allowances across our portfolios with the all-bank ACL ratio at 78 basis points, up 3 basis points quarter-over-quarter. We expect key macroeconomic indicators in Chile and Colombia to remain challenged in the near term, owing to a lagged impact of higher interest rates and the loss of purchasing power associated with high inflation. We continue to closely monitor our portfolio and will respond with adjustments to allowances as appropriate. We remain prudent with new exposures and will focus on high-quality borrowers.

With that, I will pass the call back to John for Q&A.

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

Great. Thank you, Phil. Operator, if we could queue for questions?

## QUESTIONS AND ANSWERS

**Operator**

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

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

I guess I just wanted to narrow down on the Canadian Banking segment, Raj, I think you referenced the loan-to-deposit ratio. If we look at loan and deposit balances relative to year-end, loans have been relatively flat, you've grown deposits. And I know deposits -- growth in deposits, a big priority for Scott. Just give us a sense of, is there a targeted loan-to-deposit ratio that you want that business to get to before we see loan balances grow, like is that intentional? And what is the -- and the strategy around the deposit customers who are coming on, are those really sticky customers that you can convert into a multiproduct relationship? Or is it driven by rates and it's TBD in terms of whether this becomes a lasting relationship for the bank?

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

Great. I'll just start simplistically on the loan-to-deposit ratio, and I'll pass it on to Dan to talk about customers and how we are approaching deposits and loans from a client primacy perspective. What we have seen in the reduction in loan-to-deposit ratio, both in IB as well as in the Canadian bank is what we are going to continuously aspire to achieve. And like you point out, there's two sides to it, loans and deposits. So the deposit drive, I think, will continue because we do need to build our deposit base, something we've been quite clear about since Scott talked about it. I think in January, February of this year, you'll see that momentum continue. On the entire relationship, we'll be more thoughtful about how we want to grow the share of the wallet and so on. So I'm going to pass it on to Dan, he can talk about it in greater detail.

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

Great. Thanks, Raj. Dan here. Look, a couple of things I would call out. We are aiming for an ongoing improvement in the LDR ratio in the CB segment. We're 129 this quarter. We were 139 a year ago. So that's a substantial change. Clearly, decelerating loan growth, particularly in mortgages, has had an important impact of that as well as the market appetite for term on the personal deposit side. I would call out a few

key planks of our mission towards deepening with clients or improving our client primacy. I know Scott off the top referred to the importance of seen. We have seen on the back of that customer loyalty program about 0.5 million new day-to-day accounts opened in the last year. Those would be core deposit, low-price sticky accounts which are often the result of cross-selling off the existing stock. That would be point one. We've also seen substantial improvements in our market share position with new Canadians as a result of targeted value propositions for those. Our improvement in Tangerine has also been noticeable. Scott called out in his remarks, the deepening on core there. And obviously, we've been improving our deposit growth in commercial for quite some time and in this quarter, again, at a faster growth rate than loans. So we are intensely decelerating our mortgage growth in favor of clients. And we launched in Q3 a really important pilot to deepen the deposit cross-sell off mortgages at time of origination. So I mean we're being very intentional here as we signaled a number of quarters ago, and we're really pleased with the cost of that deposit growth. As Raj mentioned, deposit margin improved again this quarter.

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

Got it. That was helpful. And just separately, in terms of when we think about expense management, not that it was a big issue this quarter, we are hearing from peers around restructuring charges, we saw one this quarter, there's probably more coming from others going into 4Q. Maybe just top of the house, your headcount is somewhat flattish, about 2% up relative to the end of '21. Give us a sense of just how you're thinking about expense management, rightsizing the franchise for the current revenue backdrop?

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**Scott Thomson - The Bank of Nova Scotia - President, CEO & Director**

It's Scott. I think it's clear to say clear for me that operational excellence will be an important component of the refresh strategy. And I was pleased to see the cost discipline in the quarter, but also recognize there's more work to do to align the organization and resources around our focus areas for growth. So good progress, but more to do as we look forward.

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**Operator**

Our next question is from Gabriel Dechaine with National Bank Financial.

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

I'd like to follow on the balance sheet management question -- line of questioning in Canada. I mean you've clearly pointed out that mortgages and decelerating growth, even shrinking that book is big part of the plan. So just wondering, considering it is mortgages, I don't -- I wouldn't expect a big impact to your revenue base in the Canadian business. And equally, wondering if the declines we've seen this quarter and prior were the main drivers of the decline in the capital risk floor add-on?

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

I'll start with the capital risk floor, and then Dan can probably talk about the business in a little more detail than he did, Gabe. The capital risk floor is actually driven by three different components. And I think it's an important factor that will impact what the floor add-on is quarter-after-quarter because there are drivers that impact the standardized risk weight, there's drivers and impact to AIRB calculation. So you're going to see that movement every quarter, not necessarily every quarter down like you saw this quarter. This quarter has three components grade. It's actually quite simple. When you break it down, we did the synthetic risk transfer, so that benefited the floor, and that gave us about $2 billion benefit in the $6.9 billion that we have called out in the slide. The next $2 billion results from when you see credit migration, which impacts the AIRB RWA and standardized, as we all know, is risk insensitive. The floor add-on reduces as you see, slightly higher credit migration, which we saw this quarter. And the third one is the split of the allowances, the expected credit losses and the expected losses, which is used for Basel. That will move between AIRB and standardized, and that moved in a direction that helped with the floor add-on this quarter of another $2 billion. So it's not got to do with the mortgages question, but I'll let Dan answer the business question that you had.

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

Thanks, Raj. We're just being more disciplined with regards to customer selection at time of origination. I think this is a good time to drive that standard higher here because it's a softer, slower housing market. I mean that is a definite fact affecting the street. We are also being more efficient with regards to our use of capital and using customer deselection at renewal as part of that conversation. We like the mortgage business, okay? We're very pleased with the pilot we put in place. Sequentially spreads expanded as we expected in the mortgage business, new spreads are good. And the deepening that we've done of the mortgages in the last 3, 4 quarters has been really encouraging. I think it slowed a little bit faster than maybe we might have expected a couple of quarters ago. But customers are behaving

well on the VRM side, as Phil mentioned, the shift into fixed-rate mortgages has been prominent through the course of this calendar year as expected. And so we just -- we know Basel changes are coming. We're focused on liquidity and focused on customers and client promising.

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

Okay. Great. And just a quick one on capital, like your CET1 ratio is getting darn close to 13%. I'm wondering what does it take to turn off the discount on the DRIP? And then ultimately, maybe implement the buyback because you're obviously in a good position here.

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

It's Raj. Yes, it is 12.7%, as you pointed out, good growth this quarter. We know it will grow again in Q4, Gabe. I think we'll be closer to 13% from what I can tell. But there's two things we need to think about from Scotia's perspective, at least. The floor is going to go up by 2.5%. So that is going to impact. So we're building for that, definitely. And at this time, the fundamental review of the trading book will be, we know it will be something, right? We don't know the exact number as this moves around with how trading positions move and how our CVA risk changes and so on. So we're preparing ourselves for those two, not to suggest it will be anywhere close to the 100 basis points. To go from 13%, we want to run about 12%. And then we also have to wait and see what ASP does in December. So a lot of it to build our balance sheet so that when we are able to talk about our strategic refresh that we have enough capital balance sheet strength to execute on it from day 1.

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**Operator**

Our next question is from Mario Mendonca with TD Securities.

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

Raj, I just want to follow up on what you just referred to because that -- the reference to getting to 13% surprises me a little bit that Scotia would target 13%. Beyond the DSB floors, is there something else that's driving this pursuit of a higher capital ratio? Are you sensitive to what's the deterioration in Latin America, for example, is there anything else that I could be missing?

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

No. I think we want to stay about 12%, right, 12% above. That hasn't changed at all. I just said it will go up to 13%. DRIP is going to give us another 10, 11 basis points. We know next quarter, Mario, so it's simply 12.70 to 12.80. We know our RWA growth has been fairly modest in this whole year. I think that will continue in Q4. It's not the pursuit of 13%, how I describe it. It is more about we will get to 13%, which puts us in a fantastic position as we think about our strategic refresh and where we want to grow going forward, apart from the two factors I called out.

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

Does the strategic refresh require the bank have a starting point of 13%? Is there something about the strategic refresh that necessitates a higher capital ratio?

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

No, it does not, Mario. It absolutely does not. The 13% is just an outcome of how we manage capital through 2023. It puts us in a great position where capital will not be a constraint for all the growth we want to have.

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

You referred to the risk transfer as your inaugural was transferred. I took that to mean there's more to come. Did I interpret that correctly?

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

No, I meant inaugural simply as the first one we have done. It doesn't mean we will do more. But what it does is it gives us another tool in the toolkit as we manage capital. And basically, we have tested out the plumbing, so to speak, and we know that if necessary, we will have the ability to do it operationally. That's all I meant to say.

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

Is there any way to size the -- what I'm trying to figure out here is for every 10 basis point lift you get in your capital ratio as a result of a risk transfer. It implies a certain percentage decline in your EPS or pennies, I mean, your EPS. Is there anything you can give me to help me understand that dynamic?

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

I can speak to you offline on that, Mario. I think the synthetic risk transfer will have a small cost attached to it. The way we think about it is what is the cost of equity of the bank, and the cost of the equity of the bank, you can take weighted average cost of capital call it, 11%. As long as it's significantly south of that, we feel like it's accretive to the EPS, which just means that we've got to manage capital through other levers if we continue to do synthetic risk transfer.

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

Final thing then perhaps this is for Scott. You referred -- I think the phrase you used was prioritized markets. Perhaps this is going to be a part of your discussion in the refresh, but what do you mean by prioritized markets? Are you signaling that the bank with exit certain markets in Latin America, for example?

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**Scott Thomson - The Bank of Nova Scotia - President, CEO & Director**

Mario, I think going forward, our plan is to prioritize capital allocation to areas where we see the highest risk-adjusted return on a full cycle basis. We'll take into consideration where we can build competitive advantage and also connectivity across the platform. So we'll have more to say on that at Investor Day. But no, I wouldn't read too much into my comments that you referred to. And then secondly, I'd come back to the capital piece, just to reinforce what Raj said, recognizing I’m relatively new in role. Right now with what OSFI has highlighted, 12%, that's the right number, plus 12%. So I don't want at all you to think that we should be running here at 13%. But we do have a situation where there's going to be some offsets in Q1 associated with Basel, and there's uncertainty with what OSFI is doing. And so the objective here would be to get off the DRIP as soon as we can. And we also recognize that the risk transfer is not a good use of capital. And so trying to manage this prudently given the uncertainties, but also being rarely sensitive to the shareholder is the key objective here going forward.

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**Operator**

Our next question is from Doug Young with Desjardins Capital Markets.

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

Just maybe part of NIM question. I mean, NIM up in Canada, it's up in International down at the all-bank level. Can you talk a bit about the drivers in corporate? And Raj, I think you signaled last quarter that you've made some changes in the hedge book. And as we think about what you've talked about and Dan has talked about on the deposit and the loan growth side, like how should we think about NIMs evolving over the next year, maybe at the divisional level, but also as it kind of goes through the corporate and to the all bank level as well?

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

Sure. I'll start, and I'll try to cover all the components of your question, Doug. All bank level NIM had a modest compression of 3 basis points. I would attribute all of that to the corporate segment, which relates to the cost of funds increase. As you know, we record it there. Since we talked in May, there's been rate increases, both in Canada and the United States. And at that time, we did not expect rate increases in Canada. So what you're seeing this quarter is the impact of that. The improvement in NIM in the Canadian bank will continue. As we pointed out, this quarter's improvement was all deposit driven, and I think that will continue. Asset margin is actually starting to show signs of growth, like Dan pointed out, mortgage margin is starting to go up. So I'm optimistic that it will also contribute maybe modestly to next quarter so that you should see it happen. International Banking NIM, many times in the past, I said there are so many moving parts within the interest bank segment. The Caribbean is benefiting from U.S. rate increases, particularly the English Caribbean, while the Pacific

Alliance countries, inflation moves it around quite a bit, business mix also does. I think it will remain in about these levels. There might be a quarter where a couple of basis points down or up. But when you take it to the all bank level, it's about 20% of the assets of the bank. So it wouldn't have a meaningful impact to the banks NIM going forward. The biggest impact will always be the cost of funds in this environment. And as we talked about before, currently, the bank is neutralized to the sensitivity across the rate curve, which is what we disclosed. However, when you have rate cuts happening at the short end of the curve, which is where we expect it to benefit us, that will be a meaningful benefit when it happens.

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

Okay. And then maybe just on the strategic risk trends for, Scott, if I heard you, you said that's not an efficient use of your capital. I mean -- and Raj, I heard you wanted to test at the plumbing. But why do a strategic risk transfer at this point in time?

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

Yes. It's a synthetic risk transfer. So it's not an actual elimination from the balance sheet, as you know. So it's a synthetic exposure. I think it's -- capital management is going to be key as we see it going forward because of the significant changes that is happening all around those, including regulatory Basel, those kind of things. Having another tool in the toolkit is an important component of how we manage capital. So we look at it from that perspective. We'd rather test it early to see we know how to make it work operationally, like I mentioned, and we've established that. So we feel very comfortable that we'll be able to do it as required in quarters where we think it is the necessary first step to do.

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**Operator**

Our next question is from Paul Holden with CIBC.

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

First question for Phil and appreciate the color in Canada you provided on the international bank. And I just want to ask in past experiences, what does history tell you in terms of how long unemployment may remain elevated and thereby, how long PCLs may remain elevated, assuming those two remain correlated?

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

Paul, are you referring to international specifically? Or do you want to -- your Canada pertain -- your question pertained to Canada mostly?

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

International, mostly.

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

Okay. So if you look at where we're having the most pockets of friction in Chile, as an example, they've decreased interest rates by about 100 basis points a few weeks ago, which we view as promising. We're going to monitor that over the next quarter or so. And we expect that we'll start to see some improvements in terms of purchasing power of our customers. But this is something that will stick around for a little bit. But you know what, one of the things I've been really pleased with, Paul, is the pivot -- the strategy pivot we made around originations about 2 years ago to focus on affluent customers. This is really paying dividends for us right now. And as I look and we double-click on that customer base. They're not -- we're not seeing the level of stress with those customers as we would see with some of our other customers. And so I think that pivot that the IB team have been doing and Francisco is now focused on has been really positive for us. But this is going to be -- this is something we're working on closely. There's a lot of activity with collections. A lot of activity between Francisco and I am looking at how we manage originations moving forward. I think, as Scott said in his opening remarks, focusing on primary customer being focused on that affluent segment international will pay dividends for us.

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

Okay. So a challenge in the near term, but how long we'll wait to see.

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

Yes, you got it.

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

Okay. And then second question, which is probably for Raj. Just want to ask on expenses. I see a decline in FTE notably in Canada quarter-over-quarter. It seems like expenses were kind of in line with what you'd expect yet still negative operating leverage. And I would argue for a challenging revenue environment going in next year for everyone, not just for Scotiabank, but for everyone. So how are you thinking about the expense management going forward? Is there a potential to take additional actions to rein in operating expenses?

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

Yes. I think like Scott referenced in his remarks, too, I think expense management is a cornerstone of this bank. I think we've been proving it over many, many years, Paul, as you know. This quarter is just a reflection of how we manage it in line with revenue. We've talked about it before, where we'd like to generate positive operating leverage this year, as you point out, likely not, probably not. It's probably a more accurate way of saying it. Quarter-over-quarter, you should see our expenses being moderated the way you saw this quarter. I wouldn't talk about 2024 at this time. I think it's a little early. We'll talk about it in our outlook call in November. But prioritizing our spend, investing appropriately where we need to invest. And as you point out, managing our staffing costs through staffing numbers has been an approach we've taken in the past. The Canadian banks reduction in employee count that you point out is something that we decided we needed to do in the right spots within the Canadian bank. So it doesn't impact revenue. It doesn't impact customers, how can we manage it prudently, and I think Dan has done a great job of that in the last 3 quarters. International Bank has always been great in managing their expenses because many times we forget they operate in an exceptionally high inflationary environment even in normal times. And to have a 5% expense growth year-over-year, I think, is very credible of how we pay attention to those lines in that segment as well. So you should expect us to continue doing that. And our expectation is always to generate positive operating leverage every year, and we hope to start doing that again in 2024 what we missed in '23.

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

Okay. And so -- sorry, I guess, just a finer point on it, to get to that positive operating leverage in 2024, you believe you're on the right path today? Or do you think additional actions might be required?

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

I think we are on the right path. We always look at what additional actions we need to take every year. We took Q4, if you look at last year, we rationalized some of the expenses in the technology teams as well as in International Banking. We always look at that call. We look at it again. So we set ourselves in the right path before we start the year. And I suspect '23 will be the same as we have done in prior years.

**Operator**

Our next question is from Mike Rizvanovic with KBW Research.

**Mike Rizvanovic - KBW Research**

A quick question for Dan on your mortgage growth. I'm just wondering -- I'm not sure if there's a way to basically remove the impact of the fact that you don't have negative amortization in that DRM product. What's your sense of what your true market share trend is here? I know you've been losing some share. I feel like it's largely related to that factor. Not sure if you're able to split that out, but what's your sense in terms of what you guys are doing on the origination side versus industry right now?

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

Yes. I don't think that the new booking mix VRM versus fixed is affecting the total new originations in the quarter. I would just reinforce the point I made earlier, which is we're being more deliberate with regards to efficient needs of capital, pricing to the full customer relationship and potential and taking this time given a slow housing market to put those plans into effect, and the pickup on cross-sell of that product is very encouraging. We like the mortgage business. We know it's important to our customers. And I think the VRM dynamic is more around

client preference for moving into fixed which we're supportive of from a financial advice standpoint as opposed to anything around volume or market share.

**Mike Rizvanovic - KBW Research**

Okay. So you don't think it's having an impact on the market share launches that you've had the last few quarters, just that negative amortization dynamic that some of the other banks have, which you don't?

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

That's possible. I mean we certainly -- we are -- we deliberately slowed the mortgage book as we signaled some time ago, and so that's intentional as an outcome. So we're actually pleased by that. I think the VRM dynamic might be showing up more fill in GILs. We do have customers who are seeing our payments rise faster than peers. And so we're -- we've been saying for at least a year now that we've been proactive with those customers. And the VRM mix is more around managing credit, which we're pleased with, than it is around market share or volume. And I would just say on the back of Raj's comments on expenses, we're really pleased with how we've been decelerating quickly. And in Q3, we printed positive operating leverage with the big retail bank, which was our ambition, and we did that a quarter ahead of schedule.

**Mike Rizvanovic - KBW Research**

Got it. And then just a quick one for Jake. Just thinking back in the fact that Scotia had maybe been underinvesting a little bit in the cap markets business heading into the pandemic and you didn't have the same upward sort of trajectory during that time. I'm just wondering where you currently sit with respect to your -- just the full platform, the capabilities? And do you see any pockets where maybe you want to allocate more capital and invest in it? Any thoughts on that just in terms of where you sit today and where you want to do your capabilities?

**Jake P. Lawrence - The Bank of Nova Scotia - CEO and Group Head of Global Banking & Markets**

Yes. Thanks for the question, Mike. You're right, heading into the pandemic and tipping back to our Investor Day in Chile, we weren't where we wanted to be. We've definitely grown to our natural share here in Canada, which has been really positive. But the U.S. market continues to be a good opportunity. There's opportunities to invest there by sector, by product and really attract into some new areas. We're not terribly large in noninvestment grade at this stage. That's an area we can look to add value. Our U.S. loan book is at zero GILs for the past 6 quarters. So there's an opportunity to grow in some different segments there. I'd also say we're underrepresented in private capital. You've seen we've launched a CLO practice that's been positive to access the private credit growth we've seen. And then when we look further into our platform, Mexico has been really promising with a strong quarter. So we think there's real opportunity across that network in North America as we build out further capabilities, whether it's treasury services, cash management, et cetera.

**Mike Rizvanovic - KBW Research**

Got it. Is it fair to say that there is some low-hanging fruit in your business at this point in time?

**Jake P. Lawrence - The Bank of Nova Scotia - CEO and Group Head of Global Banking & Markets**

Without a doubt. And as we move forward, it will be key that we allocate the capital that the bank has to generate the most profitable returns we can across our footprint, whether it's in GBM or other parts of the organization.

**Operator**

Our next question is from Lemar Persaud with Cormark Securities.

**Lemar Persaud - Cormark Securities Inc., Research Division - Research Analyst**

Maybe for Phil. I'm probably front-running the Q4 here. But just help me think through PCLs for a moment. So steady in the PCL ratios, the total PCL ratio over the last 5 quarters. The challenges in Chile and Colombia and the domestic, it looks like this trend could continue. So perhaps, should we expect continued sequential increases in the total PCLs sale? Or is there some reason where -- why we should expect it to kind of move down from the 42 basis points this quarter?

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

I appreciate the question. Yes, this is how I would think about it. There's a lot of moving parts in our portfolio. I think as I said in my prepared remarks and the answer to the last question, Chile and Colombia remain an area of great focus for us. And so I would probably look to Q4 to be at or maybe slightly elevated above where we are today, but then and then I'll come back to you next quarter with an outlook for 2024.

**Operator**

Our next question is from Joo Ho Kim with Crédit Suisse.

**Joo Ho Kim - Crédit Suisse AG, Research Division - Research Analyst**

Just one quick one for me and a question on International Banking in Chile specifically. With the country in a recession, and I know this quarter was impacted by impaired losses and potential for more as we go forward. But I'm trying to get a sense of whether it's possible to grow that business in Chile in an environment like this? And maybe if you can speak to on a pre-tax pre-provision basis.

**Francisco Alberto Aristeguieta Silva - The Bank of Nova Scotia - Group Head of International Banking**

Well, thank you very much for the question. As you said, we're going through a cycle. And when we look at our retail business, for example, in Chile is performing quite well from the PCL perspective outside of the commercial space. Similarly, on the GBM space. So we are growing quite significantly year-on-year on a PTPP basis. So we are optimistic on how the business is performing even on a very difficult year where we're seeing an economic contraction. As we look at 2024, we see Chile coming back to GDP growth, and that will play strong to our positioning in the market. So we remain optimistic with our Chile positioning ex the commercial space.

**Operator**

Our next question is from Sohrab Movahedi with BMO Capital Markets.

**Sohrab Movahedi - BMO Capital Markets Equity Research - MD of Financials Research**

Okay. Maybe if I can just stay with Francisco. Mexico, I think, has been highlighted a couple of times both in Scott's remarks and Jake's remarks is an area of opportunity. I think last year, this quarter, it contributed to about 7% of total bank earnings. It's up closer to 11%. It's been a nice offset to Chile within the Pacific Alliance. Just curious as to what the growth prospects there look like? And how much -- what's the risk appetite, I suppose, at the total bank level. How much of the total bank can be accounted for by Mexico in particular? And if you could just give us a little bit of additional color as to what is that business? Is it secured on secured? And is it going through a boom benefiting from the U.S.? Or is there a chance that we may have a similar, I guess, slowdown like Chile has been experiencing?

**Francisco Alberto Aristeguieta Silva - The Bank of Nova Scotia - Group Head of International Banking**

Well, thank you for the question. I would say, first on a macro basis, we are very bullish on Mexico. We believe the dynamics around that economy will continue to benefit growth and certainly benefit our positioning in country. So we're very, very positive about as to the outlook and position of Mexico, given what is going on around efforts like nearshoring and other dynamics that are certain to benefit economic growth in Mexico. Our business construct is very well diversified across different aspects of our universal banking capabilities. When you look at our corporate commercial positioning is very, very strong. And as Jake alluded to, we're seeing very positive growth in that business. And certainly, commercial will benefit from the near-shoring phenomenon that is expected to continue to grow sustainably over the coming years. From the retail perspective, what you'll see is our credit performance has been quite strong is primarily a secured portfolio. So in terms of our exposure currently in Mexico, the overwhelming majority is secured and therefore, performing quite well. We expect to move to primacy as we are across the bank. And we intend to penetrate further those relationships that primarily today are monoliner mortgages into a more broad-based primacy driven relationships. So we expect that again to be a contributor to outsize growth within our franchise. So overall, very positive in Mexico, not only the macro outlook, but certainly our positioning within that macro outlook. And in the context of the connectivity of Scotiabank across our Canada and the international footprint, certainly a strong contributor to our long-term positioning for growth and capital allocation.

**Sohrab Movahedi - BMO Capital Markets Equity Research - MD of Financials Research**

Francisco, how important are your local presence in places like Colombia and Peru to future success in Mexico?

**Francisco Alberto Aristeguieta Silva - The Bank of Nova Scotia - Group Head of International Banking**

Well, it is a mixed story. I would say that when you look at our positioning in each of these countries is quite relevant and at scale domestically. Our ability to connect those markets for the benefit of global initiatives will be very important to determine that relative importance in the context of the strategy, and we're working towards that in our refresh. So I would say today, it's important to get improvement in all of our operations in all the points that Scott has highlighted in terms of efficiency, disciplined allocation of capital, improvement of capital return. So that remains our core effort. And over time, what we intend is to maximize the opportunity of connectivity across that footprint.

**Operator**

And there are no further questions on the line.

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

Okay. On behalf of the entire management team, I want to thank everyone for participating in our call today and look forward to our Q4 call. This concludes our third quarter results call. Have a great day.