SCOTIABANK

Q4 2023 EARNINGS CONFERENCE CALL

NOVEMBER 28, 2023

DISCLAIMER

FORWARD-LOOKING INFORMATION

From time to time, our public communications include oral or written forward-looking statements. Statements of this type are included in this document, and may be included in other filings with Canadian securities regulators or the U.S. Securities and Exchange Commission (SEC), or in other communications. In addition, representatives of the Bank may include forward-looking statements orally to analysts, investors, the media and others. All such statements are made pursuant to the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995 and any applicable Canadian securities legislation. Forward-looking statements may include, but are not limited to, statements made in this document, the Management's Discussion and Analysis in the Bank's 2023 Annual Report under the headings "Outlook" and in other statements regarding the Bank's objectives, strategies to achieve those objectives, the regulatory environment in which the Bank operates, anticipated financial results, and the outlook for the Bank's businesses and for the Canadian, U.S. and global economies. Such statements are typically identified by words or phrases such as "believe," "expect," "aim," "achieve," "foresee," "forecast," "anticipate," "intend," "estimate," "plan," "goal," "strive," "target," "project," "commit," "objective," and similar expressions of future or conditional verbs, such as "will," "may," "should," "would," "might," "can" and "could" and positive and negative variations thereof.

By their very nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties, which give rise to the possibility that our predictions, forecasts, projections, expectations or conclusions will not prove to be accurate, that our assumptions may not be correct and that our financial performance objectives, vision and strategic goals will not be achieved.

We caution readers not to place undue reliance on these statements as a number of risk factors, many of which are beyond our control and effects of which can be difficult to predict, could cause our actual results to differ materially from the expectations, targets, estimates or intentions expressed in such forward-looking statements.

The future outcomes that relate to forward-looking statements may be influenced by many factors, including but not limited to: general economic and market conditions in the countries in which we operate and globally; changes in currency and interest rates; increased funding costs and market volatility due to market illiquidity and competition for funding; the failure of third parties to comply with their obligations to the Bank and its affiliates; changes in monetary, fiscal, or economic policy and tax legislation and interpretation; changes in laws and regulations or in supervisory expectations or requirements, including capital, interest rate and liquidity requirements and guidance, and the effect of such changes on funding costs; geopolitical risk; changes to our credit ratings; the possible effects on our business of war or terrorist actions and unforeseen consequences arising from such actions; technological changes and technology resiliency; operational and infrastructure risks; reputational risks; the accuracy and completeness of information the Bank receives on customers and counterparties; the timely development and introduction of new products and services, and the extent to which products or services previously sold by the Bank require the Bank to incur liabilities or absorb losses not contemplated at their origination; our ability to execute our strategic plans, including the successful completion of acquisitions and dispositions, including obtaining regulatory approvals; critical accounting estimates and the effect of changes to accounting standards, rules and interpretations on these estimates; global capital markets activity; the Bank's ability to attract, develop and retain key executives; the evolution of various types of fraud or other criminal behaviour to which the Bank is exposed; anti-money laundering; disruptions or attacks (including cyberattacks) on the Bank's information technology, internet connectivity, network accessibility, or other voice or data communications systems or services; which may result in data breaches, unauthorized access to sensitive information, and potential incidents of identity theft; increased competition in the geographic and in business areas in which we operate, including through internet and mobile banking and non-traditional competitors; exposure related to significant litigation and regulatory matters; climate change and other environmental and social risks, including sustainability that may arise, including from the Bank's business activities; the occurrence of natural and unnatural catastrophic events and claims resulting from such events; inflationary pressures; Canadian housing and household indebtedness; the emergence or continuation of widespread health emergencies or pandemics, including their impact on the global economy, financial market conditions and the Bank's business, results of operations, financial condition and prospects; and the Bank's anticipation of and success in managing the risks implied by the foregoing. A substantial amount of the Bank's business involves making loans or otherwise committing resources to specific companies, industries or countries. Unforeseen events affecting such borrowers, industries or countries could have a material adverse effect on the Bank's financial results, businesses, financial condition or liquidity. These and other factors may cause the Bank's actual performance to differ materially from that contemplated by forward-looking statements. The Bank cautions that the preceding list is not exhaustive of all possible risk factors and other factors could also adversely affect the Bank's results, for more information, please see the "Risk Management" section of the Bank's 2023 Annual Report, as may be updated by quarterly reports.

Material economic assumptions underlying the forward-looking statements contained in this document are set out in the 2023 Annual Report under the headings "Outlook", as updated by quarterly reports. The "Outlook" and "2024 Priorities" sections are based on the Bank's views and the actual outcome is uncertain. Readers should consider the above-noted factors when reviewing these sections. When relying on forward-looking statements to make decisions with respect to the Bank and its securities, investors and others should carefully consider the preceding factors, other uncertainties and potential events. Any forward-looking statements contained in this document represent the views of management only as of the date hereof and are presented for the purpose of assisting the Bank's shareholders and analysts in understanding the Bank's financial position, objectives and priorities, and anticipated financial performance as at and for the periods ended on the dates presented, and may not be appropriate for other purposes. Except as required by law, the Bank does not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on its behalf.

Additional information relating to the Bank, including the Bank's Annual Information Form, 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.

CORPORATE PARTICIPANTS

Scott Thomson
The Bank of Nova Scotia – President & CEO

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

Philip Thomas
The Bank of Nova Scotia – Chief Risk Officer

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

John McCartney
The Bank of Nova Scotia – SVP of Investor Relations

CONFERENCE CALL PARTICIPANTS

Doug Young
Desjardins Capital Markets, Research Division – Diversified Financials and Insurance Analyst

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

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

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

Mario Mendonca
TD Securities Equity Research – MD & Research Analyst

Mike Rizvanovic
KBW Research

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

Sohrab Movahedi
BMO Capital Markets Equity Research – Analyst

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

Nigel D’Souza
Veritas Investment Research Corporation – Senior Investment Analyst

PRESENTATION

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

Good morning, and welcome to Scotiabank's 2023 Fourth Quarter Results Presentation. My name is John McCartney, and I'm Head of Investor Relations here at Scotiabank. Presenting to you this morning are Scott Thomson, Scotiabank's President and Chief Executive Officer; Raj Viswanathan, our Chief Financial Officer; and Phil Thomas, our Chief Risk Officer. Following our comments, we will be glad to take your questions. Also present to take questions are the following Scotiabank executives: Aris Bogdaneris 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'll refer you to Slide 2 of our presentation, which contains Scotiabank's caution regarding forward-looking statements.

With that, I will turn the call over to Scott.

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

Thank you, John, and good morning, everyone. This month marks the completion of my first year in this role as President. I'm pleased to have had the opportunity to spend the year listening to and learning from our shareholders, clients and employees. I have seen personally the passion and commitment that Scotia bankers across the footprint have to making us a better bank. Our results for the year reflect a period of decelerating industry loan growth as well as our own deliberate actions to focus on balanced growth and a thoughtful approach to improving the profitability of our businesses and client relationships. We have made significant progress on key initiatives that are fundamental to strengthening our balance sheet and improving our business mix. Both will be important as we embark on our next phase of growth. The bank reported adjusted earnings of $8.4 billion or $6.54 per share in fiscal 2023. Our return on equity was 11.7%. We believe our improved balance sheet strength and liquidity positions us to manage through potentially a more difficult economic scenario that could materialize. We took actions to strengthen our capital position to meet my January 2023 commitment to a CET1 ratio of greater than 12%, up from 11.5% at this time last year. Raj will explain in more detail the impact of the regulatory capital changes, which began in Q2 and will continue to impact us in the future. We also bolstered liquidity over the course of the year, meaningfully improving the liquidity coverage ratio to 136%, up from 119% and the net stable funding ratio from 111% to 116%. Importantly, we made progress focusing the organization on deposits. Deposits across the bank increased 9% year-over-year. The all bank loan-to-deposit ratio improved to 110% from 116%, resulting in the wholesale funding ratio dropping 100 basis points year-over-year to 20.6%. 2023 reflects early success in our enterprise-wide focus on thoughtfully growing both sides of the balance sheet. In keeping with our commitment to ensure the bank is well positioned to manage through periods of slow growth and uncertain macroeconomic times, we have significantly increased the allowances for credit losses throughout the year across all portfolios by approximately $1.1 billion, mostly in performing allowances. As previously announced, in conjunction with our strategy review process, we made adjustments to our global workforce in the fourth quarter. This productivity effort reflects a continuation of the bank's long-term commitment to achieving positive operating leverage while ensuring the appropriate resource allocation in support of our future growth initiatives.

Turning to our economic outlook. Our base case assumption is that economic growth will continue to moderate in the near term in North America. Higher interest rates are having Central Bank's desired economic impact, which we are seeing through moderating inflation and our own clients' behavior. Recognizing that rates could remain elevated for the foreseeable future, we do expect some interest rate easing in North America later next year, which will be a tailwind to our profitability. Our international banking markets experienced more notable impacts of higher rates given an earlier and more rapid tightening response to inflation in the cycle. Chile and Peru are currently in the midst of modest economic contractions and have seen Central Bank easing this past quarter. Economic growth is expected to rebound in the region later next year. Mexico has consistently seen GDP growth beyond expectations. Currently forecast to deliver 3.5% growth this year and 3% plus growth again next year, significantly outpacing the sub-1% growth expected for Canada and the U.S.

We expect consumer spending to moderate at this higher rate environment persists, leading to the very modest growth in our Canadian economic forecast. Our current balance sheet strength, structural interest rate positioning and deliberate approach to loan growth reflect our cautious near-term outlook. We look forward to sharing detailed business line strategic plans with you at our upcoming Investor Day, so I will be brief today with a few updates on each business. In Canadian Banking, the performing ACL build materially impacted our profitability in Q4. However, I was encouraged by progress in certain key operating performance metrics. Deposits, up 10% year-over-year in Q4, outpaced loan growth in the Canadian Bank for the fourth consecutive quarter, resulting in notable early progress in reducing our loan-to-deposit ratio, which moved from 138% to 125%over the course of the year. Solid net interest margin expansion of 21 basis points, benefiting from higher deposit growth, loans repricing at higher rates and business mix changes driven by more balanced loan growth across products.

In retail, growth in the Scene+ loyalty program continues to outpace expectations, surpassing 14 million members this quarter. The program continues to accelerate as a strong customer growth engine responsible for over half our new-to-bank customers in the recent quarter. New day-to-day account acquisition is up 6% year-over-year, aligned to our commitment to grow everyday banking relationships. Tangerine delivered another year of strong earnings, a result of its strong deposit position and continues to widen its lead as J.D. Power's #1 ranked bank in its class for retail banking client satisfaction for the 12th year in a row. Global Wealth results this quarter reflect the impact of more challenged market performance in recent months and the resulting impact on investment industry fund flows, which have been negative throughout 2023. We continue to broaden what is already a very robust product offering with the announcement last month of a new alternative asset partnership with Sun Life to bring a more complete offering of private credit, real estate and infrastructure products to our high net worth clients. We have a differentiated wealth offering in Canada through our total wealth advice model and a unique international opportunity that our team is delivering on.

Our International Wealth Management business delivered double-digit earnings growth again this year. Our Global Banking and Markets business has delivered resilient results in a challenging year for Capital Markets businesses while continuing to add product capabilities and sectorial advisory expertise. Loan growth has moderated considerably in recent quarters as our GBM team continues to take a more targeted approach to client selection with a focus on industries and geographies where we can deliver higher returns and more multiproduct value-add to our clients. We continue to target deeper client relationships and leverage our footprint to grow our business. International Banking had a solid 2023. Results were negatively impacted by higher PCLs and moderating capital markets activity, offset somewhat by encouraging margin expansion and continued momentum in our deposit strong Caribbean franchise. Deposit growth in Q4 continued, up 3% quarter-over-quarter and 9% year-over-year. This, combined with a more disciplined approach to loan growth has seen our loan-to-deposit ratio improve from 140% to 129%. Despite inflationary pressures, International Banking held expense growth to a modest 3% on a constant dollar basis for the year as a result of continuous efforts to rationalize our operations and further digitize the bank. International Banking continued to deliver positive operating leverage. Our 2023 financial results reflect a year of transition, economic transition in the markets in which we operate and transition within the bank as we prepare for our next phase of growth. We are seeing early signs of progress across the bank on the strategic priorities previously outlined that will lead us to more consistent earnings growth over time, more specifically, client primacy, earning a greater share of the client wallet with a focus beyond the balance sheet. Disciplined capital allocation, managing resources with a view to value over volume and operational excellence, a continuous focus on productivity, process simplification and a relentless effort to build a culture that will give us competitive advantage, better, faster and at a lower cost, all underpinned by a strong balance sheet, ample liquidity and appropriate allowances for credit losses.

I am encouraged by the franchise strength across our businesses. We are recognized again this year by the Banker Magazine, with both the Bank of the Year in Canada award and the Global Award for banking in the community, recognizing our ScotiaRISE program and the positive impact it is having in our communities. The bank is also a recognized leader for our commitment to fostering a more sustainable and inclusive future for our stakeholders. We are recognized by Global Finance with 5 awards for leadership in sustainable finance, including global leadership and sustainability transparency and Best Bank for Sustainable Finance in Canada. And we continue to build our position as an employer of choice.

This year, we were recognized as one of the best workplaces in Canada by Great Places to Work and we are once again included in the Bloomberg Gender Equality Index for a sixth consecutive year. Going forward, as we focus on execution of our strategy and the cohesive enterprise-wide mindset to meeting the needs of our clients, we've also made important senior leadership additions to the bank. I'm confident in this strengthened leadership team as we focus on the future and our plans to deliver sustainable, profitable growth for our shareholders.

I would like to sincerely thank Glen Gowland for his contribution since joining the bank over 20 years ago. I am delighted that we will continue to benefit from his expertise as the transition to the role of Vice Chair reporting directly to me.

As previously announced, Jacqui Allard will assume the role of Group Head Global Wealth Management on December 1 this year. I realize 2023 has been a difficult year financially, but the actions taken have been decisive, deliberate and necessary. A strong balance sheet, our relentless focus on becoming more efficient and appropriate allowances will set the bank up for success going forward.

As I look to 2024, I am confident earnings will increase driven by benefits from the productivity initiatives and a more stable rate environment. We look forward to sharing our new strategy at our Investor Day on December 13. With that, I will turn the call over to Raj for a detailed financial of our results.

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

Thank you, Scott, and good morning, everyone. This quarter's net income was impacted by adjusting items of $289 million after tax or $0.24 of earnings per share, about 6 basis points on the Common Equity Tier 1 ratio, all of which were recorded in the Other segment. This consisted of a$258 million restructuring charge relating to workforce reductions, a $63 million charge related to the exit of certain real estate and service contracts a $159 million impairment charge to the bank's investment in Bank of Xi'an, a $114 million impairment of certain software. These were partly offset by a $319 million gain from the sale of the bank's 20% equity interest in Canadian Tire Financial Services. The full year results were also impacted by the $579 million Canada recovery dividend recorded in Q1 2023. All my comments that follow will be after adjusting for these items in the usual acquisition-related costs on a year-over-year basis unless specified otherwise.

Starting on Slide 5 on fiscal 2023 performance. The bank ended the year with adjusted diluted earnings per share of $6.54 and a return on equity of 11.7%. Revenue was up 1% and expenses increased 9%, resulting in negative operating leverage of 8.3% for the year. Provision for credit losses were $3.4 billion in 2023, approximately $2 billion higher, of which over $1 billion was performing allowance build. Phil will speak to this later. Canadian Banking earnings were $4 billion, down $757 million or 16%, primarily due to higher provision for credit losses that increased by $1.2 billion while revenues grew a strong 7%.

International Banking earnings were $2.5 billion, down 4% on a constant dollar basis. Revenues were up $710 million or a strong 7% while provision for credit losses increased $638 million. Global Wealth Management earnings of $1.5 billion were down $126 million or 8% as a result of a very challenging market environment.

Canadian Wealth was down 12%, impacted by lower fee income, while International Wealth earnings grew 19%. Global Banking and Markets reported earnings of $1.8 billion, down $143 million or 7%. Even in a slow capital markets environment, revenues grew 7%, but expenses were up 15% to support business growth initiatives. The provision for credit losses were higher by $167 million compared to the prior year. The other segment reported a net loss of $1.4 billion compared to a loss of $229 million in 2022. The higher loss of approximately $1.2 billion was due to lower revenues driven by higher funding costs and lower investment gains that were partly offset by higher income from liquid assets. The segment had some offsetting benefits from a lower provision for taxes and lower noninterest expenses. The bank's earnings in 2024 are expected to benefit from strong net interest income growth, while noninterest revenues are expected to grow modestly.

Loan growth is expected to be modest; however, we expect the benefits of repricing to support net interest margin expansion. Expense growth is expected to moderate largely in line with the inflation as strategic investments are mostly offset by efficiency savings. The bank expects to generate positive operating leverage in 2024. The bank's earnings is expected to improve marginally this year despite higher PCLs and a higher tax rate with first half profitability improving from the current quarter and the second half of the year being stronger than the push.

Moving to Slide 6 for a review of the fourth quarter results. The bank reported quarterly adjusted earnings of $1.7 billion and diluted earnings per share of $1.26. The return on equity was 8.9%. Net interest income was $4.7 billion, up 1% year-over-year and 2% quarter-over-quarter from a 6 basis point margin expansion from higher lending margins and business mix changes, including deposit growth across all business lines. Deposit growth outpaced loan growth again this quarter resulting in a loan-to-deposit ratio of 110% compared to 116% in the prior year. Noninterest income was $3.3 billion, down 3% year-over-year mainly due to lower trading revenues and investment gains, offset by higher fee and commission and wealth management revenues. The provision for credit losses increased $437 million or 53% from the last quarter, driven by higher performing loan provisions, which were $454 million this quarter. The PCL ratio was 65 basis points this quarter, of which 23 basis points were performing PCLs.

Quarter-over-quarter expenses were up 4%, mainly from higher technology costs, performance-based compensation and professional fees. Expenses increased 10% year-over-year or 7% excluding the unfavorable impact of foreign currency translation, reflecting higher staffing-related costs, technology costs and performance and share-based compensation. The productivity ratio was 59.5% this quarter, an increase of 340 basis points quarter-over-quarter. The effective tax rate was 14.7% this quarter compared to 17.6% a year ago, driven by higher tax exempt income and higher income from lower tax jurisdictions partly offsetting an increase in the bank's tax free -- tax rate and lower inflationary adjustments.

Moving to Slide 7. The bank reported a common equity Tier 1 ratio of 13%, an increase of approximately 30 basis points this quarter. Net internal capital generation was 19 basis points the sale of our 20% equity interest in Canadian Tire Financial Services contributed 16 basis points, and the dividend reinvestment plan contributed 11 basis points. This was partly offset by 10 basis points impact from the restructuring and onetime items and the negative 8 basis points from the fair value impact of available-for-sale securities. Risk-weighted assets were $440 billion, flat quarter-over-quarter as the decline in book size was offset by the impact of foreign exchange. The estimated impact from the adoption of the Basel III reforms is approximately 75 basis points in Q1 2024. The 2.5% decrease of the capital floor to 67.5% is approximately 45 basis points, and the implementation of the fundamental review of the trading book is approximately 30 basis points.

In addition, the bank's liquidity coverage ratio grew 136% and was significantly up from 119% last year. The net stable funding ratio also improved at 116% from 111% in the prior year. The capital and liquidity ratios are expected to remain strong in 2024 with our plan to manage our common equity Tier 1 ratio in the 12.5% range.

Turning now to the Q4 business line results, beginning on Slide 8. Canadian Banking reported earnings of $810 million, a decrease of 31%year-over-year due to higher provision for credit losses and higher noninterest expenses. year-over-year revenues grew 6%, while expense growth was 9%. The average loans and acceptances were in line with prior year and down 1% from the prior quarter, while the mix changed. We saw continued growth in our higher-yielding portfolios as business loans grew 11% and personal loans grew 3% and credit cards increased 18%. This was offset by a decline of 4% in residential mortgage businesses. We continue to see deposit growth primarily in term products, with average deposits up 2% quarter-over-quarter.

Year-over-year deposits grew 10% and the loan-to-deposit ratio improved to 125 basis points -- sorry, 125% from 138% last year. Net interest income increased 8% year-over-year as deposits grew a strong 10%. Quarter-over-quarter margin expanded by 12 basis points, benefiting from asset repricing and intentional changes in business mix. Noninterest income was in line with last year due to lower banking fees, mostly offset by higher insurance revenue, expenses increased 9% year-over-year, primarily due to higher personnel costs and inflationary adjustments. Quarter-over-quarter expenses were up 4%. The PCL ratio was 63 basis points, an increase of 36 basis points quarter-over-quarter from significantly higher performing loan provisions.

Looking forward to 2024, deposit and loan growth is expected to moderate from 2023 levels. This, along with the improving net interest margins is expected to drive revenue growth. Solid revenue growth in retail, including [tendering] is expected to continue, while business banking revenues are expected to moderate. The segment will grow expenses in line with revenue growth while balancing strategic growth investments.

Turning now to Global Wealth Management on Slide 9. Earnings of $333 million declined 10% year-over-year as a strong 8% growth within International Wealth was offset by Canadian wealth results declining 12%, largely due to lower average assets under management. Revenues grew 3% year-over-year due primarily to higher brokerage revenues in Canada and Private Banking revenues within our international business. Expenses were up 11% year-over-year, driven by higher volume-related expenses and technology costs. Spot asset under management increased 2%year-over-year to $317 billion as market appreciation was mostly offset by net redemptions. Assets under administration increased 5% over the same period to $610 billion from higher net sales and market appreciation. Investment fund sales in Canada continue to be under pressure with approximately $60 billion in net redemptions over the last year.

Under this backdrop, Scotia Global Asset Management investment results continue to perform well against their benchmarks. International Wealth Management generated earnings of $52 million driven by higher revenues from business volume growth. AUA and AUM grew 12% and 16%, respectively, year-over-year. Global Wealth Management expects to deliver revenue growth in 2024, driven by retail mutual fund volume growth, solid growth across our Canadian advisory businesses and continued expansion across key international markets. Earnings are expected to grow in line with the recovering market conditions and strong new business volume growth.

Turning to Slide 10. Global Banking and Markets generated earnings of $414 million, down 14% year-over-year. Capital markets revenue was up 9% year-over-year as global equities grew 25%. However, business banking revenues declined 5% as loans were flat year-over-year. Net interest income was down 19% year-over-year as a result of higher trading-related funding costs and lower corporate lending margins. Noninterest income grew $95 million or 11% year-over-year primarily due to higher fee and commission revenue, partly offset by lower trading-related revenue. Expenses were up a more of 3% quarter-over-quarter, mainly from higher technology costs and the negative impact of foreign exchange.

On a year-over-year basis, expenses were up 12%, due mainly to higher personnel costs and technology investments related to the business growth. The provision for credit losses increased 13 basis points quarter-over-quarter to $39 million mostly on performing loans. The U.S. business generated strong earnings of $228 million. GBM Latin America, which is reported as part of the International Banking segment reported earnings of $251 million, down $63 million from a record third quarter with lower earnings in Chile, Peru and Mexico due to lower capital markets activities.

In 2024, in capital markets, revenue growth will be led by FICC, while Business banking is expected to grow revenues. Expense growth will be focused on key investments in priority segments and markets. Earnings in GBM Lat Am are expected to moderate in 2024 to more normal levels from the elevated earnings in 2023 and the impact of reduced capital allocation.

Moving to Slide 11 for a review of International Banking. My comments that follow are on an adjusted and constant dollar basis. The segment reported net income of $570 million down 12% or $75 million quarter-over-quarter, primarily from lower earnings from GBM Lat Am of $63 million. Revenue was up 3% year-over-year, driven by higher net interest margins. Year-over-year loan growth moderated to 2%. Mortgages were up 7%, while business banking decreased 1%. Deposits grew a strong 9% year-over-year and 3% quarter-over-quarter. The loan-to-deposit ratio improved by over 1,000 basis points year-over-year to 129%. Net interest margin expanded 8 basis points quarter-over-quarter from asset margin expansion and business mix changes. The provision for credit losses was 119 basis points of $512 million, up a modest 1 basis point quarter-over-quarter. Expenses were up 3% year-over-year due to inflationary pressure, partly offset by the benefits of cost reduction initiatives. Expenses were up 2%quarter-over-quarter driven by technology expense. Operating leverage was positive for the year. Looking ahead to 2024, revenues in International Banking are expected to benefit from loan growth and net interest margin expansion. Expenses are expected to grow at a lower rate than revenue, reflecting expense saving initiatives. Earnings are expected to be impacted by higher provision for credit losses and a higher tax rate.

Turning to Slide 12. The other segment reported an adjusted net loss attributable to equity holders of $487 million that was higher by $188 million compared to the prior quarter. Revenue was lower than last quarter by $222 million. Higher interest from liquid assets was more than offset by increase in funding costs. Also contributing was further improvement in our liquidity levels which comes at a net cost. Revenue was also impacted by minimal investment gains and lower income from associated corporations and unrealized gains on non-trading derivatives. This was partly offset by lower taxes and noninterest expenses.

In 2024, the other segment loss is expected to remain elevated as funding costs are expected to remain at these levels for most of the year with significantly lower investment gains. We will see improvements in this segment as rates declined toward the second half of 2024. I will now turn the call over to Phil to discuss risk.

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

Thank you, Raj. Good morning, everyone. We continue to strengthen our balance sheet by increasing our ACL ratio from 71 basis points to 85 basis points this year. With this, we have now increased our allowances for credit losses by $1.1 billion in 2023, with $780 million of this increase from performing allowances. Given the macroeconomic backdrop of higher unemployment levels, higher for longer interest rates and upcoming renewals of fixed rate mortgages in Canada, we have focused on strengthening the balance sheet, including a further increase in performing allowances this quarter of $440 million, leveraging expert credit judgment for Canadian Banking and Global Banking and Markets. Higher quality originations with a focus on affluent in international and higher credit quality and business banking. Shifting business mix to a more secured across our footprint; and finally, a continued focus on building performance allowances in international, resulting in an approximate $200 million increase over the past 6 quarters. This improved ACL coverage provides us with a solid foundation to manage through periods of slow growth and an uncertain macroeconomic environment. It is important to note that while delinquencies are still within historical norms, consumer health in Canada continues to weaken, and we expect households may continue to experience financial pressure through 2024 with the build in ACL addressing this.

In Business Banking, we are not seeing increased defaults due to high quality of our portfolios. However, we are increasing our coverage ratio given the expectation of continued elevated interest rates and the potential impact on client performance.

Moving to Slide 15. The quarter-over-quarter PCL increase was primarily driven by the performing allowance build, which was 23 basis points. This compares to 4 basis points last quarter. The build was primarily in Canadian Banking. As a result of the increased ACL, our total PCLs in Q4 were$1.26 billion, including $454 million of performing PCLs. Total PCLs were up $437 million quarter-over-quarter. This translates to a PCL ratio of 65 basis points. Impaired PCLs trended higher at 42 basis points compared to 38 basis points in Q3. Canadian Banking total PCLs were 63 basis points. Quarter-over-quarter, total PCLs increased by $393 million, resulting in a total PCL of $700 million. $414 million or 37 basis points of the PCLs were related to performing allowance build, of which $240 million was for Canadian retail and $174 million was for business banking.

Retail customers in Canada continue to spend less on discretionary goods and more on essential items year-over-year. Overall, spending has continued to slow as total debit and credit card spend fell 3% quarter-over-quarter and remained flat year-over-year despite inflation. Variable rate mortgage customers continue to spend less than their fixed rate counterparts with total spend down 11% year-over-year, while spending for fixed rate customers is only down 5%. Additionally, delinquencies continue to trend up across all products in Canada. 90-day delinquency levels were 3 basis points quarter-over-quarter to 25 basis points and were up 10 basis points year-over-year. Quarter-over-quarter, we saw a deterioration in [HELOCs] and auto, increasing 9 and 6 basis points, respectively.

In Canadian Business Banking, we are cognizant of uncertain macroeconomic conditions. Included in our ACL coverage is an additional build for our real estate portfolio, which includes impacts to collateral values. Our exposure to U.S. real estate is largely to investment-grade borrowers. And as disclosed in the investor presentation, our U.S. office exposure is immaterial. Global Banking and Markets provisions for credit losses were $39 million or 11 basis points this quarter and included a performing allowance build of $30 million. Total PCLs in International Banking were $512 million or 119 basis points, up 1 basis point from the prior quarter. Total retail PCLs decreased $17 million quarter-over-quarter to bring the PCL ratio to 211 basis points, driven by lower allowances and increases in Colombia and Chile. Performance in these markets have started to stabilize with improving macroeconomic outlook. Central banks have paused interest rate hikes in Colombia and in Chile, they have started reducing rates. Mexico continues to perform within expectations, supported by resilient underlying economic fundamentals. Headwinds persist in Peru with delinquencies remaining elevated and GDP contracted. Peru entered a recession and will likely be further impacted by the upcoming El Nino. Contingency plans and loss mitigation tools are ready and have been deployed where needed.

Looking to fiscal 2024, we expect a challenging environment will persist for consumers and businesses. Canadian GDP growth is expected to remain muted and inflationary pressures on household is expected to persist with the outlook for rate cuts uncertain. We expect PCLs in 2024 to be in the 45 to 55 basis point range, assuming no significant changes to our expected economic scenarios.

With that, I'll pass the call back to John.

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

Great. Thanks, Phil. Operator, can you open the lines for questions?

QUESTIONS AND ANSWERS

Operator

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

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

Good morning. So I guess maybe, Raj, you went through a lot in terms of the outlook for next year. I just want to make sure we heard you right. It sounds like you're guiding for PTPP to be up either year-over-year and from fourth quarter levels, given revenue growth should exceed expense growth and revenue growth driven by NIM expansion. So if you don't mind, just quantify the level of margin expansion you expect at the all bank level if we don't see any action from Bank of Canada from here on? And what's the expense growth that we should think about would be the right way for 24 either year-over-year or relative to fourth quarter expense run rate?

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

Thanks, Ebrahim. I'll start. Margin expansion should continue for the whole bank in 2024 Ebrahim. Couple of reasons. One is repricing of our loans has already commenced, as you saw this quarter. Frankly, you saw it in the last couple of quarters across our portfolio, and that should continue in 2024. We know our deposit margin contribution to 2023 will be muted in '24 because there's been lots of deposit growth. And I said in my prepared remarks, that deposit growth is expected to be lower than what we saw in 2023. The net of it is you should see pretty decent margin expansion from where we finished Q4 2023, both in the business lines as well as across the bank, like you pointed out, with the Bank of Canada and the U.S. Fed expected to stop rate increases. Obviously, if they do increase, it will be a headwind to this bank. So I think margins will be a good news story. That's where we expect net interest income to grow next quarter in my prepared remarks, what I talked about. Expenses is -- Q4 tends to be seasonally higher. I think it's not unusual for us, like Q1 next year will be higher because we have what we call eligible to retire costs that comes through our business lines, which gets recorded in Q1 across our employee base. But for the whole year, like I mentioned, we expect to generate positive operating leverage for the bank, i.e., revenue growth exceeding expense growth by some margin. We know that the Canadian bank has to invest. So there, we think our revenue growth will be strong and offset the expense growth that is expected as we look forward. International Bank will continue to generate positive operating leverage as it did this year and the wealth and GBM businesses, it depends a bit on the markets. But I think for the whole bank, we expect to generate positive operating leverage.

Expense growth will be significantly lower than what you saw this year. Adjusted for FX, like I said, it was about 7% for the whole year. And next year, we're going to benefit from the productivity initiatives that we took as well. Part of it is expected to come through in '24 and year benefit should come through in '25. So all that points to an expense growth, I would call in the low end of the mid-single-digit range is what we expect next year.

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

That is helpful. And just on a separate question, Raj. You laid out the 75 basis point impact to CET1 from the Basel, FRTB/CVA changes and the floor factor in 1Q. So as we get to [1,225], remind us where you want to be on CET1 as we think about the DRIP and are there any actions that you can take to materially optimize the balance sheet to reduce that drag either on the market risk side or on floor factor?

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

Thank you, Ebrahim. I think as far as capital ratio goes, we'd like to run around the 12.5% range for the rest of 2024. And the DRIP is a contributor to that without any doubt. A lot of the actions that you referred to on muting loan growth, you've already seen it. You've seen our -- we've been targeted about where we want to deploy our capital, and we've been pulling back capital from certain parts of the business where it has not been providing the appropriate returns in a capital-constrained environment with higher cost of capital coming at us. So 1,250 is what we expect to run for 2024. Obviously, it also depends on what OSFI will do and some of the other regulatory changes that can come across starting December 8. We want to be prudent. We want around 12.5%. And we'll revisit all the actions that we need to take or not as we see how the regulatory environment evolves through 2024.

Beyond that, we'll talk about it at Investor Day to see what is the right capital levels that this bank should be running at, for FY '24, that's what you should expect from us.

Operator

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

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

I just want to put a fine-tune on the outlook commentary there and sort a few things from Scott and then the MD&A, of course. You're suggesting that earnings growth will be marginal in 2024. That's off of the full year adjusted base from 2023, I assume. And if we're looking at it from an earnings per share standpoint, you got marginal earnings growth, then you've got the DRIP, which might be ongoing for the full year, we're probably going to see lower than marginal EPS growth? Is that a reasonable interpretation?

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

No. I think Gabe, I'll start and Scott might have a comment or 2 on that. I think on an EPS basis, you should see growth, like marginal growth, right from the $6.54 that we reported this year. The DRIP definitely increases the share count, as you point out, Gabe, that's inclusive on the comment that I made. If you just look at net income growth, it will be greater than the EPS growth because the DRIP contribution, which is definitely between 8 and 9 million shares a quarter this year, and I suspect it will continue through in 2024 will be an offset. But offsetting that, we think we'll have marginal growth in the EPS.

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

Gabe. Just let me make a couple of comments on that. I mean recognizing this has been a difficult year. It's, I think, the 1-year anniversary, and we want to move quickly to address a lot of these issues around capital, liquidity, costs through the restructuring charge, allowances, and we've done that, get you the $654 million. And the guidance we're giving is conviction around growing earnings from here. And that's an important message to take away.

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

Okay. And then while on the building allowances front, I mean one way to look at it is you're being "conservative" and I think investors appreciate that. But the other way to look at it is that from a performing ACL ratio standpoint, if I look at it, including mortgages or excluding mortgages, you're just at your pre-COVID level. So it's a bit of a catch-up in that regard. As the outlook or if the outlook remains challenging, which undoubtedly will be, could we see additional uptick to your performing ACL like beyond the run rate we have Q4?

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

Thanks, Gabe. It's Phil here. Great to hear you, and thanks for the question. The -- if I look forward to 2024, we've -- we're guiding towards -- I said it in my prepared remarks, 45 to 55 basis points. The portfolio that we have today, we like, and we've done a great job over the last few years really building a strong portfolio. There are still pockets where we need to focus on in the international bank, but we've really turned a lot of the portfolio that we had pre-pandemic is not the portfolio that we have now, especially with the strong focus on affluent growth in the international banking platform. and the change in mix shift from unsecured to secured. And so that is giving a different profile. We built these allowances because we were thoughtful about the macroeconomic outlook, we wanted to continue to strengthen the balance sheet as both Scott and Raj said. And it's really a forward-looking perspective for us. But I'm not seeing a ton of weakness in our portfolio. We're going to be mindful of the macroeconomic shifts throughout the year. And if we need to build further performing allowances, we will, but the portfolio is strong.

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

Right. No, no, I'm not suggesting otherwise, just from a management standpoint, where do you see the -- an increase in your ratio next year? Is it more from the impaired or more from the performing?

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

It will be more from the impaired with the usual run rate of our performing allowances.

Operator

The following question is from Mario Mendonca from TD Securities.

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

This might be too simple, Raj, maybe you could help me. The fundamental review of the trading book was meaning -- it's going to be meaningful at 45 basis points. The next 2 years, should we -- is it appropriate to assume that the hit would also be about 45 basis points each year for the next 2 years as we get to the full $72.5 million in 2026? Or is that too simple approach to the equation?

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

No, I think the fundamental review of the trading book should not repeat, right? So it's a onetime hit like you...

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

I'm sorry, I was referring to the flows. Sorry, Raj. I meant the flows. It's my mistake.

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

Got it. No problem. I think the flow of the mathematical calculation will tell you that. Page 96 (inaudible) disclosed award is our standardized risk-weighted assets. If it remained at those levels, yes, 2.5% of that will be around the 45 basis points that you're referring to in '25 and '26, Mario. The flip side to it is Mario, will continue to work on optimizing the portfolio. That's what we've been doing through 2023, frankly, and we'll make some deliberate choices on how we allocate capital to the various portfolios to ensure we're getting paid for the additional capital that we have to put up. But at this time, that's probably the best estimate you have.

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

Okay. This next question might be more for Jake, either Raj or for Jake. The fundamental review of the trading book, I mean, it's in the title, it's fundamental. Is there anything in there that has you rethink Scotia's product throughout the company, Lat Am or Canada? This is a fundamental review book, fundamental review of the trading book have an effect on your appetite in that business?

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

Yes. I think you've heard it a couple of times, Mario. The new regulatory changes, whether it's FRTB or the floor is making us be more thoughtful about how we allocate capital, and Scott may want to add in. Whether it's by business, by product, by customer, by segment, that disciplined capital allocation and very thoughtful will be a plan moving forward. It doesn't lead to any exits of products at this stage, though. So we won't be changing the product suite materially.

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

So Jake, you wouldn't then -- the weakness in trading this quarter, you wouldn't tie that into the fundamental review of the trading book in any way then.

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

No, not at all.

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

Okay. And then my final question, if I could go to deposits for a moment. The loan-to-deposit ratio has come down. It's meaningful. I've certainly noticed that, but I've also noticed and you've described it clearly in your presentation that it's coming primarily from term. Can you talk a little bit about your confidence that, that those term deposits that were gathered this quarter, maybe talk about where it's coming from? Is it digital as it otherwise and your confidence that this is going to be sticky. It's going to stay with you in a long -- over the long term.

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

Yes, I'll start, Mario. It's Raj. On the term deposits, you're absolutely right, right? It's customer preferences. When you see this kind of rate increases over the short period of time, that's the right thing what we would advise customers, frankly, and what customers want. But a little bit of data. As far as the retail bank in Canada goes, we've seen it both in the retail bank as well as in Tangerine. We've seen the shift to term. The deposits grew$32 billion in the retail bank in Canada. And obviously, a lot of it was term, right? About 2/3 of it came from term as well as some movement between what we would call day-to-day accounts to term that happened through the year, which has significantly slowed down in Q4. Big, big increases in the beginning, a little less right now. But the core deposit mix, what we call non-term if you want to use such phrase is still meaningfully high. It's over 42% in the Canadian bank. Likewise, business banking to within the Canadian bank, there's a lot of shift to term as corporates and (inaudible) commercial accounts also want to benefit from the rate situation, and we've seen the term deposits and the commercial bank has become now about 26% of the book, which used to be about 15% prior to this. Tangerine, like I referred to, again, core deposits is down to 65%. So Tangerine does have a lot of really good quality deposits, but it's down from 72% in the previous year. So that tells you that there's the same shift that we are seeing, value customers, right, who are Tangerine customers. We think that shift has likely slowed down quite significantly, perhaps even may have stopped now as we look forward into 2024.

But a lot of the term that we have been taking, Mario, has been at the shorter end. It's between the 2- and 3-year points as we sell more GICs and so on in that space rather than perhaps in the 5-year term, pretty much to match what we're doing specifically on the fixed rate mortgage book, which happens to be between 2 and 3 years fixed rate. So we're trying to balance it out as best as we can. But we believe that the shift to term is likely slowed down, perhaps it'll stop in '24.

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

The following question is from Paul Holden from CIBC.

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

I actually want to continue with that discussion point on deposit growth because I hear the message that it remains important for the bank and totally understand why it should. But at the same time, you provided 2024 guidance that deposit growth will slow relative to 2023. And so I guess I just want to understand that message on slowing growth. Is it just because in '23, you had outsized growth and just simply won't repeat at the same pace. Or is it related to pricing dynamics maybe in the deposit market. Just help us maybe understand that 2024 guidance again relative to the long-term importance of growing deposits.

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

Completely. I'll start, Paul. It's Raj. I think the deposit growth, what we -- you should expect from us is to grow in line with loans, which is why we talk a lot about loan-to-deposit growth in this bank, both in the Canadian bank and in International Banking. So that will continue. The reason I quoted the deposit growth to be muted as we're coming off a year where we grew deposits 10%, okay? That's a lot. I talked about the $32 billion in the retail bank and so on in Canada. We know that savings levels have started coming down in Canada. Inflation is a factor. So it's also about availability of cash with our consumers and so on. And if we expect to grow in the low single-digit range is what I think it will be in Canada specifically next year from the profit plan numbers that we have. We think that's still a strong growth considering that the loan growth is expected to be muted. So it's all about balancing both sides of the consumer balance sheet. And likewise, we're doing with commercial customers. It's about managing capital on the other side and likewise managing our liquidity ratios to ensure that we have stable deposits funding our loan growth as we look forward. So I wouldn't read it as significantly lower than 2023. I would talk about it as 2023 was a lot of growth, very targeted and deliberate and we want to manage it appropriately in line with our loan growth. That's what you should see going forward.

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

Understand. Okay. So this isn't due to competitive pricing dynamics?

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

No, I think we've been very, very thoughtful on pricing, Paul. I referred to the earlier call -- earlier person's question. Clearly about managing both term how we price both sides of the balance sheet and that discipline that we expect to maintain.

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

Okay. Got it. Second question then is going back to the performing ACLs. So I just want to understand a little bit better the mechanics in terms of what drove the increase. Is it changes in model inputs? Is it some additional management overlay? Is it a bit of both? Maybe you can kind of just walk us through the specifics in terms of why the ACLs went up this quarter.

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

Yes, there's probably 3 things to look at there, Paul. Number one, changes to models from a higher-for-longer perspective. some changes as it relates to more pessimistic scenarios, but there was a significant amount of expert credit judgment that we leveraged in the quarter. Just given our thoughtfulness around where the economy is headed, the uncertainty around interest rates and then looking forward in terms of how fixed rate mortgage customers are going to start to reprice in the Canadian environment over the next year or 2 years.

Operator

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

Doug Young – Desjardins Securities Inc., Research Division – Diversified Financials & Insurance Analyst

Maybe Phil, just sticking with you, and I get your explanation around the Canadian performing allowance build. I guess the question is like maybe you can talk a bit about why we shouldn't expect something similar on the international book? Is there various items that give you more confidence that you've already taken? the build -- appropriate builds on the international banking book? Or maybe you can kind of just delve into why we shouldn't be expecting something similar?

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

Yes. Thanks Paul. Great question. We have been building ACL and performing ACL particularly in international. Over the last 6 quarters, it's around $200 million. We have been thoughtful. We started building in Peru, for example, performing ACL about 3 quarters ago as we look forward to El Nino. I'm -- if I look at the different markets, we're starting to see some green shoots in Chile, 225 basis point reduction in trade rates over the last few quarters and strong performance there. Chile remains a bit of a conversation point for us, but we're well provisioned there. Very happy with how things are going in Mexico. I'm very bullish about that market from a risk perspective. And so overall -- and I would also add, I think the shift in strategy that Francisco has brought focusing on primary acquisition of primary customers, gives me a lot of great confidence from a risk perspective that we're moving the right way as we look at building that franchise.

Doug Young – Desjardins Securities Inc., Research Division – Diversified Financials & Insurance Analyst

Okay. And then just thinking about the what kind of your stats on your macro assumptions for the Canadian book on Slide 31. And I can just simplify this and you can tell me if I'm way off base or it's a fair assumption. But in your current ACL for Canada for the performing loan side, can we just assume that the unemployment rate is about 7% to 8%. Is that essentially within the probability weighting for the different scenarios and then can you talk a bit about -- I think unemployment is one of the bigger drivers of this. Is it 40% of the variables that caused the change here? Or is it 50%+? I'm not sure if there's a way you can kind of quantify that.

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

Yes. I mean, unemployment rate has a significant impact on our models. But I would also look at the interest rate impact and the result is higher for longer, particularly on some of the retail models. But again, I mean, if you step back and look at the overall build like a good chunk of it or a majority of it, frankly, was in the ECJ section. So a lot of this is our management decision to freight -- just on our thoughtfulness rather on the macro and how we are moving forward in 2024.

Doug Young – Desjardins Securities Inc., Research Division – Diversified Financials & Insurance Analyst

Can you quantify the expert credit judgment or does that something that you'd be willing to get?

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

It's about -- if I were to look, it's about 50-50 model and ECJ. And the ECJ will be more weighted towards the towards the business banking side.

Doug Young – Desjardins Securities Inc., Research Division – Diversified Financials & Insurance Analyst

And just a clarification. So my assumption that the unemployment rate built in here, is that -- if I look at it in eyeball at 7% to 8%, is that a reasonable?

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

Yes, it is.

Operator

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

Darko Mihelic – RBC Capital Markets, Research Division – MD & Equity Research

I have some credit quality questions. But before I go there, I just want to clarify one thing. You mentioned in your remarks that you're planning to operate around 12.5% common equity Tier 1 range for 2024. What is your assumption there with respect to the regulatory environment, whether or not there's any pressure for higher capital?

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

Darko, it's Raj. I think we know the domestic stability buffer can be raised up to a maximum of 50 basis points. That's what's left in the framework. So that takes the minimum to 12% from a regulatory perspective, and that's why the 12.5%. I obviously have no insight into what will happen on December 8 or beyond in 2024, but it's a prudent way to manage it. More importantly for us, right, you'll hear more about it at the Investor Day, how we want to thoughtfully reallocate capital, which means we have to start the efforts well in advance of that so that the strategy can be implemented in the time lines that we want to do it.

Darko Mihelic – RBC Capital Markets, Research Division – MD & Equity Research

So just to be clear, Raj, then what you're suggesting is, even if the DSP were raised 50 basis points is considered to be an adequate buffer even with the uncertainty in the environment?

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

Yes. From our perspective, we think it's reasonable. Obviously, if we see signs that we need to run a higher capital ratio, we will Darko, but at this time, we think that's appropriate.

Darko Mihelic – RBC Capital Markets, Research Division – MD & Equity Research

Okay. Just a couple of quick questions for Phil on the on the credit. When we look at the increase in delinquencies in mortgages, could you maybe give us an idea, is this predominantly coming from the ARM portfolio and when we think about characteristics, are there any defining characteristics or trends that you could point out? I mean I suppose it could be random, but my suspicion is there are some things that or there are some characteristics. And I wonder if you could just share those with us. And as I think about the fixed rate mortgage portfolio renewing in 2024, what we can sort of think about extrapolating from what we're seeing in the ARM portfolio into the fixed rate. I mean any help on that would be very helpful.

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

Sure. And you're spot on Darko because this is how we've been looking at things, too. So happy to share. I mean we have been seeing 91-plus on the variable rate mortgage portfolio increasing year-over-year. And we've been monitoring that portfolio very closely. Maybe just a few little tidbits of information there. Despite the fact that we've seen customer -- consumer deposits decreasing or savings buffers decreasing. There's still a 2x savings -- 2x payment buffer on the VRM portfolio today. But and as I said in my prepared remarks, we're also seeing for those customers with VRM, their total spend is actually also down 11% year-over-year. So what we're seeing is those customers are feeling the pinch now and they're making trade-offs. So then if I look at fixed, that payment buffer that I said was 2 for VRM is actually at 3.5 for fixed. And so the fixed rate customers holding on to a little bit more of a payment buffer. But we're very conscious of the fact that in '24, we have about 10% of our fixed rate portfolio is repricing and that moves into 20% in 2025 and another 20% in 2026. So we're watching the consumer trends in the consumer behaviors in the VRM and being able to extrapolate some expectations of what may happen on the fixed rate book. Now we are optimistic that we'll see interest rates decrease at the latter half of 2024. So that's built into some of our thinking as well. And then maybe lastly, I can't remember who asked me about tail risk at one of our previous discussions. But maybe just to give an update on where the tail risk is in the mortgage portfolio. We have -- of the less than 1 million customers we have with mortgages in Canada, the tail risk is about 2,500 today. And that's up from about -- that's up about 200 customers quarter-over-quarter and about 1,000 customers year-over-year. Just to give you a sense of sort of people are people are managing through, but they're making trade-offs and some choice -- and difficult choices, obviously.

Darko Mihelic – RBC Capital Markets, Research Division – MD & Equity Research

Just to confirm, the way I should think about your variable rate portfolio customers that they have a higher FICO score and generally underwritten a bit tighter than your fixed rate portfolio. Is that still true?

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

Yes. I mean, we definitely had originations see higher FICO scores. But we also find the VRM customer tends to be a sophisticated customer because they've been playing the rate game within the -- in the market. So there's perhaps a little bit more savvy.

Darko Mihelic – RBC Capital Markets, Research Division – MD & Equity Research

And is there any other characteristic you can share, for example, postal code or something like that? (inaudible) higher delinquencies, something. Is there anything else you could provide on any other defining characteristic here?

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

No, it's -- I asked the question on my team last week. What are we seeing from a regional perspective? And it's -- there's no regional trends across the country on this.

Operator

Following question is from Sohrab Movahedi from BMO Capital Markets.

Sohrab Movahedi – BMO Capital Markets Equity Research – MD of Financials Research

Thanks for going over time here. Just 2 quickies, hopefully. Phil, a couple of times when you talked about expert credit judgment. I think you mentioned business banking. Is there a specific pocket within business banking, or industry group or a particular area that's concerning you?

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

No. I mean our portfolio -- we have a good portfolio. We've been conservative in our underwriting and criticized for such at some point in time. But we are thoughtful about real estate, as I think everybody is in the market, and we have built specifically for real estate. As I mentioned in my prepared remarks, we don't have a significant exposure in U.S. office, but we're thoughtful about the markets here in Canada, and we've been building appropriately in the performing side for that.

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

And Raj, I know we've talked over the year or past couple of years, I suppose, about the importance of moderation in the overall rate environment, just given the way you are positioned from an asset liability management perspective. Can you remind us, if we were just going to take a shortcut and take a look at either the 10-year Canadas or the 10-year U.S. like around what sort of levels are you -- would you hit the inflection point where this drag turns into a positive. Look, I know it becomes less of a drag, I suppose, with declining rates. But what are we -- what do we have our eye on? Do we want to get back down to a 10-year 3.5%? Is that Nirvana?

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

That will be nice, Sohrab, as you know. I think -- so we took some actions in Q2, right, in 2023 to position the bank to be appropriately depending on the rate situation being higher for longer. And I think that's actually paid off in space because we have done the right thing. It has reduced the level of drag we could have had otherwise based on the positioning that the bank had prior to that. So today, we are positioned neutral to the rate curve in one respect. But the expectation is if the forward rates played out, maybe that's an easier way to think about it, Sohrab at this time, we're going to see some reasonably meaningful benefits to the net interest income line through 2024 and beyond. That's the best we have at this time. For the 3.5% that you quote is when interest rates completely stabilized. And how long that will take is anybody's guess. I think the market's pricing is somewhere around 2025 from what I know. These things do tend to change quite a bit. But at this time, I think we are in my mind and in our minds, positioned the best we can be based on the structure of our balance sheet and how we see the forward rates play out, which is being neutral to it at this time. Higher for longer through a good part of '24 is likely going to be the outcome. And after that, as you point out, when rate cuts come, we're going to benefit.

Operator

Our following question is from Mike Rizvanovic from KBW Research.

Mike Rizvanovic – Keefe, Bruyette, & Woods, Inc., Research Division – Research Analyst

I want to go back to Phil, and I'm just looking for a very high-level guidance here on one specific number. So in looking at your mortgage book, I think you're sitting at a 49 loans to value. I'm just trying to better understand how much of that gets eroded by the process of taking over home and selling it so between commissions, legal, admin, any other costs related to that process, what's a good proxy that we should use based on a percentage of the home price, like is 10% a reasonable number? I guess I asked this question quite a bit by clients. I just want to get your insights on that.

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

I can start by saying our recovery rates are quite strong in that portfolio, and that's why you don't see higher gross impaired loans coming off the secured portfolio. In terms of holding me to a certain number, I can't give you that number.

Mike Rizvanovic – Keefe, Bruyette, & Woods, Inc., Research Division – Research Analyst

Okay. Does 10% sound unreasonable. I mean the commission alone would probably be close to half of that.

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

It doesn't sound unreasonable.

Mike Rizvanovic – Keefe, Bruyette, & Woods, Inc., Research Division – Research Analyst

Okay. Fair enough. And then just in light of the Finance Minister's recent public comments about the renewal cycle, I wanted to also ask about the hardship rule. And should we now maybe assume that it will be applied more loosely when people do need it? Is it going to -- it's kind of device, and I hear people say that it's very difficult to get the hardship rule applied to your situation and others say that it's probably not so hard. Do you have any thoughts on that and how that might change in light of the Finance Minister's comments?

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

No, I don't have any -- I don't have any thoughts, and I'm not going to comment on that right now.

Mike Rizvanovic – Keefe, Bruyette, & Woods, Inc., Research Division – Research Analyst

Okay. And then maybe just a quick one for -- maybe for Raj. Just on the dividend payout ratio. You're a little bit north of 60. I'm wondering, has anything changed for you? Are you comfortable holding to that level that's comfortably above your targeted 40% to 50% range if you're going to be in that high 60s range for an extended period of time, potentially, is that -- does that raise any issues for you at all?

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

No, Mike. It's Raj. I think we do expect to be outside of the range like you've seen in '23 and '24 as well and we're quite comfortable with that. The payout ratio, we want to get back to 40% to 50%, but we know it will take a couple of years because we're going to go through the strategic refresh and how we want to thoughtfully reallocate capital. And to us, that's fine because the 40% to 50% range to keep it there and hopefully achieve it in the next 2 to 3 years, gives us confidence that the earnings power is going to come back for this company, and therefore, the ratio will fall within the range. And it's also our confidence that we're investing wisely and we'll continue to invest wisely looking forward to continue to reduce the payout ratio to achieve, like I said, the 40% to 50%. So for one, we won't change it. We want to achieve that. It will take us a couple of years, and we're quite comfortable operating outside that range until we get there.

Operator

Following question is from Nigel D'Souza from Veritas Investment Research. Please go ahead.

Nigel D'Souza – Veritas Investment Research Corporation – Senior Investment Analyst

I wanted to touch on the residential mortgage book. And on the decline in the balances we've seen in that portfolio in Canada, could you comment on how much of that was driven by an increase in discharges perhaps from individuals who on the addressable side, are experiencing payment increases and electing to sell the property instead of going delinquent versus lower origination over the last, let's say, 1.5 years due to the rising rates? Any color there would be helpful.

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

Sure, Nigel. It's Raj. I'll talk to that. It is not about discharges and realizing on security and so on, like Phil pointed out, the portfolio has been actually performing quite well. People are paying down. So it's not about delinquencies. It's more about our deliberate actions in response to slowing mortgage growth. I think that's across the industry over here, so we're not unique. But we are taking deliberate action to improve the profitability as we ration our capital -- across the bank, not necessarily to the mortgage portfolio. So the 4% decline in the mortgage balances is not something that we are concerned about at this time. It's the approach that we want to take to ensure that we are thoughtfully allocating capital for the highest return that we can achieve from our -- for our investors from the loan book that we put out there. And it's about growing both sides of the balance sheet. We want to be sure that we have a multiproduct relationship. It starts with a mortgage, which is a very important product for us. But the actions that we have taken, I think Scott referred to it, that we have net interest margin expansion in the mortgage book. Some of it driven by the actions we have taken, some of it driven by repricing. But it's not about quality of the book or any sort of delinquency that drove the decline, Nigel.

Nigel D'Souza – Veritas Investment Research Corporation – Senior Investment Analyst

That's helpful. And just following up on the provisions on the mortgage book. I think there was a comment on taking account collateral values. And just trying to understand why collateral values would be at play given your healthy LTV ratios. It's only up from I understand that 2021, 2022 vintages that would be at risk of having a loan-to-value closer to 100%. So is that what you're expecting in terms of modeling in? And why would those individuals be susceptible to default if they're not adjustable given that the renewal is still a couple of years off.

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

Just to be clear, Nigel, the comment I made in my prepared remarks was related to business banking and the real estate -- our commercial real estate portfolio, not the mortgage portfolio.

Nigel D'Souza – Veritas Investment Research Corporation – Senior Investment Analyst

Okay. That's very helpful. And my last question, just the 2024 outlook on EPS growth, does that assume PCLs at the midpoint of your guidance, so 50 basis points for 2024?

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

Yes, that's about the assumption. I think Phil talked about 45% to 55%. I think 50 basis points is a reasonable assumption to the EPS growth numbers, so I spoke about Nigel.

Operator

Following question is from Lemar Persaud from Cormark Securities.

Lemar Persaud – Cormark Securities Inc., Research Division – Research Analyst

Maybe for Raj or Scott, I think you guys mentioned a more modest first half of 2024, an acceleration in the second half. Can you talk about what assumptions to that outlook? Like is the recovery in the second half hinged solely on lower interest rates and what happens if rates remain elevated.

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

Thanks, Lemar. It's Raj. I think there's 2 factors. I'll speak about the first half and how it relates to Q4. We want to be clear that Q4 really is like $1.50 quarter, right? If you take out the ACL build, so building off that, we think you should see growth in Q1, Q2. One of the items is -- the other segment is expected to be slightly better than the $487 million that you saw this quarter because there's a couple of one-off items relating to certain investments we had and lack of securities gains. So that should help with the first half. The second half is not hinging too much on interest rate declines. I think we have whatever the market has 3 rate cuts towards the latter end of 2024, which doesn't have a meaningful impact to the results. What it does have is 2 things. One is we're going to have a lot of the expense savings we talked about, the productivity initiatives, which kind of kicks into the second half of the year to be meaningful because a lot of the exits are still going to be effective in the first half of the year. So that's a benefit. And the second thing is asset repricing. What you've already seen in the mortgage book in the Canadian bank as well as an international banking for that matter, that should continue to happen. Rate cuts are expected to be accelerated in the international banking space. You've already seen that margin expand this quarter. So those benefits will come in, in the latter part of the year, and that's why we feel like the second half will be better than the first half.

Lemar Persaud – Cormark Securities Inc., Research Division – Research Analyst

Got you. That makes sense. And then maybe turning over to Phil. Can you talk about what the biggest risks are for PCLs coming in above that 45%to 55% range. Like based on where you sit today, would you suggests it's simply unemployment because that's obviously the most important input. But maybe you feel good about that assumption and maybe it's the uncertainty in the path of interest rates. So maybe talk about the inputs that give you the most forecast uncertainty and keep you up at night? And then to what geographies that you're most concerned with? I suspect you're going to point to the international portfolio, but maybe it's domestic.

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

Thanks, Lemar. Obviously, whenever you look at Canada and whenever you look at uncertainty, you have to look at unemployment. And so you said that you got it one. I mean we're very -- we're laser focused on watching unemployment. We're also looking at the effects of higher rates we're looking at the as I said in my earlier comments to Darko's question, the variable rate mortgage portfolio and the fixed rate mortgage portfolios are performing very well right now. And so I'm very thoughtful about trade-offs. So our customers making trading off paying another product to pay their mortgage. And so we're very focused on looking at payment flows off us outside the bank and to see if customers are paying another product somewhere else and vice versa. So looking at the data, looking at payment flows, looking at how customers are weathering the higher for longer and obviously very, very focused on interest rates. In terms of geography, I think IB is stabilized from where it was last year. As I said, I'm bullish about Mexico. I think there's great opportunity there. And right now, we're very, very focused on what's going on in the Canadian market.

Lemar Persaud – Cormark Securities Inc., Research Division – Research Analyst

Got you. And then is there any way that we can think about the top end for the ACL ratio. Like I think you guys touched 125 basis points at the peak of the pandemic. There are 85 currently. Maybe it's just an unreasonably high watermark, just given that, that was a health crisis. That's clearly not where we're going into now. Like is there any way we can kind of size up what that ratio could look like over time?

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

Yes. Listen, I think we're comfortable with where we are right now. And as we look at expanding our business as we look at our risk appetite, as we look at how our business develops, we'll take -- perform the appropriate performing ACLs in line with business growth moving forward, but I feel where we are right now is good.

Operator

We have no further questions from the line. Back to you.

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

Thank you. On behalf of the entire management team, I want to thank everyone for participating in our call today. We look forward to speaking again at our December 13 Investor Day. This concludes our fourth quarter results call. Have a great day.

Operator

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