SCOTIABANK

2023 Investor Day – International Banking and Global Banking and Markets Q&A

December 13, 2023

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

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INTERNATIONAL BANKING & GLOBAL BANKING AND MARKETS Q&A

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

Great. Thank you very much, Jake. Everyone in the right seat? Okay. Okay. Q&A for the International Banking and GBM panel. Sohrab?

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

Maybe a couple of questions. For Jake, the shift from corporate lending being -- or investment-grade corporate lending to perhaps non-investment grade, where there are bigger fee pools. Do you have the capabilities? Or does that require some degree of investment?

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

Yes. Good question, Sohrab. It's an important shift. I'll start with a stat. For fiscal 2023 for the Canadian banks, we've got a peer who's top 10 in lev loans, leveraged loans. We've got another peer who's just outside the top 10. We have another one that's in the 20s or a loan back in the 30s.

So we're way out of position relative to some of the peers, which is leading to some of the returns and fee outcomes that we're looking to solve for. There's 2 things that are going to be important for us to be successful in this, one you've alluded to. Do you have the right people, do you have the right talent? And so the answer to that is yes, both in the first line on the origination side. And also in the second line on the risk side, where we've added in capabilities to make sure we appropriately approach this business.

The other side is on the client side. We've had a lot of these relationships for a while, but we've really limited our exposure and business with them to activities that don't generate the highest possible returns. So as we go forward, you're going to see a bit of that rebalancing of risk out of LatAm, which currently has a lower percentage of investment grade. The capital comes north into North America, and will be deployed into that higher fee pool that I referred to in the U.S. that's available for us today, both larger fee pool and larger returns. And it will be done by the team. We've got the capabilities now. We'll continue to strengthen them as we grow.

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

So just for clarity, you're self-funding your plan?

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

It's -- we've already taken some of these hires into 2023, actually. They've joined the bank. They're hopefully listening today and know we support this business.

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

Okay. And then, Francisco, I mean, lots of exciting growth opportunities. I think you talked about how much incremental capital do you need. Or is that capital that's currently deployed within International Banking going to be remixed? And how easy is it to remix that? Or does Raj have to bridge you to at least, I don't know, for a couple of years before you can deliver on it?

Francisco Aristeguieta Silva - The Bank of Nova Scotia – Group Head, International Banking

No, first, I'm glad that you're excited because I am. I think the first thing to keep in mind is, as you look at international today, we have what we need. We have the capital we need and we have the spending level we need. What we need to do, however, is reallocate that capital to the segments and markets in which we can compete and win. And that is the process that we already started and will continue certainly over '24 and '25, the majority of which will be done in '24.

On the expense side, similar to capital, we don't need to spend more. What we need to do is spend in a different way and bring efficiency into play because where we're spending is not necessarily the right place. We're spending a lot as a result of the model that we've chose and the management process that we chose of how to run these countries. So as we begin to consistently operate, standardize our segments, the clients we serve, the products with which we serve them, standardize the processes and procedures, that will allow operations, finance, risk, all the areas to adjust to a model that is consistent. Because today, they have to serve a country that is completely different than the other.

And if you look at it from the investment point of view, we're doing the same investment every time differently because every country wants different features. So what we're changing is the operating model. So the power of this is that we will also bring the scale that Canada can generate for us, which historically, we haven't. So what you're going to see is a much more intense partnership as we develop digital tools, capabilities and platforms across cash management, multinational banking, retail banking and wealth to a degree that we then make this investment much more leverageable beyond just Canada or IB. So it is not about more resources. This is about making them work harder for the strategy. And releasing some resources out of IB into higher returning places, both expenses and capital over time.

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

Okay. And if I can just sneak 1 in for Phil. Throughout the day, I think all of the business segments that at least are lending have alluded to opportunities to go down market a little bit, obviously, pick up some better risk-adjusted margins. I'm curious why the bank chose not to include a credit metric as part of the medium-term objectives.

Phil Thomas - The Bank of Nova Scotia – Group Head and Chief Risk Officer

It's a good question. I think the way you should look at it is we have included a credit metric, and we've -- we're talking about risk-adjusted margins as one of the key metrics that we want to focus on as a management team to make sure that we're getting paid for the type of risks that we're getting into.

And maybe, Sohrab, I would say I'm very comfortable with the plan. And obviously, I've been very engaged with these folks on the stage as well as the team in the crowd as we are looking at shifting the business mix, taking capital out of Latin America, redeploying it in developed markets. I really like the focus on primacy because it helps actually reduce the risk. And for instance -- and I have been looking at the data and in Chile as an example, as we look at primary customers that we've already started to originating, they have 2x less net write-offs than the average customer. And so as each one of these elements, whether it's in Jake's business, Aris' business or in Francisco's business, we're actually derisking the strategy, and derisking the bank moving forward.

Jake alluded to non-investment-grade lending. We're redeploying people. We're hiring new expertise into the New York office. And I don't think a Saturday or a weekend goes by where Jake and I are not on the phone talking about a transaction. So we're very, very engaged in this business, which gives me a lot of comfort that I know what's going on. And there's a tremendous amount of transparency with my business partners.

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

Gabriel?

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

Good afternoon, I guess. Question, velocity of capital sounds pretty cool. What does that mean? Is that just conceptually from a business mix standpoint, less corporate lending, more transactional stuff like trading and investment banking, if I just think of how your business structured today historically and into the future?

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

Yes. Good afternoon, Gabe. Just being clear on the time. Velocity is a concept that really we're tying into our lending business. Today, with 80-plus percent in the GBM entire portfolio or 85% in the GBM book, ex GBM LatAm being investment grade. That leads to higher holds of loans and frankly, larger hold sizes. So we're putting a lot of capital, particularly under the new rules that are coming forward against existing loan book. So it's largely around the lending business.

As we move forward, we think of that velocity is showing up as we move into new areas, evolve our risk profile, frankly, being in loans that end up being originated, but more frequently distributed into the institutional market, right? You can also think of products around structured finance.

We're going to build a greater capability than we have today, and we already have a good one in securitization. It allows us to originate loans for clients and with clients then exit them in markets like the term ABS market.

The same thing would be the case for the collateralized loan obligation or CLO business I referred to. You have the opportunity to accelerate your velocity of your capital because you're financing a portfolio with a manager and then you're ultimately working with them to turn the warehouse, to distribute and syndicate in the market and create a fee event. You can do that 2, maybe sometimes 3 times a year with a manager. And the good news about that, Gabe, is it's a lot different than originating a 3- or 5-year loan with a corporate that then stays on your balance sheet for that period. And you occasionally will have a fee event, whether it's an equity raise, a debt raise, maybe some risk management solutions around FX or rates. That's what we're really thinking about in terms of tools and velocity of balance sheet. It's really around the corporate side. It's not implying more market risk or trading risk.

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

So you'll commit to the client in the hopes of getting their banking business, but you might hold less of it through subsequent transactions kind of thing?

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

For sure, in the investment-grade space. In the noninvestment-grade space, there's already a high velocity of that balance sheet as it goes into the institutional market through term loan B, et cetera.

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

That segues to my next question, the noninvestment-grade strategy because 2 of your Canadian peers are pretty big in that market in the U.S. And it's either a lending business or an originate to distribute business. Which one are you pursuing? And how do you go -- I don't know what level you're at today, if you're ground 0 or something close to that, how do you grow from your current level to something quite larger presumably and not pick up a few bumps and bruises along the way?

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

So I don't want to imply that we're going to -- there's massive growth in that area for us. I want to leave the room without understanding it. To give a bit of sense of the book today, as I mentioned, GBM today, 85% is investment-grade. When we add in the LatAm business, it goes down to 80%. That's still quite high when you talk to other global financial institutions.

So when I answered Sohrab's question earlier, I referred to us being in the 30s and some of our peers down around the top 10 and another one in the 20s. We're not looking for massive near-term growth in that space, right? And it does provide velocity of capital. And as I mentioned, we've already started to bring in the talent. We did that over the course of '23 to position for that business. And so don't expect it to be something. It will be an originate to distribute, may hold small pieces of revolver. But that's going to lead to lower capital required for the business and higher fees that generate those higher returns. So we're getting into a larger fee pool market in the U.S., and we're going to be reallocating some of that capital from a, frankly, a less liquid and a different risk profile market in South America.

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

Okay. The GBM ex Mexico business, very clear on reducing capital allocation in that business. I'm going to throw some numbers at you. I was writing them down. Hopefully, I got them right, but that's total GBM, international is at $1.1 billion, I believe. And of that, probably $700 million is ex Mexico. And you're saying -- I'm trying to interpret here, make sure I got it right for my note, maybe. You're going to take your capital down but keep the earnings flat? Is that the message?

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

Yes. Do you want to start and I can add in? Or do you want me to tackle it?

Raj Viswanathan - The Bank of Nova Scotia – Group Head & CFO

No, go ahead.

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

So we will -- I think Scott mentioned it upfront, when we look at those priority business, 90% of incremental capital is going to go to those. And the South American portion of the business wouldn't be captured in that -- those priority markets. So we've got a good amount of capital allocated there. When we go forward, we've reached scale. We think we're in a good spot.

But some of the metrics I shared around fee pool with the U.S. being 6x larger than what you have in South America, and even some of the data we shared around fees on DCM. We're going to use our scale position to drive higher returns on the existing capital moving forward, generate higher returns, create higher retained earnings, higher capital from that business. But you are going to see that incremental capital come into North America. Canada has got much limited opportunities versus our U.S. platform as well as our Mexico opportunities.

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

And this -- so for Francisco kind of dovetailing into that. The, I guess, reduced capital allocation to GBM, LatAm, ex Mexico, quite a mouthful there, that doesn't have any real serious implications for your growth strategies in the IB bank? Because originally, they've been like, oh, we're going to bank them commercially, and then we'll bank them in the capital markets, and it will be all great. But it doesn't sound like that will be too disruptive if you're pulling back a little bit.

Francisco Aristeguieta Silva - The Bank of Nova Scotia – Group Head, International Banking

No. Jake and I are very aligned on this. The view is the fee revenue in the Capital Markets business is not really south of Mexico, very limited. What we want to do, however, is as we redeploy this capital, we would be very mindful on our focus on multinationals. And that's why Jake and I are leading this, to ensure that we have an enterprise lens when we select the clients that we want to protect and the relationships we want to grow.

Now bearing that in mind, that will have no effect on the commercial bank strategy whatsoever because it's very unique. It's a space where we're going to serve them transactionally really, is cash management, is trade and enable lending just to build a relationship, not to have a relationship around lending. So I am not particularly concerned of the impact of this decision. We've actually reflected it in the plan already. So there's nothing new to be reflected in these numbers.

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

Okay. Phil, you look bored.

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

He's not bored. He always looks that way. Mike?

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

For Francisco, I guess a 2-part question. So when you think about the timing of what would be realistic for businesses that you might decide -- I think you made a comment, if it doesn't work out, were going to exit. Do you have a time line? Is it 2 years, 3 years, something longer? That's the first part. And then secondly, how does that, I guess, that ambition change if you're sitting on some pretty sizable carrying values that you can't get through a sale, you can't cover that through a sale? I'm not sure if the resulting reduction in risk-weighted assets would compensate. It could be a capital charge. And what we've seen with Scotia in the past is exiting businesses and reallocating capital has been a bit of an earnings drag versus peers, and that's something that investors have not been happy about. So what are your thoughts on that?

Francisco Aristeguieta Silva - The Bank of Nova Scotia – Group Head, International Banking

Great question, Mike. What I would say is the following. The plans are pretty robust and have very clear goals and targets. And the management teams are held accountable against those targets. I myself am one of them. What we need to understand is that the timing is something we track every quarter. So this is not something that we're going to go do it and let's talk in a year and then we'll figure it out. The reality is we are very much on top of this every single quarter.

But we need the plans to play through, right? We also need to understand the environments we're in because we're capped by the environment. So for example, I'll tell you right now, go out and sell a business in Colombia today, I wouldn't advise you do that because the market right now is at its worst, still in the midst of a recession. Political uncertainty around the current administration. Why would you sell if you don't have to sell? And remember, the journey in international is value creation. So we're going to do this in a way that we create value as we make the decisions we make.

Now Colombia as a market has the right dynamics, has the right size, over 50 million people, very robust commercial segment. We have a strong brand. We're well positioned. We are changing the way we operate and see if that change is enough to position us in a different trajectory. That will also buy us the time to see what happens in that market on the macro basis, right?

Remember, this year, only 1 bank will be profitable in Colombia because the cost of credit has been massive. And by changing the cap rate reference, they kill the profitability of the system this year. So we got to understand, this is a combination of the environment we're in and our own business. What we're confident on is that the management process we have in place and the plan we have in place should get us to a much better outcome, where over time, we can create value for you. That is where we're sitting on right now. Time will tell as we sort of execute, but we're not looking at the very long term. This is something we're managing. We have a very tight, short leash, okay?

Raj Viswanathan - The Bank of Nova Scotia – Group Head & CFO

As far as earnings go -- sorry, I didn't mean to interrupt.

Francisco Aristeguieta Silva - The Bank of Nova Scotia – Group Head, International Banking

No, no, no. I was going to tackle the second question. Do you want to jump in?

Raj Viswanathan - The Bank of Nova Scotia – Group Head & CFO

Sure. As far as the earnings go, Mike, I think Central America makes about maybe $20 million a quarter, and Colombia, of course, is not contributing at this time. So the drag, if we ended up exiting, is like $80 million a year, the bank makes $8 billion. In context, it's not as big as some of the divestitures that we did and the earnings impact that we had to the bank, about $650 million. So if we ended up doing that, we will completely look to earn through that.

Francisco Aristeguieta Silva - The Bank of Nova Scotia – Group Head, International Banking

Yes. On the divestiture impact, what I would say in my experience, and you know where I come from, stranded cost is something you have to pursue very aggressively. One of the benefits of regionalizing and standardizing is that you can tackle stranded costs much more efficiently than you -- when you're customized to 1 business. So that's 1 of the benefits that we're looking for. For potential future decisions of divestiture, we can tackle stranded cost directly in a way that, that scale will allow you to buffer that and translate that benefit to a lower cost to serve.

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

Okay. Any more questions for Francisco and Jake? Darko?

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

Thank you. I'm going to actually try and involve everyone in this question. And I don't know if I'm going to actually phrase it even correctly because I'm still trying to connect a few dots here. When I think about what the intent here is for Scotia overall, and we think about pulling capital out of low-return businesses into higher return businesses. And maybe we'll start with Raj on this, and we can dive into the other business heads there as we go. But what would be helpful for me is to better understand where you are in the journey with respect to optimization of risk-weighted assets. And under the new Basel III reform, sort of where you are with each country and each region and help me connect the dots as to -- is that driving a significant portion of what we're seeing? And what kind of capital benefits can we see in the future as you progress through that optimization program?

Raj Viswanathan - The Bank of Nova Scotia – Group Head & CFO

Sure. Let me start, Darko. It's actually a very good question. But a little bit of what's the journey we've been on for the last 12 months because we started RWA optimization at this bank over the last 12 to 18 months, frankly. The way we did it, and we are continuing to do it, is look at almost by segment and by client and find out which clients are less profitable compared to the capital that we deploy and which ones are the ones we cannot improve profitability. So there has been a deselection exercise that has actually happened. A lot of it happened within the GBM business.

And we have absorbed the earnings impact attached to it because we can actually deploy the capital differently or we expect to deploy it differently. The return on risk-weighted asset is a simple metric, as you said, capital constraints are here to stay for a long period of time. We have determined a certain threshold. I think it was in one of Scott's slides. We didn't call out the number, but we want to be something greater than 2% internal risk-weighted asset because it translates to greater than 14% ROE and so on, mathematically speaking.

As far as the capital goes in International Banking, we have today about $19 billion of capital in International Banking as a whole. And if you want to split it by the Pacific Alliance countries, Mexico has a little over $3.5 billion. It's like $3.7 billion. Peru has about $2.5 billion of capital. Chile has a little higher than $6 billion of capital, and Colombia has about $1.2 billion. That's a split.

So when we look at that, obviously, Colombia is a work in progress, like Francisco talked about. Peru and Chile for us is a value creation proposition, to use Francisco's term. How can we make the capital work harder for us. We continue to make choices. The GBM business in these 2 countries, very good, very powerful. They actually had a great run for the last 2 years. GBM LatAm last quarter or in Q3 made over $300 million. We know that it comes at a return on risk-weighted assets of about 1.6%, GBM LatAm as a whole.

So obviously, if we want to be above 2% for the bank, we need to figure out how do we improve that 1.6%. You can do it with existing clients or you can move the capital elsewhere like the United States, like Jake has talked about. So that process we've been through.

As far as the retail business goes over there, Francisco talked a lot about client primacy and the single product relationships we have, specifically when you get to the consumer finance business. They tend to be volatile. We have consumer finance business, both in Chile and in Peru as well and a little bit in Colombia. So we've been looking at those just saying, these are the businesses that we want to operate to see how we can make it more profitable under the new capital rules. Or what do we do beyond the stage where we think we cannot make it to a level where it's an acceptable return for the capital that we have deployed.

But in general, RWA optimization has got multiple components to it. The new capital rules requires a lot of data. Better data gives you a better capital treatment. For example, in Jake's business, we have a different capital treatment if you have external ratings. So a lot of it, we did not source external ratings because it didn't make a difference to how we attributed capital under our model-based approach. We've gotten better data. It's actually improved with the capital and therefore, improved with the returns for the capital that we have deployed over there.

So a lot of it is management action to see where it's not profitable to see how we can redeploy it. The others are how can we improve data. And of course, we did like synthetic risk transfer, those kind of things, one transaction we did, which tools are always available. The intent is for the $19 billion we have in IB specifically, it's not growing much. If I look forward, it's probably growing somewhere less than 10%, that's the number we quoted out there. So call it $21 billion over 5 years. But the return profile, like Francisco called out, is going to be about 16%. So that should tell you that similar amount of capital, we expect to generate better returns. Part of it is optimization. Part of it is client deselection. And part of it is increasing the share of the wallet. That's how I put the International Banking story together.

Francisco Aristeguieta Silva - The Bank of Nova Scotia – Group Head, International Banking

Very well said. Darko, I think good examples are in Chile, we have a partnership, a consumer finance partnership. We have a large chunk of RWA deployed into that. Those are monoline clients that cannot penetrate because I don't own the relationship. So I'd rather take that capital, deploy it in the Chile franchise and grow primary relationships and improve my returns in Chile.

So those are the trade-offs that we analyze as a team in the strategic refresh exercise and say, given all these options, where is the best place to have this capital working for us? And that is one of many other examples that were looked at and that are reflected in the plan.

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

Darko, maybe on the GBM business. Some of this activity has been happening in plain sight. So if you look at the Q4 '22 RWA for GBM reported, it's just a snick above 120. We finished Q4 of this year, just below 100. So you've seen a 20%-ish reduction in RWA towards this business. You haven't seen a linear decline in the overall returns for the business. We're down kind of mid-single digits, just over that this year in terms of earnings.

So we've been doing a bit of this in plain sight where we've tried to optimize capital within our business. It's good healthy practices to look at your profitability, look at your profitability of your clients and take the appropriate action. Can you grow that profitability? Can you win more business? How would you do that? Is it worth the investment? Are you not executing correctly?

I'll give you a bit of a flavor. I talked about when we did the geographic discussion earlier, about 1/3 of our loans are sitting in that LatAm -- or the rest of the world, excuse me, and it's generating about 23% of earnings. That's not the congruency we're looking for. That's out of alignment at the end of the day. And so I'm using a balance sheet and an income statement item, but it demonstrates the challenge.

So what we've been doing in GBM, and I'll give you some rough numbers. We've got -- when we look at our overall client set, we've identified, call it, high single-digit number of clients that are using roughly 15% of our RWA, and they're producing mid-single-digit revenue for us. Again, you've got that discrepancy between where you're putting your scarce resources as a bank, capital and liquidity, and the returns those are generating for our shareholders. And so we got to make sure we get the right balance, whether it's in my business, or, frankly, my partners, whether it's Aris, whether it's Jacqui, whether it's Francisco, we get it to the right spot to get that higher return, that sustainable profitable growth that Scott started with at the end of the day. And I think if you go back to Scott's presentation, the bubble chart, I don't have a better way to describe it, really shows what we're solving for here, which is to close that gap and get the businesses that generate the highest returns, the capital to do so.

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

And I really appreciate everybody piping in here. That's great. And Jake, maybe just a follow-up on that, just to maybe push the envelope here a little bit on what I'm trying to get at and it's going to require a lot of follow-up, Raj, sorry. But let's take that 1/3 LatAm, where you have 1/3 of the capital there. There's no possibility essentially to optimize that RWA, is there? Is that what I'm hearing?

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

Oh, no, there is, and we will do that. But what I'm trying to point out is the fact that we've underexposed ourselves to the largest fee market in the world, the U.S. And we've underexposed ourselves to higher fee opportunities, also the U.S. in terms of the actual rate. And so we will definitely optimize the capital in the GBM LatAm business, you've hopefully heard that. And we're going to put it in the best home, whether it's in U.S., it could be in Canada. Do you want to add anything, Raj, or...

Raj Viswanathan - The Bank of Nova Scotia – Group Head & CFO

I think that's the way to say it. I mean, I gave you the number, it's 1.6% return on risk-weighted assets. That's obviously an average, right? Certain clients being well in excess of 2%. That's where the client deselection comes in. So you leave it with the people who actually are paying you for the capital that we are deploying over there. Take away the remainder of the capital, client deselection is the term I've used and they can deploy it back in the U.S. where we do earn superior returns even today with the footprint that we have or bring it back to Canada or to the other businesses. That's what we're doing.

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

Okay. One more question here for this panel, yes? Nigel.

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

Yes. So just some finer points on comments previously made. The first is on the improvement of the credit risk experience driven by multi-product clients versus monoline. And I was wondering if you could perhaps quantify that. What is the expected benefit of credit loss? Is it 10% reduction, 15%, 20%? And how much of that is baked into your risk-adjusted margin expectations for International?

Phil Thomas - The Bank of Nova Scotia – Group Head and Chief Risk Officer

I can start. I mean if I look, Nigel, just with some of the real data that we have today, and I made reference earlier, we're seeing lower net write-offs on these primary customers by about 2x in particularly in some of our Latin America markets. It's even better in Canada. We've been very conservative with the outlook. So we don't have all of this data baked into the current plan. Obviously, I'm very thoughtful about the current macroeconomic environment in Chile, Peru, Colombia, particularly. And so we're being very thoughtful in terms of -- as you saw last quarter, we built a lot of performing allowances to make sure we're being thoughtful about the balance sheet moving forward.

But we have evidence that suggests -- and with our own data that driving this primary relationship creates this better credit quality experience. I also think one of the biggest opportunities for us as we shift away from focusing on selling a credit card to you, and that's your only product to capturing your deposit accounts, being able to have the flow and understand the data from those customers allows us to make better credit decisions. I think I said earlier, actually allows us to make better sales decisions ultimately as well. And in Latin America, it's even that much more important. So having someone's payroll is extremely important as we look at how do we get more and more comfortable with the type of credit that we're giving to these customers.

Francisco Aristeguieta Silva - The Bank of Nova Scotia – Group Head, International Banking

The message there would be we were very conservative in modeling that benefit in the 5-year plan because we want to see more data play through for us to begin to incorporate that more specifically. So there's upside in the model.

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

Great. And then another follow-up for you, Francisco. When you look at the ROEs in the Pacific Alliance, they're quite differentiated, 20%-plus, mid- to low-teens in Peru and -- sorry, Mexico is 20%, Peru and Chile is mid- to low-teens, and then Colombia, single-digit ROE. So could you comment on how much of that is structural and macro, those differences in ROEs? And how much of that is just suboptimization by Scotia? Because the International Banking ROE objective is about 250 basis points improvement. And I assume that's not evenly distributed across each region. So where is the pickup coming from region by region? And how much of it is just a structural ceiling?

Francisco Aristeguieta Silva - The Bank of Nova Scotia – Group Head, International Banking

Yes. I think Chile is a thinner market in terms of margins than the rest. Peru, to some extent. But I think what you will see in the course of the 5-year plan is that the change of the mix of business that we'll do will generate higher returns by definition. For example, our concentration on our mortgage portfolio in Chile is 77%. So 77% of my exposure in retail Chile is mortgages. Mortgages in the context of a monoline, because I haven't really been able to penetrate those relationships beyond mortgages.

So that by definition is generating lower returns that if I were to deploy that same amount of RWA in primary relationships on our multiproduct. Peru has less of a share of mortgages, but a higher share of payroll loans. Payroll loans, very low risk, very narrow returns, right? Very hard to cross-sell beyond that, too. So what you will see is on the top line aspect and returns, our business mix is driving a ceiling on returns. And that's what this, over time, will change.

The other element that we bring to the table is a higher cost to serve. Because the way we are deployed, when you put on top of our full deployment in country plus the cost of bringing the oversight from Canada to a higher regulatory standard and a higher control standard, well, you're even rendering yourself uncompetitive in some of the segments that we are -- that we're working for. So in my view, the power of this value creation journey is by changing the business mix and changing the operating model, you can generate significantly higher returns even within a restricted macro environment. And that comes to what clients do you onboard? How do you onboard them? What are the value propositions you put in front of them? All of that will generate a completely different dynamic when it comes to serving these clients.

ALL-BANK Q&A

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

Great. Thank you, Francisco, Frank. Thank you, Jake. Scott is going to join us now with Phil and Raj, if there are any final all-bank questions before Scott closes us out for the day here. Yes, Gabe?

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

Just a quick one because of the Fed commentary today. Can you remind me, you got marginal earnings growth messaging for '24 and then [5 to 7 '25]. What are your rate cut expectations under that?

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

The comments today were helpful.

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

Oh, yes, yes, yes. That's what I'm getting at.

Raj Viswanathan - The Bank of Nova Scotia – Group Head & CFO

So what we have built in the models today, Gabe, 2 rate cuts in Canada, Q3, Q4. 3 rate cuts in the U.S., so exactly what the Fed has announced in 2024. And then a further 4 rate cuts in the U.S. And the 4 rate cuts in Canada in 2025.

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

Four and 4 in '25?

Raj Viswanathan - The Bank of Nova Scotia – Group Head & CFO

That's correct. So bringing it down to 3.5% from 5% in Canada and 5.5% in the U.S. So it's very consistent with what the market is expecting. And I think that's quite conservative, and we've left it at 3.5% for the remaining period through to 2028.

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

Thank you.

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

Great. Okay. Anything else to finish up at the all-bank level? Any other questions in the room? Okay. Great. Well, I'll hand it to Scott. Just a reminder, we do have a reception, h'ordeuvres and drinks on your way out. Hope you will certainly stay and join us for that. Back to you, Scott.
