FINAL TRANSCRIPT

VersaBank

Second Quarter Fiscal 2021 Financial Results

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to VersaBank's Second Quarter Fiscal 2021 Financial Results Conference Call. This morning, VersaBank issued a news release reporting its financial results for the second quarter and year to date ended April 30, 2021. That news release, along with the Bank's financial statements and supplemental financial information, are available on the Bank's website in the Investor Relations section as well as on SEDAR.

Please note that, in addition to the telephone dial in, VersaBank is webcasting its earnings conference call live over the Internet. The webcast is listen-only. If you are listening to the webcast but wish to ask a question in the question-and-answer session following Mr. Taylor's presentation, please dial in to the conference line, the details of which are included in this morning's news release and on the Bank's website.

For those participating in today's call by telephone, the accompanying slide presentation is available on the Bank's website. Also, today's call will be archived for replay both by telephone and via the Internet beginning approximately one hour following completion of the call. Details on how to access the replays are available in this morning's news release.

I would like to remind our listeners that the statement about future events made on this call are forward-looking in nature and are based on certain assumptions and analysis made by VersaBank's management. Actual results could differ materially from our expectations due to various material risks and uncertainties associated with VersaBank's businesses. Please refer to VersaBank's forward-looking statement advisory in today's presentation.

I would now like to turn the call over to David Taylor, President and Chief Executive Officer of VersaBank. Please go ahead, Mr. Taylor.

David Taylor — President & Chief Executive Officer, VersaBank

Good morning, everyone, and thank you for joining us for today's call. With me on today's call are Shawn Clarke, our Chief Financial Officer, and Brent Hodge, General Counsel and Corporate Secretary.

The second quarter saw the continuation of the momentum in our digital banking operations, highlighted by increases in all key metrics on a year-over-year basis and substantially on all key metrics on a sequential basis. Our core digital banking operations once again delivered a number of record results. Most importantly, the highest net income in our history when we exclude the one-time non-cash accounting related to a gain generated by the amalgamation in Q1 2017. It was also a quarter that saw a number of important operational achievements that even further strengthened our prospects for the future. I'll speak to these in a moment.

And I do want to note here, that even having reached new peaks across many of these key metrics, our performance was dampened by several factors. First, we still have cash balances that are higher than our historical norms as our cash balance at the end of April, not including the proceeds of the subordinated note offering completed on the last day of the quarter, was approximately 40% higher than the average cash balance for the six months leading up to the pandemic, resulting from our very cautious stance at the start of pandemic, as I’ve discussed on past calls. Second, origination in both our point-of-sale and commercial banking lending businesses was impacted by the lockdowns across the country throughout much of the quarter due to the pandemic.

Q2 also marked the first quarter of financial contribution from Digital Boundary Group, the leading North American cybersecurity penetration testing operation that we acquired via our wholly owned subsidiary, Washington, DC based DRT Cyber in November. More on this in a few minutes.

The combination of our steady redeployment of cash and high market demand for financing in certain sectors of the economy were driving another quarter of solid loan growth, even amidst the pandemic headwinds that I mentioned a moment ago, as we continued to lower our cost of funds to an all-time low.

Net interest income increased 4% year over year and a 5% sequentially to $15.1 million. Including the non-interest income contributed by Digital Boundary Group, total revenue increased 10% year on year and 4% sequentially to a record $16 million. Cost of funds decreased by 47 basis points year over year and 14 basis points sequentially to a record low of 1.28%.

Net interest margin increased sequentially to 2.96%, although it was lower year on year due to the still elevated cash balances, which attract a lower yield than our lending assets. At our historic cash balance, net interest margin would have been approximately 10 to 15 basis points higher to 3.05% or 3.1%.

Net income increased 12% year on year and 9% sequentially to $5.7 million or $0.25 per share, a new record. When we exclude the one-time non-cash gain resulting from the recognition of the deferred tax asset on the amalgamation in Q1 2017 of the bank and its former parent, PWC Capital.

And finally, core cash earnings increased 12% year on year and 9% sequentially to $7.9 million or $0.38 per share, also a record.

Turning to the balance sheet, you can see the continued growth in our total assets, which reached just over $2.1 billion at the end of the quarter, up 9% from the end of Q2 last year and up 5% from the end of the first quarter.

Our cash balance, including liquid securities, at the end of Q2 was $272 million; however, normalizing for the recent private placement of US$75 million in subordinated notes payable and redemption of our Series 3 preferred shares, which combined result in net proceeds of approximately C$73 million, our cash balance would have been closer to C$200 million, down from C$212 million at the end of the first quarter as we continued to redeploy cash into higher-yielding assets. As a reminder, our cash position peaked at more than $400 million in Q3 of 2020 during the height of our cautionary pandemic stance.

The $272 million at the end of Q2 equates to 13% of total assets, still much higher than our typical cash levels in the range of 6% to 7%. You'll recall that previously we had expected to return to our historical liquidity levels midyear, but with the capital raise and the deployment of those funds to come, we now anticipate returning to normal cash levels towards the end of this year.

In regards to the subordinated notes payable on April 30, 2021, we completed a private placement of US institutional investors of NVCC compliant fix to floating rate subordinated notes payable in the principal amount of US$75 million or the equivalent Canadian amount of C$92 million as of April 30, 2021. Importantly, this is a non-dilutive growth capital that we issued on favourable terms. We were not only able to take advantage of the extremely low market interest rates, but also leverage our favourable debt and issuer rating of A minus and A rating, respectively, assigned by a US rating agency, Egan-Jones.

We are also pleased by the strong level of interest from US institutional investors. The demand pushed our initial debt offering from US$50 million to US$75 million, evidenced by the strong level of interest in US investors in both the digital banking space and VersaBank in particular as a leader in this section.

Finally, on the balance sheet, book value per share increased 7% year over year and 2% sequentially to $11.06 and our CET1 was essentially unchanged from the end of Q1 at 12.52% and our leverage ratio declined to 9% year on year and 8% sequentially to 10.46%, the result of the redemption of our preferred shares and our higher loan balances.

The credit quality of our loan portfolio remains very strong, as the low-risk nature of our model once again proved itself. For Q2 we recorded a recovery of credit loss provisions in the amount of $312,000 following a provision for credit losses in the amount of just $57,000 in Q1. As a result, the Bank’s PCL ratio for Q2 was negative 0.07% compared to a PCL ratio of 0.01% in Q1. And we continue to have no loans subject to deferrals and no loans in arrears.

As I noted earlier, we saw yet another sequential decline in our cost of funds to yet another record low of 1.28%. As a reminder, this number is down from 1.88% in Q1 of 2020 and has been driven primarily by the continued expansion of our insolvency professional deposits, which currently pay 0% interest. The bulk of this growth has been driven by the on-boarding of deposits from new customers we have acquired over the last year as we continued to extend our reach into insolvency professionals firms attracted to our high-value service offering. So, while we expect to see continued growth from our existing customers going forward, it is more likely to be driven by the anticipated increase in bankruptcies as government support payments are eventually curtailed.

Our total loan portfolio increased 8% sequentially to a record high of $1.83 billion. Last quarter I described that the bank was experiencing the highest loan growth in its history. Although we continue to experience overall sequential growth, as I mentioned earlier, new loan origination was impacted by the pandemic-related restrictions which temporarily affected both our commercial real estate lending and point-of-sale business, especially real estate lending, which contracted 3% sequentially, although was still up 25% on a year-on-year basis, primarily as a result of the strong momentum prior to the reinstated pandemic restrictions, especially in Ontario. In addition to the pandemic impact, the small decline in Q1 was attributable to the deferral of two large commercial mortgages into Q3 and atypically large repayments that fell into Q2.

Point-of-sale increased 6% sequentially and was up 10% year on year. With a very strong Q1, loan growth for the first half of the year is up 11% and we expect both portfolios to return to their healthy growth trajectories as the country reopens, permitting pre-lockdown levels of construction to resume. And the point-of-sale business benefits from both pent-up demand and summer season and we remain confident in our loan growth potential this year. Although it now appears that we'll be more equally weighted among the front and back half of the year with potential additional upside in the back half.

Another important development during Q2 was the receipt of investment-grade credit rating from Egan-Jones Ratings Company, a US nationally recognized statistical rating organization, a US National Association of Insurance Commissioners recognized credit rating provider. The bank received an issuer rating of A overall and A-minus rating on the US$75 million subordinated notes issue. I (inaudible) that our A issuer rating is comparable to that of several of the big six Canadian Schedule I banks and we believe an external affirmation of the low-risk nature of our digital banking model.

The importance of these ratings cannot be underestimated. They significantly expand our universe of depositors, most importantly with US-based financial institutions, and open up a new low-risk lending channel, providing the opportunity to further accelerate our growth by means that were not previously available to us. In addition, as we discussed earlier, our investment-grade rating for sub-debt provides us with new option for a significantly lower-cost, non-dilutive, tax-efficient capital that was previously not available to us to fuel our growth. Moreover, these new ratings are especially valuable as we explore the potential to launch our innovative digital banking services in new geographic markets beyond Canada where we see significant unmet needs, similar to those that have driven the Bank's strong growth and steady growth.

Yet another highlight during the quarter was our announcement in February of our intention to launch a new, highly encrypted digital deposit offering, VCAD. It is not only a natural evolution of our secure digital deposit taking business, which we have been doing right throughout our history as the first digital financial institution, but more broadly is a natural evolution of banking industry. Once again, we are the leading edge of the banking revolution.

We strongly believe that, as a Schedule I Chartered Canadian Bank, is incumbent upon us to provide the absolute highest level of security to our customers and VCAD does this as an entirely new level with blockchain technology. In fact, our mission, when we received our Schedule I license and still is today, to maximize the value of our common shares and total return to our shareholders by providing innovative financial solutions to our clients. There is no better example of this than VCAD.

Each VCAD unit will represent a C$1 on deposit with VersaBank and can be redeemed at any time with absolute certainty around the value and ability to consummate the transaction. Because of its ease of transferability, VCAD could potentially be used as a digital currency with the highest level of stability and security amongst digital currencies available today. VCAD combines all the efficiencies, audibility, and technical security of encrypted digital assets without the associated volatility and risks. And we believe VersaBank's investment-grade issuer rating will make this a very attractive offering globally. Importantly for the bank, as a deposit offering, VCAD represents a significant potential additional source of very low-cost deposits, providing the opportunity to even further reduce our already ultra-low cost of funds. We are moving steadily through the testing and plan to launch VCAD later this summer.

As our core digital banking operation delivered record results, the second quarter saw first full quarter of contribution from Digital Boundary Group, which we acquired last November through DRT Cyber. DBG has delivered more than 60% year-over-year growth in net income for the five-month period since its acquisition in November 2020, despite coming through their typically slower period seasonally, given that there is a certain amount of testing that involves outdoor work and on-site work. We have also seen some deferral in engagements later in the year due to pandemic lockdown in many parts of Canada.

We are now nearly six months with DBG as part of our cybersecurity business and are making steady progress in our strategy to capitalize on the significant business development opportunities from the combined teams, as both business and government grapple with the increasing number of high-consequence cyberattacks that can be defended through regular penetration testing. During the quarter, DRT Cyber released its new e-mail privacy compliance platform, which we call RAVEN, as an external beta to a select group of customers prior to full market release. RAVEN is the first and only fully automated and integrated solution that provides complete compliance with all major global anti-spam legislation. RAVEN is an important component of DRT Cyber's business strategy, adding a privacy solution to its broader suite of cybersecurity solutions to be able to address those critical aspects of every organization's cybersecurity needs and provide governments and corporate organizations with a comprehensive suite of effective cybersecurity solutions.

At the macro level, we have all just recently witnessed a cybersecurity breach yet again in the United States, maybe globally, with the hacking of Colonial Pipeline, which shut down the pipeline and very quickly resulted in gas shortages throughout eastern states. It is a stark reminder of how vulnerable many of our most important IT systems are and that no one is immune to such attacks in the absence of proper security. Those behind such attacks undertake them because they can, but they are preventable. DBG provides corporate and government clients with a suite of IT security assurance services and is one of the leading penetration testers. Very simply, they find the vulnerabilities in the IT system so that an organization can address them to prevent these types of breaches. In fact, a core component of DBG's client list are infrastructure assets, which include those of one of the US preeminent investors.

To conclude, our second quarter results were once again reflective of the earnings power and significant growth potential of our digital banking strategy, addressing unmet needs in banking through innovative solutions based on proprietary software platform through a highly efficient partner-based model. With the additional capital raised through the subordinated note offering in April, opportunities to continue to lower our cost of funds, our point-of-sale, and commercial lending business is poised to benefit from the relaxation of pandemic-related restrictions and the launch of our Instant Mortgage offering on the horizon, our strong performance in the first half of 2021 positions VersaBank for an even better second half and a return to our track record of strong year-over-year growth and annual profitability.

And with that, we'd like to open up the call to questions. Operator?

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have any questions, please press star followed by one on your touchtone phone. You will hear a three-tone prompt acknowledging your request and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press star followed by two. If you are using a speakerphone, please lift your handset before pressing any keys. One moment for your first question.

Your first question comes from Cihan Tuncay with Stifel. Cihan, please go ahead.

Cihan Tuncay — Analyst, Stifel GMP

Oh, hey, everyone. Good morning. Congratulations on a pretty solid quarter. Dave, maybe just with respect to your cash balance, lots of different growth opportunities, it sounds like organic and inorganic. Could you just talk about your capital deployment priorities after the sub-debt raise in the US? Maybe if we can start with that.

David Taylor — President & Chief Executive Officer, VersaBank

Well, thanks, Cihan. Yes, cash balances are much higher than historic levels and we expect that we will be able to deploy some of that excess cash into the US market. We are pursuing some new relationships in the US market presently. And there's a natural hedge to the US$75 million that we that we have on deposit with a major bank. It would be nice to fund US dollar receivables. So yeah, we're looking into the States for opportunities to grow.

And in Canada, there's a little bit of a dampening effect of the recent lockdowns in Ontario, both in the real estate financing and the point of sale, although traditionally summer point-of-sale rebounds as folks are out buying cars and fixing up their homes and I expect the real estate will rebound also.

Cihan Tuncay — Analyst, Stifel GMP

Thanks for that, Dave. And maybe just as a follow up, if you talk about expanding into the US, it sounds like initially purchasing some US-based receivables. How do you guys think about M&A opportunities in the US? Does this debt raise position you for that or is that maybe something a little bit further down the line? How should we think about that?

David Taylor — President & Chief Executive Officer, VersaBank

Well, eventually, I hope that our businesses expand to the point in the US that an acquisition from a federally licensed bank would be appropriate, but it’s probably somewhat down the road. It’s early days in the expansion south of the border.

Cihan Tuncay — Analyst, Stifel GMP

Thanks. And maybe just on gross loan growth. Appreciating that the last couple of months, Ontario lockdown, dampening on construction activity. Despite that, you were still able to put up a pretty solid quarter of results and loan growth. How do you think about the potential for loan growth in the back half of the year versus the first half of the year, order of magnitude? Any help you can give us with targeting that would be helpful.

David Taylor — President & Chief Executive Officer, VersaBank

I expect the second half to exceed the first half by quite a margin. All the positive things there, seasonality, the summer, it’s better for construction, it’s better for home purchasing, better for improvements, so the summer in itself, and then hopefully the impact of the most recent lockdown in Ontario is over. So, the second half should be a good bit better than the first half.

Cihan Tuncay — Analyst, Stifel GMP

Okay. And then maybe just an update on Instant Mortgage, you said you launch in the summertime here. Anything you can tell us about how many partnerships you have on the funding side for that? And any kind of additional information if you can provide that would be helpful as well, just on how the rollout is going and that kind of stuff.

David Taylor — President & Chief Executive Officer, VersaBank

At this point we only have a few partners and we've been working with a mortgage servicing company to finish up the electronic connection, so I'd look for Instant Mortgage to go live probably in about three weeks to a month. And then that, of course, opens up for us an entirely new channel of low risk-weighted mortgages that, up until the launch of Instant Mortgage, we haven't had access to. We don't utilize retail mortgage brokers, so this is a new way to go directly after that business through the point-of-sale partners.

Cihan Tuncay — Analyst, Stifel GMP

Okay. And then just one last one for me, if I could, maybe just an update on the VCAD rollout. It sounds like that's progressing nicely as well. Anything on the partnership side? Any updates on the regulatory side? Just any more colour on what the potential could be there and how you guys are positioning yourselves would be great.

David Taylor — President & Chief Executive Officer, VersaBank

Well, the internal testing is going very well with VCAD. We'll probably be able to complete that in the next 45 days or so.

With respect to the regulatory regime that we operate in as I think, you know, our mission statement that we got our charter, our bank charter, was to provide innovative financial solutions, and that in itself attracts a lot of regulatory attention, as it should. So we're working with our regulators, fielding their questions. But in the final analysis, we've been taking digital deposits since we started the financial institution in 1993. VCAD just represents an enhancement to those digital deposit receipts in that it employs blockchain technology, which, of course, is highly encrypted and takes the level of security, I think, to a much higher and better level. So in itself, just from those aspects, VCAD is, I think, a significant improvement over how FIs are receiving their data now.

But it comes with the added advantage that it enables the deposit receipt to be easily transferable. And that aspect, of course, likely means that VCAD can be used as a payment vehicle. And from a bank's perspective, if you have a deposit that has another feature to it, you can probably get away with paying less interest and it'll probably be a lot more sticky vis-à-vis, say, the traditional high rate daily interest savings account, which is generally people just deposit with the bank to get the high rate of interest. VCAD has another utility to it that will likely make it more attractive.

So testing wise, it's going very well, and we are continuing to work for the various regulators on answering their questions, as we do over the years, every time we come up with something innovative to new, ah, it creates all kinds of curiosities.

Cihan Tuncay — Analyst, Stifel GMP

Appreciate the colour there, Dave. I'll pass it on from here. Thanks very much and great job on a good quarter, guys.

David Taylor — President & Chief Executive Officer, VersaBank

Thank you, Cihan.

Operator

Thank you. Ladies and gentlemen, as a reminder, should you have any questions, please press star one.

We have a following question from Greg MacDonald with LodeRock Research. Greg, please go ahead.

Greg MacDonald — Analyst, LodeRock Research

Thank you. Good morning, guys. Congrats on the quarter. David, I'm curious, just a bit of a follow-on question on the VCAD product. You do a good job describing this as, in fact, being a digital deposit, and clearly there's going to be some interest from the regulators. Could you define in some way where you are, you think, with the relationship with the regulator on this product itself? Are you kind of in the middle of the regulator wrapping its head around/feeling comfortable with it? Are you closer to the end? Maybe just give us a sense of what that sort of regulatory, don't want to call it risk, but relationship is in terms of their ability to get comfortable with it.

David Taylor — President & Chief Executive Officer, VersaBank

Greg, I'd say we're in the middle. It is, in one respect, as I was saying earlier, it's almost the same as the digital deposits that we've raised since 1993. And that was a revolutionary change in the industry when we started employing telephone modems and the digital transfer of data. But that now is the standard in the industry. All small FIs use CANNEX system to receive their deposit information digitally. So VCAD, in that respect, looks just like the digital deposit receipts we presently have, except the data feed would come through the blockchain and be highly encrypted and we think a step better than the existing systems.

The fact that it will be easily transferable, because it is (inaudible) the blockchain, causes regulators to think about it a lot. I think we've been fielding a lot of questions, which is normal for us. As I was saying earlier, we got our charter to provide innovative solutions to the financial industry. The Government of Canada wants consumers to have choice and wants to encourage innovation in our sector. So we're happy to, as we have done in the past with every other product we've come out with, happy to field the questions and hopefully the regulators understand that this is a step better than the existing system and is another first for Canada in the banking industry. Good for our Bank, being first-mover advantage, and good for Canada to yet to come up with another innovative product.

Greg MacDonald — Analyst, LodeRock Research

Great. And on the commercial side, I mean the question was asked earlier, but maybe there are some more comments to be made, maybe without getting into specifics, but early interest from corporate Canada or corporate America on the commercial opportunity for a product like this. I have to think that a lot of companies are looking at the volatility in Bitcoin and really kind of questioning the potential to be using that medium for payments or any other commercial application. What kind of interest are you getting from corporate Canada on this and maybe give us a sense of that?

David Taylor — President & Chief Executive Officer, VersaBank

Well, we're getting a lot of interest from the biggest companies in the world. I think it, if seen as it is, kind of a breakthrough in digital currencies and that it's the first digital currency that would carry an A rating for one thing. It's the first digital currency that is issued by a highly regulated bank. And rather than being tethered to an asset to create stability, it actually is the asset. It actually represents a deposit at the bank. So I think it's a huge breakthrough in virtual currencies and I think it will be an ideal payment vehicle, and that has been recognized almost instantly by the payment people in the world, since we announced it, that this—it makes all the other tethered currencies and digital currencies somewhat obsolete.

Greg MacDonald — Analyst, LodeRock Research

Okay. That's helpful. And then last question I have is just on DRT. You mentioned the Colonial Pipeline hack. Clearly, security overall remains front and center in headlines. That's got to be front and center with corporations out there. Launched a new privacy product. That's an important product in terms of major themes these days. Where do we stand on the suite of products overall for DRT? And just maybe a general update on that company, that would be helpful. Thanks.

David Taylor — President & Chief Executive Officer, VersaBank

Well, DRT has developed a lot of in-house products, one being RAVEN that we just spoke about. We're still in the integration with DBG and at a stage where we're sort of not quite ready yet to go hard at the market with the new products, but we have been introducing other products we've developed to DBG's customers and to other entities in the United States, particularly in the United States and some in Canada. So it's still early days with the full integration of DRTC with DBG, but we think the market is demanding the kind of kind of state-of-the-art cybersecurity that DRT has to offer.

Greg MacDonald — Analyst, LodeRock Research

And then just context on growth, I mean that business is still growing independently, these two, as you're integrating, are still growing at double-digit rates. Any reason to think that that outlook is changing in any way?

David Taylor — President & Chief Executive Officer, VersaBank

It should grow faster than that. DBG, based on its unaudited financial statements, from the same period last year it's up about 60% this year, and it's going into its growth season in that a lot of the penetration testing is actually done physically and has been deferred somewhat by the lockdown and also by the winter. So 60% growth is based on what it's doing now, but it should be way, way more than that.

Greg MacDonald — Analyst, LodeRock Research

Okay. Thanks. I will leave the rest of the questions for others. Thanks, David.

David Taylor — President & Chief Executive Officer, VersaBank

Thank you. Thanks, Greg.

Operator

Thank you. Your next question comes from Trevor Reynolds with Acumen Capital. Trevor, please go ahead.

Trevor Reynolds — Analyst, Acumen Capital Partners

Hey, guys. Just wondering if you can touch a little further on the expansion opportunities that you're seeing in the US and whether it's a risk having that US currency right now given where rates have gone.

David Taylor — President & Chief Executive Officer, VersaBank

Trevor, good question. We, as I think everybody knows, having looked at our model over the years, we're somewhat risk averse and don't like taking any additional risk, particularly currency risk, so the entire proceeds of the US dollar raise is sitting in US dollars in a Canadian bank account. So we're naturally hedged from that respect. We are hoping that we can deploy at least that amount currently soon into US dollar receivables, again, naturally hedging, but affording us a much higher yield than what we're presently getting as a cash deposit. We think there's a huge opportunity in the United States for our point-of-sale program, but it's early days. We're working on a couple of beachhead transactions presently and thereafter we look to expand our product offering in a few states that are close by and easy to access.

Trevor Reynolds — Analyst, Acumen Capital Partners

Perfect. And then can you touch a little bit more just on your cash position? And you did kind of mention that you expect to be at normalized levels at the end of the year, just maybe how you expect that to trend down over the next quarter or two.

David Taylor — President & Chief Executive Officer, VersaBank

Well, as the loans grow, point-of-sale loans and real estate loans grow, we'll be funding out of cash and just letting the cash balances wind down. There was a bit of an anomaly at the end of the quarter in that we closed the subordinated debt offering on the last day. That bumps it up by about C$92 million. And there were a few large commercial mortgages that we were thinking would be funded towards the end of the quarter but have been deferred into the third quarter. So we would hold on to cash to fund those large mortgages and they were deferred. So it's kind of a little bit of an anomaly at the end of Q2. So with loan growth, we'll just let the cash balances reduce. Historic level is 6%, 7%, so almost half of what we have today.

Trevor Reynolds — Analyst, Acumen Capital Partners

Good. And have those two large mortgages gone through now or no?

David Taylor — President & Chief Executive Officer, VersaBank

No, I don't think so. I think one might have and I think the other one is due to go. Pandemic things slowed those types of fundings down too. The other thing about pandemics is they speed up new home purchases, as folks are leaving major centers and are kind of keen to buy residences on the outskirts of major centers, so we're seeing more rapid pay-downs, which is good from a bankers' perspective. We see our loans rolling over more rapidly than they would normally. Those folks are keen. When a condo is ready to be purchased, it is purchased. And then the pandemic itself slows down some of the process in funding loans. But hopefully most of that's behind us now in North America. Hopefully we can get sort of normal business. So, all in all, I see the second half to be a better half than the first half, which first half was 11% growth. Second half should be better.

Trevor Reynolds — Analyst, Acumen Capital Partners

Perfect. And then just one more just on the insolvency market and kind of what you—are you starting to see that pick up at all or do we really need to get to the end of the pandemic before we start to see that really have an impact?

David Taylor — President & Chief Executive Officer, VersaBank

Well, no, we're not seeing any increase in insolvencies. It's still, I think, a 10-year low for insolvencies. But the balances are still growing in that the firms that adopted our software package are still transitioning their accounts over to us. So the balances in our insolvency portfolio of deposits is still going straight up in a straight line, which is very nice, but I expect it to swing up when the support payments finally are ended and that, unfortunately, there's a lot of businesses and people have been living on the edge that the support payments have kept them out of insolvency.

Trevor Reynolds — Analyst, Acumen Capital Partners

Great. That answers my questions. I'll hand the line back. Thank you.

David Taylor — President & Chief Executive Officer, VersaBank

Thanks, Trevor.

Operator

Thank you. Ladies and gentlemen, as a reminder, should you have any questions, please press star one.

It appears we have a follow up question from Cihan Tuncay with Stifel. Cihan, please go ahead.

Cihan Tuncay — Analyst, Stifel GMP

Thanks. Just a couple of quick modelling-related questions, if you don't mind. With respect to all the different initiatives you have going on, just wondering what we should expect for that efficiency ratio line relative to the back half of the year versus the first half of the year? Any colour you can give us on that front would be helpful as well.

David Taylor — President & Chief Executive Officer, VersaBank

The efficiency ratio should improve in the second half in that Digital Boundary Group is moving into its most profitable part of the year and provides a fair amount of revenue. The net interest income from the loan growth will help too. And there isn't much in terms of fixed cost increase. So the back half, the efficiency ratio should drop below $0.50. I think April 30's number was $0.48. So it should, ideally, with the loan growth, it should keep on going down to around $0.30, but that will take a number of years.

Cihan Tuncay — Analyst, Stifel GMP

Thanks, Dave. And then just another one with respect to reserving, it looks like there was, so there was a release this quarter consistent with basically any bank in North America. How should we think about potential reserve releases going forward? I know that you've generally been, from a reserving perspective, it's never been a very large line item, but should we expect any more variability in that line as well going forward?

David Taylor — President & Chief Executive Officer, VersaBank

Well, probably a little bit more to go. Our portfolio, of course, stands up very well with no deferrals and no loans even in arrears at the end of the quarter. It, generally speaking, doesn't attract very large reserves, so there's probably a little bit more to go. But as you say, in our case reserves are a very small number to start with, the way we're structured, so they're not big numbers, but there's probably a little more to go.

Cihan Tuncay — Analyst, Stifel GMP

Appreciate that. And just one last question, again, a modelling perspective. On your funding costs, excluding the impact of the sub-debt issue in the US, how can we think about that going forward as well? I think it was around, interest on deposits averaged about just over 1.5% cost of funds. Is that potentially going lower or higher for the back half of the year? Any colour you can give us on that would be helpful, too.

David Taylor — President & Chief Executive Officer, VersaBank

Well, excluding the impact of the subordinated debt, which is about a 20 basis points increase, it should keep going down. Overall, the quarter was 1.28% and the insolvency deposits are still building nicely. It very well could be that they'll spike when CERB payments and such come to an end. So you can still look forward to a decrease in our cost of funds excluding the 20 basis point impact of the sub-debt.

Cihan Tuncay — Analyst, Stifel GMP

Thanks very much. That's it for me.

David Taylor — President & Chief Executive Officer, VersaBank

Well, Cihan, thank you very much for those questions. Are there any more questions?

Operator

There are no further questions at this time, Mr. Taylor. You may proceed.

David Taylor — President & Chief Executive Officer, VersaBank

All right. Well, I'd like to thank everybody for joining us today and I look forward to speaking to you at the time of our next quarterly call. If you have any questions that come to mind later on, don't hesitate to send me an e-mail. I would be happy to field the questions. Again, thank you very much for your interest. Have a good day.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.