# TD BANK GROUP
# NATIONAL BANK FINANCIAL CANADIAN FINANCIAL SERVICES CONFERENCE
# MARCH 31, 2016

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## PARTICIPANTS

**Mark Chauvin**
*TD Bank Group – Group Head and Chief Risk Officer*

**Peter Routledge**
*National Bank Financial – Analyst*

## FIRESIDE CHAT

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**Peter Routledge – National Bank Financial – Analyst**

Next is Mark Chauvin, Chief Risk Officer at the Toronto Dominion Bank Group. In December 2006, Mark was appointed Chief Risk Officer, which for you, must have been just fantastic timing.

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Yeah. It was good for a year or so.

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**Peter Routledge – National Bank Financial – Analyst**

You joined TD more than 35 years ago as a commercial account management trainee and here you are. So thank you for being here.

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Thanks for having me. Good to be here.

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**Peter Routledge – National Bank Financial – Analyst**

Good, good. I'm going to give you my lead off question, what are the key messages you want to leave with folks today?

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

There would be three, and it's kind of the key points I tried to make in the Q1 call, kind of. First and foremost, the credit quality across all of our portfolios in Canada, in the Wholesale bank and in the U.S. is at very strong levels. We've seen consistent improvement over the last several years and a pretty significant improvement in the U.S. over the past two years, with the exception of the oil and gas, which I'll speak about in a minute. But I mean the reality there is that they're at good levels, but I really don't think that they're getting better. I think we're – I'm not saying I don't – I would look for that to continue during the current year based upon our forecast, but it would be unrealistic to think that there'd be material further improvement.

The second point, there was a fairly significant increase in the U.S. Retail credit losses in the quarter, which we knew was coming for several quarters. And I really wanted – I didn't want people to interpret that as deterioration in credit quality where what was really driving it was a normalization of credit losses from unsustainably low levels in the latter part of 2014 and 2015.

Because what we are really seeing was that the U.S. had harder stress coming out of the financial crisis, and it takes a long time to resolve things in the U.S.  So, what you saw in 2015 is a high level of recoveries which kind of pushes down your PCLs. And then as you're witnessing a fairly strong credit quality improvement, your collective allowance methodology will kind of reduce for a portfolio, but it's used to fund growth, right? So, you're funding the growth in the portfolio and as you grow a portfolio, you naturally increase your collective allowance. It was really being funded by improved credit quality, but really it's not going to get better in 2016, so you saw that stop.

So, if you look at that number, that's a type of number that I would say is a good number if you look at each of the product categories and say, what's the loss rate? They're good loss rates. And based upon our view of the U.S. economy, we're looking for that to continue at roughly existing levels going forward, subject to things. And one of the increases too was we acquired or we entered into another partnership card arrangement that started in Q1 2016.

So, the third part is really our – the major thing that we're focused on and that we worry about is the impact of low commodity prices specifically oil, in several different impacts. So the first is to our direct exposure which is really the oil and gas producers and the servicers and so that's about $4.2 billion drawn. And then you have the impact of consumer credit in those areas and that's something that we've been watching very closely for the last year and a half and we feel that like really, I would have to say when we're at the Q1 call or at the end of February, we're looking at low 30s, 20s a few days. I was feeling a little bit more stressed about that. I'm feeling a little bit better now. But you know, our view has been that type of stress will create an incremental credit loss in our portfolio about 5% to 10%. If you equate that to dollars, it would be an increase of $100 to $200 million as a range for maybe two years.

And so, what we've seen to date has been very consistent with our expectations, if not a little bit below, but I think there is a delay point, especially in the consumer. You did see in our Q4 2015 and Q1 2016, we added to our collective allowance. And if you dissect down exactly what drove that, I would say it was like 75% of that was to cover a weakening in the oil and gas producer portfolio through migration in the portfolio and through increased deterioration in the consumer credit portfolios in the oil-impacted provinces. We haven't seen a lot in terms of specific PCL to date, but the reserves I think will kind of translate.

But I guess the message I would leave here is that it still remains well within kind of our projections as we looked at it. I've been saying now for a couple of quarters a range of 5% to 10%. I'm still comfortable with that range. I might be thinking a little lower end of the range, but this isn't an exact science so you have to give yourself a bit of range. But if you backed up to it, the other thing I take comfort from is we have a relatively low exposure to this sector. In terms of direct exposure it's under 1% of our total book. And then if I were to add the consumer credit in the impacted portfolios, it might add another 2% to get you up to the 3% range. So, I think it's something that's, well, it's manageable. But this is credit – it is a cyclical area, so it's not totally unexpected. But we feel we're managing it appropriately.

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**Peter Routledge – National Bank Financial – Analyst**

Okay. Mark, we have most of the Chief Risk Officers here – so folks that are more concerned about the downside as much as, or perhaps more than, the upside. So, with that in mind, what keeps you up at night?

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

I'll certainly tell you what does. I don't want to underestimate the concern we have over oil and gas or that we think about the housing industry in Canada or consumer debt, but these, to me, fall into the range of the risks that we manage. So, those are not the areas that will keep me up at night. What keeps me up at night, our greatest concerns, are things that we can't control as well – significant tail risk-type events.

But if you want to look at the top thing within the enterprise today, it would really be the cyber threat because it's something that – first of all, we can – we've invested a lot over the years to strengthen our perimeter, to deal with disruption of service attacks. But the reality is this game is constantly increasing, and we have to constantly be ahead of it.

And if, God forbid, something went wrong, if you had a loss of customer data that for someone trying to monetize that data, or if simply, someone disrupted your systems so that you didn't have availability for an extended period of time, those are far greater risks to me as an organization than credit losses. Because what they get to is our relationship with customers is based on trust and they have to have faith in their organization. And then anything that would question that could have a very significant impact on our brand, and our overall business. So, that's the greatest thing we worry about. We're satisfied that from an IT, technology perspective, that we're doing everything possible to do it and keep – this is the one area that all of the financial institutions in Canada and the telcos and the other areas will work together because we all have a common goal here.

The area that I think is important though from our perspective is that we have to get it engrained in our culture the risk of a cyber threat. And so what that means is that, we have to have all of our employees – because that's ultimately someone just opening something they shouldn't have or maybe being loose with access. We have to get it embedded in our culture, the importance of it, no different than AML requirements and credit. So our focus is very much on training, training and training, to ensure that our workforce understands the importance of it. And will treat it no differently, it will just be engrained in what they do, is that this is a constant thing that we have to be on the watch for and to be careful of.

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**Peter Routledge – National Bank Financial – Analyst**

Okay. So with that Mark, I'll go on to the audience, see if we have any questions for Mark. Here in the middle.

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**Unidentified Audience Member**

Some Scandinavian banks are using what can be considered as an equivalent of a VPN chip in order to log in. Have you been considering that as a way to fight cyber security?

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

You're talking about dual authentication?

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**Unidentified Audience Member**

Yes.

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

I think it's long been recognized as it would be a positive. But I would say that the Canadian marketplace isn't ready for it at this point in time. If you look at the U.S., the U.S. is even a few steps away from that. And we're just now looking for chip and pin. There's just chip in the U.S. And what's really been – and you almost think it should be automatic, why wouldn't you do it? Well, you don't do it because the merchants don't want to do it, and there is a resistance from the customer. I think that this will lessen going forward.

I know that we're very active in the FinTech-type area, working with groups that have biometric identification or other types of ways of improving and enhancing it. I think, it will come – it just would take time to come.

**Peter Routledge – National Bank Financial – Analyst**

Anyone else? Just back towards the right.

**Unidentified Audience Member**

My question concerns risk disclosure, the requirements in the United States and the requirements in Canada. Is there a big difference or is it all the same in terms of regulatory disclosure?

**Mark Chauvin – TD – Group Head and Chief Risk Officer**

I don't – there are some, I think generally speaking, I do not find large differences with the exception of in the U.S., the CCAR results are disclosed or the stress test results are disclosed. That is not the intention in Canada. But I think otherwise, the financial or the risk disclosure requirements that we've seen ramped up since the financial crisis have really been driven more by FSB or global regulatory requirements have been pretty consistently applied everywhere and adopted. So, I don't see a difference, certainly from our reporting perspective. We follow the Canadian requirements and that really meets our U.S. requirements.

**Peter Routledge – National Bank Financial – Analyst**

Anyone else? Okay, I'll come back. We talked about stress testing. So, I'm asking this of all the Chief Risk Officers today. One of the key lessons in global financial crisis that we learned was stress test run pre-crisis were perhaps not stressful enough and that the actual outcomes that were realized were far worse than what the stress tests projected. So, how has TD changed its stress testing approach since that period?

**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Peter, a lot of things have changed in the last 15 years. I mean, it's really been dramatic changes in risk management, and stress testing is one of them. I mean, the first time we as an organization did stress tests, and this was before regulatory requirements, was in 2004 and 2005. And the reason that we did it is, those that who know our history, we had very significant credit losses in 2002 that were in the Wholesale bank, and they're really concentrated in three sectors. And the reality is – so, we started to do stress testing and saying, could there be something else in our organization that would have that sort of impact? And the reality is that if we had done stress testing the way we do it today, then, it would have identified that significant risk that would have been above what we were comfortable with. So very important.

But stress testing, I think what you've seen is since this is relatively new you've seen the evolution over years. So it's just kind of getting better and better. And for us, it's kind of evolved to the point. And so for our organization, we do enterprise-wide stress testing as an enterprise-wide activity. And we do that because we think it informs our capital planning, it very clearly determines our risk appetite. It kind of gives us a barometer of saying, where are we on the relative risk scale and how have we progressed from year-over-year? But then in the U.S., we've done DFAST which is the OCC's requirements for two years. And on, I guess, it's April 6, we file our first CCAR which is a culmination of a major work effort. But all of this information is getting to the point where it's integrated in our decision making and how we operate it.

We operate as part of our capital planning process. It allows us to identify kind of our risk factors and say, well, like, investment portfolios, create AOCI, so that creates an impact on capital. So we have to structure them in a manner to dampen that. So I think we're very close to the point where it's just integrated in how we think. And whether it is capital planning or risk appetite, and – I mean, we wouldn't dream of looking at a relatively small acquisition without doing a stress scenario on it to say what it's going to look like.

And the other thing that's important is that we're in pretty – started off by indicating very strong credit quality. The reality is we're fairly benign credit conditions with the exception oil and gas. And so, when you're looking at new initiatives, it's critical that you don't assess them against the current environment. You have to say no, no – this is through a cycle, I'm going to a stress. And would that fit my risk appetite during that stress versus today? So I think it's very important.

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**Peter Routledge – National Bank Financial – Analyst**

Okay. An area that I get worried about a lot is just household debt, which is very high relative to income, at least if you look back over the last 25 years. And the asset class I worry about is not mortgages or even HELOCS but unsecured household debt. And TD is about $70 billion in exposure at default.

So, I guess the first question is, when I look at the exposure at default disclosures for all the banks, you see and you look at expected probabilities of default, loss given default. It doesn't look that bad, to be honest. And my concern is, over the last 20 years when we've had very benign credit conditions, credit scores, there's great inflation in credit scores, and then could something change in the near term, 5 to 10 years, where all of a sudden the credit loss predicted by credit scores derived over the last 20 years is just wrong, they're too low. And so, how do think about that risk and then do you already incorporate that within your stress testing?

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

I would think the – in the stress testing process, we will incorporate plausible but never-seen-before-type situations. So, a common – I think the biggest thing that would drive the stress for consumer credit would be unemployment. I think that you're point is, will be behavior will be the same kind of going forward and where we would look at that. Maybe it goes back to the discussion a bit is that if you're in an environment where there were negative equities in the homes, would the behavior be different?

We had a bit of an example of that in the U.S. I don't – we've not experienced in Canada, and we really haven't experienced it yet in those provinces where either you seize the – you get the security or get the guarantee, you don't get both. But we do apply that type of thinking over our consumer stress testing, and we also look at things of – we all have great relatively high level of insured portfolios and the put-back risk on those portfolios has been very, very low, but that's no guarantee it would be like that way in the future. And although we spend a lot of time and effort to ensure that we cross our T's and dot our I's to ensure that that insurance remains in force, but we do overlay, what if we get it wrong, by fairly significant numbers.

But you know, in the heart of it, we try to maintain underwriting standards which we feel are consistent and disciplined through a cycle and that with monitoring control procedures would allow you to identify where there is, as early as you can, so look at the level of payments people make or where their usage on an undrawn line gets and take action on that to kind of mitigate the losses while making sure that you aren't so broad-based that you're impacting customers that you should not impact, which might be a bigger risk. We've had long debates, where that's our bigger fear, that you kind of over react and hurt that customer base.

But I'm satisfied that we're prudent in our underwriting. We don't – when things are good, we keep it – we try to keep it constant as much as we can. And it's a valuable service we provide, and credit losses are part of what we – that come along with it. But in our mind, they would – we wouldn't look back and say, oh, I wish I had done that or I wish I had done this. But no, this was important for the business that we run and that we accept the losses that we take. I'm not sure if that's a great answer.

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**Peter Routledge – National Bank Financial – Analyst**

Yeah. It's is. It's clear.

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

But I do agree with you. We don't – we can't look at the past and say that's going to be an indicator of the future. We can't say, well, nobody gives their cars back because that's what they want. I mean, that happened once. Whether it happens again would never factor into our thinking.

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**Peter Routledge – National Bank Financial – Analyst**

Okay. I'd like to just ask you about your oil and gas exposure. I think numbers I took from the last quarterly report $6.1 billion in drawn exposure and then undrawn exposure a default of $9.7 billion. Can you give us a breakout of investment grade?

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

I can absolutely, but the number that you – the $6.1 billion equals is comparable to the $4.4 billion I gave because you include the midstream and pipelines. But that's just to shore up the two numbers. But if you look at the $6.1, the drawn portion, our investment grade content there is slightly under 50%. If you look at the undrawn portion, our investment grade content there is around 70%.

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**Peter Routledge – National Bank Financial – Analyst**

Okay. So, also, this is another common question I'm asking, and it relates to how you're adjudicating your oil and gas credits. Over the last six months, there have been press releases from oil and gas producers who indicated they've received some covenant relief from their lenders. And the question I get back from investors is, hey, the banks are easing their credit standards because they don't want to admit losses that are eventually going to happen. And I'd like to get your response to that critique.

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

So, thank you for asking me that question. First of all, I mean, this is not specific to the oil and gas industry. Whenever you're dealing with a company and any industry that's experiencing difficulty, it's not unusual to give covenant relief. Each decision is based upon an analysis and the merits of the decision, and to provide the covenant relief, it has to be in the best interest of the bank in recovery or just maintaining, and the customer. It's a shared mutual interest.

But to give the covenant relief, there's going to be a logical reason like if something is going to happen that makes sense that will ultimately make it better. So, it might be, I'm selling an asset. I need more time to sell the asset, and then the covenant will go back up when I've sold it. It can be I'm looking to sell the company or it can be that there's been a problem that's created the situation I'm in, and it's going to be resolved. Now, that doesn't apply so much for oil and gas because you need commodity prices, right? But when you're giving a covenant relief, it would be very unusual to not – it's an opportunity to get tighter terms and conditions and that might be through virtue of, well, I'm going to reduce availability, I'm going to introduce anti-hoarding language so you can't draw down unless there is a specific reason, I'm going to decrease the term, I'm going to get increased security. Those are all things that you would – or if their making dividends, dividends are going to stop. So, it's a wholesale look to say, okay, I'm going to do this. We're all in this together, but it has to make sense.

But the fact that – the decision to give the covenant relief and actually what your rate the borrower is independently done and it's done by risk management. And I'd say the correlation will be that when you give covenant relief, you were downgrading an account. I mean it's a totally independent decision but the fact that they need covenant relief means that there's some risk of some sort. So, to me, it would be very unusual for not to be a ratings downgrade that would come out of that.

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**Peter Routledge – National Bank Financial – Analyst**

Internal ratings?

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Internal rating. And covenant relief doesn't mean they become impaired. It just means that they were – it could be at any range in the rating structure. The idea that you wouldn't – that you defer or kicking a problem down the road or deferring, to me has not at all been my experience. It's not my experience in the last 25 years when I've been involved into more Wholesale credit. I think the more natural inclination because the rating is recommended by the business but approved by risk management, the bias is to be tougher because you really don't want – there's no penalty for downgrading it. But if it doesn't get downgraded and in hindsight it should have been, there is a penalty.

To me, to be perfectly honest, I challenge – when people look to downgrade accounts significantly, I challenge them on it because I'm saying no, we have to – I want the right decision. I don't want the one you could never be wrong for. And so in an environment where everyone is worried that kind of creeps in.

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**Peter Routledge – National Bank Financial – Analyst**

All right. Okay. I'll go out one more time for more questions, down here in front.

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**Unidentified Audience Member**

So when you were talking about stress testing, you talked about how in your mortgage book or – you talked about how you'll stress – I forget – the direct question is when you do stress testing on the capital adequacy – oh, right, you talked about how on – for you'll stress the possibility of insured loans not paying out on the insurance.

So I was just wondering in conjunction with that for stress testing capital adequacy, you guys have a significant presence in the U.S. retail market and U.S. retail mortgage loans, which are not risk weighted at

zero percent like Canadian insured loans. For capital adequacy purposes, do you guys go about stress testing your Canadian residential loan book on the insured side at rates higher than zero percent for…

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Zero percent is?

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**Unidentified Audience Member**

Zero percent for their...

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Put back or?

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**Peter Routledge – National Bank Financial – Analyst**

Loss given default, you mean?

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**Unidentified Audience Member**

No. For their risk weight....

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**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Well, the U.S. mortgage book is on standardized. But it is a relatively small book compared to Canada, and it has the benefit of being created after the financial crisis. So you had higher – tough underwriting – or appropriate underwriting standard is maybe the better way of saying it, and in a refinancing world. So it's a better quality book. And we actually do sell part of that book on an ongoing basis.

But in the Canadian context, when you stress test, you will make a certain assumption of well, X percent of my claims will be denied, but you also say in a scenario where you've got a widespread deterioration, you've got a lot of homes on your books, the fact – the amount – the operational maintenance of that portfolio is a significant expense, getting the people to look after it is a significant expense. And every year you hold a property, it kind of spirals down in value. And then we kind of – we overlay the loss given default. So you take a loss given default and then you'll throw a further amount on. It's pretty – they're fairly – they stretch the realm of plausible but I'll call them plausible. But they would have been informed by the – not last year but the year before, the Bank of Canada and OSFI did the Canadian consumer stress test, and it was like 35% down across the country, 15% in the bigger regions, and then we would overlay on that. And in that world, you got so much coming on the product that just spirals down.

**Peter Routledge – National Bank Financial – Analyst**

Right.

**Mark Chauvin – TD – Group Head and Chief Risk Officer**

And that's how we would do it.

**Peter Routledge – National Bank Financial – Analyst**

Any others? In the back.

**Unidentified Audience Member**

From a governance point of view, is there a difference the risk management that reports to the board of directors, the committees that you report to, and other banks?

**Mark Chauvin – TD – Group Head and Chief Risk Officer**

No. I think it's fairly standard in the industry that a Chief Risk Officer – I have two reports. I report to the CEO, but I also have unfettered and clear access to the risk committee. And the Risk Committee and in their charter is the one that determines hire, fire and what you get paid. I mean, they're the ones that control that. But that would generally be FSB governance guidance. I'd be surprised if others weren't very similar.

**Peter Routledge – National Bank Financial – Analyst**

Just to clarify, you meet in-camera with the Risk Committee.

**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Oh. Yeah. Yes. So, I don't run the risk committee. I'm a servant of the Risk Committee. But I put it all together and I have a 30-minute in-camera beginning at the beginning of the risk committee and I have an in-camera at the end of the Risk Committee. But the other part is that unlike other institutions, other executives of the bank do not attend the Risk Committee unless they're presenting something. And the CEO really only attends the Risk Committee for their own in-camera.

**Peter Routledge – National Bank Financial – Analyst**

Right.

**Mark Chauvin – TD – Group Head and Chief Risk Officer**

And to be honest, I think it would be a different dynamic if you were sitting there and the CEO was there the entire time, right? But because, I have a very – and if you want an example, coming out of the financial crisis and for all of 2009, I had a standing hour, hour-and-a-half call with the Chair of the Risk Committee every Saturday morning. And that was simply a touch base to say where are we, but they probably more wanted to reinforce me in terms of knowing that there would be this ongoing communication.

**Peter Routledge – National Bank Financial – Analyst**

Well, anymore? Okay. With that, Mark, I'll thank you for your time and wish you all the best.

**Mark Chauvin – TD – Group Head and Chief Risk Officer**

Thank you.