TD BANK GROUP
Q2 2013 EARNINGS CONFERENCE CALL
MAY 23, 2013

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Material economic assumptions underlying the forward-looking statements contained in this document are set out in the 2012 MD&A under the headings "Economic Summary and Outlook", as updated in this document; and for each business segment, "Business Outlook and Focus for 2013", as updated in this document under the headings "Business Outlook".

Any forward-looking statements contained in this document represent the views of management only as of the date hereof and are presented for the purpose of assisting the Bank's shareholders and analysts in understanding the Bank's financial position, objectives and priorities and anticipated financial performance as at and for the periods ended on the dates presented, and may not be appropriate for other purposes. The Bank does not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on its behalf, except as required under applicable securities legislation.

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PRESENTATION

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Good afternoon and welcome to TD Bank Group's second quarter 2013 investor presentation. My name is Rudy Sankovic. I am the head of Investor Relations for the Bank. We'll begin today's presentation with remarks from Ed Clark, our CEO, after which Colleen Johnston, the Bank's CFO, will present second quarter operating results. Mark Chauvin, our Chief Risk Officer, will then offer comments on credit quality. We will then entertain questions from those present in the room and pre-qualified analysts and investors on the phone. Also here today to answer your questions are Tim Hockey, Group Head, Canadian Banking, Auto Finance and Credit Cards; Mike Pedersen, Group Head, Wealth, Insurance and Corporate Shared Services; Bharat Masrani, Group Head, US P&C Banking; and Bob Dorrance, Group Head, Wholesale Banking. Please turn to slide 2.

At this time I'd like to caution our listeners that this presentation contains forward-looking statements. There are risks that actual results could differ materially from what is discussed and that certain material factors or assumptions were applied in making these forward-looking statements. Any forward-looking statements contained in this presentation represent the views of management and are presented for the purpose of assisting the Bank's shareholders and analysts in understanding the Bank's financial position, objectives and priorities and anticipated financial performance. Forward-looking statements may not be appropriate for any other purposes. I'd also like to remind listeners that the Bank uses non-GAAP financial measures to arrive at adjusted results to assess each of our businesses and to measure the Bank's overall performance. The Bank believes that adjusted results provide the reader with a better understanding of how management views the Bank's performance. Ed will be referring to adjusted results in his remarks. Additional information on items of note, the Bank's reported results and factors and assumptions related to forward-looking information are all available in our Q2 2013 Report to Shareholders.

With that, let me turn the presentation over to Ed.

Ed Clark – TD Bank Group – Group President & CEO

Thank you, Rudy, and welcome everyone. And thank you all for joining us here today. Colleen's going to be up shortly to review our second quarter results in detail, but I thought I would start by sharing my thoughts on how we're doing and how the second half of the year is shaping up. First, I should note there have been several milestone events since the first quarter and I'd like to take a moment just to remark on them. We closed the Target and Epoch acquisitions in March and I would like to welcome members of both teams to TD. We are absolutely delighted that they're with us. We also announced our plans for the CEO succession, and as I said at the time, and I still really think, it's terrific, I couldn't be more pleased with the choice of my successor, and frankly, the process itself which has underscored our commitment to continuity with change.

Now, to the quarter. Earnings were up 6% on a year-over-year basis. For the first half of the year, earnings were up 7% and earnings per share were up 6%, in my view, a pretty good result. Our Canadian retail bank had a good quarter. Earnings increased by 5%, driven by healthy volume growth in business banking, improved credit performance and good expense management. The underlying results were even stronger, with growth closer to 9%. Colleen's going to go into that in more detail. For the first half of the year earnings were up 8% and we would expect similar year-over-year growth in the second half, a very good result, given the environment in which we're operating. Wealth also had a good quarter as well as a good first half.

On a year-to-date basis, earnings were up 8% including Epoch expenses, and 11% excluding expenses associated with Epoch. The business is carrying good momentum into the second half of the year thanks to excellent in-flows in our advice and asset management businesses. Epoch will be relatively neutral to earnings in 2013 and will be accretive to the Bank in 2014.

It was a tougher picture in Insurance, as continued good premium growth was not sufficient to compensate for increased claims due to a severe winter. Insurance earnings grew 2% in the first half. We expect good premium growth in Insurance even with slowing creditor insurance, but the business faces increased uncertainty, including the impact of past and future Ontario auto reforms. In view of this, the 7 to 10% growth we previously expected to achieve relative to 2012 normalized earnings of CAD600 million may be difficult to achieve.

Our US Bank performed well in the second quarter. In fact, it was a record quarter. Although margins remain under pressure, loan and deposit growth continued to be strong. For the first half of the year, US Personal and Commercial Banking delivered 11% earnings growth, buoyed by strong organic loan and deposit growth, higher fees, the addition of Target and increased security gains as we restructure our balance sheet to better manage our capital and our interest rate duration. We also continued to invest in the future and are opening new stores in our higher growth markets like Boston, South Florida and New York. In fact, we recently opened our 100th store in New York City. The operating environment in the United States remains challenging, with low interest rates likely to keep margins under pressure for the rest of the year and beyond. The good news is that our strong volume growth has been able to offset most of this compression, leaving us in a very strong position should rates rise. Overall, we delivered $779 million in earnings in US dollars in the first half of the year and we are on course to match that level of earnings in the second half of the year, a very positive outcome given the operating environment.

Our Wholesale Bank also posted strong second quarter results, with trading revenues recovering from last quarter's results. Wholesale delivered 18% ROE in the first half of the year, in line with our 15 to 20% target range. We expect to maintain ROEs at this level. The second half growth will likely be less on a year-over-year basis because of non-recurrence of one-time security gains at the end of last year.

So, it was a solid quarter overall, and together with our strong performance in the first quarter led, as I said earlier, to total Bank earnings of 7% for the first half of the year and 6% EPS growth. These results are exactly where I thought we would be at this point of the year, which is to say, working hard to get into the bottom end of our 7 to 10% medium-term target for adjusted EPS growth.

Most of our challenges are familiar to you. We've talked about them quite a bit. The fundamentals of our businesses are strong but we continue to face headwinds from slower loan growth in Canada and low interest rates globally. In Canada, the slowing housing market has raised concerns about the possibility of a more dramatic correction. As you know, for several years we were worried about the housing market and the risks that Canada was running. We spoke publicly about those concerns. But the government has responded with a number of reforms, which are having an impact. In my opinion, given the structure of Canadian lending, Canadians do not need to worry that we will see the type of meltdown that has occurred in other countries. We may see some softening in prices, but this would be a good thing, not a prelude to a major correction.

Our views on the global economy have not changed materially from last quarter. On the positive side, economic fundamentals in the United States continue to improve. The main impediment to growth appears to be the speed and nature of the withdrawal of fiscal stimulus. Debate has actually now opened up on how and when to withdraw some of the monetary expansion. All of this is very good news. At the same time, the rest of the world looks no stronger. Europe is mired in a recession, Asian growth seems more modest and Japanese attempts to re-stimulate their economy through monetary stimulation have set off further downward pressure on interest rates and currency values. Canada is affected by these competing global forces, and in our view is likely to under-perform the United States in the next few years. For TD, we have to assume, despite the discussion that's going on about where interest rates are going, that for our purposes of running the business, that interest rates do not rise soon and, therefore, that we will continue to face downward pressure on margins for at least one more year.

That's why, despite the good performance we recorded in the first half of the year, we are continuing to focus on expense management. The operating environment has changed in the last couple of years and we have changed with it. Finding current-year cost savings is not enough. We continue to focus on more permanent cost reductions. We are carefully reviewing all opportunities on this front. At the same time, we have to manage expense growth carefully. Total Bank adjusted expense growth, excluding acquisitions and FX, was 3% in the second quarter, our target, as you know, for the year. We are determined to meet that target. We expect to grow expenses, measured on the same basis, by less than 3% in the second half of the year, and we are committed to reducing that growth rate still further in 2014, while still investing in future growth initiatives.

Let me talk about capital. As of April 30th, our Basel III Common Equity Tier I ratio was 8.8% or 8.5% excluding the impact of the CVA reprieve that OSFI granted in December. This ratio was unchanged from the first quarter, a truly remarkable result, given that we absorbed the Target and Epoch acquisitions in that quarter. As we indicated to you last quarter, we have been working towards articulating a capital allocation strategy. In a world of growing capital requirements, it is important to review all uses of capital, current or potential, to ensure that it is being used optimally. We got some clarity on the regulatory framework, which we needed in order to develop our strategy. OSFI has now clarified the D-SIB rules. With that framework in place and in view of our demonstrated ability to generate capital, we are now allocating roughly CAD1 billion to repurchase 12 million of our common shares. As we monitor our capital growth going forward, we will continue to review how we can best deploy any future growth in excess capital – including, potentially, additional share buybacks – to maximize shareholder returns while growing our franchise.

To wrap up, our businesses delivered a solid performance in the first half of 2013. We continue to face the headwinds that we've identified previously. But our focus at TD is always on the medium-term build of a great franchise. That is our core business model and that is the essence of our culture. That's why we will continue to invest in the future even as we look for permanent cost savings in the present. And that's why I remain confident that we'll continue to deliver on our vision of being the Better Bank.

With that, let me turn it over to Colleen.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Thanks very much, Ed, and good afternoon, everyone.

Please turn to slide 4. Our results in the second quarter were solid, with adjusted EPS of CAD1.90, up 4% year-over-year, and total Bank adjusted net income of CAD1.8 billion, up 6% from last year. Retail adjusted earnings of CAD1.6 billion were up 5% from last year and Wholesale net income was CAD220 million, up 12%. The Corporate segment had a loss of CAD26 million. It was a solid result in a challenging environment.

Please turn to slide 5. This slide presents our reported and adjusted earnings this quarter, with the difference due to three items of note. None of these are new this quarter.

Please turn to slide 6. Canadian P&C delivered a good quarter, with adjusted net income of CAD877 million, up 5% year-over-year. Excluding the MBNA credit mark release and one extra day last year, revenue grew by 4% and net income grew by 9%. Loan and deposit growth were good this quarter. Real estate secured lending volumes were up 4% versus last year and we maintained our leadership position in this category. Business lending growth was strong, up 14%. Retail deposits increased 5% and business deposit growth was 8%.

Credit performance continues to be strong, with PCL in personal banking down CAD52 million from last year, primarily due to better credit performance, enhanced collection strategies and low bankruptcies. Business banking PCLs were CAD23 million higher due to a provision for a single client.

Adjusted expense growth was 1% year-over-year as volume growth, merit increases and investment in the business were largely offset by broad-based productivity gains.

NIM was stable versus Q1, up 1 basis point sequentially due to seasonal factors. Our expectation remains that NIM will decline by 1 to 2 basis points per quarter. For the first half of 2013, earnings increased by 8%, which was within our expected range. We expect similar year-over-year growth in the second half, a very good result.

Please turn to slide 7. It was a solid quarter for our Wealth and Insurance businesses, with good underlying growth fundamentals in both businesses. Wealth earnings were up 2% year-over-year due to strong fee income driven by good growth in client assets and market appreciation. We closed the Epoch acquisition in the quarter. Excluding certain upfront costs related to Epoch, earnings grew 8%. We expect that Epoch will be relatively neutral to 2013 earnings but accretive in 2014.

Insurance earnings were down 6% versus last year. The most significant factor was higher current-year claims from a more severe winter. Wealth and Insurance expenses increased by 9% versus last year, primarily due to Epoch integration costs, higher variable compensation and increased project spend, partially offset by decreased expenses from the sale of the US insurance business and productivity initiatives.

The contribution from TD Ameritrade was CAD53 million, up CAD6 million or 13% from last year. This quarter, TD Wealth and TD Ameritrade collectively passed the CAD1 trillion mark in consolidated assets, reflecting TD's market leadership in wealth management in North America. We expect a very good year for the Wealth business driven by continued client asset growth and prudent expense management. In Insurance, we expect continued good premium growth, although the business faces increased uncertainty including the impact of past and future Ontario auto reforms and lower demand for credit-related insurance products. It is possible that our previous guidance of 7 to 10% growth off normalized 2012 earnings of CAD600 million may be difficult to achieve.

Please turn to slide 8. The US Personal & Commercial bank results were good – a new record, in fact, with adjusted net income of USD 392 million, up 9% from last year. The increase was primarily due to strong loan and deposit volume growth, improved credit quality, and a lower effective tax rate due to higher levels of tax advantaged investments, partially offset by lower margins. During the quarter we completed the acquisition of the Target credit card portfolio. Revenue and PCL related to Target are reported on a gross basis in the income statement. Non-interest expenses include TD's operating expenses related to the business and amounts due to Target under the credit card program agreement and represent TD's net share. Revenue increased by 7% year-over-year due to the inclusion of credit card revenue from Target, strong organic loan and deposit and fee growth, offset by lower margins. Excluding Target, average loans were up 14% year-over-year, with a 22% increase in personal loans and a 9% increase in business loans. We added CAD6 billion in Target credit card outstandings this quarter. Average deposits were up 10%.

Our net interest margin was up by 39 basis points from last quarter, primarily due to the mid-quarter Target acquisition. If you exclude Target, our NIM was comparable to last quarter. The drivers of the NIM were very similar to the factors discussed in Q1. We expect our margins, excluding Target and accounting noise, to continue to compress in the 5 to 7 basis point range per quarter. Low interest rates, shortened duration, security sales and the competitive loan environment will continue to exert downward pressure. Excluding Target, PCL was down versus the same quarter last year, primarily due to improved credit quality of commercial loans and lower provisions related to acquired credit-impaired loans. Adjusted expenses were up 10% versus last year, due entirely to increased expenses related to Target. This is a good outcome, given our current level of investment. Excluding Target, expenses were down. All in, a good result for our US business. For the second half of 2013, we're on course to deliver earnings at a level consistent with the first half.

Please turn to slide 9. Wholesale delivered solid results across our franchise businesses. Net income of CAD220 million was up 12% compared to the same period last year, due to higher trading-related revenue and lower non-interest expenses, partially offset by higher taxes. Trading-related revenues were CAD353 million in the quarter on higher fixed income and credit trading activity. This is ahead of our normalized expectation, which remains at CAD300 million per quarter. Non-interest expenses were down 2% compared to last year, mainly due to lower variable compensation. Annualized ROE for the quarter was 20.9%, above our ROE target range of 15 to 20%.

Please turn to slide 10. The Corporate segment posted an adjusted loss of CAD26 million in the quarter. Results were in line with last year. Higher net Corporate expenses were partially offset by favorable other items. A general allowance release of CAD19 million after tax was included in the Corporate segment this quarter.

Please turn to slide 11. We remain focused on the rate of expense growth across the Bank and are pursuing initiatives that will permanently improve productivity. We continue to target core expense growth of less than 3% for 2013. This excludes the impact of acquisitions and FX. We are on track to meet this goal. We are making progress on managing expense growth. Q2 core expenses increased 3% from last year, after absorbing higher pension costs, increased merit and investments in the business. On this basis, Canadian P&C posted 1% expense growth, while expenses in US P&C and Wholesale declined versus last year. For 2014, we are targeting core expense growth at an even lower rate and our planning process is well underway.

Please turn to slide 12. Our Basel III Common Equity Tier 1 ratio was 8.8% in the second quarter. Our capital ratio was unchanged from last quarter after closing the Target and Epoch acquisitions. Our capital position also includes the OSFI reprieve on the implementation of the CVA add-on charge described last quarter. In view of our demonstrated ability to generate capital, we've announced a 12 million share buyback program, which translates to roughly CAD1 billion in capital. Overall, we remain well positioned for the evolving regulatory and capital environment.

Please turn to slide 13. We've had a number of requests from analysts and investors to provide more color on two key areas – first, the impact to NII of security sales in the US, and second, our NII upside to future interest rate increases. As you can well imagine, there are many assumptions, variables and complexities in our NII models which we do not intend to disclose in detail. However, I will provide you with a simplified view to give you a sense of the upside to rising rates and to demonstrate that it doesn't take a big change in rates to have a fairly big impact on our NII.

As I outlined last quarter, we started a program to shorten the duration of our balance sheet and to position TD for an increase in interest rates. This strategy also locks in a portion of the unrealized gains that are part of our capital under Basel III. We are currently triggering securities gains of CAD60 million to CAD80 million per quarter by selling longer-dated securities from our investment portfolio. Selling these securities triggers a gain, but results in the proceeds being reinvested in lower-yielding short-term securities, which puts pressure on future NII.

On the NII upside, the simplest way to think about it is to segment TD's total non-maturity deposit base of CAD275 billion into fixed and floating balances. We have approximately CAD150 billion in float rate deposits which would be quite sensitive to an increase in short rates. A 25 basis point increase in short rates would increase NII by roughly CAD200 million per year, assuming a portion of the rate increase goes back to the customer. The other CAD125 billion of deposits are in fixed rate instruments. These deposits would re-price gradually over a period of time. For every 25 basis point increase in long rates, our NII pick-up would be approximately CAD100 million per year. Taken together, a 25 basis point increase in interest rates on our CAD275 billion in deposits could drive an NII increase of approximately CAD300 million per year – significant upside when rates rise.

This is an overly simplistic way of looking at the upside, but it does provide you with a way to think about rate impacts. Having said all of this, we are not assuming a rate increase any time soon. Our financial plans assume zero rate increases for at least the next two years, which we believe is a prudent way to run the Bank. In the US, NIM may compress a bit more, but strong volume growth will help offset this negative impact. Revenues should continue to grow as fee income, asset sales and balance sheet optimization, including asset acquisitions, will fuel growth. We believe that these actions balance the benefits of reduced capital volatility and interest rate upside with near-term pressure on NII.

With that, I will turn it over to Mark.

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

Thank you, Colleen, and good afternoon, everyone.

Please turn to slide 14. Once again, this quarter was quite strong from a credit perspective. Excluding the impact of the Target acquisition, Bank-wide PCL rates remained stable quarter-over-quarter, representing the lowest rates experienced in more than five years. In Canada, while we continue to closely monitor the high level of consumer indebtedness and the residential real estate market, we're not seeing any concerning trends in our credit metrics. To the contrary, during the quarter, gross impaired loans declined in each of the personal credit portfolios. Delinquency improved across the board. Canadian credit cards continued their positive momentum, leading to a further reduction in loss rates. And commercial and wholesale loss rates remained at historically low levels. To sum up, credit quality of the Canadian personal, commercial and wholesale credit portfolios remains very strong.

Turning to the US, we are seeing continued improvement in the legacy portfolios, as evidenced by a reduction in loss rates when adjusted for the Target acquisition and the normal course buildup of reserves for the growing indirect auto portfolio. Key portfolio highlights include: the quality of residential mortgage originations remains strong; while we experienced some lumpiness in commercial impaired formations during the quarter, the improving trend remains on track; and, the acquired portfolios continue to perform well within our expectations.

Now, I'll turn the presentation back to Rudy.

QUESTION AND ANSWER

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Great. Thanks, Mark.

We'll now open it up for questions.

Peter Routledge – National Bank Financial – Analyst

Question, Colleen, on interest rate sensitivity. I appreciate your disclosure, and you also have a line in the supp pack where you show the impact of a 100 basis point rise in rates on net income. And that number has gone from something near zero to around 4%, let's say, which is not massive but it strikes me as somewhat uncharacteristic of TD and TD's asset and liability management principles. Maybe can you talk about how you're thinking about that sensitivity? I'm not suggesting it's a bad thing – it's just different from where TD was traditionally on that issue.

And, two, how high could that number get? It's CAD 262 million now in your supp pack. How much higher could that get before you start to pull back?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Peter, I'm going to start off, just to respond to your question about the supp pack and then Ed's going to talk about the broader philosophy. The numbers in the supp pack are really not representative of what would happen in the case of a rate change. And they really assume that when rates move, everything moves up. In fact, customer rates move at the same rate and, obviously, market rates move.

So, it's not really a helpful number in terms of simulating what would happen with rate increases. And obviously, it doesn't model in all the other variables around customer behavior, et cetera. So the models that we have internally, and again the many variants of that, give you, I think, a little bit more of an idea of, again in this case, what we're modeling, 25 basis points.

Having said that, that isn't linear. Again, because even if you think about what happens if you go to 50 or 100 you don't necessarily take that multiple again. You have you to factor in all of the changes in behavior, et cetera, and this isn't just a NIM game obviously. These things affect volume as well.

What we really wanted to do through this process is just, without trying to drill too much into our models, at least give you an indication that there is a fair amount of NII upside. I think on the philosophy, Ed would like to walk through that.

Ed Clark – TD Bank Group – Group President & CEO

There's no question that as we shorten up the duration, we start affecting that number. The way you're required to report that number, what it basically says is that the US would go to a minus 80 basis point interest rate. You can come to your own conclusion if that's a realistic number to assume – we don't believe it is.

And so in turn, in terms of our own models, we look at a world in which definitely the Canadian rates could come down. And it's possible that the US goes down to zero, but we think you're starting to get into quite a different world if you say you're going to run the bank on the assumption that we're going to have large negative interest rates in the United States.

So as we shorten up the duration, though, that number does expand. But what we do is – the internal measure we use is a measure that says, let's have a base of zero for the United States and a number somewhat higher than that for Canada and hold that as our constraint of how short we'll actually go duration.

The reality is, it's a judgment call. As you shorten up duration, you are running a higher risk that interest rates will fall here, but you are also getting potentially three to four times upside if interest rates start to move. We're saying explicitly to the market that to hold your position – to say I want it to be neutral, which means go out long duration here – we think is the wrong positioning for the Bank. And that's why we're trying to be explicit with you that, yes, we've shortened duration and we are willing to give up earnings in the short run to have a better percentage leverage on interest rates rising – constrained, though. We have an internal measure that's not the one in the supplementary pack.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

We'll just go across the row. So, John Aiken.

John Aiken – Barclays – Analyst

Ed, in terms of the share repurchase program, keeping in mind TD's historic prudence on capital, but … when we take a look at what you've announced today is lower than what your peer group has done. How aggressive can we assume that you're going to be on the share repurchase program? And, secondarily, can we characterize this as underscoring your recent statements about large acquisitions in the US?

Ed Clark – TD Bank Group – Group President & CEO

First off, I would say when we announce something, we'll probably actually do it, so you can expect that we will actually implement this buyback program rather than announce one. But I think we are in a different position than the other banks, and so we're not going to try to imitate the other banks. They're running their strategy, which is what they believe is good for their bank, and we're running ours.

When you start with the fact that we do earn a higher rate of return on risk-weighted assets or regulatory capital, however you want to mention it, so, therefore, we have a superior ability to generate capital – so in some sense, we have a bigger issue than everyone else. But corresponding to that, we also have more opportunities.

And so I think we, as you know, we have a balance sheet in the United States that's long deposits and short assets. We've been very, very prudent and we'll continue to be very prudent, but we're obviously in the market all the time to say, can we in fact acquire more assets because clearly our return on the US investment would be significantly higher if we could fill in that balance sheet.

Right now, those are difficult to find at returns – risk-adjusted returns – that are acceptable to us. But we wouldn't want to run our capital down to a point where we couldn't afford to buy one – where we had to issue shares for this kind of small … these tend to be small acquisitions. I'll put Target as a small acquisition, sort of order of magnitude. You don't want to have to issue shares.

So we would probably carry a somewhat bigger cushion. We probably have a smaller cushion in terms of the volatility of our capital than some of our competitors, but we would want more of a cushion to be able to do small asset-backed positions. In today's market, we don't see large acquisitions of anything that's of interest to us. I think what I'm trying to say in my statement, when we look at that, we certainly wouldn't rule it out that – as we look at all those factors, as we generate this capital faster than other people, that we would decide, well, the best thing to do is to give it back.

And I do think there's a change in the world that we're in is that we're in a world, a fairly capital intensive world, and so lugging excess capital around waiting for a deal doesn't seem like a very good thing to be doing and so if we have a cushion that will allow us to do small acquisitions, I don't know why we would keep a whole lot more than that.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, John. Go across, Andre.

André-Philippe Hardy – RBC Capital Markets – Analyst

Andre Hardy, RBC Capital Markets. Question on the credit card business. It used to be a business that you described as under-penetrated – you made that statement again in justifying the MBNA acquisition in Canada. Is that still a business you view as being under-penetrated? And if, yes, is it the right time to be looking to increase that business, given the high consumer leverage?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

I'll take that. I'd say in Canada we used to talk about it being underpenetrated relative to its market share versus our sort of traditional 21/22% share. We now have number one share in the credit card space, so we would see that as being, yes, still a growth opportunity, but certainly not one that we would have had, say, five years ago. The question for us is North American, and in that case we certainly believe that there are great growth opportunities in the US ahead of us – if nothing else, other than just penetrating our existing customer base and our US store base.

Ed Clark – TD Bank Group – Group President & CEO

I guess the one follow-up comment I'd make is that the MBNA turned out to be a terrific acquisition for us. So it's been a very good acquisition. And I think it was a factor in our winning the Target deal, combined with Target, which also has turned out to be a very good deal.

It's clearly put us in the position where there are more opportunities coming our way in North America. And, given my earlier comments, we have a deposit-rich bank and so that's obviously an area that we run prudently. And I think there it's a matter of building your operational capability to take advantage of the opportunities that are coming our way.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Andre. Well go front row here.

Michael Goldberg – Desjardins Securities – Analyst

Michael Goldberg, Desjardins Securities. To get back to capital for a second, do you want to reiterate what you probably said in the past? How does continuing dividend growth fit into your capital plans in addition to the share buyback?

And in relation to looking at the asset expansion, if you are going to do something and you've been successful with auto loans, cars and mortgages in the US, would it most likely be in those areas? Or would you want to start adding to your capability in US C&I?

Ed Clark – TD Bank Group – Group President & CEO

I'll start and then I can let Bharat. First off, our dividend policy hasn't changed. As you know, it's a pretty good news story for the shareholders that we said that we would – we moved our dividend payout ratio range and so we're going to get ourselves more in the middle of that range.

As always, we're going to do it the TD way, which is just every year methodically go up to that range, but that implies that our dividends will grow faster than our earnings per share, which is exactly what has been happening. But there's probably a couple years left where that will continue to happen.

We've always separated out your dividend strategy and your capital strategy. If you have surplus capital that you don't think you're going to use in the near future, then buy back shares. If you have great earnings growth, you can have great dividend growth. In our case, it's supplemented by the fact that we decided to change the payout ratio.

I think we don't rule out entering the new spaces of asset generation. But clearly you have to be a lot more careful about doing that – in a sense buying asset generation capability that you don't have – than you are expanding it where you already have demonstrated capabilities. So your threshold of returns would be obviously much higher where you're going into a new piece of territory than it would be if you're just adding onto a portfolio.

Bharat Masrani – TD Bank Group – Group Head, U.S. P&C Banking

Michael, the only thing I'd add is that there are, apart from the three asset classes you talked about, there are other areas that are a focus for us. We already have existing capability but we're adding to those capabilities and those would be in healthcare. We have an interest in building that business even more than what we have today.

The other one is asset-based lending. We do have a small team that we've been adding onto it.

And the third one that has become a new focus area for us, given that we have TD Auto Finance, is dealer floor plan in the US. So those are the types of businesses where we are building out capabilities, and if there were suitable portfolios or assets available in those areas, we would certainly look at it seriously.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Michael. Jason?

Jason Bilodeau – TD Securities – Analyst

Jason Bilodeau, TD Securities. For Tim, your residential secured lending growth was sort of 4% percent year-on-year. I don't want to slice this too finely, but if you marry that with Ed's comments that it looks like housing is in a process of decelerating, could we see this number be slipping into low single digits in the back half of the year? And how does that frame up for your revenue picture? I know we haven't seen the rest of the group yet, but how do you feel your market share in that category has been performing in the last few months?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

I'll start with the second question. Market share actually in overall real estate secured lending is actually basically flat, slightly up year-over-year, so might be an industry type statement. Yes, we have seen a deceleration in real estate secured lending growth, probably slightly faster than we expected if you'd asked us this time last year. But we're still expecting that number to be in the, call it, high end of the middle, call it 3 to 5, 4 to 6, somewhere in there. But it's decelerating, absolutely.

Jason Bilodeau – TD Securities – Analyst

And 1-2 just seems to you to be a down side case?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

Yes, that's certainly not this year.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Jason. John?

John Reucassel – BMO Capital Markets – Analyst

John Reucassel from BMO Capital Markets. Don't know if it's a question for Colleen or Bharat. Non-interest income in the US business – looks like it was up CAD30 million this quarter versus Q1 and CAD50 million, call it, versus Q2 last year. Is that all Target related? And Target was halfway through the quarter so what else is going on there or should we expect a bigger jump coming in this number for the rest of the year?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

If you look at the quarter-over-quarter increase, that was largely Target. And to your question, Target – we really have half a quarter of Target now so you'll see the full effect in Q3.

John Reucassel – BMO Capital Markets – Analyst

So was there – not to put too fine – so instead of CAD30 million, was there CAD60 million additional non-interest income fees on this Target portfolio per quarter if I looked at it Q1…

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

The increase was about CAD40 million, I think, quarter-over-quarter and, yes, you double that for the full impact of Target on a full-quarter basis.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, John. Anyone else in the room? Darko.

Darko Mihelic – Cormark Securities – Analyst

It's Darko from Cormark Securities. Just wanted to follow up with Tim on the residential mortgage question.

Really what I'm after here is I just want to understand what's happening on the ground with respect to Ed's comments earlier about the government changes and what we're seeing at the ground level. I'll give you an example. Table 18 of your Shareholder's Report provides for us the breakdown of your insured and your uninsured residential mortgage portfolio.

If you compare that to last quarter, what you see is your insured actually went down and your uninsured portfolio went up, and not by an immaterial amount. That would sound surprising to me relative to what would have been the behavior, say, a year or two ago. Is the first-time home buyer being kicked out here in the market?

Can you talk to where these originations are coming from? Is the broker origination, the broker-originated mortgages, is that slowing as a percentage of overall originations? I'm just looking for some sort of a flavor for what the government changes have brought about.

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

I'm tempted to just say it's moderating as expected. (laughter) But I think there's an expectation of a more fulsome answer. If you want color on the ground and you asked a bunch of different questions in there. We're now into what I would consider to be a late spring market.

If you step back and say what's been happening over multiple number of years, as Ed said, we've been quite concerned about the overall growth rate of real estate secured lending for the last number of years. And so the regulatory changes that have actually been taking place over a number of years, quite prudently implemented over a long period of time, are actually having almost precisely the effect that we would have expected, which is a slow landing.

So to your point about things like what's happening with the first-time home buyer and origination shift, we don't actually track … there's not good stats on first time versus not, but clearly, because of the changes around the high ratio mortgage versus conventional, all the mortgage originations are down year-over-year, but conventional are down less. So in other words, what you would ascribe to be first-time home buyers have actually had more of an impact, which you could say is probably bang-on what the regulatory changes would have expected.

Overall, we're clearly seeing that even notwithstanding a low interest rate environment, and obviously there's been lots of conversation about that rate, that consumers are not backing up the truck and actually creating a frothy housing market as low interest rates are usually incenting them to do. And in other asset classes, obviously, the growth rates are even slower. In terms of channel originations, all channels are down year-over-year. In our particular case, our broker channel is down less, but that I would ascribe much more to service improvements and changes we've made in our own channels as opposed to an industry phenomenon.

Pricing, from that point of view – I would say pricing is aggressive, but not unduly so for a spring market. And clearly it was a cold spring, so that does have an effect on the activity as recently as just last month and early this month. There's some speculation as, is there going to be a resurgence? But if you talk to Craig Alexander at TD Economics, he would say our expectation is still for having a fairly tepid spring mortgage market. So, again, leads us to believe that there's a moderation in effect.

And so we continue to believe that there will continue to be a soft landing, generating the sort of year-over-year growth that we've been talking about going forward. I think maybe the real question is, what if we're wrong? What if in fact that there is a crisis and in fact that it's not a soft landing but it is an asset bubble that bursts.

To that end, we obviously spend a lot of time stressing our portfolio. As we said multiple times, we do stress tests to quite extreme cases including the worst case scenario going back to the depression in Canada. Every time we do that, and we've become quite expert at doing stress tests, it continues to show that in Canada, given the nature of this business, given the government guarantees and the insurance portfolio, that we continue to make money in Canadian banking overall – we don't go into the negative.

So on the one hand, we said we were worried because we think what's good for Canada is good for TD. On the other hand, three or four years into the changes, it's moderating exactly as expected. But if we're wrong, at whatever percentage of likelihood that is, then we still feel good about the stress test. Not sure if Mark has anything to add.

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

The only thing I would add on the stress tests, it's really not the mortgage portfolio that you're worried about. And that if you paint that type of scenario where you have such a reduction in house prices across the country, it's really your other credit portfolios that would be more of a concern – the unsecured credit portfolios, then your commercial portfolio. So we stress that as well, and really to the deepest scenario that we can paint, the Canadian operations remain profitable. It's not a good picture but it's a profitable picture.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Operator, why don't we go to the phones now, please.

Operator

Robert Sedran from CIBC.

Robert Sedran – CIBC – Analyst

Tim, I want to come back to the credit card issue. There's been a fair bit of chatter in the market about the travel cards and loyalty programs and such. I wonder if you can just give us a sense of whether you're satisfied with your positioning in that segment – how the card has been performing. And then, I wonder if I can paraphrase your earlier answer to the credit card question as, we definitely are looking to gain share in that business, but perhaps not necessarily in Canada.

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

We're quite comfortable with our travel card portfolio, its growth rate. But as opportunities come up and for market share expansion, whether it be in the US or in Canada, we continue to be interested. We think this is a great space, even at this point in the credit cycle.

Robert Sedran – CIBC – Analyst

What segment of the credit card market is growing more rapidly, Tim?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

I would say the high-end spend cards. Canadians love their point programs and they continue to use them probably more so than almost any other nation on the planet.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Rob. Next question, please.

Operator

Steve Theriault from Merrill Lynch Canada. Please go ahead.

Steve Theriault – BofA Merrill Lynch – Analyst

Capital markets question for Bob Dorrance, please. So, Bob, a nice trading number this quarter, exceptional really on the fixed income side and, from what I can see, without any big jump in vol, without any big jumps in originations. I was hoping you could tell us, is there something specific to TD here you can highlight for us on the fixed side or was the environment just better than what I think we've been expecting here for Q2?

Bob Dorrance – TD Bank Group – Group Head, Wholesale Banking

Okay. I'm not sure I can say whether there's anything specific to TD because I haven't seen other results. As you mentioned, the strength in the trading results was driven by the interest and credit category.

The real tailwind in the market thus far during the year, and it's globally, has really been in the credit space, broadly speaking. So corporate credit, financial institution credit have all experienced spread compression or price increases, so good volumes in secondary markets as well as very good volumes in origination markets. When you combine strong origination of credit with positive trends, it's really the secret sauce to having good trading results in that marketplace.

Steve Theriault – BofA Merrill Lynch – Analyst

So nothing unusual, as far as you can tell, it's just a nice supportive environment.

Bob Dorrance – TD Bank Group – Group Head, Wholesale Banking

No, I think just a strong supportive environment in credit across the spectrum, high yield, investment grade, leverage loan. So all those markets, as I think many of you have been pointing out in your reports, are very strong. The participation in that is really what's driven our results.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Steve. Next question, please.

Operator

Sumit Malhotra from Macquarie Capital.

Sumit Malhotra – Macquarie Capital Markets – Analyst

Two hopefully quick ones for Colleen. Lot of talk about expense management and how the Bank has put an increased emphasis on that coming into what we expected to be a slower growth revenue year. If I look ahead to Q3, in the last two Q3 conference calls you've told us about a large expense uptick that we should expect in Q4.

If I look ahead to that, in planning, certainly planning through expense management much more coming into this year, has it developed to the point where we're not going to see that kind of increase? Do you expect it to be more of a steady state as far as your expense growth is concerned?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

So, Sumit, we're working very hard to even out our expenses over the course of the year, in particular as it relates to initiative and project spend. And I know the last couple of years we've had a bit of that snowplow effect in the fourth quarter and we'd like to try to remedy that. I think the consequence this year is obviously as I think we've had some success in doing that, then our expense growth rates earlier in the year look a bit higher. I'd like to show you better proof points at this stage in the year around what we're going to achieve on a full-year basis.

So my sense is that probably in Q3, just given that phenomenon, you'll probably still see a bit of an elevated rate of expense growth. So I doubt on a Q3 year-to-date basis I'll be showing you a rate of growth at 3%, but certainly on a full-year basis. So in other words, what I'm saying is we are really actively managing our expenses so that we don't have that kind of a blip in the fourth quarter.

So again, in fact, I would definitely expect that expenses will be down in the fourth quarter versus the prior year. So that's what we're looking at, at the moment and I think some very good efforts to I think – I believe that at – spreading that expense just means that we can spend that money more wisely and more prudently and we've made a lot of progress on that.

Sumit Malhotra – Macquarie Capital Markets – Analyst

I agree. That makes sense. The second very quick numbers one for you is within the US segment. So somewhat down the same path John Reucassel was on.

When I look at the Canadian dollar adjusted expense growth sequentially it's about CAD175 million. I know you had warned us that the Target accounting would be somewhat different. So of that $175 million linked quarter, how much of that would you attribute to Target and whatever that number is, is it fair to say that it just doubles next quarter with the full-quarter impact?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

So why don't I just do a quick line-by-line review of Target. I think it would just be helpful to have it on the record.

And we haven't gone into more detailed disclosure on this, just for some competitive pricing reasons.

I'd prefer to use US dollars because it's more directly comparable. If you look at quarter-over-quarter in US P&C, I'd say if you look at the revenue increase quarter-over-quarter, you could sort of chalk that up pretty much entirely to Target. If you look at the PCL line, our PCLs were up. If you exclude Target, actually our PCLs would be down on a quarter-over-quarter basis.

And if you look at our expense growth, which was about $150 million in US dollars, about two-thirds of that would be Target related and the other increase was really more timing related to expenses. So if you strip out the Target-related expenses, in fact our expenses were down about 1% on a year-over-year basis in the US, which I think was a fantastic result when you consider all of the investments that we're making in that franchise. If you look at the Target contribution overall, I know when we announced the deal we had talked about a 1% ROA on the deal and I'm happy to say that we're actually achieving a result that's in excess of that number. So we're actually quite pleased with where we started off with Target in the first couple of months.

Sumit Malhotra – Macquarie Capital Markets – Analyst

That's very helpful. Any impact on the tax line because of Target or is that 15%-ish level in the US a reasonable run rate for your business right now?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

So, no, it didn't have any impact on the tax line. But I would just remind everyone that in the US, first of all, our tax rate is sustainable roughly at that level, I'd say probably in the sort of 15 to 18% effective tax rate. And that effective tax rate has come down certainly versus last year and a little bit quarter-over-quarter and that's because we're doing more of these tax advantaged loans and investments, partly which is a requirement under the Community Reinvestment Act.

The way that works from a reporting standpoint is that actually creates losses at the revenue level and all of the benefit goes into the tax line. So even just the way the mechanics work as you ramp up that business, would suggest a lower effective tax rate. But I would assure you it's sustainable at roughly that level. And so what that does, when you look at the all Bank tax rate – and I would say the best way to look at that is on the adjusted TEB basis, which it may look a little low – but I would say partly it's a decline in the US rate, partly Wholesale was down a bit and then mix of business is really driving that rate.

I've had a number of questions today. So I thought I would just expand my answer on that.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

We're running a little tight on time, so I'd ask that any remaining questions to be fairly brief if possible. Next question, operator.

Operator

Gabriel Dechaine from Credit Suisse.

Gabriel Dechaine – Credit Suisse – Analyst

Commercial real estate in Canada, you've got CAD21 billion of loans. It's grown pretty fast. Can you just tell me what's been driving that growth and it's in two buckets, residential and nonresidential? And then quick one for Al Jette if he's in the house. Page 17 on the supplement, mortgages securitized and retained, it's up CAD7 billion quarter-over-quarter. What's driven that? I guess relatedly, are you securitizing loans with the anticipation of using more capacity in the CMB program because industry growth has gone down, something like that that might help your NIM down the road?

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

Gabriel, it's Mark. I'll address the real estate question. As you point out, on the Canadian residential real estate, we have about CAD13 billion. That consists about three-quarters – or roughly about that amount – is operators of multi-unit residential buildings, they're apartment buildings. They would all be secured with mortgages. The maximum loan to value would be 75% but it would average below that. And it would all generally be recourse.

The balance of it, of about the remaining 25 to 30% would be the residential home builder/developer, and our condo exposure would be in that area, would be in that segment as well. Again, this is an area that's remained relatively constant over the years for us. We have a pretty constant customer base. We continue to do transactions that we think are strong and there are strong transactions out there. And the loan quality across that portfolio is quite strong and remains strong.

In terms of the nonresidential of about CAD8.4 billion, I'd say 60 to 70% of that is commercial mortgages. So they would be against income-producing properties, secured by mortgages. Maximum mortgage would be loan to value at origination but the average would be closer to about 65% and they would be recourse. The balance of that is generally where we deal with a real estate company that wants an operating line of credit that we secure by taking a charge on real estate within our normal real estate lending guidelines. Again, the quality in both of these portfolios is, well, as across the entire Canadian commercial, as I indicated earlier, is very strong but we've had a very good track record in these two segments as well.

Gabriel Dechaine – Credit Suisse – Analyst

So three quarters of that CAD13 billion is apartment buildings basically?

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

Correct, with the first number, yes.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Just speaking on behalf of Al Jette here, the increase in the MBS holdings that you called out, Gabriel, was mainly in Canada, and reflects liquidity management actions in part related to various wholesale funding maturities later in the year. So the increase doesn't really reflect any change in strategy in terms of the way we're running the bank.

And just in the interest of time I'm happy to follow up with you later if you want to probe that a bit more. It's pretty straightforward, though.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Gabriel. I think we have time for one last question, so, operator.

Operator

Mario Mendonca from Canaccord Genuity.

Mario Mendonca – Canaccord Genuity – Analyst

If you could help me think through some of your disclosures. First on slide six in the presentation, you referred, and this very likely be for Tim again, you referred to 4% revenue growth, if you exclude the MBNA credit mark release and 1% adjusted expense growth. I don't think the message you're sending is that you think 3% operating leverage in domestic retail is reasonable. Would that be a fair statement?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

No, that's right. If you look at the headline numbers, you're essentially saying, it looks like it's flat but in actual fact it's more like a point and a half. And I guess if you're asking how do I feel about the operating leverage going forward in the second half, I believe that that's achievable at that level even at lower revenue growth rates.

Mario Mendonca – Canaccord Genuity – Analyst

So the 1.5?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

Yes, about there.

Mario Mendonca – Canaccord Genuity – Analyst

If I could just squeeze in one other quick one that threw me off. In the presentation page 25 you also referred to operating leverage – not operating leverage, I'm sorry, you refer to loan to values in domestic mortgages or real estate secured as about 40%, sorry, just bear with me, 47% average current loan to values. But in the Report to Shareholders, also page 25, the loan to values look obviously very different.

What difference are we looking at here? The newly originated, newly acquired? Is that the difference? If so, what does newly mean? What time period are you talking about.

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

Yes, the difference is the latter is originations and that would be during the last quarter.

Mario Mendonca – Canaccord Genuity – Analyst

Oh, so everything disclosed on page 25 is a last-quarter disclosure?

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

On 25 of the –

Mario Mendonca – Canaccord Genuity – Analyst

Report to Shareholders.

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

Yes.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thank you very much and, Ed, over to you for final remarks.

Ed Clark – TD Bank Group – Group President & CEO

Great. Thank you and thank you for staying on for a little bit past 4 o'clock here. So I guess our main message is that we foreshadowed most of the issues that are in the industry here and that we've ended up so far in the first half about where we expected.

If we look forward, we believe that if interest rates stay flat, which we keep underscoring it has to be a planning assumption, that it isn't a forecast, we probably have one more year of NIM compression and then by that point, by the end of 2014, we will have actually worked through the NIM compression for the Bank and so we won't have this downward pressure. I think there is a possibility that the US recovery, if it keeps on coming on as strong, that that assumption that flat rates are here for that period of time will turn out to be erroneous, but it's the right basis to run the Bank. And we are adjusting to that environment and we have to adjust in terms of how we manage expenses and how we manage the expense structure of the Bank.

And we have to adjust in how we manage capital and we want to do that in the TD way, which is a way that says, but at the same time we're not going to give up future growth. So we're willing to take short-term earnings hits as we are on managing our duration to position ourselves when rates finally move, then we're in a good position. But we're also going to keep on investing in the business because we're about building great franchises. And getting this balance is a hard thing to do in the environment but as I said before that's what we get paid to do for a living. Thank you very much.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thank you, Ed. With that we will end the meeting. Thank you very much for your time today. Appreciate it. Good day.