TD BANK GROUP

RBC CAPITAL MARKETS CANADIAN BANK CEO CONFERECE

JANUARY 14, 2015

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PARTICIPANTS

Bharat Masrani
TD Bank Group – Group President and CEO

Darko Mihelic
RBC Capital Markets – Analyst

PRESENTATION

Darko Mihelic – RBC Capital Markets – Analyst

Okay, great. Our next speaker is Bharat Masrani. He was appointed the Group President and Chief Executive Officer of TD Bank on November 1, 2014 and he's had more than 27 years of banking experience and is a member of the TD Bank Group of Directors. Most recently, he was the Chief Operating Officer for TD Bank. I want to welcome Bharat to the stage.

Bharat Masrani – TD – Group President and CEO

Thank you.

Darko Mihelic – RBC Capital Markets – Analyst

The change in format, as you know, is there are some slides that we're going to start with. Let me just put it up actually.

Bharat Masrani – TD – Group President and CEO

You call this a fireside chat. I always look for the fire, I never see one.

Darko Mihelic – RBC Capital Markets – Analyst

Well, this is now a "fireslide" chat. We don't want to have flames up here with the slides.

Just before we begin, a couple of things here. Bharat's comments may contain forward-looking statements. Actual results could differ materially from forecast, projections or conclusions in these statements. Listeners can find additional details in the public filings of TD Bank Group.

Maybe we'll start with the oil and gas and exposure to energy. It actually looks on the surface as though your exposure is modest. But maybe we could start with a discussion of a breakdown of your energy portfolio, the oil and gas, if you can give us some ideas and what's actually in there. And if you're actually seeing any stress yet in the direct exposure?

Bharat Masrani – TD – Group President and CEO

Yes. I'd say our book would comprise of three or four different segments, as you probably have heard from others. You have what I'd call the big integrated players and then you have what I'd call more of an investment grade type of a portfolio. And then thirdly you'd have the producers, the E&P sector. And then, I think you also have in your numbers, though I can't see the slide from here, is pipelines. So those are the types of different sectors and we are no different than what you'd expect from a major player.

In our case, you rightly point out, I worry less about the direct impact of the lower oil prices because of the size of our exposure, the way we lend to the sectors that are on what I'd call the non-investment grade, the non-integrated players. A lot of our exposures would be on a borrowing base which is secure, where the Bank has the ability to reset the amount of credit we would make available to those customers, and that is done on an ongoing basis. So I'm not as worried. Obviously, any loss is not good. But in the overall scheme, the direct impact on TD should be manageable from that perspective.

But I picked up the tail end of your last presenter – it's the second order effects you worry about. Now in our case, we stress test all our portfolios under different scenarios. As far as oil goes, we have done a lot of work at around $40. And with that, the numbers, at least for now, appeared to be manageable. Again our exposure to what we call the Prairies, which includes Alberta, again, is not as big perhaps as people might have expected. The offsets would be in Ontario and Quebec – in Ontario TD is outsized as everybody would realize – so that's a good thing.

The second part I would talk about Darko. I actually flew in from the UK last night where TD Securities hosts an energy conference every year. We had about 100 clients there, Canadian clients, North American clients and about 100-odd investors from Europe. And some things did come out which I thought was interesting. I'd say the mood was not as pessimistic as you would have expected from these customers, and some things that I picked up which I thought I'd share with you is, number one, these companies have been through these volatile times before. A lot of them actually have tried and done well when there is volatility of the type that we are seeing now. In fact we had prices of about $35 in 2008 and 2009.

Secondly, the Canadian dollar has been somewhat of a mitigant. Third thing that I learned – and they had a lot of detail on that – a lot of the Midwest refineries in the U.S. have been re-tooled where heavy Canadian oil is the supply of choice and that's obviously the positive from them. And then obviously the spread between WTI and the Canadian Western prices has narrowed a bit, that should help them too.

There are some positives there that we sometimes don't talk about as much. But to get back to your point, the second order effect is the slowdown in consumer sentiment, what happens to loan growth in Alberta? What happens to people's ability to buy new homes and the growth? That's the part that we're worried more about.

Darko Mihelic – RBC Capital Markets – Analyst

Can we drill down into that a little bit? When you think about $40 oil, and you stressed it for $40 oil, what happens in that environment in TD's view? Do you start to get loan losses, or is it just a real slowdown in actual growth? How does it shake out?

Bharat Masrani – TD – Group President and CEO

Without a doubt, you will see some impact on PCLs as you would expect – very manageable. I don't see anything outsized that would occur in that type of a scenario at those prices. The offsets being in places like Ontario, you should see more strength coming as well, because exports will pick up at the lower Canadian dollar – I know that's the engine for Canada – Ontario. So that should be an offset. I think the direct PCL impact is not only manageable but quite small. It's more on growth that you worry about from that part of Canada.

Darko Mihelic – RBC Capital Markets – Analyst

And so, at $40 oil, small PCL impact. I'm assuming then that you're probably not thinking Alberta is in recession at $40 oil, would that be a fair comment from your stress test?

Bharat Masrani – TD – Group President and CEO

Well, there would be a slowdown. In fact, our folks think overall GDP growth in Canada would reduce by 50 basis points to 70 basis points at these prices. We'd be looking at about 2% growth in that scenario. There will be a reset of the regional story where Ontario will probably show some upside, whereas Alberta and the producing provinces will show downside. So that's how our people are looking at it, Darko.

Darko Mihelic – RBC Capital Markets – Analyst

From the retail front, you're heavily represented in Ontario and Quebec. There will be some positives, presumably, but what is your philosophical view of TD's positioning here? Is this a chance for TD to grow in Alberta? Is this a chance for TD to take share when others would be far more exposed, might in fact try to restrict credit in Alberta? Philosophically, could you give us an idea of how you're doing that?

Bharat Masrani – TD – Group President and CEO

I think you're right to point out whenever there has been any dislocation, when there has been any opportunities, TD has generally been out there through the financial crisis, we were able to substantially increase our share in commercial lending and right through our Canadian business. Obviously, we're able to do that in the U.S. as well. I'd see those opportunities reemerging. Any adversity means opportunity as well. If there are underpenetrated areas, I see that as an opportunity given the diversified nature of our business, given the strength of our capital, of our brand, our positioning in service and convenience. There is no doubt that we are well positioned from that perspective and we will keep on working at that.

Now that doesn't mean we're only working to achieve our growth just because there is a dislocation in the market. We do that on an ongoing basis. And our numbers are quite good from that perspective. So, yeah, if there are opportunities there, you would expect TD to be there to take advantage.

Darko Mihelic – RBC Capital Markets – Analyst

Well, I guess the reason why I phrase it that way is if at $40 oil, I step back and I think of TDs acquired Aeroplan Credit Card portfolio. You actually have a very large franchise in credit cards. And I would have thought of $40 oil maybe would do some unemployment and some concern, some losses. So if it's manageable, are you actually underrepresented in credit cards in Alberta? Could you give us an idea of what the unsecured credit book would look like for TD in Alberta, because it doesn't seem to match when I think of the largest credit card portfolio in Canada, or close to be, I would think that there would be sizable losses coming out of Alberta? So can you correct me on that?

Bharat Masrani – TD – Group President and CEO

Well, in our overall loan book, I think we've disclosed this number. I think you have it in your slide, hard to see from here. 18% of our book total loans will be in the Prairies – that includes Alberta. And I don't have the exact number, I don't think we've given you the granular part of what our credit card exposures might be by region.

But we did look at that. We did stress it based on unemployment going up, stress it on some asset values going through a downcycle in those provinces, and our losses were manageable from that perspective.

So can you take that to mean that we're underrepresented there? It could be partly that, could be partly that our credit card portfolio is also largely at what I'll call the premium cards. We're not playing the credit game as much, and that's the business we are in, we've always been. We've not been a sub-prime provider. So that also is helpful from that perspective. I think it's a combination of factors that has given us the confidence with our numbers.

Darko Mihelic – RBC Capital Markets – Analyst

I'd also thought about it from the auto loan perspective, and I know you have some non-prime auto loans. And I thought maybe if you could just distribute that across the country, maybe we would have seen some stress there. So any comments on the auto loan and HELOCs even?

Bharat Masrani – TD – Group President and CEO

When you look at HELOCs or mortgages, yes, there could be impact on it, but most of our portfolio we insure, as you know. We also have portfolio insurance against our book, as you know.

So we do have mitigants that I would call, first order effects from a losses perspective. I think the biggest story, if there is going to be a story, is if this is a sustained period where prices are going to remain lower – go lower than where they are – what happens to growth, what happens to consumers' sentiment in that part of the world? How are you going to see that play out rather than what's the immediate impact on assets, values and hence PCLs? Because I think that's going to be a manageable story from our perspective.

One part that we have not talked about, which is important from TD's vantage point, is that we do have a quarter of our business now in the U.S. And there is a view out there, which I fully support, that lower energy prices is net positive and stimulant for the United States' economy and we happen to be – our footprint is the Eastern Seaboard. We are players in Boston, New York, Philadelphia, in Washington DC, in the Carolinas, and Florida. And these states are viewed as even more of a beneficiary of lower energy prices.

I think sometimes we forget that for seven, eight years, all the pundits, all the economies, all the central bankers have been calling for a fiscal stimulus. And they've not been getting one and the central bankers have talked about – we are compensating for a lack of fiscal stimulus with less efficient monetary response. Well, if this is not a fiscal stimulus, I don't know what is. If you play that out as to what this could mean for the U.S., and we do have leverage to that economy, then that's a factor that we should take into account as well.

Darko Mihelic – RBC Capital Markets – Analyst

Okay, fair enough. Thank you very much. And we'll move to the slide on expenses. I'll flip it over here so you can have a better look. It's this one here.

Bharat Masrani – TD – Group President and CEO

They got to get you more hi-tech equipment, Darko.

Darko Mihelic – RBC Capital Markets – Analyst

When we look at the expenses, one of the – I think I'd like to just ask this open-ended, because from the perspective of looking at this company over the last couple of years, there's been a lot of talk of its expense control, but it seems it's been difficult for TD.

So I wonder if you can just talk about your overall philosophy towards cost control and whether or not we could see an acceleration of operating leverage at some point at TD, and whether or not a much lower efficiency ratio – the last we printed was about 53% – is the 50s possible? So it's a little open ended question. But I just kind of want to get a feel for your view on cost control here in this environment?

Bharat Masrani – TD – Group President and CEO

I think some context is probably appropriate here. If you look at our history over the past 10 years or so at TD, about 10 years ago, we used to generate net income of about $2 billion a year and now we do that on average, generally, about once a quarter.

So how did that happen? It happened through a huge amount of capability builds, acquisitions, repositioning of certain businesses, large investment in what I would call underpenetrated businesses, et cetera. And so, now fast forward 10 years later, what's the next little timeframe going to look like? And we think it's going to be more, from our perspective, is optimizing what we've got. Are we're more focused now on how do we become more efficient, how do we optimize all the acquisitions that we have done over the past 10 years. Yes, we have converted them. Yes, we have integrated them, but are we running them in the TD way, as we would normally run them? Because some of these acquisitions happened relatively recently and I think our focus is on that.

So when I look at it from that perspective, I do see opportunities from the expense side of our income statement. And, frankly, I think it is important that we adjust, we adapt to the environment we are finding ourselves in, and this is, I think generally for the industry, that the days of having double-digit revenue growth, that's going to be thrown off just by the environment are probably not going to be there going forward. And we are going to be in a world where revenue growth is going to be in low single-digits range.

So in that scenario, how do you adapt? And I think the great thing about TD has been that it's always adaptive to the environment that it's found itself in and I'd expect we'll do that now. So expenses will become important going forward. It is a key focus of mine, but having said that, I don't think I'd want to leave people with the message that TD all of a sudden has a different culture, everything is knee-jerk and we have a fire drill – that's not the way we are going to do this.

Our view is that we need to adjust our cost curve in an orderly fashion to make sure that what we stand for continues to be the case, our culture is important, our service and convenience positioning is important, investment for the future is important. So that's how you will see this play out. But are we going to work hard in ensuring that our expense base is more in line with today's environment? The answer is absolutely. And there are certain initiatives we are working on. I would say when you integrate so many companies, do you have excess real estate? And so, yeah, we do. And could we be more optimized in our real estate strategy. Can we be more focused on ensuring that our professional fees when you integrate companies, when you convert companies, you need a lot of outside help, you need contract work, can we be more efficient at use of that? And answer would be yes.

There are opportunities for us, but I don't want to do it in a manner that takes away from the future, because you will see us continue to invest in area such as technology builds – I think it's important that we are positioned to compete with the non-banks. It's one thing to compete with banks, but there is lot of areas and the payments area that you see non-players coming in, non-banking players coming in. And so we are continuing to do that.

I think the regulatory spend that's going on, which at some point won't be at the level that we've seen before, but we need to do that. It's important that we do it and, frankly, I think in a way this is good for banks. It's good for TD. Some of these builds and some of these capabilities that we need from a regulatory perspective, are going to be very useful for us to manage our business going forward as well. So I think these are all positives, and at some point, we'll be able to make sure that our cost base is in line with environment that you see now.

Darko Mihelic – RBC Capital Markets – Analyst

And then, so sitting where we sit today, where do you think the odds are that we see positive operating leverage in 2015 and 2016?

Bharat Masrani – TD – Group President and CEO

Positive operating leverage, there's two factors, it's not just the cost item; what's your view on rates? If I had asked you 90 days ago, where's the 10-year U.S. rate going to be? I don't think you would have told me, this morning it's going to be 185 basis points. And that's where it is. So I think the rates, the revenue side is more unpredictable than we've seen before. But that also throws off more opportunities. I think there are opportunities on the loan side that the people are probably not factoring in as much with the strengthening U.S. economy. You would see at some point, usage of operating lines to increase. You would see in the Canadian perspective, as the Canadian dollar has depreciated, exporters should really ramp up here. You should see more activity in some of the provinces that are more export-oriented. I think the lower gas prices are going to result in more activity on the consumer side, which should be positive as well. A lot of moving parts from that side.

On the cost side, we want to target positive operating leverage. That's been a core part of what TD does, but does that mean just to hit a short-term number? That I'm going to say, all right, we're going to cut back on investments that make very good sense, the answer is no. We are not going to compromise the long-term growth trajectory. We have been a growth company. We are a growth company and we'll continue to be that. So if it means investments, we will continue to make that.

Darko Mihelic – RBC Capital Markets – Analyst

Okay. Thank you very much. And maybe we'll flip to the next slide, which is the U.S. retail. Speaking of growth on the U.S. Retail side. One of the things that sort of stands out – and this is in U.S. dollars – if we look at the line that's adjusted net income before Ameritrade, it's bolded there. Last year in 2014, the growth of this business was about 5%. And I think you've sort of provided some outlook that it's considered low growth for this business as well in 2015.

From where shareholders sit, I'm not sure that that's what they signed up for. I thought that we were looking for growth out of the U.S. business in the upper single, high-single digits and maybe even double-digit growth out of the U.S. So can you maybe speak to why it is you have a modest outlook for growth out of this business in 2015, and where do you think you can take growth over the medium-term?

Bharat Masrani – TD – Group President and CEO

Great question. And again I think a bit of background would be helpful. As many of you know, I used to run the U.S. for a few years and I did an investor day, I guess, three years ago. We talked about what the opportunities there are for our U.S. business. So let me talk about the parts that have exceeded our expectations, the parts that have been different. At the time, we talked about can we, from a fundamental perspective, grow our customer base in the U.S., do we have more customers today than we had yesterday, and do we have a model that attracts even more customers, are we a growth customer base type of a bank in the U.S.? And the answer is it has exceeded expectations.

If you look at loan growth from the U.S., if you look at deposit growth from the U.S., look at number of customers we have – by the way, we have 8 million plus customers in the U.S. today, not a small number. So we are a major player. At the time, we had aspirations could we become among the top 10 banks, domestically in the U.S. market? And the answer is yes, we have become that.

From a fundamental growth metrics perspective, very happy, more than 1,300 stores now. In fact, three years ago, we also put out a goal that if we are an organic growth company, can we go into a market like New York City where we had no presence 10 years ago, and could we become the third largest retail bank in that city? Which, arguably is one of the most lucrative banking markets in the U.S., some might argue in the world. And we are now the third largest retail bank in New York City.

So when I look at all those metrics, I feel pretty good about it.

And so what has changed since then? When we bought Commerce Bank, five year rates we were able to reset our tractors at 5% plus. Today I talked about 10 year rate at being at a 185 basis points. So that has been somewhat different than what people were expecting. But do I expect rates to be at this level forever? I don't think so. Do I see rates going back to 5%, 6% at the five year level? Probably not, but I don't see them remaining at these levels. So that I would put in the category of delay. That probably is going to happen but it did not happen within timeline we were thinking it would happen.

Did I expect Dodd-Frank to be as intense as it has been? I think part of it we did. The part that we hadn't probably thought would be as intense would be the change in business model. Things like the Durbin Amendment that happened which took $250 million worth of revenues annually just instantly by a signature. But we were able to earn it back within two or three years; or Reg E, which changed the overdraft regulation quite substantially, took revenues away. Again it took us two or three years to readjust to it. So all of those factors I would say did not turn out perfectly from a timing perspective but I don't think they are all lost. I think they've been delayed from that level.

So overall, do I feel good about our U.S. business? I'd say absolutely. It is a great market. I think our model resonates there. I think service and convenience works there. I think we're in the right footprint in the Northeast of the U.S. We are in 15 states on the Eastern Seaboard and, frankly, making a lot of progress on our brand and what we stand for, et cetera.

So regarding specifically on what happens over the short term, I think Mike Pedersen, who runs our U.S. business, said it very well at the last quarterly call. From a number's perspective, are we going to have as many security gains as we had last year, in 2015? The answer is probably not. I don't want to say we're not going to have zero. A lot will depend on where the rates are and what it does for capital volatility or otherwise. But if you look at it from a forecasting perspective, that's what we thought we're not going to have that.

Do we think that the tailwind that we had in 2014 and frankly to some extent in 2013 on the PCL side, generally in all of TD, but specifically in the U.S., will continue? At least at the time we thought that probably not, because what's better than what is now from a credit metric perspective? But I'd say, have I been surprised on this? Yeah, I thought credit would normalize sooner than what we've seen and frankly it seems to be even more delayed. So that might be a bit of an offset going forward.

But when I look at all those factors, I feel that in today's environment where the rates are, it's probably the appropriate way to look at it. But over the long term, am I confident about our U.S. franchise? Absolutely, given the reasons that I just outlined.

Darko Mihelic – RBC Capital Markets – Analyst

And do you think longer term it could earn more or at a faster pace than Canada and by what quantum?

Bharat Masrani – TD – Group President and CEO

It's a big market, right. And our Canadian business is a fantastic business. We would not trade it for anything. And Canadian business continues to grow at a very good level. But for us, if you look at five, 10, 15 years from now, where is growth going to come from? Like we'll do extremely well in Canada and we'll continue to do so. But at some point, given our size, we cannot outgrow Canada forever, so we need another growth engine at TD. And for us, our bet is the U.S., and it's a quarter of our business and very happy with how that is progressing.

Darko Mihelic – RBC Capital Markets – Analyst

And one of the things that we see on this slide and you haven't touched on it. You touched on the securities gains, perhaps tailwind from credit. But noninterest expense, it grew last year faster than revenues. You mentioned Dodd-Frank having an impact and all the regulatory. At what point, do we see the noninterest expense growth slow? Is it next year, is it 2016?

Bharat Masrani – TD – Group President and CEO

As the regulatory spend normalizes, there's regulatory expenses, I get reminded of Sarbanes-Oxley when it first came out, all the institutions were panicked. Oh my God, the amount of money we have to spend in getting this right and all the efforts to comply and the process they have to put in place. And without a doubt for two years or three years, it was not easy for institutions. But fast forward to today, I see in our Bank and I'm sure this applies to the whole industry, it has become business as usual. Nobody panics, about oh my God, SOX is causing me issues. And frankly, with the benefit of hindsight, it's probably improved controls in every institution that has implemented it properly. And I see the same thing playing out from a – globally, frankly, and not just in the U.S.

So yes, we are going through, I would say, a period where there's heavy investment in building out regulatory capabilities. The examples would be CCAR or stress testing framework, where LCR requires very granular analytics. But what's the upside there? Well, you're going to get upside in better data management to be able to do data analytics you couldn't have done before. And that in itself is something that would have never been justified from an ROI perspective on its own, but if you're doing it for regulatory purposes, you're going to get the benefit out of it. So those expenses will continue for the next couple of years. That's my view. That's not going to disappear. Secondly, we have made a conscious decision that we are not pulling back on expansion in the U.S. So last year, we opened, I think, 34 or 35 new stores.

I think this year our plan is around the mid-20s. So that, we feel is the right thing for us to do. We got investment on the digital side there. Our ATM fleet, for example, in the U.S. is totally image enabled now. So we continue to make investments. We will be among, I think, one of the few banks that will have its ATM fleet in Canada as well, that's going to be image enabled, and our experience is that, that's a fantastic investment. Not only does it enhance customer experience but we're seeing higher amount of activity going through those ATMs. Some of the transactions are migrating from a branch or a store level to that channel which is good. It frees up capacity that can now be deployed more towards sales than purely service, that's a good thing as well. So that level of investment will continue as well.

But having said that, the component what you call core expenses, do you have opportunities there? Yes, we do, we closed down, I forgot the exact number, but 31, 32 locations in the U.S. last year, because that's the way to optimize our network. Does that give us opportunities on the cost side? The answer is yes. Is there a way as we move more towards digitization, image-enabled type of services? Can we automate lot of our processes that are internal? The answer is yes, those are opportunities. As we put all these banks together and we've done lots of transactions in the U.S., is there opportunities on the cost side to drive more efficiencies and consolidation? Yeah, we're working on all of that. So those would be the puts and takes towards expenses in the U.S. So I think in the next couple of years, you'll continue to see pressure on the expense base as we build out those capabilities including regulatory.

Darko Mihelic – RBC Capital Markets – Analyst

Okay. I think at this stage, well, I'll throw it over to you as I'd thrown it over for all of the CEOs and ask you for what you think the key takeaways and the key message is here for your shareholders today?

Bharat Masrani – TD – Group President and CEO

From my perspective, we at TD, our view is that we have a fantastic mix of businesses. Look at our franchise in Canada, not only do we have a superior sort of retail banking franchise, but if you look at the growth opportunities we have on the commercial banking side, on the wealth management side, not that we've not grown those businesses, but I see even more upside for the Bank. Our U.S. presence, seven, eight, 10 years ago did not have any presence in the United States. The size of our franchise is now meaningful. It is of a scale that can compete with the very best there. And frankly, from a North American perspective, we see capabilities that we can use across the border that are very useful for us.

We are now building out what I would call our infrastructure and customer propositions that work on both sides of the border. For example, when we build remote deposit capture where you can take photograph of a check – now we can build – that can apply to the U.S. and Canada. I think that gives us scale advantages as well. I think on the wholesale side, I see more opportunity than we might have seen previously. Again starting in the U.S., we have a commercial business that does not get support from our own wholesale business. If these commercial clients want FX services, if they want trade finance services, if they want derivative support, we didn't have those capabilities in the U.S. I see a huge upside there.

We see growth embedded in our model that is to be realized. And that's great for us. And as I mentioned, one on the hallmarks of TD is that we are a hugely adaptable organization. Whenever there have been changes in the marketplace that are fundamental in nature, we've been able to adapt and take advantage of those opportunities. And I see that continuing.

You talked about on the expense side. I see for us an ability to adjust to this reality. And frankly, given our numbers I'm convinced that we have opportunity in that regard. So when I put all those together, I feel very good about the Bank. Yes, there might be short-term headwinds either on the oil price or interest rates, that's what we get paid for to worry about that.

If you look at the long-term prospect for the Bank given its positioning, given its mix of businesses, I feel very good about the Bank.

Darko Mihelic – RBC Capital Markets – Analyst

Okay, with that we'll end this morning's session. Thank you very much for participating, Bharat.

Bharat Masrani – TD – Group President and CEO

Thank you. Thanks for having me.