TD BANK GROUP
SCOTIABANK FINANCIALS SUMMIT
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PARTICIPANTS

Bharat Masrani
TD Bank Group – Group President and CEO

Sumit Malhotra
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FIRESIDE CHAT

Sumit Malhotra – Scotia Capital – Analyst

We will keep things moving along with our next guest this morning and that will be Mr. Bharat Masrani, President and Chief Executive Officer of the TD Bank Group. Mr. Masrani joined TD in 1987, and was appointed to his current position in November of 2014. Sir?

Bharat Masrani – TD – Group President and CEO

Good to see you.

Sumit Malhotra – Scotia Capital – Analyst

So, we have started our conversations this morning by first noting, as I'm sure you have, that there's been a dichotomy between the operating performance of the banks this year, which for most members of the group including TD is on track for another year of record earnings. And, at the opposite side has been the share price performance, which hasn't been nearly as strong. From my conversations, a lot of that has related to the fact that investors are concerned about the outlook for the Canadian economy, to some extent the global economy and what that may do to the credit cycle where banks in Canada have enjoyed very good results over the last five or six years.

So, let me make this one a little open-ended to give you some runway here to discuss what's on your mind.

First off, are you expecting, as a management team, any significant change in the health of your credit portfolio in the near-term? And secondly, when you think about a period of even lower for longer interest rates, commodity prices, economic growth, what steps is the Bank taking to ensure that operating performance for your shareholders remains reasonable in that period.

Bharat Masrani – TD – Group President and CEO

Firstly, Sumit, thanks for asking me. Great to see you again and see lots of familiar faces in the crowd. So, good to see you folks as well.

Without a doubt, as you rightly pointed out, there is a perception that headwinds are pretty strong and some of that flows from the macro situation of Canada. What has happened to the energy sector and so the numbers that people have seen over the past six months or so. I think in our own case, we do monitor our credit portfolios very closely as you would expect any bank to do.

We've seen uptick in our PCLs, but largely as a result of higher volumes. If you look at our U.S. book, Canadian book, our volumes have been very healthy. Our originations are terrific. It's great to see that we continue to take share in various products that we want to take share in. And so it's largely that story that is playing out. I think in the U.S. we have also seen the net amount show higher levels because some of the tailwinds we had from the past were recoveries which are helping us with the aggregate number, are less so now. But there is nothing fundamental we are seeing in the portfolio to suggest that we are going to fall off a cliff here.

Having said that, we talked about this, Mark did, I think, a brilliant job of explaining our oil and gas exposures, what it might do to our overall situation with respect to the oil producing parts or the energy producing parts of Canada. Without a doubt, that is something that is top of mind for you and as you would expect this top of mind for me as well. So we gave some detail as to what this portfolio would do in a stress situation. I think on a direct basis, and I know people are not too thrilled about explaining this as a 'manageable' situation, but if you look at the overall size of TD, how much exposure we have on a direct basis to the oil and gas sector. And I'm thinking of a creative way of explaining it other than 'manageable', but manageable is quite apt in that respect and just to give you some flavor. Within those portfolios, you have various sectors as the international integrated players, there's a borrowing base, and then there is servicers. I think we provided a lot of detail as to how we think about that.

On the indirect side, we've yet to see a lot play out. Our share, for example, in Alberta is lower than what we have nationally, but without a doubt that is something that we are watching carefully. We haven't seen anything dramatic move yet, but I think the big message for us is that even if you assume that there will be some distress because of this thing playing out in the economy over time, we do have offsets that I am very comfortable with, i.e., size of our operations in Ontario, what lower oil prices might do for Ontario, what the lower Canadian dollar does, and is already showing signs of, would do to Ontario and then our U.S. business and I think generally people feel that the U.S. is on the mend and is growing. So a long way of saying that, I get paid to worry about the credit cycle. We've had a fantastic run for oil players in the market and it is right to worry about it, but when you go deeper and look at the fundamental drivers in our business, I would be very surprised that this turns out to be a major disaster for TD, or that we're going to be a negative outlier of any kind, when we go through that cycle.

Sumit Malhotra – Scotia Capital – Analyst

And just about some numbers on it, if I picked up Mark's comments correctly, your current loan loss ratios in the low 30 basis points. I think, in this stress scenario and to your point, I think we all know, TD has less direct energy exposure or less – or more Ontario, more U.S. You only get to something like the low 40 basis points range in terms of this scenario and that compares very favorably to the 80 plus you had in 2009, which was obviously more of U.S. led downturn.

With all that said, I do want to lean on your experience, as a Chief Risk Officer on two points. So, first off, in the producer portfolio. Again, your, TD's exposure is a smallest in that regard, but we are going through this process now about credit redetermination reviews, looking at the borrowing base.

As this process goes on, from your perspective as former CRO, should we expect that the outright loan exposure of the Bank, to the producer space, is going to be cut, as you pare some of these borrowers back? And secondly, would this trigger any kind of movement in either gross impairments or provisions if it turns out a line is extended to producer that their current economic situation shouldn't allow for?

Bharat Masrani – TD – Group President and CEO

Just by way of background, I think the portfolio you're talking about is, what we call the borrowing base-oriented portfolio. In those instances, the Bank takes security and the borrowing bases are re-determined on a fairly regular basis, but generally about twice a year it could be more frequent depending on circumstance. And there, the way it plays out is that when you re-determine, it may change the credit availability to that particular borrower, because the reserves are worth less now given where the prices are. And hence, you could potentially see a situation where the – there is a reduction in available credit. But that doesn't mean you really cut back, because there are often many instances where these borrowers are not using the whole availability anyway, so they'll have less unavailable use if that turns out to be the case. But in many cases, the fact that you set up a line for example at x doesn't mean that the borrower didn't qualify for 2x, because the reserves was so much, but their cash flows or business plan showed that they never had a need for it, so you set the line at a particular level. In those instances, I don't expect any change because there was enough headroom....

Sumit Malhotra – Scotia Capital – Analyst

Sure.

Bharat Masrani – TD – Group President and CEO

....that we could have accommodated a higher need. Without a doubt, I'm sure there will be instances where we will see some borrowers that might need some kind of an accommodation. We will work through this on a case by case basis. We've been long-term players on this, Sumit. Our franchise in that industry, I think is second to none, we've built a terrific capital markets business out of it as well, and these companies that operate in that sector are prolific in how they manage cycles. They have – that's part of their DNA, and they've been through these for many, many cycles before we got to this one in fact worse than what we are experiencing today. And many of them come out stronger than they were before. So, yes, will there be packets of issues, we'll have to manage, I would think so. But, I think there will be a lot that are going to just work through in the normal course, because that's how this works out.

Could we see formations, yeah. I think, Mark's analysis showed that perhaps that might be formations, but we don't expect to take significant losses against the collateral we would hold, should we get into that situation and it gave some numbers out which suggested that. So, that's how I see this thing playing out.

Sumit Malhotra – Scotia Capital – Analyst

It's very helpful. Thanks for that, and let's move onto more direct business for TD. So, in Q2, the Bank announced a restructuring charge and it was intimated that, we will likely see another one in Q4. Obviously, it's the sign of the times in the banking space, it's something we've been hearing more about. Yours seems to be more focused on your U.S. operations, with some spillover into Canada. You've talked a little bit about the different areas that you're looking at in the form of this restructuring. Why don't we start by maybe giving us an update firstly on how much structural cost do we think comes out of the Bank after these changes are made. And maybe to bottom line it even more, the Bank's been running with a 58% or so efficiency ratio at the top of the house. Do you have an objective on where this can get to in the medium term?

Bharat Masrani – TD – Group President and CEO

And so before I answer that, I think just to be fair to your first question, there was a second part to it which I've not addressed about general growth prospects given all the headwinds...

Sumit Malhotra – Scotia Capital – Analyst

Sure.

Bharat Masrani – TD – Group President and CEO

... You're talking about. So, I mean, from our perspective and we've been talking about headwinds for a while. I think last year when I was here, I talked about some of the issues that I was hoping would not turn out to be the case, but has. And so it's our job to manage through those headwinds and our view is that some of these factors in Canada probably taking away 100 basis points of GDP growth and we've seen that play out in some regard. But our view is that over the longer term, Canada is a mature, developed economy and it adapts to the new reality and you'll already see pockets happening, perhaps this time it takes a higher level of the valuation than what we would have normally expected in such circumstances and that's also playing out in the economy. So, over the longer term, we feel on both sides of the border, the way we are positioned with the business mix we have that we will continue to see growth in our portfolios.

In Canada, we have certain businesses that we think there is embedded growth that we have not yet realized. Wealth comes to mind. I know it's been a fantastic business for us, but we don't think that we have as much market share as we ought to have given our brand capabilities, the way we can leverage a retail distribution for wealth products.

In the credit card space, although we are the largest issuer now in Canada, it took us a bit of time to get the MBNA platform to the level that we would like it to be, but that's behind us now. So, I think we will see more momentum coming out of that as well. I see our business banking opportunities to be terrific and so I see in Canada without a doubt, notwithstanding all the headwinds and perhaps that would mean slower growth for some of these businesses, but I think over the longer term, I like our positioning, and I like the prospects we have.

The U.S appears to be on the mend. If you take – make certain assumptions on rates and economic growth and all that. And more importantly the fact that we're positioned on the Eastern Seaboard, and while the oil shock and the energy shock has been net negative for Canada, I think what the Eastern Seaboard – this is bigger than any tax cut anybody could have imagined. So I think that in itself plays out well for us over the longer term as well.

So my message is yes, you see these headwinds, but the Bank has always been positioned to manage through these situations. And I feel good about the mix of businesses, the scale of our operations, and the fact that notwithstanding our size, we still have huge opportunities to grow.

I don't want to put a particular number and what the numbers might turn out, but from a big picture perspective, I like the positioning we have notwithstanding some of the headwinds that we talked about.

Going to your second question now on the restructuring side, I think it's going quite well. We did the first phase of this, and as many of you may recall, it's centered around, what can we do to optimize our distribution because there is – we've done a lot since over the past five years to seven years. We've grown a lot, so there are opportunities for us to optimize our distribution channels, and how can we optimize some of the consolidations that kind of make sense.

In the U.S., particularly, because we are product of various acquisitions, and there is always opportunity to look at optimizing your network. I think the other part we said, we would like to really focus on in making good progress, is process reengineering, looking at our processes, would it make sense given all the investments we are making on mobile, digital and if that is the case, are we leveraging that for our general processes in the Bank.

And that I think has turned out to be a good area to focus. And lastly, what we call organizational review. Where we are attempting to become more effective than what we might have been. Not because you know we are not well placed in dealing with the competitive environment. But my view is that, the competitive environment is dynamic, we got newer non-traditional players entering our space. And we have to figure out a way is to how we are going to compete with them to make sure that we are as agile, that we are as innovative, that we are closer to our customer than what we are today, and how do we do that, and organizational review allows us to look at that in a holistic basis in the Bank.

The first phase has gone well, and I like what I see. We're working through the second and final phase of it. I expect that to be completed by the end of the year. And, you know with respect to your numeric question is to how does the structural expense base play out after we have done all this restructuring. I think important to realize that why does the Bank increase its expenses year-over-year. There are certain pockets that are, you know, sometimes lost in the discussion, okay, you can just tell me how much of this falls from the bottom-line. I mean normally, you know, we would have expense growth related to merit and how we pay our people, how we treat our people on benefits and pension and all that. And that play's out through your expense growth line.

Secondly, if you are growing bank, we have higher volumes, and we have record volumes in some of our businesses – this very well explains us that – that relate to that and that will go through our system. And then we have, I am talking generally, there's lots of categories here, but some of the big categories is that without a doubt, our expenses are higher today than they were previously due to regulatory spend, but I consider that as a transient spend, I don't expect those building up a regulatory infrastructure to be a permanent increase because at some point when you built the base, yes, there will be ongoing maintenance of that, but you will not have the type of expenses that you might have today.

And then lastly, and most importantly from our perspective is that we would invest for the future, so I've talked about as part this restructuring that we are doing, that one of the key components of the future investment is – re-architecting our technology platform so that we are more nimble, we are more agile, we can compete with the non-traditional players. So in aggregate, that's what you will see in expense growth, and against that, with the initiatives that we announce, we will reduce that expense growth in the first phase we said by 2%.

So, that's what I mean as to the structural change – those four components or five components of expense growth will be there, absent this restructuring that would have been a higher number. But with this restructuring that would be less by – whatever amounts that we've talked about.

Sumit Malhotra – Scotia Capital – Analyst

And so it does sound like, and I know it's too soon for you to comment on what we may hear in December on the Q4 charge, but this does sound to me like you should be able to reduce all bank efficiency, which has been sticky for a period of time. And I don't, I think, I hear you correctly, all bank expenses aren't going to decline, but if you're bringing the rate down, and your revenue outlook is somewhat consistent, your efficiency should get better here, no..?

Bharat Masrani – TD – Group President and CEO

Numerically, it should, and that's why we always strive for that. We do – on the one hand, I'm really not focused on a particular target for a particular quarter, because I think that would be a mistake, our shareholders, i.e., all of you, pay us a lot of money to manage the long-term well-being of the Bank.

It is important for us to continue to make those investments, so that we continue to be the growth company that we've been. And so there will be certain instances where you say, well, you could have done better or you could have generated that efficiency ratio. But I think over time, you should see an improvement in that, because we are very focused on ensuring that our core expenses, outside of the other things that I talked about, are always in keeping with what our expectation is of market conditions and what kind of growth can be generated in that...

Sumit Malhotra – Scotia Capital – Analyst

That fair.

Bharat Masrani – TD – Group President and CEO

In that economy.

Sumit Malhotra – Scotia Capital – Analyst

TD is a leading consumer bank in both Canada and the U.S. You've talked about some of the investments the Bank is making and we've certainly heard a lot about the payments space, peer-to-peer lending, digitization, security. I think your partners at Target had gone through some of the potential issues that can come up there. When you think about your franchise, is the threat from disruptors, new technological entrants, security. Is it more prevalent to you in Canada or the U.S.?

Bharat Masrani – TD – Group President and CEO

I don't think you can really segregate the two. You might debate the pace at which some of those these changes might happen, on which side of the border you might be on. But ultimately, it's only a matter of time that what happens in Canada from that respect will ultimately show up in the U.S. or the other way around.

My point on – I think you're talking about Fintech and all the new peer-to-peer lending and the payment space and all that. Lot of these innovations, I think are positive. It's great for our customers, it's great for the Bank and sometimes when you look at our own history, many times it was viewed when the dot-com thing came up, oh my god, these banks are done, because they're not going to be able to compete in the new way, because you got all these new players coming in that that have this whizz-bang technology that these folks don't have. And we always find that banks actually have a way to adapt that sometimes surprises folks, but they always do.

So, I have every expectation that at least from TD's perspective, we will adapt. I have said that I think it will make a lot of sense from a regulatory perspective to make sure that some of these non-traditional players entering this space do not put undue risk on the whole system. From a safety and soundness perspective, from a prudential management perspective, from making sure consumer protection is top of mind. So, I think that is critical.

But on the other hand, I think some of these innovative ideas that are entering our space are terrific. And I have no problem competing with them as long as it's a level playing field, and I expect it always will be. So, that would be the general comment I would make. It'd be interesting to see which part of this innovation cycle will be more permanent and which one will be in passing because of a particular point in time. And what I talk about is the lending-oriented innovation. We'll see how they play out over a cycle, because we've seen that many times over. I think some of the components of that are very interesting, on data analytics, on measuring customer behavior or predicting customer -- I think very interesting. And we are making huge investments in that respect. So we'll see how the lending side of this innovation plays out through a cycle. I think on the other components of it, I think that's very positive and we think that's a good thing over the long-term and I would expect TD to compete very effectively in that space.

Sumit Malhotra – Scotia Capital – Analyst

Let's take a bigger picture with your U.S. franchise. TD entered the U.S. in 2005, but it was really the 2007 Banknorth deal, or the Commerce Bancorp deal, that set the foundation for how you wanted the convenience model in the U.S. to run. So from that context, more branches, longer hours, nicer branches especially compared to some of your U.S. counterparts. When you think about the shifts that we're considering now, less people going to the branch, Mike Pedersen has talked about that, less transactions being conducted there. Is the brand proposition of TD changing in any way in the U.S.? And can you deliver the same experience to your customers when you're not seeing them nearly as much as you used to?

Bharat Masrani – TD – Group President and CEO

I think changing is probably not as accurate as saying TD is adapting to those trends in the market. So as part of our distribution optimization initiative, that doesn't mean we're not opening what we call new stores in the U.S. But we are also making sure that as we optimize there are certain markets, where there is an opportunity for us to say, have we opened a new store and we have this three feeder stores that are no longer necessary because the new store makes a lot of sense. So that's a net reduction of two in that case, so that's – you see that playing out in our network strategy.

And I think the part that Mike has talked a lot about this, is the level of investment, we are making in other channels. So, I mean today, I might be off slightly in the numbers, but out of our 8 million plus customers that we have in the United States, 3 million plus are online and digital customers.

And how that channel has grown, something like a mobile phone channel did not exist a few years ago, but it's a huge channel for us, driving not only transactions, but sales as well. And it's our job as bankers to figure out, how do we maintain as this change is occurring or this trend is now taking hold, how do we provide that legendary experience, the WOW! experience, that TD is famous, and we are doing that, and we are finding that that's resonating with our customers either through technology or our unique way, what we call omni-channel, where our stores continue to play a central role as our customers change the way they are dealing with us.

So it's a long way to say that notwithstanding those trends that are now emerging, I think TD is adapting to that. I think we are seeing terrific volumes out of Mike's business, very happy to see that and if we were not adapting to it, we would not be seeing that. I mean we are still generating a huge number of checking relationships in the U.S. It's just terrific, and that's the foundation of building out a great franchise. And that allows us to cross-sell other services, deepen the relationship and that's what we're seeing playing out.

Sumit Malhotra – Scotia Capital – Analyst

And you've been quite clear that, whether it's September or December or 2016, when the Federal Reserve starts to move, it clearly has a beneficial impact.

Bharat Masrani – TD – Group President and CEO

Of course it does, any I mean given that we are heavy checking bank in the U.S., so that in itself gives us an advantage. We're heavy deposit bank in the U.S., that gives us an advantage. But I think the part – apart from these direct implications on our balance sheet and our business is, if and when the Fed does move, it'll show confidence in the economy.

I think, people underestimate the psychological impact of a rate move, especially if it turns out that the markets have accepted it, and things are more businesses is usual. That shows that the U.S. is back and it's back more towards normalization and that means, we are really well placed, especially with our geography in the U.S., and value proposition, brand proposition we have.

Sumit Malhotra – Scotia Capital – Analyst

Last question for you this morning is on, what's still the biggest business, although we spend more on the U.S. these days. But, in the Canadian P&C operation, I mean for a long time, it was Royal and TD, and there was everybody else. It does seem like the competitive response from some of the smaller players in the industry has certainly picked up, and has started to win back some of the market share that they lost for a long time.

When you think about your business in particular, you mentioned MBNA, the Aimia portfolio was added as well, maybe a little bit short-term, but the growth numbers haven't looked quite as strong this year. Do you attribute that more to a short-term blip related to investment spend, and the integration of, particularly, the Aimia portfolio, or is this the fact that competition is stronger and economic growth has eaten in to everybody, including TD.

Bharat Masrani – TD – Group President and CEO

I think, it's more of the former, there are again we rightly saw people get concerned or trying to figure out exactly the reason for having a blip here or there quarter-over-quarter or whatever. But over the longer term, we feel great about our Canadian business, we have a fantastic franchise, I mean I don't need to tell you folks the size and depth of our Canadian business. It's a growing business, we saw record volumes through this season out of our Canadian business.

We have pockets as we define the segments, where like a blip on the credit card side will show up in the overall number or whatever the case might be, but that doesn't mean fundamentally that we are not doing well in that business, very happy with how that has played out. And the share we have and how we are maintaining that, because don't forget we have -- we're starting at a very high level and our shares are large and hence the level of growth you will see will be adjusted based on where the foundation is. So very happy with how that's playing out and there will always be -- it's good, that's why we live in a competitive world.

There is some innovation out there, we will see how that plays out. Generally, we would not be heavy competitors from a price perspective, not that we're going to let our core franchise wither away because of that ideological view. But generally that will not be a space where would be very competitive. So we'll see how this competitive environment plays out but I would expect TD not only to maintain but continue to grow its Canadian business.

Sumit Malhotra – Scotia Capital – Analyst

With that, let me thank you for your time.

Bharat Masrani – TD – Group President and CEO

Thanks very much, Sumit.

Sumit Malhotra – Scotia Capital – Analyst

Thank you.