TD BANK GROUP

CIBC EASTERN INSTITUTIONAL INVESTOR CONFERENCE

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PARTICIPANTS

Leo Salom
TD Bank Group – Executive Vice President, Wealth Management

Robert Sedran
CIBC World Markets – Analyst

FIRESIDE CHAT

Robert Sedran – CIBC World Markets – Analyst

So, okay. The last session before lunch. We have Leo Salom, who is the EVP of Wealth Management at TD Bank. Thank you very much for joining us today, Leo. Leo joined TD in 2011 as EVP in the Wealth Advisory Business and took on his current role in 2013, and he is responsible for TD's global wealth franchise including direct investing advisory and asset management. He spent over 25 years in retail banking and investment management, and my favorite part, includes South America, Caribbean and Europe. So – and I guess I should add North America now to that list. So, welcome to the conference.

Leo Salom – TD – Executive Vice President, Wealth Management

It's great to be here again, Rob.

Robert Sedran – CIBC World Markets – Analyst

We appreciate you coming out. I'm going to start with a bit of a general question for you, and it's really kind of relates around how the business is working from a Canadian PNC banking, cross-selling, getting the asset flows? It strikes to me that the strength of that TDCT vacuum cleaner is a big part of the story. How well is it working?

Leo Salom – TD – Executive Vice President, Wealth Management

It is the source of much of the growth that we enjoy in the Wealth business. So just to give the group a bit of a background, when we talk about the Canadian Wealth business, we are talking about serving two million clients with about CAD 600 billion in assets, around three core lines of businesses. But one of the big catalysts and what's allowed us to be able to deliver double-digit earnings growth and generate a industry-leading return on equity of 50% is this organic model. The relationship between the retail, commercial, and our Wealth businesses is at the core of that model. On an annual basis in any one given year, we generate over CAD 20 billion of referrals out of the TDCT Network, and that's the unique competitive advantage. Having worked at two other organizations, I have never experienced a model that's quite as effective as the one we have within the group.

And I still think – while I think it's been the source of growth in the past, I still believe there is tremendous opportunities there. The Bank serves 11 million clients, approximately 4 million of those would be mass affluent and high net worth in nature, and in the advice space, we only bank about 12% of those clients. So, being very deliberate about aligning distribution against that opportunity set, I think, is the real source of strength for us. And I think it's the reason why we have a great deal of confidence that we can sustain a double-digit earnings worth profile in the Wealth business.

Robert Sedran – CIBC World Markets – Analyst

We've often thought of the strength of the cross-sell at TD Bank and the concept of natural market shares at TD Bank sort of couple of defining features. And the penetration rate you just described is well below what you would probably describe as your natural market share.

Leo Salom – TD – Executive Vice President, Wealth Management

Correct.

Robert Sedran – CIBC World Markets – Analyst

So, there are some historical reasons for that, which maybe you'd get into. But is there a structural reason for it as well or is there – is that really the opportunity set, is to get it to where everything else is?

Leo Salom – TD – Executive Vice President, Wealth Management

I think it's the strategic choices that we made in the wealth space. So TD started as largely a discount brokerage arm. And we did not buy a broker dealer. So we didn't go out and buy one of the established broker dealers. So, our entire advice core business, which is our financial planners in the branches, our full service brokers, were really organically built. Today, we have over 2,000 advisors. But that means that over the last 10 years, we've been organically picking and building teams, and lining up that team with our core retail branch system.

So, it's been slower in the build, but I think that now we've got the foundation in place to begin to be able to truly franchise clients. And there's still opportunities to grow that distribution network. One of the things that we made mentioned at the Retail Investor Day is that I'd love to be able to add another 500 advisors over the next three years to five years. I think we've got the capacity to be able to do that. We're still slightly undersized to some of the existing competitors in the marketplace. And given the opportunity set that I just referenced in terms of cross sell opportunity, I think this is going to be a source of significant growth for us.

Robert Sedran – CIBC World Markets – Analyst

Just to be clear, when you talk about 500 advisors and when you talk about more 2,000 advisors, that runs the gamut, everyone from a financial planner in a branch to a full service broker to, I guess, anything in between. Is that fair?

Leo Salom – TD – Executive Vice President, Wealth Management

Correct. It would be our financial planners in the branch, which are really serving mass affluent clients, the high net worth private investment council folks are private bankers, and then our full service brokers in TD Waterhouse proper. The collection of those three groups make up our full advisory suite.

Robert Sedran – CIBC World Markets – Analyst

And so when you're thinking of adding 500 more bodies, is it in the financial planning side, which is going to help you mine the branch network? Is it in the full service brokerage, which is going to go after ultra-high net worth and high net worth? Or...

Leo Salom – TD – Executive Vice President, Wealth Management

Probably two-thirds against the mass affluent, a third against the high net worth.

Robert Sedran – CIBC World Markets – Analyst

Okay. And so you mentioned the strategic decisions around buy versus build, this has always been, from my understanding, a hard business to buy...

Leo Salom – TD – Executive Vice President, Wealth Management

Sure.

Robert Sedran – CIBC World Markets – Analyst

...when you start looking at individuals because people that are not in a bank channel today are probably because they don't want to be in a bank channel.

Leo Salom – TD – Executive Vice President, Wealth Management

Correct.

Robert Sedran – CIBC World Markets – Analyst

Is this all organic we're talking about or would you consider, without commenting on any specific activity, would you consider an acquisition there, too?

Leo Salom – TD – Executive Vice President, Wealth Management

Sure. We're sort of committed at this point to the organic strategy that we've got. We think we've got plenty of opportunities still to be able to extract from it. It's not that we're opposed to an acquisition. But as you referenced, Rob, it's difficult to buy in the full service brokerage space, it's difficult to buy in the overall advisors space because you've got the risk of attrition on purchase.

So we've opted to choose the organic route, and I think it served us quite well. That doesn't preclude us from looking at opportunities going forward, whether it would be here in Canada or the U.S. if we found an asset that we thought meet our financial hurdles, they align well to the business model that we're trying to create, and most importantly, where we felt that there was a good cultural fit.

We're not trying to run an independent European-like wealth management arm. We are an embedded part of the bank, we view ourselves as an extension of the retail franchise that we've got, and to the extent that we can leverage that, I think that's the source of our differentiation.

Robert Sedran – CIBC World Markets – Analyst

I asked the question in a different context this morning, but I long thought – earlier this morning, but I've long thought of the Wealth Management business as a double-digit earnings grower and arguably, double-digit top line grower just given the number of the trends. And then we layered in a lot of different issues that have sort of slowed that growth a little bit.

Leo Salom – TD – Executive Vice President, Wealth Management

Sure.

Robert Sedran – CIBC World Markets – Analyst

It's interesting to hear you say that you still see it as a double-digit growth engine. Is that largely through, you think you have a larger market share opportunity in front of you or do you think the industry is still actually growing at those kind of rates?

Leo Salom – TD – Executive Vice President, Wealth Management

No. I think, Rob, what you're beginning to touch on is the fact that there are some headwinds that are materializing in the wealth management space. But in order to be able to deliver double-digit, we've got to compensate for. So the two primary headwinds would be the fact that market returns are likely to be more muted going forward than they have been over the past five years, seven years, and that's just the reality, right?

So the forecast for equity market returns and bond returns are going to be lower than what they've been, and that means that some of your asset revaluation is not going to go quite as quickly. The other piece is the fact that we are going to experience some degree of modest margin compression in the asset management space, and that's driven by some of the regulatory changes, but more importantly, by the fact that asset managers are introducing different products at different price points, and the move to fee-based is going to create a little bit of downward pressure on fees.

That said, the tailwinds, I still believe, more than compensate for that. And the tailwinds from our perspective is the fact that we still think that the fundamental demographics are strong. We still think we're underrepresented in terms of wealth offerings to the broader retail group. We still think that there is an opportunity for us to franchise across North America, some of the client cross-sell opportunities. And then, finally, I think to the extent that we're able to execute against some of the product gap opportunities, you put all that together, we should be able to generate double-digit earnings growth.

Robert Sedran – CIBC World Markets – Analyst

The phrase modest margin pressure is an interesting one because, I guess, I would have guessed that more than modest in terms of the pressure on the top-line for the industry, and it's just been a challenge everyone has been dealing with. When you think about the regulatory change that has already been enacted and some of the changes that are coming, does it feel like some of that's already been absorbed in the margin, which is why you think the margin pressure might be less, or is it just that you'll find ways to overcome it somehow?

Leo Salom – TD – Executive Vice President, Wealth Management

Yeah. Rob, I would say that we are – we're already seeing some of that margin pressure materializing. And I don't think it comes from simply expecting some big regulatory event. I think the margin pressure is coming from the fact that every asset manager is introducing premium classed product. There is a big shift towards F-Series mutual funds and other fee-based pieces, which is putting a little bit of downward pressure on overall margins. We're seeing the introduction of certain alternative bundled products at more attractive price points in the fund of funds category. You put all those things together, and collectively, it's creating what I would still say is modest, because if you look at it, were talking 2 basis points to 3 basis points a year. I think that, that will be modest but persistent. I think for the next two years or three years, if you are an asset manager, you've got to build that into your formula, and you've got to be able to deliver both growth in terms of acquired assets, as well as expense efficiencies to be able to compensate for that.

Robert Sedran – CIBC World Markets – Analyst

One of the product classes that, I guess, is causing some of this and certainly gets talked an awful lot about is ETF, and TD stepped gingerly, I guess, so far into the ETF business. You want to talk a little bit about what you're doing there and what the thought process is there? Because, I guess, the worry always is about cannibalization from your existing product, which turns that modest margin pressure to something more significant if it does happen.

Leo Salom – TD – Executive Vice President, Wealth Management

Sure. So there is no question the ETF market is growing at a faster clip than your classical active solution sets. That said, at TD, we have been – we haven't necessarily been as visible in the retail ETF market, but we are one of the largest passive investment shops on the institutional side in the entire country. So we've got the core capabilities to be able to manufacture retail solutions. And earlier this year, we did announce that we're stepping into first phase, a launch with six passive ETFs. And the second phase will be a series of active ETF solutions as well.

But I don't see us necessarily using them as end solutions. We're still – if you look at our total sales as part of Wealth, the bulk of our sales are in solutions, not in individual product standalone mutual funds. So while I do think there will be some degree of substitution, which will be inevitable, I see the ETF suite as ingredients to solutions as opposed to a product on to itself. In direct investing, we'll sell the product directly. But in most of our advice channels, we'll be using them as lower cost ingredients within some of our fund solutions, which I think will mitigate some of the margin compression discussion, Rob, that you alluded to.

Robert Sedran – CIBC World Markets – Analyst

The fee-based account is another interesting development that it's becoming – I guess it's happening faster. And some banks in particular are being more proactive about it as an opportunity to gain share just by – faster than it needed to happen kind of thing.

Leo Salom – TD – Executive Vice President, Wealth Management

Sure. Right.

Robert Sedran – CIBC World Markets – Analyst

What do you think is driving that portion? And is there a plan to put them into the branches at some point? Is there a plan to become more active still on this fee-based? Because it sounds like the Series A mutual fund, the big 2% plus MER, is going away regardless of whether it gets regulated away or not.

Leo Salom – TD – Executive Vice President, Wealth Management

That's right. That's right. And so just for some context, about 60% of all of our sales today in Wealth are in fee-based product. So we're trying to get out in front of what is a logical evolution. And if regulators do decide to ban embedded commissions, we want to be in a position such that the entire distribution engine already has the capability to deliver fee-based solutions across all. I do think it will include the branches. Today, our financial planning arm sells fee-based solutions in the branches. And I could see us extending that beyond just the financial planning arm to include most of our mutual fund suite as well.

So, I think those are things that we're exploring now. I would say that it also – while we're looking at it as a potential source of margin compression, it's also a tremendous opportunity for us to innovate the offering, and be able to provide much more product solutions in fee-based type form into some of those emerging channels. So I think we're going to be working on ways of not only meeting a regulatory standard, but also providing clients much more choice as we roll out some of these fee-based solutions.

Robert Sedran – CIBC World Markets – Analyst

Okay. Switch gears a little bit and talk about the U.S.

Leo Salom – TD – Executive Vice President, Wealth Management

Sure.

Robert Sedran – CIBC World Markets – Analyst

Your friends in personal and commercial banking get all the discussion all the time, but there is a U.S. Wealth business as well, And then, I'd like to hear more about what – how it's going, but also what the vision is in terms of what you think you can build. It's a very different marketplace from what it is in Canada.

Leo Salom – TD – Executive Vice President, Wealth Management

It's probably one of the most exciting parts of my job, quite frankly. And people ask me, what's the strategy for the U.S., and it really is, at the risk of simplifying it, connecting the dots. We own 42% of TD Ameritrade, which is arguably the most capable, most sophisticated active trading, self-directed brokerage shop in the country. We have 8 million retail clients from Maine to Florida, over 1,200 branches. We've built a high-net worth platform with nearly 200 advisors that is now aligned to that retail and commercial banking footprint. And we bought, three years ago, arguably one of the best boutique large cap value-oriented investment shops in Epoch.

And so, what we're doing right now is bringing on that capability, completing it with our TDAM Canadian core product offering, and really creating an integrated U.S. wealth offering.

And I say that it's about connecting the dots because it – rarely do you get an opportunity to start with 14 million clients and be able to build a wealth management franchise based on that embedded client base, and that's essentially what we're doing. So, we're relying a great deal on TD Ameritrade for the mass affluent offerings, both self-directed and other sort of light-advice type products. We're leveraging the Bank's capabilities in the high net worth space to franchise commercial clients and retail clients into that book of business. And we're bringing TDAM's fixed income, low vol, outcome-oriented solution sets with Epoch's established position in the institutional market to really create a very distinctive asset management presence in the U.S. It is a very different market, so I don't want to – it is a more fragmented market. In some respects, it's certainly a very competitive marketplace, but some of the basic factors that allowed us to be able to build a very successful advice business in Canada, I think, also exists in the U.S.

So, the discipline around distribution, around client alignment, I think, is going to be fundamental to building a world class business there, and just to put some numbers on it. This year, that business, which is relatively young, is on track to generate just under CAD 100 million in earnings. So, it's early days for that business, but I think the potential for us to be able to replicate the success we've been enjoying in Canada organically in the U.S. is clearly there.

Robert Sedran – CIBC World Markets – Analyst

So, 200 advisors in the United States – I mean, 200 advisors in Canada would sound like a small number.

Leo Salom – TD – Executive Vice President, Wealth Management

Yeah.

Robert Sedran – CIBC World Markets – Analyst

200 advisors in the United States...

Leo Salom – TD – Executive Vice President, Wealth Management

Without question.

Robert Sedran – CIBC World Markets – Analyst

...sounds like a lot of work still to be done. Where would you like that to get to? And when you think about where these people will come from, and I guess maybe this is back to this full acquire versus buy perspective, is there – can you do this organically? Do you need an acquisition? Are you looking around? Like what's the thought process around both manufacturing and distribution in the United States?

Leo Salom – TD – Executive Vice President, Wealth Management

So, Rob, we are – I don't envision us ever having your classical bank brokerage model in the U.S. At the risk of limiting options, I don't view that, that's going to be the most successful and profitable model to build a wealth management franchise in the future.

What we would like to do is leverage the fact that we don't have a full service brokerage practice in the U.S. to be able to go much more aggressively in digital and directly driven advice solutions. I'm avoiding the term robo-advisor because I think robo-advisor is too much of a simplification. I think the end state solution that is going to win the day is a digital solution supported with a certain degree of human interaction in a very intimate manner to be able to provide sophisticated advice, but in a much more scalable manner. And we have an opportunity. Since we don't have a full service brokerage business in the U.S., I don't have much risk of channel conflict or any degree of cannibalization. I can be much more aggressive in that mass affluent space with an alternative solution to your classical full service brokerage business.

So, what you could expect from us is leveraging our TD Ameritrade knowhow, our retail banking presence, and the lack of potential, some would say, a disadvantage today that we don't have a full service brokerage business to be able to reformulate the strategy and offer something that's very distinctive, and potentially, somewhat disruptive in terms of price point.

Robert Sedran – CIBC World Markets – Analyst

I mean, it's an interesting point, clean sheet of paper, you probably wouldn't build the banks the way they are built today. And so you have the opportunity to build something different.

Leo Salom – TD – Executive Vice President, Wealth Management

Correct.

Robert Sedran – CIBC World Markets – Analyst

And it's almost a bit of a hybrid of the two. When you come back now to Canada though, and think of that same world as it exists today. When you think about TD Waterhouse, not the full service brokerage, but the direct brokerage, how does that model evolve – number one market share by a good site.

Leo Salom – TD – Executive Vice President, Wealth Management

Sure.

Robert Sedran – CIBC World Markets – Analyst

How does that market evolve to capture the robo and capture the other alternatives, but also be able to provide some advice over top?

Leo Salom – TD – Executive Vice President, Wealth Management

So, we start in the U.S., as Rob has alluded to, with an incredible position in the direct investing space.

That business has a 41% share of the marketplace. We have 1.5 million clients that deal with us today in a direct basis. Over the past 18 months, we've been spending an incredible amount in retooling the entire active trading capability, we've built an active trading engine. We've completely redone the front end, we've created mobile banking and mobile trading capabilities to be able to shore up what has been the base of that business, which is the true active trading side of the house.

But to Rob's point, unless we pivot and add a long-term investor strategy to that piece, I think we would be leaving money on the table. So, as we think about 2017, and certainly 2018, tremendous amount of focus for our direct investing business is coming up with a long-term investor strategy that allows us to complete that sort of direct advice component piece.

Now, it's not at – it's not necessarily a conflict to the full service brokers, because what I'd like to try to do is use a lot of the plumbing that we're going to build for the direct investing business and be able to provide that same infrastructure to our full service brokers, so that they could potentially build scalable sub solutions as part of their offerings.

And so we're working through that model now, but I think the one clear takeaway is algorithmic investing, the science around that is going to be foundational for Wealth Management regardless of what channel you talk about. So it's an area that we're spending a great deal of time on building the data infrastructure, building the rules engines, and building the front end applications to be able to provide that sort of solution, whether it be on a completely direct basis or in some sort of hybrid structure to the full service brokers.

Robert Sedran – CIBC World Markets – Analyst

You talked about plumbing, and you know anyone who has renovated a house knows how expensive plumbing is.

Leo Salom – TD – Executive Vice President, Wealth Management

Tell me about it.

Robert Sedran – CIBC World Markets – Analyst

Yeah. So when you think about all the various places you can spend money, and a lot of these trading tools don't come cheap.

Leo Salom – TD – Executive Vice President, Wealth Management

Sure.

Robert Sedran – CIBC World Markets – Analyst

How do you manage to not overbuild and to not sort of go down the wrong rabbit hole, so that you're investing money in things that actually people will use?

Leo Salom – TD – Executive Vice President, Wealth Management

So, we've been – at the risk of oversimplifying, we've been focusing our technology spend, which I think is critical in the Wealth Management business. I think the pace of change, both regulatory and otherwise, is dictating a focus on technology that we haven't necessarily had in the last 10 years. But we're focusing on four areas. One is the retooling of the direct investing platform because that was – we felt that we had to defend what is a critical source of profitability for TD Wealth.

Second, it's retooling the entire advisor desktop. I've got to be able to arm our advisors if I expect them to deliver legendary service, which is our aspiration within TD. We've got to arm them with the tools to be able to deliver that experience, and increasingly, given CRM2, their ability to evidence their value proposition is fundamental. So arming them with an advisor desktop CRM capability, dynamic portfolio generating capabilities, investment proposal engines, et cetera, and linking that seamlessly so they can scale their own practices is fundamental.

Third area, and this is an area that across the entire franchise, we're spending a lot of time on, is the end-to-end process automation. Is looking at – we've been looking at our top eight processes within Wealth and saying how do we fundamentally retool them so that we can take out significant costs out of our backend operations. And I need to do that in order to meet some of the margin compression challenges we might have, and to be able to fund some of the initiatives that we want to do going forward.

And then, in the final piece, which is a little bit more generic, less applied is the data architecture. In order for us to respond to regulatory changes or simply business changes, we need a completely – we needed, within TD Wealth, a completely different data architecture to be able to respond to those requests in a much more strategic way.

So, this year, a significant portion of spend around CRM2 and point of sale, et cetera, we've engineered that to be able to lay the foundation for data architecture that gives us optionality going forward. But collectively, we're spending more money on technology, but I think in the long run, it will give us significant efficiencies and also allow us to be able to innovate much more effectively going forward.

Unidentified Audience Participant

Are you able to keep your most productive salespeople in wealth? And a related question is, is it important to your customers that it's fundamentally people serving them, or not?

Leo Salom – TD – Executive Vice President, Wealth Management

Without question. In fact, retaining your best advisors, whether that be in the mass affluent space, in the high net worth space is job one, because much of our solutions in the advice businesses are dependent on that, on the intimacy of that client-advisor relationship. So making TD the most attractive place for that advisor to build a practice, and giving them the tools to be able to scale that practice so that they view that there is no plateauing based on either administration or challenges, that is fundamental in terms of being able to manage a brokerage business. And we've been fortunate, we've had very low turnover.

We've been a little bit more acquisitive in terms of trying to bring new teams to be able to round out our high net worth offerings in select markets. But thus far, I think the combination of the organic model with retail, the technology driven support structure that we're trying to drive in the Wealth business, and I think the culture within TD broadly, has allowed us to be able to create a good environment. It's a different environment than your classic full-service brokerage business, it's a much more integrated wealth management model. But it's one that has served us well thus far.

Robert Sedran – CIBC World Markets – Analyst

I guess that part of the answer, you've – you're creating an environment where I'm part of an integrated offering, I don't have to smile and dial quite so much, I'm getting referrals from the branch network, and so my – I'm more of a relationship manager than I am a hunter?

Leo Salom – TD – Executive Vice President, Wealth Management

Exactly right. And with the added twist, Rob, that what we're asking the advisors to do, is to truly be representatives of the institution from a high net worth advisory perspective. So not just view themselves as the classical investor manager, but position themselves as high net worth advisors so they can bring the entirety of the bank to bear, whether that'd be private banking, other advisory services, trust and estate, the philanthropic service group, commercial banking solutions, and do that as seamlessly as possible. If I can get our very best high net-worth brokers to act as a high net-worth advisor and truly franchise their clients effectively, that's an extremely powerful model. And it's been a journey, but I think given the fact that we built our platform organically, we have more individuals that think that way and can actually execute against that strategy.

Robert Sedran – CIBC World Markets – Analyst

You've talked about some of the tools that you put in place from a direct investing perspective, from a data architecture, data infrastructure perspective, and I noted the use more than once of the past tense. Are you kind of exiting an investment cycle here, and so the benefits to revenue should be there, the operating leverage should improve, or – I know the answer is we're always spending, but it's a bit of heightened investment spending that we're coming out of?

Leo Salom – TD – Executive Vice President, Wealth Management

Rob, the way I would say that is, I think the reason why I use the past tense is that some of the foundational builds are now somewhat past tense. I'd say somewhat because there's still -- in data, there's still some work that we have to do to convert what are more back-end applications of data to be more real-time, and much more trigger event-based, which requires some additional tooling. But foundationally, I think we've made some good progress.

I think the exciting part starts now, is the application of that infrastructure, both data and sort of core technology in terms of solutions, whether they be advisor solutions or client solutions or digital innovations. And I'm a big believer this place is – this space is awfully crowded. There's – if I try to compete on legacy capabilities in a world that's changing very quickly, we run the risk of them being a commodity price product, then that's – there's no fun in doing that. So, by staying ahead of this innovation curve, providing direct solutions to clients, supporting our advisors much more dynamically, I think it positions us well to compete.

Robert Sedran – CIBC World Markets – Analyst

Is there a room on the TD Waterhouse platform for some kind of robo-advice just to forestall that external threat or is there not needed because the external threat is not that big?

Leo Salom – TD – Executive Vice President, Wealth Management

No, no. I think going back to the question, I used the term long-term investing strategy within direct investing, but it's a proxy for robo-advisory capability. We might – I'm just – the reason why we resist robo-advisors, there is so much research that says the clients, while they will do much of their own self-exploration sort of discovery online, when they get to trade a significant portion of their net worth, they just want a degree of human validation. So, any robo-advisor model, I think, that will be truly successful at multiple tiers of segments is going to require a hybrid capability. Great plumbing, great algorithmic trading, precision in terms of the investment management science behind it, but I still think there's going to be the need to make sure that model interacts with some sort of human validation component, to be able to give our clients a little bit of confidence, to mature into direct investors and direct traders. And so, we're spending a lot of time thinking through how do we do that effectively.

Robert Sedran – CIBC World Markets – Analyst

We're out of time. That was a quick half hour. Thank you very much for participating in the questions.

Leo Salom – TD – Executive Vice President, Wealth Management

Well, thank you. Thank you, everyone.