TD BANK GROUP
Q1 2016 EARNINGS CONFERENCE CALL
FEBRUARY 25, 2016

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

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PRESENTATION

Gillian Manning – TD – Head of Investor Relations

Good afternoon and welcome to TD Bank Group first quarter 2016 investor presentation. My name is Gillian Manning, and I am the Head of Investor Relations at the Bank. We'll begin today's presentation with remarks from Bharat Masrani, the Bank's CEO. After which, Riaz Ahmed, the Bank's CFO, will present our first quarter operating results. Mark Chauvin, Chief Risk Officer, will then offer comments on credit quality. After which, we will invite questions from pre-qualified analysts and investors on the phone. Also present today to answer your questions are Teri Currie, Group Head-Canadian Personal Banking; Mike Pedersen, Group Head-U.S. Banking; and Bob Dorrance, Group Head-Wholesale Banking.

At this time, I would like to caution our listeners that this presentation contains forward-looking statements that there are risks that actual results could differ materially from what is discussed and that certain material factors or assumptions were applied in making these forward-looking statements. Any forward-looking statements contained in this presentation represent the views of management and are presented for the purpose of assisting the Bank shareholders and analysts in understanding the Bank's financial position, objectives and priorities, and anticipated financial performance. Forward-looking statements may not be appropriate for other purposes. I would also like to remind listeners that the Bank uses non-GAAP financial measures to arrive at adjusted results to assess each of its businesses and to measure overall Bank performance. The Bank believes that adjusted results provide readers with a better understanding of how management views the Bank's performance. Bharat will be referring to adjusted results in his remarks. Additional information on items of note, the Bank's reported results, and factors and assumptions related to forward-looking information are all available in our Q1 2016 Report to Shareholders.

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

Bharat Masrani – TD – Group President and CEO

Thank you, Gillian, and thank you, everyone for joining us today. Q1 was a good quarter for TD. We demonstrated our ability to grow earnings in a challenging environment with net income up 6% from a year ago to $2.2 billion, and earnings per share up 5% to $1.18. Our Retail businesses performed well as organic growth, expense discipline, and a stronger U.S. dollar helped offset the impact of higher taxes and credit provisions in line with expectations.

Our Wholesale business had a tougher first quarter due to difficult markets. Our Basel III Common Equity Tier 1 ratio ended the quarter at 9.9% and our leverage and liquidity coverage ratios remained strong. Reflecting these strong fundamentals, we declared a $0.04 dividend increase today taking our dividend to $0.55 per share, an increase of 8%. Good news for investors. We also completed the share buyback program we announced last quarter repurchasing 9.5 million shares for cancellation to offset dilution from our dividend reinvestment program and issuance related to stock options. Overall, I'm pleased with these results which reflect good execution under demanding conditions.

Turning to our businesses, Canadian Retail net income rose to $1.5 billion this quarter, up 4% from a year ago. Our banking and wealth franchises performed well, benefiting from higher volumes, rising fee income, and tightly-managed expenses. Personal Banking delivered record growth in mortgage originations and checking account balances. Our Wealth business grew net assets by more than $10 billion despite volatile equity markets. And we completed the rollout of cheque imaging across our Canadian branch network, an innovation from our U.S. franchise that is improving the customer experience and reducing costs. As expected, these good results were partly offset by higher provisions for credit losses, further margin compression due to prolonged low rates, and higher taxes.

Our U. S. Retail segment generated record earnings of US$470 million this quarter, an increase of 3% in U.S. dollars and 20% in Canadian dollars. Revenue was up 5% year-over-year reflecting strong growth in loan and deposit volumes as we continued to take share. In particular, we saw continued good momentum in household growth with our rate of customer acquisition, again, outstripping the industry. Other favorable factors included a sequential increase in margins and strong expense management across the board. While provisions for credit losses rose, this was largely due to an allowance build to reflect volume growth.

Wholesale Banking net income was $161 million, down 16% from a year ago. Higher fee-based revenue from M&A activity and corporate lending was offset by reduced equity trading volumes and lower security gains. While domestic origination markets were subdued, our U.S. platform continued to make good strides with TD Securities named co-lead on several marquee transactions.

Looking ahead, our results this quarter highlight the challenges we will face during the balance of the year and how we will meet them. We have signaled for some time that we expected a normalization in credit conditions. That became apparent this quarter. But while provisions rose, this was due in large part to volume growth, prior period recoveries, and the negative impact of foreign exchange. Underlying loss rates remain acceptable. We did experience some negative credit migration in oil and gas portfolios, and we added to reserves accordingly. We continued to monitor our oil and gas exposures closely and remain confident that any losses will be manageable given the small size of this exposure relative to our balance sheet. Mark will address credit in more detail in his remarks, but at a high level, credit quality remains strong across our Canadian and U.S. portfolios and we are comfortable that we are adequately reserved.

More generally, the heightened focus on credit and falling commodity prices reflects growing concern that fiscal and monetary authorities will be unable to prevent a slowdown in the global economy. The resulting increase in risk aversion has unsettled financial markets and shaken confidence in the outlook. While this volatility can be unnerving, it is important not to lose sight of the fundamentals. TD's business model is strong. Our retail-focused strategy and deposit-rich balance sheet have proven their resilience and continue to position us well to earn through the challenges ahead. Let me tell you how.

First, while resource-rich provinces in Canada are struggling, cheaper energy prices and a falling currency are giving a lift to export-oriented manufacturers. This is boosting economic growth and employment in central Canada where TD has an outsized presence. We expect to continue generating good organic growth in these markets, leveraging the power of One TD to meet our customers' banking, wealth management, and insurance needs.

Second, we will draw continued strength from our sizeable U.S. earnings base. The appreciation of the U.S. dollar has increased our earnings in Canadian dollar terms. It also reflects the prior improvement in the U.S. economy. While the instability in financial markets has sparked concern that the U.S. recovery may falter, steady gains in job creation and wage growth are supporting consumer spending and business investment is holding up well, particularly along the Eastern seaboard where we are based. Out Retail franchise will benefit from these conditions as well as our ability to consistently take share. In this environment, our North American footprint is a significant advantage.

Finally, the hard work we did last year to manage our cost base has equipped us better to respond to volatile markets and rising competition from nontraditional players. Customer needs are evolving and long-term success depends on the ability to invest today in the products, delivery channels, and technologies of tomorrow. By improving our productivity and streamlining our processes, we have generated savings that we are reinvesting to enhance the customer and employee experience and drive continued outperformance in our businesses.

Let me take a moment to highlight a couple of milestones that speak to these successes. In 2015, TD became the first Canadian bank to introduce touch screen, image-enabled, envelope-free ATMs. In December, TD Direct Investing regained the number one ranking among the Canadian banks in the Globe and Mail's annual online broker survey. Our redesigned WebBroker platform was recognized as best client website for delivering a more intuitive and personalized investing experience.

In January, we opened the TD-Cisco Lab in Toronto where a dedicated team will collaborate on FinTech solutions in areas including employee, mobility, the Internet of Things, contact center operations, and energy conservation. Together with the TD Lab at Communitech and our new Waterloo Technology Center, this latest hub further expands our innovation ecosystem. And just this month, we launched an employee pilot for TD MySpend, a new mobile app that will help customers track spending in their personal and credit card accounts and manage their financial wellness in real time on their smartphones. You can expect to hear about more such achievements in the quarters to come as we continue to grow our leadership position and deliver best-in-class customer service in the online and digital banking space, just as we have in our branches and stores.

To wrap up, I'm pleased with our first quarter results and the discipline our businesses are showing. While the outlook remains uncertain, we are achieving profitable growth staying within our risk appetite and continuing to adapt and innovate. I'd like to thank our 80,000 employees across the globe for continuing to deliver for our customers and our shareholders. We have much to be proud of and I'm confident that together we can build on this momentum in the year ahead.

With that, I'll turn it over to Riaz.

Riaz Ahmed – TD – Group Head and CFO

Thank you, Bharat, and good afternoon, everyone. Please turn to slide 5.

This quarter, the Bank earned adjusted EPS of $1.18, up 5% year-over-year. Canadian Retail earnings grew 4% and U.S. Retail earnings grew 20% in Canadian dollars, and 3% in U.S. dollars. Wholesale earnings declined 16% versus Q1 in 2015. Adjusted total revenue increased 12% year-over-year, or 4% excluding FX and acquisitions, led by loan, deposit, and wealth asset growth, and higher fee income. Growth was partially offset by margin compression. Adjusted expense growth was 12% year-over-year, or 1% excluding FX and acquisitions. Quarter-over-quarter, expenses declined $83 million on the same basis. The Bank posted operating leverage net of insurance claims of 4.3% for the quarter. Please turn to slide 6.

Canadian Retail delivered net income of $1.5 billion, up 4% year-over-year, led by loan, deposit, and wealth asset growth and higher fee-based revenue. The increase was partially offset by higher PCL and a higher effective tax rate. Total loan growth was 6% year-over-year with personal lending up 5% and business lending growth up 10%. Deposits increased by 5% due to growth in core chequing and savings accounts, which were up 10%, business deposits grew 3%, and wealth assets were up 2%.

Margin declined 4 basis points quarter-over-quarter, primarily due to the low interest rate environment, competitive pricing, and some seasonal impacts such as lower mortgage renewal revenue. We expect margins to remain under modest downward pressure, reflecting the interest rate environment and depending on product mix and competitive factors. PCLs increased 3% quarter-over-quarter, primarily reflecting higher commercial recoveries in prior quarters. Adjusted expenses were flat to quarter one of last year, and our efficiency ratio improved. Please turn to slide 7.

Our U.S. Retail Bank posted record earnings of US$470 million, up 3% from Q1 2015. Results for the quarter reflected revenue growth and expense management, partially offset by higher credit losses and margin compression from the prior year. Total loan growth was 15% year-over-year, reflecting a 9% increase in personal loans and a 20% in business loans. Average deposits increased 9%.

Margin increased 3 basis points quarter-over-quarter, reflecting higher deposit margins and positive balance sheet mix. Overall, absent interest rate changes, we expect margins to be relatively stable in 2016. Credit losses increased quarter-over-quarter, reflecting increased allowances for commercial loan volume growth and lower recoveries this quarter. Credit quality remains strong. Expenses were up 1% year-over-year, reflecting higher volume in investments to support the business growth, partially offset by productivity savings.

Earnings from our ownership stake in TD Ameritrade increased 4% year-over-year, primarily reflecting higher asset-based revenue and reduced operating expenses and partially offset by lower transaction-based revenue this quarter. Aggregate U.S. Retail earnings were up 3% year-over-year in U.S. dollars and 20% in Canadian dollars. Please turn to slide 8.

Net income for Wholesale was $161 million, down 16% versus quarter one last year. Revenue decreased 7% year-over-year, reflecting lower equity trading and lower security gains, partially offset by higher revenue in fee-based and fixed income and currency businesses. Non-interest expenses were down 1% due primarily to lower variable compensation and lower operating expenses, partially offset by foreign exchange translation. Please turn to slide 9.

The Corporate segment posted an adjusted loss of $178 million in the quarter compared to a loss of $143 million in the same period last year. The increase in net corporate expenses reflects ongoing investment in enterprise and regulatory projects, including unfavorable currency translation for U.S. dollar expenses this quarter. Other items include higher provisions for incurred but not identified credit losses due to volume growth and negative credit migration and exposures impacted by low oil prices within the Canadian Retail and Wholesale loan portfolios, partly offset by higher revenue from treasury and balance sheet management activities. Please turn to slide 10.

Our Common Equity Tier 1 ratio was 9.9% at the end of the first quarter, flat to Q4 2015. Internal capital generation in the quarter was offset primarily by the common share repurchase and actuarial losses on employee benefit plans. This quarter, we completed our previously announced normal course issuer bid repurchasing 9.5 million shares. Our leverage and liquidity ratios are consistent with the last quarter. Overall, our balance sheet remains well-positioned.

I will now turn the call over to Mark.

Mark Chauvin – TD – Group Head and Chief Risk Officer

Thank you, Riaz, and good afternoon, everyone. Please turn to slide 11.

Credit quality remained strong during the quarter, despite continuing uncertainty in the economy and challenges in the energy sector. Gross impaired loan formations ended the quarter at $1.7 billion, up $379 million, or 6 basis points, quarter-over-quarter. Formations in the Canadian portfolios have remained stable over the last four quarters at 19 basis points. In Canadian Commercial, we expected negative performance to emerge in the oil and gas segment, which was evidenced by $21 million in new impairments across a number of service and in-market customers. On a positive note, there were no new formations in the Wholesale portfolio during the quarter. The $379 million increase in U.S. Retail formations for the quarter was concentrated in the personal consumer loans with $121 million of the increase due to foreign exchange.

Continued renewal of the legacy HELOC interest-only product no longer offered by the U.S. Bank, accounted for $151 million of the increase. As outlined in last quarter's call, if a customer does not qualify under current underwriting standards when their interest-only HELOC comes due for renewal, we are required to classify the exposure impaired based on regulatory guidance even if payments are current. The increase in U.S. HELOC gross impaired formations is expected to moderate in future quarters, leveling off by year-end. Please turn to slide 12.

Gross impaired loans increased $555 million, or 7 basis points, for the quarter to $3.8 billion. Performance in the Canadian Retail and Wholesale portfolios remained strong. The level of Canadian Retail gross impaired loans continued to trend at cyclically low levels largely unchanged quarter-over-quarter at 29 basis points. In the U.S., our performance has been good across all portfolios with the exception of the HELOC portfolio for the reason indicated earlier. Of the $518 million increase in the U.S. Retail segment, $260 million or roughly half of the increase is attributable to foreign exchange. $246 million of the increase is due to ongoing renewal of legacy interest-only HELOCs, of which 90% remain current with their payments. The HELOC portfolio is adequately reserved with stable credit losses forecast for the balance of the year.

Continuing to slide 13. As announced earlier this quarter, U.S. strategic card PCLs are now reported in the U.S. Retail segment on a net basis including only the Bank's contractual portion of credit losses. For the purpose of the credit quality slides, however, we will continue to report the gross amount for U.S. Retail PCL to better reflect the quality of the portfolio. Provisions for credit losses are $648 million, up $98 million, or 5 basis points, quarter-over-quarter to 45 basis points. Loss rates from the Canadian Retail portfolio remained constant at 25 basis points. Allowance for incurred but not identified losses recorded in the Corporate segment increased $65 million during the quarter due largely to negative credit migration in Canadian Retail and Wholesale exposures impacted by low oil prices. This trend is expected to continue in the absence of a recovery in oil prices. The quarter-over-quarter PCL increase in U.S. Retail was $63 million, $28 million of which is due to foreign exchange. The balance is attributable to volume growth reserve builds for commercial loans and credit cards. Please turn to slide 14.

Now, I'd like to take a moment to discuss our oil and gas exposure. Drawn loans in the oil producer and services segments increased $500 million to $4.2 billion, representing less than 1% of total loans and acceptances. As expected, we are experiencing negative credit migration and loan impairments in this segment of the portfolio. Based on the current level of oil prices, we expect this trend to continue. Excluding real estate secured lending, consumer lending and small business banking exposure to Alberta, Saskatchewan, and Newfoundland and Labrador represents 2% of the Bank's gross loans and acceptances. Although we are seeing definite signs of deterioration in consumer lending, delinquency, and loss rates in the impacted regions, to-date, loan losses have been largely offset by strong performance across the rest of the country.

To conclude, the key takeaways in the quarter are: first, credit quality remains strong in the Canadian and U.S. portfolios; second, U.S. portfolio losses have largely normalized from unsustainably low levels in 2015 with losses expected to remain stable over the balance of the year. And lastly, our major concern continues to be low energy prices.

I previously indicated credit losses attributed to low oil prices to result in a 5% to 10% increase over 2015 actual levels. We are now approaching the upper end of the range in the current price environments. While material reduction in oil prices for an extended period would push losses slightly beyond this range, I am comfortable that losses will remain well within manageable levels based on our relatively small exposure to the oil sector.

With that, operator, we are ready to begin the question-and-answer session.

QUESTION AND ANSWER

Operator

Thank you. We'll take the first question from the line of Robert Sedran from CIBC. Please go ahead.

Rob Sedran – CIBC World Markets – Analyst

Hi. Good afternoon. Mark, just to come back to that 5% to 10% comment because I think people and I know I'm a little bit confused by it. I mean, in the context of a quarter where loan losses are up 26% sequentially, to say that oil is potentially less than 5% to 10% more. Are we talking just about the oil and gas specific provisions or are you talking about portfolio-wide or provision-wide 5% to 10% moves?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Yeah. So, that number represents our view or the impact of low oil prices on Wholesale or non-Retail loans that are directly related to oil. So, that would be oil and gas producers and servicers, as well as the impact to consumer credit in the impacted provinces, based upon elevated levels of unemployment. And our current view of what the economy would look throughout Canada under that scenario.

So, if you look at it, it's probably – in this quarter, I mean, the spike up, the general – the collective allowance that we established at $65 million was really largely to reflect the negative migrations in the oil and gas sector and in the consumer portfolios in those regions. So, that's really kind of a step-up as part of that process. But based upon current prices and if they're to stay at this level for a sustained period, I still think like in the 5%, or probably even closer to the 10% range now, for a year increase from 2015 would still be appropriate.

Rob Sedran – CIBC World Markets – Analyst

And that's if they hang around this level for, say, the balance of the year?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Well, and in the future years, though. A very slow recovery in oil prices.

Rob Sedran – CIBC World Markets – Analyst

Okay. So, I guess the view is that it's basically going to get lost in inter-quarter volatility, given it's far smaller than the move we saw this quarter, for example?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Well, given the relatively small size of our portfolio, I think you could look at the 45 basis point loss rate that we recorded as an enterprise this quarter, kind of includes the build-up in the reserves and I kind of would say that that's kind of the level that I would look at, barring a recovery in oil prices.

Rob Sedran – CIBC World Markets – Analyst

Okay. Thank you.

Operator

Thank you. And we'll take the next question from the line of Peter Routledge from National Bank Financial. Please go ahead.

Peter Routledge – National Bank Financial – Analyst

Hi. Thanks. I guess, Mark, a more specific question for you. You have a paragraph in your shareholders report about non-prime loans in Canada. I guess these are automotive loans and the PCL...

Mark Chauvin – TD – Group Head and Chief Risk Officer

Yeah.

Peter Routledge – National Bank Financial – Analyst

Yeah, the PCLs go up to 7.96% from 3.43% in the quarter and that kind of jumped out at me. I wonder if you could give us a little color on that.

Mark Chauvin – TD – Group Head and Chief Risk Officer

Yeah. So, I would say on the indirect auto in Canada, prime and non-prime or what you're referring to, is the one area that we're seeing the initial credit losses in the oil impacted provinces. And so, that was one factor that drove it up and there has been some other operational changes that we implemented in the collection processes for indirect auto which has had an impact. To spike it during the quarter, we expect it get part of it back next quarter going forward. But those are probably the two major drivers in that one quarter increase.

Peter Routledge – National Bank Financial – Analyst

Did that shock you? I mean, I read that now and, wow, that's a really big lift. And does that sort of caused you to look at your portfolio and say, maybe there's more risk in there than we think in our stress testing.

Mark Chauvin – TD – Group Head and Chief Risk Officer

No, I'd say, it did not. It has created a lot of attention though in terms of the operational changes that we implemented and to make sure that we bring things back to a lower level. But we are expecting them to increase in that sector. But the loss rate itself – I guess the operational issue was a bit of a surprise, but that really wasn't related to an economic factor.

Peter Routledge – National Bank Financial – Analyst

Fair enough. Thanks. And just for Mike, in U.S. Retail, net income up 3%, pre-provision income year-over-year, up 11%. It's generally a trend I've seen over the last four quarters. I mean, it just seems like you've given up your organic growth to higher credit losses and maybe get your thoughts on that.

Mike Pedersen – TD – Group Head, U.S. Banking

Yeah, so I was actually very pleased with the quarter. Last year, remember, we had a very strong quarter as well. And that was helped by two things: one was a one-time expense item that was positive which we did call out; the other was low PCLs in the quarter because we had both releases and recoveries last year. So, in that sense, I actually regard this quarter as very strong.

We had very good revenue growth and good expense management that enabled us to earn through the PCL increase which was an increase we have been expecting and alluding to in terms of the prospective normalization of the credit environment.

Peter Routledge – National Bank Financial – Analyst

I mean, presuming you get the same level of pre-provision income growth, will we see that flow directly to the bottom line in 2016?

Mike Pedersen – TD – Group Head, U.S. Banking

I expect that we'll have fairly good revenue growth in 2016. I was careful at Q4 and sort of characterized the outlook as modest NIAT growth in 2016. The truth is we've had a strong first quarter and we had the rate increase, so that makes me more positive for the year.

So, I'm hopeful the revenue growth will continue. On expenses, it reflects the productivity work we've been doing. We are going to invest, but I'm still looking to fairly low expense growth this year and strong positive operating leverage, so...

Peter Routledge – National Bank Financial – Analyst

But then, are you not worried about provisions eating up the benefits of that operating leverage?

Mike Pedersen – TD – Group Head, U.S. Banking

No, as Mark said, we don't expect them to grow from the current level during 2016.

Peter Routledge – National Bank Financial – Analyst

Right. Right. Okay. Thanks.

Operator

Thank you. And the next question comes from the line of Gabriel Dechaine from Canaccord Genuity. Please go ahead.

Gabriel Dechaine – Canaccord Genuity – Analyst

Good afternoon. I just want to talk about some Alberta stuff and then the U.S. cards business. In Alberta, can you give me just the specific balances of your auto loans, unsecured personal loans, and credit cards in Alberta for the oil-exposed regions, I should say?

Mark Chauvin – TD – Group Head and Chief Risk Officer

So, it's Mark. Yes, I can. RESL is $43 million, 62% of that is insured. Cards is...

Gabriel Dechaine – Canaccord Genuity – Analyst

Billion?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Yeah. I'm sorry, billion. Yeah. I got to get the billions. $2.5 billion on cards, and that's – and then personal lending like unsecured lines of credit and the such $1.6 billion, and TD Auto Finance is $4.2 billion. It represents about – in terms of the Bank's consumer credit, it's around 17% is in Alberta.

Gabriel Dechaine – Canaccord Genuity – Analyst

Okay. So, it's pretty proportionate to the population. Then on the U.S. business, it looks to me like the – I mean, like the cards PCLs not a big spike here, but it looks like there's some underlying deterioration there on a quarter-over-quarter basis. Is there anything going on there that we should be aware of?

And then just in general, how do you manage that cards business from a collection standpoint, if and when it does become an issue because – maybe this just a theory, but does the consumer have as much urgency to pay off a store-branded credit card in a period of stress as they would a directly issued by the bank card, or is that a wrong analysis?

Mark Chauvin – TD – Group Head and Chief Risk Officer

So, maybe I could take the first part of the question. The increase really was not risk-driven but volume-driven, if you go through the various portfolios in the cards portfolios. Whether it's in the Target, of course, Nordstrom is new so that's an addition, so that's a stepwise up increase. But if you look to – and we do an analysis of what drives the increase. And actually from a risk perspective, it was relatively stable. It was really a volume-driven exercise that resulted in the increase.

Gabriel Dechaine – Canaccord Genuity – Analyst

But how do I make that assessment though? It looks like the -this is from your data from your slide deck page 25. If I look at the GIL ratio in credit cards, it's 150 basis points, it was 125 basis points last quarter, it was lower than that in the prior quarter. Like is that – I mean, I guess, yeah, there's seasonality there perhaps, but how do I look at those numbers and say, oh, that's volume-driven not risk-driven?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Yeah, well I guess I'm looking at our reserving methodology to get the numbers that I've given which would be more detailed analysis based upon the credit metrics.

Gabriel Dechaine – Canaccord Genuity – Analyst

Okay.

Mark Chauvin – TD – Group Head and Chief Risk Officer

I'd have to look at those numbers on the slide and get back to you on that.

Gabriel Dechaine – Canaccord Genuity – Analyst

Okay.

Mike Pedersen – TD – Group Head, U.S. Banking

It's Mike. There's one factor that's built into our numbers and that we expect and it's behaving as we expect it. But that is that with cards, as we build that book quite fast, there's a phenomenon we call seasoning which means that in the second year, you tend to get a little more delinquency and loss than you do in the first year. So, as you build, that gets reflected as the cohort seasons. So, you're seeing a little bit of that across the portfolio, but that was very much – it's behaving as expected, nothing that causes us any worry.

With respect to your second question, it's difficult to answer because we have built-in expectations of losses for each of the partner portfolios and we have many. And all I would say is that they're also behaving as expected and that we don't see anything that worries us.

Gabriel Dechaine – Canaccord Genuity – Analyst

Thank you. And just a quick one here, the U.S. auto loan book, you have a very small, if any, exposure to subprime if I recall correctly. So, it's mostly prime and super prime, right?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Yeah, there's really de minimis subprime.

Gabriel Dechaine – Canaccord Genuity – Analyst

Okay. Great, thanks.

Mark Chauvin – TD – Group Head and Chief Risk Officer

We do not do subprime but there may be one or two.

Mike Pedersen – TD – Group Head, U.S. Banking

Right. And even near prime is about 10% of the portfolio.

Gabriel Dechaine – Canaccord Genuity – Analyst

Okay. That's what I have in my notes. Thanks.

Operator

Thank you. And the next question comes from the line of Meny Grauman from Cormark Securities. Please go ahead.

Meny Grauman – Cormark Securities – Analyst

Hi. Good afternoon. Just touching on the 5% to 10% credit losses. You talked about sort of the underlying assumptions regarding economic performance in the rest of Canada. I'm wondering if you could just comment on just what kind of real GDP expectations you model in, ex-Alberta, when you modeled that out and maybe the unemployment as well.

Mark Chauvin – TD – Group Head and Chief Risk Officer

Are you referring to the regions outside the oil-impacted provinces?

Meny Grauman – Cormark Securities – Analyst

Yeah. Sort of what are you assuming for the rest of the country in terms of offsetting strength in the rest of the country?

Mark Chauvin – TD – Group Head and Chief Risk Officer

The primary drivers in the consumer credit analysis is what it would impact, would be unemployment. And so, we have fairly significant increases in the oil-impacted regions. But we don't – in our current economic forecast or view for the rest of the region is not to have a material change in the unemployment rates, and therefore, you don't see a deterioration in consumer credit in our more concentrated areas being in Ontario. In fact, the reality is what we've seen over the last in this quarter is a strengthening in credit quality in those regions versus the deterioration that we've seen in the oil-impacted regions or provinces.

Meny Grauman – Cormark Securities – Analyst

Do you run a more severe scenario analysis where you assume maybe more of a downturn in the unemployment rate?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Well, we run numerous stress tests on an ongoing basis. On an enterprise-wide basis it would have peak-to-trough reductions in GDP of up to 3% to 4% and home price reductions into the 25% range, unemployment peaking in the mid-teens. And we actually have scenarios that would also be as harsh as the CCAR scenarios that we do in the U.S., and we really translate those across the enterprise. But that's a different exercise. That's an enterprise-wide stress testing exercise to determine our capital adequacy and whether we feel we're well capitalized to satisfy ourselves on those fronts.

Meny Grauman – Cormark Securities – Analyst

Would you be comfortable releasing any of that impact on credit, specifically?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Not really, no.

Meny Grauman – Cormark Securities – Analyst

Okay.

Mark Chauvin – TD – Group Head and Chief Risk Officer

Obviously, credit losses go up, but they would – yeah, I wouldn't want to give specific ranges.

Meny Grauman – Cormark Securities – Analyst

Okay. Fair enough. And then I just want to ask about the reserve build and just if you could maybe comment on the process around that. I think you mentioned maybe one of the factors driving that was the weakness you're seeing on the indirect auto side. Just any sort of comments in terms of how quantitative that process is and…

Mark Chauvin – TD – Group Head and Chief Risk Officer

I would say it's a highly quantitative process. So, really, for the non-Retail portfolios it'll be largely driven by the migration you experience in the portfolio. So, in the oil and gas segment, you've seen fairly significant negative migration. We have seen other areas. But so when it migrates, it just requires you to carry a higher reserve against them. In terms of the Retail portfolios, it's based upon your delinquency in other credit metrics. And as these change, it drives a higher number.

So, that's kind of the exercise we went through. And I say the $65 million increase, that is the outcome of what we feel is the appropriate reserving methodology, which is probably 85% math and the balance is an overlay of judgment. But the judgment in the current uncertainty tends to be on a conservative side and might bolster your number slightly.

Meny Grauman – Cormark Securities – Analyst

Thank you very much.

Operator

Thank you. And the next question comes from the line of Sohrab Movahedi of BMO. Please go ahead.

Sohrab Movahedi – BMO Capital Markets – Analyst

Thank you. A question for Teri, first. The Canadian Banking segment, excellent expense performance and operating leverage, I mean, zero expense growth. Is that – obviously not repeatable, so what do you think as far as the operating leverage outlook over the next two to four quarters, let's say?

Teri Currie – TD – Group Head, Canadian Personal Banking

So, we continue to strive for positive operating leverage net of claims for the full year. There will be some bumpiness in quarters, and we will, of course, continue to look at investments that make sense as we go through the year. We don't think flat expenses are sustainable through the year, as you mentioned, but we do expect to actively and prudently manage expenses so that we come in under last year's level.

Sohrab Movahedi – BMO Capital Markets – Analyst

Okay. And maybe one for Bharat or – and/or Mark. There was a good quote from Jacob Lew saying, don't expect a crisis response in a non-crisis environment. Are we still in a non-crisis environment vis-à-vis this oil and gas stuff?

Bharat Masrani – TD – Group President and CEO

So, this is Bharat. I think it is easy and I said this in my comments. It's unnerving because of the volatility we are seeing and the sometimes correlation that's approaching one on oil prices to market sentiment, and I think we need to take this in perspective in a sense especially from TD's perspective as I pointed out. We have a particular business model that has shown resilience in the past.

We are retail-focused. We have a deposit-rich balance sheet. The business mix we have in Canada and in the U.S. provides us with a huge advantage. If you look at what we have done on the productivity front to allow us to make the investments and to adapt to the environment we are finding ourselves in and put all those things together, this is what normally what you should expect out of TD.

But your general question, yes, there is a regional story without a doubt. But I think the other part of the story is that the central Canada appears to benefit from it, as it should. Manufacturing seems to be coming back. Exports are stronger now than they were in the previous years and currency is helping in that regard. And you're seeing fundamental moves in the U.S. and I mentioned in my comments, what you're seeing in employment growth, in wage growth especially on the Eastern Seaboard.

It's a long way of saying that we are seeing many aspects of our business that are doing quite well. But that doesn't mean that we are oblivious of what's going on in one part of Canada or the oil-producing part of Canada and we are seeing stresses there and we are managing them as you'd expect from TD.

Sohrab Movahedi – BMO Capital Markets – Analyst

Excellent. Thank you very much.

Operator

Thank you. And we'll take the next question from the line of Sumit Malhotra from Scotia Capital. Please go ahead.

Sumit Malhotra – Scotia Capital – Analyst

Thanks. Good afternoon. I'm going to have a question for Mark Chauvin on page 34 of your supplement. So, I'm going to give you a minute to get there, and in the meantime, I'm going to ask Mike Pedersen a question. For Mike, the question is on U.S. net interest margin. Riaz stated that you're expecting NIM in the U.S. to be flattish absent any changes in – or any rate hikes for the balance of the year.

Now, when I think about this quarter, you're up 3%. You have the partial benefit of the rate hike during the quarter and the first full quarter of the Nordstrom's portfolio which I presume both of which would have helped NIM. So, when we think about it for the balance of the year, especially with the long end having moved as much lower as it did, why do you think you're able to keep it flat here in this environment?

Mike Pedersen – TD – Group Head, U.S. Banking

Well. So, yeah, you're quite right; in the quarter, we had a month-and-a-half of rate increase and on that issue, if it hadn't been for the rate increase, we'd be down 1 basis point. So that was a positive effect there. Nordstrom was obviously also a positive factor.

So, the general dynamic for the balance of the year is that our deposit margins are being assisted by the rate hike. We're assuming no other rate changes. And there's some ongoing pressure on loan margins along the lines of what we suggested last time. With respect to the long end of the curve, we've taken treasury actions so that for the next several quarters, we're not exposed to that.

Sumit Malhotra – Scotia Capital – Analyst

I just hear you say those things, it sounds like it's more likely to be down than it is to be flat.

Mike Pedersen – TD – Group Head, U.S. Banking

All right. Well, we expect them to be relatively stable.

Sumit Malhotra – Scotia Capital – Analyst

Okay.

Mike Pedersen – TD – Group Head, U.S. Banking

Remember, we get twice the benefit in terms of the rate hike than we did in this quarter. So, we expect it to be relatively stable.

Sumit Malhotra – Scotia Capital – Analyst

Okay. Let me then just go to the second one and we'll wrap it up there. On that page 34, for Mark, your credit card loss rates – to go back to this uptick in U.S. PCL, so when I look at your loss rates that are shown on line 41, over the last three quarters, you've had an increase of 100 basis points per quarter each of the last two. Now I know Q3 would've been just Target; Q4 would've been the blend; and then Q1, you had the full Nordstrom's impact in there as well. I wouldn't think there'd be a major difference in loss rates in these portfolios. Maybe you can correct me if I'm wrong or perhaps just give me some flavor as to why we've seen that magnitude of increase over the last couple of quarters.

Mark Chauvin – TD – Group Head and Chief Risk Officer

Yeah, I think to some extent, there's a bit of a seasonal, not a seasoning, as very appropriately pointed out by Mike, but a seasonal where you do find – you have higher balances during this particular quarter and you do end up seeing a higher spike in PCL. But we feel it's consistent with previous quarters, and I should quickly look back and see if it's the same.

But that would be the explanation. The Christmas spending, the increased level of balances that generate a higher reserve level, and then – which then translates into a higher PCL for the quarter.

Sumit Malhotra – Scotia Capital – Analyst

So, I think you said it earlier...

Mark Chauvin – TD – Group Head and Chief Risk Officer

You should see a drop-off next quarter. It's generally always drops off in the second quarter.

Sumit Malhotra – Scotia Capital – Analyst

All right. So, the key takeaway, you said it earlier, you think where you are in provisions on the U.S. this quarter is a good example of where you feel run rate should be in 2016?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Yes. I think we've hit the – we've been signaling the normalization is coming, and I feel that Q1 shows a normalized rate which basically relates to pretty good loss rates that we expect to continue which will translate into fairly constant dollar levels for the balance of the year.

Sumit Malhotra – Scotia Capital – Analyst

Thanks for your time.

Operator

Thank you. And at this time, I would like to turn the call back to Mr. Bharat Masrani for closing remarks.

Bharat Masrani – TD – Group President and CEO

Thank you, operator. As I noted in my remarks, pleased with the quarter and we're able to perform in a challenging environment and shows the resiliency of our business model, business mix, and the diversification that we have in our earnings.

So, that concludes our call. But before we close, I'd like to take this opportunity to thank Rudy as he heads off to a happy retirement. Over the last few years, Rudy has built a world-class IR team, winning accolades from our investors and analysts. I'd like to thank him for his leadership adding to TD's winning IR brand. At the same time, I'd like to welcome back into Investor Relations, Gillian Manning, whom you just heard earlier on, who will lead our IR team from here.

Thanks again for joining us, and we will talk to you folks 90 days from now. Looking forward to it.