TD BANK GROUP

BARCLAYS GLOBAL FINANCIAL SERVICES CONFERENCE

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PARTICIPANTS

Riaz Ahmed
TD Bank Group – Chief Financial Officer

John Aiken
Barclays Capital – Analyst

FIRESIDE CHAT

John Aiken – Barclays Capital – Analyst

Okay, gentleman. I think we'll kick off the start of the afternoon session. We have TD Bank Group, Riaz Ahmed, the CFO, I guess, wrapping up the Canadian Bank participation.

Riaz, thank you very much for coming.

Riaz Ahmed – TD – Group Head and CFO

Thank you, good afternoon, everyone.

John Aiken – Barclays Capital – Analyst

Happy to have you. Riaz, if you wouldn't mind just opening up and giving us a strategic overview of where TD sits today. And I guess, what you think the best prospects for growth are going to come from for all the segments.

Riaz Ahmed – TD – Group Head and CFO

Yes. I think if I can bring you back to about the time when we entered the United States in 2004 with the – first, the acquisition of Banknorth and then, later on in 2007, the acquisition of Commerce. Those platforms were essentially put in place as a big kind of a capital-allocation strategic decision. And the object was really twofold, one, to give us diversification and, 2, to sort of look for growth outside of Canada. And so I think, if you fast forward 12, 13 years into that strategy, I think, in the last little while, you really see it paying off particularly well post the U.S. election when the – I mean, the on-the-ground economy in the U.S. was already doing well prior to the presidential election. But post the U.S. election, the markets went into a bit of a euphoric state. And so you can see in the last 9 months and prior to that our U.S. franchise has really been on a tear. Net interest income has been growing nicely. Fee income has been growing nicely. Credit losses have been in reasonable shape. And expense growth has been contained.

And similarly, in Canada, where the TD Canada Trust retail franchise is very deeply seated in the Canadian economy, I think, in some of the major centers like in the Greater Toronto area and in Calgary, et cetera, we bank almost 1 out of 2 people in those centers. So we're a deeply seated franchise in Canada. And it's when we saw the Canadian economy start performing well and it was performing better than we expected and better than any economist expected. Most people thought that we wouldn't start seeing interest rate hikes out of Bank of Canada until the middle of 2018, and it actually started until the middle of 2017, and we've now seen 2. You're really starting to see the Canadian Retail franchise also pick up the momentum from the macros. And then we've got a Wholesale bank that has a very nice presence in Canada. And we've been growing it in the United States a little bit. And it's showing more consistent performance over the last 3 quarters as well.

So I'd say overall, the third quarter felt like all of our businesses are doing incredibly well. And we've had a step function growth in earnings this year compared to last with 19% year-over-year for the quarter, but 15% year-over-year on a year-to-date basis. So in strategic terms, I'd say that we feel very good about where the Bank is positioned.

John Aiken – Barclays Capital – Analyst

Riaz, you touched on this a little bit, in terms of the Canadian economic outlook, that we've actually seen a bit of divergence, not negative, but we've seen the Canadian economy surprise to the upside and a little bit of lagging growth against expectations on the U.S. side. How does this impact your near-term outlook for the business? And I guess, what I'd be interested in finding out is, how does this actually impact your strategic planning when things don't necessarily go in alignment?

Riaz Ahmed – TD – Group Head and CFO

Look, I think, our long-term strategic plans really don't worry about these kinds of things because the way we look at it is, big picture, we're nicely situated in Canada. And we have a very good franchise that we've built out on the East Coast side of the United States. And they will reflect the economies that they operate in. And our job is to make sure that we outperform in good times and we outperform in not so good times. And so the way we set our business proposition in customer convenience and service, in essentially running the bank from a low-risk side of the spectrum and making sure that we make the investments that we need to make to respond to what our customers' needs are and what our infrastructure development needs are. And then I think, the environment will go where the environment will go.

So I think we focus more on what is important for us from a strategy point of view, from our execution capabilities perspective and make sure that, if I can call it, all our ducks are aligned. And then, the amount of adjustment that you have to do in the short term in relation to what we think the economic outlook is, we worry about less, because we're not really in the business of making those calls from a timing point of view. I mean, were we making timing calls, we would have called the Canadian recovery wrong because it may happen faster than we expected it to. So really, we're not in the timing game, we're more in the franchise development game, I'd say.

John Aiken – Barclays Capital – Analyst

And then in the third quarter, you achieved a CET1 ratio of 11%. We're getting a little bit of a shift within the peer group in terms of where capital ratios are falling out. When you see 11% for TD, do you view this as a capital position that actually has excess?

Riaz Ahmed – TD – Group Head and CFO

Yes - we've constantly held the belief that we're not going to find ourselves chasing our CET1 up in relation to our peers or the global standards. I think we have a very well-defined regulatory regime in Canada that establishes a capital and a liquidity framework. And while sometimes – my perspective on this is if capital starts exceeding too much, then we return it to our shareholders. And then, John will call me a laggard on CET1, but that's okay, because what I'm really interested in is, do I have sufficient capital to grow my business, to manage – to carry the risks that I have. And if I have some acquisition opportunities that I feel I might want to store up some capital for, then we will do that. But other than that, we'll prefer to return that capital to shareholders. So our risk profile, when we stress test our balance sheet, I would say to you, nowhere near requires a CET1 of 11%. And so that's why we chose to extend the buyback this quarter.

John Aiken – Barclays Capital – Analyst

Fantastic. Riaz, before I ask the audience if they have any questions, can we actually start with the first polling question, please?

What's the most undervalued segment of TD's operations? It's domestic retail; it's U.S. Retail bank exposure; Wealth Management, including TD Ameritrade; relatively low capital markets exposure; or lower risk profile relative to the Canadian peer group? I didn't say excess capital, I'm sorry.

U.S. Retail exposure and Wealth Management. Actual, Riaz, I know that we are going to touch upon on U.S. Retail banking because it's what differentiates the group. But if you want to talk about Wealth Management, because that's something that we don't usually talk about with Canadian banks and, I think, it's something that does need to be reflected a lot better.

Riaz Ahmed – TD – Group Head and CFO

Yes. So my view is that actually the whole TD Bank is undervalued. I don't know if it's well appreciated or not, but if you look at 2017 consensus EPS and look at its growth over 2014 actual EPS, so I'm talking about the last few years, we've grown EPS by 30%, and that is clearly leading in the Canadian bank space.

So I think that we continue to believe that we are delivering the best growth in a low-risk manner. And what I get – what is a really interesting is that in even most of our mature businesses, we find products and businesses where we have growth opportunities. So if you think about a Canadian bank and think about the mortgage product and you'd say that's one of the most mature spaces that a Canadian bank would be in, especially one that would have a leading retail franchise. But 2 years ago, we discovered that we didn't have the right HELOC product. And in 2014, we made some innovative amendments to essentially introduce a more flexible HELOC product. And we're getting tremendous growth out of it.

And our business banking was not #1, and we're on a march to become #1 in the business banking. We're underrepresented in small business banking. We're underrepresented in Western Canada and in Québec. We're underrepresented in U.S. wholesale, as an example. So what I'd say to you is that even though we're a mature bank in the Canadian space, there are plenty of growth opportunities depending on the product and the business that we look that. And we focus on those and make them a focus area for us.

So Wealth, we – if you look at our Wealth earnings over the last 3 or 4 years, it has been a business that we internally designated a while ago as a super-growth business – one that we wanted to invest in. And both on the private banking side, the advice side and on the product side, we've been experiencing tremendous growth. And you can see as a result, the growth in the NIAT of the business has been spectacular. So in the U.S., we are essentially attempting to replicate that. And it's a longer build because the U.S. banks, remember, Commerce and Banknorth were 2 smaller banks that we put together to create TD Bank, America's Most Convenient Bank, which is now, if you take out the money center banks, among the regional banks, it would rank anywhere from #2 to #4 depending on what metrics you're looking at. So it's a relatively young franchise and there's a lot of work to do to build that out.

But we do have, in TD Ameritrade, an investment in a platform that is a leading trading platform, a leading asset gathering platform. And it's a source of a tremendous amount of deposits for us. So we feel like we are on a good journey and there's a lot of work to do to continue to build it out. And we feel that there is going to be lots of upside in that business for us.

John Aiken – Barclays Capital – Analyst

Great. We'll take the opportunity at this stage, if there's any questions from the audience? We'll run a mic down to you.

Unidentified Audience Member

Could you just give us your thoughts on the Canadian housing market, condo exposure, et cetera? That would be helpful. Thank you.

Riaz Ahmed – TD – Group Head and CFO

On the big-picture Canadian housing market, we had, coming into the oil and gas crisis, essentially three markets that were showing runaway characteristics – being the Greater Vancouver Area, Calgary and then the Greater Toronto Area – and the oil and gas crisis essentially settled the Calgary market down. And so I would say it's exhibiting more of a normal growth and stable patterns. And the changes that the B.C. government brought about in August of 2016 cooled the Vancouver market, although it's showing signs of a resurgence. And then, since April of 2017, when the Province of Ontario brought similar but deeper measures in Ontario. The Ontario market seems to have cooled. So sales activity is definitely cooling and prices are cooling.

So generally speaking, I would say that, overall, the market is appearing to suggest that it's headed for a soft landing, not a hard landing. And I think all the regulatory initiatives together with the market activity would seem to support a cooling. We're actually in favor of cooling markets because runaway markets are really not great markets to operate in. They might provide some short term boosts, but long-term, they're not good for people that are living in those markets. And therefore, they're not good for us in the banking industry. So I think, as long as we continue to see the effects the interest rates coming up and regulations essentially constantly taking measures to cool the markets, I think a soft landing seems to be where we're heading here.

Unidentified Audience Member

Do you have any interest in M&A in the U.S.? If so, what geographies? What lines of business?

Riaz Ahmed – TD – Group Head and CFO

We're always really open to looking at what is available out there. We have a Corporate Development Group that is constantly looking at the markets and what is available. I'd say that we generally look for two or three things in acquisitions. One is what capabilities do they bring for us? So if it turns out that there are customers, then obviously customers within the market will be more synergistic to us than out-of-footprint customers. So I think anything in the Northeast or in the Southeast of the United States, from a customer acquisition perspective, would be useful. Secondly, we look for assets. As you know in the United States in our U.S. Retail bank, we have a very low loan-to-deposit ratio because we're more prolific deposit gatherers. And anything that helps us fill that loan-to-deposit ratio within risk appetite would be of interest to us. And lastly, if there were capabilities that were more technology-oriented, distribution-oriented, et cetera that would help us build out capabilities on that front, we'd be prepared to look at those. So we're continually looking for that. I'd say, to date, valuations have not been very attractive. That might correct itself, where maybe there are some signs of corrections that were beginning to emerge. But largely speaking, I'd say that our platform now is of a size, with about $350 billion of assets, that we don't think that, that is the main driver of what we need to do to continue to build out our platform.

Unidentified Audience Member

Just looking at TD Ameritrade, can you just explain maybe the long-term plan with that asset? How you think about it? Where you'd like to go with it?

Riaz Ahmed – TD – Group Head and CFO

Yes. So first of all, in terms of TD Ameritrade's strategy itself, I'd kind of refer you back to what Tim Hockey has been saying on the calls about his desires to build out the customer side as well as the product side of the business. And so we're very supportive of that strategy and feel that it would bring tremendous amount of benefits to our banking customers to be able to refer them to the TD Ameritrade platform and vice versa.

As far as our investment is concerned, we own about 42% of it and have, from time-to-time, owned up to 45% of it. And I think we're happy being at that level because it does provide a very healthy return to us to own it at that level. And because of our – the fact that we provide the banking arrangements to Ameritrade, it is a very attractive source of deposits for us as well. So I'd say that, big picture, we're happy with the investments and the strategy that Ameritrade is pursuing and don't anticipate any changes in the near-term.

John Aiken – Barclays Capital – Analyst

Riaz, you touched on, obviously with those questions, a couple of things, but one of the things that came to us is you're clearly excited about the prospects for TD with the rising interest rate environment in the U.S.

Riaz Ahmed – TD – Group Head and CFO

Yes.

John Aiken – Barclays Capital – Analyst

…and the belief that there's a lot of margin expansion over time available there. You talked about Ameritrade and the deposits there, but what type of advantage do think that TD has against the U.S. regional banks in terms of the ability to retain funding and expand margin? Like, do the Canadian investors have it correct? Or do you think that your performance is going to be more in line with the U.S. regional banks on margins?

Riaz Ahmed – TD – Group Head and CFO

I think several things on that front, John. So first of all, we are operating in, economically, very attractive markets in the U.S. in the Northeast in New York and Philadelphia, Pennsylvania, the Carolinas and Florida. So we feel we're positioned in the markets that we're in. Secondly, we are a very young franchise that still has lots of room to mature in terms of deepening household acquisition, customer acquisition in the stores. And we've been leaders in household penetration. I think, if I can remember correctly, our household per store is, order of magnitude, double of industry average. So we're continuing to attract households and customers into our franchise. And we're able to do so with a very attractive product set in checking and savings, and we don't need to compete on expensive term deposits because we are very liquid already. So we don't need to rush out with our betas. We don't need to rush out into high – in expensive sources of funding. And therefore, I think we're better positioned in relation to our peers in how we can optimize the deposits, the liability side of the balance sheet.

John Aiken – Barclays Capital – Analyst

And then, I guess, on the other side of the border, with the rate hikes that seen out of Canada. What impact do you think that's going to have on the operations on both the margins as well as volumes?

Riaz Ahmed – TD – Group Head and CFO

What's interesting is, for us in Canada – so first of all, I'll go back and just, without repeating, I'll just remind you of the points that I made about how many Canadians we bank. So we have a very deeply seated franchise in Canada. We bank a number of Canadians. And so we happen to have their chequing accounts and savings accounts. And I think it is driven by our customer oriented strategy in service and convenience. Those and – what has been interesting is, if you've looked at the trends the last little while, even in Canada, our deposit gathering has been outperforming our asset side. So that has actually caused our margins to rise because we're able to displace expensive wholesale funding with low-cost deposits even in Canada.

Now there's a number of things that affect net interest margins. Among them, deposit margins is maybe one of 6 things that go into measurement of margin and average earning assets. You also have to look at the asset side. You have to look at cost of hedging, you have to look at impact of accretion, you have to look at the balance sheet mix among the various items that go into it. So overall, in Canada, we saw deposit – we saw our margin on average earning assets expand this quarter because of balance sheet mix because deposits were – deposit growth was outpacing loan growth. But in the United States, margins rose purely out of deposits because we got the full quarterization of the Fed rate increases and some of the offsetting factors that can materialize, as I mentioned, like cost of hedging, accretion, balance sheet mix, et cetera, were not as prevalent in the quarter. So, aggregate margin expansion in both sides of the retail franchise was great. So I think that with interest rate increases, the impact of that on our float rate products, both on the assets and deposit side is instantaneous. And so I think you can expect that there'd be a substantial lift, absent all those other factors that I talked about. And then we'd have to just work out what the competition chooses to do on pricing.

John Aiken – Barclays Capital – Analyst

So then that will affect the volume side, but you don't expect any material dampening in demand because of the rate hikes on the consumer side?

Riaz Ahmed – TD – Group Head and CFO

No. I wouldn't expect to be a material dampening of demand. No.

John Aiken – Barclays Capital – Analyst

Fantastic. We'll give you another break. If we can have the second polling question up, please?

How big a growth opportunity for the banking industry does FinTech and Big Data represent over the next 5 years? Significant tailwind; modest tailwind; no real impact; modest headwind; significant headwind. You know where my next line of questions will be.

Riaz Ahmed – TD – Group Head and CFO

Yes.

John Aiken – Barclays Capital – Analyst

Well, that's interesting. A bit of a split decision but still believe it's a benefit. Riaz, all of the banks, globally not just Canadian, are talking about the investments they're doing in technology and the benefits of digitization and front-line, customer-facing technology. Can you talk to what TD is doing and what you're trying to do to differentiate yourselves against the competition?

Riaz Ahmed – TD – Group Head and CFO

So I think that FinTech, I think, has a tremendous amount of opportunity for us, because, one, a good 70% of our – so we have about 11.5 million digital customers. And I'd say 70% of those customers really interact with us on mobile. So I think as this FinTech revolution has been occurring and as banks are adapting to that and figuring it out – figuring out what engages our customers, it appears that our customers are reacting to that and are interacting with us more digitally. And I think the question of how fast and how deeply – how quickly we can deepen that penetration is a function of two things.

One is customer preferences of course. And as you know, customer preferences do change quickly. So we've been more cautious in deciding where we make our investments. But the second issue is making sure that we address security concerns to our customers' satisfaction. The one big advantage that banks have is trust, and we need to keep investing in that trust, preserving it and deepening it. But FinTech also gives us a tremendous amount of middle-office and back-office opportunities. And so the amount of investments that we've made in looking at robotics and artificial intelligence to drive essentially low-value work and drive it into the middle-office and back-office part of the bank is growing exponentially for us.

I think as far as the Big Data side of it is concerned, we've started down this road. We have now three different data points at which we interact with our customers. There is an application called TD for Me where what we do is provide essentially budgeting and spending data to our customers on their mobile devices. And where we push out, if our customers choose to receive them, information to them about their spending habits and their availability of spending envelopes if they happen to be at a Starbucks or buying something at a big hardware store or whatever. And we have 1.1 million customers who have signed up for that service. So it tells us that it is picking up momentum and customers are liking it and engaging with us on it. And we're collecting data out of that.

The other one is that TD for Me where essentially what, if customers choose, we can tell where they are. And if they happen to be walking into a dealership, we'll offer them auto-financing or auto-insurance or if they happen to be looking for, visiting condo sites, then we will talk to them about that particular condo building and what's going up and our ability to finance it and give them mortgages, et cetera. And thirdly, we're doing the same thing in our auto insurance business with TD MyAdvantage application. So we've started down this road of engaging with our customers using Big Data. And so far, it's showing good growth and good momentum. But there are also issues of trust and privacy and security to be dealt with here. And so it's – I think this whole area is in its infancy for banks.

John Aiken – Barclays Capital – Analyst

Do we have any questions outside? That's right. Can I have a mic down at the front? We're just giving you exercise today.

Unidentified Audience Member

It would seem that the tough experience that traditional retailers have been having in the face of growing e-commerce might be something that traditional banks could experience. Why do you think it hasn't happened yet? And what might it take for that to happen in the future?

Riaz Ahmed – TD – Group Head and CFO

I think that the reason it hasn't happened yet is because, supposing if you compare financial services to purchasing apparel – you might go to a store to buy a suit and shirt and socks and you might choose to buy them online and that issue doesn't pose you much risk. Maybe you'll find itchier wool, I don't know, but that's about it, right? Whereas in financial services, you're talking about your money. And so I think, consumers are little more cautious to say, do I really want to engage with the companies that I don't know, for my money. And people have experienced fraud – almost probably everybody in the room has experienced some sort of fraud on you from a financial services side. And so I think that the element of trust is big when it comes to money.

Now, people would say, okay, we should take a prepayment card, it's a store of value and therefore that amount of money is no longer in your chequing account and that store of value has been disintermediated from the banks. Yes. But so far with the – all that has done so far is disintermediated cash. Generally, in the banking industry, the number of transactions has actually been increasing on people's debit cards and credit cards, not decreasing. So the pie seems to be getting bigger. What will it take to change this? I think it will take essentially trust – that people say, well, I want to, when it comes to my money and my wealth, I want to engage with people that I trust. You've sort of seen this in the wealth management space as well, where people kind of get convinced to go deal with different actors in the economy. And then, they move their money around and then things don't quite work out and they go back to the traditional actors. So I think money and trust is a different game from buying apparel and goods and services, and buying goods.

John Aiken – Barclays Capital – Analyst

Riaz, then do you find that the Canadian Banking operations might be more defensible in that scenario than in the U.S. given the, not the greater oligopoly, but the greater propensity for consumers to have more products with an individual institution?

Riaz Ahmed – TD – Group Head and CFO

Yes, I think it's fair. I think it is true that most Canadian consumers' behavior has been that they consolidate all their financial services with one. It's rare that maybe they might have two, but then it doesn't go much further than that. And so I think that there is a behavioral difference there that there, there is a kind of a protective moat around that as far as Canadians' relationship with their banks is concerned.

John Aiken – Barclays Capital – Analyst

Any other questions?

Unidentified Audience Member

Curious if you could just comment a little bit about your card relationship with Ally Bank? And how that has progressed over the past year versus your expectations and, more broadly, kind of your appetite for underwriting card relationships with other banks?

Riaz Ahmed – TD – Group Head and CFO

I think, generally, what we will tend to look at in those kinds of relationships is whether we can get a decent forward flow of business? And we only operate, principally, in the Super Prime and Prime Area. We have a small non-prime portfolio of auto loans in Canada and then we have about an equal amount, but in U.S. dollars, of near prime auto loans in the United States. So to us, it's about – mostly in the U.S., it's mostly about deploying excess liquidity. And if we find attractive relationships to do that we will continue to do that. But it's – we don't look at it as a market share game, we look at it as a value-added game.

John Aiken – Barclays Capital – Analyst

Riaz, in terms of I can gauge this in terms of technology spend, but I wanted to talk about expenses, just overall. There is a lot of ongoing costs to the banks in terms of technology, regulatory costs, that – not just TD but just system wide. How do you manage, as the CFO, to try to generate positive operating leverage, and how difficult is that in context of these expenses that have a greater inflationary tendency than others?

Riaz Ahmed – TD – Group Head and CFO

Well, I think a lot of the regulatory build we went through post the financial crisis, so I think we're kind of – the industry is at sort of a new level of spending. Having said that, from my perspective, I don't really worry so much about operating leverage, I worry more about shareholder value. And to illustrate that I'd say that supposing if I have two business choices, I can grow a business that has a high efficiency ratio but very low capital requirements, like our Wealth Management business would have those kinds of characteristics. Or we have a high efficiency ratio, business in Wholesale Banking, but where we are making investments because we think that, in aggregate, we're delivering good shareholder value.

So we'll continue to deploy capital and resources to those businesses even though, overall, they'd be a headwind on our overall operating leverage because in the end the shareholder value matters more and the diversification of our businesses matters more than a single laser focus on operating leverage. So I tend to use operating leverage to evaluate the performance of individual businesses. And what I'm looking for in evaluating the performance of individual businesses is are they scaling appropriately? And are they eking productivity out? And they should be eking productivity out to make the investments that they need to make to deal with the issues of technology, cyber, et cetera, or new platform or whatever it may be. And if the costs of technology are rising, then their productivity needs to be getting better.

That's the kind of framework that I generally try to apply. And then, if the business mix is such that, that produces aggregate that when I add everybody's operating leverage up, the bank's operating leverage was positive, then I'll crow about it and make sure John feels happy. And if it's not so good, then I explain it because I say that, yeah, that's not essentially what we're trying to do. We're not – I'm not trying to manage operating leverage at the bank level, I'm managing it at the individual business line level to make sure that they're delivering the productivity that they need to.

John Aiken – Barclays Capital – Analyst

Great. Maybe we've got time for one final question. I guess it's up to me then. Riaz, one of the things that you touched upon was TD being relatively undersized on domestic commercial banking. And I was wondering, given the fact that the expectation is for consumer lending volumes to slow down a little bit, what are you seeing on the competitive front in terms of either pricing or in terms of what banks are willing to take on in terms of risk?

Riaz Ahmed – TD – Group Head and CFO

Yes. What's been interesting for us is that we have been on this quest to raise our commercial banking and small business banking market share but not in terms of buying the business. So there are times when competition becomes frothy and pricing gets unattractive or structures are unattractive, and we'll tend not to go there. What we tend to go is where we have relationships that we like and that we're comfortable supporting through the cycle. So what we saw in the last oil and gas crisis, a year and a half ago, is many banks in Calgary abandoned clients. And we were successful in maintaining consistency of coverage with those clients and able to support the clients that we want and we pick up market share as a result of that. So I think we've figured out a model that focuses on the long term and not worry about the vagaries of the moment.

John Aiken – Barclays Capital – Analyst

Fantastic. Thank you very much. We appreciate you coming in.

Riaz Ahmed – TD – Group Head and CFO

Thank you, John. Thank you and thanks, very much, everyone.