TD BANK GROUP

NATIONAL BANK FINANCIAL CANADIAN FINANCIAL SERVICES CONFERENCE

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PARTICIPANTS

Greg Braca
TD Bank Group – Group Head, U.S. Banking

Gabriel Dechaine
National Bank Financial – Analyst

FIRESIDE CHAT

Gabriel Dechaine – National Bank Financial – Analyst

All right. So, I'd like to welcome you to my last session of the day. I'd like to introduce Greg Braca. Greg is the Group Head of U.S. Banking at TD Bank and has been the Head of U.S. Banking since June of last year. Pleasure to have you here.

Greg Braca – TD – Group Head, U.S. Banking

Thank you.

Gabriel Dechaine – National Bank Financial – Analyst

Good mix of presenters. So, I think this is the only one where we get to talk about the U.S., which is of course a big part of the U.S. story.

Greg Braca – TD – Group Head, U.S. Banking

Happy to do it. Thanks for having us.

Gabriel Dechaine – National Bank Financial – Analyst

With the previous discussions, we've spent a fair bit of time talking about technology and the latest trends and stuff like that. But I want to start off with the branch and get an update on your branch strategy in the U.S. There have been some – the majority, I guess, of strategies have shifted towards downsizing branch networks. But one big competitor, JPMorgan, is I guess expanding, which is a bit against the grain. What's the TD Bank looking at doing?

Greg Braca – TD – Group Head, U.S. Banking

Well, Gabe, first, thanks for having us. And as you can imagine, over the last 20 years, I can't tell you how many times I've been asked about the death of the branch and that these things are going away. And I think if we had this session probably 15 to 20 years from right now, we'd still be having a similar chat, although they'll probably be far smaller and maybe a few less. It is interesting, though, how the conversation even over the last several years has been around FinTech and digital and apps and capability and omni-experiences. And one big bank announces that they're thinking about opening 400 stores. And I tell you, that's probably one of the leading questions we talk about and I've been asked about over the last couple of weeks since they did announce it.

So, from our standpoint, at least, the TD in the U.S., branches – we call them stores in the U.S. and that's a legacy moniker that we hang on them because of all of the activities that go on around that store in the communities and around that particular site. So, A, to answer your question directly, I can envision where, as leases come due or as we're thinking about certain geographies and locations, over time, digital capabilities certainly will enable us and others to downsize the size of stores and perhaps join locations and think of other uses for those physical sites. But with that said, even today, as I really think through some of the most digitally-enabled competitors, including ourselves, 80% of the volume from a retail standpoint is still flowing through the brick-and-mortar. And the way I like to think about it is we want to make sure that all of this hangs together from our own capabilities that, if this cliff event were to occur, we want to certainly be positioned correctly. But by the same token, we're seeing even the youngest millennials, the most digitally-savvy customers that maybe initially start a relationship with us only online or through their smartphone. At some point or another, we still see them using our physical locations. So, it is kind of interesting when folks are thinking about mortgages or they're thinking about life events or thinking about perhaps IRAs or something else that they think they need advice around, they're still coming into these physical locations. And by far and away, it's still driving a lot of our traffic.

From our store and own distribution standpoint, for the first time for our business in the U.S., the last year or two, we're actually closing more stores than we're opening them, and we are adjoining that strategy to – and we have the opportunity to – in some locations, perhaps smaller physical footprint around these things. But from our standpoint, the store strategy is going to be a cornerstone of what we do. We're spending a lot of time around that. And as I think about upside for our business, whether it's small business or wealth management capabilities, very much that physical community location will be at the heart of how we think about our business.

Gabriel Dechaine – National Bank Financial – Analyst

Auto lending, I mean, it's been made a mountain out of a molehill, a little bit, the subtle shift towards more near-prime or I don't know how close to prime, it's out of the line you're on there, but taking on a bit more risk. Can you explain the rationale behind that move? And I know it's not going to be a big part of the total mix, but something obviously changing your appetite.

Greg Braca – TD – Group Head, U.S. Banking

Well, Gabe, you certainly know this is a business that we had acquired, and this is not just a Maine through Florida business for us. And when I think about indirect auto lending, and for us this is an asset class that's north of US$20 billion now in outstanding, so, it's not without size. But core to all the models and how we would look at a business, first and foremost, on a risk-adjusted basis, we want to make sure we're making money out of the business.

And when we picked up this business a few years ago, I think it had been in various stages and states, being sold a couple of times. And when we really stared this thing down, what was the most important consideration was, how are we adding value and being relevant with the dealers that our indirect auto folks are facing off with? And what's near and dear to the auto dealer is, are they moving vehicles? Whether they're new or used cars. And if you're only going to play in the utmost high end of the range, in the super prime space, you're probably less relevant to those dealers. And certainly, from a model standpoint, we had the view, there was a better, smarter way, including on a risk-adjusted way, to look at how we played a little bit further down the risk curve in the prime and very selectively in the near-prime space. So, the near-prime space is still a very small part of our business. And we do know subprime in the U.S. on the auto side of the house.

But we wanted to be, A, relevant to the dealers. We wanted to help them with their objectives; and, B, if you were to really look at a model that you only took on the financing for the top echelon of the super prime well north of 800 FICO scores in the U.S., very, very hard to make money in and of itself. So, look, we had a 50-state coverage strategy, and we thought it was very clear that we should have a more fulsome offering in the market. And even today, a few years later, after we've implemented this, I know the auto space has garnered a lot of attention, but it's performing as we thought. The portfolio is seasoning for sure. There's some seasonality to it. But by and large, it's performing as we thought. We're very happy with this business.

Gabriel Dechaine – National Bank Financial – Analyst

That business, the consumer and the commercial floor plan stuff, is that integrated there...

Greg Braca – TD – Group Head, U.S. Banking

We did. We recently integrated it because, at the end of the day, we also announced that we took the commercial end of the floor plan business, we took that national as well. And maybe, as many of you know, our business in the U.S., from a retail standpoint, it's a Maine through Florida business, it's mostly an I-95 business, so all the way down. But the auto business was a 50-state business for us. And again, going back to relevance, when we're thinking about indirect business, how do we provide more fulsome relationships and support to that dealer network? And we did announce that we would also take the commercial end of that business nationwide since we already had the coverage on the indirect side.

Gabriel Dechaine – National Bank Financial – Analyst

So, deposit market, let's talk about the competitive dynamics there. When the Fed first started hiking rates, banks were able to retain the majority of the benefit. But that's not the situation we find ourselves in today, correct? Like, how much of the like...

Greg Braca – TD – Group Head, U.S. Banking

Betas.

Gabriel Dechaine – National Bank Financial – Analyst

Yes.

Greg Braca – TD – Group Head, U.S. Banking

Betas, everyone is asking about betas.

Gabriel Dechaine – National Bank Financial – Analyst

Betas, I don't know what that means but...

Greg Braca – TD – Group Head, U.S. Banking

So, in the U.S., we just had last week our last latest and greatest rate hike, another 25 bps up. And if you go all the way back to December 2015, this has been six rate hikes, five in the last five or six quarters or so. And if I were here last year at this conference which I couldn't make, apologies, I would have probably said if we had a few more rate hikes, if I was sitting here in the spring of 2018, I would have expected to see the betas, or the amount that banks were giving back as far as rate hikes, to higher interest rates in their books to be a little bit higher than they are today.

Actually, there's been decent discipline around from most of the larger banks in the U.S. And I would generally say that most banks have talked about this, and I think it's certainly true for us and probably would continue for another rate hike or two that most of the betas that banks were giving up are generally below the way they would model rate hikes for their own view or longer-term view. Or said another way, if we were to have a few rate hikes again later in this year and then a few more in 2019 and as the rate progression gets a little further along, I think you'll see a rise in those betas, which up until now has been fairly benign.

Gabriel Dechaine – National Bank Financial – Analyst

So, by betas what do you mean?

Greg Braca – TD – Group Head, U.S. Banking

Well, we think about the delta between the absolute rate hike – every time we get a 25 basis point rate hike in fed funds rate versus the percentage you're giving back to customers in terms of increasing interest rates.

Gabriel Dechaine – National Bank Financial – Analyst

What would the bank normally model? Like, 60% retention?

Greg Braca – TD – Group Head, U.S. Banking

Yeah – no. I think, if you're a little more conservative, you'd probably view that the give-up would be somewhere in the 50 to 60 basis point range and a little bit more mature. So, split it the other way, 50% to 60% of it goes back to the customer. And I think most banks have been signaling, as we have, that that's probably half of that real-time right now.

Gabriel Dechaine – National Bank Financial – Analyst

Okay. You came from the commercial side, right?

Greg Braca – TD – Group Head, U.S. Banking

I did.

Gabriel Dechaine – National Bank Financial – Analyst

What's your – we'll talk about growth outlook later but, well, it kind of ties into this. Growth in commercial lending has been pretty slow for the past year plus, post-election basically. That's been one of the big story lines in the U.S. Are you seeing any like fallout from that weaker growth like late cycle behavior that banks are kind of like they've been chomping at the bit to grow and it's not there, so they're doing foolish things?

Greg Braca – TD – Group Head, U.S. Banking

Yeah. So – well, let me start in reverse.

Gabriel Dechaine – National Bank Financial – Analyst

Sure.

Greg Braca – TD – Group Head, U.S. Banking

I don't necessarily think I'm seeing terribly foolish things, and I go back with many legacy banks too many decades to count at this point. But if I go back to 2005, 2006 and 2007, I'm not seeing some of the more egregious behaviors. And quite honestly, some of the leverage lending attributes of the more highly leveraged transactions have been jawboned out of the banking market or in private equity and funds and are being taken up in alternate bank space.

But just maybe a little context from what we're seeing. And, yes, you have seen commercial lending rates for most of the large banks come down. And again, I'd like to provide just a little bit of color around that. If you go back to 2014, 2015 and 2016, you had very strong M&A markets. There was a lot of deal flow. There were episodic financing events and not only for the industry, but particularly for TD in the U.S. We were in the throes of building out our own corporate and specialty businesses in the U.S. For a bank of our size, we had very muted or small and underweight share of many of the larger asset classes in the U.S. or in corporate banking and all of the verticals, whether you're thinking about food and beverage, utilities, chemical companies, pharmaceuticals and how larger banks face off with those industry sectors in the U.S. Healthcare is another large business for us. Commercial, real estate on the institutional side, asset-based lending, leasing – these are all large levers that the banks have at their disposal. In TD, we were very subscale. So, if you go back a few years ago, for us, you would have seen from us in some of those businesses very, very strong growth 25%, 30% in some quarters or more as we were coming into our own natural share of size, about how we would think about, for a bank of our size and balance sheet, where we should play.

And as that continued over a number of years and we started to really gain a share and come into where we thought we should be, some of those growth rates would naturally taper off. Over the last six quarters, we've been talking about not only because of a confluence of us gaining our own natural share. We saw M&A come down pre-election. There's been uncertainty around taxes, repatriation of cash, regulation. By the way, stock market valuations. M&A is naturally slowed because deal costs have crept up.

So, a lot of features have crept into normal loan growth, but there's been some also other dynamics in the U.S. that you'd overlay against that. The bond market has been very vibrant in any investment-grade or near investment-grade issuer choosing in a rising rate environment, like, you would think most CFOs and corporate treasurers would think about have tapped the bond market. Commercial Paper, CP, markets are back in vogue again on the short end. And all of this culminates not only from lower deal flow, but you're seeing utilization rates or the way we think about available credit to used credit for many of our commercial and corporate borrowers in a lot of industries are at all-time lows. So, that's mightily contributed to it.

And I'd say the last output of this is balance sheets in the U.S. are full with liquidity and cash. And in absence of either making some decisions while they've been on the sidelines, they've been utilizing cash to pay for CapEx, infrastructure, inventory, including liquidating some debt, so all of those things have come together. From our viewpoint, though, I think, TD, we're still well positioned. And whether we're talking about a low-growth environment, there's many asset classes we're still subscale in, in my mind. And we should have the ability to outgrow and continue to outperform for a number of years.

Gabriel Dechaine – National Bank Financial – Analyst

Do you think we're going to get a surprise to the upside with a big CapEx wave because of the new deductibility?

Greg Braca – TD – Group Head, U.S. Banking

You know what's interesting? I just did – last six to seven weeks, I was doing some road shows across all of our markets from Maine to Florida. And I was quite interested in doing these roundtables with clients. And I've met with clients everywhere from the smallest business to the tree service firms that would service utilities to the largest commercial and corporate names we have. And the environment in the U.S. is actually quite strong and very, very bullish. And I can't naturally think of one industry or client that we sat with that ultimately wasn't thinking about taking advantage of reduction in taxes or better regulatory environment, depending on the space they might play in or continued strong consumer spending trends or whatever the case may be.

Most were quite bullish around, A, investing in technology, looking for further leverage in their own capability; two, investing in revenue-producing individuals and people. One of the biggest actual downsides you heard time and time again was the availability of people and finding talent. And I think, ultimately, we would probably see that playing out in terms of wage increases. And that would be the one concern many of the clients had voiced is finding quality talent. But I would say to you, in a very, very long time, it's the most bullish I've seen many of these industries in a decade.

Gabriel Dechaine – National Bank Financial – Analyst

Do you play much in the Shared National Credits?

Greg Braca – TD – Group Head, U.S. Banking

Yeah. So, we do. As you can imagine, if – as we built what we call the corporate and specialty business in the U.S. And overall, our C&I portfolio has grown quite a bit over the last 8 or 10 years in the U.S. And today, for us, it probably represents 25% to 30% of our book of business. But when you think about those names, they tend to be larger, and Shared National Credits for the U.S. just means it's of a certain size overall credit and its three banks or more. And for us, it would represent 30% of the exposure, but a far smaller percentage of the absolute names and number of customers that we would face off in the commercial because they tend to be larger and a little bit lumpier.

Gabriel Dechaine – National Bank Financial – Analyst

So, the – was it the Fed, I guess, that loosened the definition of $20 million...

Greg Braca – TD – Group Head, U.S. Banking

Went up to US$100 million.

Gabriel Dechaine – National Bank Financial – Analyst

Went up to US$100 million. Is that a good thing?

Greg Braca – TD – Group Head, U.S. Banking

Yeah. I don't think there's really any meaningful. I mean, the definition around that. Most of the exposure and transactions that the fed and the OCC would have been concerned about would have been north of US$100 million in the first place.

Gabriel Dechaine – National Bank Financial – Analyst

So, moving from commercial to the consumer side of things – the mortgage business. So, tax deductibility of, I guess, jumbo mortgages is becoming less of a thing. And given where you are present in the U.S., northeast and southeast, does that mean maybe a weaker mortgage growth for you because of less attractive tax treatment?

Greg Braca – TD – Group Head, U.S. Banking

I guess one of the good things about starting with a very small base of business; it's far easier to start getting on a percentage basis growth. Mortgage, home equity – just to make sure everyone – from my standpoint, we're only a 12 or 13-year-old bank in the U.S. And it's amazing that in 12 to 13 years we're now the 7th, 8th largest bank by any measure in the U.S. And many of these asset classes that are far larger and much more mature organizations, we still have a very small share, not only relative to our own book, but relative obviously to the overall market.

When I think about mortgage and home equity, first, I'd say the dynamic switched 18 months ago or so, two years ago from what was a heavy refinance. And the refinance offer of the day with rates so low and much of that is done obviously in a rising rate environment with six rate hikes in the U.S. and 10-year Treasuries of 2.80% to 2.90%, very, very different. So, that's flipped. It was 70/30, 65/35 refinance to purchase with a lot of volume on the top side for the refinance. And that's now the other way. It's 70% of the volume. Any of the banks we see would be on the purchase side, far smaller amount on the refinance. So, the overall volume of deals and applications that the industry would be seeing has come down. And then, two, sure, there are changes in rules around deductibility – not only around mortgage interest but real estate taxes and in some of the northeast states where you have higher taxes and higher state taxes, those are all issues. But I don't necessarily see it as an enormous issue. You mentioned jumbo mortgages. They were already capped at US$1 million in total deductibility. So, now, they're capped at US$750,000.

Gabriel Dechaine – National Bank Financial – Analyst

Okay.

Greg Braca – TD – Group Head, U.S. Banking

So maybe there's a little bit of an impact there but I don't think it's dramatic. Now, you are seeing a migration of population given the aging demographics so people moving from the Northeast states, which are higher state tax basis to some of the Southern states and we'll have to see how that plays out from the overall demographics of the states. But from an initial blush on mortgage volumes or purchase volumes, I don't see it as a huge deal.

Gabriel Dechaine – National Bank Financial – Analyst

Your perspective is an interesting one, being obviously U.S.-focused. My comparison, U.S. and Canada banking, there's a lot of them that we made. But FinTechs, seems like the potential to disrupt is greater in the U.S. because consumers in the U.S. are, I guess, less complacent than Canadian ones. Is that a fair assessment? And have you been able to maybe get, for the bank overall, some better insight on these disruptors because of the U.S. experience?

Greg Braca – TD – Group Head, U.S. Banking

Yeah. So, I think it's a fair question. And maybe just the lens of the way I think about the U.S. market. It's probably fair to say the U.S. market has been very hot as far as FinTech entrants and the amount of capital it's attracted, the overall investment, things that you're seeing come out. Partnership arrangements are far more active than you probably see in the Canadian markets. And so, I think it's very helpful, as I think about Teri Currie from Canada, and myself and how we talk about the nuances and differences across there.

So, it's a helpful lens. But then, again, the pool is far deeper in the U.S. So, the number of banks that are potentially being disrupted are in the several thousands, and the market is very, very different. I think the one thing we should pay attention to is, for the last few years, if I came to something like this, FinTech was very much at the forefront. And I think what you're seeing is a lot of the smaller start-ups or the ones with less dominant established positions more in partnership mode with U.S. banks. And the U.S. banks have been far more, I think, agreeable to thinking through partnerships and buying capability rather than trying to build internally on their own platforms, and I think you'll see that continue in the U.S.

So, the absolute disruption from FinTechs, sure, it's there. We think about this. It's one of the reasons that we can spend as much time as you want on this. But we spend a lot of time on how we're building our own core foundation's platforms, not just the whiz bang apps that sit on top of what the customer might see, but how are we stitching together the plumbing of our own organization that allows us to think through data gathering and support for all of these capabilities with an end-to-end view. And the more banks think through these sorts of things, I think they're going to be in a far better position to defend upstarts or to cede control to folks that are historically outside their space.

I would say the interesting – as we saw, recently, the announcement in the U.S. a week before last of JPMorgan talking to Amazon. Now, if the regulatory environment continues to come down a bit and you would have seen one of these very large, very liquid entrants of the Amazons or the Facebooks or someone like that, that could be a game changer. But I'm less worried about the FinTechs in an absolute sense that maybe we would have talked about it a year or two ago.

Gabriel Dechaine – National Bank Financial – Analyst

Well, I guess, it's – maybe the markets got it wrong in a sense that the – you might have some disruption on the asset side, but the banks control the lifeblood of the ecosystem, the funding. So, maybe the competitive threat is overblown in that regard. And then, I get – maybe tied back into a strategic question, do you see potential for TD to do something like these partnerships with originators?

Greg Braca – TD – Group Head, U.S. Banking

Sure. So, we are not only thinking about these real-time, but I think partnership is a great way to think through our own capabilities and how do we advance whether they're niche plays, core capabilities, whether they're white labeled and the public doesn't see them or they're actually blatantly out there in the public for partnerships like this. I think we need to think through those things.

But I think the banks – and I've talked about this in sessions this morning that we sat through. I think what you're seeing is with 5,000 or 6,000 banks in the U.S., what we are seeing is, for the first time in a couple of decades that I can remember, for the last 20 years, it was the smaller mid-sized banks, small banks, larger regional banks taking share from the absolute largest banks in the market. And what you are now finally seeing over the last year or two was the largest banks are again taking share for the first time in a very, very long time. And I think what you'll eventually see over the next three to five years, you'll see partnership arrangements, sure. And you'll see some banks make some bets with some of these FinTech or other data sort of companies.

But I think what you're going to see is the top 10 or 15, 20 banks in the U.S. have the capability and desire to build our own capabilities, make sure our own platforms from an end-to-end digital standpoint, a data standpoint, a customer visibility standpoint build capabilities that will really make the gulf even wider between the largest banks and the investments that we're able to make in some of the smaller players that are in the market. And I would just liken it to – if we were all shopping for a smartphone today, you have the iPhone, the Samsung and maybe a few others. But certainly, the flip phone wouldn't even make the cut anymore because of core capabilities. And I think that's where I'm going to with bank capabilities. The largest banks, us included, are making those investments real-time. And we're already seeing that the likes of JPMorgan and BofA, even for the size of their balance sheets are again taking share because they do bring those core capabilities.

Gabriel Dechaine – National Bank Financial – Analyst

Quick one, hopefully. Credit card delinquency rates have been rising but you've got the U.S. unemployment picture very, very strong. How do you view that trend? Like, it seems like illogical...?

Greg Braca – TD – Group Head, U.S. Banking

Unemployment rates are low, things would be good. I think what you're also seeing is they're coming in off an all-time low. And for the last seven or eight years, things have been, from a credit quality standpoint, extremely benign and the U.S. consumer has really delevered over the last bunch of years, going back to the start of the downturn. So, I think you're seeing them spike up a little bit. You're seeing a little bit more spending on the consumer side, and the GDP recovery story has really been consumer led. So, they are taking on a little bit more debt, but certainly off of all-time highs.

When I think about us at TD, credit card exposure is a little bit newer of a business for us. And what you're seeing for us in the last quarter and over the last year, you're seeing something we would call seasoning and that's just normal attribution of the way the portfolio would season over time into a more mature state. And then, from quarter-to-quarter, we shouldn't lose sight, and most banks would see this – you have the seasonality aspect of it. Folks get tax returns in the spring. They spend them down, they recharge up and you'll see higher usage as you get into the holiday season. And you'll also see some delinquencies spike up in that fall and into the winter period until tax receipts come back in. And you'll see folks come back down again. So, a couple of things going on depending on the maturity of the individual bank. For us, we would see some seasoning of the portfolio, and most banks would see some seasonality aspect, too.

Gabriel Dechaine – National Bank Financial – Analyst

All right. Greg, I think we covered a lot of business here today.

Greg Braca – TD – Group Head, U.S. Banking

Thank you. You made that very easy. Thank you very much.

Gabriel Dechaine – National Bank Financial – Analyst

Thank you, Greg.