TD BANK GROUP

NATIONAL BANK FINANCIAL CANADIAN FINANCIAL SERVICES CONFERENCE

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PARTICIPANTS

Riaz Ahmed
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FIRESIDE CHAT

Gabriel Dechaine – National Bank Financial – Analyst

Thanks to Riaz Ahmed, TD Bank's CFO for joining us at the conference. I don't know if you've been here in the past, but first time for me. So, a great opportunity to get an overview of TD's operations, recent results and outlook. So, let's get comfortable here.

Riaz Ahmed – TD – Group Head and CFO

Merci. Thank you very much for having me.

Gabriel Dechaine – National Bank Financial – Analyst

I don't know if you have any opening overview-type comments you want to make, or I can jump right into it?

Riaz Ahmed – TD – Group Head and CFO

Let's jump right into it.

Gabriel Dechaine – National Bank Financial – Analyst

So, growth, Q1 obviously was a challenging quarter isolated to one particular business line. Nonetheless, it did put you behind the ball a little bit vis-à-vis your 7% and 10% EPS growth target for the year, yet you still are confident in achieving at least around the low end of that target range. What areas do you think are going to help drive you there?

Riaz Ahmed – TD – Group Head and CFO

Well, look, I think what's most important to say here is that we're obviously operating in a very challenging and fluid environment. If you look at the time in Q4 when we set out the expectations for the year and also coming into Q1, you saw very good performance and very good momentum in our retail businesses in the U.S., but also, particularly, in Canada where the personal and commercial bank did particularly well.

I think what's important to remember is that 7% to 10% adjusted EPS growth target that we put out is a medium-term target that we expect a franchise like ours should be able to achieve. And it reflects our confidence in the business model and it reflects how we feel about the potential of the franchise.

That guidance has been around for over 15 years, and we've missed it in that period three times. We missed it in 2008 during the financial crisis, then again in 2013 when we had our insurance reserves adjustments, and then in 2016.

So, every now and then, we do happen to miss that target. But that being said, when we look at our performance in relation to the macroeconomic environment, we feel that this franchise should be able to deliver a decent growth with its retail orientation, et cetera.

Now, it's very obvious though to you and to us that we called out a number of factors that could affect our performance of TD Bank. And among those are financial markets and how financial markets are doing. So, if you look at the last four quarters, yield curves have come off quite significantly. Central bankers have scaled back their expectations of rate hikes quite significantly. The environment even since our Q1 call, in that respect, has actually gotten tougher.

So, this is kind of a situation, where more recently we see tailwinds. The environment can sort of shift towards tailwinds, and then shift again towards headwinds, and shift back to tailwinds in a very rapid period. But I think what I can say with a degree of confidence is no matter what the environment, we feel very confident about this franchise. And you should expect that we will deliver the best performance that this franchise can deliver in any macro environment.

Gabriel Dechaine – National Bank Financial – Analyst

So, you mentioned the capital markets business as being one facing some headwinds. We had a presenter earlier today citing capital markets is also a business that's still slow. Your business did have a difficult Q1, in particular. Have you made any changes to the operation, or do you truly view it as a one-off result that's unlikely to be repeated?

Riaz Ahmed – TD – Group Head and CFO

Well, I think if you look at the history of our Wholesale segment and TD Securities, this is the dealer that we set out to build. I mean, prior to the acquisition of Canada Trust, so I'm going back to 1999, 20 years ago, TD Bank was disproportionately more corporate and investment banking oriented. And we shifted our strategic profile to go more towards retail, not only in Canada, but then also look to expand in the U.S. in a retail way. And what we did in the meantime on the Wholesale side is we scaled back its global ambitions and where we were involved in high-yield, leverage lending, structured products, global distribution and global clients, and we said that, that did not fit the risk appetite of the TD Bank that we wanted to build.

We've built a dealer through this period, post-financial crisis, et cetera, that is very investment-grade oriented. It is still quite Canadian-centric. I mean, we've started building out our U.S. dollar strategy. It is quite fixed income oriented. And so, it does operate on the lower risk side of the spectrum of corporate investment banking.

So, this is the strategy we set out, and we don't think that one quarter performance, in which the markets are more stressed in the areas that we operate, should get us to re-look at this and say, well, our strategy is all wrong because of one quarter of performance. Even through the financial crisis and since then, the franchise has consistently delivered a mid-$200 million slowly growing earnings and a very attractive return on equity for us.

So, no, I don't think that we would shift strategy over one stressed quarter. But I do think it is an opportunity for us to stare at our growth strategy and say, should we actually go faster and build out the U.S. dollar to get more scale and to get more diversification a little bit faster than we've been going.
I think that you can expect that our strategy will remain pretty much as we have set out, but we may take the opportunity to perhaps accelerate where we see chances to do that without going out the risk curve in a meaningful way.

Gabriel Dechaine – National Bank Financial – Analyst

I don't want to spend too much time on capital markets, because it's a small percentage of the overall business. But you did mention the U.S. dollar strategy, and what I see in the capital markets business, where some of the growth has been most apparent is that the corporate loan book has had some of the fastest growth in the sector over the last number of years.

Is there an expectation that you'll have the balance sheet being put to work, and then a follow-up with ancillary fee income? And is that still kind of in the early innings of that process?

Riaz Ahmed – TD – Group Head and CFO

I would say it is in the early innings. I mean, you're seeing the fastest growth, because we're starting from a very low base and naturally, when you start from a very low base, and you start getting some growth, we might look like an outlier, but we're really not. If you look at the size of our drawn book in the U.S., it's about $20 billion. Some of our peers have $80 billion. So, we have a long way to go before we can actually get to a meaningful level that we feel that we're capable of getting there.

So, yes, our U.S. dollar strategy is essentially around building out around the investment-grade corporate clients, government clients; building out the securitization, debt capital markets side of the business; serving our commercial clientele up and down the franchise with FX services, cash management services, treasury services. I think that this has been a steady build, and it'll continue to be a steady build. But we as we've been accelerating and growing more confident in building out the U.S. dollar strategy we've added a substantial number of clients, and therefore, our drawn book is growing out a little bit.

Gabriel Dechaine – National Bank Financial – Analyst

I want to spend a bit of time on technology spending and a trend in the banking space over the last few years has been kind of bragging about how much you're spending on technology. TD has not given a number... and quantify, in this case, how much you're spending. What can you tell me about your tech spending strategy, how much has been growing in the last few years relative to non-IT spending? And then, do you think the whole trend of rapid escalation of IT spending growth, is that kind of petering out at this stage?

Riaz Ahmed – TD – Group Head and CFO

If you think about the business environment, you generally say that retail and business banking, well, really all aspects of banking are becoming more and more digitalized. And as they're becoming more and more digitalized, banks have had an urgency to modernize our platforms and to be able to engage with our customers in the way that they want to engage with us.

We've made it a big priority. We are the largest digital bank in Canada. Including our U.S. customer base, almost all self-service transactions are now being conducted online or on mobile platforms. And so, I think that tells you, by definition, that yes, our technology investment has been rising, and it's probably the fastest-growing part of our investment spend, as we not only build new capabilities to deliver banking services to our customers in an omni fashion; as we introduce new capabilities like the homeowner journey that we've been on; modernizing our WebBroker platform; introducing better tools.

The WebBroker platform, for example, has now three capabilities: One for simply online trading; one for the more active digital user; and one for using the thinkorswim platform from TD Ameritrade for the most active sophisticated traders. So, all of those kinds of enhancements, which are occurring right across the business platforms are requiring investment. And then, of course the other side of it is that as the world is becoming more digitalized, we're equally concerned about security, privacy, regulatory compliance, and making sure that our customers can have the confidence to deal with us in a secure way.

Now, for some reason, some of these other banks want to necessarily categorize themselves as to who's spending the most and what that rate of spend is between run the bank and change the bank. But I'd say to you that for us, our proof point is if you are customers of TD Bank Group, you're watching how we're transforming the way that we're engaging with you. And if you're not, I encourage you to become one, because I think you'll have a much better experience.

We do compete occasionally. So, I think that our proof point is in the nature of engagement and the scores that our customers are giving us on this front. So, we are still the fastest acquirer of checking and savings account in Canada. And various raters like Comscore, who look at their level of engagement that customers now are placing against their suppliers still rate us as the number one digital bank from a customer engagement perspective.

So, that's how we look at it, and then whether you're spending it on infrastructure or digital banking, or, even modernizing the finance platform, which we are undertaking, we've got a fairly significant transformation going on also in the back-office components of the bank, in my opinion, is actually enhancing the end-to-end customer journey.

Because you can't have back office platforms which are, pardon me for using these words, on Motorola, when you've got the front office apps behaving like Google Maps or Uber. You can't plug Google Maps and Uber into Motorolas anymore. All of that is a holistic journey for us, and we therefore refuse to categorize it in the way that sometimes banks want to say that they're changing the bank, run the bank. To me, I look at it more as a holistic strategy.

Gabriel Dechaine – National Bank Financial – Analyst

So, maybe from a more CFO-type mindset. How much of your tech spending do you expense versus capitalize? In other words, if we really do see a slowdown, how quickly can you pull the reins on these investments?

Riaz Ahmed – TD – Group Head and CFO

Well, I can assure you, I'm not very popular with my colleagues, because I tend to want to amortize things very quickly. And our philosophy is that technology is evolving rapidly, and you can build technology, you can build intellectual property, you can build platforms, but it's not that we are kind of in a very mature state of technology evolution and the technology ecosystem, like it is still evolving and innovating very rapidly.

So, mostly, you can see in our financial statements that we amortize our developed software and intangibles over no more than five years. Occasionally, we may go a little longer, if we've done a platform investment, but we amortize very quickly. And my attitude on that from a stewardship perspective is I want businesses to get used to the idea that they have to pay for their spend, and that I don't want the balance sheet intangibles growing unnecessarily and growing in too rapid a manner, because what I don't want is down the road, to find out that currency requirements and whatnot have made what's on the balance sheet obsolete.

So, I think it's a good discipline that we've embedded in the bank, trying to roughly make our spend equal to our P&L write-off so that the capitalization and the depreciation become much more in balance. And it does cause us, therefore, to be even more disciplined in prioritizing where we're spending, what we're spending on, and how much we're spending on it.

Gabriel Dechaine – National Bank Financial – Analyst

So, if you need to pull back?

Riaz Ahmed – TD – Group Head and CFO

Well, I think on the matter of pulling back, there's no doubt that on some of these investments, for example, if we're talking about building out our security systems, whether it's on the cyber side of things, or fraud, or whatever that the fixed costs of delivering that are increasing. But what we have to do to offset that is take fixed costs from traditional processes, but the ones that might be more manual out just as quickly.

And I think in terms of project spending, there's more and more science being introduced to project spending every day, where approaches are going to, well, you can have a very large vision of what you want your technology, or platform, or your processes to look like. But you essentially invest in it by chunking it down to minimum viable products, using more agile methodology, so as to give you that flexibility to stop and start, and adjust as you go.

It's not that we are doing that from an expense control point of view, but it just turns out that it's a better way to build out your technology, because there's a lot of test and learn along the way. You want to be able to try new things, and if they're working, build the second phase of it; and if they're not working you want to be able to move on from it quickly.

So, the idea of building big buildings in one go is no longer how projects are being done. Projects are being done more incrementally so that you're building floors and rooms at a time and adjusting your strategy accordingly but powered by a vision behind it.

Gabriel Dechaine – National Bank Financial – Analyst

So, just to take a look a bit more of the macro picture here. Late cycle, I'm sure you've heard that term 1,000 times over the past year…

Riaz Ahmed – TD – Group Head and CFO

Housing has been in late cycle for six years now!

Gabriel Dechaine – National Bank Financial – Analyst

Yeah. And then, with the yield curve now inverting, we're going to hear more of it. So, how does it affect your risk appetite? And I also want to talk about the margin outlook and the capital management.

Hopefully, we can cover these things in the last few minutes, but with risk appetite, these things don't change on a dime, you have to have a longer-term view. But in the last few months, have you reconsidered some areas of growth whether it's in the Canada or the U.S.?

Riaz Ahmed – TD – Group Head and CFO

Well, the way we have built the TD Bank and the way that our credit risk culture works is that we have emphasized for many, many years consistency. Not only consistency of underwriting, but also in the selection of the customers and clients that we want to do business with. So, what that does is that it means that we are not abandoning clients in stressed positions, because we selected them well, and because we applied that level of consistency. But it also means that sometimes, when the market is starting to get too loose, so for example, when you start seeing commercial real estate deals, as an example, which are interest-only, no amortization, 100% loan-to-value, perhaps even non-recourse, we're not doing them.

We are seeing more of those kinds of deals in the market now, so hence, perhaps, your comment about the late cycle. And since we don't do them, then, naturally, during those periods, our market share bumps down a little bit, and our view is that we're okay with that.

The flip side of it is that we have actually been able to grow the bank very well during downtimes. So, when we go through financial crisis and events like that, we're able to attract more talent, we're able to attract more clients, we're able to buy businesses on the cheap, we're able to build out our capabilities faster. So, while we don't like to live through a downturn, we're always prepared to go through it because, actually, we think we can build long-term franchise value through a downturn.

Gabriel Dechaine – National Bank Financial – Analyst

Margin outlook, both Canada and the U.S.; Teri gave some, relatively more conservative commentary on margins during Q1 than some of your peers did, said maybe if the rate of Bank of Canada holds, we're going to see margins compress in Q4. Has that become incrementally or meaningfully more conservative? And then, the same question, but the U.S.

Riaz Ahmed – TD – Group Head and CFO

Well, I think because in the last four weeks, the way the potential rate hike seems to have evaporated. I mean, really, the curve is saying right through to 2020 and I think even central bankers are indicating a pause for some period of time now. And you're seeing a somewhat inverted yield curve in Canada and a very flat yield curve in the U.S. And swap rates today, five and seven-year swap rates today are about the same as they were five, seven years ago.

So, I think that the possibility for margins to expand in a meaningful way has more or less priced itself out of the market right now. I would say that my view on margins now is a little more neutral, plus or minus. And deposit margins aren't going to likely expand much more from here, absent changes in the interest rate environment. And as competition continues to be fierce and voracious, we may actually see a little bit of bumpiness and some potential that we could even see slight compression.

But this is not the first time that the banks are finding themselves in this kind of an environment where interest rates are not very supportive. I mean, we just, in fact, lived through that for 10 years and just came out of it for two years, and got all excited about it, and things were looking very good into 2017 and 2018. And here, we're in 2019, and we're finding ourselves back to where we were just two years ago.

Our view is we know how to manage our way through this and that perhaps betas will start coming back, that loan pricing will perhaps start becoming a little more rational again, as the rate environment contracts.

Gabriel Dechaine – National Bank Financial – Analyst

And these are comments applicable both to Canada and the U.S.?

Riaz Ahmed – TD – Group Head and CFO

I would say, yeah.

Gabriel Dechaine – National Bank Financial – Analyst

Okay. Then, a third element of this late-cycle, recessionary, kind of panic environment we're in – maybe not panic. But capital, you had mentioned earlier that you don't like seeing a potential downturn, but it's also an occasion to be opportunistic. You're sitting on a 12% Core Tier 1 ratio. Do you feel any urgency to deploy that, or is it exactly where you want to be, because it gives you optionality?

Riaz Ahmed – TD – Group Head and CFO

We don't see urgency to deploy it. And we're very, very patient and prudent capital managers, as most of you know. And perhaps some of you might think that we're too frustratingly patient with it, but we are very patient at it. I mean, just remember that we were in the low-10s just five quarters ago. And the reason that we are finding ourselves at 12% today is because five quarters ago, the Basel I floor got released. So, we're comfortable operating in the low-10s. If that's where we found ourselves again, it wouldn't bother us, because we know based on our risk appetite and the quality of our balance sheet that, that is – we've proven that we can operate there. And I think, in the meantime, in an environment like this, we don't think it's – well, as long as we're delivering very good ROEs and very good total shareholder returns, we feel that we can be patient with the capital deployment opportunities, and we'll see what comes up.

Gabriel Dechaine – National Bank Financial – Analyst

Actually, one last one I'll sneak in under the same umbrella, credit/IFRS 9. Are we at the cusp of starting to see the volatility induction of this lovely accounting methodology?

Riaz Ahmed – TD – Group Head and CFO

Well, I think you're already seeing that volatility. I mean, a lot of commentators or a lot of practitioners are looking for consistency in IFRS 9 and comparability in IFRS 9. And I think, actually, that accounting provision is really more driven towards individualizing the expected credit loss rather than making it comparable across the industry, because we're going to have a situation that we're in now, where every bank is to make its economic forecasts. And we know in the last six months, economic forecasts don't actually quite work out the way that people think they do.

And then, we're supposed to have a base case, an adverse case, and an upside case. And then, we're supposed to apply a probability. So, really we're sitting here trying to peer in and say is the probability of that downside now 25%, or 27%, or 30%. So, anyway, that's what the accounting standard wants us to do, and we do it to the best of our ability. But I think you're going to see that volatility continue.

Gabriel Dechaine – National Bank Financial – Analyst

Okay. Well, thanks for coming to Montréal, and hope you have a good day.

Riaz Ahmed – TD – Group Head and CFO

Thank you very much for having us and thank you for being great shareholders. Really appreciate it.