Bank Financial Group
Investor Relations

TD BANK FINANCIAL GROUP
LEADERSHIP VIEWS WITH ED CLARK
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FORWARD-LOOKING INFORMATION

PARTICIPANTS

Ed Clark	President & CEO, TD Bank Financial Group
Tim Thompson	SVP Investor Relations, TD Bank Financial Group

INTERVIEW

Tim Thompson - TD Bank Financial Group - SVP - IR

We are joined today by Ed Clark, President and CEO of TD Bank Financial Group. Ed, welcome.

Ed Clark - TD Bank Financial Group - President and CEO

It's great to be here, Tim.

Tim Thompson - TD Bank Financial Group - SVP - IR

So let's jump right to that first question: the economy. Are we on the road to recovery yet?

Ed Clark - TD Bank Financial Group - President and CEO

I think we're in a different phase. If you want to sort of break up what's gone on.

If you take the period from August 2007 to August 2008, I call that sort of the liquidity crisis where in the sense we ended up in the situation where people lost confidence in the financial institutions. There was a huge shrinkage of liquidity around the world.

Then what you have is what I call the great financial panic. And that really was triggered by the collapse of Lehman, where the market was surprised that the US government allowed Lehman to collapse. And by the fact that the US government had different responses to AIG, Washington Mutual, Wachovia, all created a sense of dramatic uncertainty in the market and really then the market totally froze up for a period of time.

All the way through to, you know, the period where in the new year we were dealing with the stress tests in the financial institutions in the United States, and people were openly talking about whether or not the US government was going to have to nationalize the banking industry or the major firms in the banking industry.

We've got through this. I think in fact the stress test turned out to calm the market down, and in fact the speed with which American banks have been able to recapitalize have been really quite remarkable. I think in one sense then there's a euphoria that's hit the equity markets that say, "We're done, we're through this problem".

Unfortunately that's not the case. I think the damage done by the liquidity crisis and then the great financial panic is now rolling through the economy, and I think we're going into a recession. Now whether or not that's a great recession where we're going to go deeper and longer than we've ever seen, or a more normal recession, I think that's in fact still being debated. I think the tendency now, where I would be, is that it won't be as severe in terms of the downturn as we thought. I think we're now starting to see some floors in the recession, but I think we could see anemic growth, being sort of 2 to 4 percent GNP growth, really for the next three or four years, and we certainly can see unemployment rates continuing to rise all the way through 2010. And unfortunately that means for the banking industry that we're going to see loan losses increase during this period.

Tim Thompson - TD Bank Financial Group - SVP - IR

So what were the macro economic forces at play that contributed to the US housing bubble and subsequent financial crisis?

Ed Clark - TD Bank Financial Group - President and CEO

Well I think you really have to step back. You know it's really been since the mid-seventies the United States has been running a current account deficit. And so you've had more than 30 years that the US economy, one of the wealthiest economies if not the wealthiest economy in the world, has actually not been able to live within its means. It has actually consumed more than it was producing. And so you have this really strong inflationary bias in the United States.

At the same time, monetary policy during all this period accommodated growth. And in fact when you had things like the dotcom bubble of 2000, September 11th, the response was to say, "We don't want to have this economy slow down. Let's in fact drop interest rates". What you saw was, instead of getting what people thought of as ordinary inflation so consumer price growing, you didn't have that, but what you had were asset bubbles: asset bubbles in the stock market, and then followed by an asset bubble in the housing market.

And when all of that blew, unfortunately when the asset bubble blew, it blew in the financial services industry. And I think the surprise to most people is that the products, that, in the sense, turned out to be bad, had been spread around the world. And so the impact on that was much more dramatic than anyone thought possible.

Tim Thompson - TD Bank Financial Group - SVP - IR

Which financial institutions have come out of this in the best position?

Ed Clark - TD Bank Financial Group - President and CEO

Well I think part of it is, did you have those products on your balance sheet? So did you have the structured products on your balance sheet? And if you were operating in the United States, did you have the subprime lending, option ARM, particularly the kind of mortgages that turned out to be trouble? Good news for us is we exited the structured product area, and when we went in to the United States we consciously stayed away from them.

I think the second kind of characteristic is did you have strong capital position? A lot of banks around the world over this whole period decided they would leverage themselves up more and more and have less capital for the amount of assets. Happily in Canada we had a regulatory regime that was pretty tough – in fact the toughest in the world – not only by the amount of capital that we had to have and leverage we were allowed, but also the nature of the capital, where we had large amounts of common equity, the best form of capital, to sustain ourselves.

I think the third factor is business mix: how oriented you were to the wholesale securities business versus the retail business. And so the great thing about a retail business is it provides stability of earnings, so that in fact if you do run into trouble, you actually have the earnings power to work your way out through that trouble.

Well we had gradually shifted our business mix, so in 1999 TD Bank was 55 percent wholesale, 45 percent retail. And now we're somewhere between 85 percent retail, 85 to 90 percent and 10 to 15 percent wholesale. And so that means came out of this or went through this cycle with very strong dependable earnings.

Tim Thompson - TD Bank Financial Group - SVP - IR

Let's look forward. What are the forces shaping the global banking system?

Ed Clark - TD Bank Financial Group - President and CEO

There's some pretty fundamental forces going on right now. You know during this whole period, and one of the things that allowed the leverage to be as much as it was, is we had the disintermediation of the banks and the use of the capital markets to fund much of the lending: little bit less in Canada than in the rest of the world, certainly most in the United States. That is being reversed. In fact the capital markets were the ones that were most damaged by this crisis. And while I think the capital markets will come back and some forms of securitization will continue, clearly they're not going to come back to the levels that they were pre this crisis. And so this means that banks are going to play a much more dramatic role going forward, funding the capital needs of the economy.

The second broad force is that you have tremendous globalization going on in this period. And that's in a sense the thing that I think most surprised people in the crisis, that how could a lending problem in a mortgage business in California affect a German bank or a hedge fund in Australia. Well it's because everything became globalized.

I think now there's in a sense an element of de-globalization that's going on. Most of the major banks around the world themselves are looking at their businesses and saying, “Do I have a strong enough position in this market that I want to stay in every market in the world, or should I concentrate my efforts?” At the same time they're being encouraged by their own governments and the regulatory authorities who say, “We want you to de-select some of this and get out of things where we really don't see you having a competitive position”. But also because governments have ended up having to bail out so many banks, they're putting pressure on those banks to say, “Well why are we the taxpayers funding for activities outside our own country? Why don't you in fact come back and focus your efforts on your own company?”

I think the third major force that's going on is because we are in a recession, the governmental authorities – and they believe this is a unique recession, maybe worse than things we've ever seen before – they've reacted very vigorously to lower interest rates, and have signaled that they are determined to hold interest rates low for an extended period of time. Well the reality is, in the banking business, your nominal interest rates are a major factor in determining how profitable you are.

If you have a deposit, there's a floor to your deposit. People won't pay for you to hold their money. So as nominal interest rates come down you squeeze margins. And so I think we're in a period where in fact you are going to have margin squeeze going on in the whole banking industry.

Tim Thompson - TD Bank Financial Group - SVP - IR

So what does all of that mean for banks?

Ed Clark - TD Bank Financial Group - President and CEO

Well I think banks are going to have to rethink their strategies in many cases. Because there's pressure I think from the regulatory authorities to make sure, given that they had to come in and intervene here in such a massive way and provide such massive amount of government aid to the banks. Canada's unique being the only country in the world where they didn't have to do this.

Then there's pressure by those regulatory authorities to say, "Well are you doing activities that really add value to the economy? Or are you actually just using your license as a bank to take bets? And when the bets go bad, then the governments own the losses, but if they go well, you own the profits?"

So I think there's some pressure and there will be continuous pressure over time to re-look at your business model and say, "OK, let's get out of some of the activities that we had before". I think the other thing, because of the margin pressures, you're going to get pressures where everyone is going to be looking at their models and saying, "How can I lower my permanent cost structure so I can live in a thinner margin world?"

The good news for TD Bank is that we don't have to do that. We had already exited the businesses that the regulatory authorities are worried about, and we had built our security dealer around a franchise play. We asked a very simple question: is this activity geared to helping our clients and our customers? And if not, we don't want to be in that business. So we'd already reshaped our wholesale business to be compatible with the business of the future because we have this strong retail franchise that owns a space in the marketplace called customer service and convenience, we actually have a sustainable organic growth machine. And we've always operated very efficiently, so we have one of the lowest cost ratios in the industry.

Tim Thompson - TD Bank Financial Group - SVP - IR

So going forward, what changes are we going to make at TD?

Ed Clark - TD Bank Financial Group - President and CEO

We're not going to make many changes at TD going forward, other than to grow and try to take advantage of this dislocation. So I think this could turn out to be a unique downturn. Normally when an economic downturn comes, your growth slows. But because in fact there's been this reintermediation, and so the capital markets participants have exited the markets, and some of the non bank lenders have exited the market, and because of the deglobalization some foreign lenders have exited the market, we have huge opportunity to actually take market share. And because we're rightly positioned, we're not spending our energy trying to reorganize our business. We're simply focused on how we have growth.

And so we're continuing to grow our brand system in both the United States and in Canada. We're adding business bankers, we're adding financial advisors. And we're saying, let's take advantage of this period where we can take market share and grow.

Tim Thompson - TD Bank Financial Group - SVP - IR

And what about acquisitions?

Ed Clark - TD Bank Financial Group - President and CEO

I think the great advantage we have is that we don't have to buy. We have an organic growth strategy and we have a position already in the market place in Canada and in Northeastern United States, that if we never made any acquisitions we'd still be a phenomenally successful company. And that is why it's always so important to say, "Do I have an organic growth strategy that works?"

And so for the moment right now we're following that path. We're going to add 20 branches in Canada this year, 30 branches in the United States, and we believe that in the future we can ramp up our branch growth in the United States even faster than that.
But that doesn't mean that if the market presents you with opportunities you don't take advantage of them.

What's the problem right now though in terms of acquisitions, is when you buy a bank you buy a balance sheet, you buy assets. And the real issue is, well, what is the value of those assets that you're buying? It's very hard to know that in the United States now because we don't know how deep this recession is going to go. Nor do we know how long it's going to go. And so housing prices are still falling in the United States.

And so when we look at acquisitions, and they would have to be acquisitions that are in our footprint, so that's basically east coast of the United States, and that fit in the kind of cities where we want to expand in that footprint. When we look at those we say, well, I don't think I know whether or not what the value is, and so I don't think we would go ahead and make acquisitions like that.

There in the marketplace today, it is possible to do other types of acquisitions, where the government in the form of the FDIC come in and say, "You know we'll all share with you. We can provide you some protection on the assets if you're willing to take this bank." And so we've signaled that we're prepared to look you know for the moment, those are the kind of deals we're looking at. When in the future we get clarity on where asset values are, we can look at other than assisted deals. But for the moment that's our focus.

Tim Thompson - TD Bank Financial Group - SVP - IR

So Ed, what are you telling employees at TD these days?

Ed Clark - TD Bank Financial Group - President and CEO

I'm telling employees at TD: you are in one of the few companies/banks in the world that went through this whole crisis and not only emerged unscathed, you emerged with a brand that's recognized around the world as different. Indeed if you take the top North American financial institutions, TD Bank is the only bank whose brand actually increased in value during a financial crisis – an amazing feat. So we are extraordinarily well-positioned both in Canada and the United States, to opportunistically take advantage of what the dislocation offers us. We're going to do it though in the TD way, which has always been a way that's conservative in risk management, that relies on fundamental strategies that say, "Do you have a competitive advantage?", and backs our people and grows our people so we can take advantage of growth opportunities.

Tim Thompson - TD Bank Financial Group - SVP - IR

Ed, thank you very much for doing this.

Ed Clark - TD Bank Financial Group - President and CEO

Well thank you for giving me the opportunity.