TD BANK GROUP
RBC 2023 GLOBAL FINANCIAL INSTITUTIONS CONFERENCE
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Material economic assumptions underlying the forward-looking statements contained in this document are set out in the 2022 MD&A under the heading "Economic Summary and Outlook", under the headings "Key Priorities for 2023" and "Operating Environment and Outlook" for the Canadian Personal and Commercial Banking, U.S. Retail, Wealth Management and Insurance, and Wholesale Banking segments, and under the heading "2022 Accomplishments and Focus for 2023" for the Corporate segment, each as may be updated in subsequently filed quarterly reports to shareholders. Any forward-looking statements contained in this document represent the views of management only as of the date hereof and are presented for the purpose of assisting the Bank's shareholders and analysts in understanding the Bank's financial position, objectives and priorities and anticipated financial performance as at and for the periods ended on the dates presented, and may not be appropriate for other purposes. The Bank does not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on its behalf, except as required under applicable securities legislation.

PARTICIPANTS

Kelvin Tran
TD Bank Group – Chief Financial Officer

Darko Mihelic
RBC Capital Markets – Analyst

FIRESIDE CHAT

Darko Mihelic – RBC – Analyst

Okay. Good morning, everybody. My name is Darko Mihelic. For those of you who haven't met me, I'm the research analyst in Toronto. I cover the Canadian banks and the Canadian Life Insurers. Welcome to the session, we're excited to have Kelvin Tran, the CFO of TD Bank here. And for those of you who follow Canadian banks, we reported earnings just last week. So this is going to be a bit of a second kind of earnings call, maybe some follow-ups in there, a few longer-term questions I'm going to throw in to just for some added spice.

Before we begin, I've been asked to tell you that Kelvin's comments today may include forward-looking statements. Actual results could differ materially from forecasts, projections or conclusions in these statements. Listeners can find additional details in the public filings of TD Bank Group.

So Kelvin, with that out of the way, thank you for joining us this morning.

Kelvin Tran – TD – Chief Financial Officer

Good morning, Darko. Thank you for having me.

Darko Mihelic – RBC – Analyst

So last week, just before the call, I got some news through the First Horizon filings. And I'd appreciate we're probably -- unless anything has changed, not going to talk too much about the process there. But I did have a couple of follow-up questions that I thought would be useful. One of the things that I get the benefit of is my colleague, Jon Arfstrom, covers First Horizon. So I get to plop that in my model, throw in some expense synergies and call it a day.

But stuff must have changed. And now potentially this deal could go much further into the future than in the past. So is there anything you could tell us about -- and if you don't want to tell us numbers, that's cool, but maybe talk about some of the things that might be changing with respect to the original expense synergies or any other assumption that may be interesting for us with respect to First Horizon.

Kelvin Tran – TD – Chief Financial Officer

Sure. Good morning, everyone. It's great to be here. Like you said, I think the main benefits continue to be there. We're very excited about the deal. When you see the sum of the moving parts, you would have seen it in the recent results from First Horizon, they continue to benefit from the rate hike. So you see expanding margins and higher NII. And as expected, when rates rise, you have a negative impact on other businesses like the mortgage warehousing business. And so you see that as kind of an offset. But that's expected in a diversified business and so there's some puts and takes there. In terms of the expense synergy, the number is still the same, but if it gets delayed a little bit.

And also, I would say that what we keep our eyes very closely on is the impact on goodwill. And we talked about that on the purchase price equation where with rising rates, we would have to have a bigger fair value decrement on the loans that we booked on closing. So that would have an impact on goodwill, but that accretes back over time benefiting the P&L. So those are all the different moving parts that we're looking at.

Darko Mihelic – RBC – Analyst

Yes. That brings to mind the hedge, right? So you've implemented a hedge. But presumably, there would have been some time horizons and duration stuff on the hedge. Is there anything changing there with respect to the hedge, especially if this deal was delayed significantly?

Kelvin Tran – TD – Chief Financial Officer

Well, what we do is we continue to monitor the bulk of First Horizon and refine, modify and extend as appropriate. And I know there are questions on the call, even with the investors of what happens to the hedge if we don't need it. And I would say it's very similar when we don't need the hedge whether on close or not. And what happens with that is that when we don't need to hedge, we unwind the hedge at that point in time and we put on a new hedge.

And at the end of the day, it's just a timing difference. So overall, cash-to-cash, it's net neutral for the portfolio. But then assuming rates continue to stay at this level or have risen, then the gains that you would have seen in the book life-to-date, would be there. And then with the swap coming in at a higher rate, you would have a negative carry over time, effectively unwinding that cash. So it's really a timing difference from a hedge perspective.

Darko Mihelic – RBC – Analyst

So there isn't really any difficulty in managing this hedge over time with an uncertain time horizon?

Kelvin Tran – TD – Chief Financial Officer

Correct. And we just continue to roll that. We have a lot of smart people. And some of them are in this room.

Darko Mihelic – RBC – Analyst

Okay. Great. Maybe they can pipe in. So of course, it brings about the other question, which is the other side of this -- what if the deal doesn't close? You're carrying a lot of excess capital. What's Plan B? Is there a Plan B? I'm sure there is, but I'm not sure that you're willing to talk about it. But what can you tell investors who are thinking about the possibility that First Horizon doesn't actually close?

Kelvin Tran – TD – Chief Financial Officer

Well, we're very committed to the transaction, very focused on that. And we're working really hard to get the deal closing as soon as we can.

Darko Mihelic – RBC – Analyst

Okay. So we don't want to talk about the possibility of $13 billion, I think the price is changing -- what about that mechanism for the price to increase past May 27? So as we got past February, I think you renegotiated to the end of May 27. So once again, when you think of the purchase price of First Horizon, is there like a running meter that would cause a rise in the price to purchase First Horizon if it was December?

Kelvin Tran – TD – Chief Financial Officer

Well, we have what we call it a ticking fee. $0.65 on an annualized basis that's disclosed in our filing. And that's something that we look at. But every month that passes by, we continue to add to our book value as well.

Darko Mihelic – RBC – Analyst

All right. We'll poll the audience later for questions. But hopefully, that kind of gets that out of the way. And now we can talk a little bit more about what the quarter was like because I felt like it was a good quarter, maybe a little overshadowed by all of the First Horizon stuff.

Kelvin Tran – TD – Chief Financial Officer

We're very pleased with the quarter.

Darko Mihelic – RBC – Analyst

Maybe first, I wanted to chat a little bit about risk-weighted assets. So it was a bit of an increase. You talked about some of the things in there. One of the things that I've had a lot of questions from folks, is the possibility of negative migration happening, in, as we perceive maybe a mild slowdown coming here in North America economically, people talk to me about the threat of RWA migration. Can you maybe touch on that? And what are your views on RWA possible migration?

And I have a bit of a follow-up, maybe a tag end to the quarter on the Stanford litigation. Because one of the things that the Stanford litigation cost does under the newer rules is it creates higher operational risk. Not sure if that's material or not. So maybe you can weave in RWA migration and then talk about the potential for higher operational risk going forward.

Kelvin Tran – TD – Chief Financial Officer

The credit risk migration is really dependent on the economy and how your exposure plays out, and we've taken that into account in our forecast. So to the comments that we've made last week, it has been built into our forecast credit risk migration. And I would say we are confident that our allowance credit loss is adequately reserved. Then when you talked about Stanford, that is already also taken into account. So in Q2, when we implement operational risk and credit risk under Basel III, the net-net effect is very small either way, positive or negative. So a negative on the operational risk side and then positive on the credit risk side.

Darko Mihelic – RBC – Analyst

Well put. So that was included in the overall discussion?

Kelvin Tran – TD – Chief Financial Officer

Correct.

Darko Mihelic – RBC – Analyst

Okay. Great. Then moving quickly on to some of the other fundamentals in the quarter. I wanted to talk about loan growth in Canada. One of the things that we noticed with respect to TD is slightly less growth than peers. And certainly, we've been noticing that with mortgages for some time. Then there was a bit of a pickup, and now it's sort of peeled back a little bit. So maybe you could talk a little bit about loan growth and touch on all important loan categories. But first, let's kick off with mortgages.

Kelvin Tran – TD – Chief Financial Officer

Sure. I mean there was a slowdown in RESL in the quarter, and that was a cautious business decision that we made given the margins that we've seen in certain segments. So we've made some business decisions close to the end of last year. And obviously, that would have impacted funding throughout this time, including Q1.

But if you look at Q1 spot year-over-year, spot-to-spot, we were about one third in terms of relative peer comparison for RESL. And so we continue to see good pipeline there. We're happy with it. And then in terms of other loan categories, we continue to see good spending on credit cards. Paydown rates are still high but normalizing. And so we expect that to continue to grow and also add to not just the volume but NII margin as well because they are a higher-margin business.

And then Business Banking loans continue to hit double-digit growth year-over-year. And that's something that we're monitoring given the economy and given the need to invest in inventory. But the cost is high now for people to make a decision on do they want to stock up more on inventory because of potential supply chain disruption. But, rates are higher, so it costs more and so businesses are thinking about that.

Darko Mihelic – RBC – Analyst

And now flipping to the U.S. quick on the loan growth side. You had some PPP loans in Commercial. Can you talk a little bit about that outlook as well with respect to the U.S. business?

Kelvin Tran – TD – Chief Financial Officer

Yes. I mean the PPP loans were really important for our customers. We wanted to be there for them in their times of need. And being able to support them is really important to continue to build that franchise relationship. And so we were, I would say, over-indexed a little bit compared to our peers on PPP loans. So when you compare the year-over-year changes, that would have been the impact. But also what you've seen our peers do is that they are more indexed in C&I loans and middle market. And that category was significantly impacted by the pandemic. So you actually see a bigger retrenchment and then a bigger pickup. With us, we're more a gradual decline and now picking up as well. And if you look over the last few quarters, we've been picking up momentum, seeing good credit line utilization and continue to acquire new customers.

Darko Mihelic – RBC – Analyst

As I hear that, it begs the question of what is your longer-term strategy with C&I. And does that become a bigger focus point for TD going forward?

Kelvin Tran – TD – Chief Financial Officer

Yes, it absolutely is, it becomes a bigger focus point for us. But we don't swing for the fences. We do things gradually. We invest in and acquire customers. And we're definitely seeing the middle market and C&I loans growing as a proportion of our total loans. And then with the acquisition closing of Cowen, they are also in that space, and so we see synergies and potential there as well.

Darko Mihelic – RBC – Analyst

So switching to deposits. We just had Comerica here in the session before this one. We spoke about deposit beta. I wanted to talk a little bit about your deposits in the U.S. because you have a significant chunk of sweep deposits from the Schwab arrangement, plus you have a very good core deposit base in the U.S. So maybe you can talk a little bit about your margin outlook with respect to the strong funding source that you have and your view on deposit beta in the U.S. and maybe how your NIM will evolve in the U.S. for the rest of the year?

Kelvin Tran – TD – Chief Financial Officer

Sure. I mean we have a strong deposit franchise business, as you've mentioned. And because of the customer convenience and our distribution channel, we don't need to lead with pricing. But we're obviously very cautious about the competitive dynamics in the industry and the higher beta that you see and we want to make sure that we're competitive as well for our customers. But what we're seeing is that we continue to acquire new customers, so adding new customer volume to our franchise and then being conscious about pricing. We're seeing customers, also very similar to the industry, migrating from non-interest-bearing deposits to interest-bearing deposits and from non-term to term, and that's what we're seeing as well.

And the dynamic is slightly different from Personal Banking versus Business Banking. With Business Banking, a lot of our business owners are also clients of our wealth business because they have succession planning needs, they have other financial planning needs. And so we're working very closely with our partners in Wealth to make sure that we retain those customers within the TD franchise.

Darko Mihelic – RBC – Analyst

And are you talking both sides of the border there or specifically...

Kelvin Tran – TD – Chief Financial Officer

Well, I was more focusing on the U.S. And then when we look forward, deposit ex-sweep is how we look at it, and is I would say, relatively flat quarter-over-quarter. But we're seeing more of a shift from non-interest bearing to interest-bearing.

Darko Mihelic – RBC – Analyst

And is that shift faster in the U.S. or is it faster in Canada?

Kelvin Tran – TD – Chief Financial Officer

Well, I think the timing differs. What you see in terms of beta historically and as it plays out in this cycle as well, is that when rates rise, the beta in Canada was earlier to react, but the Canadian dynamics is that they are earlier to react, but they are more gradual over time. Whereas the U.S. beta there's a lag and then there's a bigger shift and I think that's what you're seeing in the dynamics in the U.S. right now. So, there was a period of lag, and now you see a bigger shift in the U.S. which is obviously something we're monitoring very closely and we're introducing new products to make sure that we remain competitive in the market.

Darko Mihelic – RBC – Analyst

And with respect to that sort of dynamic on the deposit side, one of the discussions we had on the call was about your NIM and with respect to what we could expect for future NIM expansion. And I think you touched on your securities book and your tractoring. Maybe you can just go over that a little bit because I think some other Canadian banks do things a little differently. Maybe we can chat a little bit about weaving in your tractoring and how that should still support some NIM expansion despite the changing deposit beta in finance.

Kelvin Tran – TD – Chief Financial Officer

Sure. If you look at our deposit base, a lot of it is savings deposits that are more a float-type of exposure. And because of that, we invest that excess cash into float rate investments. And that's why when you saw over the last year a 75 basis point increase or 50 basis point increase, you see a rapid rise in margin. And rightly so, the question now is if the next few moves are either a pause potentially in Canada or smaller increases. I guess it depends on what Powell says right now, that you would expect slower margin expansion.

But I would note that when you look at the margin, it's the total encompassing margin. You should also have loan pricing competition there as well. And so over the last few quarters, while deposit margin has been expanding, there continue to be competition on the loan side and loan margins have depressed a little bit. And so that was an offset. And then you'd also expect that, as products like deposits migrate from savings accounts to term deposits. And term deposits are lower-margin products. So that would have an impact and I'll talk about that a little more for the near term. So the near term, you would expect the margins to bounce around a little bit because of some of these dynamics. But in, I would say, the remainder of 2023, if you look at a little bit of a longer-term horizon, that's where our tractors come into play. And so the tractors for us means a laddered bond portfolio. These are stickier deposits for the longer term. And so what we do is we invest them into either a 5-year investment in Canada or swap equivalent or 7 years in the U.S. and then they reprice. So as the investments or swaps mature, the rates that we invested in back 5 or 7 years ago are lower than the rate that we would put on today. And so as they reprice, even if rates remain the same, it would still be supportive to margin expansion but much more gradual because they are much smaller over a 5- or 7-year time horizon, and that would continue to support margin.

Darko Mihelic – RBC – Analyst

So, it's fair to say, over a 5-year horizon, I think every month, one sixtieth of the book is more or less repriced?

Kelvin Tran – TD – Chief Financial Officer

Something like that.

Darko Mihelic – RBC – Analyst

Is it that tightly structured?

Kelvin Tran – TD – Chief Financial Officer

It's fairly tight.

Darko Mihelic – RBC – Analyst

Okay. All right. So maybe then just moving on to -- because I'm very mindful of the time, I wanted to talk on a few other things here, but -- of course, when you want technology to work, it's not going to help you.

Kelvin Tran – TD – Chief Financial Officer

Well, you have a note there that says, Kelvin, you look great today. Feel free to elaborate.

Darko Mihelic – RBC – Analyst

I wanted to jump back to, and I apologize, this is something that's sort of come up more recently with respect to the mortgage scenario in Canada. I apologize for bouncing around a little bit because this is something I said that's just recently come up. But essentially, what we're seeing in Canada -- as we all know in the room, Canadian mortgages are structured a little bit differently. Interest rates went up pretty quickly. We now have some mortgages that are variable rate and significant variable rate mortgages that were put on books by all Canadian banks in 2021-2022. And now we've had a very big increase in rates.

We're now in a spot where some of these mortgages are negatively amortizing. And I believe one bank has put out some information on that. I can't imagine for a minute it's just one bank. So let's think about the industry as a whole and think about TD within this industry. You're a very large mortgage provider in Canada. Presumably, you too would have negative am mortgages on the books. I don't know if you're willing to disclose how much or where we're at. But can you talk a little bit about that phenomenon? And why or why not it should be concerning to investors?

Kelvin Tran – TD – Chief Financial Officer

Yes. So we monitor that very closely as like our peer banks. The credit quality is strong. And in Canada, in terms of the qualifying rates, our regulators have made sure that there's a stress testing buffer from that perspective when these consumers qualify for the mortgages initially. So I think that's a good buffer there. But also, less than 1% of our RESL portfolio is uninsured, has a bureau score of less than 650 and a loan-to-value ratio of more than 75%. So what we consider higher risk is contained. And then also, we work very closely with our customers that we proactively reach out to them with the rising rate environment and work out and say hey what options do they have, and provide guidance. And we're encouraged to see that they are taking action, whether they're putting a lump sum payment or they're changing their payment schedule. And so we continue to do stress testing and scenarios, and that gives us comfort that it is manageable.

Darko Mihelic – RBC – Analyst

Presumably you're having these conversations and so what is the most likely scenario? As in, what is the customer telling you more often than not? 'Yes, you know what, I'll put more money down or I'll agree to a higher mortgage'. What is the most likely and most often kind of reaction from your customers?

Kelvin Tran – TD – Chief Financial Officer

It really varies. It depends on the consumer and their personal situation. But we take comfort in our stress testing and our reserve methodology, and we take that into account in our allowance for credit loss. I mean our allowance today, as you would know, is 12 basis points higher than pre-pandemic, so we're adequately reserved.

Darko Mihelic – RBC – Analyst

But is there a potential that it -- I mean if rates stay high, there's also the fixed book and there's the variable book. So there's the fixed book, which will presumably in '25, '26 start to roll and face potentially significantly higher interest rates. Are we just putting off a potential problem? Or is this also something that's built? Because I think 5 years out, your ACL would really not have a lot of migration for stuff that's that far into the future. So I think the concern will be, 'Okay, there's nothing imminent this year. But is there an issue 3, 4 years down the line, if rates stay high'?

Kelvin Tran – TD – Chief Financial Officer

Well, we've always said the way to not get into trouble is to not get into trouble in the first place. We have robust underwriting standards through the cycle. We don't swing for the fences just because it's a bull market, and we don't step back just because it's a bear market. And that is the best protection that you have to make sure that you are lending to quality borrowers. And the best indication continues to be the unemployment rate, and the labor market continues to be very tight. So we're continuing to work with our customers and monitor our portfolio very closely.

Darko Mihelic – RBC – Analyst

Okay. I'm going to poll the audience if there's any questions that anybody wants to lob up here. There's a hand up right there.

Q&A Participant

I think you and your peers have talked about the ongoing remix from chequing and savings product into term and that being one of the bigger drags on that long-term NIM grind up that you and peers will experience. I just wonder if you could talk about the limits of that and kind of what inning of the process. You can't buy a gig twice, I suppose, with the same dollar.

Kelvin Tran – TD – Chief Financial Officer

Yes. Well, I think the -- what our focus is, is making sure that we provide the right advice and the product for our customers and that our pricing remains competitive. And we expect to see that migration over time. Because rates continue to rise, you could see that migration also occur. And we just manage it appropriately, and we'll adapt to the situation at that moment.

Darko Mihelic – RBC – Analyst

Okay. No other hands in the audience. So I wanted to get back to capital, which was a big discussion on the conference call. You mentioned that you're guiding towards -- or working towards a 12% Common Equity Tier 1 ratio. I think you mentioned midway through next year was the view. The question sort of jumps up, why 12%, right? Minimum's now 11%. Most of the time, banks operate at 50 basis points above that. So what is it that's driving you to go to 12%?

Kelvin Tran – TD – Chief Financial Officer

Well, I don't want to speculate on the regulatory requirements. I think 12% is a good number. And given what we are seeing in terms of the environment, we continue to forecast conservatively. And as we talked about on the call, we have strong internal capital generation. And so every quarter that passes by, we would add to our capital ratios.

And then on top of that, we have flexibility, we have levers. And we've shown that we could deploy that, whether it was reintroducing the DRIP discount; whether it was selling investments that are high-RWA consumption that are not impacting our core franchise; whether there are risk transfer trades; and then for the Cowen acquisition, we sold down some Schwab shares to fund that. So we have a lot – we generate strong internal capital, and then we have flexibility. We feel very good and comfortable with that given the outlook.

Darko Mihelic – RBC – Analyst

It begs the question -- because the one thing that's been on my mind ever since the regulator increased the DSB buffer all the way up to a maximum of 4%. And in my mind, I think to myself, if a regulator pushes that out to 4% then eventually, they're going to get you to 4%. How do you think about that from a longer-term perspective of managing the bank? Do you think that it's reasonable to assume that if the economy doesn't really slow down, we somehow manage a soft landing, Goldilocks kind of environment, that we're eventually going to go all the way up to the 4% DSB and that's just going to push even higher?

Kelvin Tran – TD – Chief Financial Officer

Well, the regulator has said publicly that this is not debt capital, right? And so we take comfort in that. But like any organization, we would adapt. And so we manage our bank with enough flexibility that we can adapt with changing environments.

Darko Mihelic – RBC – Analyst

Okay. Any last questions before I. . ? We got 3 minutes left, and you've been ripping through my questions really quickly. So are there any other questions before I wrap it up, up here? To the crowd, no? You're satisfied this morning, so great. So the last question, I guess, I have for you...

Kelvin Tran – TD – Chief Financial Officer

I thought that was the last question.

Darko Mihelic – RBC – Analyst

Oh, no, sorry, I meant one last question, one from the crowd, sorry. So when we sit back and we think about TD's overall North American strategy, you're clearly acquiring First Horizon, you're committed to the deal. That very much is clear. Once you actually close the First Horizon acquisition, the question then becomes – sure, we've got a couple of years of integration work which I'm sure you all were prepared for that, but begs the question for the longer-term strategy beyond First Horizon, which is wealth and, where do you stand on the wealth build-out, so to speak, in the U.S., knowing that you have a shareholding in Schwab? But beyond that, how do you view – is it simply that what we do in Canada is what we want to do in the U.S.? Or is it a little more nuanced than that?

Kelvin Tran – TD – Chief Financial Officer

Well, we like the wealth business a lot, it generates consistent, high ROE returns. And right now, we're building that organically. But we're always open to opportunities if they arise. It's a great business to be in.

Darko Mihelic – RBC – Analyst

Yes. Thank you. We'll wrap it up here. Thank you, Kelvin, for being part of the conference.

Kelvin Tran – TD – Chief Financial Officer

Thank you Darko, Appreciate it.