TD BANK GROUP
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PARTICIPANTS

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TD Bank Group – Chief Financial Officer

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FIRESIDE CHAT

Darko Mihelic – RBC – Analyst

Great. Thank you very much. So we'll start the next session with TD Bank. We have the Chief Financial Officer, Kelvin Tran, here with us. Kelvin, welcome to the conference.

Kelvin Tran – TD – Group Head & CFO

Thanks for having me.

Darko Mihelic – RBC – Analyst

So as I mentioned sometime yesterday in some of my conversations, the timing of this event is pretty unique, in that it comes right after the banks have reported first quarter. So sometimes, we get a chance to sort of circle back and ask a few lingering questions that maybe we hadn't sorted out on the call or maybe people have been -- and certainly, I get a lot of questions from investors on the first quarter.

So I think maybe to start, we can maybe clear up a few things from the quarter and some of the recent events as well. So I think yesterday, the CFPB put out a notice that they will be lowering late fees, capping them. And we know you have credit card portfolios in the U.S. with Nordstrom and Target. So we were hoping to at least maybe start right off the bat with a discussion on if there's any impact to TD.

Kelvin Tran – TD – Group Head & CFO

Yes. There will be an impact, but the credit card late fees are not a big proportion of our revenues. Remember, there's a sharing -- revenue sharing agreement with the partners, such as Nordstrom and Target. So that's what I would say. And like any fees, we continue to evolve our product lines and adapt to the environment.

Darko Mihelic – RBC – Analyst

And so where should we be looking? Maybe you can talk a little bit about where we will see this impact. And I'm not sure when, so that's another big question. But we know that they're reported in the U.S. segment and as well, there's an offset in corporate. Maybe you can just give us a bit of that.

Kelvin Tran – TD – Group Head & CFO

Yes. It's complicated because the way the accounting works for these partnerships is that we're required to record 100% of the revenues in our financial statements. And then -- so these fees would be reported under 'Other Income'. And then the recovery of that, like the sharing with the partners, is in the non-interest expense line. So -- but again, it's not a big part of our total revenues, and so we think it's manageable.

Darko Mihelic – RBC – Analyst

Okay. So we'll see that movement, but net-net...

Kelvin Tran – TD – Group Head & CFO

When it comes, it comes. We'll see.

Darko Mihelic – RBC – Analyst

Okay. And then maybe just a few other things from the quarter that stood out to me because there was a lot of discussion around expenses, and we were looking at the corporate segment and we were trying to, in the middle of that conference call, sort of sort out to ourselves what are we thinking about with respect to the incremental costs that are required for the AML compliance program in the U.S.?

And so maybe I thought I'd give you a chance to sort of discuss how you see these costs rolling in. And are they coming in, in a steady fashion? Are they already there? Or will they start to increase throughout the year? So maybe you can give us a little bit of an idea on how to think about that.

Kelvin Tran – TD – Group Head & CFO

It's a great question. So the risk and control infrastructure, the investment would be recorded in corporate segment and then the running the bank – the BAU, that's going to be build as well – that would be in the various segments.

What we provided our expectation for 2024 is that on a total expense base, it's a growth of mid-single digit growth, right? But I would say I'll break it down into a few parts. Recognizing that there are significant risk and control costs that we need to invest in, we still want to continue to invest in the business to drive growth, right? So we're not dialing that down.

And so, therefore, in Q4, we announced a restructuring plan to drive savings of expected $400 million this year and then $600 million on a run rate basis in 2025. And so when you look at our BAU expenses, investment for growth, net of these savings, you're looking at a year-over-year growth of about 2%. So we're self-funding a lot of those investments through this restructuring program. And then when you add the TD Cowen 4 months this year because of the year-over-year, TD Cowen was not part of the bank in the first 4 months of last year, plus the risk and control costs, so that would add to mid-single-digit expense growth in 2024. So it's a mid-single digit.

Darko Mihelic – RBC – Analyst

I see. You're going to be – the picking up of TD Cowen...

Kelvin Tran – TD – Group Head & CFO

Yes, because I think it's just part of the M&A equation, but that was actually a big driver of the Q1 expense growth as well, right? And so mid-single digit for 2024. And then another way to triangulate that is to look at the corporate segment losses. Previously, it was on an after-tax basis, $100 million to $125 million, and now we're expecting $200 million to $250 million.

Now when you look at that amount, there are a lot of moving parts in the corporate segment, right, and timing is really different. And so what is in corporate segment that could impact that amount? Hedging, P&L volatility would be part of that. Earnings on excess capital would be part of that. And so as you buy back shares, that would impact it. Your forecast of rates would have an impact on that amount. And then other expenses and productivity would also be part of it.

So when you look at that, there are a lot of moving parts, but because we know we're investing more in risk and control infrastructure, overall, when you add up that on average, I think is going to be that range in 2024.

And then the question is, well, how should you look at it versus prior quarters? I mean, if you look at our investor presentation, the CFO deck, we go segment by segment. And even in the SFI, the supplemental information pack, there's a table that shows corporate net expenses and then other. When you look at quarter-over-quarter, the increase in the losses – 1/3 is because of expenses and 2/3 is because of other items. And other items, one of the contributors would be less earnings on excess capital because we're buying back shares. But if you look at year-over-year, most of that increase in loss is all driven by expenses. So when you look at that, we've been investing. You're not going to see suddenly a step-up in expenses, but it would continue to increase throughout the year. And then the losses in corporate segment would depend on a lot of these other items.

Darko Mihelic – RBC – Analyst

That's very helpful. Thank you for that. That was good. And so maybe just – we'll just switch gears here and talk a little bit more about some of the longer term. But I am very curious, I know you mentioned the investments that you want to continue over and above just the AML program, but also invest for growth. So there's going to be some of that going on. And then I want to weave that into, all right, let's think about – you recently had Investor Day, right? And you shared a lot of targets. And some of them, we thought, myself, anyway, I thought, were pretty aggressive targets for Canada, in particular and certainly in the mortgage side.

So maybe you can give us a bit of an update on how that's progressing, where you see things going and is the investment pace kind of where we thought it would be at this point for the Canada business? So broad-ranging question, but we are seeing TD certainly more aggressive in the mortgage market today than we have seen in the past. And relative to peers, it looks like you're gaining share. So maybe we can talk a little bit about that and sort of weave that into the Investor Day targets for you.

Kelvin Tran – TD – Group Head & CFO

We're very excited about the business itself. We've been working hard at executing on our strategies since we laid out those goals. We're making good progress, so I'm very pleased with the progress we've made and we believe that we continue to be on target.

But remember, these are medium-term goals, right? So it's not a year-over-year or quarter-over-quarter goal. And so that means that it's going to ebb and flow, depending on the year, especially when you have market-dependent factors that are driving that. And you've mentioned RESL (real estate) is a good example because once we set out that goal, rates have risen dramatically.

You saw a slowdown in the market, but we're still doing well. And the way we do that is to continue to work on, first of all, retention of existing clients, right? Because what you want to do is optimize, maximize your retention rate. If you have a leaky bucket, it's very hard to replace and then drive growth, right? So we're doing well there.

And then also making sure that we get leads early, leads that we can execute on and work on that funnel to bring leads to transactions. So that would be actions that we continue to take to optimize that growth. And that's going to ebb and flow, but we believe that $500 billion continues to be an achievable target.

And then on the other side, like new customers that were driving growth. And that one, we've outpaced where we thought we're going to be at this point in time. But that doesn't mean that we've stopped. It just means that it's working, and we continue to fine-tune and optimize our strategies.

And when we look at the Canadian P&C results for the quarter, it was a very strong quarter. And why we said that it's not just the earnings or PTPP number, but it's also growing both sides of the balance sheet and then growing your margin. That's really hard to do. Like I said, it's a Rubik's cube that you're trying to optimize various metrics. And so we're able to do that, continue to gain share, grow your balance sheet and still improve on margin.

Darko Mihelic – RBC – Analyst

And one of the things that you'd sort of guided to a medium-term goal, I totally understand, we're talking about a 16% plus ROE. Last year, it came in around 14%.

So maybe we can talk a little bit about your path to 16% and how you see it evolving and if the path has altered a little bit since you've had that Investor Day or is it really still sort of on track.

Kelvin Tran – TD – Group Head & CFO

Still on track. So let me break it down into a few buckets here. First, we look at revenue growth. And so even though forward rates would imply that there would be rate cuts, you would have heard on our earnings call that we're guiding to stable margin in Q2. And because of the positive reinvestment income generating through the tractors, right, we have a laddered bond portfolio, investment portfolio where the rates that we're now investing in, as these investments mature, is much higher than several years ago. That's going to continue to provide positive impact.

And then volume growth is also good. And so even though margin may be stable, we continue to believe that net interest income would grow in 2024. So let's not confuse margin because of balance sheet mix, whatnot, with net interest income growth.

And then when you look at the positive of integration with TD Cowen, we had a record quarter in Q1 in the wholesale bank. And so if the market continues to be supportive, then it's not just on growing on the retail bank side, but also on the wholesale and fee-based income, including wealth and direct investing and trading.

And then on the expense side, we already talked about it. We announced a restructuring program. We wanted to go harder at productivity, and that's going to drive $400 million expected savings in '24 and then $600 million in '25.

And then meanwhile, we have the share repurchase program. We've announced 90 million shares. We repurchased almost 50% by the end of Q1. And so that's going to reduce your denominator. And so all these three would put us to continue to be on track to deliver that ROE goal.

Darko Mihelic – RBC – Analyst

And maybe just a follow-up on that, though. So if you complete the program (the buyback program), it's probably an integral part of getting to the ROE. But do you think as it stands now, would you maybe perhaps need another buyback program to help kind of give you that final push to get towards the 16%? Or do you think the revenue, the NII growth and the expense savings can get you there on its own without another buyback program?

Kelvin Tran – TD – Group Head & CFO

So we don't have anything to announce on the buyback, like another buyback program or not. If you look at the volume growth in RWA for the quarter was quite healthy. So we continue to see good opportunities in the market to gain customer relationships. And so who knows what the future would hold, but we continue to focus on organic growth.

Darko Mihelic – RBC – Analyst

And so maybe just taking it from another different angle. You'd still have a high capital ratio, even after that buyback program. And I think you're still generating capital per quarter over and above. So it seems as though there's going to be excess capital here for some time.

Kelvin Tran – TD – Group Head & CFO

If it's good, if there is, great. It is an uncertain environment. And we're very proud of the fact that we could be a defensive play and an offensive play at the same time. Let the first program -- let this program end first, and then we'll see what the environment holds.

Darko Mihelic – RBC – Analyst

Okay. And I'm just wondering, where is the long-term common equity Tier 1 ratio?

Kelvin Tran – TD – Group Head & CFO

We said the goal is 12%. And then between now and then, it depends on the environment. Even the pace of share buyback, as you know, depends on market conditions. So a lot of moving parts. But we continue to look at the environment, adapt, look at the opportunity. If we can gain clients, good client relationships for long term shareholder return, we'll do that every day.

Darko Mihelic – RBC – Analyst

Yes. So maybe I want to turn attention a little bit to the U.S. operations and talk a little bit about what we're just kind of talking about, which is you're trying to grow both sides of the balance sheet. Up here in Canada, difficult to manage, difficult to do. You're doing it.

But in the U.S., we have seen deposits run off a little bit. The Schwab deposits have been coming down, a little bit of pressure there. So how do you see that evolving over the course of 2024? And can you talk a little bit about deposit competition? Because there's been some of that discussion around here in terms of the deposit market in the U.S. So how is TD faring on that front?

Kelvin Tran – TD – Group Head & CFO

We're faring well. I think it was at this fireside chat last year where I said we don't compete on price, but we will be competitive. And we don't lead on price, let's say. And so what we've seen is that, yes, deposit migration continues to occur, but that has slowed down a little bit. And same thing with the pricing side on customer rates. And we've seen good deposit growth quarter-over-quarter. But again, more on the term side, term deposit.

And when you look at rate decline in the future, I think we need to separate into two things. There's the rate component and there's a volume component. And so the rate component, rate cut because of where we are, and in terms of the beta, there would be some of that, that would go to the customer. But then there's also -- when that happens, you would expect inflation to moderate, to come down. And also because rates are down, people would be spending less in servicing some of the debt as well.

And so part of the deposit attrition that you've seen over the last year is because people have to pay more for goods and services and pay more to service debt. So even without that pressure, we expect that there would be growth, people would be able to retain more of their cash, and that's helpful to deposit.

I've already talked about the slowing down of the migration or attrition, and that would continue to occur because there's going to be a smaller gap between various products. So I think the wildcard is how would competition play out. Because the competition is not just on profitability or client relationship, some banks would depend on that to fund their balance sheet. And so depending on the competition's needs, that could drive very different dynamics, and that is yet to be seen at this moment.

Darko Mihelic – RBC – Analyst

And so then thinking about the other side of the balance sheet for the U.S. business, we outlined some pretty good growth ambitions for 2024 and 2025. And so as I think about that in a falling rate environment, it could spur growth again and I just wanted to sort of better understand, from your seat at the CFO level, when you look at the U.S. business and you say, "Well, I've got all these moving parts. I've got falling rates. Maybe there'll be pressure on NIM, but I've got volume growth coming in the back side." Where do you see that growth potentially coming at TD in a falling rate environment? Where -- is it going to be a big commercial push? Or do you think it's going to be in the -- I know there's big plans for credit cards, but maybe you can talk a bit more about...

Kelvin Tran – TD – Group Head & CFO

Yes. I mean, if you look at our balance sheet in Q1, there was healthy growth in all product classes on the asset side of the balance sheet. And what we're very pleased about is our performance on commercial banking, as you've mentioned, in the middle market, in C&I area. And our customers are telling us that they are waiting a little bit, given some of the uncertainty in the environment and the cost of credit is high.

And so there are pent-up demand, especially on the efficiency side. What we're hearing is that they are also like us thinking about how can I invest to drive efficiency. So we're excited about all of those prospects. So that's why there's another reason for "let's wait and see what we do with the capital" because there's a lot of opportunity to support our customers through this growth.

Darko Mihelic – RBC – Analyst

And with that plans for branch expansion and geographic, can you just touch gently on what we should be expecting to see in terms of -- you guys call them stores, I'm sorry, store growth for the near term and medium term, maybe a better way of saying it.

Kelvin Tran – TD – Group Head & CFO

So I mean, stores continue to be a very important part of our customer service. During the pandemic, obviously, digital played a bigger part. And what we see now is that the customers want to see people face-to-face, and store continues to be an important part.

And so what we do is we think about it as a portfolio of investment, whether you invest in bankers because now you have commercial banking growth or whether it's credit cards. And so we look at all of that in this environment, given the risk and control infrastructure, where do you want to spend the next dollars. They're all-important levers, and it depends on the year.

Darko Mihelic – RBC – Analyst

Okay. So I'd be remiss if I didn't have this conversation and have a little bit of touch on credit quality. So maybe we can talk a little bit about what we saw in Q1. But more importantly, what we're hearing as a general theme here at this conference is, although there's going to be issues with commercial real estate, there is not a great sense of concern that they will develop into losses that are not manageable.

So maybe you can give everybody a little bit of a reminder of your commercial real estate exposures and sort of what we've seen to date and how you look at that portfolio going forward.

Kelvin Tran – TD – Group Head & CFO

Sure, sure. So high level, commercial real estate makes up about 10% of our loans and acceptances. And then for office CRE that people are very more focused on is about 1% of the overall portfolio. We feel good about it. We have experienced bankers. We have good experience in this diversified portfolio, and it's a portfolio that we stress often, and it's a bottom-up approach, looking at their cash flow, looking at various situations.

And as a matter of fact, our reserves are 2.5x that of the pre-pandemic level. And so we're adequately reserved, but obviously, the scenarios need to be played out. And we continue to monitor that, but we believe that it is manageable.

Darko Mihelic – RBC – Analyst

And so then thinking about -- and I'll pause there. If there's any questions from the audience, please raise your hand now because we're going to quickly run into the sort of the end of my questions. So if you have any questions, let me know.

But then switching gears to the consumer. So TD has got a fairly good portfolio of credit cards and mortgages in Canada. So maybe you can just touch briefly on your outlook for credit losses there and some of the trends that we're seeing. We're starting to see across, I'm going to say, the industry – the rise in delinquency rates in credit cards. So maybe you can talk a little bit about the behaviours that you're seeing and some of the loss characteristics there. And maybe dovetail that into mortgages, if there's anything to talk about there.

Kelvin Tran – TD – Group Head & CFO

It's interesting. The Canadian market is quite different than the U.S. market, both as a market that they're different, but also in terms of our business on both sides of the border. So when you look at our credit card business in Canada, it's indexed towards travel and luxury categories. And so the credit losses there are not yet at pre-pandemic level, and revolving rates are still below pre-pandemic levels. But are they rising? Yes, as we expected, these are unsecured exposures. Whereas in the U.S., it is different, because of the partnership portfolio that we have as well. And for those ones, we're actually seeing them slightly above pre-pandemic levels already.

And when you talk about what we're seeing in terms of consumer behaviour, we're seeing that consumers are adjusting. What we do is we monitor the excess cash that they have in their accounts. And in Canada, the fear is that because people understand that rates are high, their debt-to-service ratio is -- they're more indebted. You actually see them adjusting their behaviour, spending less, holding more cash cushion.

And then when you look at the RESL renewal over the last 12 months, we saw really good actions taken by the customer, meaning they either pay a lump sum down or they are increasing their payments. And when you look at mortgages that hit the trigger rate, which is like nonamortizing on our variable interest rate mortgages, those amounts have been coming down quarter-over-quarter.

So that means that people are adjusting to the scenario, and they are taking the appropriate action. And we as a bank, we proactively go and reach out to them before the situation arises and help them manage through that situation. So all in all, we feel good about it, and RESL losses continue to be very low.

Darko Mihelic – RBC – Analyst

And with that, I suppose, there would be some concern that if people are making these mortgage payments and there's less discretionary spend happening in the marketplace, that there would be some concern with some industries, like service industries, hotel. Is there anything on the commercial side that you are seeing in Canada that might be connected in any way to lower discretionary spend from the consumer? Or is it still too early?

Kelvin Tran – TD – Group Head & CFO

Yes. Nothing that would be alarming to us. But overall, you do expect the rising rate environment to have an impact. That's the intent of the rate increases. But I would say, still, it all depends on the customer segment as well.

You have customers who are in the mass affluent market. They continue to be gainfully -- that's why unemployment rate is so important. They continue to be gainfully employed. And then through this environment with inflation, they got pay increases. So when you monitor the direct deposit chequing amounts that goes into the account, that continues to grow. So yes, I think it's -- we'll have to see how this plays out.

Darko Mihelic – RBC – Analyst

Okay. And maybe just a final question, Kelvin. So it's been a pretty unique year last year with the cancellation of FHN, but Cowen coming onboard. So what is it that you're most excited about for 2024?

Kelvin Tran – TD – Group Head & CFO

Well, as a Chinese, I'm excited about the Year of the Dragon. It's also a special year. It's going to be great from that perspective.

What I would say is that we're off to a great start. Look at our Q1 results. CAD P&C, which is our biggest, most profitable business, delivered a strong quarter. And then very pleased with the results of the integration of TD Cowen and TD Securities. And it just shows you the power of putting these 2 franchises together.

So I think there's a lot to be excited about, and look forward to continuing to execute on the strategies that we've outlined to you.

Darko Mihelic – RBC – Analyst

All right. Great. Well, with that, we can end with about a minute left. So thank you very much, and great to have you.

Kelvin Tran – TD – Group Head & CFO

Thank you.