



TD BANK GROUP
Q1 2013 EARNINGS CONFERENCE CALL
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PRESENTATION

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Good afternoon and welcome to TD Bank Group's First Quarter 2013 Investor Presentation. My name is Rudy Sankovic and I am the Head of Investor Relations at the Bank. We will begin today's presentation with remarks from Ed Clark, the Bank's CEO, after which Colleen Johnston, the bank's CFO, will present our first quarter operating results. Mark Chauvin, Chief Risk Officer, will then offer comments on credit quality, after which we will entertain questions from those present and from prequalified analysts and investors on the phone. Also present today to answer your questions are Tim Hockey, Group Head, Canadian Banking, Auto Finance, and Credit Cards; Mike Pedersen, Group Head, Wealth, Insurance, and Corporate Shared Services; Bharat Masrani, Group Head, US P&C Banking; and Bob Dorrance, Group Head, Wholesale Banking.

Please turn to slide two. At this time, I'd like to caution our listeners that this presentation contains forward-looking statements, that there are risks that actual results could differ materially from what is discussed, and that certain material factors or assumptions were applied in making these forward-looking statements. Any forward-looking statements contained in this presentation represent the views of management 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. Forward-looking statements may not be appropriate for other purposes.

I'd also like to remind listeners that the bank utilizes non-GAAP financial measures to arrive at adjusted results, to assess each of its businesses, and to measure overall bank performance. The bank believes that adjusted results provide the reader with a better understanding of how management views the bank's performance.

Additional information on items of note, the bank's reported results, and factors and assumptions related to forward-looking information are all available in our 2012 MD&A, available on td.com.

With that, let me turn the presentation over to Ed.

Ed Clark – TD Bank Group – Group President & CEO

Thanks, Rudy. And welcome, everyone, and thank you all for joining us this afternoon. Colleen's going to be up shortly to review our first quarter results in detail, but let me start by sharing my thoughts on the quarter overall.

This was a very strong quarter for TD. Total adjusted earnings were up 9 percent from a year ago. And at \$2.00, our earnings per share were up 8 percent. We had record earnings in all of our retail businesses, driven by good loan and deposit growth in Canada and the United States, and impressive revenue growth in Wealth and Insurance. Our Wholesale bank had a softer quarter, but the business's underlying performance was quite solid.

Along with these positive results, we are pleased to declare a dividend increase of 4 cents, reflecting the Board's desire to continue increasing our dividend twice a year as we progress towards the midpoint of our new higher payout range. We also announced an end to the 1 percent discount on our dividend reinvestment program. With the transition to IFRS now behind us, we determined that, at this time, the discount was not required to support our capital build.

As of January 31st, 2013, our Basel III common equity Tier 1 ratio was a healthy 8.8 percent, although the core number is closer to 8.5 percent excluding the impact of the one year CVA reprieve that OSFI granted in December.

So, strong earnings, a healthy dividend increase, and reduced EPS dilution from lower share issuance. It's a very good news story. It obviously feels good to start the year at 8 percent adjusted EPS growth, given that we've been saying it will be tough to get into the 7 to 10 percent range.

But, I don't think anything has fundamentally changed with respect to that outlook. We're pleased with the earnings momentum that we have in our businesses, but we continue to face a number of short term challenges in the operating environment. At the same time, looking further ahead, we are increasingly encouraged by signs of progress in the US economy. The housing market appears to have turned the corner, and the recovery has considerable upside. The labor market is on the mend, and there are promising developments in the US energy sector that could herald a substantial lift to growth in years to come.

Now, all of this has important implications for interest rates. The Fed has signaled that rates are likely to stay on hold for some time. But, the reality is that the downside risk to rates is dramatically lower than the upside potential. The market is likely to price in rate hikes before the Fed delivers them. We don't believe that the correct strategy today is to run the bank on the assumption that rates will stay low forever. We expect them to be low for a while, but at some point they will move up. Predicting the timing of such a move is not in our paradigm. The good news is that, while low interest rates hurt your margins temporarily, they also produce temporary security gains. So, our conclusion is that we should be methodically repositioning our balance sheet to shorten duration, both to ensure we realize the upside earnings when rates rise and to reduce the risk to our capital now that unrealized gains are included in our capital base under Basel III.

Therefore, as you know, over the last few quarters we have begun to systematically shorten the duration of our balance sheet by selling some of our long-dated securities. This will lock in unrealized gains into our capital, although at a price of putting additional pressure on margins for the next couple of years, offset by security gains over the same period. In Canada, we are also shortening duration to ensure we are poised to benefit from higher rates. But, the impact on margins should be less pronounced because of the shape of the yield curve.

With that macro backdrop in mind, let me now talk about each of our businesses. Our Canadian retail bank started the year on a very strong note, supported by good lending growth and stable margins. However, with Canadian households deleveraging, consumer lending growth is slowing across the industry. Business lending growth remained strong, but this provides only a partial offset, and the tailwind from credit is diminishing. All told, we expect Canadian Personal and Commercial banking to have a solid year in fiscal 2013, with positive operating leverage and earnings growth consistent with our meeting our overall bank earnings target.

Our Wealth business is benefiting from continuing strong asset growth. And as we previously indicated, we expect our Insurance business to have earnings growth in the 7 to 10 percent range in 2013 relative to the pre-reserve run rate of \$600 million in 2012. Collectively, these two businesses should be a source of above average growth for the Bank over the medium term.

Our US retail bank continues to experience impressive loan and deposit growth, reflecting steady improvement in the US economy and our ability to take market share. Low interest rates are putting more significant pressure on margins, but strong organic volume growth, the additional earnings from the Target acquisition once it closes, and the expected security gains that we will generate in order to effect our desired shift in duration should help us meet our \$1.6 billion adjusted earning target for 2013.

Our Wholesale bank continues to target 15 to 20 percent ROE on a full-year basis, with a continued expectation of unevenness in earnings from quarter to quarter.

If much of this sounds familiar, it is because it is familiar. These are the same themes and trends we've been highlighting for some time. So, it shouldn't surprise you to hear that my conclusion hasn't changed – namely, that we will have to work hard to stay in the 7 to 10 percent range for total bank adjusted EPS growth this year.

We also continue to believe we can achieve positive operating leverage. That's a much tougher task in today's revenue environment, but our retail businesses all met the challenge in the first quarter. And while total bank adjusted expense growth exceeded 3 percent in the first quarter, that was partly a reflection of the sustained effort we're making to achieve more even initiative and project spend over the full year cycle. We remain committed to limiting adjusted expense growth, excluding acquisitions and FX, to 3 percent for the fiscal year 2013 as a whole. This will allow us to maintain positive operating leverage while continuing to deliver legendary service and convenience and continuing to invest in the future.

To wrap up, overall, our businesses performed very well in the opening quarter of 2013. We continue to face the same headwinds that we battled last year, but my conviction has never been stronger that we have the right business model, the right tools and resources, and most importantly of all, the right people to overcome these challenges and continue to deliver on our vision of being the Better Bank.

Before I hand things over to Colleen, let me turn back to a topic which I had hoped I had dealt with last quarter. But, given recent media reports, just to be sure, I want to try to put this question firmly to bed. Last quarter, I indicated that if we were to look at a larger deal, it would need to fit the bank's strategy, timing, and risk appetite. In addition, it would need to meet our financial hurdles and be supported by the market. We do not believe that a transaction to acquire RBS's Citizens Bank is available that meets these criteria.

With that, let me turn the call over to Colleen.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Thanks very much, Ed, and good afternoon, everyone. Let me walk you through our results. Please turn to slide four.

Our results in the first quarter were very strong, with adjusted EPS of \$2.00, up 8 percent year-over-year, and total bank adjusted net income of \$1.9 billion, up 9 percent from last year. Retail adjusted earnings of \$1.7 billion were up 10 percent year-over-year, a new record. Wholesale net income was \$159 million, down 18 percent from last year. And the corporate segment had a gain of \$51 million. Overall, it was a very strong start to 2013. Please turn to slide five.

This next slide presents our reported and adjusted earnings this quarter, with the difference due to four items of note. There are no new items of note this quarter, but let me mention an increase of \$70 million to the previously disclosed litigation reserve. The US litigation environment remains challenging. However, with respect to Rothstein, which has been our most significant matter in the past year, we believe we are much closer to the end than the beginning. We will also no longer treat normal course general allowance changes as an item of note. They are now part of the corporate segment.

Please turn to slide six. The Canadian Personal and Commercial Bank delivered a record quarter, with adjusted net income \$944 million, up 11 percent year-over-year. Our results included an extra month of MBNA versus last year. Excluding MBNA, revenue growth was 3 percent and expense growth was 1 percent. Loan and deposit growth were good this quarter, with lending growth of 6 percent versus last year. Real estate secured lending volumes were up 5 percent, reflecting a slowing housing market and continued consumer deleveraging. Business lending growth remained strong, up 13 percent, while retail deposits increased 7 percent and business deposit growth was 8 percent.

Credit performance remained strong, with PCL and personal banking, excluding MBNA, down \$14 million from last year due to better credit performance, enhanced collection strategies, and record low bankruptcies. Business banking PCLs were also lower year-over-year. We continue to see retail PCL as a tailwind, while the impact of commercial PCL is less certain given the nature of commercial losses.

Excluding the impact of MBNA, expense growth was 1 percent year-over-year. Higher costs associated with volume growth, Merit increases and growth initiatives were largely offset by the impact of productivity initiatives. The first quarter also set a new record for productivity with a segment efficiency ratio of 43.8 percent.

NIM was down 4 basis points sequentially due entirely to the Q4 MBNA credit mark release, which added five basis points last quarter and did not recur this quarter.

For the rest of 2013, Canadian banking is faced with a low interest rate environment and slowing demand for retail loans. Our focus remains on generating positive operating leverage through productivity gains and by managing expenses.

Please turn to slide seven. It was a strong quarter for our Wealth and Insurance businesses, with both posting record results. Wealth earnings were up 15 percent year-over-year, mostly due to continued growth in client assets. We had very strong Q1 long-term mutual fund sales, up 34 percent year-over-year, driven by a doubling of sales in our TD Canada Trust branches.

Insurance earnings were up 10 percent year-over-year. Revenues increased due to lower weather-related claims and growth in premiums. Operating leverage in Wealth and Insurance was 300 basis points this quarter due to strong revenue growth and a continued focus on expense management.

The contribution from TD Ameritrade was \$47 million, down \$8 million from last year. TD Ameritrade's reported earnings declined 3 percent year-over-year.

Moving on to slide eight, the US Personal and Commercial bank delivered strong adjusted net income of US \$387 million for the quarter, up 12 percent from last year. The increase was primarily due to strong volume and fee growth, gains on sales of securities, and a lower effective tax rate, partially offset by lower net interest margins. Average loans were up 16 percent year-over-year, including a 23 percent increase in personal loans and a 10 percent increase in business loans, while average deposits, excluding government deposits and TD Ameritrade IDAs, were up 9 percent.

Let me spend a couple of minutes on US NIM. I think Ed has done a great job of outlining this, but I'll continue. Our NIM came in at 328 basis points this quarter. This is well below the target range we laid out previously. Last quarter, we cited downward pressure on NIM from deposit margin compression. We also called out accounting volatility and changes in balance sheet mix, which cause NIM to vary. Let me expand on these factors and talk about what's changed this quarter and how we're managing the income statement and balance sheet, including capital.

Interest rates at historically low levels are driving continued deposit margin compression – nothing new here. In addition, given the rate environment, this quarter we made a deliberate decision to further shorten the duration of our asset portfolio relative to our neutral target, in part through security sales.

This effectively reduces our core deposit duration and avoids locking in today's low long-term rates. This strategy will contribute moderately to NIM compression due to the lower yield earned on assets, but better positions us for rising rates.

A major reason for security sales is balance sheet and capital management. The low rate environment has hurt margins but has generated large unrealized gains in our available for sale securities portfolio, which are reflected in AOCI, and hence in capital under Basel III. This is a bigger issue for TD, given the size of our investment portfolio.

Security sales convert AOCI into permanent capital and help us manage capital volatility. Security gains were \$82 million this quarter, and we expect gains in the \$60 to \$80 million range per quarter this year.

The accounting associated with acquired portfolios can be volatile and difficult to forecast. This item represented roughly half of the NIM decline versus Q4. Given declining acquired portfolio balances, we are now assuming that these amounts are neutral to negative going forward.

In terms of mix, rates of loan growth that exceed deposit growth add to our NIM. We expect a small positive contribution from mix going forward. Excluding the impact of the Target acquisition, we expect our NIM for 2013 to continue to compress, but at a much slower rate than you saw this quarter.

Total adjusted PCL was up 14 percent from last year, primarily due to strong volume growth partially offset by a decrease in acquired credit impaired PCL. The underlying credit quality of the loan portfolio continues to improve.

Adjusted expenses were up 4 percent, primarily driven by continued investments in our franchise including the opening of 11 new stores in Q1, partially offset by increased productivity in our stores.

Please turn to slide nine. Wholesale banking delivered a solid quarter from our core businesses. Net income of \$159 million was down 18 percent compared to the same period last year due to lower trading-related revenues partially offset by lower non-interest expenses and a PCL recovery.

We were pleased with client activity across all of our businesses in Q1. However, trading related revenue performance was muted by changes in valuation reserves versus last year. Our normalized expectation for trading related revenue remains \$300 million per quarter.

PCL for the quarter was a net recovery of \$5 million due to recoveries of previously recorded provisions. Lower variable compensation expense, in line with reduced revenues, led to lower non-interest expenses in the quarter, down 3 percent compared to last year. Annualized ROE for the quarter was 15 percent, in line with our medium term ROE target of 15 to 20 percent.

Please turn to slide 10. The Corporate segment posted an adjusted gain of \$51 million in the quarter. Results were higher than last year due to gains in Treasury and hedging activities, including higher earnings on excess capital, and release of the allowance for incurred but not identified credit losses relating to the Canadian loan portfolio, partially offset by higher net corporate expenses.

Please turn to slide 11. We continue to focus on expenses. We are working to slow the rate of expense growth across the bank by pursuing initiatives that will permanently improve efficiency. At the all bank level, Q1 adjusted expenses were up 4 percent year-over-year due to business growth and the timing of expenses. Expenses were down 6 percent quarter-over-quarter as expected. All of our retail segments had positive operating leverage.

In 2013, we expect project and initiative spend to be better distributed throughout the year, which has been an area of focus for us. We expect elevated expense growth in the first half of the year followed by lower growth in the second half. But, let me stress that we continue to target a rate of expense growth for 2013, excluding acquisitions and FX, at or below the 3 percent rate of growth in 2012.

Please turn to slide 12. Effective Q1 of 2013, capital is calculated in accordance with the Basel III regulatory framework. Under the new framework, our common equity Tier 1 ratio was 8.8 percent in the first quarter. Excluding the impact of the temporary OSFI reprieve on the implementation of the CVA add-on charge, our Basel III capital ratio was 8.5 percent. We expect this ratio to decline next quarter, assuming we close the Target and Epoch deals during the quarter. Overall, we remain well positioned for the evolving regulatory and capital environment.

With that, I'll turn the presentation over to Mark.

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

Thank you, Colleen, and good afternoon, everyone. Please turn to slide 13.

I am pleased to report that this quarter was a very good one from a credit perspective. First, if you look across the enterprise, gross impaired loan formations decreased \$177 million, returning to normal levels after the one-time impact seen last quarter. Total bank PCL was \$360 million, a \$129 million improvement from the previous quarter, resulting in the lowest PCL rate we've reported since 2007.

Turning to Canada, our credit profile is strong and the near-term outlook is for this trend to continue. Retail delinquencies decreased by 2 percent in the quarter. The credit card PCL rate reduced to 3.7 percent, a 160 basis point improvement from a year ago when we acquired MBNA Canada. And HELOC portfolio performance returned to its previous levels after last quarter's one-time reclassification of certain accounts.

With respect to the US, we are optimistic that 2013 will continue to show improvement in credit quality. Commercial resolutions outpaced new formations for the fifth quarter in a row. Criticized and classified volumes continued to decline. And we are seeing more of our problem loans repaid or refinanced away from us. We remain happy with the quality of residential mortgage originations. Lastly, we are confident that the Superstorm Sandy provision taken in Q4 is adequate to cover related losses. We expect to see this largely cleaned up by the end of the third quarter.

And now, I'll turn the presentation back to Rudy.

QUESTION AND ANSWER

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thank you, Mark.

We'll now open it up for questions. To give everyone a chance to participate, please keep to one question and then re-queue if there's time. For those participating in person, can I ask you to identify your name and firm before asking your question? And before ending the call today, I will ask Ed to offer some final remarks.

So, let's get started in the room. Jason?

Jason Bilodeau – TD Securities – Analyst

Jason Bilodeau, TD Securities. Ed, the capital plan is moving ahead. You've turned off the DRIP. You've raised the dividend. When do we start thinking about buybacks, and how do you fit that in with your overall capital strategy?

Ed Clark – TD Bank Group – Group President & CEO

I think what we would say is, rather than focus on buybacks per se, I think about an overall capital plan. It's been difficult to permanently lock that down while there are still moving parts. Everyone seems to think they know what the D-SIB surcharge will be, but we haven't had that formally confirmed. We don't know what kind of cushion for capital volatility that OSFI is going to want. And, as you can see with the CVA, it doesn't take much of a change in rules to make a significant difference in the number.

We would certainly hope that by the summer, all those issues would have been cleared away. Maybe not all issues, but we'd be down to things where there is predictability of exactly what kind of capital regime there will be, and then we could be more articulate about what our overall capital strategy is. But, we wouldn't rule out buybacks, if that's your question.

Jason Bilodeau – TD Securities – Analyst

I was just trying to think how you...

Ed Clark – TD Bank Group – Group President & CEO

Philosophically, given our capacity to generate capital, we're going to have to look at that as one of the possibilities.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Jason. Michael?

Michael Goldberg – Desjardins Securities – Analyst

Michael Goldberg, Desjardins Securities. Ed, I guess this question's for you. What's your view of the likely endurance of a retail franchise in the United States, where you've obviously placed your bet, versus a wholesale capital markets franchise over time?

Ed Clark – TD Bank Group – Group President & CEO

One of my views from a broader business point of view is that, particularly where you go outside your country, you should always do things that you're confident that you know how to do and you do well. But, I think even inside your country, you can have companies that do one thing, or are braver in one area than other companies are in another area.

I think we've taken the position that going head to head with the top banks – the Goldman Sachs, the J.P. Morgans of the world, Citibank – as a capital market strategy in the United States, for us, is not a 'high probability of success' strategy.

We think we have a very successful strategy that we're implementing, which is to go and use the fundamental strength of our retail commercial franchise. We sit where most of the Fortune 500 companies are. We have a great brand with those companies, because, in fact, their employees and often their executives bank with us, and we can use that relationship to get a security relationship with them and do things with them.

But, to go head to head and say we're going to become another Goldman Sachs isn't a strategy that we think would be a winning strategy for us. So, we do have a capital market strategy in the US, but it's very much built around leveraging the strength that we have there.

Michael Goldberg – Desjardins Securities – Analyst

But, specifically with regards to the endurance of the two businesses, what could you say about the degree to which one may have a bigger moat around it than the other?

Ed Clark – TD Bank Group – Group President & CEO

Well, I think we're trying to have the moat that we've built work for both businesses – I think that would be our thing. To use your language, I think what's attractive about retail businesses is that you do build moats – you get a strong enough base that you can survive even an incompetent leader for a while, just because of the strength of the brands and other things. And so, they're very enduring businesses.

I like to build businesses where you have deep franchises, and the world can go against you for a while and it's not perfect. I think we've said that our best TD Securities strategy in the US is, in a sense, to hide behind those dams and say, "why don't we build a relationship bank, rather than duke it out in a world in which it's just your money and your risk appetite against my money and their risk appetite, or my risk appetite".

So, we want to build a franchise TD Securities place – which you could say is what all the Canadian banks have frankly built in Canada. We think that's available to us. It's just not going to be available for us, if you will, on the big ticket M&A – lots of the stuff that the money centre banks do. But, we think, down to corporate America and junior corporate America, it is available to us.

Michael Goldberg – Desjardins Securities – Analyst

Thank you.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Michael. John?

John Aiken – Barclays – Analyst

Tim, Colleen addressed the efficiency ratio in terms of the bank wide ratio. But, when we're in an environment now where we actually are starting to see the retail lending slow, how difficult is it going to be for you for 2013 to hit your own personal targets for cost saving – or rather, cost growth and the efficiency ratio? Because, to be quite honest, the efficiency ratio that you reported this quarter was very strong. Are we going to see some retracement through the rest of the year?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

No.

John Aiken – Barclays – Analyst

Do you want to...?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

That's not just an answer to you. I'm partly speaking to my own executive team when I give you that answer. We're feeling quite confident, as Colleen said, that our productivity agenda is actually quite robust, not only for 2013 but also for 2014. And we're now starting to talk about 2015 and 2016.

The way I think of it is the comments that Ed talked about relative to our positioning for a higher rate environment in the future on the balance sheet. That's a balance sheet position. I have to run the P&L

based on a low rate environment for a long period of time. That's the way we position it, so that drives lower revenue growth than we've been used to.

And as a result, we've been talking about this for over two years. I'm quite confident we'll continue to keep our expense growth quite low and inside our rate of revenue growth, which will give us positive operating leverage.

John Aiken – Barclays – Analyst

And the structure that Colleen talked about in terms of the project spend trying to be evened out, is it a similar dynamic within your operations?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

Absolutely.

John Aiken – Barclays – Analyst

Thank you.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, John. And the next John?

John Reucassel – BMO Capital Markets – Analyst

John Reucassel from BMO Capital Markets. Just a question for Colleen, or a clarification, really. On the securities gains in the US, are they taxed at a lower rate than what you report in the US P&C segment? And what are the unrealized gains in that group today?

And then finally, you talked about NIM compression being less this quarter, but it was 20 basis points. So, I guess I hope it would be less. Is there any way you could give us a little tighter view on that – on the NIMs?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

So, to start with your question about the unrealized gains, we have total AOCI of \$1.3 billion on the balance sheet, and about 60 percent of that is in the US segment. That, by the way, is an after-tax number, and those security gains are taxed at regular rates.

The next part of your question was...sorry?

John Reucassel – BMO Capital Markets – Analyst

Just on the NIM compression. You said it would be less in this quarter.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Yes.

John Reucassel – BMO Capital Markets – Analyst

I know you're hesitant, but...

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Yes.

John Reucassel – BMO Capital Markets – Analyst

Is it likely to be 20 basis points...?

Ed Clark – TD Bank Group – Group President & CEO

Come on, Colleen – tell *me* that it's not going to be another 20 basis points!

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

I can tell you that for sure, Ed.

Ed Clark – TD Bank Group – Group President & CEO

Great. Well, there you are with that.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

We'd like to be more predictive. And, when we talk about our Canadian margins, we're usually much more accurate. The fact is that it's tougher in the US. It's partly the accounting phenomenon and the accounting noise that comes from that. And, as I said in my remarks, I think that number is going to be neutral to declining going forward. But, again, it's sometimes hard to predict where these items appear on the geography of the P&L.

Clearly, there is some downward pressure. And I'm not going to cite a number for you, John, because it'll probably be wrong. But, I'd say it'll be a much lower decline than what you saw this quarter. Again, in particular, if the acquired loan accounting is relatively stable, I think you'll see a much lower number.

But, you will see the further shortening of duration and deposit compression continue to take margins down. And obviously, as we have further security gains, that'll put some pressure on the margins. But, mix is a positive. In fact, as we continue to have loan growth that outpaces deposit growth, with the way our NIMs are calculated in the US, you'll actually see that help to expand NIMs.

In addition, we've got the Target deal, which is currently expected to close in the middle of the second quarter, and I'll update everybody on that next quarter. It's going to have a pretty profound impact on the NII line, to a lesser extent other income, and then PCLs, because the way the accounting is going to work is that these amounts are going to be taken in at 100 percent for the Target portfolio. And then, the way we'll adjust to come back to our proportionate share is entirely through expenses.

So, it's going to have a pretty big impact on all of those line items, and in the NIM, as well. But, we will call that out next quarter – the partial quarter impact. And obviously, you'll see that continue to impact in the third quarter.

John Reucassel – BMO Capital Markets – Analyst

Will the securities gains be sufficient to offset the spread compression on the overall revenue growth, like it was this quarter?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Yes. So, I think that's the case. We have good volume growth, which is partially or almost entirely being taken away on the NIMs. But, yes, the security gains will offset. And we expect about \$60 to \$80 million a quarter over the next couple of years.

Ed Clark – TD Bank Group – Group President & CEO

I think what we're saying is that we think we can do \$60 to \$80. And obviously, with the size of the security gains we have, we can do that for at least the next couple of years.

And we're also telling you we're going to make the \$1.6 billion target.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Good. Thanks, John.

Operator, why don't we go to the phones, please?

Operator

Your next question comes from Peter Routledge from National Bank Financial. Please go ahead.

Peter Routledge – National Bank Financial – Analyst

Hi. Thanks for taking my call.

Just to follow up on the wholesale banking question, one thing we've observed with some of your peers is that they're getting net interest income expansion via more aggressive wholesale banking. So, is one outlet for your pretty good deposit position in the US to be a more active corporate banking lender?

Ed Clark – TD Bank Group – Group President & CEO

I think so. Bob

Bob Dorrance – TD Bank Group – Group Head, Wholesale Banking

I thought you answered the last one, so you could keep going. But yes, I think it is. As Ed alluded to, we're working with our US bank partners to grow with them in terms of the corporate banking sector. They would have the loan growth in terms of corporate banking, and where we would be working is to have the cross-sells that come with that.

We have traction in that strategy, but it's a 'one win at a time' type of strategy, because it's been a relatively smaller part of the balance sheet of the banks that we've purchased in the United States. But,

that is, in effect, the strategy that we have in the US, other than the stuff that TD Securities is doing on its own – things like energy and mining and media and telecom.

So, we will grow the corporate side, but we'll do it within the risk appetite of TD Bank, America's Most Convenient Bank.

Peter Routledge – National Bank Financial – Analyst

We're not hearing a shift in risk appetite for corporate lending. And, I guess the question is, isn't now the time to start taking on a bigger corporate book to get better spread out of your deposit base on the assumption that it's early in the cycle and let's lend aggressively to pick up some spread at a time we need it, and then we'll pull back before the cycle turns? I know it's easier said than done.

Bharat Masrani – TD Bank Group – Group Head, U.S. P&C Banking

So, Peter, this is Bharat. We do have a strategy to grow what I'd call junior corporate business, which is the sweet spot for TD Bank, America's Most Convenient Bank. It's largely based out of our footprint. We did acquire some capabilities through the acquisitions we made, and we have added some of the capabilities from TD to make sure that we do this in a prudent fashion.

You know, it's easy to say – to market-time credit and say, "Hey, why don't you just pile on?" Having been in that business over many years, I know that lending can be unforgiving if you get it wrong, so we want to be prudent.

We are growing the book that makes sense from a risk appetite perspective. And as Bob said, it is critical that these are key relationships for the bank, where we cross-sell TD Securities' products to these clients, as well as bank products.

It's been a good business for us – we are happy with the way we are growing. If there are more opportunities in the marketplace, we will certainly look at them seriously and make sure that we are exploiting such opportunities, as long as it's within our risk appetite and it makes sense from a strategic perspective.

Peter Routledge – National Bank Financial – Analyst

Fair enough. Thank you.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Okay. Thanks, Peter. Next question?

Operator

Your next question comes from Gabriel Dechaine from Credit Suisse. Please go ahead.

Gabriel Dechaine – Credit Suisse – Analyst

Good afternoon. The commentary about how you're managing interest rate risk to an extent in the US by selling these AFS securities. I see the rationale and the soundness of that strategy. But, where I see an inconsistency, I guess, is on the mortgage side. It's now 20 percent of your US loan book, and the way I

look at it, it opens you up to some disintermediation risk if rates start rising. So, how are you managing that risk? That's my first question.

Ed Clark – TD Bank Group – Group President & CEO

Do you want me to take that one?

Bharat Masrani – TD Bank Group – Group Head, U.S. P&C Banking

Go ahead.

Ed Clark – TD Bank Group – Group President & CEO

Absolutely. I mean, in the sense that, if your asset flow is a long-dated asset flow, and you've come to a view that you actually want to shorten your duration, that just compounds the difficulty of doing so. So, we accept that.

And I think we have come to a view that, while in general we would like to keep these assets on our balance sheet, for two reasons, we want to at least experiment with some sales of them. And the two reasons would be, number one, that I think it would be a good market test for us to know whether the market likes our product. You can believe you've got a great product, but it's a nicer and more comfortable feeling for people who are obsessed with risk to be able to say that the market also likes your product.

And it does mean that you build yourself the optionality, particularly in managing the negative convexity that's inherent in those products, that if you reach the point where you say, "I'm not sure I'm comfortable with the scale of that kind of risk, that I can manage it," you have the option and you've built the system. So, we are building the system so that we can do some periodic mortgages sales there.

To the extent that your natural asset origination is long, then that means it puts even more pressure on you to say that you ought to sell. Where we have a securities portfolio, you ought to offset that by selling those securities. And you can say that the collateral damage of doing so is that it's going to kick up security gains for you. It happens to come at a good time, because you're also getting squeezed on the margins by the same thing that gave you those security gains.

Gabriel Dechaine – Credit Suisse – Analyst

I appreciate that response. And then, Ed, while I've got your attention here, the dividend. A 5 percent increase - that's healthy. But, you maybe my expectations were too high. Given that your payout ratio is relatively lower than your peers', and given that you bumped up your payout ratio target last quarter, I would have expected you to have been getting closer to 10 percent, or something like that. Is there any particular reason that you held back?

Ed Clark – TD Bank Group – Group President & CEO

No. I think that, if a company can have a psychological personality, it would be that we never 'lurch' to do anything. We just do things, and then we get a paradigm and do it steady state.

When you look at 2013 and see what our average dividend was over the average dividend in 2012, you're going to find that a pretty impressive number.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

I'd just expand on that. With this increase alone, we'll be up 11 percent on a year-over-year basis in fiscal 2013 versus 2012. And as Ed said previously, we are looking to increase the dividend, ideally a couple of times a year, as we gradually make our way to the midpoint of the 40 to 50 percent range.

So, obviously the goal is to have a rate of dividend increase in excess of our rate of EPS growth. That's how we look at it over that horizon.

Gabriel Dechaine – Credit Suisse – Analyst

Good. Thank you for adding that, Colleen.

Rudy Sankovic – TD Bank Group - SVP, Investor Relations

Thanks, Gabriel. Next question, please?

Operator

Your next question comes from Brad Smith from Stonecap Securities. Please go ahead.

Brad Smith – Stonecap Securities – Analyst

Thanks very much.

My question relates to expenses. When we look at the non-interest expenses in the quarter, it looks to me like most of the expense reductions that were achieved at the segment levels came out of things like professional fees, marketing, communications, and things like that. So, I was just curious how we should think about the sustainability of those expense saves, when some of the core expenses – like salaries, compensation, etc. – continue to advance.

And then, I was also hoping that you might make some comment about the recurrence of this litigation reserve and update us as to where you think that's headed.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Well, Brad, let me start overall with the expenses. I've had a number of people say to me today that they were really pleased to see the Q1 expense number, because it was down a lot quarter-over-quarter, and that our productivity agenda is really – that we're really starting to prove that out.

Now, I hate to contradict people on that, but I'll feel better when I start to see that year-over-year growth rate at or below the 3 percent level. On a year-over-year basis, we were up 4 percent. So, really, what you're seeing on the quarter-over-quarter basis is the fact that we do have this effect around project initiatives. And the timing of certain items – like marketing, as you mentioned – definitely tends to be over-weighted to the fourth quarter of the year.

For a variety of reasons, good management being the number one reason, we'd like to even that out over the course of the year. I'm not saying you won't have some increase in the fourth quarter, but we'd like to even that out a bit more. So, as I say, what you'll see in the first half of the year is our expenses increase probably in the 4 or 4.5 percent range, with a much lower rate of increase in the second half of the year.

I can certainly tell you that this is a huge area of focus for all of us on the senior executive team and for everyone across the bank. And we're definitely confident that we are taking out expenses. We're leveraging our scale and buying power. We're taking out those expenses, and we have a lot of good initiatives around that. So, I'm confident in our ability to meet the full year number.

Your second question was?

Brad Smith – Stonecap Securities – Analyst

Well, just about the litigation reserve, Colleen.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Yes. That's a tough one to comment on, Brad. But, we did try to go a little bit further in my remarks. As you know, these items are related generally to the Rothstein family of cases. What we really have tried to say is – never say never – but that we're really much closer to the end of that process than we are to the beginning. Hopefully, you won't see large charges going forward.

Brad Smith – Stonecap Securities – Analyst

Right. And then lastly, the MBNA restructuring charge, how long is that now going to go on for?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

That's going to go on for at least all of 2013, probably into early 2014.

Brad Smith – Stonecap Securities – Analyst

Thanks very much.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thank you, Brad. Next question, please?

Operator

Your next question comes from Robert Sedran from CIBC. Please go ahead.

Robert Sedran – CIBC – Analyst

Hi. Good afternoon. A question for Tim Hockey, please.

Tim, I guess the margin nicely outperformed the guidance that we got last quarter, especially if we exclude MBNA. I'm wondering if we can get a little bit more color as to why and how and whether you think you can keep doing it.

And then, on a related note, if the Bank of Canada does stay on the sidelines for the next year or two, is there a point at which the structural pressure eases and the margin can just go sideways?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

So, for the quarter, as we said last call, we expected to be down seven basis points, because five was built in already. But, in fact, we outperformed and we were actually up one, excluding that five.

So, frankly, we outperformed on the standard answer – mix. But, to give you an example of that, one of the things that we did is we grew our core deposits at a much faster rate than our term deposits, which pay a much higher rate. And we decided not to compete so heavily, notably in the brokered term market, which has very thin margins. As a result, we got a very positive shift compared to what we thought would happen in the quarter.

Looking forward, there is no question that we continue to see the same outlook for low interest rates. If you're asking what our outlook is, we've been fairly consistent in saying that we expect to see the numbers either bump around at this level or be down 'ones' and 'twos'. We think, with the same sort of structured low level interest rates, that that should continue to trend downward.

When we look at our overall margins, it does feel like we're getting closer to the bottom, especially with the balance sheet restructuring that we're talking about. But, I always find that it's best to expect a couple of basis points dripping off each quarter. And we plan for that in terms of our expense growth.

Robert Sedran – CIBC – Analyst

Thank you.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Okay. Thank you, Robert. Next question, please?

Operator

Your next question comes from André Hardy from RBC Capital Markets. Please go ahead.

André-Philippe Hardy – RBC Capital Markets – Analyst

Thank you. Back to the US division and the securities gains of \$60 to \$80 million a quarter. Assuming those go away in a higher rate environment, how much do you need interest rates to rise to compensate for that lost revenue?

And then, also on the US business, your tax rate is quite low. What is the risk of that tax rate going higher? And if you think the risk is low, why would that be?

Bharat Masrani – TD Bank Group – Group Head, U.S. P&C Banking

André, this is Bharat. It's tough to calculate exactly, to the basis point, how much rates have to go up to offset and all that. All I'll say is that we're very happy with the core growth we are generating in the US.

Colleen went through the numbers for loan growth, deposit growth, the number of accounts we are opening and all the new stores that are coming onboard. Given this strategy, obviously, if rates do go up, that will help our NIM and will help the bottom line.

It's hard to give you specific numbers as to – for example, this many basis points will get you X dollars. We haven't given out such numbers before, and I think I don't want to be speculating on this call.

André-Philippe Hardy – RBC Capital Markets – Analyst

A range going forward would be helpful, because we're talking about \$250 to \$300 million of revenue that might go away one day. It's quite meaningful.

Bharat Masrani – TD Bank Group – Group Head, U.S. P&C Banking

Yes.

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

André, your second question was really around the effective tax rate. A big part of the reason for the lower effective tax rate is that we have higher volumes of tax incented businesses. These are low income housing tax credits and new market tax credits, and some tax-exempt income on some of our commercial exposures.

The reason that we have some of these investments is that they help us meet our obligations under the Community Reinvestment Act in the United States. That actually ends up taking a little bit off the top line, the way we do the accounting. This actually had more of an effect last year, when we changed the reporting.

It is actually a negative at the revenue line – all the positive goes into the tax line. So, that's what is actually contributing to a lower effective tax rate.

To your question around the sustainability of the current effective tax rate, I think it's reasonably sustainable, although what you'll find over time is that, as our earnings grow in the United States, because the value of our tax structure is pretty much constant, you will see the effective rate go up over time, as more of those earnings are taxed at the higher marginal rate.

You have to take those things into account. Given where we're at today in terms of earnings, I think that that tax rate is pretty reasonable.

André-Philippe Hardy – RBC Capital Markets – Analyst

And when you say 'that tax rate', you're talking about the last quarter?

Colleen Johnston – TD Bank Group – CFO & Group Head, Finance

Yes.

André-Philippe Hardy – RBC Capital Markets – Analyst

Okay. Thank you.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, André. Next question, please?

Operator

Your next question comes from Sumit Malhotra from Macquarie Capital Markets. Please go ahead.

Sumit Malhotra – Macquarie Capital Markets – Analyst

Good afternoon. The first question is back to the US net interest margin, and maybe taking a look at what I'll call the core portion of the decline. When you think about your balance sheet growth, which has been very strong on both the lending and the deposit side, in looking to manage that loan growth - or balance sheet growth versus margin balance, I guess is the term I want to use – are there any products where you're looking at making a concerted effort to slow the rate of growth because you're not achieving the kind of yields or margins you would want?

Bharat Masrani – TD Bank Group – Group Head, U.S. P&C Banking

So, on the deposits, I think one thing we should clarify is that, even though NIM may drop, that doesn't mean it's negative NII necessarily. When we generate new accounts and DDA balances build up, we're obviously earning less on those than we might have earned a couple of years ago. We are not going out of our way to stop DDA growth, for example. We are consciously not offering, and it's a small part of our business, the CD business – it's relatively small – and we are not a big competitor in that space. And that makes sense given where the rates are and our own liquidity position relative to some of our competitors.

On the asset side, we do look at other products. We have strategy to build our ABL business. That's a business that we inherited through one of our acquisitions. It's a very small business. We are building capabilities around that. We think that's a good business that not only fits our strategy, but is also within our risk appetite. And given the rate environment, it also helps our business.

The other area in which we have traditionally been strong and are looking to grow even further, if the right opportunities come by, would be the healthcare space. It's an important space for us. It's a franchise business for us, because we do a lot of cross-sell in that area. So, there are good opportunities there. I think there's a chance we'd be growing new products around that particular sector.

And then, as you've heard, the credit card space is a very attractive space for us. The Target deal is an example of what would be of interest to us going forward.

Sumit Malhotra – Macquarie Capital Markets – Analyst

You've made some references – and this might be for Tim. You've made some references to the rate of growth in auto and the yields that have been achieved there perhaps being thinner than you would have originally expected. Is that still an area where it's reasonable for us to expect to see slower loan growth in the foreseeable future?

Tim Hockey – TD Bank Group – Group Head, Canadian Banking, Auto Finance, and Credit Cards

We expect – this is Tim. In the U.S., we expect to see loan growth actually get a little stronger as auto sales go higher. If you remember, we're actually shifting our strategy around mix from sort of 90/10 to 80/20. I'd say we're about halfway there. And that's mix between prime and near prime.

The margins are a little thicker, but certainly the competitive forces are quite strong in the US. As that transition happens, we expect our quarterly volume growth in originations will go up a little higher from here.

Sumit Malhotra – Macquarie Capital Markets – Analyst

And Mark, I'll wrap this one up for you. I heard your comments on the loan loss ratio being at the lowest levels in quite some time. Your comments didn't sound like you think that's going to change very much. That's the first part of it.

And second, has your outlook on the credit environment improved to the point where you're willing to go a little further out on the risk curve in the environment you see for credit quality in the interim?

Mark Chauvin – TD Bank Group – Group Head & Chief Risk Officer

Okay. Relative to the first one, maybe the easiest way to look at it is by the major portfolios. In Canada, in the commercial book and the wholesale book, we've effectively got very few losses. Clearly, that's an area that could be lumpy, so we could see some there. I'm certainly not looking for major increases, but an increase above existing levels would not be unusual.

In terms of the consumer credit portfolio, based on our current outlook for the economy, we are looking for that to stay relatively stable. The dollar amount may go up with volume growth, but we would look for the loss rates to stay relatively constant.

And then, if I turn to the US, I am quite encouraged by the strength in the commercial book in the last quarter. And in the consumer book – mortgages – we're seeing that the loss rate is keeping pace with the growth in mortgages. We're comfortable with the originations there. I would look for continued improvement there, not material, but continued improvement going forward.

And in terms of the risk appetite question, you are talking to the risk person. I do think that we like to stay stable. A good loan is a good loan, and we can certainly have volatility there. If you use the example of the commercial bank, I think the last four quarters in Canada, the average loss rate was 17 basis points. Something higher than that - 30 basis points – would be well within reason. So, I think there's a tolerance for us to go up, but it'd still be within our risk appetite.

Sumit Malhotra – Macquarie Capital Markets – Analyst

Thanks for your time.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Good. Thanks, Sumit. The next question, please?

Operator

There are no further questions on the phone. Please go ahead.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

We're going to give Michael Goldberg one last chance here, because he stuck to the one question limit. Michael?

Michael Goldberg – Desjardins Securities – Analyst

Thank you. Getting back to the question about interest sensitivity, I know that you're pretty religious about matching. But, you've got about \$170 billion of personal demand and notice deposits, excluding the TD Ameritrade sweep deposits. Could you look at those and say that, even with a 10 basis point increase in interest rates, that would increase your revenue by \$170 million on an annualized basis?

Ed Clark – TD Bank Group – Group President & CEO

I think we should probably come back to you on that, rather than give you a quick off the cuff answer, which is probably what I'd be inclined to do, and then everyone would look at me and think, "Don't do that!".

It's a legitimate issue to ask how we describe this. Just so you understand what makes it complicated, there's an element of still working our way through a decline in the margin, which goes forward as we do all these different things. And so, only some of it would be offsetting a decline that didn't occur, if you want to put it that way.

Then, you have to work your way through, where there is a customer or competitor response, what happens when interest rates go up. Do people start moving rates around? So, you have to make guesses about that.

When we look at this internally, we end up with quite a range of things, depending on what your view is of the outcome. The simplest example is TD Ameritrade, because they really only have two levers: trades per day and NIM. It's pretty clear – a simple balance sheet, and here's where it goes.

So, why don't we take this away and see whether we can come back next quarter and give you a little bit more color on how much interest rate lift we are building into the balance sheet, rather than me talking off the top of my head here.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Michael. Ed, over to you for final remarks.

Ed Clark – TD Bank Group – Group President & CEO

Well, it's 4:00 and you guys have all had a long day, so I'll be sensitive to that. We were just delighted with the quarter. We think it's a fantastic quarter, a great way to start the year. And frankly, a little better than we thought we were going to do going into the year. So, I think that's a good thing. And, I think we keep saying, yes, it's going to be hard to get into the 7 to 10 percent range, but you pay us to do the hard things. That's what our job is, and that's what we're going to try to do.

Thank you.

Rudy Sankovic – TD Bank Group – SVP, Investor Relations

Thanks, Ed.

With that, I will end the meeting and thank you for joining us today. Thank you.