TD BANK FINANCIAL GROUP
NATIONAL BANK FINANCIAL CANADIAN FINANCIAL SERVICES CONFERENCE
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CORPORATE PARTICIPANT

Ed Clark TD Bank Financial Group - President & CEO

CONFERENCE PARTICIPANT

Rob Sedran National Bank Financial - Analyst

PRESENTATION

Rob Sedran - National Bank Financial - Analyst

We're pleased to be joined by Ed Clark, President and CEO of TD Bank since 2002. Prior to this role, he was President and Chief Operating Officer of the bank, a role he took on following TD's year 2000 acquisition of Canada Trust where Ed was also President and CEO. Of note, he has a Master's Degree and Doctorate in Economics from Harvard, which must be particularly useful given the mess the markets have made of themselves. Hopefully Ed's going to provide the direction back to normalcy. Ed?

Ed Clark - TD Bank Financial Group - President & CEO

Good morning, and thank you for inviting me to this conference. As indicated I'm Ed Clark, I'm the CEO of TD Bank, and I was told to keep it short and sweet so that we could have maximum time for the questions. I think I can handle the short, I'm not sure I can handle the sweet in today's business environment.

I think the story that we have to tell, I think most of you in this room know the story, it's a fairly simple story. We set out five years ago to say we know how to build franchises, we know how to build franchises that will grow the revenue faster than our competition, we know how to run an operating company to keep our expenses growing inside our revenue. And we know how to stay out of trouble, because when you look at the history of banks around the world, they are phenomenal profit machines, except that every five years or seven years they figure out a way to blow themselves up and set themselves back. And so, if you could just avoid those errors, you in fact have the best investment you could find around the world. I think so far we've been pretty successful in doing that.

You know all this stuff, so I won't bother going through it. So again, very quickly what's our story? Well clearly, we have an outstanding franchise in Canada, and we've been using the strength of that franchise in Canada to allow us to go into the United States, both on the wealth management side and the personal and commercial banking side, and in that process, turning ourselves into an integrated North American company. I'm happy to get into that in further detail.

Secondly, obviously at the same time we shifted our risk so that the earnings picture of TD in 1999 gained 55% of its earnings from the wholesale business. This year we'll be a little less than 15%, next year less again than 15%. So probably there are not very many financial institutions around the world that made that degree of shift in their business mix. But I think equally important, and I'll get into this, it's what we've done inside each of the businesses to manage risk better.

But third, we are a growth company. We believe in growth, we believe in investing in the future, and I think we can show you that we continuously grow our earnings faster than our competition. And as I indicated, what we're doing is in fact establishing ourselves in what we think are sustainable franchises in the United States.

So, what is the core of our business strategy? As I say, we tell everybody we're franchise builders. Now, what does franchise builders mean? It's that each of my business leaders, when we meet for our sessions, have to explain to me why they win the ties. And by that I say, I can tell you why. If we put a branch on a corner with three other big banks, we will take more than 25% of the business.

And to use that analogy, we go to each of our businesses and if someone says to me, well I'll pay my employees more and I'll give them more capital, then I say you don't have a franchise you just have a pet. And so, you have to explain to me what in fact differentiates you. What I say to our people is, I want to be able to go to Antarctica for two weeks and come back, and know that the firm will have grown earnings without anyone doing anything. That's what a franchise looks like.

Secondly, our relentless focus on the customer. Big organizations, big banks are dominated by head office, they tend to look at the center and go out rather than start with the customer and look in. So how do you change the culture, which is very fundamental, and that's why once you do that cultural change it's hard for people to duplicate your model.

Where you shift and say no, no, no, everybody in the center is a kept person. Their overhead, their job is to facilitate the work done by the people on the front lines, the people who are facing clients, and how do you reinforce that.

Well, one way we reinforce that is that we call about 8,000 customers every week to ask them how we did on the front lines. And then, we insist that everybody, including me, gets paid off how well the front line is doing, so that I can go to the front line and say, you set my bonus, I don't set your bonus. That shifts the power structure within the organization.

Third, as I said, how can you learn to grow without going out the risk curve? It's easy to grow your earnings if you just go out the risk curve, everybody can do that. The question is, how can you grow without going out the risk curve, and do you understand your risk? And so, we live in a world of economic profit, where we understand the economic profit of every action. The people have to understand, in fact, what the risks are.

And so, when we have people come and say this is a great investment, you get 20 basis points more and there's no more risk. You know they just don't know the risk or they're lying to you, one of those two choices. And so, explain to me what is the risk that I'm actually taking to get the incremental rate of return, and build that culture deep within your organization.

So in the case of TD securities, it's not that we don't take risks. I want to be clear on that. We take lots of risk, we are a risk-taking institution, but in fact we systematically went out and said, let's take off the tail risk because that's what causes these upsets. Make sure that you understand what the tail risks are, and pay the price in today's earnings to eliminate those tail risks.

And you won't look good in the short run, the people [who] are taking the tail risk, because tail risk is always apparently free risk, straight returns, no risk, and it's only those ones -- every five or seven years that you find how much tail risk people are taking. That's the price that we're willing to pay to be in business to avoid those dips.

Fourthly, as I said, we're operators. We're not financial engineers, we're operators. And by operators that means that we have to look ahead. And so, we're all the time -- our exercise today is around what are we going to do on our expenses and revenue for 2009. Frankly, 2008 is in the can. We can't change what 2008's going to be, these are big businesses. I've said to people on lots of occasions, we're a balance sheet company that drives an income statement, not an income statement that drives a balance sheet.

And so, we already have 2008 sitting on our balance sheet and we're playing it out. If you want to change what goes on in an organization, you have to start 18 months in advance and how to get your people to think about that. And finally, how do you get them where they're constantly investing in the future.

There are no prizes for robbing the future to look good in the short run at the TD Bank. And so, we do not manage the bank to try to achieve short-term earnings targets. It sometimes makes us unhappy in the investment community, but that's how we run the bank.

So, this is our earnings mix. As you can see, we're still TD Canada Trust, our personal and commercial firm is still overwhelmingly the dominant source of profits. And I'll get into how successful it's been. We've had an unbelievably successful run in TD Wealth Management, our wealth management arm, where we've been able to grow earnings very aggressively at the same time, and this is very important, at filling in some real structural deficiency in the Wealth Management where we didn't have the advise capability.

Third, you can see the growing size of our U.S. arm, that will get bigger. And then this is last year's number, 20% in securities as I indicated. You will see that number shrink, not because we're trying to shrink TD Securities, but just because we are growing our retail businesses faster.

Another feature of us is that we've had a consistent philosophy on dividends. We resisted, frankly, the market pressure to say why don't we jam up our ratio of paying out dividends. We told the market the way to grow dividends fastest over the long run is to grow earnings over the long run. And so, have been a consistent grower of earnings, that's what we've done.

We had a 19% increase in dividends last year, because we had a 23% increase in earnings per share. This year, we announced this quarter we're going to increase our dividend by $0.02, given already [in logistically] arithmetic, that means that dividends will increase 10% this year despite what will be, in our case, modest earnings growth.

Now turning to the retail franchise, really truly a remarkable story, and I picked this year because that's when I gave up running the retail side. So we've got good management in there running it, and look at the job that they did, really quite spectacular. People always look at the Canadian scene and say well there's five big banks, no one can take market share on a consistent basis from the other four. Not true.

Year in, year out, every single year we take market share in revenue and market share in profits. Those are the measures that investors should care about, not these fancy statistics that you say, well what is your actual deposit share? What is your mortgage share? Because in those statistics that says $100,000 mortgage is worth a lot more than $1,000 core banking account.

Well, in the world of shareholders it's not true. A core banking account is worth a lot more than $100,000 mortgage. So when we measure ourselves, we measure on what matters to our shareholders, are we growing our revenue faster than our competition? Are we taking market share in revenue, and are we taking market share in profits? It doesn't mean we don't look carefully at those statistics as what's happening in the marketplace, but they don't tend to be good indicators of what really is going on.

How are we positioned? Well, basically you can see the pretty dramatically and powerful position in the Canadian marketplace. We're basically one or two, so Royal and ourselves are either one or two in almost every retail product. But clearly, we own the service and convenience space in Canada, whether it's Synovate or JD Power, our own internal surveys or frankly the internal surveys of our competitors.

There's no question we are in a simply different league in the kind of service we offer, but we also have our branches in better locations, we grow them faster than our competition and they're open 50% longer than our competition. So, we own the convenience/service space in Canada, and then it shows up in all the different awards that people give out across-the-board, but I don't think that anyone would dispute that we have the premium retail franchise in Canada.

Now the more controversial part of our strategy is we've said -- in the end, is it conceivable that one bank in Canada can always just constantly take market share from the other four, and that the Canadian economy will constantly grow faster than the United States?

And we took a view some time ago that that was probably an unlikely event, and that we should use the strength here that we had to go into the United States. But we should go into the United States, which is the other element, in places that we understood and where we were sure that we could win the ties.

And with those conditions we said, well we do understand the online brokerage business, we don't want to go in the United States and not be in the top three positions in the markets in which we choose to compete. And that's why we did the Ameritrade deal to in fact take Waterhouse, vendor it into that deal and end up with one of the top three online brokers in the United States.

And the same is true in the personal and commercial area. If you take a look at what we're building in the United States, we're building a regional -- in the deposit business that's a regional business, we are having very strong market positions. But equally important is that we believe, and I know there are skeptics of this, we believe that the TD Canada Trust model is in fact not only just as appealing to Americans, but all the evidence we have is in fact more appealing to Americans than to Canadians.

So, I know I've been told that Americans don't care about service, they don't care about convenience, but I would say to you that the Commerce Bank shows you that that's not true. And our own experience in Banknorth, where we extended the hours and improved the service showed us that it wasn't true as well.

So we're building, in fact, a North American personal and commercial model, where we will be offering the whole 2,100 branches the same basic business model, dominance in the convenience and service space.

The other thing is, I think what we do bring is we bring additional products. So clearly, in the case of both Banknorth and Commerce, underdeveloped on a whole set of retail products that we're very good at in Canada. And, there's no bank in North America that knows how to cross-sell as well as we do.

If you take a look at the kind of referrals and why were we able to have 26% compounded annual growth rate in Wealth Management earnings, it's totally dependent on our ability to take people out of the retail network and get it into our Wealth Management channels. And that's built around a culture that you do what's best for the customer, not what's best for you as an individual.

We believe we can do the same in the United States, we're building out North American capabilities in wealth management. We have the huge advantage of having TD Ameritrade, a very strong brand in the United States, we'll be integrating them into TD Commerce in the United States the same way as Waterhouse is integrated with TD Canada Trust here. And, we'll also be running a North American insurance strategy.

Now I know there are -- and I thought what I might do is deal with it in question period since I know it'll come up. I know there are skeptics to this model. I know there are people that worry a lot about what's going to happen to us in a U.S. recession. And, I think they worry a lot about whether or not we know how to integrate.

Let me just say, I'm a lot less worried about those issues than the marketplace is. That doesn't mean I don't worry about them, I get paid to worry, but I'm a lot less worried than the marketplace.

Let me turn to the more immediate outlook, a lot of that is history. Obviously, we in a relative sense had a very good first quarter, for us not such a good quarter, but relative to everyone else a good first quarter. And so, our earnings were basically up in the quarter and our competitors were down, even if you exclude all their items that they took as one-time items.

I have a skepticism of this strategy that I'm going to wait and see whether in 2009, when the earnings come back in from those written down items, whether they also declare them one-time gains, or whether they treat them back in as ordinary income.

So, I'm skeptical of this when I lose you don't count it and when I win you do count it strategy. But in our case, we're beating our competitors even if you give them that gain. And so, that was obviously a very good quarter. I'm not going to leave you, though, with the impression that it's a fun place to be right now, banking.

I think right now, we're still in an environment where the dominant problem is the financial services industry. If you go back and you say -- I think the Fed is worried about a couple things, it has the subprime crisis, and it has the consequential financial services crisis. I think they're worried about whether or not there is now going to follow an economic recession.

We don't see that. We don't see that in our data, -- what I mean by that, our economists see it coming, but I can't tell you I see it in the data that we have for Canada, and I can't see it in the data that we have for our banking in the U.S. But, we definitely can see in TD Securities and our domestic Wealth Management business the significant impact of the result of a financial services crisis.

And while I would like to be optimistic, and indeed a year ago I would have said this can cure itself fairly quickly, I have been struck by how many wounded players there are out there.

I've been struck by the degree of dispersion of this type of complex risk and the difficulty of, in a sense, how many institutions have to go to church, do their penance and recapitalize themselves to a very significant extent, in order to deal with what's coming down the pipe. And so, I think any industry participant has been struck of how long and hard the risk this is.

And so, I'm less confident today that this will cure itself quickly. There is a chance that it could happen in the second half, but I think there's equally a chance that it'll take the full period of 2008 to cure itself, and therefore we will be living with this financial services crisis. And obviously, the longer this goes on, the higher the risk that we also then have a more severe economic slowdown, which is what the Fed is worried about. And I think that's, of course, what makes it a challenging environment.

As I said, for us we're not impacted directly by the structured product meltdown, because we don't have them. And, we're not seeing the economic slowdown so our core businesses are still -- they're living in a world of a slowdown, but they're not being directly impacted other -- and we can get into this in the discussion, than on the deposit side. But clearly, TD Securities and TD Wealth Management are impacted.

So, I'll just end up here and then take questions. You know what we are. We're clearly a North American financial institution. We clearly have a lower risk. Wherever we go, we have industry leading performances because we build around franchises, and we believe we can take these franchise capabilities and grow them in the United States. Thank you.

QUESTION AND ANSWER

Rob Sedran - National Bank Financial - Analyst

Sorry, thanks. Am I correct in assuming from those slides that you intend to, given Commerce Bancorp's a very different business model and culture, that you made that acquisition to keep it as a separate entity and just build it out?

Ed Clark - TD Bank Financial Group - President & CEO

No. I think for us, I used to, back in the old days when I ran Canada Trust, I used to argue that if you looked at the Commerce you would see the Canada Trust model, and that the Canada Trust model worked equally well in the United States. And so, our attraction to the Commerce is that we don't have to tell them about service, about the WOW! factor, about extended hours, better locations, better looking branches, all of that is instinctive.

They do have certain weaknesses. They're really a deposit gathering institution, they have very strong lending practices, very conservative lending practices as it is because of this deposit bias, but they don't having lending assets that are equivalent to their deposit size.

And I would say they're a top-line sales driven organization not a bottom-line economic profit driven organization. And, they don't have the array of products, wealth management, insurance and indeed more sophisticated retail lending products that we would have.

So, we were driving Banknorth down our model. So we spent a fair amount of money investing in systems in Banknorth to make them -- if you want to run a service model you have to be employee friendly, because really it's the employees that deliver the service, changing the front line platforms, changing the side counter, improving the back rooms to make it easier to serve the customers.

And, we have 260 branches we extended the hours on, we introduced more products, introduced a credit card, more deposit products, refined the pricing. But when we saw Commerce we said, well we can move this journey a whole lot faster if we're marrying up with an institution that we don't have to teach them this part, what we have to do is just widen out their product set.

So the danger that the market thinks is that I'm going to go and blow up the Commerce model. And I sit there and I say, do you think I bought this bank to shut it down? And so, that's why when we did the brand we said TD Commerce, America's Most Convenient Bank, open seven days a week.

So they're up there, they're going to be on pillars, and so then I can say -- frankly as much to the employees as it is to, because the employees who really carry your brand, relax. I know what you are and I bought you for that, but being all that doesn't mean you can't make money. I know how to make money using that position in the marketplace. And so that's the trick is -- how do we get them, how do we introduce more products to them, how do we get them to focus on where you make money.

And you saw in the run down of some of the governmental deposits, where we didn't think the spread was worth raising those deposits. Well, when you're running the companies that they're running in the marketplace, more like a dotcom company that you get paid off your revenue growth, that or in their case the deposit growth, that was a smart strategy.

When you're working for someone who's paid off the earnings growth it's not such a good strategy. They correctly said, okay, why don't we get rid of those -- why don't we go through now we see where the profitability is. So it's that transformation that we have to do at TD Commerce. And, we have to integrate the two, and that will frankly mean rolling some of the Commerce attributes even faster in the Banknorth than we would have done.

Rob Sedran - National Bank Financial - Analyst

Ed, I thought the initial plan was to perhaps run these franchises a little more separately and take a little more time to see what you have. And now, it seems like you are being a little more aggressive on the integration of Banknorth and Commerce -- the Banknorth name I guess vanishes shortly. What's changed? And, are you concerned at all in your existing Banknorth footprint that you've got some work to do to maintain the brand there?

Ed Clark - TD Bank Financial Group - President & CEO

Right. So, there's clearly a couple of things that are going on here. When we bought Banknorth, now it seems years ago in terms of the changes in financial services industry, we bought an acquisition machine. And we saw an opportunity, which still exists that the northeast -- what was attractive about the northeast was their very large number of unconsolidated banking opportunities. And so, we saw a conservative lender, good solid operators, low-cost operators good at quickly doing mergers.

I think when we started to do those we said, but I don't see the economics in this because the prices didn't come down as we saw the environment change. So that's when we announced that, in fact, we were going to switch strategies and work -- because we originally thought consolidate then transform, we said let's reverse that, let's transform, wait this out and then consolidate.

I think the other thing is that we originally -- we are conservative people, and so we said let's not roll the dice here. We bought 51%, let's get our feet on the ground, see what we learn, and then we bought the subsequent. And I think the cultural impact on that is that when you only own 51% you had to be careful that you weren't fully integrating.

Clearly now, Commerce is not an acquisition machine, it's an organic growth machine, and it has the mentality of an organic growth machine, which is what we are in Canada. And secondly, we now own 100% of everything. And so, I think the other big change that's going on is that we're saying let's more explicitly leverage our North American capabilities. And, I think we're more self confident that the skill sets that we have here in Canada can be not only exported, but they add a tremendous leverage point.

And what's quite interesting with the Commerce people and now with the Banknorth people, they're quite excited by it. They see -- take wealth management, all of them had little wealth management enterprises, but the chances of [building] something to compete with the big wealth management entities in the United States were pretty difficult. Well we're a serious wealth management player, and so they're leveraging off those people, and that's true right across the Company.

So, I think there has been fairly significant change. The reality is, today if you go in and talk to the employees in TD Banknorth, they're unbelievably excited, I've been out visiting branches, because they see us as a winner in the marketplace. And generally, that's all employees want, they want to be with the winner -- with the more job opportunities.

Rob Sedran - National Bank Financial - Analyst

We've got time for one more.

Unidentified Audience Member

Yes, I'd like to know how you're going to finance the high loan growth that you would like to have in '09/'10. The Tier 1 that will be at like 8.5 at the end of '08 with all of the Basel II changes it seems like you're very, very tight.

Ed Clark - TD Bank Financial Group - President & CEO

In terms of capital?

Unidentified Audience Member

Yes.

Ed Clark - TD Bank Financial Group - President & CEO

I wouldn't want to say we're rolling in dough, because I don't think we are. When we do our forward projections we don't see it, we actually -- because as you know we're an extremely high ROE company, we have a lot of, relative to everyone else, our return on risk weighted assets is dramatically higher than everyone else.

So, our capital generation I think is also pretty strong. But there's no question I think the market has -- I think if every bank who is being honest, there's two phenomena going on.

There's been a dramatic shift in the marketplace, so deposit margins are thinning as in a liquidity crisis people desperately search deposits. And that for us is clearly the biggest impact on our ordinary, our non-TD Securities-Wealth Management businesses that are directly in the capital markets.

But a main collateral impact is, we are a deposit rich bank relative to every bank in the world virtually, certainly every bank in North America, and everybody wants our deposits. And so, we have this constant dilemma of do we defend our deposits, or do we let them go. If we aren't going to lose the customers, do we let the hot money go across. And so, that impact is clear.

But the other impact is that loan growth is actually growing rather rapidly. And so, what's happening in the U.S. is that 75% of the -- both retail and commercial lending was securitized in some form. It was financed by the capital market, that market is dead, and so you really had the elimination of a huge capacity on the lending side.

And so, we can see volumes going up, terms have improved dramatically so you now talk sensible loan terms to people, and spreads are widening out and so you're getting this shift. But then your point is that the banks went through four or five years of low capital intensity in growth, and are now going through a period of higher capital intensity.

And that's worsened by the impact of Basel II, which I'm not sure is fully understood in the marketplace, is that Basel II, for its good or bad, is a pro-cyclical regulatory instrument. And so, as credit deteriorates the amount of capital we have to put up for every loan goes up. And so, capital demands on the banks are going to go up even with no loan growth, just because of the migration in credit that's going on here.

So, it's an issue that we're on top of. As I say, when we run out our projections, and we do this on a very, very regular basis because, out of capital out of [the game], we don't have a capital constraint here. But it's definitely an issue, if I was an investor looking at the different banks, I'd look at it carefully.

Rob Sedran - National Bank Financial - Analyst

Okay, thanks. On behalf of NBF and everyone here, Ed, I'd like to thank you for your contribution to this year's conference. Thanks, Ed.