TD BANK GROUP
Q4 2016 EARNINGS CONFERENCE CALL
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CORPORATE PARTICIPANTS

Bharat Masrani
TD Bank Group – Group President and CEO

Riaz Ahmed
TD Bank Group – Group Head and CFO

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

Teri Currie
TD Bank Group – Group Head, Canadian Personal Banking

Mike Pedersen
TD Bank Group – Group Head, U.S. Banking

Gillian Manning
TD Bank Group – Head of Investor Relations

CONFERENCE CALL PARTICIPANTS

Ebrahim Poonawala
Bank of America Merrill Lynch – Analyst

Gabriel Dechaine
Canaccord Genuity – Analyst

Meny Grauman
Cormark Securities – Analyst

Sumit Malhotra
Scotia Capital – Analyst

Peter Routledge
National Bank Financial – Analyst

Sohrab Movahedi
BMO Capital Markets – Analyst

PRESENTATION

Gillian Manning – TD – Head of Investor Relations

Thank you. Good afternoon and welcome to TD Bank Group's fourth quarter 2016 investor presentation. My name is Gillian Manning and I am the Head of Investor Relations at the bank. We'll begin today's presentation with remarks from Bharat Masrani, the bank's CEO; after which Riaz Ahmed, the bank's CFO will present our fourth quarter and fiscal 2016 operating results. Mark Chauvin, Chief Risk Officer, will then offer comments on credit quality, after which we will invite questions from prequalified analysts and investors on the phone. Also present today to answer your questions are Teri Currie, Group Head-Canadian Personal Banking, Mike Pedersen, Group Head-U.S. Banking; and Bob Dorrance, Group Head-Wholesale Banking. Please turn to slide 2.

At this time, I would 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 would also like to remind listeners that the bank uses 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 readers with a better understanding of how management views the bank's performance. Bharat will be referring to adjusted results in his remarks. Additional information on items of note, the bank's reported result and factors and assumptions related to forward-looking information are all available in our Q4 2016 Report to Shareholders.

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

Bharat Masrani – TD – Group President and CEO

Thank you, Gillian, and thank you, everyone, for joining us today. I'm very pleased with our Q4 and fiscal 2016 results, which reflect the power of our low risk franchise, a geographically diversified business model and a good execution in each of our businesses. Let me speak to the results.

During Q4, we earned $2.3 billion, up 8% from a year ago, and EPS was $1.22, up 7%, reflecting strong performances in our U.S. Retail and Wholesale segments and stable earnings in Canadian Retail. For the full year, earnings were $9.3 billion and EPS was $4.87, both up 6% from 2015. The revenue increased across all our businesses. Expense growth excluding FX and acquisitions was 2% and we maintained positive operating leverage while continuing to invest in our businesses for future growth. Provisions for credit losses stabilized in the second half of the year, and credit quality overall remains strong.

Our capital and liquidity positions ended the year on an equally strong footing. Our CET 1 ratio was 10.4% and our leverage and liquidity coverage ratios remained above target. We increased our dividends paid per share by 8% in 2016. And we delivered an 18% total shareholder return near the top of the Canadian peer group.

Let me turn to the segments. Canadian Retail earnings increased 1% this fiscal year. And personal and commercial bank net income rose 2%. We continue to grow revenue and manage expenses in a slow growth economy while making investments to optimize our branch network and improve the customer and employee experience.

Our Wealth business performed very well. Earnings growth was 9%. And we achieved record asset levels and enhanced our advisory and client trading capabilities. Our Insurance business also did well, increasing pre-tax earnings by 6%. Overall, the fundamentals of our Canadian Retail business remained strong. We're putting good risk-adjusted business on the books. And we continue to leverage the power of One TD to strengthen and deepen customer relationships.

This year, we received further recognition for our differentiated service and convenience offering and our ability to deliver that experience seamlessly in a digital environment. In addition to retaining top spot in the Ipsos survey for overall customer service excellence among the Big Five banks for a 12th consecutive year, we were repeat winners of the Ipsos online and mobile banking awards. And we have the highest number of mobile unique visitors according to Comscore.

Turning to the U.S., earnings in our U.S. Retail Bank rose 9% to US$1.9 billion in fiscal 2016. We grew revenues on strong volumes, better margins, as well as the addition of the Nordstrom assets to our strategic card portfolio. Expenses were well managed resulting in strong operating leverage, and credit performance was stable. It was a strong year across the board for our U.S. business as we outperformed our peers in loan and deposit growth and household acquisition by continuing to put the customer first.

In October, in conjunction with TD Ameritrade's agreement to acquire Scottrade, we agreed to acquire Scottrade Bank. These transactions are strategically important for us. Scottrade's three million-plus client accounts, nearly 500 branches and US$170 billion in assets under management will add significant size and scale to TD Ameritrade's online brokerage business and expand our suite of deposit program. We are very pleased with these transactions, which strengthen our relationship with TD Ameritrade and reinforce its contribution to our U.S. Retail growth strategy.

Our Wholesale Bank generated high-quality earnings growth reflecting the strength of our franchise. Net income increased from 2015 and ROE was 16%, reflecting good revenue growth. TD Securities maintained its top three dealer status in Canada and led some of the year's marquee transactions, most recently acting as joint bookrunner on Aritzia's $460 million IPO. The largest Canadian IPO of the year. We also made significant progress in our U.S. dollar businesses, nearly doubling for a second successive year the number of lead U.S. dollar debt deals. And with our agreement to acquire Albert Fried, we will further expand our U.S. capabilities and client offerings. The transaction will leverage our leadership position in the prime brokerage space in Canada and mark an important step forward in our efforts to build an integrated dealer in the U.S. aligned with our U.S. businesses.

As I reflect on the year just ended, the benefits of our strategy to diversify our earnings base are clear. As growth in some of our Canadian Retail businesses has moderated, the performance of our U.S. Retail segment, coupled with our expanding Wholesale franchise, has provided support to overall earnings growth. We expect this trend to continue next year.

In Canada, GDP growth is expected to remain modest in 2017 and 2018 as the economy continues its adjustment to a lower growth environment and its policy efforts to address the rising housing prices and household debt start to take effect. With the yield curve largely flat out to five years, we think it is prudent to moderate our medium term growth expectations for the Canadian Retail segment from the 7%-plus target identified at our Investor Day to mid-single-digits.

By contrast, the economic picture is brighter in the U.S. The Fed appears likely to raise rates in the coming months, and the market has responded, with bond yields rising and the U.S. dollar on the upswing. While there are global risks, these conditions in the U.S., if sustained, may enable us to deliver total bank adjusted EPS growth for 2017 inside our 7% to 10% medium-term target range.

We have a resilient, diversified business model that generates strong risk-adjusted returns. And this enables us to continue to make strategic investments to improve our operational efficiency and lay the foundation for future growth, including enhancements to our digital capabilities. I've been sharing examples this year of how we are investing and innovating in the digital space. By putting the customer front and center, we've been able to drive engagement to new levels, particularly in mobile.

Let me highlight a few of our latest accomplishments. This fall we launched TD for Me, a new capability integrated with our TD banking app. TD for Me is a digital concierge that allows customers to opt into a service that sends real-time notifications about special offers and nearby events. Let me give you an example. If you visit a real estate development site served by a TD mobile mortgage specialist in a TD for Me zone, you'll get a push notification on your home screen connecting you with an adviser who can answer your questions and guide you through the process of getting a mortgage. Early feedback on TD for Me has been very positive with over 900,000 customers registering for the service on their mobile devices. Our companion app in Canada, TD MySpend, is also growing in popularity. Since launch in May, we have over 700,000 customers who love the way it helps them manage their financial well-being.

In our wealth business, we completed the transformational journey that began nearly three years ago. All of our direct investing clients have now being successfully migrated to our award-winning new WebBroker platform. We've implemented a new active trading platform and a new order entry system. And we introduced a mobile trading applications that is fully integrated into the TD banking app. As a result of these investments, we have now fully deployed a strong platform that positions us well for further innovation and continued success.

It's a similar story in the U.S. with our next-generation digital platform. 2.2 million customers are using our app across Android and Apple devices. The new capabilities that powered strong adoption and engagement on our mobile platform with digital sales of retail products now representing more than 10% of all sales. In our Wholesale Bank, we introduced a new electronic foreign exchange trading platform that provides faster and more automated pricing for clients which has led to a significant increase in trading volumes and we are delivering the same kind of innovation internally to help our colleagues do their jobs more easily. This year, we implemented a paperless claims process in our Insurance business. We began to digitize our back office processes and we launched TD Apps, an internal app store that allows colleagues to download capabilities on to their mobile devices, simplifying a range of tasks. I look forward to providing more updates on our front and back office innovations in future quarters.

To wrap up, I'm proud of what we achieved in 2016 and excited about our opportunities next year. I would like to thank our 80,000 colleagues for their hard work and dedication in making TD the better bank as well as our clients and customers for the opportunity to serve them. I would also like to thank our investors and shareholders who have supported us on several landmark debt and preferred share deals this year and who have reflected our strong performance in an all-time high for our stock price. We appreciate your confidence and we are committed to continue executing on our long-term strategy and delivering strong shareholder returns.

With that, I will turn things over to Riaz.

Riaz Ahmed – TD – Group Head and CFO

Thank you, Bharat. Good afternoon, everybody. Please turn to slide 4. In 2016, the bank reported earnings of $8.9 billion and EPS of $4.67. Adjusted earnings were $9.3 billion and adjusted EPS was $4.87, both up 6% year-over-year.

Revenue increased 9% and across all of our segments led by volume growth. Expenses increased 4%, or 2% on an adjusted basis excluding currency and acquisition, resulting in 200 basis points of operating leverage. PCL increased year-over-year primarily reflecting volume growth, provisions related to oil and gas exposures, and the impact of foreign exchange. Most of the increase occurred in the first half of the year, as loss rates have since stabilized.

Canadian Retail and U.S. Retail delivered net income of $6 billion and $3 billion for the year respectively while Wholesale reported over $900 million in earnings. Please turn to slide 5.

This quarter, the bank reported earnings of $2.3 billion and EPS of $1.20. Adjusted earnings are $2.3 billion, up 8% and adjusted EPS was $1.22, up 7% year-over-year. Adjusted revenue increased 6% excluding FX and acquisitions led by volume growth. And adjusted expenses increased 5% excluding FX and acquisitions, resulting in 100 basis points of operating leverage. Expenses ticked up this quarter, reflecting seasonality, as well as investments in our business and infrastructure. These investments will continue into fiscal 2017. And as a result, expense growth is expected to be higher on a year-over-year basis in the first half of the year, particularly in our Retail businesses.

PCL decreased 1% quarter-over-quarter. Segment reported earnings were $1.5 billion for Canadian Retail, approximately $700 million for U.S. Retail and $238 million for Wholesale. The Corporate segment reported a loss of $138 million or $94 million on an adjusted basis. Please turn to slide 6.

Canadian Retail segment net income was $1.5 billion, an increase of $6 million as we earn through margin compression in Canadian personal banking, higher expenses, a higher effective tax rate in Insurance and increased provisions for credit losses. Total loan growth was 5% year-over-year with increases in personal lending and business lending volumes. Deposits increased by 10% reflecting growth in core chequing, savings, and business deposits, and wealth assets grew 10%. Insurance claims decreased reflecting more favorable prior years' claims development and less severe weather conditions in the quarter.

Margin was stable, down only 1 basis point quarter-over-quarter and PCLs were also relatively stable increasing 2% quarter-over-quarter. Expenses increased 5% year-over-year as a result of business growth, including investment in client-facing advisors, volume-related expenses, branch optimization, and initiatives to modernize our platforms and digitize the client experience, all partially offset by productivity savings. Please turn to slide 7.

U.S. Retail earnings were US$536 million, up 9% year-over-year on an adjusted basis. The U.S. Retail Bank earned US$465 million, up 14% on an adjusted basis from the fourth quarter last year. Results for the quarter reflected revenue growth on higher loan and deposit volume, good credit quality and strong operating leverage. Total loan growth is 11% year-over-year reflecting growth in both personal loans and business loans, and deposits increased by 9%. Margin was down 1 basis point quarter-over-quarter reflecting good deposit growth. While many factors affect margins, we expect continued improvement in 2017, with potential upside if U.S. rates increase.

PCL increased 12% quarter-over-quarter reflecting seasonal increases in the auto lending and credit card portfolios. Adjusted expenses increased 5% year-over-year, reflecting business initiatives including store optimization, the impact of additional FDIC surcharges, seasonality, volume growth and investments in front line employees, partially offset by productivity savings. Earnings from our ownership stake in TD Ameritrade decreased 15% year-over-year reflecting higher operating expenses, partially offset by favorable tax items in the quarter. Please turn to slide 8.

Net income for Wholesale was $238 million, up 21% year-over-year on higher revenue, lower PCL and some favorable tax items this quarter, partially offset by higher compensation expenses. Revenue increased 11% reflecting higher origination activity in debt and equity capital markets and higher fixed income trading, partially offset by lower equity trading and advisory fees. PCL was $1 million and down year-over-year reflecting specific oil and gas provisions in the prior year. Please turn to slide 9.

The Corporate segment posted an adjusted loss of $94 million in the quarter compared to a loss of $161 million in the same period last year. Net corporate expenses increased year-over-year largely due to ongoing investments in enterprise and regulatory projects. The contribution from other items increased $90 million on a year-over-year basis reflecting higher revenue from treasury and balance sheet management activities, some favorable tax items in the current quarter and higher provisions for incurred but not identified credit losses in the prior year. Please turn to slide 10.

Our common equity Tier 1 ratio was 10.4% at the end of the fourth quarter. Organic capital growth was offset by increased risk weighted assets and pension valuations. The higher RWAs reflect growth in business volumes, the effects of the Basel I floor and the temporary capital impact of rating downgrades to certain student loan asset-backed securities in our investment portfolio, which may continue. We remain very comfortable with the credit quality of the portfolio. Our leverage and liquidity ratios are consistent with last quarter's level.

Overall, I'm happy with our financial performance this year. Our results reflect the strength of our franchise model and diversified business mix, and we are well positioned to continue growing our businesses and meeting the needs of the evolving regulatory and capital environment.

I will now turn the call over to Mark.

Mark Chauvin – TD – Group Head and Chief Risk Officer

Thank you, Riaz, and good afternoon, everyone. Please turn to slide 11.

Credit was strong throughout the year, continuing into the fourth quarter. On a year-over-year basis, gross impaired loan formations are down 3 basis points or $111 million, driven by reductions in U.S. legacy interest-only HELOC formations.

For the quarter, gross impaired loan formations are flat at $1.2 billion or 21 basis points. U.S. Retail formations are up $65 million due to seasonal trends in the credit card portfolio and the negative impact of foreign exchange. There were no new formations in the Wholesale portfolio.

Turning to slide 12, gross impaired loans ended the year at $3.5 billion, stable at 58 basis points on both a year-over-year and quarter-over-quarter basis. U.S. Retail gross impaired loans are up $101 million in the quarter, primarily driven by seasonal trends in the credit card portfolio and the negative impact of foreign exchange. The increase was partially offset by a $48 million decrease in Wholesale gross impaired loans due to resolutions in the oil and gas sector.

Moving on to slide 13, as indicated in previous quarters, U.S. strategic card PCLs are reported on a net basis for segment reporting including only the Bank's contractual portion of credit losses. For the purpose of the credit slides, we continue to report gross losses to better reflect portfolio credit quality.

The full year loss rate is 41 basis points, up 7 basis points from 2015 driven by credit losses for exposures impacted by low oil and gas prices, reserve build for incurred but not identified credit losses in the retail and non-retail portfolios, and the negative impact of foreign exchange. Provisions for credit losses were $554 million for the quarter, down 2 basis points quarter-over-quarter to 37 basis points. The primary factors impacting PCL in the quarter were reductions in reserve build offset by a $35 million increase in U.S. Retail PCL driven by seasonal trends in the credit card and auto portfolios.

Moving to slide 14, we are continuing to see improvement in the performance of our Oil and Gas Producer and Services portfolios as evidenced by resolutions in some of our impaired loans attributable in part to the recent stabilization in prices and more positive market tone. Consumer losses in oil-impacted regions are stable and continue to be offset by favorable performance in the rest of Canada.

To conclude, the key takeaways for the quarter are credit quality remained strong, the credit impact associated with low oil and gas prices continues to moderate, and we are well positioned for continuing growth going into 2017. With that, operator, we are now ready to begin the question-and-answer session.

QUESTION AND ANSWER

Operator

We'll go first to Ebrahim Poonawala with Bank of America Merrill Lynch.

Ebrahim Poonawala – Bank of America Merrill Lynch – Analyst

Good afternoon. I was wondering if you could start with your comments around the growth outlook for the U.S. as you look into 2017. And I was wondering if you can provide some color around what areas do you expect U.S. growth to really sort of maybe pick up in 2017 or probably stay the same as we've seen in 2016?

Mike Pedersen – TD – Group Head, U.S. Banking

Yeah. So, it's Mike. So, we've obviously seen very good revenue growth in the U.S. this year and based on what I see right now, I expect that to continue. I expect our volumes to continue to be strong. I also expect our margins to increase based on what we're seeing. It's possible we'll see a bit of moderation in categories like commercial and auto finance lending but not seeing that yet. There are some signs that there's a bit of pricing pressure in some of those sectors, so that may adjust our flows a bit. But broadly speaking, I expect good growth across the categories that have produced good growth this year with improving margins.

The fee growth will be, I think, also robust with the caveat that we made a move this year to time order posting for overdraft charges and that's had an effect this year. We'll see the full-year effect of that in 2017. And then I would say that all of which I had – all of what I've just said is assuming no rate increases. If there is a rate increase, that's upside to what I've said.

Ebrahim Poonawala – Bank of America Merrill Lynch – Analyst

And do you care to sort of quantify what that upside could be if we get maybe multiple rate hikes at the short end in the U.S. next year?

Mike Pedersen – TD – Group Head, U.S. Banking

No. The comments that Bharat and Riaz have made with respect to the upside includes our assumptions of what that'll be, but we're not disclosing anything more than that.

Ebrahim Poonawala – Bank of America Merrill Lynch – Analyst

Understood. And if I can quickly ask a question just in terms of capital, I guess to Riaz. If you can remind us in terms of what the targeted capital ratio is? If I recall correctly, Scottrade is going to consume about 20 basis points of CET1. So, where do you want that ratio to be as we sort of think about ending 2017?

Riaz Ahmed – TD – Group Head and CFO

Ebrahim, the way I look at capital is we're well above the minimums that are required. And when we look at the risk factors in our bank, I feel very comfortable with the capital ratio where it is. I don't generally tend to run any particular target in my mind about capital. We look at our surplus capital position and determine its best use from time to time which can be prioritized by way of funding growth. And then which could include potential acquisitions and then returning capital to the shareholders.

Ebrahim Poonawala – Bank of America Merrill Lynch – Analyst

Understood. Thanks for taking my questions.

Operator

We'll go next to Gabriel Dechaine with Canaccord.

Gabriel Dechaine – Canaccord Genuity – Analyst

Good afternoon. Also, a question on the capital, we saw this disclosure for the first time. The impact to the regulatory floor – $5 billion increase in RWAs that kind of popped up. And I believe that's in relation to the impact of Basel I floors on your AIRB RWAs that were recently transitioned in the U.S. Is that correct first of all?

Riaz Ahmed – TD – Group Head and CFO

Yes, that would be correct, Gabriel. As you know, what every Basel III-compliant bank has to do is calculate its risk-weighted assets using internal risk-based model and compare that against the risk-weighted assets that it would calculate under the old Basel I framework and the benefits that one can draw from moving to internal risk-based models is capped by reference to this floor. And when you have a low risk bank like ours, you would expect that we would get there at some point. And you will remember that in the last quarter, we transitioned our U.S. Retail portfolio from standardized to internal risk-based methodologies as well. So no surprise that at some point we would get to this floor.

Gabriel Dechaine – Canaccord Genuity – Analyst

I'm a little bit dumb on this, I guess. Why would this happen so soon? And I've never seen anything like this from Canada. Like, for example, real estate secured loans are risk-weighted at anywhere between 10% to 15%, depending on the bank and standardized is 35%. I'm just cherry picking an example, but I've never seen an impact from these floors having an effect on the banks. And then, what's the difference? And then why did this happen so soon after your AIRB transition in the U.S.?

Riaz Ahmed – TD – Group Head and CFO

Well, I think the calculation, Gabriel, is in relation to the entire balance sheet and so you know the Canadian portfolio has transitioned some years ago.

Gabriel Dechaine – Canaccord Genuity – Analyst

Right.

Riaz Ahmed – TD – Group Head and CFO

But we have a certain amount of the balance sheet that is risk-weighted using internal risk-based models and some that is risk-weighted using standardized model. And the process of movement from standardized to risk-based models includes the development of internal data and capabilities and models, which then get approved by the regulators. And then once the regulators are satisfied with them you implement them. So the fact that we introduced the U.S. Retail model in Q3 was just one aspect of our balance sheet that transitioned in Q3. So I don't think you should take away from that that the effect was so soon. In fact, it is an effect that low-risk banks would feel faster than high-risk banks.

Gabriel Dechaine – Canaccord Genuity – Analyst

Okay. My next question is rate-related. And I've seen you raise prices on mortgages this quarter, as have other banks. And I wonder what that does to you – and we have seen the five-year rate increase as well. I wonder what that does to your margin outlook for the Canadian business in particular. And then pursuant to that, if it's not going to cause your margin to go up, what kind of rate increases do we need to see for this margin issue to kind of dissipate materially and how long does that take to go through your tractors I guess?

Teri Currie – TD – Group Head, Canadian Personal Banking

So, it's Teri. Just on margins in general and then talk about RESL as we go through. So, obviously, we have the highest absolute margins in Q4. We were flat in CAD P&C and as you mentioned we had the benefit of our tractoring strategy and acquisitions over the last several years but we can't outrun low interest rates. And to your point, that takes a few years to work its way through.

But because we have a majoritively fixed rate mortgage portfolio and a very large and growing fixed rate mortgage portfolio, RESL portfolio overall. We are more differentially impacted. We expect as we look ahead to 2017 that that margin compression that we've experienced this year will moderate over the full year. There'll be bumpiness in quarters but we should expect it to moderate in the next year. And obviously, when you look at the re-pricing, when the re-pricing is only for new originations or renewals that takes a bit of time to work its way through the mortgage book.

Gabriel Dechaine – Canaccord Genuity – Analyst

All right. But there's no ballpark rates have to go up by X before we start to see margins increasing in Canada again.

Teri Currie – TD – Group Head, Canadian Personal Banking

No. We don't have something like that to talk about.

Riaz Ahmed – TD – Group Head and CFO

I think in relation to one part of that which is the tractoring strategy that you talked about, Gabriel. What you have to do is look at what five to seven year swap rates might be doing today compared to what they might have been five to seven years ago. So, I think you have to look at what rate are you coming off and at what rate are you going on. And so, you'll see that the swap rates today are still lower than what they might have been historically and that will give you an indication of where rates need to be.

Gabriel Dechaine – Canaccord Genuity – Analyst

Okay. Thank you. Mark didn't say limit yourself to one question. So, I asked a couple.

Mark Chauvin – TD – Group Head and Chief Risk Officer

No worries.

Operator

We'll go next to Meny Grauman at Cormark Securities.

Meny Grauman – Cormark Securities – Analyst

Hi, good afternoon. Just wanted to better understand your revision to your growth targets for the Canadian Retail business and I think, Bharat, you mentioned the yield curve. But I'm wondering is this change just driven by the outlook for margins? Or is there something else as well that is causing this reappraisal?

Teri Currie – TD – Group Head, Canadian Personal Banking

So, it's Teri. I'll take it. If you recall when we had our Investor Day, there were a couple of rate increases embedded in that target that we set. And obviously, the context has changed both around that and around real estate secured lending since the time that we had Investor Day. So, those are the two main factors that have caused us to change the outlook.

Having said that, next year's outlook, I would say, you should expect similar growth in loan and deposit books for CAD P&C. You should expect, again, as I said, compression in margins moderating. Expenses will be elevated, as has been said, in the first half of the year. And you take that together with PCLs growing largely in line with the volume growth of our businesses, and you should expect better performance from CAD P&C next year.

Meny Grauman – Cormark Securities – Analyst

On the expense front, if I look at sort of the run rate savings that you're looking for from your restructuring announcements, it definitely looks at the lower end of the peer group. And you've talked about it before but I'm wondering given the upward pressure you're seeing on expenses, why not be more aggressive in terms of restructuring into next year? Or I guess the question is, are you contemplating in light of this outlook, maybe taking more restructuring charges?

Riaz Ahmed – TD – Group Head and CFO

I don't think so, Meny. What I would say to you is you have to look at what we said in 2015 when we took the restructuring charges is that we would get productivity benefits that we would reinvest. And so, if you look at 2016 for the whole year, ex the impact of currency and acquisitions, our expense growth rate was in the mid-2s. And within that envelope, we made some very significant investments in the items that I talked about earlier.

So, I don't think that you should see that as a pressure on expenses. I think you should see it as a good expense management in delivering operating leverage this year and making the investments that we feel are necessary to make. So, I think you can continue to expect that we will do that and that it may result in an occasional quarter bumpiness in expenses, but that doesn't bother me too much.

Meny Grauman – Cormark Securities – Analyst

Thank you.

Operator

We'll go next to Sumit Malhotra with Scotia Capital.

Sumit Malhotra – Scotia Capital – Analyst

Thanks. Good afternoon. A couple of sensitivity questions and I want to go back to something you gave us. It's been a few years now. And I'll direct this to Riaz and he can send it along appropriately.

The rate sensitivity, the Bank had given us the net interest income sensitivity to changes in rate increments both at the short and long end of the curve and you had gone as far as to break that up geographically. Just because it has been a few years, and obviously the composition and size of the balance sheet has changed, are you in a position to update those numbers?

Riaz Ahmed – TD – Group Head and CFO

So, Sumit, what we gave in Q2 2013 was an illustration to give you a perspective on how our bank thought about our asset liability management and interest rate sensitivity. I don't intend to update that as a guidance matter on an ongoing basis because a fair bit of it you could reasonably expect would be proprietary to us. But to your point, a lot has changed. The deposit book grows, currency has an impact, the geographical mix of your deposits plays a role, how much of your deposits are floating versus fixed.

So, there's a number of assumptions that go into that, but I think what you can take away is that we are a deposit heavy bank, and therefore as interest rates go up, as you would expect our deposit margins would widen, and the impact of which I would refer you to Bharat's outlook remarks for you to get a perspective on how we think about it.

Sumit Malhotra – Scotia Capital – Analyst

And it's still the short end of the curve. I think it's fair to say that's more than beneficial to the bank from a net interest income perspective. Is that correct? So if I'm talking sense?

Riaz Ahmed – TD – Group Head and CFO

That depends on how much the yield curve steepens. If the yield curve steepened very substantially, then the longer side of the curve could overwhelm the shorter end of the curve. So, that's what I mean that it's subject to so many assumptions that you really have to build your model to kind of get to our perspective on how you would view different banks' profiles.

Sumit Malhotra – Scotia Capital – Analyst

Okay. I might follow-up with you offline on that. The second one, last one for me is on your tax rate in the U.S. It's obviously with the – in the aftermath of the presidential election, there's been a lot of focus on corporate tax rates. TD's tax rate in the U.S. Banking segment has averaged about 17% for a few years now. And I recall the bank telling us that that lower rate had to do with some certain programs that you participated in.

If there was to be a meaningful corporate tax rate reduction at the U.S., given where you're being taxed in this segment, would you benefit in a material way or is your tax rate where it stands right now already as good as it gets for the bank in the U.S.?

Riaz Ahmed – TD – Group Head and CFO

I think, Sumit, the way you should think about that is the tax rate is established by reference to statutory rates that are in place at the time, and then there's deducts from that. So, for example, we – as an example, we participate in various community reinvestment activities that are subject to tax credits et cetera. And so those tend to be deductions that get you to your effective tax rate. So, if the overall tax rate would reduce, then yes, we would have benefits come out of that.

Sumit Malhotra – Scotia Capital – Analyst

Thanks for your time.

Operator

We'll go next to Peter Routledge with National Bank Financial.

Peter Routledge – National Bank Financial – Analyst

Hi. Thanks. Just a question on the impact, or potential impact, of the proposed changes to housing finance, specifically on your funding strategy in Canada. TD has always sort of set itself out as having pretty advanced and innovative funding approach that certainly capitalized on the housing finance system as it existed, and it's changing. Big picture question, how does that change your funding strategy, particularly lender risk sharing?

Riaz Ahmed – TD – Group Head and CFO

No, I think that you are correct that we took our mortgage portfolio then securitized them and used them, so what we are doing now is just continuing to diversify our funding strategy using more global markets and more products, such as covered bonds in order to create new funding strategies. And of course along those have had a very strong balance sheet management program, so that we can experience the benefits of having some of the best ratings, and keeping our name in demand.

So, that's an aspect of our treasury funding strategy that we spend a lot of time on and spend a lot of time with our fixed income investors to make sure that we're creating a continuous – and being an attractive name out there. And as you know, that allows us to crack the U.S. dollar subordinated debt market this year in a very attractive way. So, we're just resorting to more traditional methodologies and maintaining our innovation and focus on this area.

Peter Routledge – National Bank Financial – Analyst

Absent yield curve changes, does the shift in strategy either increase your funding costs or make them more volatile?

Riaz Ahmed – TD – Group Head and CFO

Probably a little bit of both, because you are going to more traditional market methodology than global markets. So the covered bond market is a helpful source of stability. So you would see that our – that you would see some increase in cost of funds which is partly also the margin compression story we've been talking about. And you always want to be more careful with the volatility that the global markets would pose. But we do have a fair bit of – we're very active in funding and making sure that we're funding our balance sheet well in advance of needs.

Peter Routledge – National Bank Financial – Analyst

And just final related question on NHA MBS balances. So, these would be your balances on balance sheet which I believe qualify as high quality liquid assets under the LCR. Those balances may shrink. There just may not be as much NHA MBS. Does this pose an additional headwind for your margin, again, absent any other change, or do you think it's just nominal?

Riaz Ahmed – TD – Group Head and CFO

No, I think that this is more an issue for the global industry about availability of HQLA-eligible assets. So, you've seen banks pick up more of their balance sheet in sovereign and treasury bonds. So, I think it's more a matter of managing your liquidity than anything else.

Peter Routledge – National Bank Financial – Analyst

But if you had instead of $35 million in NHA MBS, you had $25 million. That wouldn't materially impact your all bank margin?

Riaz Ahmed – TD – Group Head and CFO

I'd just have to substitute other low investments to maintain the liquidity, yes.

Peter Routledge – National Bank Financial – Analyst

Ok. Thanks.

Operator

We'll go next to Sohrab Movahedi with BMO Capital Markets.

Sohrab Movahedi – BMO Capital Markets – Analyst

Hey, thank you. A couple of numbers questions maybe from Mark and then a broader one for Bharat. Mark, what's the percentage of your non-conforming mortgages of the portfolio, what percentage of the portfolio with non-conforming mortgages? Call it defined as non-residence, newcomers and self-employeds. What percentage would that be?

Mark Chauvin – TD – Group Head and Chief Risk Officer

It would be roughly 1% on the existing portfolio.

Sohrab Movahedi – BMO Capital Markets – Analyst

Perfect. And then just a quick follow-up on that one as well like if I look at your – if I ask you to kind of tell me what you would view to be the higher-risk end of your mortgage portfolio by LTV and Beacon score or some sort of a credit score, what would be the thresholds that you would use?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Well, I think the idea of a Beacon score below 650 with a loan-to-value of above 75%, if you want to kind of identify the high-risk sector. That would be an appropriate way of looking at it which I've seen our peers have done. But I think that's a fairly traditional way of looking at it.

Sohrab Movahedi – BMO Capital Markets – Analyst

And so what percentage of your portfolio would be in that bucket?

Mark Chauvin – TD – Group Head and Chief Risk Officer

Well, through no coincidence, around 1%.

Sohrab Movahedi – BMO Capital Markets – Analyst

Okay. Thank you. And I guess, Bharat, the broader question I would have is as you've given us the outlook, have a feel for what Canadian Retail is going to do, have a feel for what U.S. is going to do, if you were going to handicap the direction arrow on your ROE as a bank next year or next couple of years, two, three years doesn't matter. I mean, is it pointing higher or is it flat or do you think it's still going lower?

Bharat Masrani – TD – Group President and CEO

Sohrab firstly, on the – as you said, different segments you have a sense for what our thinking is. And for the overall bank, some of the indications out of the U.S., Mike talked about the growth in volumes in our business there. You see what's happening with the yield curve there and what's happening with the currency, so, and hence my comment on – we do have a chance to get into our 7% to 10% target that we had set out over the medium term.

Now, on ROE, obviously with the percentage of the bank's earnings that come from the U.S., does impact our ROE, so there could be some pressure from that perspective. But on the other hand, we are putting on very good risk-adjusted businesses. We are happy with how we are tracking with our ROE given the type of business model that we run, the percentage of our business that is retail-oriented versus not. The volatility that you experience out of TD is more predictable. That's our view. And if you put all those things together, we are happy with how we are tracking on the ROE but you will see some bumpiness year-over-year depending on where our earnings growth is coming and where it may reverse itself.

Sohrab Movahedi – BMO Capital Markets – Analyst

Okay. I mean, I guess – maybe I misunderstood it. But I mean Mike Pedersen was talking a little bit about potential improvement in margins, not even factoring in any rate increases and the like. Why wouldn't that be accretive to the U.S. segment's ROEs all else equal?

Riaz Ahmed – TD – Group Head and CFO

Sohrab, can I give you a technical answer?

Sohrab Movahedi – BMO Capital Markets – Analyst

Yeah. Sure. Yes, yes.

Riaz Ahmed – TD – Group Head and CFO

You have a situation under current IFRS accounting rules, where the goodwill gets translated as well. So, what you're seeing in the ROE is essentially your earnings get translated and your capital gets translated, and that translation adjustment, as you know, goes to shareholders' equity, and therefore also raises your capital base. So, historical price that you paid for that goodwill from a currency perspective is irrelevant under the IFRS rules.

So, if you see a stronger dollar, like if you had a rise in U.S. earnings, and your dollar was flat to your acquisition price, yes your ROE would go up. But as the U.S. dollar strengthens, you would have different impact. So, that's what Bharat's telling you is that you have to look at the performance of the U.S. Retail segment in U.S. dollars, and then also look at the Canadian dollar translation of the goodwill in relation to the price that was originally paid. And that's what causes that bumpiness.

Sohrab Movahedi – BMO Capital Markets – Analyst

That's perfect. So, absent Canadian dollar further depreciating against the U.S. dollar in your scenario, you would see an ROE improvement?

Riaz Ahmed – TD – Group Head and CFO

Yes.

Bharat Masrani – TD – Group President and CEO

Yes, you would. And just having said that, in Mike's business, in U.S. dollar terms when you measure it, of course, with improving margins and a growth in our business and we are generating very good, what we call operating ROEs, out of the U.S. So, over time, we would see better ROEs within our U.S. segment.

Sohrab Movahedi – BMO Capital Markets – Analyst

Okay. And then outside of the U.S. segment, but at a total bank level, I mean, Teri has also talked about this stuff. I mean, just generally speaking how do you feel about the direction arrow in the ROE over the next two to three years?

Bharat Masrani – TD – Group President and CEO

It's hard to put a particular number, Sohrab, but our view is that ROE as we put on more business over time, we should see improvements especially with some of the sentiment you see in the market with respect to what's happening in the U.S. Over time, we feel in Canada, it will readjust to a more normal environment than what we've seen recently and that should help our business. Apart from the margin, you have also this issue in Canada where GDP growth is more muted and is expected to continue for the next couple of years.

So, all these factors would play a role in how the Bank does. But having said all that as I started answering the question that given our balance sheet, given the type of risk profile that we run in the Bank, the type of volatility you experience out of TD, we think our ROE is reflective of that and we are pretty happy with how we are performing.

Sohrab Movahedi – BMO Capital Markets – Analyst

Thank you very much.

Operator

This concludes our question-and-answer session. At this time I would like to turn the conference back to Mr. Bharat Masrani for closing remarks.

Bharat Masrani – TD – Group President and CEO

Thank you very much, operator. And again, very happy with how TD has been able to deliver very good numbers for the year since it's our fiscal year-end as well. And I'd like to take this opportunity once again to thank our nearly 80,000 colleagues around the world who continue to deliver for our customers, as well as our shareholders. And for folks on the phone in case if we do not get together in the near term, I wish you happy holidays and good health and we will see you in the New Year. Thanks very much, operator.

Operator

Thank you. This concludes today's conference. We do thank you for your participation. You may now disconnect your lines.