

# ESG Engagement Example

## Q3 2023

### BACKGROUND

In May of this year, TD and First Horizon Corp. (FHN) jointly announced the mutually agreed termination of their merger, citing TD's uncertainty regarding the timeline of regulatory approvals. This announcement prompted us to question the potential reasons for not receiving approval, including the correlation to TD's deficient AML controls and the impact on TD's growth and capital deployment strategy.

A few days after this announcement, the Wall Street Journal reported that the Office of the Comptroller of the Currency (OCC) and the Fed's concerns stemmed from TD's handling of unusual transactions and its timeliness of reporting suspicious activity. As a result, two lawsuits were filed against the issuer in May and June by FHN shareholders over the failed acquisition and misleading statements regarding the likelihood of regulatory approval, in addition to the failure to disclose deficient AML procedures and policies.

Additionally, Sustainalytics downgraded the outlook for the Toronto-Dominion Bank's Business Ethics from Category 2 to Category 3, Neutral. We felt these events and the subsequent rating change required engaging with TD Bank's management team to address our questions.

### ENGAGEMENT FOCUS

#### 1. AML Compliance

Disclosed that they have been on top of and responding to inquiries from regulatory authorities including US Department of Justice on matters concerning the bank's AML compliance program in the U.S. and anticipates monetary and non-monetary penalties to be imposed. The size of both impacts is difficult to estimate at the time we spoke as the discussions with regulators are still ongoing.

#### 2. Operational Risks

Litigation issues mean the bank must hold additional operational risk capital, which stays with the bank for the next 10 years as it cannot be reversed very quickly. Monetary penalty is possible and there may be additional expenses to cure any deficiencies. Impact will be longer-term, but we believe the impacts on both expenses and capital are manageable.

### 3. Growth Plans

Management confirmed the bank's strategy for growth in the Southeast region of the U.S. has not changed. In our view, it is a positive sign that the bank has already been using excess capital into growing that market organically through new branches in targeted cities and regions.

We also discussed TD's recent activity in the market with a few unsecured bond issuances. Management explained that the bank is pursuing healthy growth in the U.S. and Canadian market, which requires liquidity and has driven the need for additional wholesale funding.

## PROGRESS & MONITORING

In our view, the cessation of the deal works favourably for TD's creditors from a fundamental perspective. TD's regulatory capital levels solidly at the top of the peers. Moreover, we believe the timing is not optimal for closing this substantial U.S. regional bank deal given the current turmoil in the US banking space.

We will continue to monitor TD's plans to enhance their U.S. AML compliance program and any impact on operational risks as discussions continue between the bank and regulators. AML deficiency is of concern; however, at this time, it is important to continue engaging with the management team to understand how the team will address the issue and what the magnitude of the impact will be once discussions with regulators come to a close.

Following this engagement, given our analysis of both ESG and fundamental risk factors, we did not believe it necessary to change our position in TD as the issue was not deemed material enough to change our view on the issuer as a whole.

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