Should You Be Worried About Toronto-Dominion Bank's 80 New Competitors?

Description

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) shareholders are likely aware of its major risks thanks to plentiful media coverage. Risks include soaring home prices, low interest rates, an over-leveraged consumer, and increasing regulations. Possibly the biggest threat to banks has been getting the least attention though; that is, the upcoming disruption from financial technology companies.

A recent PwC report stated that Canada now has 80 financial technology firms, and this number is growing at a rapid rate. Not only are these smaller firms a threat to market share with their innovative products, but tech giants like **Apple Inc.** (NASDAQ:AAPL) and **Facebook Inc.** (NASDAQ:FB) are also entering the banking space.

Apple, for example, has debuted its Apple Pay mobile app. This app allows customers to load credit and reward cards onto their phones and pay quickly by tapping their phone at a special terminal at the check-out. If Canadian banks want to be included, they will likely need to pay up and allow Apple to get in between them and their customer.

Facebook is also allowing users to send money via their messenger app, meaning money can be transferred without visiting a bank website. The end result is that McKinsey thinks 60% of bank profits could be at risk. Fortunately, Canadian banks have some advantages.

1. Canadian banks are heavily regulated

As of now, this is a major disadvantage. TD Banks CEO Bharat Masrani stated at the recent annual meeting that "thousands" of FinTech players are vying for bank customers and, at the same time, these players are not subject to the intense regulatory rules that banks are.

He mentioned that there have been many issues with FinTech players, like solvency issues, security breaches, and service interruptions, and as a result customers should have assurances—regardless of the financial firm they deal with—that their funds and personal information are safe.

Currently, banks have strict requirements they have to meet to ensure there are no solvency issues. These regulations limit a bank's growth.

For example, banks must maintain certain leverage and capital ratios. Canadian banks must maintain a tier 1 common equity ratio of at least 8%. This basically means that at least 8% of risk-weighted assets must be owned by the bank. This also means that if a bank wants to make an acquisition or do more lending, it needs to first build its capital, which puts limits on growth and return on equity.

Banks are also required to make sure they've got plenty of liquid capital (which means investing in lower-return assets). Eventually, FinTech names will be subject to similar requirements (especially those engaged in lending), and this process is already beginning in the U.S. This will allow TD to compete on a level playing field.

2. TD has been investing heavily in technology

TD is not taking the threat of FinTechs lightly and is investing heavily in digital capability and innovation. TD took $686 million of restructuring charges in 2015, and these charges are largely related to real estate optimization. This means closing and merging branches (to reflect the fact that branch transactions are declining and digital transactions are growing).

These charges are expected to save $600 million annually by 2017. TD plans to use a portion of these savings to re-invest in digital and mobile and has already been investing heavily in these areas.

TD, for example, just revamped its online WebBroker platform to be more efficient and easier to use. It will be launching a new app called MySpend, which is a real-time money management tool that will allow customers to easily track their spending habits and helps users set and achieve financial goals. This allows TD to compete with names like Mint and makes sure TD customers are using TD to track their spending rather than alternatives.

Investments along with partnerships (like the recent partnership with **Cisco Systems** to develop new technology solutions) mean that TD is doing its part to protect and grow its market share, even in the face of new FinTech threats.

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