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E*TRADE Financial Corp. (ETFC)

Q3 2013 Earnings Call

CORPORATE PARTICIPANTS

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Matthew J. Audette

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OTHER PARTICIPANTS

Richard H. Repetto

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Alex Blostein

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Chris J. Allen

Analyst, Evercore Partners (Securities)

Chris M. Harris

Analyst, Wells Fargo Securities LLC

Howard H. Chen

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Michael R. Carrier

Analyst, Bank of America Merrill Lynch

Devin P. Ryan

Analyst, JMP Securities LLC

MANAGEMENT DISCUSSION SECTION

[Operator]

FINANCIAL MEASURES

- During the call, the company may also discuss non-GAAP financial measures
 - For a reconciliation of such non-GAAP measures to the comparable GAAP figures and for a discussion of additional risks and uncertainties that may affect the future results of E*TRADE Financial, please refer to our earnings release furnished with Form 8-K, and our 10-Ks, 10-Qs and other documents the company has filed with the SEC
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Paul Thomas Idzik

*Chief Executive Officer & Director, E*TRADE Financial Corp.*

Q3 REVIEW

Q3 Accomplishments

- This third quarter was solid in terms of results and retail activity, it was also marked by some important accomplishments

- Most notably, the regulatory approval for distribution of an intercompany dividend, something this company has been working toward for quite some time and a significant development in our ever improving capital strength
- And secondarily, entering into an agreement to sell our marking unit, allowing management to more acutely focus our energy on things that truly matter to our customers and drive value for our shareholders
- I will cover some of the highlights, and then pass the baton to Matthew to walk you through the details

Financial Plan

- Starting with our financial plan
- Five quarters ago, the company submitted a comprehensive plan to our regulators, with the objective of achieving capital strength and flexibility
- I am delighted that the focus and hard work of my colleagues led the company to achieve the goals outlined in the plan, and continue to deliver on the ongoing concomitant improvements to enhanced risk management and control of the business
- We received regulatory approval for \$100mm dividend from the bank to the parent in early September, one quarter sooner than we had originally anticipated
- We intend to build on this first milestone with recurring quarterly dividends of similar amounts, over the near-term

Divestment

- Today, we also announced that we signed a deal to sell our market making unit to Susquehanna, concluding a process begun last quarter
- As you will recall, we made the decision to exit this business after determining it was not strategically core
- The transaction upon which Matthew will elaborate, is one with which we are quite pleased, and we believe is in the best outcome for our customers and shareholders
- We are confident in Susquehanna's ability to deliver, best executing for our customers, and we look forward to having them as a partner
- In terms of results, we posted earnings of \$0.16 per share, reflecting some positive trends in retail engagement, improving performance in our legacy loan portfolio which supports continued de-risking of the balance sheet and prudent expense control benefiting from our previously completed \$110mm cost reduction exercise

Trading Activity

- Trading activity improved y-over-y for the second consecutive quarter, after declining for the previous six
- DARTs of 145,000, were up 13% from the year ago quarter and exhibited a mix consistent with recent history, in that approximately a quarter of trades were in options
 - It's also worth noting that our customers are increasingly engaging with their finances in a broad variety of environments, as trades executed via mobile devices grew to a record 9% of total DARTs this quarter, more than three times the level we saw only three years ago
- Margin balances, an important indicator of customer engagement and confidence grew to their highest levels in five years during the quarter averaging \$5.9B and finishing the quarter up at \$6.2B
- In the midst of the political morass in Washington, our customers have remained engaged and active in October with DARTs averaging 158,000 month-to-date, a 7% increase over September

Brokerage Accounts and Assets

- In terms of brokerage accounts and assets, we had reasonable quarter, generating fewer accounts than both the prior quarter and Q3 2012, but exceeding both comparable periods in terms of net new assets
- We added 13,000 net new accounts this quarter while attrition increased modestly to 9% on an annualized basis, from our firm-record 8.4% last quarter
 - This increase does reflect some seasonality
- We brought in \$2.4B of net new brokerage assets to total \$7.2B YTD, representing an annualized growth rate of 5.6%

Retirement, Investing, and Savings Business

- Our retirement, investing, and savings business continues to be a central focus, as we aim to drive greater awareness and interest in our offerings
- Leveraging our cadre of financial consultants is key to this effort and especially crucial with retirement planning season having kicked off at the beginning of this month
- Through Q3, results in this area have been promising
- Our retirement assets under management have grown 16% YTD and now exceed \$40B
 - And we are particularly pleased with the continued growth in managed accounts, now surpassing the \$2B mark, a significant achievement for the company and representing roughly 60% growth YTD
- This past quarter we continued to bolster our education and planning resources to help investors organize, save, and invest to meet their financial goals
- Recently our redesigned Investor Education Center received recognition from Corporate Insights with the only A+ rating in their just completed e-Monitor study
- Customer and prospects use our education resources to hone their investing skills, discover trends and opportunities, and learn about various financial products, all to help make them better informed as they make decisions to take control of their financial health
 - The retirement, investing, and savings area of our business is a strategic priority and it is gratifying that we're seeing the fruits of our labor

New Board Members Additions

- Lastly, we announced two additions to our Board of Directors during the quarter welcoming, Mr. Richard Carbone and Mr. Christopher Flink
- Mr. Carbone is a seasoned industry veteran having most recently served as EVP and CFO of Prudential Financial for 16 years
 - He brings a wealth of experience and financial perspective
- Mr. Flink brings visionary leadership with the experience as a design and innovation expert at IDEO, serving some of the world's most successful consumer brands including Target, Apple and JetBlue
 - These two new members bring unique competencies to our board and we are excited to have them
- With the additions of Rich and Chris, we are now at our target level of 12 board members

SUMMARY

- In summary, I'm proud of our accomplishments this quarter
- The dividend approval was a result of much hard work across the business, and reflective of the good progress we have made implementing a culture of risk management and professionalism in control

- And the sale of our market maker illustrates our commitment to focus management's attention on what truly matters to our customers and our owners
- With our financial strength improving, and a cohesive executive team in place, we are focused even more sharply on ensuring the customer experience is at the forefront of everything we do
- Somewhat in that same vein, with ongoing reductions to legacy risks and related expenses coupled with an improving environment and customer engagement, we are exploring additional areas for prudent investment in the core business, to drive even more value for our customers and our owners
 - I look forward to updating you once we have more to share on this topic

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

FINANCIAL RESULTS

Net Income and Revenues

- For Q3, we reported net income of \$47mm, or \$0.16 per share, an improvement from the prior and year ago quarters, where we posted net losses of \$54mm or \$0.19 per share, and \$29mm or \$0.10 per shares respectively
- The prior period's net losses were driven primarily by \$142mm impairment to goodwill in Q2, and \$50mm in charge-offs related to the untimely reporting of borrower bankruptcies in the year ago quarter
- Our third quarter net revenues were \$417mm, down from \$440mm in the prior quarter

NET INTEREST INCOME

- Revenues included net interest income of \$241mm, down slightly q-over-q as a result of 5BPS of net interest spread compression to 230BPS, which was partially offset by \$600mm increase in average balance sheet size on higher customer cash balances
 - The decline in spread was primarily driven by less income from our stock lending business and higher average cash balances
- We also saw prepayments speeds on our securities portfolio slow late in the quarter, which had minimal impact on our Q3 results, but we anticipate will improve spread in Q4, if the slowing continues, as we have seen thus far in Q4
- Our full year 2013 expectation remains just about 230BPS
- If rates more in line with what the forward curve assumes, we expect a slight improvement in 2014 with an average spread in the mid 230s
 - This is down slightly from our estimate last quarter as the interest rate environment was more favorable three months ago than it is today
- Commissions, fees and service charges, principal transactions and other revenue in Q3 were \$164mm, down 7% from the prior quarter and up 8% from the same quarter of 2012
- Average commission per trade was \$11.15, up from \$11.10 in the prior quarter, and down from \$11.24 in the year ago period
- The sequential increase related to a higher portion of stock plan trades

Principal Transactions Revenue

- Principal transactions revenue was down \$9mm in the quarter as volatility remained at historically low levels and overall volumes in our market making unit were down 16% from last quarter

- Upon completion of the sale of our market making unit, the principal transactions line will be going away, as it relates solely to this business
- Our fees and service charges revenue was in benefit from increased payment for order flow as 100% of our order flow be routed to third parties
 - I'll cover this in more detail shortly

Net Gains on Loans and Securities

- Revenue this quarter also included \$12mm of net gains on loans and securities, in line with our previously communicated expectations
- We expect gains for the next quarter or two will continue in the \$10mm to \$15mm range
 - Though in 2014 we expect this range to decline to \$5mm to \$10mm quarterly, barring significant volatility in the rate environment

Provision for Loan Losses

- This quarter's provision for loan losses was \$37 mm, compared with \$46mm in the prior quarter
 - This is slightly below our originally forecasted range due to smaller-than-expected charge-offs of \$29mm in the quarter, which were at their lowest levels since early 2007
- Going forward we expect provision expense to be in the \$25mm to \$50mm range per quarter
 - And while I say this every quarter, I must emphasize that while this is our best estimate today, it could vary meaningfully
- In particular, I want to underscore that with the provision at such relatively low levels, the volatility of actual results vs. our estimates is likely to increase as rather small improvements or deteriorations in credit performance or outlook could drive material changes in an individual quarter's provision

Loan Paydowns

- Loan paydowns also came in better than anticipated this quarter at \$500mm, driving a total decline in the portfolio of \$530mm vs. our expectations for \$400mm
- Paydowns were the highest level in seven quarters as improving home values enabled more borrowers to refinance
- LTVs and CLTVs have improved substantially over the last two quarters and now average 94% for 1-4 family and 102% for home equity
- We expect the quarterly runoff of the portfolio to be roughly \$500mm over the next quarter or two, dropping off to \$350mm per quarter by the end of next year
- Our loan portfolio ended the quarter at \$9B
 - And our allowance ended the quarter at \$459mm, increasing \$8mm from the prior quarter
- Our allowance includes \$135mm for modified loans, which combined with the prior write-downs accounts for the full life of loan loss expectation

Portfolio Balance

- While the portfolio balance continues to decline and the relative performance and quality continues to demonstrate improvement, we are mindful of future conversions in the home equity portfolio, which could drive higher defaults
- Accordingly, our reserves have begun to capture these events, and we expect this will continue in future quarters

- Total special mention delinquencies were up 3% sequentially, and included some intra-quarter noise
- In June, we completed a servicer transfer of \$1.6B of 1-4 family loans, driving a temporary spike in delinquencies resulting from changes to borrower payment process
- Consistent with past, transfers the temporary spike has largely reversed in the following months and we expect it to fully revert to pre-transfer levels
- Our loan modifications continue to be at relatively low levels, as we modified \$17mm of loans this quarter
 - This compared to \$35mm in the prior quarter and represents the lowest amount since we began the program
- We expect these to remain at low levels over the near term, though they serve as an impactful loss mitigation tool should they be needed when our HELOCs begin to convert from I/O to amortizing in a meaningful way

Capital Plan

- Moving to progress on our capital plan
- We have made great strides since we submitted the initial plan back in June of 2012, accomplishing the many quantifiable goals, addressing the more qualitative ones, and achieving our crucial Tier 1 leverage target at the bank
- This quarter's \$100mm dividend represents important progress with our regulators and an early milestone in our efforts to create a more efficient capital structure
 - It is now imperative that we continue to execute on the many ongoing commitments included in our plan upon which our continued progress is paramount to future dividend approvals
- Our plans for dividend requests remain to seek approval for \$100mm a quarter over the near term
- Over the long-term, the capital we intend to request will be determined by the amount in excess of our ultimate target threshold of 8% Tier 1 leverage at the bank
- Including the bank dividend, corporate cash ended the quarter at \$373mm, which is approximately \$150mm above our target of two years of debt service coverage

CORPORATE CASH LEVELS

- We expect our corporate cash levels to continue to grow, assuming we receive regulatory approval for future dividends
- As such, we are intensely focused on analyzing the best use of this corporate cash
- Our initial thoughts are squarely focused on reducing our debt level at the parent
 - However, there is more work to do to finalize this deal
- We feel quite good about our bank's Tier 1 leverage ratio, ending the quarter at our targeted 9.5%, even in the face of \$500mm of balance sheet growth from customer net selling, and the \$100mm dividend

CAPITAL RATIOS

- As far as our other capital ratios, we improved across the board at both the bank and parent
- As we discussed last quarter, the Basel III capital rules are favorable to us across all risk-based measures, improving Tier 1 common ratios at the bank and parent from their current 22.2% and 12.9% respectively, to 32.3% and 19.6%
- Regarding our parent Tier 1 leverage ratio, we continue to plan for the phase-out of TruPS, which would have reduced our current ratio of 6.6% by 110BPS this quarter
- Regarding the sale of our market maker, I am pleased we were able to execute an efficient sales process

- We have agreed to sell the business for \$75mm and subject to regulatory approvals and other closing conditions; we hope to close on the sale in three months to six months

Corporate Cash Balances

- I would also note that the sale proceeds of \$75mm will increase our corporate cash balances upon closing
- In addition to the sale, we entered into an order flow agreement under which we will route 70% of our equity order flow to Susquehanna over the next five years subject to best execution standards
- We expect the impact of this transaction on our ongoing earnings to be immaterial
- More specifically, upon completion of the transaction principal transactions will be eliminated
- Fees and service charges will increase from additional payment for order flow, and offsetting expenses predominantly in clearing and compensation will be eliminated
 - And just to reemphasize, we expect the net impact of all these changes to be immaterial to ongoing earnings

SUMMARY

- In closing, Q3 was a good one, as our brokerage business produced solid results in what tends to be a seasonally slow quarter, and the credit performance of our legacy assets improved nicely
- We are happy to have reached a deal to sell our market making unit to such a quality partner as Susquehanna in a deal that we view to be positive for all parties involved
- I am incredibly proud of what we have accomplished in our capital plan and feel good about where we stand going forward
- Today I believe our company is in its strongest position in years
 - And frankly, I look forward to continuing the trend of hosting earnings calls of diminishing complexity

QUESTION AND ANSWER SECTION

Richard H. Repetto

Analyst, Sandler O'Neill & Partners LP

Q

My question is for Mr. unflappable first. So first, Matt, you did address this in the prepared remarks a bit when you talked about the reserve, how you're rebuilding the reserve in home equity for the potential conversion. Can you give us a little bit more color on what you're expecting I guess? And you've updated us on metrics in the past on paydowns and stuff, but what do you expect and what level you're going to build the reserve and some metrics on what we can expect there going forward?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Yeah. Sure, Rich. I think the trends that we've talked about in the last few quarters have still continued, right? So the comments on the average loan size of home equities is relatively small at \$75,000. The average payment increase we're talking about here is a few hundred dollars. A lot of the borrowers, even though they only need to make interest only payments today are still making some principal payments, 40% have paid over \$500 in the last 12 months. Just under 20% have paid over \$2,500. So all those dynamics are continuing at play. And if you look at the reserves, just looking over the last few quarters looking at the trends in the 1-4 family book where charge-offs are coming down and the provision is actually negative on that particular portfolio. Then on the home equity side, you see the provisions on the last few quarters hovering in the 50-plus range. So I think the comments are really that all the trends that we've seen the past few quarters really continue on the home equity book.

Richard H. Repetto

Analyst, Sandler O'Neill & Partners LP

Q

Okay, all right. And then I guess a question for Paul more broadly about E*TRADE. So, Paul, you've been there for a while, you got your team more in place – new marketing officer, new president and COO. Can you talk to us a little bit how the culture is changing and I know you stress process improvement and efficiency, but what's going on inter E*TRADE now, as we're seeing all these other metrics improve, financial metrics?

Paul Thomas Idzik

*Chief Executive Officer & Director, E*TRADE Financial Corp.*

A

Sure, Rich, let me point to two things in our announcement today that will underscore some of the transition we're going through. And the transition we're going through is moving from a company that's been focused to quite a great extent on its past to a company that's focused much more on its existing customers, its future and between those delivering the best value for our shareholders. Today, we were able to announce that we've sold G1X, which allows this management team to focus on the core business and drive value there, and the team did a great job executing a transaction that will be immaterial to our earnings, but quite material to our ability to focus on what's important. And secondly, underscoring the fact that we were allowed to generate a dividend intercompany illustrating the regulators' confidence in our capital position and quite frankly their confidence in how we built out risk management and controls. So the new team is focused together on really driving to the next generation, if you will, of E*TRADE and changing and improving how we deliver value to our customers and our shareholders. Does that make sense, Rich?

Richard H. Repetto

Analyst, Sandler O'Neill & Partners LP

Q

Yes, I guess, it does. Well, I know you put these new people in and I guess that, after the three months that they've been there or so, whether there was any more concrete things that they have implemented, but I see things are changing.

Paul Thomas Idzik

*Chief Executive Officer & Director, E*TRADE Financial Corp.*

A

Yeah. Well, things are changing. I mean, if you were here, Rich, you'd see more attention to process improvement, you'd see much more science around listening to customers and understanding what they want and baking that into product development, much tighter integration between the technology resources and the business and the business development people. So, it's difficult to describe over the phone. If you were here you'd find it palpable and you'll start to see it in our customer numbers over time.

Alex Blostein

Analyst, Goldman Sachs & Co.

Q

So, a quick clarification on the provision and Matt to your comments around the home equity portfolio and the potentially higher risk associated with it heading into 2015. The way you guys think about the provision and the guidelines you sort of provided, \$25mm to \$50mm per quarter. Does that already reflect, I guess, your potential expectations for higher losses in that home equity portfolio or that could creep higher?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Absolutely, Alex. So keeping in mind the conversion from I/O to amortizing for home equity don't happen in a meaningful way for a couple of years, but that's absolutely included in our expectations. And, again, just repeating the points that I made earlier, the loan values are relatively small. The payment increase is relatively small. One thing also to keep in mind, I mean in addition to the borrowers are making principal payments today. Home values continue to go up, right. So if you just look at the LTVs and the 1-4 family book, they are now meaningfully below 100% at 94%. But if you look at the home equity book, when you go about a year ago they were at 115%, today they are at 102%, right? So by the time we are in 2015 and 2016, even if you just extrapolate at that, we start to get to a place where there is actually a fair bit of equity behind our loans. So I think there is a lot of momentum going towards, the loss expectation you may have is going to be relatively mitigated, but only time will tell, because there is a lot of good things we see.

Alex Blostein

Analyst, Goldman Sachs & Co.

Q

Yep, makes sense, just wanted to double check. And then, the second question is on the capital levels. When you guys look at the HoldCo and the leverage ratio, there historically used to be a contributing factor for you guys as well, clearly not any more. You guys had 6.5% to 6.6% and that's not including against the \$75mm you're getting for the market maker. The question is, you guys still have four quarters or so until you can start reducing the first tranche I guess of the debt in 2014. Is there anything else you guys can do with the capital flexibility in the interim [ph] rights (25:25) over the next three quarters, whether it's a buy back or maybe starting to bring some of the deposits back on the balance sheet, because again, as I said now you have the capital flexibility. Help us kind of understand like what's the plan until you can start reducing the corporate debt.

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Yeah. So, Alex, we are looking at all those things. I think when we start to think about what's the best use of the dividend, it really brings you back to what's the best use of the capital for shareholders, right. So reducing debt at

the parent, doing share repurchases, investing in the business, bringing deposits back on balance sheet, those are all the things that we are looking at. I think as I said in the prepared remarks, we're squarely focused on reducing debt at the parent. There is still more analysis to be done. There is lots of other parties involved, including our board, including our regulators that will have input on what makes the most sense to do. But I think at its core we're looking at what makes the most sense for shareholders. So I think there will be more to comment as we make decisions on it, but we're focused squarely focused on the parent debt right now.

Chris J. Allen

Analyst, Evercore Partners (Securities)

Q

Afternoon guys. I just had I guess a quick follow-up on HELOC provision. I know it's been already asked a couple of different ways. Wondering if you could give us any color on what your future loss expectations are for the loans as they are repriced, because the jump in provision expense – sorry, the provision build in HELOC has been pretty material the last couple of quarters, even though net charge-offs in the loan balances are coming off pretty hard. So anyway you could help frame it for us?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Not too much beyond what's in the numbers, right. So if you look back last three or four quarters, the provision on home equities has hovered above \$50mm for quite some time. It's certainly a bit of a reserve build vs. the low charge-offs this quarter, but there is probably no more incremental detail I can get into other than we feel confident on the overall provision in the \$25mm to \$50mm range. We feel confident on the wind at our back with home prices going up, delinquencies coming down that we get to the period where these loans are going to adjust, that they are small, the payment increases are small. I think there is just a lot of factors that give us comfort that we're headed in the right direction. But when you look at the individual buckets the 1-4 family losses are coming down much more meaningfully than home equity figures, so you see a shift in the provision or the allowance from one bucket to the other.

Chris M. Harris

Analyst, Wells Fargo Securities LLC

Q

So you guys highlighted a little bit the success you are having in retirements and managed assets and we've clearly seen very impressive growth there. Just wondering, can you guys kind of share with us the economics you are getting on those assets and then maybe a little color on what are the inflows you are seeing there? Are new customers that are coming to E*TRADE for the first time because you have these solutions or are they more of your existing customer base you are kind of cross-selling to?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

So I think on the retirement assets, I think just growing assets for the customers overall, just deepening that relationship is incredibly important, right. So having \$40B of retirement assets is improvement. And then specific to our managed product, right. So we're now up to \$2B of our managed product. We earn anywhere call it 70 to 80BPS on that, so there is some nice recurring fee income there on that that when you look at the fees and service charges line, you are not going to see it jump dramatically in the short term, but I think over time as we continue to build those products that's the line where you are going to see some success there. So when you look out several years from now, hopefully, you'll get a nice redistribution of our revenue into that area. So that's really where I'd focus, focusing on that.

Chris M. Harris

Analyst, Wells Fargo Securities LLC

Q

All right. So just to clarify, is the y-over-y growth you guys are seeing in that line item part of that is being driven by the growth in managed assets you are saying or is it going to be too small – okay all right.

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Keep in mind, retirement assets overall \$40B, managed accounts are \$2B, right, so it's a very small piece in that proportion, but it is part of the growth.

Chris M. Harris

Analyst, Wells Fargo Securities LLC

Q

Okay. And then a real quick follow-up on capital. Matt, I tried to write-down quickly but I probably missed it, the conditions where you guys can potentially ask the regulators for more than \$100mm in quarterly dividends from the bank. I think I heard you say it's when the amount of excess capital you'll have over your 8% Tier 1 leverage target, but that's a target I don't believe that's really in play until the end of 2016. Is that the right way to think about it or am I getting that wrong?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Yes, so I was just reiterating our existing plans which are getting up to 9.5% and then floating that 9.5% down 50BPS a year. So I think you got that right. It's just we're focused on a short-term \$100mm. Just want to reiterate that our long-term plans are to bring that down over time.

Chris M. Harris

Analyst, Wells Fargo Securities LLC

Q

Okay, so you can't – like in a year, you can't go back to the regulators and say, hey, can we do more than \$100mm. You're going to go with this plan for the next few years and then kind of reassess at that point?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Well, I think it's incumbent upon us to continue to execute on all the things that are important to improve our financial health. So I think if we continue to do that, then we'll be in a position where we'd feel comfortable even asking to bring that down, so I think that's the core. I just wanted to make sure that we reiterate that our long-term target would be to come down to 8%, but I think it's back to we need to execute well, improve our financial health, and the dividends will take of themselves.

Howard H. Chen

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Matt, when you speak to the Susquehanna order execution arrangement being relatively immaterial, what's the right base to think about that. If we annualize this quarter's principal transaction revenues, that's \$50mm; but if you annualize H1, that's \$85mm and it's a fairly wide bid/ask spread. Just wanted to kind of touch base on it.

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Yes. So this quarter's principal transactions were fairly low. So, I think if you look at, the average YTD, at least for the nine months you're at \$56mm. So I think a good range is in the \$60mm to \$70mm of principal transactions. Keeping in mind that the margins on this business bounce around, but historically they've been in the 10% to 20% range, probably closer to 10% today, right. So that's the net economics that we would be losing, if you will, to sale and I think the economics of the order flow agreement would somewhat offset that, bringing it to a place where we're comfortable the impact would be immaterial.

Howard H. Chen

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

And what do you assume for DART levels and how much variability can there be in that negotiated rate?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Well, there can definitely be variability, so I think there are no specific assumptions around DART levels. I think if you just look at the volumes that we have today, the net impact would be immaterial.

Howard H. Chen

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Okay, and then my follow-up. On the core brokerage franchise, your net new asset picture continues to improve nicely. Was just hoping, if you drill down into that, could you give us an update on that what you're seeing in [ph] TOA (32:45) data and how that maybe compares to a year ago for the franchise? Thanks.

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Yes. Sure, Howard. There's nothing new. I think the broad trend of assets and customers moving from the offline space to the online space is what we continue to see. There is always puts and takes within our space amongst our direct competitors, but I think the long-term trend of getting assets from that space simply continues.

Michael R. Carrier

Analyst, Bank of America Merrill Lynch

Q

Just on the net interest income, you gave updated guidance on the net interest margin or the spread. Just on the interest earning assets, we saw some growth this quarter. So when you think about customer cash coming in, managing the capital ratios, how should we think about the growth of the balance sheet vs. what we have seen is it being relatively stable?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Yes, we had a bunch of growth this quarter. I think it's tough to tell. I mean the government shutdown activities I don't think helped as you saw a lot of customers move cash to the sidelines. We had customer net selling in the quarter of \$700mm which puts more cash on the balance sheet. And looking at the three quarters preceding that, we had customer net buying every quarter. So it's hard to predict, Mike. But I think that is absolutely the item that we always look at when we're focused on, are we comfortable with our capital ratios. I don't get overly concerned with small increases like we saw this quarter. I think at 9.49% it's not as if we have a problem with our capital ratio and at 9.50% we're okay. But if you had a meaningful increase in customer cash that really put pressure on the leverage ratio, we'd be looking to do something about that on the deleveraging front, but what I saw this quarter doesn't give me that concern.

Michael R. Carrier

Analyst, Bank of America Merrill Lynch

Q

Okay, thanks. And then just a follow-up, kind of just like two random things, but just on the principal transactions, seems like that decline was pretty significant. I think the revenue capture was down. Just any color on what drove that? And then on the share count just noticed the creep this quarter, could be just the stock price, but just wanted to figure out if it was any of the new hires, just what the outlook was there?

Paul Thomas Idzik

*Chief Executive Officer & Director, E*TRADE Financial Corp.*

A

Yes, so on the share count, are you looking at the diluted increase?

Michael R. Carrier

Analyst, Bank of America Merrill Lynch

Q

Yes.

Paul Thomas Idzik

*Chief Executive Officer & Director, E*TRADE Financial Corp.*

A

It was just we were – I always hate when you ask that because then I have to answer it with it's because we lost money last quarter, so whenever you lose money actually the basic and diluted are the same, with the goodwill write-down last quarter, so just return to profitability you go back to the actual diluted share count, so nothing going on really other than that. The principal transactions are definitely down. If you look at the trend, this was the lowest quarter that we had in quite some time. Volumes were down, both volumes from our own broker dealers as well as our internal volumes. Volatility is at historically low levels even last quarter. Went even lower this quarter. And then if I look at the individual months, which aren't in the release, but if I look at the individual months, July and August were relatively normal. September was just a low month. What we've seen so far in October is an improvement back up. So I think I would put in the bucket, just volumes are really low, volatility is really low, and it drove down principal transactions for the quarter.

Devin P. Ryan

Analyst, JMP Securities LLC

Q

Appreciate the color on the margin expectations. Can you remind us on the timing and how long it takes to essentially the loans rolling off or paying down, the ability to reinvest those assets in the securities portfolio, how long does that take? And then I guess with interest rates being volatile, how much market timing is involved with essentially putting that cash into the securities portfolio?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

A

Yes. So I mean it's not a lot of time. We are investing and looking at our cash balances investments on a daily basis. I think it's fair to say that we're very sophisticated in delivering in what we are doing and what we are buying. So we are not immediately just taking cash and buying anything that's out there. It's fairly deliberate, but I don't have any more precision for you beyond that other than we have a very sophisticated focused treasury group that works on this.

Devin P. Ryan

Analyst, JMP Securities LLC

Q

Okay. Thank you. And then if you were to bring some of the deposits back on the balance sheet in the future as discussed, what would the timing of that look like, in terms of if you decided to do it, how long will it take to actually do it? And I'm just thinking about the contracts and how long these deposits are contractually tied up?

Matthew J. Audette

Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.

A

Sure. So we probably get the deposits off-balance sheet in two primary buckets. The simplest bucket to bring back on are the deposits that are at third-party banks, and those agreements have typical notice periods in the 90-day period. So it wouldn't be a long period of time to bring them back. The other funds that went off-balance sheet are in-money funds. That would certainly take longer. There's customer notification and consent period that are applicable there, so that would take longer, but there is a fair bit of those deposits we could do in 90 days.

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