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E*TRADE Financial Corp. *(ETFC)*

Q1 2013 Earnings Call

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Joel M. Jeffrey
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MANAGEMENT DISCUSSION SECTION

GAAP AND NON-GAAP FINANCIAL MEASURES

- During the call, the company may also discuss non-GAAP financial measures
- For a reconciliation of the 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
- All of these documents are available at investor.etrade.com

Paul T. Idzik
*Chief Executive Officer, E*TRADE Financial Corp.*

BUSINESS HIGHLIGHTS

Opening Remarks

- It's a pleasure to be here speaking with you

- I've come to learn a lot over the last three months, and I'm pleased to share my thoughts on the quarter and the company with you
- To begin, I want to make my mission here clear, which includes three things
    - First, to ruthlessly execute on the financial and capital plan laid out by management and the board nearly one year ago
    - Second, to refine and intensify our focus within the brokerage franchise, to drive a superior customer experience
    - And third, to maximize value for our owners
- As for how I am spending my time, I'm focused on gaining a deep understanding of what my colleagues do across the business and how it impacts our customers and our profitability
- And learning everything I can about the company and, what I believe to be, significant opportunities to improve customer engagement and satisfaction

Management Departures

- Now, my first quarter here was a busy one, and I'd like to address the more provocative items up front, including the handful of management and board departures, and the final sale of stock by our largest shareholder for the better part of five years
- On management departures, ensuring we have the right leadership team in place is a critical priority of mine, so I have been accordingly focused on reviewing the composition, roles and responsibilities of the executive committee, since I arrived

NEW MARKETING LEADER

- First, consistent with the company's and my own philosophy to drive efficiency, I made the decision to eliminate the role of Chief Technology and Operations Officer
- We are now in the midst of better aligning these functions to enhance the customer experience and get the most from each dollar spent
- On the marketing side, our team has done a good job creating compelling advertising and building brand awareness
    - However, given the current stage of the company's evolution, I saw a need for a much sharper focus in our customer and prospect marketing, specifically, more analytical decision-making and less emphasis on blanket advertising
- Accordingly, I am in the process of searching for a new marketing leader
- I've seen a number of impressive candidates thus far, and hope to make an announcement in the near future
- I also made an addition to the team during the quarter, bringing in an experienced, long-standing colleague of mine, Mike Foley
    - Mike is leading the tech infrastructure and operations functions, as well as overseeing the marketing organization, pending the completion of our search
- Mike also brings a highly professional approach to project management, which is important at E*TRADE, given the many initiatives and projects underlying the successful execution of our operational strategy, and our continued success in serving our customers overall

Executive Appointment

- At the board level, we have three current members who have let us know that they do not wish to stand for re-election at the Annual Meeting on the May 9

- The first is our Chairman, Frank Petrilli, who has been a board member since January 2012, and served as Interim CEO for nearly six of those months
- Frank's decision relates to his other business and personal obligations
    - He leaves the Chairman position in capable hands with Rodger Lawson slated to assume the role
- Rodger has been a board member since February of 2012, served as Lead Independent Director during Frank's tenure as Interim CEO, and brings a wealth of relevant industry experience, through prior roles at Fidelity and Prudential
- I've been working closely with Rodger and I am confident that his capabilities and judgment will serve our board and our shareholders well

INVESTMENTS

- Another valued board member, Ron Fisher, who has been with the company since 2000 has decided to leave based on his increased responsibilities in his full-time job as President of SoftBank
- Ron's professionalism and insight will be missed
- Finally, Ken Griffin, founder and CEO of Citadel
- Ken has decided not to stand for re-election following the final sale of his company's investment in E*TRADE
    - Since late 2007, Citadel has been our largest investor, and Ken has served on the board since 2009
- Citadel, and Ken specifically, played a critical role in recapitalizing the company in both 2000 and again in 2009
- I will very much miss Ken's counsel, drive and insight on our board
- On behalf of the board and management, I'd like to personally thank each one of these individuals for their commitments and contributions through the years

Q1 RESULTS

Capital Generation and Deleveraging

- Now, moving on to the business and our results
- Aside from some minor perturbations in the results, it was a decent quarter from a core business perspective
- We posted a profit of $35mm, or $0.12 per share, and encouragingly recorded solid client metrics
- Matthew will provide more detail on the financials, but to highlight one bright spot, as a result of capital generation and deleveraging, the bank's Tier 1 leverage ratio ended the quarter at 9.3%, just 20BPS shy of the objective in our capital plan, with three quarters of the year yet to go

Core Retail Franchise

- With respect to our core retail franchise, we helped clients re-engage in a slightly more meaningful way this quarter, as DARTs of 149,000 were up 16% sequentially
- April to-date, we are seeing a slight pullback, with DARTs tracking down 5% from Q1 levels, though up 1% from March
    - While retail investors across the industry remain understandably cautious, we are pleased with the activity we've seen thus far

Net New Brokerage Assets

- Derivatives continue to be an important component of how our customers engage with the markets, and during the quarter, options represented 24% of our DARTs, up slightly from a year ago
- Net new brokerage assets for the quarter were a healthy $3.1B, representing an annualized growth rate of over 7%

Financial Consultant Network

- We brought in 30,000 net new brokerage accounts, which is off the pace of 46,000 in the same quarter last year
    - While growing accounts is obviously core to our success in the brokerage business, the quality of these new accounts is of even greater importance
- Our financial consultant network of approximately 270 professionals is key to that quality growth, as they were responsible for about 35% of our net new assets
- As a reminder, the accounts brought in through our FCs tend to be over 5 times larger than those acquired through our other channels
- Beyond bringing new accounts on board, importantly we also are doing a better job of retaining those accounts
    - With 8.5% annualized brokerage attrition in Q1, we posted an improvement of a 130BPS from the prior quarter, and a 50BPS improvement from the full year 2012

Customer Offering

- Deepening our relationship with our customers, through better service or assignment to an FC proves critical to doing more to help our customers, and in doing so, drive value for our shareholders
- We made a series of upgrades to our customer offering during the quarter, enhancing our customer education and research resources, introducing thematic-based investing tools, and significantly bolstering our already-powerful active trader platform
    - We also hosted our Second Annual Retirement Education Day in New York followed by events at each of our 30 branches, all with noteworthy attendance

iPhone and Android Platforms

- With customers increasingly disconnecting from desktop computing, our mobile platforms are an important component to fit customers' lifestyles
- Within our seven platforms offered, we launched a revamped tablet experience, and enhanced our iPhone and Android platforms during the quarter, adding useful tools like mobile bill pay, and access to index futures. giving customers better insight into the markets outside of traditional trading hours
- Our mobile trades this quarter grew to over 7% of our DARTs, up from just under 6% a year ago
    - Continually innovating and upgrading our industry-leading active trader platform E*TRADE Pro is core to maintaining our competitive edge
- Recently, we significantly enhanced its capabilities with the integration of futures trading, allowing us to provide customers with a much more streamlined futures trading experience

Retirement and Investing

- Within retirement and investing, we continue to make progress as we gain traction with enhanced brand awareness and new and expanded products and services
- We ended the quarter with $37B in retirement assets, an all-time high for the firm, and inclusive of $15B of rollover assets
- Net rollover flows for the quarter were $400mm, up 8% from the year-ago quarter

Internal Targets

- Slightly more than three years after our launch, we are well ahead of our internal targets for growth in managed products
- We ended the quarter with $1.6B in managed accounts, a 24% increase from the prior quarter and an 83% increase from the year-ago quarter
- We are encouraged here and are working on ways to accelerate this growth
    - We have been hiding our capabilities here a bit under a bushel
- As we do a great job for our customers and tell our story a bit better, I see some real potential for growth in these areas, along with helping our customers strengthen their financial health

SUMMARY

- So, in summary, it was a busy first quarter for me on the job
- I'm pleased with the changes we've made to-date and the direction this company is headed
- I look forward to updating you next quarter as I continue to gain traction across the firm, with our customers, and with our owners

Matthew J. Audette

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

FINANCIAL HIGHLIGHTS

Net Income

- For Q1, we reported net income of $35mm, or $0.12 per share
- Our results included a couple of noteworthy items, which collectively did not impact our bottom-line results
- They are:
    - $13mm benefit to provision for loan losses from a settlement with a third-party mortgage originator
    - And restructuring and other severance-related costs of $12mm, attributable to the company's cost reduction program and executive terminations

Net Revenues

- Our first quarter net revenues were $420mm, down from $468mm in the prior quarter, which included deleveraging-related gains, and $489mm in the year-ago quarter

- Revenues included net interest income of $241mm, a 7% sequential decline as a result of 8BPS of net interest spread compression, as well as $2B reduction in the average balance sheet size
- The decline in our spread this quarter was driven primarily by the continued run off of our loan portfolio and reinvestment into lower yielding securities, as well as a slight increase in prepayment speeds on the securities portfolio

Liabilities

- On the liabilities side, our cost of funding increased 3BPS in the quarter, driven by an increase in FHLB funding costs, related to the deleveraging actions we completed in Q4
- Going forward, we expect FHLB funding rates to be roughly in line with this quarter
  - We continue to expect our average net interest spread in 2013 to decline approximately 10BPS from 2012's average, implying a full year spread of slightly below 230BPS
- I would also highlight that our Q1 results do not include the full impact of our deleveraging actions completed during the quarter
- The majority of planned deleveraging is behind us, so there should be little in the way of proactive balance sheet reduction in H2 this year

AVERAGE COMMISSION PER TRADE

- Commissions, fees and service charges, principal transactions, and other revenue in Q1 were $164mm, up 8% from the prior quarter and down 5% from the same quarter of 2012
- Average commission per trade was $11.30, up from $11.10 last quarter, largely as a result of an increase in the number of stock plan trades, along with a more favorable customer mix, as a smaller portion of trades came from active traders
- Principal transactions revenue was down sequentially, as a result of mix and the lowest levels of market volatility we have seen since late 2006

Deleveraging

- Revenue in this quarter also included $15mm of net gains on loans and securities, down from $56mm in the prior quarter, which included deleveraging-related gains
- Historically, gains have been in the range of $25mm to $35mm per quarter
- Going forward, we expect them to be in the $10mm to $15mm range per quarter
  - However, while this is our expectation today, this range can be materially impacted by the interest rate environment, and any deleveraging needs

Legacy Loan Portfolio

- Our legacy loan portfolio ended the quarter at $10B, a contraction of approximately $500mm during the quarter, and it is now down 69% from its peak
- We expect loan runoff to average approximately $400mm per quarter for the rest of 2013, generally consistent with the 4% to 5% quarterly decline we have experienced for some time
  - This quarter's provision for loan losses was $43mm, including $13mm benefit from a settlement related to loans purchased from a third-party mortgage originator
- Since 2008, we have actively pursued these types of settlements, amounting to approximately $420mm to-date

Net Charge-Offs

- Excluding the benefit from this settlement, provision was $56mm, down from $74mm last quarter, relating primarily to lower charge-offs in the quarter
- For the remainder of this year, barring any unforeseen external disruptions, we expect quarterly provision expense to be in the range of $50mm to $70mm
    - However, I must emphasize the nature of the quarterly provision is inherently uncertain
- So this range, while our best estimate today, could vary meaningfully
- Total net charge-offs in the quarter were $68mm, down from $102mm in the prior quarter, and again benefitted from the $13mm settlement
- Delinquencies in the quarter were down 9% sequentially in the 30 day to 89 day category, reversing the seasonal increase we saw in Q4
    - The total allowance for loan losses ended the quarter at $455mm, down $26mm from last quarter, and inclusive of $148mm specific reserve for modified loans

Modified Loans

- Our coverage remains relatively constant for non-modified loans with this quarter's allowance covering 80% of loans at least 90 days past due
- This compares to 76% last quarter
- For modified loans, our total expected losses decreased from 37% in the prior quarter to 35% as of March 31

HELOC Portfolio

- During the quarter, we modified $34mm of loans, down from $44mm in the prior quarter, and again representing the lowest quarterly level of modifications since we began the program in 2009
- We expect modifications to remain at low levels over the near-term
    - However, we are monitoring the HELOC book closely, with a focus on loans that are not yet amortizing
- Once those loans do convert to amortizing, modification is one of the tools we could use as part of our overall loss mitigation strategy
- And I realize this topic has been an area of focus for many of you
- As we have indicated in past presentations, these conversions will not take place in a material way until 2015 and beyond
- Of our $3.2B HELOC portfolio, 26% are scheduled to convert in 2015, with an additional 40% in 2016

Principal Balance

- I would remind you that our average loan size is $75,000, and that during all of 2012 we saw annual voluntary principal reductions of at least $500 from 40% of our borrowers
- And approximately half of those borrowers, or 20% of the total, reduced their principal balance by at least $2,500 during 2012
    - So this portfolio continues to shrink as a result of these paydowns as well as charge-offs, so at the point when these begin to amortize in a material way, we expect the balances to be smaller than they are today

De-Risking and De-Leveraging

- Moving on, as we continue to focus on de-risking and de-leveraging, we took additional steps this quarter to clean up our balance sheet
- We sold approximately $230mm of non-agency CMOs, from a legacy portfolio that has reduced in size from $1.8B at its peak in 2007 to just $14mm today
    - We are also planning to sell approximately $30mm of credit card loans that resided within the consumer and other portfolio
- We expect the sale to close later in the year
- Individually, these steps may not appear to be significant; however, taken together, they represent solid progress on our strategy to de-risk the bank

Expense Reduction Efforts

- Operating expenses for the quarter were $296mm, including $12mm of severance and restructuring-related charges
- And to update you on the status of our expense reduction efforts and the build out of our Enterprise Risk Management capabilities, through Q1, we have implemented 85% of our targeted $110mm in cost saves
    - Additionally, we continue to expect our ongoing investment in ERM to total approximately $10mm annually
- Consistent with our plan, we expect the full $100mm in net savings to be included in our run-rate in Q1 2014
- For the remainder of 2013, keeping in mind that seasonality and market volumes can impact individual quarters, we expect our expense run-rate to be in the range of $265mm to $280mm

Corporate Cash

- Turning to corporate cash, we ended the quarter at $352mm, a decline of $56mm from year-end levels, related predominantly to seasonal compensation-related uses, in addition to other intercompany allocations
- For the remaining quarters of this year, we expect corporate cash to decline in line with our debt servicing costs, though there can be noise in the individual quarters related to tax settlements and other intercompany allocations
- I'd also point out that our current level of corporate cash represents approximately three years' worth of debt service coverage

Capital Ratios

- Our capital ratios improved at the bank across all measures during the quarter, with our Tier 1 leverage ratio ending the quarter at 9.3%, up 60BPS from last quarter's and within striking distance of our 9.5% target
- For all other bank risk-based ratios, we were between 20% and 22%, well in excess of regulatory minimums
- At the parent, our ratios increased across the board as well
    - We ended the quarter with a Tier 1 leverage ratio of 6%, up 50BPS from the prior quarter
- Our risk-based measures at the parent are between 11% and 15%, again, well in excess of regulatory minimums

Parent Tier 1 Common Ratio

- Our parent Tier 1 common ratio ended the quarter at 11.2%, and we estimate it would be approximately 100BPS higher under the current Basel III proposed guidelines

TruPS

- One more note on consolidated capital ratios, a yet-to-be-enacted element of capital reform, outlined under Dodd-Frank, includes the ultimate exclusion of trust preferred securities from Tier 1 capital
- Initial guidance required companies to phase out TruPS from inclusion in capital, from the beginning of 2013 to 2016, with a quarter of the balance coming out each year
    - These changes have not yet been enacted by the regulators
- So this transition out of capital has yet to begin
- So we are still including 100% of our $433mm of TruPS in our parent capital calculations
- Had this phase-out begun in Q1, it would have reduced our parent Tier 1 leverage ratio by 30BPS, to 5.7% at quarter-end

Capital Plan

- Moving to progress on our capital plan, we have now completed the majority of our deleveraging actions, which, in conjunction with earnings generation, have been integral to our efforts to bolster our bank leverage ratio, with a focus on exceeding our target of 9.5%
- During Q1, we completed $3.0B of deleveraging, which consists of; $2.3B in sweep deposits transferred off-balance sheet; $600mm of new customer cash directed to money funds
    - And $100mm of customer payables converted into money funds

MONEY FUNDS

- We have another $500mm of sweep deposits scheduled to transfer off-balance sheet this month
- In total, this brings us to $8.4B, just shy of our stated goal of $8.5B
- Accordingly, we do not have any additional plans to deleverage beyond continuing to direct new customer cash to money funds
    - However, it is important to keep in mind that customer activity is the great unknown when it comes to forecasting balance sheet size
- So, in the event that customer net selling leaves us with the need to reduce assets further, we do have additional actions we can take
- Therefore, we are confident in our ability to exceed the target of 9.5% Tier 1 leverage at the bank, which is a central component of our capital plan

Core Business

- In closing, in addition to the healthy results in our core business, we are quite satisfied with the progress made on our capital plan
- De-risking, de-leveraging, implementing enhanced enterprise risk management capabilities, cutting costs, and improving our key capital ratios, are all critical to achieving the objectives laid out in our strategic plan, and were all areas where we made good progress during the quarter

QUESTION AND ANSWER SECTION

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP

Q

So, I guess the first question, given that you're tracking so well on the Tier 1 leverage ratio, the de-leveraging plans, cost cutting, so if you get there earlier than say year-end, could you accelerate the request through the regulators to upstream capital?

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

A

So, Rich, so the leverage ratio is the most visible and measurable component of our plan, but just keep in mind there are lots of other things that we're working on, right. We've got to continue to build out the enterprise risk management framework. We've got to finish the cost cutting. We've got to continue to improve our earnings, de-risk the bank, so there's lots of things that we need to do to get to a point where we're comfortable making that request and where I think the regulators would be comfortable receiving that request, so our plans are just the same, Rich, towards the end of this year.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP

Q

You wouldn't say that in these other areas, besides the visible Tier 1 lever – that you're ahead of plan as well?

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

A

Well, I'd say I feel good about what we're working on. I think the capital ratios are very quantitative so you can see exactly where you are. I mean, these – a lot of these other areas are subjective. So we know what's important to work on. But we have to complete them. We have to implement them, we have to track how they're going. So I'd say in general, we are on track.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP

Q

Okay. And Paul, I guess, getting your views as a relative newcomer, but now three months, you made some quick decisions or big decisions. So, I guess, the question is, as you look at the firm now, what's your view on both risk management and the cost saves? I don't expect you to update targets on cost saves, but do you think it's – from the beginning when you took over to now, are they easily achievable or – as well as the overall risk management process at the firm?

Paul T. Idzik
*Chief Executive Officer, E*TRADE Financial Corp.*

A

I'd say on cost saves those things are never easy because it always in a firm like us involves taking action with individuals and that's always difficult. But we've communicated the process and where we are to our employees and we're very confident. We've achieved 85%. We've communicated the actions that are going to take us over the top on the rest. So, I'm feeling very good about the cost reduction.

With regard to the risk management, we clearly had some work to do. I feel very good about the progress to-date. My opinion, while very important, needs to be paired up with the opinion of the regulators and we'll continue to work with them to improve what we do on the risk management front. But I think we've made a lot of progress in the last year, and certainly I have seen a lot of progress in the three months I am here. And importantly what I'm seeing is many, many more of my colleagues actively involved in putting that front and center of what they do as they try to help – as they try and help customers. Sorry, Rich, was a little long there, but I feel good about both those areas.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP

Q

Thank you. And one last quick thing, Matt. On the bank loans, the gain or loss on loans to go – essentially it looks like you're cutting the gain run rate in half. And I guess, could you give us a little bit more color on the [ph] change (27:13)? I know the interest rate environment plays a big – but that seems like an abrupt thing that is going to impact the models here?

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

A

Sure, Rich. I thing we've – I've tried to long indicate over the long term we would expect gains to come down. I think when you look at the last six months, meaning H2 2012, we had a lot of deleveraging going on, and planning for some of the deleveraging that we're going to be – do this quarter, so you had a lot of activity there. I think now that most of the deleveraging is done, the gain on sale is going to come down with respect to that. But keep in mind of course that that rate can change based on any additional deleveraging needs and changes in the interest rate environment. But where we sit right now, 10% to 15% is how we view it per quarter going forward.

Howard H. Chen
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Matt, I'm having a little difficulty reconciling the $260mm to $280mm expense run rate guidance with continuing to realize and make steady progress at the $100mm net savings plan over the course of the year. Can you help kind of square those two items up?

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

A

Sure, Howard. So, looking at Q1, a few things to keep in mind; first, you've got the $12mm of severance and restructuring related costs in there; second, Q1 is seasonally our highest quarter. So if you just look at our marketing expenses, right, where our expectation is to spend $30mm less in 2013 than 2012, which would put us at a total spend for the year in the – roughly the $110mm range. And we spent – our biggest quarter is going to be Q1, right? So the quarters for the rest of the year are going to be much smaller. Compensation and benefits, Q1 is seasonally the highest quarter on comp and ben, right? You've got the benefit expenses, taxes start over, people take a lot less vacation, so it's just a seasonally high quarter. So, when you factor those things out, that's kind of where the range comes from, Howard, and I think hopefully when you write those down, it should make sense.

Howard H. Chen
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Right. Maybe just to walk through it, because I must be missing something. But if I strip out that $12mm of severance and restructuring for this quarter, and you just run it at the midpoint of the $260mm to $280mm, you get just shy of $1.1B of expenses and that's call it down $50mm from the beginning point of when you announced that $100mm net plan. So, I guess, that's where I'm having difficulty bridging the gap.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Yes. So if you just do that, Howard, you've got comp – you're annualizing comp and ben which is – for Q1 is typically high and the same thing with marketing, right? We've got $37mm of marketing and we plan to spend around $110mm for the whole year, right? So those things are going to come down later in the year.

Howard H. Chen
Analyst, Credit Suisse Securities (USA) LLC (Broker)
Q

Okay. All right. Thanks. And then, just a quick – another numbers question. The $4mm of equity income on investments this quarter, what's the nature of that and what's the outlook for just future contributions there?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So the outlook's pretty small, Howard. It is – if you go way back in the company's history, 10 plus years, we had some venture funds that we still have one of them left today and we update the value of that fund every quarter. It's typically very small in its noise. But we had some components in there that had big gains in the quarter, so it came from that venture fund. But if we were to see something like this in the future, I'd be surprised. I'd be pleasantly surprised, but I'd be surprised.

Howard H. Chen
Analyst, Credit Suisse Securities (USA) LLC (Broker)
Q

Okay. Just one clarification, is that mark up or harvesting?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Mark up.

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Just a quick question, in terms of the interest earning assets, I appreciate the color in terms of the efforts you're making on the deleveraging side but can you give us a sense for where the asset level ended the quarter?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

The interest earning assets?

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Yes.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Yeah. About $0.5B less than the average.

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay. Great. And then, just another – bit of a housekeeping question, in terms of the $12mm in severance and restructuring charges, how much of that was in the comp line and how much was in the restructuring line?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So the majority of the restructuring line was severance, right? So that's – $7.5mm was in restructuring. The majority of that was severance, so I'd say roughly $5mm of it was back in comp and ben.

Joel M. Jeffrey
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay. And then just lastly, I apologize if I missed this earlier, but the increase in the fees and service charge line, is that driven by higher payment for order flow or was there something else in there?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

So the biggest item in that category is payment for order flow. In general it should move in line with commissions and you saw it increase. So, that would be the main item.

Alexander Blostein
Analyst, Goldman Sachs & Co.
Q

I wanted to go back on the discussion for potentially getting some dividend out of the bank to the HoldCo and the regulatory approval process that you guys are going through. Paul, one of the things you mentioned is de-risking the bank. You guys are selling $30mm of credit card loans. Is that something that we should think about as more of a viable option for you guys in the current environment, where real estate prices are maybe a little bit better and maybe there's little more of a bid for riskier assets, for you to, I guess, de-risk the bank more aggressively by actually selling either the first liens or the home equity loans?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Alex, this is Matt. I'll take that one. The credit card loan was more of a tactical item similar to the CMO sales we did. When you go back to the loan portfolio we pay very close attention to the best way to maximize value for our shareholders on that portfolio, keeping it and managing it the way we have vs. if there's anything to do in the secondary market. So things are definitely improving overall. I think it's one of the reasons we saw provision come down. Home prices are going up which helps. But the dynamic, does it make more sense to sell it vs. keep it, hasn't changed, so our intention is to continue to do what we've been doing.

Alexander Blostein
Analyst, Goldman Sachs & Co.
Q

Got it. And then, I guess, along similar lines, you mentioned reserves and the provisions for the quarter. I guess, when we look at the first lien book, it looks like even after you adjust for the settlement, you guys still release some reserves in that book. Can you walk us through the rationale there?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Sure, Alex. I think from the allowance, we always focus on an overall. So keep in mind, charges-offs came down pretty much in line with what provisions coming down. I think that the majority or the vast majority of that settlement at $13mm was in the one-to-four book. But I think broadly when you look at the performance, even just looking at the charge-offs, the charge offs for the one-to-four book came down dramatically as well. So, I wouldn't focus on the individual bucket. I think it's more overall. And then keeping in mind the home equity book came down a little bit less as well. So, I don't think there's anything to that other than the settlement came into that line item.

Alexander Blostein Q
Analyst, Goldman Sachs & Co.

Okay. Yeah. I mean just even excluding the settlement, it's still an add back. That's why I didn't – it looks like allowance to total delinquencies has been coming down pretty progressively over the last few quarters, and I just wonder if house prices continue to recover, is that I guess, the area where we should see more relief on the provision side?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Oh, sure.

Alexander Blostein Q
Analyst, Goldman Sachs & Co.

I mean, it seems like that was the only difference, I guess, this quarter?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Yeah, so continued improvements in home prices would certainly benefit the one-to-four book, more than the home equity book, just because the home equity book is primarily a second lien vs. the one-to-four is going to be a first lien. So improvements in the collateral are going to help more in the one-to-four side, so that's certainly part of the dynamic.

Alexander Blostein Q
Analyst, Goldman Sachs & Co.

Got it. And then the last one from me, I just want to spend a second I guess, on the roll forward for net interest income, how we should think about, I guess, some of the rates. I guess one of the things you highlighted for a decline in the yields you guys earn in the securities portfolio is a pickup in prepay speeds. I find it a little surprising because given the fact that rates have come up during the quarter and I think generally what we've heard so far in the quarter that prepayments have slowed down, not the other way. So I guess, maybe you can help us understand how much of the drag the prepayments were in the quarter and whether or not that rate should, I guess, pick up a little bit as prepayments maybe continue to slow?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Sure. So it was, if you look at the overall spread, so 230BPS for the quarter. So the impact of those prepayments was about 5BPS, meaning if we didn't have them, it'd be around 235BPS. And then, if you look at the individual month, we primarily saw it in January and February. We did see a slowdown in March, but what we can see so far in April, it's continuing to slow down. So from what we see right now, we don't expect that prepayment pick up we saw in January, February to continue into Q2. So that's what we've seen so far.

Alexander Blostein
Analyst, Goldman Sachs & Co.
Q

Got it. So you should see a little bit of recovery there? And most of that is in held to maturity or available for sale?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

I'd look at – I'd view it as both books together.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Just wanted to actually keep on the NII and net interest spread, Matt, you mentioned that the full impact of deleveraging was not reflected in the spread. I'm just wondering what that would have been if it had been fully in place for the quarter?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Well, just going back to the earlier question on the ending interest earning assets, are about $500mm less than the average. And then we've got plans for another $500mm of deleveraging in the month of April. So those are the two things I would add to that.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Got it. But you would expect the spread to remain around the 230BPS that we saw reported for the quarter?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Well, I wouldn't comment on individual quarters. Our expectation for the year is to be slightly below 230BPS.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Got it.

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

I don't have precise numbers on me for Q2, Q3 and Q4 individually though.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

No, I was just asking for Q1, if it was fully implemented on deleveraging, but I guess – yeah, just on the outlook, I mean, obviously we've had a pretty material move in rates since the beginning of the year. That hasn't factored into the outlook for the full-year? Or it hasn't changed it materially?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

It has not. I mean, if you look at all the individual nuances that go into a yield – a spread forecast, things are always moving, but our overall view has not changed.

Keith A. Murray Q
Analyst, Nomura Securities International, Inc.

Can we spend a minute on the provision guidance? You talked about the $50mm to $70mm. I know obviously it's a wide range there. But should we be thinking about it – that provision should generally be getting close to matching net charge-offs?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

No. Not necessarily. I mean I don't have charge-off guidance for you other than the ultimate guidance of – as the loan portfolio ultimately disappears, the allowance itself is ultimately going to disappear. But I think from a – for 2013 perspective, the guidance is really just on provisions, so that's $50mm to $70mm.

Keith A. Murray Q
Analyst, Nomura Securities International, Inc.

Okay. And then, on the TruPS that you mentioned, if you were to call them or replace them, do you have a guess at this point if that would equate to savings on the interest expense side?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Well, I don't. I think it's more back in the bucket of what would we do with capital. If and when we get out of the bank at the parent, kind of thinking about the different uses for that capital, but that's not something that we can do today. So we'd look at what the best use of that capital was at that time and TruPS could be one of the things that we would look at or could look at.

Keith A. Murray Q
Analyst, Nomura Securities International, Inc.

Thanks. And then finally, if there is a potential for anymore settlements with other mortgage originators?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

There is potential but not much. I mean I think we're looking at a handful of things. I'd put them in the bucket of single-digit range from settlement purposes. So I'd say that largely our settlements are behind us. And if we have anything of size in the future, I think we would be pleasantly surprised by that.

Michael R. Carrier Q
Analyst, Bank of America Merrill Lynch

Just on the balance sheet, so if we look after Q2 and we get into H2, is your assumption until you get the regulatory approval to keep the balance sheet basically as is? I mean obviously it depends on what clients do, but you can offload some of that to third parties or money market funds in terms of cash, but in the near-term, kind of stick around on the current levels?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Yeah, Mike. I mean the customer activity is the big item that moves the size of the balance sheet. But as far as our expected deleveraging actions, we've got that $500mm planned for this month. And then, just continuing to direct new customer cash to money funds which is not a dramatic amount, but it'll be a small amount, so that's really all we have planned for now.

Michael R. Carrier Q
Analyst, Bank of America Merrill Lynch

Okay. Got it. And the – just on that provision, the $50mm to $70mm, it just seems like if we look over the past three years, credit quality continues to improve. The provision has declined pretty consistently over time. Obviously there's been kind of one-offs in there. But if we look at the adjusted provision for the quarter being around $56mm, it just seems like $50mm to $70mm, it seems a little bit on the high end. Is that like conservatism? Is it – you just don't know? Other things can pop up like they have in the past? It just seems like it's a little bit higher than just given where the credit trends are and just given where the current provision is?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

Well, a year from now, looking back, I hope you're right. But it is definitely our best estimate today. And if we go back two, three years, individual quarters, it definitely moves around. So it's – we're giving you the best information or best insight that we have at $50mm to $70mm.

Michael R. Carrier Q
Analyst, Bank of America Merrill Lynch

Okay. And Paul, just one thing, you mentioned some of the growth areas. Just anything, you know that – granted it's early and maybe we'll get more updates next quarter or the quarter after, but just any maybe one or two areas that kind of stand out where you feel like there's more opportunity just given who E*TRADE is, or your background that can drive some growth going forward?

Paul T. Idzik A
*Chief Executive Officer, E*TRADE Financial Corp.*

Yeah. I think there are two areas clearly where we're making good progress. One is in managed product where we're constructing products that provide the type of risk and return profile that our clients are finding attractive. And clearly, our overall investment product space is an area that we can absolutely continue to grow. And I would also say we have the opportunity to do more for existing customers across a number of products and I think we'll be looking to just continue increasing the intimacy with customers and therefore gaining a little greater share of what they're doing each day with us.

Brian B. Bedell Q
Analyst, International Strategy & Investment Group, Inc.

Can you just, just going back to the capital plan, if you do get to where you want to be by yearend, can you just outline, again, through the priorities of what you think you would do to deploy excess capital I guess between, as we said in the past, paying down debt over the two large tranches or probable in later 2014 and then 2015 vs. say a share buyback or paying down the wholesale borrowing?

Matthew J. Audette A
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*

So sure, Brian. So the wholesale borrowings I think is more of a bank capital thing. But I think once we have capital up at the parent, we would look at all those things. Right? Our guiding principle here is going to be within the best interests of our shareholders and also keeping in mind that we have – in addition to the OCC at the bank, we have a regulator at the parent called the Fed and they're certainly going to have a view and input on what we would do with capital at the parent, so we would just have to work through all those things at that time.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Great. You're just keeping it flexible at this stage. Is a share buyback a possibility?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

We look at everything, again, keeping in mind our regulator's input as well as what's in the best interest for the shareholders.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Okay. Great. And then on the – just on the principal transactions, the market-making business, are there any structural changes in your business there or is it really just a factor of market volume and as you mentioned volatility going forward for this year?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Yeah. Well, in the quarter it was definitely volatility, right. That was the big driver of a reduction of the revenues there, reducing principal transactions from down to that roughly $22mm for the quarter. I don't have a comment on the rest of the year just that was really the impact on Q1.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Okay. Great. And then just – and while we are on seasonality, obviously the stock plan business is very strong in Q1. Given your efforts on the growth side in bringing in relatively decent net new asset numbers, can you sort of comment on what your view is coming into Q2, whether we'll see any kind of negative seasonality comps vs. Q1 given this strong stock plan business or do you feel that you're making pretty good progress on the FC side that might offset that?

Matthew J. Audette
*Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.*
A

Well, Brian, we definitely – I mean Q1 is definitely the best quarter, the biggest quarter on the stock plan side, and then keeping in mind just on the asset side, the proceeds that come through stock plan we typically keep 35% after three months and 15% at the end of the year, so you're going to have a natural outflow later in the year, but that happens every year. So I think if you look at our historical, look at the past couple of years and just look at the trends that happened in individual quarters that's probably going to be the best guide there on what we would see for this coming year.

Brian B. Bedell
Analyst, International Strategy & Investment Group, Inc.
Q

Okay. Great. That's helpful. And then just lastly, a question for Paul. Just you mentioned obviously the growth opportunities. Can you talk about whether there is any interest in venturing into the RAA channel that Ameritrade

and Schwab and Fidelity are in or would you rather continue to focus on the advice and guidance and retirement planning segment investing incremental capital or incremental dollars in that area?

Paul T. Idzik
*Chief Executive Officer, E*TRADE Financial Corp.*

A

The RAA channel is something that this company has tried in the past and it didn't turn out well for our shareholders. And so that's unlikely to be anything that features in our future at least in the short term. We think we have a lot to offer by continuing to provide better tools for FCs, our existing FCs, so they can help our customers more, and adding FCs over time. So I think we don't have any intention of changing the model that we see is doing quite well for our customers and increasingly well for our shareholders.