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# E\*TRADE Financial Corp. (ETFC)

Q4 2014 Earnings Call

## CORPORATE PARTICIPANTS

Paul Thomas Idzik  
*Chief Executive Officer & Director*

Matthew J. Audette  
*Chief Financial Officer & Executive Vice President*

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## OTHER PARTICIPANTS

Richard H. Repetto  
*Sandler O'Neill & Partners LP*

Alexander V. Blostein  
*Goldman Sachs & Co.*

Steven J. Chubak  
*Nomura Securities International, Inc.*

Michael R. Carrier  
*Bank of America Merrill Lynch*

Chris M. Harris  
*Wells Fargo Securities LLC*

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*JMP Securities LLC*

Chris J. Allen  
*Evercore Partners (Securities)*

Brian B. Bedell  
*Deutsche Bank Securities, Inc.*

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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 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-K's, 10-Q's and other documents the company has filed with the SEC
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Paul Thomas Idzik  
*Chief Executive Officer & Director*

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## BUSINESS HIGHLIGHTS

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### Opening Remarks

- It is truly a pleasure to be joining you to share our perspectives on E\*TRADE's performance and progress in 2014
- This was a momentous year for E\*TRADE, one in which we benefited from a more focused organization and reshaped our brand, both to better connect with our customers
- A year of sustained operation under a significantly upgraded risk management framework, ensuring we executed deliberately and with the right controls
- And even more striking, all our accomplishments are buoyed by the strong financial position and regulatory standing we've had in years, leading to consistent delivery on our capital plan and value creation for our shareholders while positioning us to create even more in the future

### Leverage Ratio

- Building on this momentum and on behalf of the board and my colleagues, I am incredibly proud to announce the most significant developments the company has seen in years with respect to capital efficiency and company structure
- To quickly summarize the announcements we made today, we received the go-ahead from our regulators to operate E\*TRADE Bank at a leverage ratio of 9% and to remove our broker dealers from under the bank, placing them closer to the parent, enabling us to distribute to the parent excess capital of approximately \$430 mm
  - We will cover these items in more detail shortly

### Key Highlights

- Now back to 2014 and a quick walk-through of our key highlights
- During the year, we posted our strongest bottom line results since 2006
  - Saw record customer engagement across a host of metrics, particularly in asset and account growth
  - Evolved the public face of E\*TRADE with a revamped brand platform
  - Enhanced the digital experience for our customers
  - Seized opportunities to eliminate asymmetric risks by selling legacy assets and a non-core business
  - Navigated our first required stress test submission with satisfying results and feedback
  - Received regulatory approval for consistent quarterly capital distributions from our bank
  - And paid down corporate debt with cash for the first time in the company's history
    - This is a distinguished list of achievements and I cannot thank my colleagues enough for their hard work this year

### Operating Structure

- When I began two years ago we went to great lengths to realign our internal operating structure to empower colleagues to execute more effectively
- We then took a hard look at our processes to see what we could improve
- During 2014 we were well into implementation, and we are just starting to see the benefits of increased rigor, improved connectivity across the firm, and the upgraded quality of our delivery, all centering on a

resolute drive in everything we do results in improvements to the customer and drives long-term value for our owners

- With these many internal changes, we are well positioned to deliver the industry-leading products and top-notch services our customers deserve
- We're just beginning to see this culture impact our results and look forward to more fully witnessing the product of our labors in the coming years

#### ETRADE.COM

- You've heard me talk a lot about our commitment to reclaim our disruptive digital roots
- In pursuit of this goal, we've also realigned our technology development to be more intricately woven into the fabric of our entire organization
- Our technologists now work more seamlessly across the company to wipe out customer pain points and deliver innovative products backed by more rigorous and robust design and testing
- As a result, this quarter caps a year of significant additions and enhancements to the digital experience for our customers
- Most recently, we rolled out new customer navigation for etrade.com, delivering a more elegant and intuitive web experience
- We also further enhanced the mobile experience through added stock plan functionality, which builds on a year of impressive mobile advancements, including our iOS 8 app with first-to-market functionality, new ETF screeners and additional research tools and resources, just to name a few

#### Innovative Browser Trading App

- Our innovative browser trading app came out of beta this quarter, which delivers real-time quotes, research and trade execution at any webpage being browsed
- This follows the year in which we enhanced our online advisor and fixed income solution center, added more functionality to our elite trading platform, E\*TRADE Pro, and launched back-end enhancements allowing us to be more nimble with deliver of web content
  - These efforts, atop our already strong offerings, resulted in external recognition throughout the year across a number of renowned publications
- We received a four-star rating from Barron's and Best-In-Mobile from Kiplinger's
- StockBrokers.com awarded us number one ratings for mobile and client dashboards, along with five best-in-class ratings for customer service, investor education, research, mobile trading and new investors
  - We were named most improved in the industry by J.D.
- Power and given a number one rating for Client Satisfaction and Loyalty for the third consecutive year by industry critic Group Five for our stock plan management platform, Equity Edge Online

#### Digital-Centric Organization

- As a digital-centric organization, we devote significant time and energy to make sure we deliver an industry-leading mobile experience
- The accolades we have received attest to my colleagues' success in building a robust, digital mobile environment, which is only increasing importance across the industry
- About 12% of our trades came through our mobile app during Q4 and even more telling, over a quarter of customer log-ins occurred through this channel; proof that the future of personal finance is increasingly quite literally in the palm of our customers' hands

## NEW LEADERSHIP

- Our digital experience, however, is only one side of the E\*TRADE coin, as it's backed by personal support and expert guidance
- So, this year, we also enhanced the human experience, capitalizing on the new leadership in our corporate services division, customer service teams, financial consultants, sales and branches, and arming our front-line employees with better tools to meet our customers' wants and needs

## Q4 RESULTS

## Earnings and Debt Transaction

- Turning to our financial results, we recorded earnings of \$1.12 for the year, a net income of \$330mm, excluding \$59mm pre-tax charge related to our debt transaction in November
- Earnings benefited from increased customer engagement, low credit costs, and an elevated net interest spread
- Following Q1's multi-year high-end DARTs, trading activity held in well increasing 12% for the year inclusive of a 10% sequential increase in Q4
- Options continue to account for about 22% of trades in Q4, consistent with the full year mix
- Our customers' trading across other asset classes continues to be minimal, with futures accounting for 1.5% of trades and forex making up about 30BPS.

## Trading

- Trading in January to date is holding quite steady compared to December, currently up 3% thus far
  - While solid, not exactly the jump in activity we'd like to see at the start of the year as investors have remained somewhat sidelined in light of uncertainty around oil and major turbulence within European markets and currencies
- Another important indicator of customers' engagement with the market is margin receivables which reached record levels during the year and ended at \$7.7B, down from \$8.1B at the end of Q3
- The yield actually ticked up this quarter for the first time since 2011 as a result of the balances shifting to higher pricing tier accounts

## Net New Assets and Accounts

- In terms of bringing in net new assets and accounts, we added over 17,000 net new accounts in the quarter, bringing our full year total to 146,000, the highest in over a decade
- Meanwhile, attrition improved for the seventh consecutive year, albeit modestly to 8.7% from 8.8% and Q4 was consistent with the prior quarter at 9.1% annualized
- Net new assets of \$3.5B in Q4 brought our 2014 total to \$10.9B, yet another record and up from \$10.4B in each of the previous two years
- These numbers are encouraging and even more so when noted that one-third of our net new assets for the year are in retirement accounts
  - This is a strategically important area for us as we strive to do more for our customers across the full spectrum of their investing activity
- Building on our unbiased approach to investment products and investment solutions, we've had a lot of success growing our managed assets – which ended the year at \$3.1B, up a third from the end of 2013

- Moving on to expenses and investments in 2015, we intend to carry our momentum forward and continue investing in the business, as we've made a lot of progress and feel good about our continued prospects and related value generation

#### Investments

- Let's take a step back, the motive forces behind our investments are, first, our focus on the business and customer offering
- This includes everything from our back office to our marketing dollars
- We've done a lot in this category and I can tell you that we've benefitted tremendously from our attention here
  - We operate in a more deliberate manner, with more cross-collaboration, and more discipline across the business
- Along with our foundation, we are investing in customer-facing roles
- We continue to elevate the state of play of our service and sales organizations, while technology remains at the forefront of our effort
  - We also continue to spend opportunistically on marketing, environment permitting
- And, while we are clocking records across assets, accounts and margin, we have yet to truly yield benefits of our internal improvements here, but I feel sanguine about our prospects

#### LEGAL, RISK AND COMPLIANCE

- And the second category is far less elective, falling squarely in the table stakes category and that relates to the investments we've made in response to the heightened demands of today's regulatory and security environments
- Our spend in legal, risk and compliance alone for 2014 totaled approximately \$90mm, which is an increase of 50% from what we spent just two years prior
- And we expect that number to continue its rise into 2015 to upwards of \$100mm, certainly not insignificant, but absolutely necessary to progress with confidence in today's operating and regulatory landscape

#### Risk Management

- While these areas – legal, risk, and compliance are often lumped into the category of enterprise risk management, our broader efforts go beyond this level of spend and truly encapsulate the fact that risk is now engrained in everything we do across the company
- We have invested in risk management within all other departments of the firm, as well as our systems and technology related to risk
- Our headway in building out these areas has been paramount to our regulatory progress and was prerequisite to our ability to secure the approvals we announced today

#### Capital Plan

- Moving on to the capital plan and the jolly important announcements we made today, all of our progress de-risking the company and executing on the components of our plan culminated in significant approvals
  - First, we received regulatory approval to operate E\*TRADE Bank at a Tier 1 leverage ratio of 9% providing more opportunities for capital utilization, upon which Matthew will expand

- Second, our regulators approved our plans to simplify our legal entity structure removing our broker-dealer subsidiaries from under E\*TRADE Bank which more efficiently positions a source of earnings and capital

#### Dividend

- And in conjunction with these approvals, excess capital at the broker-dealers of approximately \$430mm will be distributed to the parent during Q1 2015
- Going forward the excess capital generated by these entities will also be available to the parent
- Separately, we plan to request a dividend of another \$75mm from the bank to the parent in Q1 and beginning in Q2, we will request quarterly dividends equal to the bank's net income, one quarter in arrears

#### E\*TRADE Bank

- For a brief history lesson, in 2009, as part of the company's efforts to shore up the bank's financial position, and with some logical regulatory encouragement, our introducing broker-dealer, E\*TRADE Securities, was moved under E\*TRADE Bank, where our clearing broker-dealer, E\*TRADE Clearing, already resided
  - This was done to ensure that the bank could stand on its own during a time of significant global stress
- Suffice it to say, our bank is now in a much healthier position, so with regulatory approval, we have taken the steps to remove both broker-dealers from under E\*TRADE Bank in order to create a more streamlined corporate structure

#### Brokerage Operations

- So what does this mean? The income, and therefore the capital generation from our brokerage operations will now be housed directly below our parent company greatly simplifying the movement of capital
- Moreover, given the explicit regulatory approval to operate the bank at a 9% Tier 1 leverage ratio, we have much greater flexibility to utilize bank capital generated above that threshold

#### Debt

- We are now faced with the high-quality challenge of what to do with this capital, and I assure you it is top of mind for us
- Reducing our debt by another \$400mm continues to be a priority of ours, though as you can imagine, we are evaluating the most appropriate uses beyond that
- Again, Matthew will update you more on the process

#### Capital

- A final note on the capital front, this year we received five full notch upgrades by our three credit ratings agencies, two of which occurred in conjunction with our November debt pay down and refinance
  - While we'd ultimately like to be investment grade, these upgrades are a sound testament to the progress we're making and the greatly improved health of the company

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## Management Team

- On the management team, I regret to announce that our Chief Marketing Officer, Liza Landsman has decided to leave the company to pursue other opportunities
- Liza was one of my first hires here and she made significant contributions during her tenure
- She revolutionized our approach to marketing turning what was historically an advertising-centric organization into a data-driven, analytical one that allows us to continue to make deeper and more meaningful connections with customers and prospects
- I'm sorry to see her go

## RISK OVERSIGHT COMMITTEE

- At the board level, we've made significant progress to round out and strengthen our director composition, introducing two talented individuals over the last few months
- Shelley Leibowitz and Jim Healy, both of whom sit on the Risk Oversight Committee
- Ms. Leibowitz has a deep history with information technology and most recently worked at the World Bank overseeing its product delivery infrastructure and managing its cybersecurity program
- Mr. Healy has 25 years of experience with the financial markets in investment banking at Credit Suisse, and as an economist at the International Monetary Fund
  - Both Shelley and Jim are exceptional managers of risk and seasoned operators in their respective fields
- With the addition of these two, and after bringing on a distinguished former Fed President in the past year, our board governance and support is stronger than ever with a depth of knowledge and expertise across all aspects of our business

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## CLOSING REMARKS

- In closing, I want to reiterate how proud I am of all the team and all that it accomplished in 2014
- As we enter 2015, we have the backbone in place to enhance our relationships with our customers and continue to grow the business
- I have every confidence that everything we have done to set up the business for executional excellence will continue to benefit our customers and our owners

## New Corporate Structure

- And I am particularly proud of our commitment to continuously improve our regulatory standing and all we have accomplished to bring us to a position of announcing some of the most significant progress we've made since the financial crisis
- The vote of confidence from our regulators and the improved capital efficiency in our new corporate structure underscore all that we have done to reduce and manage our legacy risks over the past several years, and to install and maintain enterprise risk management capabilities of which we are quite proud

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**Matthew J. Audette**

*Chief Financial Officer & Executive Vice President*

## FINANCIAL HIGHLIGHTS .....

## Performance

- 2014 truly a defining year for the company as we operationalized a very clear focus and path forward that was started in 2013
- From a financial standpoint – after laying out a plan less than three years ago, and executing on all the major components, we took yet another giant step forward with our announcements today

## Corporate Debt Transactions and Net Interest Income

- Our unwavering commitment to executing on that plan is quite literally paying dividends
- But before I get into that, I'd like to go over our results for the quarter and year
- We reported fourth quarter net income of \$78mm, or \$0.26 per share, excluding \$59mm pre-tax charge related to our corporate debt transactions
  - This compares to net income of \$86mm or \$0.29 per share in Q3, and net income of \$58mm or \$0.20 per share in the year-ago quarter
- Net revenues of \$461mm were up from \$440mm in the prior quarter and \$446mm in the year-ago quarter
- Revenue included net interest income of \$283mm – up \$14mm from the prior quarter, as net interest spread increased 15BPS and our average assets contracted \$400mm

## Stock Lending

- Our Q4 spread of 269BPS reflected an outsized benefit from stock lending and margin receivables
- On stock lending, while we are obviously thrilled with the results over the past couple of quarters, we have noted a big pullback in stock lending revenue toward the end of the quarter, which has continued into Q1
  - So, from where we sit today, stock loan yields are down meaningfully from Q4
- Margin receivables, on a similar note, which benefitted from record-high average balances and an uptick in yield during the quarter, declined toward the quarter-end and remain near those levels today

## Macro Environment

- The macro environment has also failed to cooperate with the unprecedented drop in oil prices, followed by a steep drop in interest rates – obviously having an impact on our marginal rates of reinvestment
- So while the environment in Q4 was quite beneficial to spread, the environment we find ourselves in today is much more challenging
- And if we assume this current environment holds, our net interest spread would decline to the low to mid \$240s million

## Balance Sheet

- Our balance sheet ended the quarter at \$45.5B, down \$0.3B from the prior quarter as a result of \$1.2B of customer net buying and \$240mm decline in wholesale funding
- The decline in wholesale funding was driven by a temporary funding need in Q3 related to customer activity, and rolled off during Q4 as planned
  - We have \$365mm of wholesale obligations expiring during 2015, all of which occur during Q2

- Commissions, fees and service charges, and other revenue in Q3 were \$172mm, up 6% from the prior quarter and up 8% from the year-ago quarter
- Average commission per trade of \$10.84 declined \$0.21 from the prior quarter and \$0.13 from the year-ago period
- The sequential decrease was primarily driven by our mix of options and stock plan trades

#### Fees and Service Charges Revenue

- Fees and service charges revenues of \$48mm included \$23mm of payment for order flow, compared with \$22mm in the prior quarter
- Net gains on loans and securities were \$6mm this quarter, down from \$8mm in the prior quarter
- Over the next few quarters, we expect gains to continue to be in our range of \$5mm to \$10mm, though if rates persist at their current low levels, gains would likely be at the high end of that range

#### Operating Expenses

- Our operating expenses for the quarter were \$294mm, up from \$277mm in the prior quarter, largely related to marketing and professional services
- In marketing, where we typically see a seasonal increase, we also spent dynamically as the environment permitted
- And in professional services, there was a mix of both increased hiring as well as some temporary project related engagements
  - So there is some room for this to decline going forward

#### Headcount

- For the full year 2015, we expect a low to mid single digit percent increase in full year 2015 expenses
- The increase is driven mostly by headcount as we hired throughout 2014 and will have the full year run rate in 2015
- It also includes a mid to high single digit increase in marketing, the area where we obviously maintain the most flexibility
  - However, with multi-year records in net new accounts and assets in 2014, we are feeling good about our returns on those dollars

#### Loan Portfolio

- The loan portfolio ended the quarter at \$6.4B, down \$320mm from the prior quarter
- This was again predominantly prepayments, while charge-offs remained minimal at just \$7mm
  - We expect quarterly runoff for 2015 to remain in the range of 4% to 5% per quarter

#### Loan Losses

- Provision for loan losses was \$10mm in Q4, flat with the prior quarter
- For all of 2014, our provision of \$36mm declined 75% from the prior year
- While that is tremendous improvement, I want to again reiterate that we expect provision to increase in 2015 and 2016, when the majority of our HELOCs are scheduled to convert to amortizing

- With that in mind, there is no change to our \$10mm to \$30mm per quarter range, but a bit more color on our expected timing with 2015 expected to be at the lower half of that range, and 2016 to be at the upper half
- Our allowance for loan losses ended the quarter at \$404mm, up marginally from the prior quarter
- Reserves for the 1-4 book remained stable at \$27mm, as charge-offs again netted to zero and the release of reserves abated, as we foreshadowed last quarter
- Meanwhile, the home equity allowance again inched upward, ending the quarter at \$367mm, \$7mm increase

#### Loan Portfolio

- One last point on the loan portfolio
- While CLTVs of both portfolios were unchanged from the prior quarter, at 79% for 1-4 family, and 92% for home equity, they trended downward during 2013 (sic) [2014], driven by an increase in home prices as well as voluntary principal reductions
- Now, with respect to progress on our capital plan, it was a busy year and we accomplished a tremendous amount
  - While I know you have heard this before, at least for now, I won't get tired of delivering the recap
- So to quickly hit the highlights
- We successfully cleared our first round of Dodd-Frank Act Stress Tests
- We reduced significant tail risk through actions taken on our legacy investments, including the sale of \$800mm of TDRs, the elimination of our remaining non-agency CMOs, and the early termination of \$100mm of wholesale funding
- We demonstrated the sustainability of our Enterprise Risk Management capabilities
  - We ended the year with a bank Tier 1 leverage ratio of 10.6%, even after dividenting a total of \$300mm from the bank to the parent
- And we put that capital to work with \$400mm reduction of corporate debt, in conjunction with \$540mm refinance at the lowest coupons in our company's history
- And we are certainly starting 2015 on a high note

#### Tier 1 Leverage Ratio

- As Mr. Idzik covered earlier, we are delighted to announce regulatory approval on one of the key components of our capital plan, operating the bank at a Tier 1 leverage ratio of 9.0%
  - Additionally, we received regulatory approval to move our broker-dealers out from under the bank which marks tremendous progress in achieving ongoing capital flexibility

#### Dividend

- And lastly, we plan to dividend to the parent excess capital in the broker-dealers of approximately \$430mm in Q1, taking yet another significant step toward putting capital to work for our shareholders
- With respect to the bank's Tier 1 leverage ratio, we ended the year at 10.6%
- Pro forma for the brokerage entity moves, it would be 9.2%, so still above our new 9% target

#### Broker-Dealer Entities

- Regarding the movement of our broker-dealer entities, post the financial crisis, we were left with a constraining legal entity structure, where our brokerage subsidiaries resided under our bank

- The planned realignment involves moving the two subsout from the bank in an effort to create a more streamlined and simplified legal entity structure:
  - E\*TRADE Securities, which was moved under the bank in 2009 to serve as a source of strength at a time when the bank needed it, will be moved in early February
- And E\*TRADE Clearing, which previously resided under the bank, will be moved later in the year

#### Bank Regulatory Approvals

- Under our old structure, this meant that substantially all of E\*TRADE's earnings were generated within the bank and were subject to bank regulatory approvals in order to extract the resulting capital
- Following this reorganization, a significant amount of capital generation will be within closer proximity to the parent
- To put this in context around dividends, our old methodology of \$75mm per quarter led to \$300mm in 2014 dividends to the parent
- Assuming our new structure had been implemented on January 1, 2014, we would have moved approximately \$225mm of earnings from the bank, along with approximately \$200mm of capital generation at the broker-dealers
- In total, this would have led to dividends of approximately \$425mm to the parent

#### Capital

- As for Q1, once E\*TRADE Securities is moved, we plan to dividend excess capital to the parent, which we estimate to be around \$430mm
- In Q1 2015, we also plan to request approval for another \$75mm
- And in Q2 2015, we will transition to our new methodology of requesting the full amount of the prior quarter's earnings from the bank, as well as distributing the excess capital generated at the broker-dealers

#### BASEL III

- Now with respect to capital calculations and the forthcoming implementation of BASEL III, we've spent a lot of time applying the U.S. final BASEL rules to our capital ratios and there are several items which meaningfully impact us
- A few of these we've highlighted previously
  - These include the phase-out of TRUPs from the parent capital which will have a negative impact, and changes to the risk weighting across our assets will result in net favorable impact to our ratios, predominantly driven by the way we risk weight margin receivables
- One additional impact we've identified is quite positive in that we will be able to include a much larger portion of our DTA in regulatory capital
  - While we still have not finalized the impact of these changes, we do expect a meaningful benefit to our capital ratios. And as a reminder, these rules became effective at the beginning of this year, so the impact will be reflected in our Q1 ratios

#### Capital Ratios

- One other item that impacted our capital ratios in 2014
- We benefited from exceptionally robust customer net buying activity of \$7.7B, which muted natural balance sheet growth
  - This is well above normalized levels, which are in the \$2B-\$3B range

- As we've mentioned in the past, customer activity-related growth is one element that can be challenging to control
- To address this, we are in the process of redesigning our program that sweeps balances to third party banks that will enable us to manage the size of our balance sheet with greater precision while staying in tune with the quality of the customer experience
  - We expect it to be up and running in the coming months

#### Cash and Dividend

- With regard to the cash at the parent, we ended the quarter with corporate cash of \$233mm
- Assuming our planned Q1 dividends of \$430mm and \$75mm, pro forma corporate cash would be \$738mm
- After taking into account debt service needs, this is approximately \$500mm above our target of maintaining two years' debt service coverage
  - Additionally, at the time we completed our recent debt transactions, we installed \$200mm revolving credit facility, giving us an added layer of liquidity and flexibility

#### Capital Plan

- Given all we have accomplished on our capital plan, the questions we are now faced with are less around the timing and process of accessing capital and more around how to put it to use
- And that is squarely where our focus lies today
- As you're aware, reducing our corporate debt to \$1B remains a high priority
  - While the nearest callability on our debt is still 10 months away, we are analyzing whether it makes sense to do something sooner, obviously keeping economics at the top of mind
- And there are other options available to us as well, one of the most obvious of which is growing the balance sheet, now that we have regulatory approval to operate the bank at an explicit ratio

#### Loan Portfolio

- Also, while the loan portfolio continues to be most valuable in our hands and we have no intention of disposing of it in the foreseeable future, the secondary market continues to firm up, so we are keeping a watchful eye on market activity
- Lastly, and very importantly, we are mindful of the merits of returning capital directly to our shareholders via buybacks and/or dividends
  - So while there are several potential iterations, those are the broad strokes for capital utilization and we will obviously keep you posted as we make decisions and prepare to take action

#### SUMMARY.....

- So in summary, we accomplished a lot in 2014 and are even better positioned for 2015
- I'm excited about the opportunities that lie ahead, both for the business and for our customers as well as our capital structure and for our shareholders

## QUESTION AND ANSWER SECTION

Richard H. Repetto  
*Sandler O'Neill & Partners LP*

Q

It's definitely a notable step forward. So I guess my question, Paul and Matt, is you went through the laundry list of potential things that you could possibly do. I guess one question is, when would we expect a decision, or outline on what you're actually going to implement? And then, you mentioned potentially increasing the balance sheet and from what I understand, even if you separate the broker from the bank, it would have no impact on the SIFI designation. So you're saying you're now entertaining potentially growing the balance sheet at the bank to be in that cap of \$50B category?

Paul Thomas Idzik  
*Chief Executive Officer & Director*

A

Rich, it's always nice to hear from you, thanks for dialing in. I'll take the second part of that question first and then Matthew will answer the first part of that question if that's okay with you. On that \$50B mark, Rich, we still have no intention of going past that number. We think it would raise some significant costs in the near term with limited returns, particularly given where the yield curve is. But where our balance sheet is today, we still have some room to grow if we so choose. And with some of the new facilities put in place, we have the ability to manage our balance sheet to a little better degree than we have in the past. And now Matthew will turn and answer the first part of the question.

Matthew J. Audette  
*Chief Financial Officer & Executive Vice President*

A

Yes. That's right on the second, Paul. On the first, Rich, I think the broad strokes that I laid out in the prepared remarks are the things that we are thinking through. I think you know us pretty well at this point; as we make decisions on things, we'll update you and – you, the public, and tell you what's going on. I think our primary focus remains on getting our debt down to \$1B, but I think we're in that place where we've got that high quality problem of figuring out what to do. We are analyzing everything that we highlighted and we'll just tell you as we make decisions going along. But where we sit today, the debt reduction is still high on our list.

Richard H. Repetto  
*Sandler O'Neill & Partners LP*

Q

Okay. And then I guess my follow-up, staying on this topic, I can – you certainly did a good job at explaining the added capital flexibility by having it closer to the parent, the broker, the meaningful generator of earnings. I guess are there any – I know this is a sensitive question, but is there more flexibility from a corporate transaction standpoint now that that entity is out from underneath bank regulators?

Paul Thomas Idzik  
*Chief Executive Officer & Director*

A

Rich, irrespective of where the broker dealers sit, we will always be having constructive discussions with our regulators to make sure that they're comfortable with whatever we might do with the business, with our business model or anything else. So – and we don't intend to change wanting to have that type of relationship. So, no, it doesn't really in practice change that very much at all.

Alexander V. Blostein

*Goldman Sachs & Co.*

Q

So just picking up on the last topic, maybe we can spend a minute kind of dissecting the opportunities now that we have the kind of Holdco, excess cash and then there's the bank. So I guess on the Holdco level, maybe help us understand a little bit what are the constraints for you guys to use that excess cash, which I guess you guys defined as about \$500mm pro forma for the transfer? Do you have to ask the regulator for any additional approval for either buyback or debt repurchase? Does the Tier I leverage at the Holdco level come into effect? So that's the first part of the question.

Paul Thomas Idzik

*Chief Executive Officer & Director*

A

Yes. We would need to get regulatory approval. And as I said, even if that wasn't a formal requirement, it's something that we would do as a matter of how we like to run the business. We not only have leverage ratio requirements at the Holdco, but we also will continue to have that leverage ratio requirement at the bank, and both of those ratios will be carefully examined by us to make sure that we maintain the appropriate leverage ratios as expected by the regulators prior to us even thinking about doing it.

Alexander V. Blostein

*Goldman Sachs & Co.*

Q

Got you. And then so the second part of the question, moving on to the bank piece, so 9.2% perform the transfer, to your point a little bit above 9%, but even with the new methodology you guys I think will still be generating excess capital at the bank kind of over and above the dividend because of the DTA utilization? And that's obviously without even going to even lower target as you guys have outlined before. So maybe spend a minute on how we should think about utilization of that extra capital piece at the bank?

Matthew J. Audette

*Chief Financial Officer & Executive Vice President*

A

Yeah. Sure, Alex. So you summarized it well. If history is a guide, we would still be generating a little bit more capital at the bank and growing that ratio. I think there is a couple things to think through, both of which go back to balance sheet size. First is the point I highlighted in the prepared remarks. Our balance sheet really didn't grow during the year because of all the customer net buying, nearly 8B of customer net buying. You typically would not have that amount, right? So when I think about capital utilization, you're going to have a – as things return to normal level, you're going to have a natural bias up in the balance sheet size.

And then second to the comments we made and then Paul highlighted on an earlier question on our ability to bring deposits back on balance sheet, we're going to get to a place in the next couple of months of customer activity driving the amount of deposits that are on balance sheet transitioning to weaken effectively the size very quickly with good precision of how much deposits to put back on balance sheet. That, combined with having an explicit Tier 1 leverage ratio of 9%, those two things together I think will give us comfort to bring those deposits back on balance sheet vs. where we've been for the last few quarters. We've been running well below that \$50B mark to have a much bigger buffer. So, I think deposits back on balance sheet is one of the primary things. But just reiterating a few of the other things that we highlighted in the prepared remarks, we'll be looking at things like making sure we're following the loan portfolio, things like the wholesale funding, all the things we've talked about before we will continue to analyze.

Alexander V. Blostein

*Goldman Sachs & Co.*

Q

Got it. And you guys will be – and again, the way we talk about the balance sheet size is just total consolidated basis, right. So like you guys are at \$46B or so right now and you'd be comfortable going up almost to the \$50B level. Is that the right way to characterize that?

**Matthew J. Audette**

*Chief Financial Officer & Executive Vice President*

A

Yeah. It's definitely consolidated balance sheet. And then when thinking through bringing deposits back on as wholesale funding runs off, that creates capacity to bring deposits back on without increasing balance sheet size.

**Alexander V. Blostein**

*Goldman Sachs & Co.*

Q

Yeah. Makes sense. And just the last one for me. Matt, I think you mentioned both of these numbers but I just want to make sure we get it right. When we think about the actual just capital generation now at the bank sub and the broker dealer sub, what are those two numbers now? I know you said kind of with respect to the dividend that you would've paid, but just from a capital generation perspective would be helpful just to get those two numbers.

**Matthew J. Audette**

*Chief Financial Officer & Executive Vice President*

A

Yeah, sure. So we did a pro forma of 2014, it'd be \$225mm from the bank and \$200mm from the brokers, so \$425mm total.

**Steven J. Chubak**

*Nomura Securities International, Inc.*

Q

So I just first want to do a quickie on the capital side. Matt, I was hoping you could verify where the BASEL III ratio stands today and potentially dissect the benefit from the DTA side. And also where the assets as well as RWAs sit?

**Matthew J. Audette**

*Chief Financial Officer & Executive Vice President*

A

Yes. Well, on RWA, when you look at our risk-weighted ratios, they are incredibly high and only going higher. So they're not going to be – I'd be quite surprised if there were constraints. So we focus on the leverage side. And I think while we don't have the numbers completed, just to give you some directional direction on those numbers. So at the parent there's two things going on. The trust preferred securities will be coming out of capital, 75% in 2015 and then the remainder in 2016. And then, on the DTA side, there'll be a larger amount of the DTA will be included in capital. When I put those two things together, the DTA being a positive and the trust preferred being a negative, we estimate the net impact of that is going to be an increase to that leverage ratio at the parent, not dramatic, but an increase.

Down at the bank, there is the impact to the TRUPs – there is no impact to the TRUPs. So the primary driver down at the bank is going to be – is going to be the deferred tax asset. Now the deferred tax asset overall is around \$1B. \$600mm of that, roughly \$600mm of that is down at the bank and I would say broadly \$300mm – half of that \$600mm is included in capital today. So when I think through what's the max increase the DTA could have down at the bank, it'd be another \$300mm. So I think that at least gives you some direction on what benefit we would expect under Basel III.

**Steven J. Chubak**

*Nomura Securities International, Inc.*

Q

Okay. That's really helpful. And then, switching over to the expense side, you guided to low single-digit growth for 2015, and I appreciate the color on the incremental, I guess cost build that we expect just relating to regulatory and compliance related matters. How should we be thinking about that balance in terms of what's driving the growth to the extent that it's investing in revenue generating activities vs. regulatory cyber security and other related functions, which are simply part of the new normal?

Paul Thomas Idzik

Chief Executive Officer & Director

A

We've – that's a fair question, and we've been pretty clear on where we've been investing. And it'll be the same in 2015, which is investing more and improving the client experience they have with E\*TRADE and that involves customers facing professionals as well as spending more on technology. There is no doubt that there has been a tremendous shift and the bar has been raised on the whole cyber front. And so, we are absolutely investing in that as well as making sure that the networks we operate, the way we control and manage data is state of the art. And so we're investing there as well. So those would be the three places where you'd see headcount added. And then, as Matthew mentioned, we'll invest in marketing as it makes sense and as we can be focused in order to drive the type of customer numbers you saw in Q4. So that's where we're going to continue to think about investing as well as keeping an eye on what's happening in the revenue line, so that we can protect our margins.

Steven J. Chubak

Nomura Securities International, Inc.

Q

Thanks. And just last one from me, when thinking about managing to a specific capital constraint that the parent, is 9% going to be the change Tier 1 leverage bar that you're going to managing to in terms of how much capital you have available for deployment? And could that potentially evolve over time?

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

Well, I mean, we don't have a specific ratio there, but I think when you factor in our goal of getting down to \$1B of debt, right, inherently there's going to be some double leverage, which means the parent ratio will be something less than 9%. So other than that directional, we don't have an explicit ratio that we're focused on yet.

Steven J. Chubak

Nomura Securities International, Inc.

Q

Okay, but we shouldn't be looking at something like the well capitalized threshold, which is clearly much lower around, I believe it's 5% actually, that's imposed by the regulators as being the bar that you would manage to?

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

Well, I'm sure every financial institution would enjoy being able to go down to that level and be surprised if any of us could.

Michael R. Carrier

Bank of America Merrill Lynch

Q

Hey, Matt, just on the balance sheet, when you think about what you are talking about for the net interest spread for 2015 when you set guidance, are you assuming that that kind of new plan is in place and should we be thinking like low single-digit would be normal growth of client-cash balances, move more normal, meaning there's not as much buying activity into the market?

**Matthew J. Audette**

*Chief Financial Officer & Executive Vice President*

A

You were talking about the spread guidance?

**Michael R. Carrier**

*Bank of America Merrill Lynch*

Q

Yeah, meaning when you gave the spread guidance, are you assuming in that, that you have a more kind of normal level of client cash moving, relative to what happened in 2014.

**Matthew J. Audette**

*Chief Financial Officer & Executive Vice President*

A

Yeah. The answer is no. The spread guidance was more – was less guidance, it was more as we sit here in a more difficult environment today, which is not only a few weeks removed from Q4, and even each time I'll do a calculation on the impact of the yield curve, as I'm doing the calculation, rates move dramatically in that hour. So it was more just to highlight if the environment we're in at this moment the impact that environment would have. It is not a forecast on any other changes that we make including the deposits on balance sheet.

**Michael R. Carrier**

*Bank of America Merrill Lynch*

Q

Okay. Got it. And then, just as a follow-up, I don't know if you can give us any update on what you're seeing in the HELOC portfolio. I know in the past you've given some metrics and maybe you didn't give them just because nothing has really changed or there wasn't anything to bring up. But just in terms of any of the payment rates that you're seeing among the customers. Just any update there.

**Matthew J. Audette**

*Chief Financial Officer & Executive Vice President*

A

High level stuff, Mike, I think would be helpful. I mean, the most – the primary thing we're focused on are the home equities converting from interest only to amortizing. I think everybody knows very little of that's occurred so far, the majority of that happens in 2016 of \$1B and then \$600mm in 2015. So we've had very little occur so far. But for the amounts that have occurred so far, if you just look at from a quarter-to-quarter basis our delinquency metrics, our actual losses, all of those things continue to be stable or improved. So at least that's a high level on what we see going on there; keeping in mind again its small balances, they're the oldest vintages that have come through, so it's a better quality stock. Beyond that, I wouldn't really highlight anything going on in the portfolio other than we continue to focus on the [oil drop] movements.

**Chris M. Harris**

*Wells Fargo Securities LLC*

Q

Another one real quick on the capital, under the old plan, there's the goal of stepping the bank down to 8% ultimately. I know you've got this restructuring going on that you announced today. Is that 8% bogie kind of completely off the table for the interim? Or is that possibly a target you could look to seek in a year or two's time?

**Paul Thomas Idzik**

*Chief Executive Officer & Director*

A

We've been consistent that that's the target we're shooting for. We'll continue to aim that way. If we change that, we'll let you know. It's a target that we will continue to have discussion and dialog with our regulators. And as things continue in that vein, we will update you if we have anything to report.

Chris M. Harris

Wells Fargo Securities LLC

Q

Okay. Fair enough. A follow-up question on your loan portfolio, this might be a little tough question to answer, but have you guys done any stress testing on that portfolio as to whether there're any concentrations in areas that might have a negative impact from falling energy prices? Just wondering if there's any significant concentration in areas like Texas or similar places?

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

Sure. I mean – it's not specific to falling oil prices, but being subject to the stress testing process, DFAST stress process. We definitely stress the loan portfolio. As far as concentrations go, our portfolio was built by us buying it in the secondary market, meaning our concentrations are pretty consistent with where mortgages simply reside in America, which means our biggest concentration by far is California, then New York and things like that. So there's nothing unique to oil or anything that we would be concerned about.

Devin P. Ryan

JMP Securities LLC

Q

Most of my questions were asked. I just have a couple clean-ups here. So following up on the loan resets and thinking about just the next couple of years, are there any months here kind of in this year that \$700mm is going to amortize where it's concentrated just as we're looking toward that? And then, the bigger chunk in the next year, is that front-end loaded or back-end loaded because I'm assuming that would impact kind of the 12-month look-through for provisioning.

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

So, well, you can...

Paul Thomas Idzik

Chief Executive Officer & Director

A

\$600mm.

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

Yeah. So \$600mm in 2015.

Devin P. Ryan

JMP Securities LLC

Q

\$700mm total, right?

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

\$600mm in 2015, and \$1B in 2016, so \$1.6B total that's going to start to amortize. While it's not exactly split by every quarter, I'd say there's nothing dramatic that one quarter is incredibly low and another quarter is incredibly high, right. It's not the same every quarter, but I don't think there's anything I would highlight on be aware of this quarter or that quarter.

Devin P. Ryan

JMP Securities LLC

Q

Okay. Fair enough. And then just on the fees and service charges, nice tick-up from the prior quarter. And I think I heard we're running fees a little bit higher, but is there anything else in there that's seasonal or should we think about this as a reasonable starting point?

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

It's a reasonable starting point. The biggest item in there is payments for order flow. The second biggest item is basically a recurring fee income, whether it'd be from our managed products or from our mutual funds. And as those balances continue to grow, those amounts continue to grow as well. It's up to roughly \$12mm a quarter now. So that's, the nature of that stuff is pretty consistent and should grow, we would hope would grow over time. And then everything else in there is pretty small. So those are the two biggest buckets.

Chris J. Allen

Evercore Partners (Securities)

Q

Just on the NIM outlook. Obviously, sec lending has been the key driver. In recent periods, you talked about it kind of coming back down. Are we talking about more towards levels that we saw in the back half of 2013, early 2014? And anything to think about in terms of the securities portfolio moving forward? Are current run rates kind of stable or do you expect those to kind of roll over a little bit too, given where we're seeing the yield curve right now?

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

So on the stock loan side, I think if you look at the yield table in the release, it was on the stock borrow side it was north of 20% yield.

Chris J. Allen

Evercore Partners (Securities)

Q

Yes.

Matthew J. Audette

Chief Financial Officer & Executive Vice President

A

I would say where we are today is probably something north of 10%, right? It's come back in a pretty big way. And, again, this stuff is very volatile. There is no way to know whether it goes down from here or returns back to Q4 levels tomorrow. It could move pretty quickly. But that's where it is at the moment.

On the securities side, I think the primary driver there is going to be, assuming the balance sheet grows, which means we would be buying securities, what's the interest rate environment look like. And specifically, what's the interest rate environment look like where we buy bonds which is more in the belly of the curve.

So when you look at the 10-year coming down in a big way in Q4, well, the belly of the curve didn't move much at all, so it didn't have a huge impact on things vs. the last two or three weeks, the three-year to five-year point of the curve moved down in a pretty big way. So it all depends on where that plays out and how much balance sheet growth we have will drive whether or not there'd be a meaningful change in security yields going forward.

**Chris J. Allen***Evercore Partners (Securities)*

Q

Got it. And just – I mean, on the balance sheet growth topic, the simple way to think about it, in terms of maybe accelerated deposits is the 9.2% adjusted Tier 1 ratio plus the potential of the \$300mm from Basel III, is that kind of the key lever if you wanted to increase your deposits and bank balance sheets specifically?

**Matthew J. Audette***Chief Financial Officer & Executive Vice President*

A

Yeah. The \$300mm was just a range, the potential benefit of the DTA, but when we think through in 2015 and managing to the 9%, yeah, we will be subject to Basel III then. So if there is a positive impact there, it would be capital capacity and growing the balance sheet could be one of the potential options there.

**Chris J. Allen***Evercore Partners (Securities)*

Q

Thanks. And just one last question, are you also considering paying down your wholesale debt with the excess cash you have on here? Is that one of your better options?

**Matthew J. Audette***Chief Financial Officer & Executive Vice President*

A

Yeah. So when we think through over the long-term, the things that we want to accomplish, running off the wholesale book is an objective, running off the loan portfolio is an objective. So sitting here today, we have no plans to change that natural runoff but we're always analyzing and looking to see if that dynamic changes. So where we sit today, no plans to do that, but we're always analyzing it.

**Brian B. Bedell***Deutsche Bank Securities, Inc.*

Q

Congrats on the announcement. Just Matt and/or Paul, as you think about the long-term implications of the excess capital, aside from the additional DTA that comes back into the capital, have you modeled to what extent you think you will be generating more excess capital in this new structure vs. the prior structure, say over the next three or four years?

**Paul Thomas Idzik***Chief Executive Officer & Director*

A

Well....

**Brian B. Bedell***Deutsche Bank Securities, Inc.*

Q

I think there's a lot of moving parts to that.

**Paul Thomas Idzik***Chief Executive Officer & Director*

A

Yeah, well we definitely look at it. I mean, the thing I can highlight for you is more the pro forma of 2014, which I suspect you heard, but just to repeat it, if we took the process we had in 2014 that generated the \$300mm, under the new structure it would be \$425mm. So I don't have guidance going forward but hopefully that gives you an idea of the difference.

**Brian B. Bedell***Deutsche Bank Securities, Inc.*

Q

Right, okay. So you use that, that's helpful. And then just, Paul or actually Matt, if you want to talk a little bit more about the mechanics of the cash management. How quickly can you move balances between sweep deposits off-balance sheet and on balance sheet, is that something you can do pretty much inter-quarter or is there a timeline to that?

**Matthew J. Audette***Chief Financial Officer & Executive Vice President*

A

So, where we sit today, it's a little bit difficult and time consuming to do it. There's a bunch of different buckets. There's a deposits with third-party banks, there's deposits in money funds and there's a bunch of different processes and procedures to do that. Over time, as we implement this new program, we will have much more control to move it back on balance sheet quite quickly. So, as we put that in place I think we'll be in a position in future quarters to walk you through with more specificity how that works but just know that it'll put us in a position to act faster in the future.

**Brian B. Bedell***Deutsche Bank Securities, Inc.*

Q

Okay, great. And then maybe just lastly just the – Paul, you mentioned a lot of technology improvements that you've worked on all year. I guess, maybe just to frame what you think how that might improve your organic growth rate and even growth in DARTs as the year progresses. Obviously the macro environment determines a lot more from that, but do you see sort of an inflection upward in organic growth as a result of the initiatives that you've put in place?

**Paul Thomas Idzik***Chief Executive Officer & Director*

A

Well, certainly – I'm quite hopeful that we're taking the right steps to do that and I think we're just starting to see those shoots start to emerge in Q4. This is a retail business and accretion of new accounts and value related to those accounts takes a bit of time. And so, we're feeling good about what we've done and we're hearing good things from our customers. And anything we do to improve the experience and engage them more has historically led to higher account values and more activity to those customers. So, yeah, I'd stick to my – what I said during the prepared remarks. I'm sanguine about our opportunities.

**Patrick J. O'Shaughnessy***Raymond James & Associates, Inc.*

Q

So my question would be how close an eye do you guys keep on the conversation about potentially raising the SIFI cap? And if it were changed, how much would that change your calculus in terms of potential capital uses?

**Paul Thomas Idzik***Chief Executive Officer & Director*

A

We stay pretty close to that discussion, Patrick, and without giving too snappy of reply on this one, the – it would absolutely just reduce some of the anxiety we have about going over \$50B. And so it would just make those economics more attractive in the mix of all the other things we're doing in determining how to create value, paying down debt, returning capital to shareholders, investing in the business, bringing deposits on; all those things go in the mix. If \$50B were to move up and quite frankly I think it should move up, that would just make it easier to look at that without some of the ambiguity of estimating the complete economics.

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