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E*TRADE Financial Corp. *(ETFC)*

Q2 2011 Earnings Call

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CORPORATE PARTICIPANTS

Susan Hickey
*Head-Media Relations, E*TRADE Financial Corp.*

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

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

Michael J. Curcio
*Executive Vice President, E*TRADE Financial Corp.*

OTHER PARTICIPANTS

Daniel F. Harris
Research Analyst, Goldman Sachs & Co.

Richard H. Repetto
Principal, Sandler O'Neill & Partners

Patrick J. O'Shaughnessy
Research Associate, Raymond James & Associates

Howard H. Chen
Research Analyst, Credit Suisse (United States)

Michael Carrier
Research Analyst, Deutsche Bank Securities, Inc.

Michael M. Tarkan
Research Analyst, FBR Capital Markets

David J. Chiaverini
Research Analyst, BMO Capital Markets (United States)

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

Eric Bertrand
Research Analyst, Barclays Capital, Inc.

Matt Fischer
Analyst, CLSA

Brian B. Bedell
Managing Director, International Strategy & Investment Group, Inc.

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the E*TRADE Financial Second Quarter 2011 Earnings Conference Call. At this time, all participants have been placed in a listen-only mode. Following the formal remarks, we will open the call for Q&A. [Operator Instructions]

Thank you. It is now my pleasure to turn the floor over to Susan Hickey from E*TRADE Financial. Please go ahead.

Susan Hickey

*Head-Media Relations, E*TRADE Financial Corp.*

Good afternoon, and thank you for joining us for E*TRADE Financial's second quarter 2011 conference call. Joining me today are Steven Freiberg, E*TRADE's Chief Executive Officer; Matt Audette, our Chief Financial Officer and other members of E*TRADE's management team.

Before turning the call over to Steve, I'd like to remind everyone that during this conference call, the company will be sharing with you certain projections or other forward-looking statements regarding future events or its future performance.

E*TRADE Financial cautions you that certain factors, including risks and uncertainties referred to in the 10-Ks, 10-Qs and other documents E*TRADE files with the Securities and Exchange Commission, could cause the company's actual results to differ materially from those indicated by its projections or forward-looking statements.

This call will present information as of July 20, 2011. Please note that E*TRADE Financial disclaims any duty to update any forward-looking statements made in the presentation.

During this call, E*TRADE Financial may also discuss some non-GAAP financial measures in talking about its performance. These measures will be reconciled to GAAP either during the course of this call or in the company's press release, which can be found on its website at investor.etrade.com.

This call is being recorded and a replay of the call will be available via phone and webcast beginning this evening at approximately 7 p.m. The call is being webcast live at investor.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

And with that, I will now turn the call over to Steve Freiberg.

Steven J. Freiberg

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

Good afternoon, everyone. Before getting into our discussion about the quarter, let me take just a moment and comment on what I'm sure is top of mind for many of you; the filing made this morning by one of our shareholders, Citadel. We were surprised and disappointed by the letter we received this morning.

Maximizing value per shareholders has been and will always be our primary focus. We believe this priority has been clearly demonstrated by our tangible actions over the past few years as we significantly bolstered our capital

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position and moved the company back toward consistent earnings even in a challenging macroeconomic environment.

We value the opinions of all shareholders and have always been committed to acting in their best interest. We will be carefully considering the letter received this morning and at this time, have no further comment.

Turning now to the quarter, I will begin by covering the highlights from the second quarter, and then Matt will take you through the results. I will follow with a few additional comments. Afterwards, we will be happy to take your questions.

We are pleased with our second quarter performance as our business demonstrated strength, even as trading slowed across the industry. We reported net income of 47 million, or $0.16 per share, on revenue of 518 million.

We continue to execute against our strategic plan. Our loan-loss provision declined on positive credit trends. Expenses declined sequentially and we successfully refinanced the company's 2013 notes.

During the quarter, we executed a number of franchise enhancing initiatives to expand our offering and position us well for the future. We continue to grow our sales organization and grew our team of financial consultants by 30% in the first half of the year, focusing on sales of products and services to investors seeking both wealth management and retirement solutions. We also added professionals dedicated to growing our relationships with corporate clients.

On the product front, we introduced weekly options, increased fixed income news and research in the bond resource center and expanded the availability of personalization tools. E*TRADE Securities customers had access to the AIG public offering and our new issues desk continues to build a pipeline as we advocate for a level playing field for retail investors to have access to IPOs and other offerings.

Our corporate services group, a leader in stock plan administration, signed more than 30 new client contracts during the quarter. We continue to execute on our strategy of servicing both private and public companies, which provides a terrific foundation to grow relationships with corporate clients, while strengthening an important channel for future retail brokerage account growth.

Recent IPOs LinkedIn and Tesla Motors are examples of leading companies that we worked with for many years prior to their entering the public markets. And as Matt will detail later in the call, we remain focused on de-risking the company's balance sheet through strategic initiatives designed to minimize credit losses and earnings volatility. One such initiative gaining momentum is the movement of loans to higher quality servicers.

As of quarter-end, 1.1 billion of mortgage loans were with these high-quality servicers and we transferred an additional 1.4 billion this month. A productive quarter on many fronts. We are executing against the strategic plan we put in place nearly one year ago and are positioned well for the balance of the year.

I will now turn the call over to Matt to take you through the numbers.

Matthew J. Audette

*Chief Financial Officer, E*TRADE Financial Corp.*

Thank you, Steve. During the quarter, we recorded net income of 47 million, or $0.16 per share, compared with net income of 45 million, or $0.16 per share in the prior quarter and net income of 35 million, or $0.12 per share in the second quarter of 2010. We generated 518 million in net revenue in the second quarter. This compares with

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net revenue of 537 million in the first quarter and 534 million in the same quarter of 2010, with higher trading activity driving slightly higher revenue during the previous periods.

Our second quarter revenue included net interest income of 315 million, up 6 million from last quarter. This reflected a net interest spread of 2.89% on average interest earning assets of 42.9 billion, up from the first quarter spread of 2.84% on 42.7 billion in assets. While our net interest spread continues to face headwinds due to the low rate environment, we benefited from a few items in the quarter, which led to the sequential increase.

First, we saw an increase in the yield on loans, due primarily to a reduction in non-performing loans. Second, our stock loan business performed exceptionally well, as hard-to-borrow securities spiked in the quarter related to dislocations in foreign markets, and a handful of high-profile IPOs. These items improved our spread by roughly 8 basis points this quarter.

While we're pleased with these results, if the current low interest rate environment persists, which is widely expected to be the case, we will continue to see moderate pressure on our net interest spread.

Commissions, fees, and service charges, principal transactions and other revenue in second quarter were 174 million, a decrease of 13% from 201 million in the first quarter. This decline was driven by a 17% decline in DARTs during the period. Average commission per trade during the second quarter declined from the previous quarter, driven by customer mix, from $11.32 to $11.14, an increase from $11.05, compared to the same quarter of 2010.

Revenue this quarter also included 28 million in net gains on loans and securities, including net impairment of 3 million, as we managed our investment portfolio to limit our risk and realize gains due to favorable market opportunities.

Our total operating expenses for the quarter declined 2%, or 7 million from the prior quarter. Our second quarter expenses reflected a seasonal decline in advertising spend and, as expected, we recognized a 3 million increase in FDIC insurance premiums as a result of the new FDIC rules that took effect during the quarter. We continue to expect full-year 2011 expenses to be roughly flat overall, with quarterly variability driven mainly by advertising spend.

Turning now to the metrics; DARTs for the second quarter were 148,000, down 17% over last quarter, and down 13% from a year ago. During the second quarter, net new brokerage accounts were 25,000, following a very strong first quarter when we added 51,000 net new accounts, and up from 18,000 in the second quarter of 2010. Year-to-date net new accounts are 75,000, comparing quite favorably to 54,000 for the full-year of 2010.

Net new brokerage assets for the quarter were 1.5 billion. Year-to-date, brokerage asset inflows totaled 5.4 billion, compared with 4.3 billion acquired in the first half of 2010.

We ended the quarter with 26.3 billion in brokerage-related cash, an increase of 400 million during the quarter, and up 5.6 billion, or 27%, compared with the brokerage cash balance on June 30, 2010. Customers were net buyers of 200 million of securities during the quarter.

Margin loans made a positive contribution to our quarterly results with average margin receivables growing 6% sequentially from 5.4 billion to 5.7 billion, and up from 4.5 billion, or 27%, compared to the same quarter in 2010.

We continue to be pleased with the performance of our legacy loan portfolio and with the success of our loss mitigation activities. The portfolio contracted by approximately 700 million during the quarter. We reported a meaningful decline in net charge-offs and delinquency trends continue to be favorable.

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With respect to our TDR program, we continue to be active in our modification efforts, driving a meaningful reduction in losses, while allowing homeowners to remain in their homes. Through modifications, we expect our loss forecast to improve by approximately 25% to 30% relative to our loss forecast on the loans prior to the modification.

Additionally, we have seen an improvement in the performance of the loans we are modifying, with average re-delinquency rate at 12 months, up 31% for one-to-four family and 43% for home equity loans.

This compares favorably to rates of 36%, and 44% experienced last quarter, and speaks to continued improvements in the selection and modification process.

Building on our risk mitigation strategy, we continue to transfer loans to higher quality servicers who employ a higher touch model to improve loan performance. As of the end of the second quarter, 1.1 billion of our mortgage loans were at these higher quality servicers. Given the improvement to performance of loans that we have transferred, we completed on July 1 the transfer of an additional 1.4 billion in loans.

With this transfer, we now have 2.5 billion, or just under 20% of our mortgage portfolio, at high-quality servicers. While our expectation is for a reduction in delinquencies, we typically experience a temporary increase at the time of transfer as a result of changes to the payment process.

We noted such an increase in our main metrics, and saw that newly delinquent loans returned to current status within a very short period. We anticipate a corresponding temporary increase in delinquencies related to our recent transfer, and expect an improvement to overall loan performance over time.

Our loan-loss provision was 103 million, down 11% from 116 million in the first quarter, and down 38% from 166 million in the second quarter of 2010. We expect these favorable long-term trends to continue, although they are subject to variability in any given quarter.

Loan charge-offs declined by approximately 15 million in the second quarter to 178 million, and we were down from the 225 million we reported in the second quarter of 2010.

The allowance for loan losses at quarter-end was approximately 900 million. We were pleased that the bank generated 135 million of regulatory risk-based capital, and 138 million of tier 1 capital in the second quarter.

As of June 30, E*TRADE Bank's tier 1 capital ratio was 7.9% and its risk-based capital ratio was 16.2%. We continue to track our consolidated ratios as we prepare for Fed regulation of the parent company under Dodd-Frank.

This quarter, we have included our consolidated ratios in our press release on page 13 for the first time, and as of June 30, all of our acquired ratios are above the well-capitalized minimums. In addition, our consolidated tier 1 common ratio was 8.4%. We also continue to track our consolidated ratios under Basel III requirements.

We believe that Basel III in its current form will reduce this ratio by 70 basis points from 8.4% to 7.7%, meaning we estimate we are above the 2019 fully phased in requirements today. The main reason for the decrease in tier 1 common ratio under Basel III is the difference in the capital treatment of unrealized gains and losses on available for sale securities and deferred tax assets.

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During the quarter, we accessed the capital markets to refinance our nearest maturity debt at an attractive rate. We issued 435 million of 6.75% notes due in 2016, effectively refinancing the entirety of our 415 million of 7.375 notes due in 2013.

This transaction makes our next maturity December 2015 and affords us the flexibility to focus on other outstanding indebtedness. The extinguishment of the 2013 notes resulted in a $3.1 million gain in the quarter. Finally, we ended the quarter with 424 million in corporate cash, compared with 461 million at the end of the first quarter. To summarize, we are pleased with our quarterly and first half results. We continue to execute well on our retail and corporate businesses, prudently manage expenses and minimize risk in the portfolio.

With that, I will turn the call back to Steve for closing remarks.

Steven J. Freiberg

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

Thank you, Matt. Before taking questions, I would like to share a few additional comments. Again, we are pleased with our quarterly results, as well as the progress we have made to-date executing against our strategy to grow the brokerage franchise, expand our corporate client base, mitigate risk and optimize the value of customer deposits. As market uncertainty persists, it is difficult to predict investor engagement, but we continue to be confident about our strategy. As it relates to retail investing engagement, month-to-date in July DARTs are up 8%, when compared to June, and we expect seasonality during the summer months.

With that said we remain focused on growing accounts and assets and satisfying retaining our valued customers, while managing expenses and continuing to de-risk the franchise. At the same time, we continue to focus on initiatives that support our mission to deliver the best investing experience period. A few highlights include: We are the in the late stage beta phase of E*TRADE 360, our new personalized investing experience.

Through E*TRADE 360, customers can access everything they need on a single page, choose their favorite features to support investing decisions and enjoy an enhanced visual experience, while viewing all accounts. We believe it will be unique in providing personalization tools to all customers, including those new to online investing, as well as the most sophisticated traders. We will introduce enhancements for options traders, including enhanced screener, analyzer and optimizer tools, as well as other offerings for traders, including futures in FX and portfolio margining.

We will continue to grow our sales resources in both our retail and corporate sales teams and ensure we are better positioned to serve our current customers, while attracting new customers and assets, focusing on both wallet and market share. Building on a 30% growth in financial consultants in the first half of the year and managing towards a similar increase in the second half, we are well on our way to doubling our relational sales force by the end of 2012.

Again, we are pleased with our second quarter performance and look forward to building on our progress through the balance of the year.

With that operator, we are ready to take questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you, [Operator Instructions] Your first question comes from Daniel Harris of Goldman Sachs.

Daniel F. Harris
Research Analyst, Goldman Sachs & Co.

Q

Hey, good afternoon, guys. How are you?

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

A

Good, Dan.

Daniel F. Harris
Research Analyst, Goldman Sachs & Co.

Q

Hey, Steve I appreciate that you don't want to speak specifically about the conversations you guys have had today, and the documents that came out. But I was wondering as you think forward in terms of how you define success strategically or quantitatively, I mean, how should we be thinking about that in terms of whether that's a margin at some point, a return at some point, ROI, I mean, if we try to put some quantitative measures around where you're looking to go to over the next four and eight quarters, how should we think about that?

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

A

Yeah, I think there's several metrics that are important. One is the continued progress towards normalized earnings, and the way I think about that, I know we've had discussions before. There are still two areas that weigh heavily on the P&L of the company that are really legacy. One would be in the provisioning with an expectation that over time the provision will become much less of a burden on the company. So, if you look back over the course of the two-year period, really in 2010, we provisioned in excess of $700 million. And if you just take the first half of the year, this year, right now, we've provisioned roughly speaking about $220 million. And if you double that, not to say that's a projection because it's not, it's just a simple extrapolation, we'd be close to, let's say, to $400 million and that's still a tax that we carry that most of our competitors in the industry do not. And we would expect with the passage of time and with good management that will become much less of a burden. And I think the trend is very clear.

The other, which I think Matt alluded to, which is the other part of the corporate tax, we carry fairly sizable interest service costs because of the recaps that we've done over the last several years. And we do have very high priced debt that's outstanding. And I think it's a good example, in the quarter we were able to refinance at what we would say are quite good rates, a large bulk of the piece of the debt, but clearly not the highest cost debt. And not to predict what we would do out over the horizon, but as we have more degrees of freedom, as we have more capital and we basically have more access to markets and more flexibility, we would hope to lessen that burden on the company as well. And so that's on one side, which is how do we manage down the legacy burden.

On the other side, continuing to grow our core franchise, both our core franchise in brokerage, our core franchise in banking, and our core institutional franchises at a rate that at least at, if not in advance or higher than, the industry. And so we want to introduce not only more normalized earnings, but we want to introduce a faster level of growth. And we've seen if you take the first half of the year into account, we think we've seen good progress on

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that point. And at that point, we're starting to basically think about our business in more traditional metrics of return on equity and other types of valuation that become important, but until we get closer to normalize, we are basically working on what I just addressed. But if you're thinking four to eight quarters out, the trends you're seeing should continue and/or accelerate, and the earnings basically really should manifest themselves through the P&L in a way that is stronger than we're seeing either in the current period or the recent past. But this is nothing new, but it's staying with the strategy we're put into force roughly a year ago and continuing to execute. The variable we can't control, but it's systemic, is the macroeconomic environment, which clearly has influence not only on provisioning, but has influence on spreads and has clearly influence on consumer confidence, and therefore, level of DART activity. But assuming we believe the industry is a strong viable industry with good prospects over the horizon, our real focus is on the strategy and execution of the strategy. We believe within relatively short order that those elements will play out.

Daniel F. Harris
Research Analyst, Goldman Sachs & Co.

Q

Okay. It's fair enough. We'll focus on normalized earnings for now. But let me actually turn to the one another area that I think a lot of – that we're certainly focused on and that's in the capital and thanks for the parent company capital of -

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

A

Yep.

Daniel F. Harris
Research Analyst, Goldman Sachs & Co.

Q

On the Basel basis. So, if you guys are sort of ahead of where you need to be in 2019, can you walk us through how you think about return on capital via debt retirements or any other way to think about it in terms of increasing EPS? Increasing earnings?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

Sure Dan, this is Matt. So, I think building on what Steve said, I think the most obvious area of focus would be on de-levering the parent company. I think the key there is while we're quite comfortable with where we are in the Basel III ratios, I think the key to doing anything is having capital dividend in the bank. So, if you looked at those ratios for the quarter, we had some nice improvement there as well, just under 8% on the tier 1 and just over 16% on the risk base. So, our view is each quarter those ratios get better. We feel more comfortable about dividend and capital of the bank. But the key and mainly obvious point is a regulator would have to approve that. Given that we're transitioning regulators essentially tomorrow from the OTS to the OCC that would be something that the OCC would have to approve. So, from our perspective, we've been continuing to improve the ratios, continuing to generate earnings and do all the things that Steve described. In our view, it only improve our ability to dividend capital, but we can speculate on whether the OCC would agree with that. And so we're focused on the business and improving those ratios and we think it will take care of itself overtime.

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

A

And I will just – Dan I'll just reemphasize because Matt positioned it exactly the way it should be. All we need to do is continue basically to be profitable, grow our profitability, continue to build our capital and finally, continue to de-risk the enterprise and expectation is if we do that well, we do it consistently, we think we've been doing

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that, good things will occur and more degrees of freedom will basically arise, but we can't predict that with a certain point or a certain date.

Daniel F. Harris Q
Research Analyst, Goldman Sachs & Co.

Okay guys. Thanks a lot.

Steven J. Freiberg A
*Chief Executive Officer & Director, E*TRADE Financial Corp.*

Thanks, Dan.

Operator: Your next question comes from Rich Repetto of Sandler O'Neill.

Richard H. Repetto Q
Principal, Sandler O'Neill & Partners

Good evening, guys.

Steven J. Freiberg A
*Chief Executive Officer & Director, E*TRADE Financial Corp.*

Hi, Rich.

Richard H. Repetto Q
Principal, Sandler O'Neill & Partners

I'm at least going to try with a question and I'll respect your answer either way. But in today's letter from Citadel, they talked about specifically a lock-in value to a sale, in a sale in a transaction. So, I guess the question is, has the Board – first has the Board met to contemplate Citadel's letter, and then he specifically pointed towards two directors, Mr. Parks and Ms. Weaver, and I guess do these Board members play, if you could go over their roles and any relationships with sort of the merger or process would be helpful?

Steven J. Freiberg A
*Chief Executive Officer & Director, E*TRADE Financial Corp.*

Yeah. Let me say a few things. One is I still respect you as a gentlemen, but let me just read the last sentence of at least the prepared remarks. Our Board of Directors will be carefully considering the letter received this morning and at this time, we will have no further comment and we're going to stick to it. And I'll just add, which is independent because it's consistent with what I have said earlier, what I've said consistently over time, our clear mandate and objective is to maximize shareholder value over any reasonable period of time and that's what our objective is. We don't waver from it and we'll continue to focus in on that as basically a critical element or priority. I apologize, but I really won't elaborate further at this point on this particular topic.

Richard H. Repetto Q
Principal, Sandler O'Neill & Partners

Got it. I respect that answer Steve, as well. Moving on, the movement of loans to higher quality services, just wondering Matt, where are we going to see the impacts, is it just pure lower delinquencies, is it going to be – is there any added expense in doing this other than, and I know you talked about the temporary blip up in delinquencies, but any other balance sheet – income statement impacts as you do this?

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Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

So Rich, the most meaningful impact we expect is improvements in credit losses over the long-term. Higher quality servicers certainly know they're higher quality, so they can charge more. So, your servicing expenses would be slightly higher, but I wouldn't view it as anything meaningful. Materially getting our loans to the servicers that we believe are more high-quality and long-term provisions coming down.

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

A

And let me just add to it, Rich. Since we have the experience with a large number of servicers, we have good internal information as to who executes well on different segments or categories of paper. And so overtime the base of knowledge that we've acquired has been important and powerful. And what's really been challenging, because oftentimes as you know, we don't own the servicing rights to our paper, so even if we could optimize mathematically in a model, the real challenge is around execution. So, we've actually felt quite good that in this past period, which is really the month of July, that we effectively moved $1.4 billion of paper that we believe has not been effectively serviced to a combination of either specialty servicers, where warranted, both for first and seconds, or home equity. And then in addition to that, to servicers that do just a better job even on I would say the current paper. And if we can do more of that – and remember we've only done 1.1 billion like in the last year and we've done 1.4 billion in essentially the last period, but this is a very good outcome for us on a whole host of fronts. But it's not an easy thing to accomplish, and it is very lumpy.

Richard H. Repetto
Principal, Sandler O'Neill & Partners

Q

Got it. Got it. And last quick question. Matt, another quarter with 30-plus million in security gains. I guess what's the outlook for the back half of the year? Do you believe that would the outlook be to maintain this pace from this quarter?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

Yeah, Rich. I would say that our view is almost exactly the same or exactly the same as we discussed it last quarter. So, I think if you look back to 2009 and '10, those gains hovered in the 150 million to 160 million range. Given the volatility in the environment back then, compared to where we are today, we would expect those levels to come down. But I wouldn't go as precise to give a specific estimate for the second half of the year.

Richard H. Repetto
Principal, Sandler O'Neill & Partners

Q

Okay. Thank you very much.

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

A

Thanks, Rich.

Operator: Your next question comes from Patrick O'Shaughnessy of Raymond James.

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Patrick J. O'Shaughnessy
Research Associate, Raymond James & Associates

Q

Hey, good afternoon, guys.

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

A

Hi, Pat.

Patrick J. O'Shaughnessy
Research Associate, Raymond James & Associates

Q

So my first question is around your net new asset trends. You certainly saw some great some great momentum around those in the first quarter of this year. And then it looks like the last few months it started to trail off a little bit. How much of that do you think is a function of overall macro versus how much is company specific and even if the macro environment continues to be pretty difficult, how do you start to reaccelerate those net new assets?

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

A

Yeah, let me kind of give you some insight or some color around that. Clearly, we were lighter in the quarter than we would have preferred to be, about 1.5 billion or so of net new asset flows. If you sort of chunk it down into its two primary pieces, we really get net new asset flows from two areas; one being our corporate services group, and the other being our broad-based retail brokerage business.

Our broad-based retail brokerage business has been relatively consistent. If you look back over the – over the last several quarters, except for the first quarter, where it outperformed in quite an extraordinary way. In addition, in the first quarter, we did see a fair amount of execution come through from our corporate services group clients, their employees. If you remember the dynamic of that business, when we get a dollar of flow from that business, remember these are employees of companies that either executed options and/or basically had deferred equity vested to their accounts. A large percentage of that, upwards of about 70% over the course of the first year, flows away from us to firms where they have typically their main account. So, we understand that will occur. We just happen to have had an atypical quarter in the first quarter and we did see outflows, where normally we might get $1 billion of net out of that business. We got substantially less in the second quarter, but it was predictable. So, we don't think there's anything that material that clearly the environment has had some impact because we've looked across our industry and everyone's net flows were down on a sequential basis. Ours were down as well because of the environment. But in addition to that, the corporate services group, which had a terrific first quarter, you've paid back some of that in the subsequent quarters and we did. So, this was not surprising.

Patrick J. O'Shaughnessy
Research Associate, Raymond James & Associates

Q

Got you. Thank you for that. And then my follow-up question. Recently a competitor announced that it was going to start offering international trade. So, international trades with the local currency, I think that's something that you guys have offered for a while. What sort of opportunity is that, or even beyond international trades what sort of other asset classes do you think can really be big drivers for E*TRADE? Are we looking at ForEx futures certainly options looks it has some growth potential, kind of where do you look as kind of the evolution of trading at E*TRADE?

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Steven J. Freiberg
*Chief Executive Officer & Director, E*TRADE Financial Corp.*
A

Yeah. I'm going to ask Mike Curcio who runs the brokerage – pool brokerage side of the company is here and I think he is best able to give you perspective on that.

Michael J. Curcio
*Executive Vice President, E*TRADE Financial Corp.*
A

Yes, so we've had global trading for a few years now in six markets where customers could trade in the current markets. So, we're still committed to that, but where we see the most growth is through ADRs still. They're just easier to trade and most customers understand them better. We've really invested in options, and it was a record first half. Our futures business is doing well, we really think it will see significant lift once it's integrated into E*Trade pro, which is due later this year or early next year and we're working on a FX offering as well.

Patrick J. O'Shaughnessy
Research Associate, Raymond James & Associates
Q

Great. Thank you very much.

Michael J. Curcio
*Executive Vice President, E*TRADE Financial Corp.*
A

You're quite welcome.

Operator: Your next question comes from Howard Chen of Credit Suisse.

Howard H. Chen
Research Analyst, Credit Suisse (United States)
Q

Hi, good afternoon, everyone.

Steven J. Freiberg
*Chief Executive Officer & Director, E*TRADE Financial Corp.*
A

Good afternoon, Howard.

Howard H. Chen
Research Analyst, Credit Suisse (United States)
Q

Steve, if we focus on achieving that normalized earnings power that you allude to, I would still love some more color on the balance sheet. What ultimately you think it looks like, how big is it, and what are some of the macro factors underpinning that 3% spread that you've alluded to in the past?

Steven J. Freiberg
*Chief Executive Officer & Director, E*TRADE Financial Corp.*
A

Yeah, let me – I want to go back to size of balance sheet and I think that Matt had highlighted in the – in his section that the interest earning component of the balance sheet continues to expand and it's predominantly if not exclusively driven by the cash or the deposits that our brokerage customers hold with us either via the suite and/or the CSA of the savings account. And we did see if you recall, – back when I first arrived, it was an expectation that that balance sheet or at least that element of the balance sheet was going to contract for –

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contract for quite a while. And we didn't see any contraction and in fact, we saw – we've seen the expansion in it. But we're not consciously expanding the balance sheet for balance sheet's sake. It really is more of the representation of having more brokerage customers and more basically brokerage assets and a concentration of those assets being held in deposits. So, that is driving it.

From the standpoint of the spread on the portfolio, we've gone on record to say that we think over any cycle, so any period where we could actually define a cycle, that based on the duration of those deposits and essentially what we invest in today on the margin, which is typically credit risk free, which most of your agency-backed securities of similar duration, we typically think that we can obtain over a long period or a cycle about 300 basis points of spread. Obviously, in any given cycle that may be higher or any – if given part of the cycle, that may be higher or lower. So, right now, clearly, and Matt made the point, there's some pressure on the system, so we were at 284 basis points -

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Matthew J. Audette — A
*Chief Financial Officer, E*TRADE Financial Corp.*

For the last quarter.

Steven J. Freiberg — A
*Chief Executive Officer & Director, E*TRADE Financial Corp.*

289 this quarter. And we still think there'll be some pressure potentially on spreads, but if, in fact, we get back to any type of normalized macro environment, we'd expect that 300 is a very reasonable number. We've had basically outside folks look at this and we've run a lot of data, and the sense is that 300 is a reasonable target, a reasonable number, it could vary plus or minus on that 25, 30, 40 basis points on both sides and right now, we're probably again on a bit more of the challenge side, but we don't expect 300 to be a unattainable number, but I just can't tell you at any particular period. As you're trying to basically do what we do, which is predict tomorrow, next week and next month, that tends to be harder than predicting it in a longer term model. What we're doing though is everything possible, which is putting all the cash or as much of the cash to work, so less idle cash, making sure that we invested smartly, making sure that we price the deposits or the liabilities in a very smart way to keep that spread as stable as possible, although you have seen basically some movement, and the bias at the moment is down.

Howard H. Chen — Q
Research Analyst, Credit Suisse (United States)

Thanks, Steve. That's very helpful. And then just thoughts on the long-term composition of the asset side of the balance sheet?

Steven J. Freiberg — A
*Chief Executive Officer & Director, E*TRADE Financial Corp.*

It's a good question. On the margin, which I think everyone is aware, there are two fundamental trends or really three that are going on. One are the legacy loans are rolling off. That's the good news, bad news. They clearly have higher coupons, but on a net contribution basis, when you put the provisioning through, not so good, but the optics are clear, they show up on different line items. But the reinvestment rate at the moment, which is basically going back into agency securities, largely is clearly below that and that's putting pressure on the system. But that is the primary vehicle we are reinvesting in today.

In addition to that, we are growing, Matt made the point, we are growing our margin book. It's growing 25% to 30% year-on-year, and it grew to 5.7 billion in the particular quarter, but it's not going to grow fast enough to

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compensate for $700 million, or $800 million of run-off of the legacy loan book. That said, we currently are not either contemplating or planning in the very near term re-entering any type of lending relationship with our clients or our customers, but we will basically do some testing to our client base off our balance sheet, meaning we will not take the risk on to our balance sheet, trying to calibrate scale meeting demand in our portfolio of our high quality customers, as well as the economic model that may basically stand behind it.

So I would say if we were talking three, four quarters out, we may have a position around our own client base as it may relate to an expanded relationship, which you know is always good. But at the moment, what we're doing is exactly what we've been doing, which is investing on the margin in agency securities. We don't have credit risk, but we do have essentially sometimes duration risk, but we hedge largely for this group as we can against keeping the duration of the asset and decreasing the duration of the liability largely intact.

Howard H. Chen
Research Analyst, Credit Suisse (United States)

Q

Okay. Thanks. And then, so along the same vein, the firm securities gains continue to pace at the very high end of the banking industry. Can you just refresh us on why you're doing that, your outlook for more? And so ultimately what do you think all this has impact-wise on your 3% spread guidance and your normalized earnings power?

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

A

Yeah. Several things. One, absolutely just to give you a context, a year ago the gains were approaching $50 million and this quarter they were approximately 30 million. So, we're running at about 60% of kind of last year's numbers. Now, the net impact has been helpful because typically net gains against impairments. Impairments were much higher last year, and so the net impact clearly looks reasonably good, 28 million again, a number that was probably closer to 36. But the trends are what they are. We basically expect over the near, intermediate and longer term to have gains come down from where they are today. But at the same time, we would expect provisioning over that period of time to also come down, and not to say that we're in a foot race between the two, but we are basically in any given period trying to be smart about how we manage our balance sheet and we're looking at where we have opportunity; where we think securities we purchased were relatively cheap, maybe other option adjusted spreads, and where the spreads have changed. Typically, we'll take gains not from the standpoint of trying to manage the net interest margin on our portfolio, but we think essentially we made a good swap or a good deal or a good buy or a good sell. So, that happens on a continuous basis and at the same time, we are on a continuous basis, adjusting our assets and liabilities and taking gains when we think the market is favorable. It's not a bad thing as well and as you know, there's been a lot of market volatility over the last six, nine months, which allows us to take basically trading profits as well. And just to answer your question completely, it does have some impact on our ongoing net interest margin. Obviously, if we're swapping out higher coupons and swapping in lower coupons, we do pay for a part of this over time, but it's not one generic mass. There are a whole host of items that play out as we pursue a broad-based treasury strategy, but the broad trend should not mislead anybody. If it was almost 50 million last year and 30 million this year, same quarter, it will basically come down over a period of time.

Howard H. Chen
Research Analyst, Credit Suisse (United States)

Q

Thanks. That's very helpful color, Steve.

Operator. Your next question comes from Michael Carrier of Deutsche Bank.

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Michael Carrier
Research Analyst, Deutsche Bank Securities, Inc.
Q

Thanks, guys. Just one follow-up on the – just on the capital ratios, I know for all firms in the industry, everyone is waiting on regulators or to get the approval by regulators. But based on what you see in the industry, and then what you know about your balance sheet, your capital needs, like as an internal target, like where are you comfortable with the capital ratios? Obviously, you got to wait for the regulatory approval, but where do you feel like you want those capital ratios to be in order to even think about or start to consider deploying capital, whether it's on the debt side or buying back stock?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*
A

Hey Michael, this is Matt. I think it's almost a circular reference, because where we want to be is to be able to dividend capital and maximize return for our shareholders. So, given the regulatory environment we're in, where those levels are not especially clear, and as said a little bit earlier, especially because we're transitioning from the OTS to the OCC. The main thing that we know we can do is continue to focus on growing net capital, continuing to focus to generate earnings and de-risk the balance sheet, and that's the thing that we can focus on and control. And so that's where we're focused.

Michael Carrier
Research Analyst, Deutsche Bank Securities, Inc.
Q

Okay. And then just going back to the balance sheet, just the net interest margin, I think you mentioned during the quarter some of the benefit on the sec lending, and then non-performing loans declining. You guys, you have mentioned like a target on the held-to-maturity portfolio, that's been building. I just wanted to go back to that in terms of what should that level be, and then if we're thinking about over the next year, two years and assuming the current interest rate environment, if the loans are rolling off, and you're pulling the new cash into securities, then assuming this current interest rate environment, should we be thinking that ultimately, it goes back down to where the other online brokerage margins are, or is there something unique that you guys can provide or do that can be different?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*
A

Yeah, Michael. So, on the held-to-maturity portfolio, so we started building that again last quarter. So, the growth you saw this quarter-ending the quarter around 5 billion is the main growth that we've been focused on of late, meaning we're at this point done. But keep in mind that is something that we look at each and every quarter. So, depending on where our balance sheet is overall, the regulatory environment we're in, our liquidity position, that's something that we could re-look at and grow some more, but the 5 billion is where we've targeted the growth so far.

Specific to loans paying down. So, I think as Steve commented on our spread over the long-term being at 300 basis points, there's a lot of positives and negatives that impact that. The biggest positive that we have are our customer deposits in a more normalized environment, in a more normalized interest rate environment, that there's much more earnings power from a spread perspective there.

The second item is over the long-term, we still have a fairly large wholesale borrowings book, which is quite expensive. So, over time, we would expect that to come down and be a positive. But what you've hit on is the primary negative. So, as the loan portfolio pays down, we would expect to reinvest at lower rates. So, it's certainly

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a headwind, but I think when you put all three of those things together, Steve's comments on the 300 basis points over the long-term still hold true, but I would reiterate the point that in the current environment, and taking the spread of 289 basis points, and kind of carving out those items that I highlighted, you're at 281, and there's really pressure on that 281 if the interest rate environment does not move today.

Michael Carrier
Research Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thanks, guys.

Operator: Your next question comes from Mike Tarkan of FBR.

Michael M. Tarkan
Research Analyst, FBR Capital Markets

Q

Hey, guys. Just back to the higher touch servicers real quick. With the 2.5 billion moved over so far, can you give us any color on how that breaks down between one-to-four family and home equity? And then along the same lines, I would assume you're moving some more loans over – is this a situation where you're going to move over half of your portfolio, the whole thing? I'm just looking for like an endpoint there.

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

So, this is Matt. I think the – we don't have a breakdown of one-to-four versus home equity, other than to say it's primarily one-to-four, so that's 2.5 billion. We don't have a specific target on where we would go with that. But being just under 20%, we think, is a fairly meaningful amount that we've moved over. And as far as what we're focused on moving, it would be our highest risk loans. So, just under 20%, I would say you've got a fairly good amount of what we're focused on. But you could certainly see it grow a little bit in the future.

Michael M. Tarkan
Research Analyst, FBR Capital Markets

Q

Okay. That's helpful. And then I guess, lastly, just real quick. Can you tell us where your deferred tax assets are at this point?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

Sure. So, consolidated, it's at 1.4 billion.

Michael M. Tarkan
Research Analyst, FBR Capital Markets

Q

Great. Thanks.

Operator: Your next question comes from David Chiaverini of BMO Capital Markets.

David J. Chiaverini
Research Analyst, BMO Capital Markets (United States)

Q

Thanks, good afternoon. You mentioned in your prepared comments that the corporate services group added more than 30 new client contracts in the quarter. For context, how many client contracts are there in existence in total, and how does the 30 compare to prior quarter wins?

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

A

Yeah. Overall, we've approximately 1000. Just a little bit above 1000. As I said earlier, about 70% are public companies; about 30% are non-public companies. 30 is – I'm seeing whether or not I have the prior quarter, I don't have it on the top of my head, I don't know, Mike, if you have the prior quarter?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

What we know is 30 is actually a healthy number. I'm almost convinced it's higher than both trend, as well as the prior quarter. I just don't want to give you a number that we'll have to go back and qualify. We don't have – I don't have it, stop. And as you would expect, not all companies are created equal.

So, we really break the universe by size, and so you can acquire 25 companies that don't provide anywhere near what one significant company would provide. We're not going to break it down on the call, but we're very focused on the universe or the segment that these companies come from, and I would tell you our trend data for the year is looking quite good when you look at it in terms of assets and look at it in terms basically of employees.

And the contracts that we signed today or last quarter, most of those companies will not get bordered, because remember there is a conversion process that's quite substantial for about six to nine months out. So, essentially think about this as the pipeline of future business that we will realize, but it does take us six to nine months then to move these companies from where they are to basically to our platform.

David J. Chiaverini
Research Analyst, BMO Capital Markets (United States)

Q

And then, are there any stats you can share to give us an indication of how much customers are embracing your long-term managed portfolio offerings such as UMA?

Michael J. Curcio
*Executive Vice President, E*TRADE Financial Corp.*

A

Yeah, this is Mike Curcio. We have slightly over 0.5 billion in our managed investment products. And two things are driving this: One, just to take a step back, we're delighted with the number; we just rolled it out last year. And we have two big initiatives going on. One Steve talked about, scaling up the sales force, we added 30% already. So, we're well on our way to double that by the end of 2012. And what we're seeing is we are getting a better quality of salesperson in that is comfortable selling these types of products.

And the second initiative was performance management, which is true pay for performance. And that just rolled out at the beginning of Q2. So, we're seeing a lot more. We had a great quarter in all the managed investment products, and we're also seeing more mutual funds, syndicates and fixed income flows as well. So, we're happy, and we're on track.

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

A

And so the trend is very good, albeit off, as Mike made a point, a still relatively small base because it's a relatively new program. And the way we view it, which I think is just a broader context, that our customers have approximately $190 billion of financial assets with us, and we believe through data that's both on us and off us that those customers have approximately $2 trillion of financial assets overall. And so through a combination of

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good segmentation models, appropriate product, and now, an enhanced both in productivity and number of financial consultants, we basically did a lot of testing and learning, and we think we can make inroads into penetrating not only the trading component of what these customers do, but the investing component as well.

But it's a relatively speaking newer effort will take time to become meaningful at scale, but we think we have a sense of the unit model. Now, we're just executing on bringing it to a scale that would be meaningful to E*TRADE. That does take some time.

David J. Chiaverini Q
Research Analyst, BMO Capital Markets (United States)

Thank you.

Operator: Your next question comes from Joel Jeffrey of KBW.

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

Good afternoon, guys.

Steven J. Freiberg A
*Chief Executive Officer & Director, E*TRADE Financial Corp.*

Good afternoon, Joel.

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

Just going back, I think you mentioned earlier that the commission for trade was down due to mix. I was just wondering if you can give us any more color on what the mix looked like during the quarter.

Steven J. Freiberg A
*Chief Executive Officer & Director, E*TRADE Financial Corp.*

We can. It's not that exciting. And, but basically – just to give you – we have it; I just don't want to go through the detail, because if you think about the way we're used to thinking about commissions, you're talking about $0.10 or $0.15 quarter-to-quarter, you're talking about $0.10 year-over-year. There's just a lot of noise in movement.

But effectively, what drives that number up will be more trades from our corporate services clients, which are at a much higher trade rate, and more options on our futures in the mix, and what drives it down is essentially more or less of the same thing. And so, in any given quarter, there's some minimal movement between that distribution, but even if we provided it, one, it's very hard if not impossible, to predict, and I don't think the numbers are really all that meaningful. But to the points made by several people in the room earlier, the more we can do with options futures and ultimately FX, and the faster we can build our corporate, or grow our corporate services group, they will have a more meaningful impact on the mix.

But the mix in any given quarter, in my view, is mostly noise as that distribution or stratification has some mild movement. And I would say last year's, last quarter, and this quarter's commissions more or less are same-same. There's just not enough there to spend a lot of time on, at least in my view.

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

Okay. And then just sort of sticking with customer activity, I mean, average – it looks like average margin receivables were up quarter-on-quarter. But it looks like the period ends were relatively flat. I mean, with the markets the way they are, do you think margin activity declines a little bit, or is it going to sort of stay at this level?

Steven J. Freiberg
*Chief Executive Officer & Director, E*TRADE Financial Corp.*
A

It's, again, very hard to predict. For those who've studied it, it clearly is a function of when customers have any type of significant net buying, margin tends to expand. The number that I think Matt addressed in the quarter, that net buying in the quarter was, relatively speaking, neutral. I think it was in there for a couple of hundred million dollars and remember, the customers have something in the neighborhood of $186 billion of financial assets with us.

So, I would say that if consumer confidence and retail trading begins to move forward, and I said I think earlier in the call, we did see sequentially an 8% improvement. So, at least it's some degree of incremental improvement. We typically see the margin book expand, but if that were to stay relatively subdued for a while, then I would think that the margin book would basically follow that form and that's sort of what we see.

So, the goal is, in order to grow the margin book, is to get basically an active group of customers and in addition to that get more customers, and we're working clearly on both fronts. One we have more control over than the other.

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

Great. Thanks for taking my questions.

Steven J. Freiberg
*Chief Executive Officer & Director, E*TRADE Financial Corp.*
A

Our pleasure.

Operator: Your next question comes from Eric Bertrand of Barclays Capital.

Eric Bertrand
Research Analyst, Barclays Capital, Inc.
Q

Hi, guys. Thanks for taking my question. Again, I appreciate the disclosure on the consolidated Basel III tier 1 comment. If I recall correctly, it was 5.7 at the end of the first quarter and 7.7 at the end of this quarter. The majority of that increase should be the conversion, if I'm not mistaken. Is this a fair assessment about where you think the pro forma ratio is, and are there any other big inputs that you would see moving the ratio on a chunky basis in the near term?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*
A

Sure, Eric. So, I think everything you said, you got right. I think that it is our best estimate under the current framework of what our Basel III ratio is. I think the biggest factor that would move that ratio going forward, separate and apart from our earnings and utilization and deferred tax assets, is under Basel III, the unrealized

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gain or losses on the available-for-sale portfolio would be a deduction from capital, whereas under the current regulations, they're not. So, the reason that can be volatile is that will move with the interest rate environment. So, as that moves, the capital ratio will be impacted by that. So, that's the main thing I would say could move it.

Eric Bertrand
Research Analyst, Barclays Capital, Inc.

Q

Okay. I'm coming back to a question that was asked earlier a little differently. If the regulatory threshold is 7%, and you have no systemic buffer, where would you expect to run your capital ratio, a 50 or 100 basis point cushion versus that 7%, is that sufficient for your business model, or do you think you need more?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

Sure. That's the same thing I said earlier. I think the primary focus for us is going to be more down at the bank. So, the consolidated ratios, as we highlighted, we feel fairly good about. And it's more down at the bank if the tier 1's just under 8%, and the risk-based over 16, at what level would those be at to be able to move that capital up to the parent, and then deploy that capital in a manner that's best for our shareholders.

So, we wouldn't know what those ratios are today, other than we know to continue to improve them, continue to improve profitability, and de-risk the balance sheet are good things to do. So, that's what we're going to focus on.

Eric Bertrand
Research Analyst, Barclays Capital, Inc.

Q

Okay. That's fair. And my last question would be around the interest rate hedges attached to your wholesale liabilities, the FHLB and REPO. You had previously discussed, probably about a year ago at this point, the pace of decline and roll-off that you would expect on those liabilities. Could you give us an update as to where you think those are these days, and if possible, a mark-to-market cash flow, if you were to unwind those hedges today?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

Yeah, so Eric, because the wholesale book, not unlike the loan book, is the run-off portfolio, so things haven't changed, which is to say that the run-off is going to take a long time. You probably noticed that the REPO book did come down a bit this quarter. But that's probably the most meaningful decline you'll see for some time. The mark-to-market on the hedges on that book will be in our – is in our OCI, and you'll get more specific disclosure of that in the 10-Q, but suffice it to say, it's fairly large.

Eric Bertrand
Research Analyst, Barclays Capital, Inc.

Q

Okay. If I could squeeze in one last one, could you comment on the mix of the global trading and your total volume and also, ADRs?

Michael J. Curcio
*Executive Vice President, E*TRADE Financial Corp.*

A

It averages, the global trading is very modest, and ADRs fluctuate. I don't have the exact number on hand, because we don't break it out, but we could get back to Brett on that.

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Steven J. Freiberg
*Chief Executive Officer & Director, E*TRADE Financial Corp.*
A

Yeah, Brett can follow up and we'll see what we're able to disclose or not. But to Mike's point, the global platform doesn't generate a substantial amount of volume, but it's not surprising. I think most Americans, particularly since we're mostly a domestically focused company, tend to be more comfortable trading on the domestic exchanges, so when they want to go outside of domestic exchanges.

ADRs are the preferred vehicle, even though we give them access to six major exchanges. We even give them access in local currency if they would want it, but it tends not to be something heavily utilized, and then outside of that, we do have some physical presence in several geographies. That only generates probably 2% to 3% of our overall trading volume. Think London, Hong Kong, and Singapore.

Eric Bertrand
Research Analyst, Barclays Capital, Inc.
Q

Right. Pretty small. Thank you very much, guys.

Steven J. Freiberg
*Chief Executive Officer & Director, E*TRADE Financial Corp.*
A

Yeah. Pretty small.

Operator: Your next question comes from Matt Fischer of CLSA.

Matt Fischer
Analyst, CLSA
Q

Hi, Good evening. First question just on your loans. What's the fair market value of your loans? Can you provide that?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*
A

Yeah, Matt. This is Matt. So, that's a disclosure we do provide, but we provide it in our 10-Q, so we don't have that for you today.

Matt Fischer
Analyst, CLSA
Q

Okay.

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*
A

You'll get it in about two weeks.

Matt Fischer
Analyst, CLSA
Q

Okay. And I mean, the gap between the net loans and fair market value is about 1.6 billion in the first quarter, do you think that's kind of consistent?

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Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.* A

Consistent with the second quarter number?

Matt Fischer
Analyst, CLSA Q

Right.

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.* A

Yes. So, we'll, not that I'm dodging the question, but we'll have that number for you in a couple of weeks in the 10-Q.

Matt Fischer
Analyst, CLSA Q

Okay. And then just regarding the second quarter, were there any observable transactions or – to help you derive the fair value, were you dependent upon your models?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.* A

So we certainly did not sell any loans during the quarter, but if you're referencing the markets themselves, that's not the specifics of what we reference. I'd say that the loan markets in general are fairly illiquid. But I wouldn't have any more specific comments for you on how we derive the value.

Matt Fischer
Analyst, CLSA Q

Okay. All right. That's fine. Thank you very much.

Operator: Your next question comes from Brian Bedell of ISI Group.

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

Hi, Good evening, folks.

Steven J. Freiberg
*Chief Executive Officer & Director, E*TRADE Financial Corp.* A

Hi, Brian.

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

If you think about some of the – this question's for Steve I guess, in terms of thinking long-term strategically say two, three, four years out, and the business mix that you currently have, can you comment on maybe four different types of businesses. If I think of the RIA business, obviously that's where some of your bigger competitors are in.

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The other being the corporate service business that you're currently in, and then the other being the penetration opportunity that you talked about with 190 billion on the 2 trillion of your own customers clients, total asset book. And then the fourth would be maybe positioning your company to better leverage to a higher rate environment than obviously the Ameritrades and Schwabs, Schwabs have. Maybe just a sort of a broad comment about, is there a desire to get in more deeply into the RIA business over time and to lever your business mix over time to higher rates or would you rather just focus on the other two?

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

A

Yeah, let me put it in perspective the way we think about E*TRADE. And this should be consistent. For about the last year or so, we put a strategic plan into play, and then I will try to address the majority of the questions that you've asked, including our – basically our position vis-a-vis a rising rate environment as well. Think about E*TRADE basically in let's say four strategic areas. One being the traditional brokerage business, particularly with the focus on trading. Second being institutional with a dominant piece of that clearly is the corporate services group. Third being an area of the long-term investor or wealth management, where I will give you a sense of our thoughts there, as well as our activities. And then finally, the bank, which we think is a very valuable asset to this enterprise as well.

On the brokerage side over the last year, we've spent a fair amount of time on – really on strategies that would allow us to increase the level of growth of our customer base, net new account base. And I think as I addressed it in the prepared remarks, that so far year-to-date, we put on approximately 74,000 net new accounts. If you look back a year ago for the full-year, we put on 54,000. So, the first as we've kind of learned in any consumer franchise, if you can't grow your customer base, it's highly problematic over time and you have to also keep in mind, not grow the customer base, but grow the customer base with quality at a cost that makes sense. And so we're very focused on all those metrics.

In addition to that, and I'll jump over the institutional piece to long-term investor or wealth management, it's evident to us that we have a lot of customers, basically a lot of brokerage accounts, almost 3 million, but the brokerage accounts look at us in a narrow way that they look at some of our key competitors. So, if you look at E*TRADE where we have 10% to 12% or so of the wallet, financial wallet of our customers, if you look over at a company like Schwab, who's been positioned more for long-term investors for a longer period of time, that penetration number is probably 35% to 40%. So, it's not herculean, others have done it.

We basically are relatively new, and what we've been working on is better positioning our company from the standpoint of marketing. So, you've seen the bifurcation between the baby on our advertising and more hard-hitting product and platform so that we can talk about our capabilities not just our imagery. So, we are basically – we think the baby is terrific for awareness, but we think we have to also provide more tangibility and specificity, particularly if we want to compel you to think about us or consider us as a good place to invest.

In addition to that, what we found is that we segment our portfolio correctly and we put a financial consultant, one of ours not an RIA, with the right group of customers, the relationship improves remarkably, in particular, in the area of a better relationship from the standpoint of helping then manage to the longer term versus just a transactional business all things being equal. And as Mike made the point, we're working on doubling that sales force over a two-year period and we're well down the road, as it relates to that. And then finally, but these are not sequential they're running in parallel, having the right sort of products and services, and the awareness that we have the right set of products and services, which we believe we have a full set of products and services to serve the needs of that particular client base. So, those two are highly related, but we think about them somewhat

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distinctive at the moment, because we're ahead on one and somewhat behind on the other, because we started late, not because we failed at execution.

In the middle is this institutional set of businesses that are only focused for the moment on the corporate services group, the corporate services group, which we say we have 21% market share of corporate America measured by the Fortune 1000 and we do a terrific, we think, a terrific job for those folks in the administration of the deferred equity and option plans, and the real benefit to us is not only an economic benefit from the program, but 25% to 30% of our new retail customers flow to us from that business at a much reduced cost if we have to go out to the open market. So, we want to accelerate the growth of that business both for strategic, as well as economic reasons.

And then finally, there is the bank, and the bank is serving us well. But the bank is really in two businesses today. One, it really does take the deposits we bring in or the cash we bring in, and tries to optimize the value, which it's done, I think, a terrific job at. And the other is it's been a collection agency, on collecting the money from the legacy loans that go back mostly from '07, '06, '05 and just prior to that, but that essentially fortunately is not a growth industry. That's an industry basically that's under control and over time becomes less impactful to our business. So we kind of think about it across that spectrum. We're executing across all those elements.

Then in addition to that, you asked a question about rate exposure. And oftentimes we go on the record, which we have, saying that we're rate neutral roughly speaking, but we typically have to reinforce that to a parallel shock in change in rates. But if rates rise or the curve steepens with the passage of time, we like that a lot and that will accrue value to us over any reasonable period of time. So, we tend to be rate neutral when we run our models again for a shock to the system whether it's a parallel shock or a non-parallel shock. But we tend not to be rate neutral if rates are going to sustain themselves higher and steeper, that's a very good situation for us with the passage of time.

Brian B. Bedell
Managing Director, International Strategy & Investment Group, Inc.

Q

Do you ever think about – and thanks so much for the answer, that's a very good in-depth description. Do you ever think about using capital to break some of the hedges on the liability side that would give you more rate exposure?

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

A

Put it this way, we've talked about it, but at this point we've concluded that when you look at cost-benefit, probably not the right thing for us to do, all things being equal. [ph] Mike Peasy (65:30) is here who is essentially both the corporate and bank treasurer, I don't know Mike if you want to add anything in addition to that, I think that's more or less where we come out.

A

We continually look at it and we continually look at our active hedge position versus the designated hedge positions that you are referring to, and at this point in time, we think the best practice is to continue the run-off that we -

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

A

So we'll continue to review it. But we've concluded at this point, it's not economic for us to take action.

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Brian B. Bedell
Managing Director, International Strategy & Investment Group, Inc.

Q

And so the debt pay down is still the primary or the favored use of capital when you get to the point where you can deploy it, is that correct?

Matthew J. Audette
*Chief Financial Officer, E*TRADE Financial Corp.*

A

Sure. This is Matt. So, I think we would make that judgment at the time. But I think it is most certainly is one of the most obvious uses sitting here today.

Brian B. Bedell
Managing Director, International Strategy & Investment Group, Inc.

Q

Great. Thanks so much for taking my questions.

Operator: This concludes the question-and-answer session of today's call. I would now like to turn the floor back over to Mr. Steven Freiberg, for closing remarks.

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

Thank you, operator. And thank you, again for joining us tonight and we look forward to speaking with you again next quarter. Good evening to everyone.

Operator: Thank you for participating in today's conference call. You may now disconnect.

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