

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2013

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-11921

E*TRADE Financial Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

94-2844166
(I.R.S. Employer
Identification Number)

1271 Avenue of the Americas, 14th Floor, New York, New York 10020
(Address of Principal Executive Offices and Zip Code)

(646) 521-4300
(Registrant's Telephone Number, including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of May 3, 2013, there were 286,834,552 shares of common stock outstanding.

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E*TRADE FINANCIAL CORPORATION
FORM 10-Q QUARTERLY REPORT
For the Quarter Ended March 31, 2013
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*Unless otherwise indicated, references to "the Company," "we," "us," "our" and "E*TRADE" mean E*TRADE Financial Corporation and its subsidiaries.*

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FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements involving risks and uncertainties. These statements relate to our future plans, objectives, expectations and intentions. These statements may be identified by the use of words such as “expect,” “may,” “anticipate,” “intend,” “plan” and similar expressions. Our actual results could differ materially from those discussed in these forward-looking statements, and we caution that we do not undertake to update these statements. Factors that could contribute to our actual results differing from any forward-looking statements include those discussed under Risk Factors, Management’s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report. The cautionary statements made in this report should be read as being applicable to all forward-looking statements wherever they appear in this report. We further caution that there may be risks associated with owning our securities other than those discussed in our filings. Important factors that may cause actual results to differ materially from any forward-looking statements are set forth in Item 1A. Risk Factors in the Annual Report on Form 10-K for the year ended December 31, 2012.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and the related notes that appear elsewhere in this document and with the Annual Report on Form 10-K for the year ended December 31, 2012.

GLOSSARY OF TERMS

In analyzing and discussing our business, we utilize certain metrics, ratios and other terms that are defined in the Glossary of Terms, which is located at the end of Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

OVERVIEW

Strategy

Our core business is our trading and investing customer franchise. Building on the strengths of this franchise, our strategy is focused on:

- *Strengthening our overall financial and franchise position.* We are focused on achieving a more efficient distribution of capital between our regulated entities, improving capital ratios by reducing risk, deleveraging the balance sheet and reducing costs, and enhancing our enterprise-wide risk management culture and capabilities.
- *Improving our market position in our retail brokerage business.* We plan to accelerate the growth in our customer franchise and to continue enhancing the customer experience.
- *Capitalizing on the value of our complementary brokerage businesses.* Our corporate services and market making businesses enhance our strategy by allowing us to realize additional economic benefit from our retail brokerage business.
- *Enhancing our position in retirement and investing.* We believe growing our retirement and investing products and services is key to our long term success. Our primary focus is to expand the reach of our brand along with the awareness of our products to this key customer segment.
- *Continuing to manage and de-risk the Bank.* We are focused on optimizing the value of customer deposits, while continuing to mitigate credit losses in our loan portfolio, and improving the Bank’s risk profile. In addition, we do not plan to offer new banking products to customers, including mortgages.

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Key Factors Affecting Financial Performance

Our financial performance is affected by a number of factors outside of our control, including:

- customer demand for financial products and services;
- weakness or strength of the residential real estate and credit markets;
- performance, volume and volatility of the equity and capital markets;
- customer perception of the financial strength of our franchise;
- market demand and liquidity in the secondary market for mortgage loans and securities;
- market demand and liquidity in the wholesale borrowings market, including securities sold under agreements to repurchase;
- our ability to obtain regulatory approval to move capital from our bank to our parent company; and
- changes to the rules and regulations governing the financial services industry.

In addition to the items noted above, our success in the future will depend upon, among other things, our ability to:

- have continued success in the acquisition, growth and retention of brokerage customers;
- generate meaningful growth in the retirement and investing customer group;
- strengthen our risk management capabilities;
- reduce credit costs;
- achieve the capital ratios stated in our strategic plan, with a particular focus on the Tier 1 leverage ratio at E*TRADE Bank;
- generate capital sufficient to meet our operating needs at both our bank and our parent company;
- assess and manage interest rate risk; and
- have disciplined expense control and improved operational efficiency.

Management monitors a number of metrics in evaluating the Company's performance. The most significant of these are shown in the table and discussed in the text below:

	As of or For the Three Months Ended March 31,		Variance
	2013	2012	2013 vs. 2012
Customer Activity Metrics:			
Daily average revenue trades ("DARTs")	148,538	156,988	(5)%
Average commission per trade	\$ 11.30	\$ 11.04	2%
Margin receivables (dollars in billions)	\$ 5.7	\$ 5.3	8%
End of period brokerage accounts	2,933,225	2,829,006	4%
Net new brokerage accounts	30,034	45,994	(35)%
Annualized brokerage account attrition rate	8.5%	8.7%	*
Customer assets (dollars in billions)	\$ 218.7	\$ 201.9	8%
Net new brokerage assets (dollars in billions)	\$ 3.1	\$ 4.0	(23)%
Brokerage related cash (dollars in billions)	\$ 34.7	\$ 31.0	12%
Company Financial Metrics:			
Corporate cash (dollars in millions)	\$ 351.6	\$ 483.8	(27)%
E*TRADE Financial Tier 1 leverage ratio	6.0%	5.5%	0.5%
E*TRADE Financial Tier 1 common ratio	11.2%	9.4%	1.8%
E*TRADE Bank Tier 1 leverage ratio	9.3%	7.3%	2.0%
Special mention loan delinquencies (dollars in millions)	\$ 312.1	\$ 374.9	(17)%
Allowance for loan losses (dollars in millions)	\$ 455.0	\$ 579.2	(21)%
Enterprise net interest spread	2.30%	2.49%	(0.19)%
Enterprise interest-earning assets (average dollars in billions)	\$ 40.9	\$ 44.9	(9)%

* Percentage not meaningful.

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Customer Activity Metrics

- DARTs are the predominant driver of commissions revenue from our customers.
- Average commission per trade is an indicator of changes in our customer mix, product mix and/or product pricing.
- Margin receivables represent credit extended to customers to finance their purchases of securities by borrowing against securities they own. Margin receivables are a key driver of net operating interest income.
- End of period brokerage accounts, net new brokerage accounts and brokerage account attrition rate are indicators of our ability to attract and retain brokerage customers. The brokerage account attrition rate is calculated by dividing attriting brokerage accounts, which are gross new brokerage accounts less net new brokerage accounts, by total brokerage accounts at the previous period end. This rate is presented on an annualized basis.
- Changes in customer assets are an indicator of the value of our relationship with the customer. An increase in customer assets generally indicates that the use of our products and services by existing and new customers is expanding. Changes in this metric are also driven by changes in the valuations of our customers' underlying securities.
- Net new brokerage assets are total inflows to all new and existing brokerage accounts less total outflows from all closed and existing brokerage accounts and are a general indicator of the use of our products and services by existing and new brokerage customers.
- Brokerage related cash is an indicator of the level of engagement with our brokerage customers and is a key driver of net operating interest income.

Company Financial Metrics

- Corporate cash is an indicator of the liquidity at the parent company. It is the primary source of capital above and beyond the capital deployed in our regulated subsidiaries.
- E*TRADE Financial Tier 1 leverage ratio is Tier 1 capital divided by average total assets for leverage capital purposes for the parent company. E*TRADE Financial Tier 1 common ratio is Tier 1 capital less elements of Tier 1 capital that are not in the form of common equity, such as trust preferred securities, divided by total risk-weighted assets for the holding company. The Tier 1 leverage and Tier 1 common ratios are non-GAAP measures as the parent company is not yet held to these regulatory capital requirements and are indications of E*TRADE Financial's capital adequacy. See Liquidity and Capital Resources for a reconciliation of these non-GAAP measures to the comparable GAAP measures.
- E*TRADE Bank Tier 1 leverage ratio is Tier 1 capital divided by adjusted total assets for E*TRADE Bank and is an indication of E*TRADE Bank's capital adequacy.
- Special mention loan delinquencies are loans 30-89 days past due and are an indicator of the expected trend for charge-offs in future periods as these loans have a greater propensity to migrate into nonaccrual status and ultimately charge-off.
- Allowance for loan losses is an estimate of probable losses inherent in the loan portfolio as of the balance sheet date and is typically equal to management's forecast of loan losses in the twelve months following the balance sheet date as well as the forecasted losses, including economic concessions to borrowers, over the estimated remaining life of loans modified as troubled debt restructurings ("TDR").
- Enterprise interest-earning assets, in conjunction with our enterprise net interest spread, are indicators of our ability to generate net operating interest income.

[Table of Contents](#)**Significant Events in the First Quarter of 2013***Enhancements to Our Trading and Investing Products and Services*

- We launched a revamped tablet experience, and enhanced our iPhone and Android platforms adding useful tools such as mobile bill pay, and access to index futures, giving customers better insight into the markets outside of traditional trading hours;
- We upgraded our E*TRADE Pro platform by enhancing its capabilities with the integration of futures trading, allowing us to provide customers with a much more streamlined futures trading experience; and
- We hosted our second annual National Retirement Education Day in New York and at all our branches to provide customers with perspectives on how to better prepare for and manage their retirement assets.

EARNINGS OVERVIEW

We generated net income of \$35.1 million, or \$0.12 per diluted share, on total net revenue of \$419.9 million for the three months ended March 31, 2013. Net operating interest income decreased 15% to \$241.3 million for the three months ended March 31, 2013 compared to the same period in 2012, which was driven primarily by decreases in enterprise interest-earning assets and enterprise interest-bearing liabilities as a result of our deleveraging initiatives, in addition to a decrease in enterprise net interest spread. Commissions, fees and service charges, principal transactions and other revenue decreased 5% to \$164.1 million for the three months ended March 31, 2013, compared to the same period in 2012, which was driven primarily by lower trading activity during 2013. In addition, gains on loans and securities, net decreased 55% to \$15.7 million for the three months ended March 31, 2013 compared to the same period in 2012.

Provision for loan losses declined 41% to \$42.7 million for the three months ended March 31, 2013 compared to the same period in 2012. The decline was driven primarily by improving credit trends and loan portfolio run-off, as well as a \$12.5 million benefit from a settlement with a third party mortgage originator. Total operating expenses decreased 3% to \$295.5 million for the three months ended March 31, 2013 compared to the same period in 2012. This decrease was driven primarily by decreases in advertising and market development and other operating expenses, partially offset by an increase in facility restructuring and other exit activities expense for the three months ended March 31, 2013.

The following sections describe in detail the changes in key operating factors and other changes and events that affected net revenue, provision for loan losses, operating expense, other income (expense) and income tax expense.

Revenue

The components of revenue and the resulting variances are as follows (dollars in millions):

	Three Months		Variance	
	Ended March 31,		2013 vs. 2012	
	2013	2012	Amount	%
Net operating interest income	\$241.3	\$284.9	\$(43.6)	(15)%
Commissions	100.7	107.4	(6.7)	(6)%
Fees and service charges	32.5	32.0	0.5	2%
Principal transactions	21.8	24.1	(2.3)	(10)%
Gains on loans and securities, net	15.7	34.9	(19.2)	(55)%
Net impairment	(1.2)	(3.5)	2.3	*
Other revenues	9.1	9.6	(0.5)	(6)%
Total non-interest income	178.6	204.5	(25.9)	(13)%
Total net revenue	<u>\$419.9</u>	<u>\$489.4</u>	<u>\$(69.5)</u>	(14)%

* Percentage not meaningful.

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Net Operating Interest Income

Net operating interest income decreased 15% to \$241.3 million for the three months ended March 31, 2013 compared to the same period in 2012. Net operating interest income is earned primarily through investing customer cash and deposits in enterprise interest-earning assets, which include: real estate loans, margin receivables, available-for-sale securities and held-to-maturity securities.

The following table presents enterprise average balance sheet data and enterprise income and expense data for our operations, as well as the related net interest spread, yields and rates and have been prepared on the basis required by the SEC's Industry Guide 3, "Statistical Disclosure by Bank Holding Companies" (dollars in millions):

	Three Months Ended March 31,					
	2013			2012		
	Average Balance	Operating Interest Inc./Exp.	Average Yield/ Cost	Average Balance	Operating Interest Inc./Exp.	Average Yield/ Cost
Enterprise interest-earning assets:						
Loans ⁽¹⁾	\$10,398.1	\$ 106.7	4.10%	\$12,972.7	\$ 139.5	4.30%
Available-for-sale securities	12,987.0	64.2	1.98%	16,054.9	105.9	2.64%
Held-to-maturity securities	9,500.4	58.1	2.44%	6,917.6	53.4	3.09%
Margin receivables	5,666.7	54.4	3.90%	4,857.3	48.0	3.97%
Cash and equivalents	1,593.4	0.8	0.21%	1,604.6	0.8	0.21%
Segregated cash	158.2	0.1	0.11%	1,830.0	0.4	0.08%
Securities borrowed and other	592.4	12.8	8.76%	653.1	12.7	7.80%
Total enterprise interest-earning assets	40,896.2	297.1	2.91%	44,890.2	360.7	3.22%
Non-operating interest-earning and non-interest earning assets ⁽²⁾	5,096.2			4,441.2		
Total assets	<u>\$45,992.4</u>			<u>\$49,331.4</u>		
Enterprise interest-bearing liabilities:						
Deposits	\$26,950.1	3.2	0.05%	\$27,927.9	8.3	0.12%
Customer payables	5,059.0	1.9	0.15%	5,965.7	2.7	0.18%
Securities sold under agreements to repurchase	4,453.6	36.7	3.30%	4,989.2	40.7	3.23%
Federal Home Loan Bank ("FHLB") advances and other borrowings	1,261.1	16.9	5.37%	2,732.2	25.4	3.68%
Securities loaned and other	749.0	—	0.01%	588.5	0.2	0.12%
Total enterprise interest-bearing liabilities	38,472.8	58.7	0.61%	42,203.5	77.3	0.73%
Non-operating interest-bearing and non-interest bearing liabilities ⁽³⁾	2,600.5			2,153.3		
Total liabilities	41,073.3			44,356.8		
Total shareholders' equity	4,919.1			4,974.6		
Total liabilities and shareholders' equity	<u>\$45,992.4</u>			<u>\$49,331.4</u>		
Excess of enterprise interest-earning assets over enterprise interest-bearing liabilities/Enterprise net interest income/Spread						
	<u>\$ 2,423.4</u>	<u>\$ 238.4</u>	2.30%	<u>\$ 2,686.7</u>	<u>\$ 283.4</u>	2.49%
Enterprise net interest margin (net yield on enterprise interest-earning assets)			2.33%			2.53%
Ratio of enterprise interest-earning assets to enterprise interest-bearing liabilities			106.30%			106.37%
Return on average:						
Total assets			0.31%			0.51%
Total shareholders' equity			2.86%			5.03%
Average equity to average total assets			10.70%			10.08%

Reconciliation from enterprise net interest income to net operating interest income (dollars in millions):

	Three Months Ended March 31,	
	2013	2012
Enterprise net interest income	\$ 238.4	\$ 283.4
Taxable equivalent interest adjustment	(0.2)	(0.3)
Customer cash held by third parties and other ⁽⁴⁾	3.1	1.8
Net operating interest income	<u>\$ 241.3</u>	<u>\$ 284.9</u>

- (1) Nonaccrual loans are included in the average loan balances. Interest payments received on nonaccrual loans are recognized on a cash basis in operating interest income until it is doubtful that full payment will be collected, at which point payments are applied to principal.
- (2) Non-operating interest-earning and non-interest earning assets consist of certain segregated cash balances, property and equipment, net, goodwill, other intangibles, net and other assets that do not generate operating interest income. Some of these assets generate corporate interest income.
- (3) Non-operating interest-bearing and non-interest bearing liabilities consist of corporate debt and other liabilities that do not generate operating interest expense. Some of these liabilities generate corporate interest expense.
- (4) Includes revenue earned on average customer assets of \$9.5 billion and \$4.0 billion for the three months ended March 31, 2013 and 2012, respectively, held by third parties outside the Company, including money market funds and sweep deposit accounts at unaffiliated financial institutions.

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The fluctuation in enterprise interest-earning assets is driven primarily by changes in enterprise interest-bearing liabilities, specifically customer cash and deposits. Average enterprise interest-earning assets decreased 9% to \$40.9 billion for the three months ended March 31, 2013 compared to the same period in 2012. This was primarily a result of decreases in average loans, average available-for-sale securities and average segregated cash, partially offset by an increase in average held-to-maturity securities.

Average enterprise interest-bearing liabilities decreased 9% to \$38.5 billion for the three months ended March 31, 2013 compared to the same period in 2012. The decrease in average enterprise interest-bearing liabilities was due primarily to our deleveraging strategy which drove a decrease in average FHLB advances and other borrowings.

Enterprise net interest spread decreased by 19 basis points to 2.30% for the three months ended March 31, 2013 compared to the same period in 2012, due primarily to lower yields on loans and reinvestment at lower rates in the current interest rate environment, which remains challenging. We expect enterprise net interest spread will continue to average approximately 10 basis points below the average from 2012; however, enterprise net interest spread may further fluctuate based on the size and mix of the balance sheet, as well as the impact from the level of interest rates.

Commissions

Commissions revenue decreased 6% to \$100.7 million for the three months ended March 31, 2013 compared to the same period in 2012. The main factors that affect commissions are DARTs, average commission per trade and the number of trading days during the period. Average commission per trade is impacted by customer mix and the different commission rates on various trade types (e.g. equities, options, futures, fixed income, stock plan, exchange-traded funds, mutual funds, forex and cross border). Accordingly, changes in the mix of trade types will impact average commission per trade.

DART volume decreased 5% to 148,538 for the three months ended March 31, 2013 compared to the same period in 2012. Option-related DARTs as a percentage of total DARTs represented 24% of trading volume for the three months ended March 31, 2013 compared to 23% in the same period in 2012. Exchange-traded funds-related DARTs as a percentage of total DARTs represented 7% of trading volume for the three months ended March 31, 2013 compared to 8% in the same period in 2012.

Average commission per trade increased 2% to \$11.30 for the three months ended March 31, 2013 compared to the same period in 2012. The increase was driven by a favorable change in customer and product mix, when compared to the same period in 2012.

Fees and Service Charges

Fees and service charges increased 2% to \$32.5 million for the three months ended March 31, 2013 compared to the same period in 2012. The table below shows the components of fees and service charges and the resulting variances (dollars in millions):

	Three Months Ended		Variance	
	March 31,		2013 vs. 2012	
	2013	2012	Amount	%
Order flow revenue	\$ 15.4	\$ 15.5	\$ (0.1)	(1)%
Mutual fund service fees	4.4	3.8	0.6	16%
Foreign exchange revenue	3.4	3.5	(0.1)	(3)%
Advisor management fees	2.5	1.2	1.3	108%
Reorganization fees	1.2	1.7	(0.5)	(29)%
Other fees and service charges	5.6	6.3	(0.7)	(11)%
Total fees and service charges	<u>\$ 32.5</u>	<u>\$ 32.0</u>	<u>\$ 0.5</u>	<u>2%</u>

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The increase in fees and services charges for the three months ended March 31, 2013 was driven primarily by increases in advisor management fees and mutual fund service fees.

Principal Transactions

Principal transactions decreased 10% to \$21.8 million for the three months ended March 31, 2013 compared to the same period in 2012. Principal transactions are derived from our market making business in which we act as a market-maker for our brokerage customers' orders as well as orders from third party customers. The decrease in principal transactions revenue was driven primarily by lower levels of market volatility when compared to the same period in 2012.

Gains on Loans and Securities, Net

Gains on loans and securities, net decreased 55% to \$15.7 million for the three months ended March 31, 2013 compared to the same period in 2012. The table below shows the activity and resulting variances (dollars in millions):

	Three Months Ended March 31,		Variance 2013 vs. 2012	
	2013	2012	Amount	%
Gains on available-for-sale securities, net	\$ 15.8	\$ 34.9	\$(19.1)	(55)%
Hedge ineffectiveness	(0.1)	—	(0.1)	*
Gains on loans and securities, net	<u>\$ 15.7</u>	<u>\$ 34.9</u>	<u>\$(19.2)</u>	<u>(55)%</u>

* Percentage not meaningful.

Net Impairment

We recognized \$1.2 million and \$3.5 million of net impairment during the three months ended March 31, 2013 and 2012, respectively, on certain securities in our non-agency CMO portfolio due to continued deterioration in the expected credit performance of the underlying loans in those specific securities. The gross other-than-temporary impairment ("OTTI") and the noncredit portion of OTTI, which was or had been previously recorded through other comprehensive income, are shown in the table below (dollars in millions):

	Three Months Ended March 31,	
	2013	2012
Other-than-temporary impairment ("OTTI")	\$ (0.6)	\$ (12.6)
Less: noncredit portion of OTTI recognized into (out of) other comprehensive income (before tax)	(0.6)	9.1
Net impairment	<u>\$ (1.2)</u>	<u>\$ (3.5)</u>

Provision for Loan Losses

Provision for loan losses decreased 41% to \$42.7 million for the three months ended March 31, 2013 compared to the same period in 2012. The decrease in provision for loan losses was driven primarily by improving credit trends, as evidenced by the lower levels of delinquent loans in the one- to four-family and home equity loan portfolios, and loan portfolio run-off, as well as a \$12.5 million benefit recorded from a settlement with a third party mortgage originator for the three months ended March 31, 2013. The provision for loan losses has declined 92% from its peak of \$517.8 million in the third quarter of 2008. We expect provision for loan losses to continue to decline over the long term, although it is subject to variability in any given quarter.

[Table of Contents](#)**Operating Expense**

The components of operating expense and the resulting variances are as follows (dollars in millions):

	Three Months Ended		Variance	
	March 31,		2013 vs. 2012	
	2013	2012	Amount	%
Compensation and benefits	\$ 95.7	\$ 92.3	\$ 3.4	4%
Advertising and market development	36.6	47.6	(11.0)	(23)%
Clearing and servicing	31.6	34.6	(3.0)	(8)%
FDIC insurance premiums	29.3	28.4	0.9	3%
Professional services	17.3	20.3	(3.0)	(15)%
Occupancy and equipment	17.5	17.8	(0.3)	(2)%
Communications	18.5	19.1	(0.6)	(3)%
Depreciation and amortization	23.0	22.2	0.8	4%
Amortization of other intangibles	6.1	6.3	(0.2)	(4)%
Facility restructuring and other exit activities	7.6	(0.4)	8.0	*
Other operating expenses	12.3	18.0	(5.7)	(32)%
Total operating expense	<u>\$ 295.5</u>	<u>\$ 306.2</u>	<u>\$(10.7)</u>	(3)%

* Percentage not meaningful

Compensation and Benefits

Compensation and benefits increased 4% to \$95.7 million for the three months ended March 31, 2013 compared to the same period in 2012. The increase resulted primarily from \$4.5 million in severance associated with the executive terminations that was recorded during the three months ended March 31, 2013.

Advertising and Market Development

Advertising and market development decreased 23% to \$36.6 million for the three months ended March 31, 2013 compared to the same period in 2012. This fluctuation is due largely to the planned decrease in advertising expenditures as part of our expense reduction initiatives.

Clearing and Servicing

Clearing and servicing decreased 8% to \$31.6 million for the three months ended March 31, 2013 compared to the same period in 2012. This decrease resulted primarily from lower trading volumes and lower loan balances compared to 2012.

Professional Services

Professional services decreased 15% to \$17.3 million for the three months ended March 31, 2013 compared to the same period in 2012. The decrease was due primarily to lower consulting fees when compared to 2012.

Facility Restructuring and Other Exit Activities

Facility restructuring and other exit activities were \$7.6 million for the three months ended March 31, 2013. These costs were driven primarily by severance costs incurred as part of our expense reduction initiatives.

Other Operating Expenses

Other operating expenses decreased 32% to \$12.3 million for the three months ended March 31, 2013 compared to the same period in 2012. The decrease was driven primarily by reduced expenses related to real estate owned ("REO") compared to the same period in 2012 and a \$2.4 million benefit from sales tax refunds that was recorded during the three months ended March 31, 2013.

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Other Income (Expense)

Other income (expense) decreased 46% to \$24.3 million for the three months ended March 31, 2013 compared to the same period in 2012 as shown in the following table (dollars in millions):

	Three Months Ended		Variance	
	March 31,		2013 vs. 2012	
	2013	2012	Amount	%
Corporate interest expense	\$ (28.6)	\$ (45.1)	\$ 16.5	(37)%
Equity in income (loss) of investments and other	4.3	(0.1)	4.4	*
Total other income (expense)	\$ (24.3)	\$ (45.2)	\$ 20.9	(46)%

* Percentage not meaningful.

Total other income (expense) included corporate interest expense on interest-bearing corporate debt for the three months ended March 31, 2013 and 2012. Corporate interest expense decreased 37% to \$28.6 million for the three months ended March 31, 2013 compared to the same period in 2012 as a result of the refinance of \$1.3 billion of higher yielding corporate debt during the fourth quarter of 2012. During the three months ended March 31, 2013, corporate interest expense was partially offset by a gain of \$4.8 million included in equity in income (loss) of investments and other related to an investment in a venture fund.

Income Tax Expense

Income tax expense was \$22.2 million and \$3.4 million for the three months ended March 31, 2013 and 2012, respectively. The effective tax rate was 38.8% for the three months ended March 31, 2013 compared to 5.2% for the same period in 2012.

During the first quarter of 2012, we recorded an income tax benefit of \$26.3 million related to certain losses on the 2009 Debt Exchange that were previously considered non-deductible. Through additional research completed in the first quarter of 2012, we identified that a portion of those losses were incorrectly treated as non-deductible in 2009 and were deductible for tax purposes. The \$26.3 million tax benefit resulted in a corresponding increase to the net deferred tax asset.

Valuation Allowance

We are required to establish a valuation allowance for deferred tax assets and record a charge to income if we determine, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. If we did conclude that a valuation allowance was required, the resulting loss could have a material adverse effect on our financial condition and results of operations.

We did not establish any valuation allowance against federal deferred tax assets as of March 31, 2013 as we believe that it is more likely than not that all of these assets will be realized. We continue to maintain a valuation allowance for certain of our state, foreign country and charitable contribution deferred tax assets as it is more likely than not that they will not be realized.

SEGMENT RESULTS REVIEW

We report operating results in two segments: 1) trading and investing; and 2) balance sheet management. Trading and investing includes retail brokerage products and services; investor-focused banking products; market making; and corporate services. Balance sheet management includes the management of asset allocation; loans previously originated by the Company or purchased from third parties; customer cash and deposits; and credit,

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liquidity and interest rate risk for the Company as described in the Risk Management section. Costs associated with certain functions that are centrally-managed are separately reported in a corporate/other category.

Trading and Investing

The following table summarizes trading and investing financial information and key metrics as of and for the three months ended March 31, 2013 and 2012 (dollars in millions, except for key metrics):

	Three Months Ended		Variance	
	March 31,		2013 vs. 2012	
	2013	2012	Amount	%
Net operating interest income	\$ 134.1	\$ 170.4	\$ (36.3)	(21)%
Commissions	100.7	107.4	(6.7)	(6)%
Fees and service charges	32.0	31.0	1.0	4%
Principal transactions	21.8	24.1	(2.3)	(10)%
Other revenues	8.1	7.9	0.2	1%
Total net revenue	296.7	340.8	(44.1)	(13)%
Total operating expense	198.2	211.5	(13.3)	(6)%
Trading and investing income	<u>\$ 98.5</u>	<u>\$ 129.3</u>	<u>\$ (30.8)</u>	<u>(24)%</u>

Key Metrics:

DARTs	148,538	156,988	(8,450)	(5)%
Average commission per trade	\$ 11.30	\$ 11.04	\$ 0.26	2%
Margin receivables (dollars in billions)	\$ 5.7	\$ 5.3	\$ 0.4	8%
End of period brokerage accounts	2,933,225	2,829,006	104,219	4%
Net new brokerage accounts	30,034	45,994	(15,960)	(35)%
Annualized brokerage account attrition rate	8.5%	8.7%	(0.2)%	*
Customer assets (dollars in billions)	\$ 218.7	\$ 201.9	\$ 16.8	8%
Net new brokerage assets (dollars in billions)	\$ 3.1	\$ 4.0	\$ (0.9)	(23)%
Brokerage related cash (dollars in billions)	\$ 34.7	\$ 31.0	\$ 3.7	12%

* Percentage not meaningful.

The trading and investing segment offers products and services to individual retail investors, generating revenue from these brokerage and banking relationships and from market making and corporate services activities. This segment generates five main sources of revenue: net operating interest income; commissions; fees and service charges; principal transactions; and other revenues. Net operating interest income is generated primarily from margin receivables and from a deposit transfer pricing arrangement with the balance sheet management segment. The balance sheet management segment utilizes the vast majority of customer cash and deposits and compensates the trading and investing segment via a market-based transfer pricing arrangement. This compensation is reflected in segment results as operating interest income for the trading and investing segment and operating interest expense for the balance sheet management segment and is eliminated in consolidation. Customer cash and deposits utilized by the balance sheet management segment include retail deposits and customer payables. Other revenues include results from providing software and services for managing equity compensation plans from corporate customers, as we ultimately service retail investors through these corporate relationships.

Trading and investing income decreased 24% to \$98.5 million for the three months ended March 31, 2013 compared to the same period in 2012. We continued to generate net new brokerage accounts, ending the first quarter of 2013 with 2.9 million accounts. Brokerage related cash, which is one of our most profitable sources of funding, increased by \$3.7 billion when compared to the same period in 2012.

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Trading and investing commissions decreased 6% to \$100.7 million for the three months ended March 31, 2013 compared to the same period in 2012. This decrease in commissions was primarily the result of a decrease in DARTs of 5% to 148,538 for the three months ended March 31, 2013 compared to the same period in 2012.

Trading and investing fees and service charges increased 4% to \$32.0 million for the three months ended March 31, 2013 compared to the same period in 2012. This increase for the three months ended March 31, 2013 was primarily driven by increases in advisor management fees and mutual fund service fees.

Trading and investing principal transactions decreased 10% to \$21.8 million for the three months ended March 31, 2013 compared to the same period in 2012. The decrease in principal transactions revenue was driven primarily by lower levels of market volatility when compared to the same period in 2012.

Trading and investing operating expense decreased 6% to \$198.2 million for the three months ended March 31, 2013 compared to the same period in 2012. The decrease for the three months ended March 31, 2013 resulted primarily from the planned decrease in advertising expenditures as part of our expense reduction initiatives.

As of March 31, 2013, we had approximately 2.9 million brokerage accounts, 1.2 million stock plan accounts and 0.4 million banking accounts. For the three months ended March 31, 2013 and 2012, our brokerage products contributed 77% and 70%, respectively, and our banking products contributed 23% and 30%, respectively, of total trading and investing net revenue.

Balance Sheet Management

The following table summarizes balance sheet management financial information and key metrics as of and for the three months ended March 31, 2013 and 2012 (dollars in millions):

	Three Months Ended March 31,		Variance 2013 vs. 2012	
	2013	2012	Amount	%
Net operating interest income	\$ 107.2	\$ 114.4	\$ (7.2)	(6)%
Fees and service charges	0.5	1.0	(0.5)	(56)%
Gains on loans and securities, net	15.7	35.0	(19.3)	(55)%
Net impairment	(1.2)	(3.5)	2.3	(67)%
Other revenues	1.0	1.6	(0.6)	(40)%
Total net revenue	123.2	148.5	(25.3)	(17)%
Provision for loan losses	42.7	71.9	(29.2)	(41)%
Total operating expense	50.1	58.6	(8.5)	(15)%
Balance sheet management income	<u>\$ 30.4</u>	<u>\$ 18.0</u>	<u>\$ 12.4</u>	69%
Key Metrics:				
Special mention loan delinquencies	\$ 312.1	\$ 374.9	\$ (62.8)	(17)%
Allowance for loan losses	\$ 455.0	\$ 579.2	\$(124.2)	(21)%

The balance sheet management segment generates revenue from managing loans previously originated by the Company or purchased from third parties, as well as utilizing customer cash and deposits to generate additional net operating interest income. The balance sheet management segment utilizes customer cash and deposits from the trading and investing segment, wholesale borrowings and proceeds from loan pay-downs to invest in available-for-sale and held-to-maturity securities. Net operating interest income is generated from interest earned on available-for-sale and held-to-maturity securities and loans receivable, net of interest paid on wholesale borrowings and on a deposit transfer pricing arrangement with the trading and investing segment. The balance sheet management segment utilizes the vast majority of customer cash and deposits and compensates the

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trading and investing segment via a market-based transfer pricing arrangement. This compensation is reflected in segment results as operating interest income for the trading and investing segment and operating interest expense for the balance sheet management segment and is eliminated in consolidation. Customer cash and deposits utilized by the balance sheet management segment include retail deposits and customer payables.

Balance sheet management income increased 69% to \$30.4 million for the three months ended March 31, 2013 when compared to the same period, due primarily to a decrease in provision for loan losses of 41% to \$42.7 million for the three months ended March 31, 2013.

Gains on loans and securities, net were \$15.7 million for the three months ended March 31, 2013 compared to \$35.0 million for the same period in 2012.

We recognized \$1.2 million and \$3.5 million of net impairment during the three months ended March 31, 2013 and 2012, respectively, on certain securities in the non-agency CMO portfolio due to continued deterioration in the expected credit performance of the underlying loans in those specific securities.

Provision for loan losses decreased 41% to \$42.7 million for the three months ended March 31, 2013 compared to the same period in 2012. The decrease in provision for loan losses was driven primarily by improving credit trends and loan portfolio run-off, as well as a \$12.5 million benefit from a settlement with a third party mortgage originator for the three months ended March 31, 2013.

Total balance sheet management operating expense decreased 15% to \$50.1 million for the three months ended March 31, 2013 compared to the same period in 2012. The decrease in operating expense for the three months ended March 31, 2013 resulted primarily from reduced servicing expenses due to lower loan balances, reduced expenses related to REO and lower consulting fees when compared to the same period in 2012.

Corporate/Other

The following table summarizes corporate/other financial information for the three months ended March 31, 2013 and 2012 (dollars in millions):

	Three Months Ended		Variance	
	March 31,		2013 vs. 2012	
	2013	2012	Amount	%
Total net revenue	\$ —	\$ —	\$ —	*
Compensation and benefits	20.5	18.3	2.2	12%
Professional services	8.4	7.3	1.1	15%
Occupancy and equipment	1.1	0.9	0.2	21%
Communications	0.3	0.4	(0.1)	(11)%
Depreciation and amortization	4.0	4.3	(0.3)	(7)%
Facility restructuring and other exit activities	7.6	(0.4)	8.0	*
Other operating expenses	5.3	5.3	—	0%
Total operating expense	47.2	36.1	11.1	31%
Operating loss	(47.2)	(36.1)	(11.1)	31%
Total other income (expense)	(24.3)	(45.2)	20.9	(46)%
Corporate/other loss	<u>\$ (71.5)</u>	<u>\$ (81.3)</u>	<u>\$ 9.8</u>	(12)%

* Percentage not meaningful.

The corporate/other category includes costs that are centrally-managed, technology related costs incurred to support centrally-managed functions, restructuring and other exit activities, corporate debt and corporate investments.

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The corporate/other loss before income taxes was \$71.5 million for the three months ended March 31, 2013, compared to \$81.3 million for the same period in 2012.

The operating loss increased 31% to \$47.2 million for the three months ended March 31, 2013 when compared to the same period in 2012, due primarily to an increase in facility restructuring and other exit activities expense as a result of severance costs incurred as part of our expense reduction initiatives.

Total other income (expense) included corporate interest expense on interest-bearing corporate debt for the three months ended March 31, 2013 and 2012. Corporate interest expense decreased 37% to \$28.6 million for the three months ended March 31, 2013 compared to the same period in 2012 as a result of the refinancing of \$1.3 billion of higher yielding corporate debt during the fourth quarter of 2012. During the three months ended March 31, 2013, corporate interest expense was partially offset by a gain of \$4.8 million included in equity in income (loss) of investments and other related to an investment in a venture fund.

BALANCE SHEET OVERVIEW

The following table sets forth the significant components of the consolidated balance sheet (dollars in millions):

	March 31, 2013	December 31, 2012	Variance 2013 vs. 2012	
			Amount	%
Assets:				
Cash and equivalents	\$ 1,507.7	\$ 2,761.5	\$(1,253.8)	(45)%
Segregated cash	318.8	376.9	(58.1)	(15)%
Securities ⁽¹⁾	22,633.4	23,084.2	(450.8)	(2)%
Margin receivables	5,748.6	5,804.0	(55.4)	(1)%
Loans receivable, net	9,585.3	10,098.7	(513.4)	(5)%
Investment in FHLB stock	61.4	67.4	(6.0)	(9)%
Other ⁽²⁾	5,111.1	5,194.0	(82.9)	(2)%
Total assets	\$44,966.3	\$47,386.7	\$(2,420.4)	(5)%
Liabilities and shareholders' equity:				
Deposits	\$25,877.8	\$28,392.5	\$(2,514.7)	(9)%
Wholesale borrowings ⁽³⁾	5,724.9	5,715.6	9.3	0%
Customer payables	5,084.3	4,964.9	119.4	2%
Corporate debt	1,765.9	1,765.0	0.9	0%
Other liabilities	1,561.6	1,644.2	(82.6)	(5)%
Total liabilities	40,014.5	42,482.2	(2,467.7)	(6)%
Shareholders' equity	4,951.8	4,904.5	47.3	1%
Total liabilities and shareholders' equity	\$44,966.3	\$47,386.7	\$(2,420.4)	(5)%

(1) Includes balance sheet line items trading, available-for-sale and held-to-maturity securities.

(2) Includes balance sheet line items property and equipment, net, goodwill, other intangibles, net and other assets.

(3) Includes balance sheet line items securities sold under agreements to repurchase and FHLB advances and other borrowings.

Segregated Cash

Segregated cash decreased by \$58.1 million to \$318.8 million during the three months ended March 31, 2013. The level of cash required to be segregated under federal or other regulations, or segregated cash, is driven largely by customer cash and securities lending balances we hold as a liability in excess of the amount of margin receivables and securities borrowed balances we hold as an asset. The excess represents customer cash that we are required by our regulators to segregate for the exclusive benefit of our brokerage customers.

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Securities

Trading, available-for-sale and held-to-maturity securities are summarized as follows (dollars in millions):

	March 31, 2013	December 31, 2012	Variance 2013 vs. 2012	
			Amount	%
Trading securities	\$ 100.5	\$ 101.3	\$ (0.8)	(1)%
Available-for-sale securities:				
Residential mortgage-backed securities:				
Agency mortgage-backed securities and CMOs	\$11,429.2	\$12,097.2	\$ (668.0)	(6)%
Non-agency CMOs	14.1	235.2	(221.1)	(94)%
Total residential mortgage-backed securities	11,443.3	12,332.4	(889.1)	(7)%
Investment securities	1,233.1	1,110.6	122.5	11%
Total available-for-sale securities	\$12,676.4	\$13,443.0	\$ (766.6)	(6)%
Held-to-maturity securities:				
Residential mortgage-backed securities:				
Agency mortgage-backed securities and CMOs	\$ 8,106.2	\$ 7,887.5	\$ 218.7	3%
Investment securities	1,750.3	1,652.4	97.9	6%
Total held-to-maturity securities	\$ 9,856.5	\$ 9,539.9	\$ 316.6	3%
Total securities	\$22,633.4	\$23,084.2	\$ (450.8)	(2)%

Securities represented 50% and 49% of total assets at March 31, 2013 and December 31, 2012, respectively. The decline in available-for-sale securities during the three months ended March 31, 2013 was due primarily to a decrease of \$668.0 million in agency mortgage-backed securities and CMOs. In addition, we sold \$230.5 million in amortized cost of available-for-sale non-agency CMOs during the first quarter of 2013 as part of our focus to reduce risk and deleverage the balance sheet.

Loans Receivable, Net

Loans receivable, net are summarized as follows (dollars in millions):

	March 31, 2013	December 31, 2012	Variance 2013 vs. 2012	
			Amount	%
One- to four-family	\$5,217.1	\$ 5,442.2	\$ (225.1)	(4)%
Home equity	4,021.1	4,223.4	(202.3)	(5)%
Consumer and other	739.8	844.9	(105.1)	(12)%
Unamortized premiums, net	62.3	68.9	(6.6)	(10)%
Allowance for loan losses	(455.0)	(480.7)	25.7	(5)%
Total loans receivable, net	\$9,585.3	\$10,098.7	\$ (513.4)	(5)%

Loans receivable, net decreased 5% to \$9.6 billion at March 31, 2013 from \$10.1 billion at December 31, 2012. This decline was due primarily to our strategy of reducing balance sheet risk by allowing the loan portfolio to pay down, which we plan to do for the foreseeable future.

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Deposits

Deposits are summarized as follows (dollars in millions):

	March 31, 2013	December 31, 2012	Variance 2013 vs. 2012	
			Amount	%
Sweep deposits	\$18,923.1	\$21,253.6	\$(2,330.5)	(11)%
Complete savings deposits	4,827.4	4,981.6	(154.2)	(3)%
Checking deposits	1,061.7	1,055.4	6.3	1%
Other money market and savings deposits	974.9	995.2	(20.3)	(2)%
Time deposits	90.7	106.7	(16.0)	(15)%
Total deposits	<u>\$25,877.8</u>	<u>\$28,392.5</u>	<u>\$(2,514.7)</u>	<u>(9)%</u>

Deposits represented 65% and 67% of total liabilities at March 31, 2013 and December 31, 2012, respectively. At March 31, 2013, 92% of our customer deposits were covered by FDIC insurance. Deposits provide the benefit of lower interest costs compared with wholesale funding alternatives. Deposits decreased 9% to \$25.9 billion at March 31, 2013 from \$28.4 billion at December 31, 2012. The decrease was driven primarily by \$2.3 billion in sweep deposits that were transferred off of the balance sheet to third parties during the first quarter of 2013 as part of our deleveraging initiatives.

The deposits balance is a component of the total customer cash and deposits balance reported as a customer activity metric of \$41.7 billion and \$41.0 billion at March 31, 2013 and December 31, 2012, respectively. The total customer cash and deposits balance is summarized as follows (dollars in millions):

	March 31, 2013	December 31, 2012	Variance 2013 vs. 2012	
			Amount	%
Deposits	\$25,877.8	\$28,392.5	\$(2,514.7)	(9)%
Less: brokered certificates of deposit	(2.0)	(11.2)	9.2	(82)%
Retail deposits	25,875.8	28,381.3	(2,505.5)	(9)%
Customer payables	5,084.3	4,964.9	119.4	2%
Customer cash balances held by third parties and other	10,699.3	7,644.2	3,055.1	40%
Total customer cash and deposits	<u>\$41,659.4</u>	<u>\$40,990.4</u>	<u>\$ 669.0</u>	<u>2%</u>

Wholesale Borrowings

Wholesale borrowings, which consist of securities sold under agreements to repurchase and FHLB advances and other borrowings, are summarized as follows (dollars in millions):

	March 31, 2013	December 31, 2012	Variance 2013 vs. 2012	
			Amount	%
Securities sold under agreements to repurchase	<u>\$4,459.4</u>	<u>\$4,454.7</u>	<u>\$ 4.7</u>	<u>0%</u>
FHLB advances	\$ 836.4	\$ 831.7	\$ 4.7	1%
Subordinated debentures	427.7	427.7	—	0%
Other	1.4	1.5	(0.1)	(7)%
Total FHLB advances and other borrowings	<u>\$1,265.5</u>	<u>\$1,260.9</u>	<u>\$ 4.6</u>	<u>0%</u>
Total wholesale borrowings	<u>\$5,724.9</u>	<u>\$5,715.6</u>	<u>\$ 9.3</u>	<u>0%</u>

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Wholesale borrowings represented 14% and 13% of total liabilities at March 31, 2013 and December 31, 2012, respectively. Securities sold under agreements to repurchase and FHLB advances are the primary wholesale funding sources of the Bank. As a result, we expect these balances to fluctuate over time as deposits and interest-earnings assets fluctuate.

Corporate Debt

Corporate debt by type is shown as follows (dollars in millions):

	<u>Face Value</u>	<u>Discount</u>	<u>Net</u>
March 31, 2013			
Interest-bearing notes:			
6 3/4% Notes, due 2016	\$ 435.0	\$ (5.3)	\$ 429.7
6% Notes, due 2017	505.0	(4.4)	500.6
6 3/8% Notes, due 2019	800.0	(7.1)	792.9
Total interest-bearing notes	1,740.0	(16.8)	1,723.2
Non-interest-bearing debt:			
0% Convertible debentures, due 2019	42.7	—	42.7
Total corporate debt	<u>\$1,782.7</u>	<u>\$ (16.8)</u>	<u>\$1,765.9</u>
December 31, 2012			
Interest-bearing notes:			
6 3/4% Notes, due 2016	\$ 435.0	\$ (5.8)	\$ 429.2
6% Notes, due 2017	505.0	(4.6)	500.4
6 3/8% Notes, due 2019	800.0	(7.3)	792.7
Total interest-bearing notes	1,740.0	(17.7)	1,722.3
Non-interest-bearing debt:			
0% Convertible debentures, due 2019	42.7	—	42.7
Total corporate debt	<u>\$1,782.7</u>	<u>\$ (17.7)</u>	<u>\$1,765.0</u>

Shareholders' Equity

The activity in shareholders' equity during the three months ended March 31, 2013 is summarized as follows (dollars in millions):

	<u>Common Stock / Additional Paid- In Capital</u>	<u>Accumulated Deficit / Other Comprehensive Loss</u>	<u>Total</u>
Beginning balance, December 31, 2012	\$ 7,322.1	\$ (2,417.6)	\$4,904.5
Net income	—	35.1	35.1
Net change from available-for-sale securities	—	(15.1)	(15.1)
Net change from cash flow hedging instruments	—	26.1	26.1
Other ⁽¹⁾	1.2	—	1.2
Ending balance, March 31, 2013	<u>\$ 7,323.3</u>	<u>\$ (2,371.5)</u>	<u>\$4,951.8</u>

⁽¹⁾ Other includes employee share-based compensation and changes in accumulated other comprehensive loss from foreign currency translation.

LIQUIDITY AND CAPITAL RESOURCES

We have established liquidity and capital policies to support the successful execution of our business strategies, while ensuring ongoing and sufficient liquidity through the business cycle. We believe liquidity is of critical importance to the Company and especially important within E*TRADE Bank. The objective of our policies is to ensure that we can meet our corporate and banking liquidity needs under both normal operating conditions and under periods of stress in the financial markets. Our corporate liquidity needs are primarily driven by the amount of principal and interest due on our corporate debt as well as any capital needs at E*TRADE Bank. Our banking liquidity needs are driven primarily by the level and volatility of our customer deposits. Management maintains an extensive set of liquidity sources and monitors certain business trends and market metrics closely in an effort to ensure we have sufficient liquidity and to avoid dependence on other more expensive sources of funding. Management believes the following sources of liquidity are of critical importance in maintaining ample funding for liquidity needs: Corporate cash, Bank cash, deposits and unused FHLB borrowing capacity. Management believes that within deposits, sweep deposits are of particular importance as they are the most stable source of liquidity for E*TRADE Bank when compared to non-sweep deposits. Overall, management believes that these liquidity sources, which can fluctuate in any given period, are more than sufficient to meet our needs for the foreseeable future.

Capital is generated primarily through the business operations of the trading and investing and balance sheet management segments, which are primarily contained within E*TRADE Bank; therefore, we believe a key indicator of the capital generated or used in our business operations is the level of regulatory capital in E*TRADE Bank. As of March 31, 2013, E*TRADE Bank's Tier 1 leverage ratio was 9.3%, an increase from 8.7% at December 31, 2012. We have been focused on improving the Tier 1 leverage ratio at E*TRADE Bank through deleveraging the balance sheet by a reduction in wholesale borrowings, retail deposits and customer payables, the majority of which has been completed. We are now focused on continuing to generate capital through earnings.

We submitted an initial long-term strategic and capital plan to the OCC and Federal Reserve during the second quarter of 2012. The plan included: our five-year business strategy; forecasts of our business results and capital ratios; capital distribution plans in current and adverse operating conditions; and internally developed stress tests. During the third quarter of 2012, we received initial feedback from our regulators on this plan and we believe that key elements of this plan, specifically reducing risk, deleveraging the balance sheet and the development of an enterprise risk management function, are critical. We submitted an updated long-term strategic and capital plan to the OCC and Federal Reserve in February 2013, which included the key elements outlined in the initial plan as well as the progress made during 2012 on those key elements. We believe that our targets for capital levels at E*TRADE Bank and corresponding distributions of capital from E*TRADE Bank and its subsidiaries to the parent company will be achievable over time. We plan to continue an active and ongoing dialogue with our regulators to ensure our execution of the plan is consistent with their expectations.

Consolidated Cash and Equivalents

The consolidated cash and equivalents balance decreased by \$1.3 billion to \$1.5 billion at March 31, 2013 when compared to December 31, 2012. The majority of this balance is cash held in regulated subsidiaries, primarily the Bank, outlined as follows (dollars in millions):

	<u>March 31,</u> <u>2013</u>	<u>December</u> <u>31,</u> <u>2012</u>	<u>Variance</u> <u>2013 vs. 2012</u>
Corporate cash	\$ 351.6	\$ 407.6	\$ (56.0)
Bank cash	1,126.2	2,319.6	(1,193.4)
International brokerage and other cash	29.9	34.3	(4.4)
Total consolidated cash and equivalents	<u>\$1,507.7</u>	<u>\$2,761.5</u>	<u>\$ (1,253.8)</u>

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Corporate cash is the primary source of liquidity at the parent company. We define corporate cash as cash held at the parent company as well as cash held in certain subsidiaries that can distribute cash to the parent company without any regulatory approval. We believe corporate cash is a useful measure of the parent company's liquidity as it is the primary source of capital above and beyond the capital deployed in our regulated subsidiaries. Corporate cash can fluctuate in any given quarter and is impacted primarily by tax settlements, approval and timing of subsidiary dividends, debt service costs and other overhead cost sharing arrangements. We target corporate cash to be at least two times our annual debt service, or approximately \$220 million. From the level of corporate cash at March 31, 2013, we expect that it will decline generally in line with our corporate interest expense. However, the parent company has approximately \$400 million in net deferred tax assets, which will ultimately become sources of corporate cash as the parent's subsidiaries reimburse the parent for the use of its deferred tax assets.

Liquidity Available from Subsidiaries

Liquidity available to the Company from its subsidiaries is limited by regulatory requirements. In addition, neither E*TRADE Bank nor its subsidiaries may pay dividends to the parent company without approval from its regulators. Loans by E*TRADE Bank to the parent company and its other non-bank subsidiaries are subject to various quantitative, arm's length, collateralization and other requirements.

E*TRADE Bank is subject to capital requirements determined by its primary regulators. At March 31, 2013 and December 31, 2012, E*TRADE Bank had \$1.8 billion and \$1.6 billion, respectively, of Tier 1 leverage capital in excess of the regulatory minimum level required to be considered "well capitalized."

The Company's broker-dealer subsidiaries are subject to capital requirements determined by their respective regulators. At March 31, 2013 and December 31, 2012, all of our brokerage subsidiaries met their minimum net capital requirements. Our broker-dealer subsidiaries had excess net capital of \$670.8 million at March 31, 2013, an increase of \$15.7 million from \$655.1 million at December 31, 2012. The excess net capital of the broker-dealer subsidiaries at March 31, 2013 included \$526.0 million and \$96.8 million of excess net capital at E*TRADE Clearing LLC and E*TRADE Securities LLC, respectively, which are subsidiaries of E*TRADE Bank and are also included in the excess capital of E*TRADE Bank.

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Financial Regulatory Reform Legislation and Basel III Framework

The Dodd-Frank Act requires all companies, including savings and loan holding companies, that directly or indirectly control an insured depository institution to serve as a source of strength for the institution. The implementation of holding company capital requirements will impact us as the parent company was not previously subject to regulatory capital requirements. These holding company capital requirements are expected to become effective in 2015. We believe these capital ratios are an important measure of capital strength and accordingly manage our capital against the current capital ratios that apply to bank holding companies. The Tier 1 leverage, Tier 1 risk-based capital and total risk-based capital ratios are non-GAAP measures as the parent company is not yet held to these regulatory capital requirements and are calculated as follows (dollars in millions):

	March 31, 2013	December 31, 2012	March 31, 2012
Shareholders' equity	\$ 4,951.8	\$ 4,904.5	\$ 5,035.9
Deduct:			
Losses in other comprehensive income on available-for-sale debt securities and cash flow hedges, net of tax	(304.4)	(315.4)	(345.3)
Good will and other intangible assets, net of deferred tax liabilities	1,883.1	1,899.4	1,930.6
Add:			
Qualifying restricted core capital elements (TRUPs) ⁽¹⁾	433.0	433.0	433.0
Subtotal	3,806.1	3,753.5	3,883.6
Deduct:			
Disallowed servicing assets and deferred tax assets	1,265.2	1,278.9	1,353.2
Tier 1 capital	2,540.9	2,474.6	2,530.4
Add:			
Allowable allowance for loan losses	237.6	251.8	282.5
Total capital	<u>\$ 2,778.5</u>	<u>\$ 2,726.4</u>	<u>\$ 2,812.9</u>
Total average assets	\$ 45,679.4	\$ 48,152.7	\$ 49,331.4
Deduct:			
Goodwill and other intangible assets, net of deferred tax liabilities	1,883.1	1,899.4	1,930.6
Subtotal	43,796.3	46,253.3	47,400.8
Deduct:			
Disallowed servicing assets and deferred tax assets	1,265.2	1,278.9	1,353.2
Average total assets for leverage capital purposes	<u>\$ 42,531.1</u>	<u>\$ 44,974.4</u>	<u>\$ 46,047.6</u>
Total risk-weighted assets ⁽²⁾	<u>\$ 18,741.8</u>	<u>\$ 19,849.9</u>	<u>\$ 22,244.0</u>
Tier 1 leverage ratio (Tier 1 capital / Average total assets for leverage capital purposes)	6.0%	5.5%	5.5%
Tier 1 capital / Total risk-weighted assets	13.6%	12.5%	11.4%
Total capital / Total risk-weighted assets	14.8%	13.7%	12.6%

(1) The Company included 100% of its trust preferred securities ("TRUPs") in E*TRADE Financial's Tier 1 capital due to the delay in the implementation of the TRUPs phase-out by regulatory agencies. If the TRUPs phase-out had been implemented, E*TRADE Financial's Tier 1 leverage ratio would have been 5.7% at March 31, 2013.

(2) Under the regulatory guidelines for risk-based capital, on-balance sheet assets and credit equivalent amounts of derivatives and off-balance sheet items are assigned to one of several broad risk categories according to the obligor or, if relevant, the guarantor or the nature of any collateral. The aggregate dollar amount in each risk category is then multiplied by the risk weight associated with that category. The resulting weighted values from each of the risk categories are aggregated for determining total risk-weighted assets.

As of March 31, 2013, the parent company Tier 1 leverage ratio was approximately 6.0% compared to the minimum ratio required to be "well capitalized" of 5%, the Tier 1 risk-based capital ratio was approximately 13.6% compared to the minimum ratio required to be "well capitalized" of 6%, and the total risk-based capital ratio was approximately 14.8% compared to the minimum ratio required to be "well capitalized" of 10%.

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Our Tier 1 common ratio, which is a non-GAAP measure and currently has no mandated minimum or “well capitalized” standard, was 11.2% as of March 31, 2013. We believe this ratio is an important measure of our capital strength. The Tier 1 common ratio is defined as Tier 1 capital less elements of Tier 1 capital that are not in the form of common equity, such as trust preferred securities, divided by total risk-weighted assets. The following table shows the calculation of the Tier 1 common ratio (dollars in millions):

	March 31, 2013	December 31, 2012	March 31, 2012
Shareholders' equity	\$ 4,951.8	\$ 4,904.5	\$ 5,035.9
Deduct:			
Losses in other comprehensive income on available-for-sale debt securities and cash flow hedges, net of tax	(304.4)	(315.4)	(345.3)
Goodwill and other intangible assets, net of deferred tax liabilities	<u>1,883.1</u>	<u>1,899.4</u>	<u>1,930.6</u>
Subtotal	3,373.1	3,320.5	3,450.6
Deduct:			
Disallowed servicing assets and deferred tax assets	<u>1,265.2</u>	<u>1,278.9</u>	<u>1,353.2</u>
Tier 1 common	<u>\$ 2,107.9</u>	<u>\$ 2,041.6</u>	<u>\$ 2,097.4</u>
Total risk-weighted assets	\$18,741.8	\$ 19,849.9	\$22,244.0
Tier 1 common ratio (Tier 1 common / Total risk-weighted assets)	11.2%	10.3%	9.4%

In June 2012, the U.S. Federal banking agencies published notices of proposed rulemaking for comment related to the implementation of the Basel III framework for the calculation and components of a banking organization's regulatory capital and a U.S. version of the international standardized approach for calculating a banking organization's risk-weighted assets. In November 2012, the banking agencies announced a delay in the implementation of Basel III in the U.S. and have not yet issued final Basel III rules. We believe the most relevant elements of the proposal to us relate to the proposed risk-weighting of mortgage loans and margin receivables in addition to the inclusion in the calculation of Common Tier 1 capital of unrealized gains (losses) on all available-for-sale debt securities. Under the current proposal, we do not believe the incorporation of these elements have a significant impact on our current capital ratios; however, the final impact of the Basel III capital standards on regulatory requirements will remain uncertain until the final rules implementing Basel III are adopted for U.S. institutions. We will continue to monitor the ongoing rule-making and comment process to assess both the timing and the impact of the Dodd-Frank Act and Basel III capital standards on our business.

On October 9, 2012, the Federal Reserve adopted final regulations implementing the requirement for certain Federal Reserve-regulated savings and loan holding companies, including the Company, to conduct company-run stress tests on an annual basis. Under the Federal Reserve's stress test regulations, we will be required to utilize stress-testing methodologies providing for results under at least three different sets of conditions, including baseline, adverse, and severely adverse conditions. The final regulations will apply to the Company in the fall of the calendar year after it becomes subject to minimum capital requirements, a period which has not yet been specified. We conducted a company-run stress test for the Company, which we believe is consistent with the Federal Reserve's methodologies, and provided the results to the Federal Reserve with the submission of the long-term strategic and capital plan in February 2013.

Also on October 9, 2012, the OCC adopted final regulations implementing the requirement for national banks or federal savings associations with over \$10 billion in average total consolidated assets, including E*TRADE Bank, to conduct company-run stress tests on an annual basis. Under the OCC's stress test regulations, E*TRADE Bank also will be required to utilize stress-testing methodologies providing for results under at least three different sets of conditions, including baseline, adverse and severely adverse scenarios. The final regulations require E*TRADE Bank to conduct its first stress test using financial statement data as of

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September 30, 2013, and it will be required to report results to the OCC on or before March 31, 2014. We conducted a company-run stress test for E*TRADE Bank, which we believe is consistent with the OCC's methodologies, and provided the results to the OCC with submission of the long-term strategic and capital plan in February 2013.

Other Sources of Liquidity

We also maintain uncommitted lines of credit with unaffiliated banks to finance margin lending, with available balances subject to approval when utilized. At March 31, 2013, there were no outstanding balances.

We rely on borrowed funds, from sources such as securities sold under agreements to repurchase and FHLB advances, to provide liquidity for E*TRADE Bank. Our ability to borrow these funds is dependent upon the continued availability of funding in the wholesale borrowings market. In addition, we can borrow from the Federal Reserve Bank's discount window to meet short-term liquidity requirements, although it is not viewed as a primary source of funding. At March 31, 2013, E*TRADE Bank had approximately \$3.7 billion and \$1.0 billion in additional collateralized borrowing capacity with the FHLB and the Federal Reserve Bank, respectively. We also have the ability to generate liquidity in the form of additional deposits by raising the yield on our customer deposit account products.

Off-Balance Sheet Arrangements

We enter into various off-balance-sheet arrangements in the ordinary course of business, primarily to meet the needs of our customers and to reduce our own exposure to interest rate risk. These arrangements include firm commitments to extend credit and letters of credit. Additionally, we enter into guarantees and other similar arrangements as part of transactions in the ordinary course of business. For additional information on each of these arrangements, see Item 1. Consolidated Financial Statements (unaudited).

RISK MANAGEMENT

As a financial services company, our business exposes us to certain risks. The identification, mitigation and management of existing and potential risks are key to effective enterprise risk management. There are certain risks that are inherent to our business (e.g. execution of transactions) whereas other risks will present themselves through the conduct of that business. We seek to monitor and manage our significant risk exposures through a set of board-approved limits as well as Key Risk Indicators ("KRIs") or metrics. We have in place a governance framework that regularly reports metrics, major risks and exposures to senior management and the Board of Directors. During 2013, we will continue to enhance our risk management culture and capabilities while complying with evolving regulatory guidelines and expectations.

We developed a Board-approved Risk Appetite Statement ("RAS") which was disseminated to all employees and specifies the significant risks we are exposed to and our tolerance of those risks. As described in the RAS, our business exposes us to the following eight major categories of risk:

- *Credit Risk*—the risk of loss arising from the inability or failure of a borrower or counterparty to meet its credit obligations.
- *Interest Rate Risk*—the risk of loss of income or value of future income due to changes in interest rates arising from the Company's balance sheet position. This includes convexity risk, which arises from optionality in the balance sheet, related to deposit flows or to prepayments in mortgage assets.
- *Liquidity Risk*—the potential inability to meet contractual and contingent financial obligations either on- or off-balance sheet, as they come due.
- *Market Risk*—the risk that asset values or income streams will be adversely affected by changes in market prices.

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- *Operational Risk*—the risk of loss due to failure of people, processes and systems, or damage to physical assets caused by unexpected events.
- *Strategic Risk*—sometimes called business risk, is the risk of loss of market size, market share or margin in any business.
- *Reputational Risk*—the potential that negative perceptions regarding our conduct or business practices will adversely affect valuation, profitability, operations or customer base or require costly litigation or other measures.
- *Legal, Regulatory and Compliance Risk*—the current and prospective risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, internal policies, and procedures, or ethical standards.

For additional information about our interest rate risk, see Item 3. Quantitative and Qualitative Disclosures about Market Risk. For additional information on liquidity risk, see Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources. Market risk, operational risk, strategic risk, reputational risk and legal, regulatory and compliance risk and the management of risk are more fully described in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2012. We are also subject to other risks that could impact our business, financial condition, results of operations or cash flows in future periods. See Item 1A. Risk Factors in the Annual Report on Form 10-K for the year ended December 31, 2012.

Credit Risk Management

Credit risk is the risk of loss arising from the inability or failure of a borrower or counterparty to meet its credit obligations. We are exposed to credit risk in the following areas:

- We hold credit risk exposure in our loan portfolio. We are not currently originating or purchasing loans for investment. Even though the portfolio is running off, losses are likely to remain significant.
- We extend margin loans to our brokerage customers which exposes us to the risk of credit losses in the event we cannot liquidate collateral during significant market movements.
- We engage in financial transactions with counterparties which expose us to credit losses in the event a counterparty cannot meet its obligations. These financial transactions include our invested cash, securities lending, repurchase and reverse repurchase agreements and derivatives contracts, as well as the settlement of trades.

Credit risk is monitored by our Credit Committee, whose objective is to evaluate current and expected credit performance of the Company's loans, investments, borrowers and counterparties relative to market conditions and the probable impact on the Company's financial performance. The Credit Committee establishes credit risk guidelines in accordance with the Company's strategic objectives and existing policies. The Credit Committee reviews investment and lending activities involving credit risk to ensure consistency with those established guidelines. These reviews involve an analysis of portfolio balances, delinquencies, losses, recoveries, default management and collateral liquidation performance, as well as any credit risk mitigation efforts relating to the portfolios. In addition, the Credit Committee reviews and approves credit related counterparties engaged in financial transactions with the Company.

Loss Mitigation on the Loan Portfolio

We have a credit risk operations team that focuses on the mitigation of potential losses in the loan portfolio. Through a variety of strategies, including voluntary line closures, automatically freezing lines on all delinquent accounts, and freezing lines on loans with materially reduced home equity, we have reduced our exposure to open home equity lines from a high of over \$7 billion in 2007 to \$0.3 billion as of March 31, 2013.

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We have an initiative to assess our servicing relationships and, where appropriate, transfer certain mortgage loans to servicers that specialize in managing troubled assets. We believe this initiative has improved and will continue to improve the credit performance of the loans transferred in future periods when compared to the expected credit performance of these same loans if they had not been transferred. A total of \$2.7 billion of our mortgage loans were held at servicers that specialize in managing troubled assets as of March 31, 2013.

We have a loan modification program that focuses on the mitigation of potential losses in the loan portfolio. We consider modifications in which we make an economic concession to a borrower experiencing financial difficulty a TDR. During the three months ended March 31, 2013, we modified \$31.5 million and \$2.8 million of one- to four-family and home equity loans, respectively, in which the modification was considered a TDR.

We also processed minor modifications on a number of loans through traditional collections actions taken in the normal course of servicing delinquent accounts. These actions typically result in an insignificant delay in the timing of payments; therefore, we do not consider such activities to be economic concessions to the borrowers. As of March 31, 2013 and December 31, 2012, we had \$33.0 million and \$33.4 million of mortgage loans, respectively, in which the modification was not considered a TDR due to the insignificant delay in the timing of payments. Approximately 4% and 8% of these loans were classified as nonperforming as of March 31, 2013 and December 31, 2012, respectively.

We continue to review the mortgage loan portfolio in order to identify loans to be repurchased by the originator. Our review is primarily focused on identifying loans with violations of transaction representations and warranties or material misrepresentation on the part of the seller. Any loans identified with these deficiencies are submitted to the original seller for repurchase. During the first quarter of 2013, we agreed to a settlement with a third party mortgage originator specific to loans sold to us by this originator. A one-time payment of \$12.5 million was agreed upon to satisfy in full all pending and future repurchase requests with this specific originator. We applied the full amount in the first quarter of 2013 to the allowance for loan losses, resulting in a corresponding reduction to net charge-offs as well as provision for loan losses. Approximately \$14.5 million of loans were repurchased by or settled with the original sellers for the three months ended March 31, 2013. A total of \$421.0 million of loans have been repurchased by the original sellers, including global settlements, since we actively started reviewing our purchased loan portfolio beginning in 2008.

CONCENTRATIONS OF CREDIT RISK

Loans

We track and review factors to predict and monitor credit risk in the mortgage loan portfolio on an ongoing basis. These factors include: loan type, estimated current loan-to-value ("LTV")/combined loan-to-value ("CLTV") ratios, delinquency history, documentation type, borrowers' current credit scores, housing prices, loan vintage and geographic location of the property. In economic conditions in which housing prices generally appreciate, we believe that loan type, LTV/CLTV ratios, documentation type and credit scores are the key factors in determining future loan performance. In a housing market with declining home prices and less credit available for refinance, we believe the LTV/CLTV ratio becomes a more important factor in predicting and monitoring credit risk. These factors are updated on at least a quarterly basis. We track and review delinquency status to predict and monitor credit risk in the consumer and other loan portfolio on at least a quarterly basis.

The home equity loan portfolio is primarily second lien loans on residential real estate properties, which have a higher level of credit risk than first lien mortgage loans. Approximately 15% of the home equity loan portfolio was in the first lien position as of March 31, 2013. We hold both the first and second lien positions in less than 1% of the home equity loan portfolio. The home equity loan portfolio consists of approximately 21% of home equity installment loans and approximately 79% of home equity lines of credit.

Home equity installment loans are primarily fixed rate and fixed term, fully amortizing loans that do not offer the option of an interest-only payment. The majority of home equity lines of credit convert to amortizing

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loans at the end of the draw period, which typically ranges from five to ten years. At March 31, 2013, the majority of the home equity line of credit portfolio had not converted from the interest-only draw period to an amortizing loan. In addition, approximately 80% of the home equity line of credit portfolio will not begin amortizing until after 2014. However, during the year ended December 31, 2012, approximately 40% of our borrowers made voluntary annual principal payments of at least \$500 on their home equity lines of credit and approximately half of those borrowers reduced their principal balance by at least \$2,500 during the year ended December 31, 2012. The following table outlines when home equity lines of credit convert to amortizing for the home equity line of credit portfolio as of March 31, 2013:

<u>Period of Conversion to Amortizing Loan</u>	<u>% of Home Equity Line of Credit Portfolio</u>
Already amortizing	9%
Through December 31, 2013	4%
Year ending December 31, 2014	7%
Year ending December 31, 2015	26%
Year ending December 31, 2016	41%
Year ending December 31, 2017	13%

Additionally, in the current and anticipated interest rate environment, we do not expect interest rate resets to be a material driver of credit costs in the near future. As of March 31, 2013, a total of \$2.5 billion of one- to four-family loans had already reset for the first time and another \$2.2 billion were expected to reset for the first time in the next five years. We expect approximately \$1.9 billion in one- to four-family loans that have already reset to experience another interest rate reset in the remainder of 2013. We estimate that less than 1% of all one- to four-family loans expected to reset in the remainder of 2013 will experience a payment increase of more than 10% and nearly 80% are expected to reset to a lower payment in the remainder of 2013. The following table outlines the percentage of one- to four-family loans that have reset and are expected to reset for the first time as of March 31, 2013:

<u>Period of First Interest Rate Reset</u>	<u>% of Total One- to Four-Family First Resets</u>
Already reset	54%
Through December 31, 2013	2%
Year ending December 31, 2014	5%
Year ending December 31, 2015	5%
Year ending December 31, 2016	15%
Year ending December 31, 2017	19%

The following tables show the distribution of the mortgage loan portfolios by credit quality indicator (dollars in millions):

<u>Current LTV/CLTV (1)</u>	<u>One- to Four-Family</u>		<u>Home Equity</u>	
	<u>March 31, 2013</u>	<u>December 31, 2012</u>	<u>March 31, 2013</u>	<u>December 31, 2012</u>
<=80%	\$ 1,419.4	\$ 1,324.2	\$ 954.8	\$ 927.5
80%-100%	1,434.9	1,404.4	800.0	776.2
100%-120%	1,141.0	1,231.5	899.7	932.0
>120%	1,221.8	1,482.1	1,366.6	1,587.7
Total mortgage loans receivable	\$ 5,217.1	\$ 5,442.2	\$ 4,021.1	\$ 4,223.4
Average estimated current LTV/CLTV (2)	104.7%	108.1%	111.0%	113.8%
Average LTV/CLTV at loan origination (3)	71.3%	71.2%	79.4%	79.4%

(1) Current CLTV calculations for home equity loans are based on the maximum available line for home equity lines of credit and outstanding principal balance for home equity installment loans. Current property values are updated on a quarterly basis using the most recent property value data available to us. For properties in which we did not have an updated valuation, we utilized home price indices to estimate the current property value.

(2) The average estimated current LTV/CLTV ratio reflects the outstanding balance at the balance sheet date and the maximum available line for home equity lines of credit, divided by the estimated current value of the underlying property.

(3) Average LTV/CLTV at loan origination calculations are based on LTV/CLTV at time of purchase for one- to four-family purchased loans and undrawn balances for home equity loans.

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Documentation Type	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
Full documentation	\$2,211.1	\$ 2,317.9	\$2,057.0	\$ 2,166.5
Low/no documentation	3,006.0	3,124.3	1,964.1	2,056.9
Total mortgage loans receivable	\$5,217.1	\$ 5,442.2	\$4,021.1	\$ 4,223.4

Current FICO ⁽¹⁾	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
≥720	\$2,658.5	\$ 2,819.5	\$2,105.4	\$ 2,238.3
719 - 700	487.3	498.1	410.1	417.9
699 - 680	416.8	425.5	333.7	345.8
679 - 660	320.8	347.2	268.8	279.7
659 - 620	442.7	494.0	355.5	370.3
<620	891.0	857.9	547.6	571.4
Total mortgage loans receivable	\$5,217.1	\$ 5,442.2	\$4,021.1	\$ 4,223.4

⁽¹⁾ FICO scores are updated on a quarterly basis; however, as of March 31, 2013 and December 31, 2012, there were some loans for which the updated FICO scores were not available. The current FICO distribution as of March 31, 2013 included original FICO scores for approximately \$115 million and \$12 million of one- to four-family and home equity loans, respectively. The current FICO distribution as of December 31, 2012 included original FICO scores for approximately \$121 million and \$20 million of one- to four-family and home equity loans, respectively.

Vintage Year	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
2003 and prior	\$ 179.9	\$ 190.4	\$ 201.1	\$ 218.2
2004	491.8	514.3	337.1	359.7
2005	1,043.3	1,095.1	1,078.3	1,131.3
2006	2,041.9	2,123.4	1,876.8	1,962.9
2007	1,456.2	1,515.0	519.0	542.2
2008	4.0	4.0	8.8	9.1
Total mortgage loans receivable	\$5,217.1	\$ 5,442.2	\$4,021.1	\$ 4,223.4
Average age of mortgage loans receivable (years)	6.9	6.7	7.2	6.9

Geographic Location	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
California	\$2,465.3	\$ 2,568.7	\$1,271.6	\$ 1,333.3
New York	369.5	386.4	298.2	313.1
Florida	349.4	368.3	284.2	298.9
Virginia	229.1	235.0	182.5	192.1
Other states	1,803.8	1,883.8	1,984.6	2,086.0
Total mortgage loans receivable	\$5,217.1	\$ 5,442.2	\$4,021.1	\$ 4,223.4

Approximately 40% of the Company's real estate loans were concentrated in California at both March 31, 2013 and December 31, 2012. No other state had concentrations of real estate loans that represented 10% or more of the Company's real estate portfolio.

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Allowance for Loan Losses

The allowance for loan losses is management's estimate of probable losses inherent in the loan portfolio as of the balance sheet date. The estimate of the allowance for loan losses is based on a variety of quantitative and qualitative factors, including the composition and quality of the portfolio; delinquency levels and trends; current and historical charge-off and loss experience; our historical loss mitigation experience; the condition of the real estate market and geographic concentrations within the loan portfolio; the interest rate climate; the overall availability of housing credit; and general economic conditions. The allowance for loan losses is typically equal to management's forecast of loan losses in the twelve months following the balance sheet date as well as the forecasted losses, including economic concessions to borrowers, over the estimated remaining life of loans modified as TDRs. The general allowance for loan losses also included a qualitative component to account for a variety of factors that are not directly considered in the quantitative loss model but are factors we believe may impact the level of credit losses. The qualitative component was \$60 million and \$44 million at March 31, 2013 and December 31, 2012, respectively.

The following table presents the allowance for loan losses by major loan category (dollars in millions):

	<u>One- to Four-Family</u>		<u>Home Equity</u>		<u>Consumer and Other</u>		<u>Total</u>	
	<u>Allowance</u>	<u>Allowance as a % of Loans Receivable⁽¹⁾</u>	<u>Allowance</u>	<u>Allowance as a % of Loans Receivable⁽¹⁾</u>	<u>Allowance</u>	<u>Allowance as a % of Loans Receivable⁽¹⁾</u>	<u>Allowance</u>	<u>Allowance as a % of Loans Receivable⁽¹⁾</u>
March 31, 2013	\$ 161.0	3.07%	\$ 263.1	6.49%	\$ 30.9	4.13%	\$ 455.0	4.53%
December 31, 2012	\$ 183.9	3.37%	\$ 257.3	6.04%	\$ 39.5	4.62%	\$ 480.7	4.54%

⁽¹⁾ Allowance as a percentage of loans receivable is calculated based on the gross loans receivable for each respective category.

During the three months ended March 31, 2013, the allowance for loan losses decreased by \$25.7 million from the level at December 31, 2012, primarily driven by improving credit trends and loan portfolio run-off. The following table shows the trend of the ratio of the general allowance for loan losses, excluding the qualitative component, to loans that are 90+ days delinquent excluding modified TDRs (dollars in millions):

	<u>Total 90+ Days Delinquent Loans, Excluding Modified TDRs</u>	<u>General Allowance for Loan Losses Before Qualitative Component</u>	<u>Coverage Ratio</u>
March 31, 2013	\$ 310.0	\$ 247.3	80%
December 31, 2012	\$ 348.7	\$ 265.2	76%
September 30, 2012	\$ 383.3	\$ 276.5	72%
June 30, 2012	\$ 432.6	\$ 290.4	67%
March 31, 2012	\$ 520.9	\$ 326.6	63%

Troubled Debt Restructurings

TDRs include loan modifications completed under our programs that involve granting an economic concession to a borrower experiencing financial difficulty, as well as loans that have been charged-off based on the estimated current value of the underlying property less estimated selling costs due to bankruptcy notification. As of March 31, 2013, we had \$206.7 million net investment of TDRs that had been charged-off due to bankruptcy notification, \$108.1 million of which were classified as performing.

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The following table shows the TDRs by delinquency category as of March 31, 2013 and December 31, 2012 (dollars in millions):

	<u>TDRs Current</u>	<u>TDRs 30-89 Days Delinquent</u>	<u>TDRs 90-179 Days Delinquent</u>	<u>TDRs 180+ Days Delinquent</u>	<u>Total Recorded Investment in TDRs</u>
March 31, 2013					
One- to four-family	\$ 915.9	\$ 115.5	\$ 60.1	\$ 125.0	\$ 1,216.5
Home equity	228.3	17.5	9.7	19.5	275.0
Total	<u>\$1,144.2</u>	<u>\$ 133.0</u>	<u>\$ 69.8</u>	<u>\$ 144.5</u>	<u>\$ 1,491.5</u>
December 31, 2012					
One- to four-family	\$ 927.6	\$ 118.8	\$ 48.6	\$ 134.1	\$ 1,229.1
Home equity	231.9	17.6	7.9	19.6	277.0
Total	<u>\$1,159.5</u>	<u>\$ 136.4</u>	<u>\$ 56.5</u>	<u>\$ 153.7</u>	<u>\$ 1,506.1</u>

TDRs on accrual status, which are current and have made six or more consecutive payments, were \$942.4 million and \$981.4 million at March 31, 2013 and December 31, 2012, respectively.

Troubled Debt Restructurings—Loan Modifications

The following table shows TDR loan modifications by delinquency category as of March 31, 2013 and December 31, 2012 (dollars in millions):

	<u>Modifications Current</u>	<u>Modifications 30-89 Days Delinquent</u>	<u>Modifications 90-179 Days Delinquent</u>	<u>Modifications 180+ Days Delinquent</u>	<u>Total Recorded Investment in Modifications</u>
March 31, 2013					
One- to four-family	\$ 830.6	\$ 105.0	\$ 54.1	\$ 80.2	\$ 1,069.9
Home equity	187.2	14.0	6.8	6.9	214.9
Total	<u>\$ 1,017.8</u>	<u>\$ 119.0</u>	<u>\$ 60.9</u>	<u>\$ 87.1</u>	<u>\$ 1,284.8</u>
December 31, 2012					
One- to four-family	\$ 838.0	\$ 105.2	\$ 43.9	\$ 79.1	\$ 1,066.2
Home equity	195.0	15.1	6.2	7.1	223.4
Total	<u>\$ 1,033.0</u>	<u>\$ 120.3</u>	<u>\$ 50.1</u>	<u>\$ 86.2</u>	<u>\$ 1,289.6</u>

Included in allowance for loan losses was a specific valuation allowance of \$148.1 million and \$171.4 million that was established for modifications at March 31, 2013 and December 31, 2012, respectively. The specific valuation allowance for these individually impaired loans represents the forecasted losses over the

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remaining life of the loan, including the economic concession to the borrower. The following table shows TDR loan modifications and the specific valuation allowance by loan portfolio as well as the percentage of total expected losses as of March 31, 2013 and December 31, 2012 (dollars in millions):

	Recorded Investment in Modifications before Charge-offs	Charge-offs	Recorded Investment in Modifications	Specific Valuation Allowance	Net Investment in Modifications	Specific Valuation Allowance as a % of Modifications	Total Expected Losses
March 31, 2013							
One- to four-family	\$ 1,391.1	\$(321.1)	\$ 1,070.0	\$ (81.7)	\$ 988.3	8%	29%
Home equity	370.8	(156.0)	214.8	(66.4)	148.4	31%	60%
Total	<u>\$ 1,761.9</u>	<u>\$(477.1)</u>	<u>\$ 1,284.8</u>	<u>\$(148.1)</u>	<u>\$ 1,136.7</u>	12%	35%
December 31, 2012							
One- to four-family	\$ 1,383.3	\$(317.1)	\$ 1,066.2	\$ (89.7)	\$ 976.5	8%	29%
Home equity	382.6	(159.2)	223.4	(81.7)	141.7	37%	63%
Total	<u>\$ 1,765.9</u>	<u>\$(476.3)</u>	<u>\$ 1,289.6</u>	<u>\$(171.4)</u>	<u>\$ 1,118.2</u>	13%	37%

The recorded investment in TDR loan modifications includes the charge-offs related to certain loans that were written down to the estimated current value of the underlying property less estimated costs to sell. These charge-offs were recorded on modified loans that were delinquent in excess of 180 days or in bankruptcy and on TDRs when certain characteristics of the loan, including CLTV, borrower's credit and type of modification, cast substantial doubt on the borrower's ability to repay the loan. The total expected loss on TDR loan modifications includes both the previously recorded charge-offs and the specific valuation allowance. Total expected losses on TDR loan modifications decreased slightly from 37% at December 31, 2012 to 35% at March 31, 2013.

Net Charge-offs

The following table provides an analysis of the allowance for loan losses and net charge-offs for the three months ended March 31, 2013 and 2012 (dollars in millions):

	Charge-offs	Recoveries ⁽¹⁾	Net Charge-offs	% of Average Loans (Annualized)
Three Months Ended March 31, 2013				
One- to four-family	\$ (18.8)	\$ 12.5	\$ (6.3)	0.47%
Home equity	(57.4)	7.9	(49.5)	4.65%
Consumer and other	(16.2)	3.6	(12.6)	6.10%
Total	<u>\$ (92.4)</u>	<u>\$ 24.0</u>	<u>\$ (68.4)</u>	2.63%
Three Months Ended March 31, 2012				
One- to four-family	\$ (90.5)	\$ —	\$ (90.5)	5.61%
Home equity	(225.0)	9.8	(215.2)	15.90%
Consumer and other	(12.9)	3.0	(9.9)	3.64%
Total	<u>\$ (328.4)</u>	<u>\$ 12.8</u>	<u>\$ (315.6)</u>	9.74%

⁽¹⁾ Recoveries include the impact of mortgage originator settlements.

Loan losses are recognized when it is probable that a loss has been incurred. The charge-off policy for both one- to four-family and home equity loans is to assess the value of the property when the loan has been delinquent for 180 days or is in bankruptcy, regardless of whether or not the property is in foreclosure, and

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charge-off the amount of the loan balance in excess of the estimated current value of the underlying property less estimated costs to sell. TDRs are charged-off when they are identified as collateral dependent based on the terms of the modification, which includes assigning a higher level of risk to loans in which the LTV or CLTV is greater than 110%, a borrower's credit score is less than 600 and certain types of modifications, such as interest-only payments and terms longer than 30 years. Consumer loans are charged-off when the loan has been 120 days delinquent or when it is determined that collection is not probable.

Net charge-offs for the three months ended March 31, 2013 compared to the same period in 2012 decreased by \$247.2 million. During the first quarter of 2012, we completed an evaluation of certain programs and practices that were designed in accordance with guidance from our former regulator, the OTS, which resulted in loan modification policies and procedures being aligned with the guidance from the OCC and a significant increase in charge-offs during the first quarter of 2012. Net charge-offs for the three months ended March 31, 2013 included a \$12.5 million benefit recorded from a settlement with a third party mortgage originator during the first quarter of 2013. The timing and magnitude of charge-offs are affected by many factors and we anticipate variability from quarter to quarter while continuing to see a downward trend over the long term.

Nonperforming Assets

We classify loans as nonperforming when they are no longer accruing interest, which includes loans that are 90 days and greater past due, TDRs that are on nonaccrual status for all classes of loans and certain junior liens that have a delinquent senior lien. The following table shows the comparative data for nonperforming loans and assets (dollars in millions):

	March 31, 2013	December 31, 2012
One- to four-family	\$ 644.4	\$ 639.1
Home equity	223.9	247.5
Consumer and other	2.0	6.4
Total nonperforming loans	870.3	893.0
REO and other repossessed assets, net	58.1	71.2
Total nonperforming assets, net	\$ 928.4	\$ 964.2
Nonperforming loans receivable as a percentage of gross loans receivable	8.67%	8.44%
One- to four-family allowance for loan losses as a percentage of one- to four-family nonperforming loans	24.98%	28.77%
Home equity allowance for loan losses as a percentage of home equity nonperforming loans	117.51%	103.96%
Consumer and other allowance for loan losses as a percentage of consumer and other nonperforming loans	1545.00%	617.19%
Total allowance for loan losses as a percentage of total nonperforming loans	52.28%	53.83%

During the three months ended March 31, 2013, nonperforming assets, net decreased \$35.8 million to \$928.4 million when compared to December 31, 2012. This was attributed primarily to a decrease in home equity nonperforming loans driven by improving credit trends.

Delinquent Loans

We believe the distinction between loans delinquent 90 to 179 days and loans delinquent 180 days and greater is important as loans delinquent 180 days and greater have been written down to their expected recovery value, whereas loans delinquent 90 to 179 days have not (unless they are in process of bankruptcy or are modifications that have substantial doubt as to the borrower's ability to repay the loan). We believe loans delinquent 90 to 179 days are an important measure because these loans are expected to drive the vast majority of

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future charge-offs. Additional charge-offs on loans delinquent 180 days and greater are possible if home prices decline beyond current expectations, but we do not anticipate these charge-offs to be significant, particularly when compared to the expected charge-offs on loans delinquent 90 to 179 days. We expect the balances of one- to four-family loans delinquent 180 days and greater to decline over time; however, we expect the balances to remain at high levels in the near term due to the extensive amount of time it takes to foreclose on a property in the current real estate market. The following table shows the comparative data for loans delinquent 90 to 179 days (dollars in millions):

	March 31, 2013	December 31, 2012
One- to four-family	\$ 99.9	\$ 94.7
Home equity	52.5	64.2
Consumer and other loans	2.0	6.2
Total loans delinquent 90-179 days	<u>\$ 154.4</u>	<u>\$ 165.1</u>
Loans delinquent 90-179 days as a percentage of gross loans receivable	1.54%	1.56%

In addition to nonperforming assets, we monitor loans in which a borrower's current credit history casts doubt on their ability to repay a loan. We classify loans as special mention when they are between 30 and 89 days past due. The following table shows the comparative data for special mention loans (dollars in millions):

	March 31, 2013	December 31, 2012
One- to four-family	\$ 220.2	\$ 233.8
Home equity	76.1	89.3
Consumer and other loans	15.8	19.1
Total special mention loans	<u>\$ 312.1</u>	<u>\$ 342.2</u>
Special mention loans receivable as a percentage of gross loans receivable	3.11%	3.23%

The trend in special mention loan balances is generally indicative of the expected trend for charge-offs in future periods, as these loans have a greater propensity to migrate into nonaccrual status and ultimately charge-off. One- to four-family loans are generally secured in a first lien position by real estate assets, reducing the potential loss when compared to an unsecured loan. Home equity loans are generally secured by real estate assets; however, the majority of these loans are secured in a second lien position, which substantially increases the potential loss when compared to a first lien position. The loss severity of our second lien home equity loans is approximately 95%.

During the three months ended March 31, 2013, special mention loans decreased by \$30.1 million to \$312.1 million and are down 69% from their peak of \$1.0 billion as of December 31, 2008. This decrease was largely due to a decrease in both one- to four-family and home equity special mention loans. While the level of special mention loans can fluctuate significantly in any given period, we believe the continued decrease is an encouraging sign regarding the future credit performance of the mortgage loan portfolio.

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Securities

We focus primarily on security type and credit rating to monitor credit risk in our securities portfolios. The table below details the amortized cost of municipal bonds, corporate bonds and non-agency debt securities by average credit ratings and type of asset as of March 31, 2013 and December 31, 2012 (dollars in millions):

	AAA	AA	A	BBB	Below Investment Grade and Non-Rated	Total
March 31, 2013						
Municipal bonds and corporate bonds	\$10.3	\$19.9	\$—	\$ 5.5	\$ —	\$35.7
Non-agency CMOs	—	—	—	—	21.1	21.1
Total	<u>\$10.3</u>	<u>\$19.9</u>	<u>\$—</u>	<u>\$ 5.5</u>	<u>\$ 21.1</u>	<u>\$56.8</u>
December 31, 2012						
Municipal bonds and corporate bonds	\$10.3	\$19.9	\$—	\$ 5.5	\$ —	\$ 35.7
Non-agency CMOs	3.9	3.0	7.4	8.2	237.6	260.1
Total	<u>\$14.2</u>	<u>\$22.9</u>	<u>\$ 7.4</u>	<u>\$13.7</u>	<u>\$ 237.6</u>	<u>\$295.8</u>

We also held \$22.3 billion and \$22.5 billion of agency mortgage-backed securities and CMOs, agency debentures and agency debt securities at March 31, 2013 and December 31, 2012, respectively. We consider securities backed by the U.S. government or its agencies to have low credit risk as the long-term debt rating of the U.S. government is AA+ by S&P and AAA by Moody's and Fitch.

Certain non-agency CMOs were other-than-temporarily impaired as a result of the deterioration in the expected credit performance of the underlying loans in those specific securities. As of March 31, 2013, we held approximately \$21.1 million in amortized cost of non-agency CMOs that had been other-than-temporarily impaired. We recorded \$1.2 million and \$3.5 million of net impairment for the three months ended March 31, 2013 and 2012, respectively, related to other-than-temporarily impaired non-agency CMOs. During the three months ended March 31, 2013, we sold \$230.5 million amortized cost of available-for-sale non-agency CMOs as part of our focus to reduce risk and deleverage the balance sheet. Further declines in the performance of our remaining non-agency CMO portfolio could result in additional impairments in future periods.

SUMMARY OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with GAAP. Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies of Item 8. Financial Statements and Supplementary Data in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 contains a summary of our significant accounting policies, many of which require the use of estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes for the periods presented. We believe that of our significant accounting policies, the following are noteworthy because they are based on estimates and assumptions that require complex and subjective judgments by management: allowance for loan losses; valuation of goodwill and other intangible assets; estimates of effective tax rates, deferred taxes and valuation allowance; classification and valuation of certain investments; accounting for derivative instruments; and fair value measurements. Changes in these estimates or assumptions could materially impact our financial condition and results of operations and actual results could differ from our estimates. These policies are more fully described in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2012.

GLOSSARY OF TERMS

2009 Debt Exchange—In the third quarter of 2009, we exchanged \$1.7 billion aggregate principal amount of our corporate debt, including \$1.3 billion principal amount of the 12 1/2% springing lien notes due November 2017 and \$0.4 billion principal amount of the 8% senior notes due June 2011, for an equal principal amount of newly-issued non-interest-bearing convertible debentures due 2019.

Active accounts—Accounts with a balance of \$25 or more or a trade in the last six months.

Active customers—Customers that have an account with a balance of \$25 or more or a trade in the last six months.

Active Trader—The customer group that includes those who execute 30 or more trades per quarter.

Adjusted total assets—E*TRADE Bank-only assets composed of total assets plus/(less) unrealized losses (gains) on available-for-sale securities, less disallowed deferred tax assets, goodwill and certain other intangible assets.

Agency—U.S. Government sponsored and federal agencies, such as Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Government National Mortgage Association, the Small Business Administration and the Federal Home Loan Bank.

ALCO—Asset Liability Committee.

AML—Anti-Money Laundering.

APIC—Additional paid-in capital.

Average commission per trade—Total trading and investing segment commissions revenue divided by total number of trades.

Average equity to average total assets—Average total shareholders' equity divided by average total assets.

Bank—ETB Holdings, Inc. ("ETBH"), the entity that is our bank holding company and parent to E*TRADE Bank.

Basis point—One one-hundredth of a percentage point.

BCBS—International Basel Committee on Banking Supervision.

BOLI—Bank-Owned Life Insurance.

Brokerage account attrition rate—Attriting brokerage accounts, which are gross new brokerage accounts less net new brokerage accounts, divided by total brokerage accounts at the previous period end.

CAMELS rating—A U.S. supervisory rating of a bank's overall condition. The components of the rating consist of Capital adequacy, Asset quality, Management, Earnings, Liquidity and Sensitivity to market risk.

Cash flow hedge—A derivative instrument designated in a hedging relationship that mitigates exposure to variability in expected future cash flows attributable to a particular risk.

CFPB—Consumer Financial Protection Bureau.

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Charge-off—The result of removing a loan or portion of a loan from an entity’s balance sheet because the loan is considered to be uncollectible.

CLTV—Combined loan-to-value.

CMOs—Collateralized mortgage obligations.

Corporate cash—Cash held at the parent company as well as cash held in certain subsidiaries that can distribute cash to the parent company without any regulatory approval.

Customer assets—Market value of all customer assets held by the Company including security holdings, customer cash and deposits and vested unexercised options.

Customer cash and deposits—Customer cash, deposits, customer payables and money market balances, including those held by third parties.

Daily average revenue trades (“DARTs”)—Total revenue trades in a period divided by the number of trading days during that period.

Derivative—A financial instrument or other contract, the price of which is directly dependent upon the value of one or more underlying securities, interest rates or any agreed upon pricing index. Derivatives cover a wide assortment of financial contracts, including forward contracts, options and swaps.

DIF—Depositors Insurance Fund.

Economic Value of Equity (“EVE”)—The present value of expected cash inflows from existing assets, minus the present value of expected cash outflows from existing liabilities, plus the expected cash inflows and outflows from existing derivatives and forward commitments. This calculation is performed for E*TRADE Bank.

Enterprise interest-bearing liabilities—Liabilities such as customer deposits, repurchase agreements, FHLB advances and other borrowings, certain customer credit balances and securities loaned programs on which the Company pays interest; excludes customer money market balances held by third parties.

Enterprise interest-earning assets—Consists of the primary interest-earning assets of the Company and includes: loans, available-for-sale securities, held-to-maturity securities, margin receivables, trading securities, securities borrowed balances and cash and investments required to be segregated under regulatory guidelines that earn interest for the Company.

Enterprise net interest income—The taxable equivalent basis net operating interest income excluding corporate interest income and corporate interest expense and interest earned on customer cash held by third parties.

Enterprise net interest margin—The enterprise net operating interest income divided by total enterprise interest-earning assets.

Enterprise net interest spread—The taxable equivalent rate earned on average enterprise interest-earning assets less the rate paid on average enterprise interest-bearing liabilities, excluding corporate interest-earning assets and liabilities and customer cash held by third parties.

Exchange-traded funds (“ETFs”)—A fund that invests in a group of securities and trades like an individual stock on an exchange.

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Fair value—The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value hedge—A derivative instrument designated in a hedging relationship that mitigates exposure to changes in the fair value of a recognized asset or liability or a firm commitment.

Fannie Mae—Federal National Mortgage Association.

FASB—Financial Accounting Standards Board.

FCA—United Kingdom Financial Conduct Authority.

FDIC—Federal Deposit Insurance Corporation.

Federal Reserve—Board of Governors of the Federal Reserve System.

FHLB—Federal Home Loan Bank.

FICO—Fair Isaac Credit Organization.

FINRA—Financial Industry Regulatory Authority.

Fixed charge coverage ratio—Net income before taxes, depreciation and amortization and corporate interest expense divided by corporate interest expense. This ratio indicates the Company's ability to satisfy fixed financing expenses.

Forex—A type of trade that involves buying one currency while simultaneously selling another. Currencies are traded in pairs consisting of a "base currency" and a "quote currency."

Freddie Mac—Federal Home Loan Mortgage Corporation.

Generally Accepted Accounting Principles ("GAAP")—Accounting principles generally accepted in the United States of America.

Ginnie Mae—Government National Mortgage Association.

Gross loans receivable—Includes unpaid principal balances and premiums (discounts).

IFRS—International Financial Reporting Standards.

Interest rate cap—An options contract that puts an upper limit on a floating exchange rate. The writer of the cap has to pay the holder of the cap the difference between the floating rate and the upper limit when that upper limit is breached. There is usually a premium paid by the buyer of such a contract.

Interest rate floor—An options contract that puts a lower limit on a floating exchange rate. The writer of the floor has to pay the holder of the floor the difference between the floating rate and the lower limit when that lower limit is breached. There is usually a premium paid by the buyer of such a contract.

Interest rate swaps—Contracts that are entered into primarily as an asset/liability management strategy to reduce interest rate risk. Interest rate swap contracts are exchanges of interest rate payments, such as fixed-rate payments for floating-rate payments, based on notional principal amounts.

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LIBOR—London Interbank Offered Rate. LIBOR is the interest rate at which banks borrow funds from other banks in the London wholesale money market (or interbank market).

Long-term investor—The customer group that includes those who invest for the long term.

LTV—Loan-to-value.

NASDAQ—National Association of Securities Dealers Automated Quotations.

Net new customer asset flows—The total inflows to all new and existing customer accounts less total outflows from all closed and existing customer accounts, excluding the effects of market movements in the value of customer assets.

NOLs—Net operating losses.

Nonperforming assets—Assets that do not earn income, including those originally acquired to earn income (nonperforming loans) and those not intended to earn income (REO). Loans are classified as nonperforming when they are no longer accruing interest, which includes loans that are 90 days and greater past due, TDRs that are on nonaccrual status for all classes of loans and certain junior liens that have a delinquent senior lien.

Notional amount—The specified dollar amount underlying a derivative on which the calculated payments are based.

NYSE—New York Stock Exchange.

OCC—Office of the Comptroller of the Currency.

Operating margin—Income before other income (expense), income tax expense and discontinued operations, if applicable.

Options—Contracts that grant the purchaser, for a premium payment, the right, but not the obligation, to either purchase or sell the associated financial instrument at a set price during a period or at a specified date in the future.

OTTI—Other-than-temporary impairment.

OTS—Office of Thrift Supervision.

Real estate owned (“REO”) and other repossessed assets—Ownership or physical possession of real property by the Company, generally acquired as a result of foreclosure or repossession.

Recovery—Cash proceeds received on a loan that had been previously charged off.

Repurchase agreement—An agreement giving the seller of an asset the right or obligation to buy back the same or similar securities at a specified price on a given date. These agreements are generally collateralized by mortgage-backed or investment-grade securities.

Retail deposits—Balances of customer cash held at the Bank; excludes brokered certificates of deposit.

Return on average total assets—Annualized net income divided by average assets.

Return on average total shareholders’ equity—Annualized net income divided by average shareholders’ equity.

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Risk-weighted assets—Primarily computed by the assignment of specific risk-weightings assigned by the regulators to assets and off-balance sheet instruments for capital adequacy calculations.

S&P—Standard & Poor's.

SEC—U.S. Securities and Exchange Commission.

Special mention loans—Loans where a borrower's current credit history casts doubt on their ability to repay a loan. Loans are classified as special mention when loans are between 30 and 89 days past due.

Stock plan trades—Trades that originate from our corporate services business, which provides software and services to assist corporate customers in managing their equity compensation plans. The trades typically occur when an employee of a corporate customer exercises a stock option or sells restricted stock.

Sweep deposit accounts—Accounts with the functionality to transfer brokerage cash balances to and from a FDIC insured account at the banking subsidiaries.

Taxable equivalent interest adjustment—The operating interest income earned on certain assets is completely or partially exempt from federal and/or state income tax. These tax-exempt instruments typically yield lower returns than a taxable investment. To provide more meaningful comparison of yields and margins for all interest-earning assets, the interest income earned on tax exempt assets is increased to make it fully equivalent to interest income on other taxable investments. This adjustment is done for the analytic purposes in the net enterprise interest income/spread calculation and is not made on the consolidated statement of income, as that is not permitted under GAAP.

Tier 1 capital—Adjusted equity capital used in the calculation of capital adequacy ratios. Tier 1 capital equals: total shareholders' equity, plus/(less) unrealized losses (gains) on available-for-sale securities and cash flow hedges and qualifying restricted core capital elements, less disallowed servicing and deferred tax assets, goodwill and certain other intangible assets.

Troubled Debt Restructuring ("TDR")—A loan modification that involves granting an economic concession to a borrower who is experiencing financial difficulty, and loans that have been charged-off due to bankruptcy notification.

Wholesale borrowings—Borrowings that consist of securities sold under agreements to repurchase and FHLB advances and other borrowings.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following discussion about market risk disclosure includes forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of certain factors, including, but not limited to, those set forth in Item 1A. Risk Factors in the Annual Report on Form 10-K for the year ended December 31, 2012.

Interest Rate Risk

Our exposure to interest rate risk is related primarily to interest-earning assets and interest-bearing liabilities, the vast majority of which are held for non-trading purposes. The management of interest rate risk is essential to profitability. The primary objective of the management of interest rate risk is to control exposure to interest rates within the Board-approved limits, as outlined in the scenario analysis below, and with limited exposure to earnings volatility resulting from interest rate fluctuations. Our general strategies to manage interest rate risk include balancing variable-rate and fixed-rate assets and liabilities and utilizing derivatives in a way that

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reduces overall exposure to changes in interest rates. Exposure to interest rate risk requires management to make complex assumptions regarding maturities, market interest rates and customer behavior. Changes in interest rates, including the following, could impact interest income and expense:

- Interest-earning assets and interest-bearing liabilities may re-price at different times or by different amounts creating a mismatch.
- The yield curve may steepen, flatten or change shape affecting the spread between short- and long-term rates. Widening or narrowing spreads could impact net interest income.
- Market interest rates may influence prepayments resulting in maturity mismatches. In addition, prepayments could impact yields as premium and discounts amortize.

Exposure to interest rate risk is dependent upon the distribution and composition of interest-earning assets, interest-bearing liabilities and derivatives. The differing risk characteristics of each product are managed to mitigate our exposure to interest rate fluctuations. At March 31, 2013, 90% of our total assets were enterprise interest-earning assets.

At March 31, 2013, approximately 64% of total assets were residential real estate loans and available-for-sale and held-to-maturity mortgage-backed securities. The values of these assets are sensitive to changes in interest rates, as well as expected prepayment levels. As interest rates increase, fixed rate residential mortgages and mortgage-backed securities tend to exhibit lower prepayments. The inverse is true in a falling rate environment.

When real estate loans prepay, unamortized premiums are written off. Depending on the timing of the prepayment, the write-offs of unamortized premiums may result in lower than anticipated yields. The Asset Liability Committee (“ALCO”) reviews estimates of the impact of changing market rates on prepayments. This information is incorporated into our interest rate risk management strategy.

Our liability structure consists of two central sources of funding: deposits and wholesale borrowings. Cash provided to us through deposits is the primary source of funding. Key deposit products include sweep accounts, complete savings accounts and other money market and savings accounts. Wholesale borrowings include securities sold under agreements to repurchase and FHLB advances. Other sources of funding include customer payables, which is customer cash contained within our broker-dealers, and corporate debt issued by the parent company.

Deposit accounts and customer payables tend to be less rate-sensitive than wholesale borrowings. Agreements to repurchase securities and the majority of FHLB advances re-price as agreements reset. Sweep accounts, complete savings accounts and other money market and savings accounts re-price at management’s discretion. Corporate debt has fixed rates.

Derivative Instruments

We use derivative instruments to help manage interest rate risk. Interest rate swaps involve the exchange of fixed-rate and variable-rate interest payments between two parties based on a contractual underlying notional amount, but do not involve the exchange of the underlying notional amounts. Option products are utilized primarily to decrease the market value changes resulting from the prepayment dynamics of the mortgage portfolio, as well as to protect against increases in funding costs. The types of options employed include Cap Options (“Caps”), Floor Options (“Floors”), “Payor Swaptions” and “Receiver Swaptions”. Caps mitigate the market risk associated with increases in interest rates while Floors mitigate the risk associated with decreases in market interest rates. Similarly, Payor and Receiver Swaptions mitigate the market risk associated with the respective increases and decreases in interest rates. See derivative instruments discussion in Note 6—Accounting for Derivative Instruments and Hedging Activities in Item 1. Consolidated Financial Statements (Unaudited).

[Table of Contents](#)**Scenario Analysis**

Scenario analysis is an advanced approach to estimating interest rate risk exposure. Under the Economic Value of Equity (“EVE”) approach, the present value of all existing interest-earning assets, interest-bearing liabilities, derivatives and forward commitments are estimated and then combined to produce an EVE figure. The approach values only the current balance sheet in which the most significant assumptions are the prepayment rates of the loan portfolio and mortgage-backed securities and the repricing of deposits. This approach does not incorporate assumptions related to business growth, or liquidation and re-investment of instruments. This approach provides an indicator of future earnings and capital levels because changes in EVE indicate the anticipated change in the value of future cash flows. The sensitivity of this value to changes in interest rates is then determined by applying alternative interest rate scenarios, which include, but are not limited to, instantaneous parallel shifts up 100, 200 and 300 basis points and down 100 basis points. The change in EVE amounts fluctuate based on the parallel shifts in interest rates primarily due to the change in timing of cash flows in the Company’s residential loan and mortgage-backed securities portfolios. Expected prepayment rates on residential mortgage loans and mortgage-backed securities increase as interest rates decline. In a rising interest rate environment, expected prepayment rates decrease.

The EVE method is used at the E*TRADE Bank level and not for the Company. The ALCO monitors E*TRADE Bank’s interest rate risk position. E*TRADE Bank had nearly 100% of enterprise interest-earning assets at both March 31, 2013 and December 31, 2012, respectively, and held 99% of enterprise interest-bearing liabilities at both March 31, 2013 and December 31, 2012, respectively. The sensitivity of EVE at March 31, 2013 and December 31, 2012 and the limits established by E*TRADE Bank’s Board of Directors are listed below (dollars in millions):

Parallel Change in Interest Rates (basis points) ⁽¹⁾	Change in EVE				Board Limit
	March 31, 2013		December 31, 2012		
	Amount	Percentage ⁽²⁾	Amount	Percentage ⁽²⁾	
+300	\$(618.8)	(14.7)%	\$(446.3)	(11.1)%	(25)%
+200	\$(313.0)	(7.4)%	\$(168.5)	(4.2)%	(15)%
+100	\$ (68.3)	(1.6)%	\$ 23.6	0.6%	(10)%
-100	\$(155.8)	(3.7)%	\$(175.6)	(4.4)%	(10)%

(1) On March 31, 2013 and December 31, 2012, the yield for the three-month treasury bill was 0.07% and 0.05%, respectively. As a result, the requirements of the EVE model were temporarily modified, resulting in the removal of the minus 200 and 300 basis points scenarios for the periods ended March 31, 2013 and December 31, 2012.

(2) The percentage change represents the amount of change in EVE divided by the base EVE as calculated in the current interest rate environment.

We actively manage interest rate risk positions. As interest rates change, we will re-adjust our strategy and mix of assets, liabilities and derivatives to optimize our position. For example, a 100 basis points increase in rates may not result in a change in value as indicated above. The Company compares the parallel shift in interest rate changes in EVE to the established board limits in order to assess the Company’s interest rate risk on a monthly basis. In the event that the percentage change in EVE exceeds the board limits, E*TRADE Bank’s Chief Risk Officer, Chief Financial Officer and Treasurer must all be promptly notified in writing and decide upon a plan of remediation. In addition, E*TRADE Bank’s Board of Directors must be promptly notified of the exception and the planned resolution.

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PART I-FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INCOME
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended	
	March 31,	
	2013	2012
Revenue:		
Operating interest income	\$300,060	\$362,261
Operating interest expense	(58,731)	(77,409)
Net operating interest income	<u>241,329</u>	<u>284,852</u>
Commissions	100,732	107,431
Fees and service charges	32,510	31,998
Principal transactions	21,746	24,146
Gains on loans and securities, net	15,680	34,906
Other-than-temporary impairment ("OTTI")	(568)	(12,634)
Less: noncredit portion of OTTI recognized into (out of) other comprehensive income (before tax)	<u>(597)</u>	<u>9,102</u>
Net impairment	(1,165)	(3,532)
Other revenues	9,033	9,596
Total non-interest income	<u>178,536</u>	<u>204,545</u>
Total net revenue	<u>419,865</u>	<u>489,397</u>
Provision for loan losses	42,650	71,947
Operating expense:		
Compensation and benefits	95,651	92,278
Advertising and market development	36,584	47,588
Clearing and servicing	31,644	34,555
FDIC insurance premiums	29,291	28,362
Professional services	17,302	20,335
Occupancy and equipment	17,516	17,854
Communications	18,514	19,120
Depreciation and amortization	23,048	22,239
Amortization of other intangibles	6,067	6,296
Facility restructuring and other exit activities	7,569	(424)
Other operating expenses	<u>12,349</u>	<u>18,036</u>
Total operating expense	<u>295,535</u>	<u>306,239</u>
Income before other income (expense) and income tax expense	81,680	111,211
Other income (expense):		
Corporate interest income	13	14
Corporate interest expense	(28,620)	(45,125)
Equity in income (loss) of investments and other	4,294	(106)
Total other income (expense)	<u>(24,313)</u>	<u>(45,217)</u>
Income before income tax expense	57,367	65,994
Income tax expense	<u>22,243</u>	<u>3,403</u>
Net income	<u>\$ 35,124</u>	<u>\$ 62,591</u>
Basic earnings per share	\$ 0.12	\$ 0.22
Diluted earnings per share	\$ 0.12	\$ 0.22
Shares used in computation of per share data:		
Basic	286,626	285,478
Diluted	291,696	290,017

See accompanying notes to consolidated financial statements

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E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2013	2012
Net income	\$ 35,124	\$ 62,591
Other comprehensive income		
Available-for-sale securities:		
OTTI, net ⁽¹⁾	352	7,889
Noncredit portion of OTTI reclassification (into) out of other comprehensive income, net ⁽²⁾	371	(5,684)
Unrealized gains (losses), net ⁽³⁾	(6,037)	36,175
Reclassification into earnings, net ⁽⁴⁾	(9,791)	(21,816)
Net change from available-for-sale securities	(15,105)	16,564
Cash flow hedging instruments:		
Unrealized gains, net ⁽⁵⁾	5,975	8,396
Reclassification into earnings, net ⁽⁶⁾	20,128	19,327
Net change from cash flow hedging instruments	26,103	27,723
Foreign currency translation gains (losses), net	(6)	725
Other comprehensive income	10,992	45,012
Comprehensive income	<u>\$ 46,116</u>	<u>\$107,603</u>

(1) Amounts are net of benefit from income taxes of \$0.2 million and \$4.7 million for the three months ended March 31, 2013 and 2012, respectively.

(2) Amounts are net of provision for income taxes of \$0.2 million and benefit from income taxes of \$3.4 million for the three months ended March 31, 2013 and 2012, respectively.

(3) Amounts are net of benefit from income taxes of \$3.7 million and provision for income taxes of \$21.8 million for the three months ended March 31, 2013 and 2012, respectively.

(4) Amounts are net of provision for income taxes of \$6.0 million and \$13.1 million for the three months ended March 31, 2013 and 2012, respectively.

(5) Amounts are net of provision for income taxes of \$3.8 million and \$5.2 million for the three months ended March 31, 2013 and 2012, respectively.

(6) Amounts are net of benefit from income taxes of \$12.8 million and \$11.9 million for the three months ended March 31, 2013 and 2012, respectively.

See accompanying notes to the consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
(In thousands, except share data)
(Unaudited)

	March 31, 2013	December 31, 2012
ASSETS		
Cash and equivalents	\$ 1,507,722	\$ 2,761,494
Cash required to be segregated under federal or other regulations	318,817	376,898
Trading securities	100,538	101,270
Available-for-sale securities	12,676,378	13,443,020
Held-to-maturity securities (fair value of \$10,173,470 at March 31, 2013 and \$9,910,496 at December 31, 2012)	9,856,513	9,539,948
Margin receivables	5,748,626	5,804,041
Loans receivable, net (net of allowance for loan losses of \$455,032 at March 31, 2013 and \$480,751 at December 31, 2012)	9,585,286	10,098,723
Investment in FHLB stock	61,400	67,400
Property and equipment, net	278,266	288,170
Goodwill	1,934,232	1,934,232
Other intangibles, net	254,555	260,622
Other assets	2,643,981	2,710,921
Total assets	<u>\$44,966,314</u>	<u>\$47,386,739</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits	\$25,877,748	\$28,392,552
Securities sold under agreements to repurchase	4,459,421	4,454,661
Customer payables	5,084,337	4,964,922
FHLB advances and other borrowings	1,265,489	1,260,916
Corporate debt	1,765,905	1,764,982
Other liabilities	1,561,587	1,644,236
Total liabilities	<u>40,014,487</u>	<u>42,482,269</u>
Commitments and contingencies (see Note 13)		
Shareholders' equity:		
Common stock, \$0.01 par value, shares authorized: 400,000,000 at March 31, 2013 and December 31, 2012, shares issued and outstanding: 286,776,149 at March 31, 2013 and 286,114,334 at December 31, 2012	2,868	2,861
Additional paid-in-capital ("APIC")	7,320,491	7,319,257
Accumulated deficit	(2,072,596)	(2,107,720)
Accumulated other comprehensive loss	(298,936)	(309,928)
Total shareholders' equity	<u>4,951,827</u>	<u>4,904,470</u>
Total liabilities and shareholders' equity	<u>\$44,966,314</u>	<u>\$47,386,739</u>

See accompanying notes to the consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(In thousands)
(Unaudited)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount				
Balance, December 31, 2012	286,114	\$ 2,861	\$ 7,319,257	\$ (2,107,720)	\$ (309,928)	\$ 4,904,470
Net income	—	—	—	35,124	—	35,124
Other comprehensive income	—	—	—	—	10,992	10,992
Exercise of stock options and related tax effects	12	—	(3,624)	—	—	(3,624)
Issuance of restricted stock, net of forfeitures and retirements to pay taxes	650	7	(4,458)	—	—	(4,451)
Share-based compensation	—	—	9,316	—	—	9,316
Balance, March 31, 2013	<u>286,776</u>	<u>\$ 2,868</u>	<u>\$ 7,320,491</u>	<u>\$ (2,072,596)</u>	<u>\$ (298,936)</u>	<u>\$ 4,951,827</u>

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount				
Balance, December 31, 2011	285,368	\$ 2,854	\$ 7,306,862	\$ (1,995,137)	\$ (386,629)	\$ 4,927,950
Net income	—	—	—	62,591	—	62,591
Other comprehensive income	—	—	—	—	45,012	45,012
Exercise of stock options and related tax effects	2	—	(3,078)	—	—	(3,078)
Issuance of restricted stock, net of forfeitures and retirements to pay taxes	306	3	(1,457)	—	—	(1,454)
Share-based compensation	—	—	4,873	—	—	4,873
Other	—	—	7	—	—	7
Balance, March 31, 2012	<u>285,676</u>	<u>\$ 2,857</u>	<u>\$ 7,307,207</u>	<u>\$ (1,932,546)</u>	<u>\$ (341,617)</u>	<u>\$ 5,035,901</u>

See accompanying notes to the consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2013	2012
Cash flows from operating activities:		
Net income	\$ 35,124	\$ 62,591
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	42,650	71,947
Depreciation and amortization (including discount amortization and accretion)	113,472	92,738
Net impairment and gains on loans and securities, net	(14,515)	(31,374)
Equity in (income) loss of investments and other	(4,294)	106
Share-based compensation	9,316	4,873
Deferred taxes	17,683	(66,569)
Other	481	1,188
Net effect of changes in assets and liabilities:		
Decrease (increase) in cash required to be segregated under federal or other regulations	58,081	(136,091)
Decrease (increase) in margin receivables	55,415	(459,535)
Increase in customer payables	119,415	115,355
Proceeds from sales of loans held-for-sale	2,010	93,071
Originations of loans held-for-sale	—	(95,348)
Net decrease (increase) in trading securities	732	(4,372)
Decrease in other assets	101,486	126,049
(Decrease) increase in other liabilities	(77,590)	36,269
Net cash provided by (used in) operating activities	<u>459,466</u>	<u>(189,102)</u>
Cash flows from investing activities:		
Purchases of available-for-sale securities	(1,976,909)	(3,928,003)
Proceeds from sales, maturities of and principal payments on available-for-sale securities	2,681,770	2,076,018
Purchases of held-to-maturity securities	(928,807)	(1,729,615)
Proceeds from maturities of and principal payments on held-to-maturity securities	593,911	162,227
Net decrease in loans receivable	414,304	445,434
Capital expenditures for property and equipment	(15,087)	(22,887)
Proceeds from sale of REO and repossessed assets	22,372	29,820
Net cash flow from derivatives hedging assets	3,747	(38,784)
Other	6,000	(2,147)
Net cash provided by (used in) investing activities	<u>\$ 801,301</u>	<u>\$(3,007,937)</u>

See accompanying notes to the consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS-(Continued)
(In thousands)
(Unaudited)

	Three Months Ended	
	March 31,	
	2013	2012
Cash flows from financing activities:		
Net (decrease) increase in deposits	\$(2,514,805)	\$ 3,121,381
Net increase in securities sold under agreements to repurchase	4,760	6,754
Advances from FHLB	170,000	820,000
Payments on advances from FHLB	(170,000)	(820,000)
Net cash flow from derivatives hedging liabilities	(4,475)	(9,210)
Other	(19)	(3,287)
Net cash (used in) provided by financing activities	<u>(2,514,539)</u>	<u>3,115,638</u>
Decrease in cash and equivalents	(1,253,772)	(81,401)
Cash and equivalents, beginning of period	2,761,494	2,099,839
Cash and equivalents, end of period	<u>\$ 1,507,722</u>	<u>\$ 2,018,438</u>
Supplemental disclosures:		
Cash paid for interest	\$ 39,034	\$ 61,888
Cash paid for income taxes	\$ 944	\$ 3,608
Non-cash investing and financing activities:		
Reclassification of loans held-for-investment to loans held-for-sale	\$ 41,102	\$ —
Transfers from loans to other real estate owned and repossessed assets	\$ 19,252	\$ 24,915

See accompanying notes to the consolidated financial statements

E*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1—ORGANIZATION, BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization—E*TRADE Financial Corporation is a financial services company that provides online brokerage and related products and services primarily to individual retail investors under the brand “E*TRADE Financial.” The Company also provides investor-focused banking products, primarily sweep deposits and savings products, to retail investors.

Basis of Presentation—The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries as determined under the voting interest model. Entities in which the Company holds at least a 20% ownership interest or in which there are other indicators of significant influence are generally accounted for by the equity method. Entities in which the Company holds less than a 20% ownership interest and does not have the ability to exercise significant influence are generally carried at cost. Intercompany accounts and transactions are eliminated in consolidation. The Company also evaluates its continuing involvement with certain entities to determine if the Company is required to consolidate the entities under the variable interest entity model. This evaluation is based on a qualitative assessment of whether the Company has both: 1) the power to direct matters that most significantly impact the activities of the variable interest entity; and 2) the obligation to absorb losses or the right to receive benefits of the variable interest entity that could potentially be significant to the variable interest entity.

Certain prior period items in these consolidated financial statements have been reclassified to conform to the current period presentation. These consolidated financial statements reflect all adjustments, which are all normal and recurring in nature, necessary to present fairly the financial position, results of operations and cash flows for the periods presented. All prior periods have been adjusted to present gains on sales of investments, net and equity in income (loss) of investments and venture funds on a single line item, equity in income (loss) of investments and other, on the consolidated statement of income. These two line items were previously presented as separate line items on the consolidated statement of income.

The Company reports corporate interest income and corporate interest expense separately from operating interest income and operating interest expense. The Company believes reporting these two items separately provides a clearer picture of the financial performance of the Company’s operations than would a presentation that combined these two items. Operating interest income and operating interest expense is generated from the operations of the Company. Corporate debt, which is the primary source of corporate interest expense, has been issued primarily in connection with recapitalization transactions and past acquisitions.

Similarly, the Company reports gains on sales of investments, net separately from gains on loans and securities, net. The Company believes reporting these two items separately provides a clearer picture of the financial performance of its operations than would a presentation that combined these two items. Gains on loans and securities, net are the result of activities in the Company’s operations, namely its balance sheet management segment. Gains on sales of investments, net relate to investments of the Company at the corporate level and are not related to the ongoing business of the Company’s operating subsidiaries. Gains on sales of investments, net is reported in the equity in income (loss) of investments and other line item on the consolidated statement of income.

These consolidated financial statements should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2012.

Related Parties—Kenneth Griffin, President and CEO of Citadel, joined the Board of Directors on June 8, 2009 pursuant to a director nomination right granted to Citadel in 2007. During the periods presented, the Company routed a portion of its customer equity orders in exchange-listed options and Regulation NMS

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Securities to an affiliate of Citadel for order handling and execution at current market rates. Payments for these customer equity orders represented approximately 1% of the Company's total net revenue for both the three months ended March 31, 2013 and 2012, respectively.

Joseph M. Velli, Chairman and CEO of ConvergEx Group, joined the Board of Directors in January 2010. During the periods presented, the Company used ConvergEx Group for clearing and transfer agent services. Payments for these services represented less than 1% of the Company's total operating expenses for the three months ended March 31, 2013 and 2012.

Use of Estimates—The consolidated financial statements were prepared in accordance with GAAP, which requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes for the periods presented. Actual results could differ from management's estimates. Certain significant accounting policies are noteworthy because they are based on estimates and assumptions that require complex and subjective judgments by management. Changes in these estimates or assumptions could materially impact the Company's financial condition and results of operations. Material estimates in which management believes changes could reasonably occur include: allowance for loan losses; valuation of goodwill and other intangible assets; estimates of effective tax rates, deferred taxes and valuation allowance; classification and valuation of certain investments; accounting for derivative instruments; and fair value measurements.

Financial Statement Descriptions and Related Accounting Policies

Margin Receivables—The fair value of securities that the Company received as collateral in connection with margin receivables and securities borrowing activities, where the Company is permitted to sell or re-pledge the securities, was approximately \$8.2 billion as of both March 31, 2013 and December 31, 2012. Of this amount, \$1.6 billion and \$1.5 billion had been pledged or sold in connection with securities loans, bank borrowings and deposits with clearing organizations as of March 31, 2013 and December 31, 2012, respectively.

Offsetting Assets and Liabilities—Effective January 1, 2013, the Company adopted the amended disclosure guidance about offsetting certain assets and liabilities, which required additional information about derivative instruments, repurchase agreements and securities borrowing and securities lending transactions that are offset or subject to an enforceable master netting arrangement or similar agreement. For financial statement purposes, the Company does not offset derivative instruments, repurchase agreements or securities borrowing and securities lending transactions. The Company's derivative instruments, repurchase agreements and securities borrowing and securities lending transactions are transacted under master agreements that are widely used by counterparties and that may allow for net settlements of payments in the normal course as well as offsetting of all contracts with a given counterparty in the event of bankruptcy or default of one of the two parties to the transaction; therefore, all of these transactions are presented in the amended disclosures. The following table presents information about

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these transactions to enable the users of the Company's financial statements to evaluate the potential effect of rights of setoff between these recognized assets and recognized liabilities as of March 31, 2013 and December 31, 2012 (dollars in thousands):

	Gross Amounts Not Offset in the Consolidated Balance Sheet					
	Gross Amounts of Recognized Assets and Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts Presented in the Consolidated Balance Sheet	Financial Instruments	Collateral Received or Pledged (Including Cash)	Net Amount
March 31, 2013						
Assets:						
Deposits paid for securities borrowed ⁽¹⁾⁽⁵⁾	\$ 464,160	\$ —	\$ 464,160	\$(214,344)	\$ (241,039)	\$ 8,777
Derivative assets ⁽¹⁾⁽³⁾	16,307	—	16,307	(15,122)	—	1,185
Total	\$ 480,467	\$ —	\$ 480,467	\$(229,466)	\$ (241,039)	\$ 9,962
Liabilities:						
Repurchase agreements ⁽⁴⁾	\$ 4,459,421	\$ —	\$ 4,459,421	\$ —	\$ (4,458,797)	\$ 624
Deposits received for securities loaned ⁽²⁾⁽⁶⁾	786,014	—	786,014	(214,344)	(521,386)	50,284
Derivative liabilities ⁽²⁾⁽³⁾⁽⁴⁾	289,285	—	289,285	(15,122)	(274,163)	—
Total	\$ 5,534,720	\$ —	\$ 5,534,720	\$(229,466)	\$ (5,254,346)	\$ 50,908
December 31, 2012						
Assets:						
Deposits paid for securities borrowed ⁽¹⁾⁽⁵⁾	\$ 407,331	\$ —	\$ 407,331	\$(142,410)	\$ (259,490)	\$ 5,431
Derivative assets ⁽¹⁾⁽³⁾	14,734	—	14,734	(5,176)	(8,427)	1,131
Total	\$ 422,065	\$ —	\$ 422,065	\$(147,586)	\$ (267,917)	\$ 6,562
Liabilities:						
Repurchase agreements ⁽⁴⁾	\$ 4,454,661	\$ —	\$ 4,454,661	\$ —	\$ (4,454,659)	\$ 2
Deposits received for securities loaned ⁽²⁾⁽⁶⁾	735,720	—	735,720	(142,410)	(554,400)	38,910
Derivative liabilities ⁽²⁾⁽³⁾⁽⁴⁾	328,464	—	328,464	(5,176)	(323,288)	—
Total	\$ 5,518,845	\$ —	\$ 5,518,845	\$(147,586)	\$ (5,332,347)	\$ 38,912

(1) Net amounts presented in the consolidated balance sheet are reflected in the other assets line item.

(2) Net amounts presented in the consolidated balance sheet are reflected in the other liabilities line item.

(3) Excludes net accrued interest payable of \$18.7 million and \$14.1 million as of March 31, 2013 and December 31, 2012, respectively.

(4) The Company pledges available-for-sale and held-to-maturity securities as collateral for amounts due on repurchase agreements and derivative liabilities. The collateral pledged included available-for-sale securities at fair value and held-to-maturity securities at amortized cost for both March 31, 2013 and December 31, 2012.

(5) Included in the gross amounts of deposits paid for securities borrowed is \$182.3 million and \$93.9 million as of March 31, 2013 and December 31, 2012, respectively, transacted through a program with a clearing organization, which guarantees the return of cash to the Company. For presentation purposes, these amounts presented are based on the original counterparties to the Company's master securities loan agreements.

(6) Included in the gross amounts of deposits received for securities loaned is \$475.0 million and \$419.6 million as of March 31, 2013 and December 31, 2012, respectively, transacted through a program with a clearing organization, which guarantees the return of securities to the Company. For presentation purposes, these amounts presented are based on the original counterparties to the Company's master securities loan agreements.

New Accounting and Disclosure Guidance—Below is the new accounting and disclosure guidance that relates to activities in which the Company is engaged.

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Disclosures about Offsetting Assets and Liabilities

In December 2011, the FASB amended the disclosure guidance about offsetting assets and liabilities. The amended disclosure guidance will enable users of the Company's financial statements to evaluate the effect or potential effect of netting arrangements on the Company's financial position. This includes the effect or potential effect of rights of setoff between recognized assets and recognized liabilities within the scope of amended disclosure guidance, such as derivative instruments, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions. The amended disclosure guidance became effective for annual and interim periods beginning on January 1, 2013 for the Company and was applied retrospectively for all comparative periods presented. The Company's disclosures reflect the adoption of the amended disclosure guidance in Financial Statement Descriptions and Related Accounting Policies section in Note 1—Organization, Basis of Presentation and Summary of Significant Accounting Policies.

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the FASB amended the presentation guidance on the reporting of amounts reclassified out of accumulated other comprehensive income. The amended guidance does not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the guidance amends the presentation of the amounts reclassified out of accumulated other comprehensive income by component. In addition, the amended guidance requires the presentation, either on the face of the statement where net income is presented or in the notes, of significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amended guidance became effective for annual and interim periods beginning on January 1, 2013 for the Company and was applied prospectively. The Company's disclosures reflect the adoption of the amended presentation guidance in Note 10—Shareholders' Equity.

NOTE 2—OPERATING INTEREST INCOME AND OPERATING INTEREST EXPENSE

The following table shows the components of operating interest income and operating interest expense (dollars in thousands):

	Three Months Ended	
	March 31,	
	2013	2012
Operating interest income:		
Loans	\$106,669	\$139,501
Available-for-sale securities	64,005	105,661
Held-to-maturity securities	58,069	53,406
Margin receivables	54,447	47,990
Securities borrowed and other	16,870	15,703
Total operating interest income	<u>300,060</u>	<u>362,261</u>
Operating interest expense:		
Securities sold under agreements to repurchase	(36,703)	(40,764)
FHLB advances and other borrowings	(16,930)	(25,422)
Deposits	(3,153)	(8,342)
Customer payables and other	(1,945)	(2,881)
Total operating interest expense	<u>(58,731)</u>	<u>(77,409)</u>
Net operating interest income	<u>\$241,329</u>	<u>\$284,852</u>

NOTE 3—FAIR VALUE DISCLOSURES

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company may use various valuation approaches, including market, income and/or cost approaches. The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair value is a market-based measure considered from the perspective of a market participant. Accordingly, even when market assumptions are not readily available, the Company's own assumptions reflect those that market participants would use in pricing the asset or liability at the measurement date. The fair value measurement accounting guidance describes the following three levels used to classify fair value measurements:

- Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities that are accessible by the Company.
- Level 2—Quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3—Unobservable inputs that are significant to the fair value of the assets or liabilities.

The availability of observable inputs can vary and in certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to a fair value measurement requires judgment and consideration of factors specific to the asset or liability.

Recurring Fair Value Measurement Techniques

U.S. Treasury Securities and Agency Debentures

The fair value measurements of U.S. Treasury securities were classified as Level 1 of the fair value hierarchy as they were based on quoted market prices in active markets. The fair value measurements of agency debentures were classified as Level 2 of the fair value hierarchy as they were based on quoted market prices observable in the marketplace.

Residential Mortgage-backed Securities

The Company's residential mortgage-backed securities portfolio was comprised of agency mortgage-backed securities and CMOs, which represented the majority of the portfolio, and non-agency CMOs. Agency mortgage-backed securities and CMOs are guaranteed by U.S. government sponsored and federal agencies. All of the Company's non-agency CMOs were backed by first lien mortgages and were below investment grade or non-rated as of March 31, 2013. The weighted average coupon rates for the residential mortgage-backed securities as of March 31, 2013 are shown in the following table:

	<u>Weighted Average Coupon Rate</u>
Agency mortgage-backed securities	3.16%
Agency CMOs	3.47%
Non-agency CMOs	3.43%

The fair value of agency mortgage-backed securities was determined using a market approach with quoted market prices, recent market transactions and spread data for similar instruments. The fair value of agency CMOs was determined using market and income approaches with the Company's own trading activities for identical or similar instruments. Agency mortgage-backed securities and CMOs were categorized in Level 2 of the fair value hierarchy.

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Non-agency CMOs were valued using market and income approaches with market observable data, including recent market transactions when available. The valuations of non-agency CMOs reflect the Company's best estimate of what market participants would consider in pricing the financial instruments. The Company considers the price transparency for non-agency CMOs to be a key determinant of the degree of judgment involved in determining the fair value. As of March 31, 2013, the Company's non-agency CMOs were categorized in Level 3 of the fair value hierarchy. The Company's portfolio management group determines the fair value measurements using a discounted cash flow methodology for non-agency CMOs on a monthly basis with market observable data to the extent available. The fair value measurements, valuation techniques and level classification methodology are reviewed and compared to prior periods on a quarterly basis by management from the finance, credit, enterprise risk management and compliance departments.

The significant inputs used in the fair value measurement of non-agency CMOs are yield, default rate, loss severity and prepayment rate. Significant changes in any of those inputs in isolation would result in a significant change in the fair value. Generally, an increase in the yield, default rate or loss severity in isolation would result in a decrease in the fair value, and an increase in the prepayment rate would result in an increase in the fair value. In addition, an increase in the assumption used for the prepayment rate generally will result in an increase in yield.

The following table presents additional information about the underlying loans and significant inputs used in discounted cash flow methodologies for the valuation of non-agency CMOs that were categorized in Level 3 of the fair value hierarchy as of March 31, 2013:

	Weighted Average	Range
Underlying loans:		
Coupon rate	3.07%	2.86% - 6.42%
Maturity (years)	21	20 - 25
Significant inputs:		
Yield	4%	3% - 10%
Default rate ⁽¹⁾	19%	4% - 53%
Loss severity	38%	16% - 66%
Prepayment rate	8%	3% - 24%

⁽¹⁾ The default rate reflects the implied rate necessary to equate market price to the book yield given the market credit assumption.

Other Debt Securities

The fair value measurements of agency debt securities were determined using market and income approaches along with the Company's own trading activities for identical or similar instruments and were categorized in Level 2 of the fair value hierarchy.

The Company's municipal bonds are revenue bonds issued by state and other local government agencies. The valuation of corporate bonds is impacted by the credit worthiness of the corporate issuer. The majority of the Company's municipal bonds and corporate bonds were rated investment grade as of March 31, 2013. These securities were valued using a market approach with pricing service valuations corroborated by recent market transactions for identical or similar bonds. Municipal bonds and corporate bonds were categorized in Level 2 of the fair value hierarchy.

Derivative Instruments

Interest rate swap and option contracts were valued with an income approach using pricing models that are commonly used by the financial services industry. The market observable inputs used in the pricing models include the swap curve, the volatility surface, and prime or overnight indexed swap basis from a financial data provider. The Company does not consider these models to involve significant judgment on the part of

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management, and the Company corroborated the fair value measurements with counterparty valuations. The Company's derivative instruments were categorized in Level 2 of the fair value hierarchy. The consideration of credit risk, the Company's or the counterparty's, did not result in an adjustment to the valuation of its derivative instruments in the periods presented.

Securities Owned and Securities Sold, Not Yet Purchased

Securities transactions entered into by broker-dealer subsidiaries are included in trading securities and securities sold, not yet purchased in the Company's fair value disclosures. For equity securities, the Company's definition of actively traded is based on average daily volume and other market trading statistics. The fair value of securities owned and securities sold, not yet purchased was determined using listed or quoted market prices and the majority were categorized in Level 1 of the fair value hierarchy.

Nonrecurring Fair Value Measurement Techniques

Loans Receivable and REO

The Company records certain other assets at fair value on a nonrecurring basis: 1) one- to four-family and home equity loans in which the amount of the loan balance in excess of the estimated current value of the underlying property less estimated costs to sell has been charged-off; and 2) real estate acquired through physical possession of property or upon foreclosure that is carried at the lower of the property's carrying value or fair value, less estimated selling costs.

Loans that have been delinquent for 180 days or in bankruptcy are charged-off based on the estimated current value of the underlying property less estimated selling costs and are classified as nonperforming loans. These loans continue to be reported as nonperforming unless they subsequently meet the requirements for being reported as performing loans. TDRs that are charged-off based on the estimated current value of the underlying property less estimated selling costs are classified as nonperforming loans at the time of modification and return to accrual status after six consecutive payments are made in accordance with the modified terms. Property valuations for these one- to four-family and home equity loans are based on the most recent "as is" property valuation data available, which may include appraisals, broker price opinions, prices for similar properties, automated valuation models or home price indices. Subsequent to the recording of an initial fair value measurement, these loans continue to be measured at fair value on a nonrecurring basis, utilizing the estimated value of the underlying property less estimated selling costs. These property valuations are updated on a monthly, quarterly or semi-annual basis depending on the type of valuation initially used. If the value of the underlying property has declined, an additional charge-off is recorded. If the value of the underlying property has increased, previously charged-off amounts are not reversed. If the valuation data obtained is significantly different from the valuation previously received, the Company orders additional property valuation data to corroborate or update the valuation.

Property valuations for real estate acquired through physical possession of property or upon foreclosure are based on the lowest value of the most recent property valuation data available, which may include appraisals, listing prices or approved offer prices. Nonrecurring fair value measurements on one- to four-family and home equity loans and real estate owned were classified as Level 3 of the fair value hierarchy as the majority of the valuations included Level 3 inputs that were significant to the estimate of fair value.

Real estate owned and loans receivable that have been subject to fair value measurement requirements are evaluated and reviewed on a quarterly basis in accordance with policies and procedures that were designed to be in compliance with guidance from the Company's regulators. These policies and procedures govern the frequency of the review, the use of acceptable valuation methods, and the consideration of estimated selling costs.

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The following table presents additional information about significant unobservable inputs used in the valuation of assets measured at fair value on a nonrecurring basis that were categorized in Level 3 of the fair value hierarchy as of March 31, 2013 (dollars in thousands):

	<u>Unobservable Inputs</u>	<u>Average</u>	<u>Range</u>
One- to four-family	Appraised value	\$ 367	\$ 25 — \$2,150
Home equity	Appraised value	\$ 264	\$ 8 — \$1,475
Real estate owned	Appraised value	\$ 273	\$ 13 — \$1,000

Recurring and Nonrecurring Fair Value Measurements

Assets and liabilities measured at fair value at March 31, 2013 and December 31, 2012 are summarized in the following tables (dollars in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Fair Value</u>
March 31, 2013:				
Recurring fair value measurements:				
Assets				
Trading securities	\$ 99,576	\$ 962	\$ —	\$ 100,538
Available-for-sale securities:				
Residential mortgage-backed securities:				
Agency mortgage-backed securities and CMOs	—	11,429,270	—	11,429,270
Non-agency CMOs	—	—	14,054	14,054
Total residential mortgage-backed securities	—	11,429,270	14,054	11,443,324
Investment securities:				
Agency debentures	—	604,484	—	604,484
Agency debt securities	—	592,717	—	592,717
Municipal bonds	—	31,453	—	31,453
Corporate bonds	—	4,400	—	4,400
Total investment securities	—	1,233,054	—	1,233,054
Total available-for-sale securities	—	12,662,324	14,054	12,676,378
Other assets:				
Derivative assets ⁽¹⁾	—	16,307	—	16,307
Deposits with clearing organizations ⁽²⁾	30,999	—	—	30,999
Total other assets measured at fair value on a recurring basis	30,999	16,307	—	47,306
Total assets measured at fair value on a recurring basis ⁽³⁾	<u>\$130,575</u>	<u>\$12,679,593</u>	<u>\$ 14,054</u>	<u>\$ 12,824,222</u>
Liabilities				
Derivative liabilities ⁽¹⁾	\$ —	\$ 289,285	\$ —	\$ 289,285
Securities sold, not yet purchased	96,604	249	—	96,853
Total liabilities measured at fair value on a recurring basis ⁽³⁾	<u>\$ 96,604</u>	<u>\$ 289,534</u>	<u>\$ —</u>	<u>\$ 386,138</u>
Nonrecurring fair value measurements:⁽⁴⁾				
Loans receivable:				
One- to four-family	\$ —	\$ —	\$113,355	\$ 113,355
Home equity	—	—	26,708	26,708
Total loans receivable	—	—	140,063	140,063
REO	—	—	29,522	29,522
Total assets measured at fair value on a nonrecurring basis	<u>\$ —</u>	<u>\$ —</u>	<u>\$169,585</u>	<u>\$ 169,585</u>

(1) All derivative assets and liabilities are interest rate contracts. Information related to derivative instruments is detailed in Note 6—Accounting for Derivative Instruments and Hedging Activities.

(2) Represents U.S. Treasury securities held by a broker-dealer subsidiary.

(3) Assets and liabilities measured at fair value on a recurring basis represented 29% and 1% of the Company's total assets and total liabilities, respectively.

(4) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet as of March 31, 2013, and for which a fair value measurement was recorded during the period.

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	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Fair Value</u>
December 31, 2012:				
Recurring fair value measurements:				
Assets				
Trading securities	\$100,259	\$ 1,011	\$ —	\$ 101,270
Available-for-sale securities:				
Residential mortgage-backed securities:				
Agency mortgage-backed securities and CMOs	—	12,097,298	—	12,097,298
Non-agency CMOs	—	185,668	49,495	235,163
Total residential mortgage-backed securities	—	12,282,966	49,495	12,332,461
Investment securities:				
Agency debentures	—	527,996	—	527,996
Agency debt securities	—	546,762	—	546,762
Municipal bonds	—	31,346	—	31,346
Corporate bonds	—	4,455	—	4,455
Total investment securities	—	1,110,559	—	1,110,559
Total available-for-sale securities	—	13,393,525	49,495	13,443,020
Other assets:				
Derivative assets ⁽¹⁾	—	14,890	—	14,890
Deposits with clearing organizations ⁽²⁾	32,000	—	—	32,000
Total other assets measured at fair value on a recurring basis	32,000	14,890	—	46,890
Total assets measured at fair value on a recurring basis ⁽³⁾	<u>\$132,259</u>	<u>\$13,409,426</u>	<u>\$ 49,495</u>	<u>\$ 13,591,180</u>
Liabilities				
Derivative liabilities ⁽¹⁾	\$ —	\$ 328,504	\$ —	\$ 328,504
Securities sold, not yet purchased	87,088	489	—	87,577
Total liabilities measured at fair value on a recurring basis ⁽³⁾	<u>\$ 87,088</u>	<u>\$ 328,993</u>	<u>\$ —</u>	<u>\$ 416,081</u>
Nonrecurring fair value measurements:⁽⁴⁾				
Loans receivable:				
One- to four-family	\$ —	\$ —	\$752,008	\$ 752,008
Home equity	—	—	90,663	90,663
Total loans receivable	—	—	842,671	842,671
REO	—	—	75,885	75,885
Total assets measured at fair value on a nonrecurring basis	<u>\$ —</u>	<u>\$ —</u>	<u>\$918,556</u>	<u>\$ 918,556</u>

(1) The majority of derivative assets and liabilities are interest rate contracts. Information related to derivative instruments is detailed in Note 6—Accounting for Derivative Instruments and Hedging Activities.

(2) Represents U.S. Treasury securities held by a broker-dealer subsidiary.

(3) Assets and liabilities measured at fair value on a recurring basis represented 29% and 1% of the Company's total assets and total liabilities, respectively.

(4) Represents the fair value of assets prior to deducting estimated selling costs that were carried on the consolidated balance sheet as of December 31, 2012, and for which a fair value measurement was recorded during the period.

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The following table presents the losses associated with the assets measured at fair value on a nonrecurring basis during the three months ended March 31, 2013 and 2012 (dollars in thousands):

	Three Months Ended	
	March 31,	
	2013	2012
One- to four-family	\$15,875	\$100,347
Home equity	18,852	151,825
Total losses on loans receivable measured at fair value	<u>\$34,727</u>	<u>\$252,172</u>
Losses on REO measured at fair value	\$ 896	\$ 4,296

Transfers Between Levels 1 and 2

For assets and liabilities measured at fair value on a recurring basis, the Company's transfers between levels of the fair value hierarchy are deemed to have occurred at the beginning of the reporting period on a quarterly basis. The Company's transfers of securities owned and securities sold, not yet purchased between Level 1 and 2 are generally driven by trading activities of those securities during the period. The Company had no material transfers between Level 1 and 2 during the three months ended March 31, 2013 and 2012.

Level 3 Rollforward for Recurring Fair Value Measurements

Level 3 assets and liabilities include instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. While the Company's fair value estimates of Level 3 instruments utilized observable inputs where available, the valuation included significant management judgment in determining the relevance and reliability of market information considered.

The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the three months ended March 31, 2013 and 2012 (dollars in thousands):

	Available-for-sale
	Securities
	Non-agency
	CMOs
Opening balance, January 1, 2013	\$ 49,495
Losses recognized in earnings ⁽¹⁾	(1,165)
Net gains recognized in other comprehensive income ⁽²⁾	1,716
Sales	(34,949)
Settlements	(1,043)
Closing balance, March 31, 2013	<u>\$ 14,054</u>

⁽¹⁾ Losses recognized in earnings were related to instruments held at March 31, 2013 and are reported in the net impairment line item.

⁽²⁾ Net gains recognized in other comprehensive income are reported in the net change from available-for-sale securities line item.

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	<u>Available-for-sale</u> <u>Securities</u> <u>Non-agency</u> <u>CMOs</u>
Opening balance, January 1, 2012	\$ 97,106
Losses recognized in earnings ⁽¹⁾	(2,753)
Net gains recognized in other comprehensive income ⁽²⁾	31
Settlements	(4,182)
Transfer in to Level 3 ⁽³⁾⁽⁴⁾	53,639
Transfer out of Level 3 ⁽³⁾⁽⁵⁾	(61,572)
Closing balance, March 31, 2012	<u>\$ 82,269</u>

- (1) Losses recognized in earnings were related to instruments held at March 31, 2012 and are reported in the net impairment line item.
(2) Net gains recognized in other comprehensive income are reported in the net change from available-for-sale securities line item.
(3) The Company's transfers in and out of Level 3 are as of the beginning of the reporting period on a quarterly basis.
(4) Non-agency CMOs transferred in to Level 3 due to a lack of observable market data, resulting from a decrease in market activity for the securities.
(5) Non-agency CMOs transferred out of Level 3 because observable market data became available for those securities.

The Company's transfers of certain non-agency CMOs in and out of Level 3 are generally driven by changes in price transparency for the securities. Financial instruments for which actively quoted prices or pricing parameters are available will have a higher degree of price transparency than financial instruments that are thinly traded or not quoted. As of March 31, 2013, less than 1% of the Company's total assets and none of its total liabilities represented instruments measured at fair value on a recurring basis categorized as Level 3.

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Fair Value of Financial Instruments Not Carried at Fair Value

The following table summarizes the carrying values, fair values and fair value hierarchy level classification of financial instruments that are not carried at fair value on the consolidated balance sheet at March 31, 2013 and December 31, 2012 (dollars in thousands):

	Carrying Value	March 31, 2013			Total Fair Value
		Level 1	Level 2	Level 3	
Assets					
Cash and equivalents	\$ 1,507,722	\$1,507,722	\$ —	\$ —	\$ 1,507,722
Cash required to be segregated under federal or other regulations	\$ 318,817	\$ 318,817	\$ —	\$ —	\$ 318,817
Held-to-maturity securities:					
Agency mortgage-backed securities and CMOs	\$ 8,106,185	\$ —	\$ 8,356,974	\$ —	\$ 8,356,974
Agency debentures	163,439	—	169,602	—	169,602
Agency debt securities	1,586,889	—	1,646,894	—	1,646,894
Total held-to-maturity securities	\$ 9,856,513	\$ —	\$10,173,470	\$ —	\$ 10,173,470
Margin receivables	\$ 5,748,626	\$ —	\$ 5,748,626	\$ —	\$ 5,748,626
Loans receivable, net:					
One- to four-family	\$ 5,078,187	\$ —	\$ —	\$4,499,149	\$ 4,499,149
Home equity	3,789,974	—	—	3,484,719	3,484,719
Consumer and other	717,125	—	—	738,760	738,760
Total loans receivable, net ⁽¹⁾	\$ 9,585,286	\$ —	\$ —	\$8,722,628	\$ 8,722,628
Investment in FHLB stock	\$ 61,400	\$ —	\$ —	\$ 61,400	\$ 61,400
Liabilities					
Deposits	\$25,877,748	\$ —	\$25,878,474	\$ —	\$ 25,878,474
Securities sold under agreement to repurchase	\$ 4,459,421	\$ —	\$ 4,497,790	\$ —	\$ 4,497,790
Customer payables	\$ 5,084,337	\$ —	\$ 5,084,337	\$ —	\$ 5,084,337
FHLB advances and other borrowings	\$ 1,265,489	\$ —	\$ 926,244	\$ 206,600	\$ 1,132,844
Corporate debt	\$ 1,765,905	\$ —	\$ 1,889,139	\$ —	\$ 1,889,139

(1) The carrying value of loans receivable, net includes the allowance for loan losses of \$455.0 million and loans that are valued at fair value on a nonrecurring basis as of March 31, 2013.

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	December 31, 2012				
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Assets					
Cash and equivalents	\$ 2,761,494	\$2,761,494	\$ —	\$ —	\$ 2,761,494
Cash required to be segregated under federal or other regulations	\$ 376,898	\$ 376,898	\$ —	\$ —	\$ 376,898
Held-to-maturity securities:					
Agency mortgage-backed securities and CMOs	\$ 7,887,555	\$ —	\$ 8,182,064	\$ —	\$ 8,182,064
Agency debentures	163,434	—	169,769	—	169,769
Agency debt securities	1,488,959	—	1,558,663	—	1,558,663
Total held-to-maturity securities	<u>\$ 9,539,948</u>	<u>\$ —</u>	<u>\$ 9,910,496</u>	<u>\$ —</u>	<u>\$ 9,910,496</u>
Margin receivables	\$ 5,804,041	\$ —	\$ 5,804,041	\$ —	\$ 5,804,041
Loans receivable, net:					
One- to four-family	\$ 5,281,702	\$ —	\$ —	\$4,561,821	\$ 4,561,821
Home equity	4,002,486	—	—	3,551,357	3,551,357
Consumer and other	814,535	—	—	838,721	838,721
Total loans receivable, net ⁽¹⁾	<u>\$10,098,723</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$8,951,899</u>	<u>\$ 8,951,899</u>
Investment in FHLB stock	\$ 67,400	\$ —	\$ —	\$ 67,400	\$ 67,400
Liabilities					
Deposits	\$28,392,552	\$ —	\$28,394,400	\$ —	\$ 28,394,400
Securities sold under agreement to repurchase	\$ 4,454,661	\$ —	\$ 4,493,463	\$ —	\$ 4,493,463
Customer payables	\$ 4,964,922	\$ —	\$ 4,964,922	\$ —	\$ 4,964,922
FHLB advances and other borrowings	\$ 1,260,916	\$ —	\$ 926,750	\$ 196,765	\$ 1,123,515
Corporate debt	\$ 1,764,982	\$ —	\$ 1,837,736	\$ —	\$ 1,837,736

(1) The carrying value of loans receivable, net includes the allowance for loan loss of \$480.7 million and loans that are valued at fair value on a nonrecurring basis as of December 31, 2012.

The fair value measurement techniques for financial instruments not carried at fair value on the consolidated balance sheet at March 31, 2013 and December 31, 2012 are summarized as follows:

Cash and equivalents, cash required to be segregated under federal or other regulations, margin receivables and customer payables—Fair value is estimated to be carrying value.

Held-to-maturity securities—The held-to-maturity securities portfolio included agency mortgage-backed securities and CMOs, agency debentures, and agency debt securities. The fair value of agency mortgage-backed securities is determined using market and income approaches with quoted market prices, recent market transactions and spread data for similar instruments. The fair value of agency CMOs and agency debt securities is determined using market and income approaches with the Company's own trading activities for identical or similar instruments. The fair value of agency debentures is based on quoted market prices that were derived from assumptions observable in the marketplace.

Loans receivable, net—Fair value is estimated using a discounted cash flow model. Loans are differentiated based on their individual portfolio characteristics, such as product classification, loan category, pricing features and remaining maturity. Assumptions for expected losses, prepayments and discount rates are adjusted to reflect the individual characteristics of the loans, such as credit risk, coupon, term, and payment characteristics, as well as the secondary market conditions for these types of loans. There was limited or no observable market data for the home equity and one- to four-family loan portfolios, which indicates that the market for these types of loans is considered to be inactive. Given the limited market data, these fair value measurements cannot be determined with precision and changes in the underlying assumptions used, including discount rates, could significantly affect the results of current or future fair value estimates. In addition, the amount that would be realized in a forced liquidation, an actual sale or immediate settlement could be significantly lower than both the carrying value and the estimated fair value of the portfolio.

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Investment in FHLB stock—FHLB stock is carried at cost, which is considered to be a reasonable estimate of fair value.

Deposits—Fair value is the amount payable on demand at the reporting date for sweep deposits, complete savings deposits, other money market and savings deposits and checking deposits. For certificates of deposit and brokered certificates of deposit, fair value is estimated by discounting future cash flows using discount factors derived from current observable rates implied for other similar instruments with similar remaining maturities.

Securities sold under agreements to repurchase—Fair value is determined by discounting future cash flows using discount factors derived from current observable rates implied for other similar instruments with similar remaining maturities.

FHLB advances and other borrowings—Fair value for FHLB advances is estimated by discounting future cash flows using discount factors derived from current observable rates implied for similar instruments with similar remaining maturities. For subordinated debentures, fair value is estimated by discounting future cash flows at the rate implied by dealer pricing quotes. For margin collateral, overnight and other short-term borrowings, fair value approximates carrying value.

Corporate debt—Fair value is estimated using dealer pricing quotes. The fair value of the non-interest-bearing convertible debentures is directly correlated to the intrinsic value of the Company's underlying stock. As the price of the Company's stock increases relative to the conversion price, the fair value of the convertible debentures increases.

NOTE 4—AVAILABLE-FOR-SALE AND HELD-TO-MATURITY SECURITIES

The amortized cost basis and fair value of available-for-sale and held-to-maturity securities at March 31, 2013 and December 31, 2012 are shown in the following tables (dollars in thousands):

	Amortized Cost	Gross Unrealized / Unrecognized Gains	Gross Unrealized / Unrecognized Losses	Fair Value
March 31, 2013:				
Available-for-sale securities:				
Residential mortgage-backed securities:				
Agency mortgage-backed securities and CMOs	\$11,252,894	\$ 212,231	\$ (35,855)	\$11,429,270
Non-agency CMOs	21,062	1,473	(8,481)	14,054
Total residential mortgage-backed securities	<u>11,273,956</u>	<u>213,704</u>	<u>(44,336)</u>	<u>11,443,324</u>
Investment securities:				
Agency debentures	596,692	8,047	(255)	604,484
Agency debt securities	580,264	13,389	(936)	592,717
Municipal bonds	30,235	1,218	—	31,453
Corporate bonds	5,478	—	(1,078)	4,400
Total investment securities	<u>1,212,669</u>	<u>22,654</u>	<u>(2,269)</u>	<u>1,233,054</u>
Total available-for-sale securities	<u>\$12,486,625</u>	<u>\$ 236,358</u>	<u>\$ (46,605)</u>	<u>\$12,676,378</u>
Held-to-maturity securities:				
Residential mortgage-backed securities:				
Agency mortgage-backed securities and CMOs	\$ 8,106,185	\$ 261,782	\$ (10,993)	\$ 8,356,974
Investment securities:				
Agency debentures	163,439	6,163	—	169,602
Agency debt securities	1,586,889	62,338	(2,333)	1,646,894
Total investment securities	<u>1,750,328</u>	<u>68,501</u>	<u>(2,333)</u>	<u>1,816,496</u>
Total held-to-maturity securities	<u>\$ 9,856,513</u>	<u>\$ 330,283</u>	<u>\$ (13,326)</u>	<u>\$10,173,470</u>

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	Amortized Cost	Gross Unrealized / Unrecognized Gains	Gross Unrealized / Unrecognized Losses	Fair Value
December 31, 2012:				
Available-for-sale securities:				
Residential mortgage-backed securities:				
Agency mortgage-backed securities and CMOs	\$11,881,185	\$ 232,905	\$ (16,792)	\$12,097,298
Non-agency CMOs	260,064	4,362	(29,263)	235,163
Total residential mortgage-backed securities	<u>12,141,249</u>	<u>237,267</u>	<u>(46,055)</u>	<u>12,332,461</u>
Investment securities:				
Agency debentures	515,990	12,434	(428)	527,996
Agency debt securities	525,408	21,354	—	546,762
Municipal bonds	30,235	1,111	—	31,346
Corporate bonds	5,478	—	(1,023)	4,455
Total investment securities	<u>1,077,111</u>	<u>34,899</u>	<u>(1,451)</u>	<u>1,110,559</u>
Total available-for-sale securities	<u>\$13,218,360</u>	<u>\$ 272,166</u>	<u>\$ (47,506)</u>	<u>\$13,443,020</u>
Held-to-maturity securities:				
Residential mortgage-backed securities:				
Agency mortgage-backed securities and CMOs	\$ 7,887,555	\$ 301,686	\$ (7,177)	\$ 8,182,064
Investment securities:				
Agency debentures	163,434	6,335	—	169,769
Agency debt securities	1,488,959	69,705	(1)	1,558,663
Total investment securities	<u>1,652,393</u>	<u>76,040</u>	<u>(1)</u>	<u>1,728,432</u>
Total held-to-maturity securities	<u>\$ 9,539,948</u>	<u>\$ 377,726</u>	<u>\$ (7,178)</u>	<u>\$ 9,910,496</u>

Contractual Maturities

The contractual maturities of all available-for-sale and held-to-maturity debt securities at March 31, 2013 are shown below (dollars in thousands):

	Amortized Cost	Fair Value
Available-for-sale securities:		
Due within one to five years	\$ 62,094	\$ 63,915
Due within five to ten years	1,266,374	1,281,083
Due after ten years	11,158,157	11,331,380
Total available-for-sale securities	<u>\$ 12,486,625</u>	<u>\$ 12,676,378</u>
Held-to-maturity securities:		
Due within one year	\$ 84	\$ 83
Due within one to five years	488,161	513,562
Due within five to ten years	2,821,346	2,972,697
Due after ten years	6,546,922	6,687,128
Total held-to-maturity securities	<u>\$ 9,856,513</u>	<u>\$ 10,173,470</u>

The Company pledged \$2.6 billion and \$2.8 billion at March 31, 2013 and December 31, 2012, respectively, of available-for-sale securities and \$3.0 billion and \$2.9 billion at March 31, 2013 and December 31, 2012, respectively, of held-to-maturity securities as collateral for repurchase agreements, derivatives and other purposes.

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Investments with Unrecognized or Unrealized Losses

The following tables show the fair value and unrealized or unrecognized losses on available-for-sale and held-to-maturity securities, aggregated by investment category, and the length of time that individual securities have been in a continuous unrealized or unrecognized loss position at March 31, 2013 and December 31, 2012 (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized / Unrecognized Losses	Fair Value	Unrealized / Unrecognized Losses	Fair Value	Unrealized / Unrecognized Losses
March 31, 2013:						
Available-for-sale securities:						
Residential mortgage-backed securities:						
Agency mortgage-backed securities and CMOs	\$2,914,594	\$ (30,738)	\$541,537	\$ (5,117)	\$3,456,131	\$ (35,855)
Non-agency CMOs	—	—	11,317	(8,481)	11,317	(8,481)
Investment securities:						
Agency debentures	108,117	(255)	—	—	108,117	(255)
Agency debt securities	199,065	(936)	—	—	199,065	(936)
Corporate bonds	—	—	4,400	(1,078)	4,400	(1,078)
Total temporarily impaired available-for-sale securities	<u>\$3,221,776</u>	<u>\$ (31,929)</u>	<u>\$557,254</u>	<u>\$ (14,676)</u>	<u>\$3,779,030</u>	<u>\$ (46,605)</u>
Held-to-maturity securities:						
Residential mortgage-backed securities:						
Agency mortgage-backed securities and CMOs	\$1,868,969	\$ (10,929)	\$ 65,687	\$ (64)	\$1,934,656	\$ (10,993)
Agency debt securities	322,701	(2,333)	—	—	322,701	(2,333)
Total temporarily impaired held-to-maturity securities	<u>\$2,191,670</u>	<u>\$ (13,262)</u>	<u>\$ 65,687</u>	<u>\$ (64)</u>	<u>\$2,257,357</u>	<u>\$ (13,326)</u>
December 31, 2012:						
Available-for-sale securities:						
Residential mortgage-backed securities:						
Agency mortgage-backed securities and CMOs	\$2,588,947	\$ (16,680)	\$ 16,337	\$ (112)	\$2,605,284	\$ (16,792)
Non-agency CMOs	—	—	198,635	(29,263)	198,635	(29,263)
Investment securities:						
Agency debentures	62,786	(428)	—	—	62,786	(428)
Corporate bonds	—	—	4,455	(1,023)	4,455	(1,023)
Total temporarily impaired available-for-sale securities	<u>\$2,651,733</u>	<u>\$ (17,108)</u>	<u>\$219,427</u>	<u>\$ (30,398)</u>	<u>\$2,871,160</u>	<u>\$ (47,506)</u>
Held-to-maturity securities:						
Residential mortgage-backed securities:						
Agency mortgage-backed securities and CMOs	\$1,240,008	\$ (6,937)	\$ 2,427	\$ (240)	\$1,242,435	\$ (7,177)
Agency debt securities	84	(1)	—	—	84	(1)
Total temporarily impaired held-to-maturity securities	<u>\$1,240,092</u>	<u>\$ (6,938)</u>	<u>\$ 2,427</u>	<u>\$ (240)</u>	<u>\$1,242,519</u>	<u>\$ (7,178)</u>

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The Company does not believe that any individual unrealized loss in the available-for-sale or unrecognized loss in the held-to-maturity portfolio as of March 31, 2013 represents a credit loss. The credit loss component is the difference between the security's amortized cost basis and the present value of its expected future cash flows, and is recognized in earnings. The noncredit loss component is the difference between the present value of its expected future cash flows and the fair value and is recognized through other comprehensive income. The Company assessed whether it intends to sell, or whether it is more likely than not that the Company will be required to sell a security before recovery of its amortized cost basis. For debt securities that are considered other-than-temporarily impaired and that the Company does not intend to sell as of the balance sheet date and will not be required to sell prior to recovery of its amortized cost basis, the Company determines the amount of the impairment that is related to credit and the amount due to all other factors.

The majority of the unrealized or unrecognized losses on mortgage-backed securities are attributable to changes in interest rates and a re-pricing of risk in the market. Agency mortgage-backed securities and CMOs, agency debentures and agency debt securities are guaranteed by U.S. government sponsored and federal agencies. Municipal bonds and corporate bonds are evaluated by reviewing the credit-worthiness of the issuer and general market conditions. The Company does not intend to sell the securities in an unrealized or unrecognized loss position as of the balance sheet date and it is not more likely than not that the Company will be required to sell the debt securities before the anticipated recovery of its remaining amortized cost of the securities in an unrealized or unrecognized loss position at March 31, 2013.

The majority of the Company's available-for-sale and held-to-maturity portfolio consists of residential mortgage-backed securities. For residential mortgage-backed securities, the Company calculates the credit portion of OTTI by comparing the present value of the expected future cash flows with the amortized cost basis of the security. The expected future cash flows are determined using the remaining contractual cash flows adjusted for future credit losses. The estimate of expected future credit losses includes the following assumptions: 1) expected default rates based on current delinquency trends, foreclosure statistics of the underlying mortgages and loan documentation type; 2) expected loss severity based on the underlying loan characteristics, including loan-to-value, origination vintage and geography; and 3) expected loan prepayments and principal reduction based on current experience and existing market conditions that may impact the future rate of prepayments. The expected cash flows of the security are then discounted at the interest rate used to recognize interest income on the security to arrive at the present value amount. The following table presents a summary of the significant inputs considered for securities that were other-than-temporarily impaired as of March 31, 2013:

	March 31, 2013	
	Weighted Average	Range
Default rate ⁽¹⁾	7%	4% - 25%
Loss severity	51%	45% - 70%
Prepayment rate	6%	2% - 8%

(1) Represents the expected default rate for the next twelve months.

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The following table presents a roll forward for the three months ended March 31, 2013 and 2012 of the credit loss component on debt securities held by the Company that had a noncredit loss recognized in other comprehensive income and had a credit loss recognized in earnings (dollars in thousands):

	Three Months Ended March 31,	
	2013	2012
Credit loss balance, beginning of period	\$186,722	\$202,945
Additions:		
Subsequent credit impairment	1,165	3,532
Securities sold	(23,393)	—
Credit loss balance, end of period ⁽¹⁾	<u>\$164,494</u>	<u>\$206,477</u>

⁽¹⁾ The credit loss balance at March 31, 2013 included \$113.7 million of credit losses associated with debt securities that have been factored to zero, but the Company still holds legal title to these securities until maturity or until they are sold.

Within the securities portfolio, the highest concentration of credit risk is the non-agency CMO portfolio. As of March 31, 2013, the Company held approximately \$21.1 million in amortized cost of non-agency CMO securities that had been other-than-temporarily impaired as a result of deterioration in the expected credit performance of the underlying loans in the securities. The following table shows the components of net impairment for the three months ended March 31, 2013 and 2012 (dollars in thousands):

	Three Months Ended March 31,	
	2013	2012
Other-than-temporary impairment (“OTTI”)	\$ (568)	\$(12,634)
Less: noncredit portion of OTTI recognized into (out of) other comprehensive income (before tax)	(597)	9,102
Net impairment	<u>\$(1,165)</u>	<u>\$(3,532)</u>

Gains on Loans and Securities, Net

The detailed components of the gains on loans and securities, net line item on the consolidated statement of income for the three months ended March 31, 2013 and 2012 are as follows (dollars in thousands):

	Three Months Ended March 31,	
	2013	2012
Gains (losses) on loans, net	\$ 2	\$ (7)
Gains on securities, net		
Gains on available-for-sale securities and other investments	24,192	34,937
Losses on available-for-sale securities and other investments	(8,401)	—
Gains on trading securities, net	—	1
Hedge ineffectiveness	(113)	(25)
Gains on securities, net	<u>15,678</u>	<u>34,913</u>
Gains on loans and securities, net	<u>\$15,680</u>	<u>\$34,906</u>

During the first quarter of 2013, the Company sold \$230.5 million in amortized cost of its available-for-sale non-agency CMOs for proceeds of approximately \$227 million, which resulted in a pre-tax net loss of \$3.8 million.

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Loans receivable, net at March 31, 2013 and December 31, 2012 are summarized as follows (dollars in thousands):

	March 31, 2013	December 31, 2012
One- to four-family	\$5,217,118	\$ 5,442,174
Home equity	4,021,046	4,223,461
Consumer and other	739,820	844,942
Total loans receivable	9,977,984	10,510,577
Unamortized premiums, net	62,334	68,897
Allowance for loan losses	(455,032)	(480,751)
Total loans receivable, net	<u>\$9,585,286</u>	<u>\$10,098,723</u>

At March 31, 2013, we pledged \$7.8 billion and \$0.7 billion of loans as collateral to the FHLB and Federal Reserve Bank, respectively. At December 31, 2012, we pledged \$8.2 billion and \$0.8 billion of loans as collateral to the FHLB and Federal Reserve Bank, respectively. Additionally, the Company's entire loans receivable portfolio was serviced by other companies at March 31, 2013 and December 31, 2012.

The following table represents the breakdown of the total recorded investment in loans receivable and allowance for loan losses by loans that have been collectively evaluated for impairment and those that have been individually evaluated for impairment at March 31, 2013 and December 31, 2012 (dollars in thousands):

	Recorded Investment		Allowance for Loan Losses	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
Loans collectively evaluated for impairment	\$ 8,548,789	\$ 9,073,326	\$306,926	\$ 309,377
Loans individually evaluated for impairment (TDRs)	1,491,529	1,506,148	148,106	171,374
Total loans evaluated for impairment	<u>\$10,040,318</u>	<u>\$10,579,474</u>	<u>\$455,032</u>	<u>\$ 480,751</u>

Credit Quality

The Company tracks and reviews factors to predict and monitor credit risk in its mortgage loan portfolio on an ongoing basis. These factors include: loan type, estimated current LTV/CLTV ratios, delinquency history, documentation type, borrowers' current credit scores, housing prices, loan vintage and geographic location of the property. In economic conditions in which housing prices generally appreciate, the Company believes that loan type, LTV/CLTV ratios, documentation type and credit scores are the key factors in determining future loan performance. In a housing market with declining home prices and less credit available for refinance, the Company believes the LTV/CLTV ratio becomes a more important factor in predicting and monitoring credit risk. The factors are updated on at least a quarterly basis. The Company tracks and reviews delinquency status to predict and monitor credit risk in the consumer and other loan portfolio on at least a quarterly basis.

The home equity loan portfolio is primarily second lien loans on residential real estate properties, which have a higher level of credit risk than first lien mortgage loans. Approximately 15% of the home equity portfolio was in the first lien position as of March 31, 2013. The Company holds both the first and second lien positions in less than 1% of the home equity loan portfolio. The home equity loan portfolio consists of approximately 21% of home equity installment loans and approximately 79% of home equity lines of credit.

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Home equity installment loans are primarily fixed rate and fixed term, fully amortizing loans that do not offer the option of an interest-only payment. The majority of home equity lines of credit convert to amortizing loans at the end of the draw period, which typically ranges from five to ten years. At March 31, 2013, the majority of the home equity line of credit portfolio had not converted from the interest-only draw period to an amortizing loan. In addition, approximately 80% of the home equity line of credit portfolio will not begin amortizing until after 2014. The following table outlines when home equity lines of credit convert to amortizing for the home equity line of credit portfolio as of March 31, 2013:

Period of Conversion to Amortizing Loan	% of Home Equity Line of Credit Portfolio
Already amortizing	9%
Through December 31, 2013	4%
Year ending December 31, 2014	7%
Year ending December 31, 2015	26%
Year ending December 31, 2016	41%
Year ending December 31, 2017	13%

The following tables show the distribution of the Company's mortgage loan portfolios by credit quality indicator at March 31, 2013 and December 31, 2012 (dollars in thousands):

Current LTV/CLTV ⁽¹⁾	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
<=80%	\$1,419,410	\$1,324,167	\$ 954,727	\$ 927,559
80%-100%	1,434,958	1,404,415	800,021	776,199
100%-120%	1,140,987	1,231,448	899,677	932,033
>120%	1,221,763	1,482,144	1,366,621	1,587,670
Total mortgage loans receivable	<u>\$5,217,118</u>	<u>\$5,442,174</u>	<u>\$4,021,046</u>	<u>\$4,223,461</u>
Average estimated current LTV/CLTV ⁽²⁾	104.7%	108.1%	111.0%	113.8%
Average LTV/CLTV at loan origination ⁽³⁾	71.3%	71.2%	79.4%	79.4%

(1) Current CLTV calculations for home equity loans are based on the maximum available line for home equity lines of credit and outstanding principal balance for home equity installment loans. Current property values are updated on a quarterly basis using the most recent property value data available to the Company. For properties in which the Company did not have an updated valuation, it utilized home price indices to estimate the current property value.

(2) The average estimated current LTV/CLTV ratio reflects the outstanding balance at the balance sheet date and the maximum available line for home equity lines of credit, divided by the estimated current value of the underlying property.

(3) Average LTV/CLTV at loan origination calculations are based on LTV/CLTV at time of purchase for one- to four-family purchased loans and undrawn balances for home equity loans.

Documentation Type	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
Full documentation	\$2,211,060	\$2,317,933	\$2,056,966	\$2,166,554
Low/no documentation	3,006,058	3,124,241	1,964,080	2,056,907
Total mortgage loans receivable	<u>\$5,217,118</u>	<u>\$5,442,174</u>	<u>\$4,021,046</u>	<u>\$4,223,461</u>

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Current FICO ⁽¹⁾	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
≥720	\$2,658,498	\$2,819,541	\$2,105,361	\$2,238,296
719 - 700	487,307	498,057	410,098	417,926
699 - 680	416,784	425,474	333,653	345,771
679 - 660	320,761	347,219	268,817	279,765
659 - 620	442,735	494,021	355,500	370,282
<620	891,033	857,862	547,617	571,421
Total mortgage loans receivable	\$5,217,118	\$5,442,174	\$4,021,046	\$4,223,461

(1) FICO scores are updated on a quarterly basis; however, as of March 31, 2013 and December 31, 2012, there were some loans for which the updated FICO scores were not available. The current FICO distribution as of March 31, 2013 included original FICO scores for approximately \$115 million and \$12 million of one- to four-family and home equity loans, respectively. The current FICO distribution as of December 31, 2012 included original FICO scores for approximately \$121 million and \$20 million of one- to four-family and home equity loans, respectively.

Vintage Year	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
2003 and prior	\$ 179,896	\$ 190,407	\$ 201,091	\$ 218,182
2004	491,801	514,283	337,089	359,737
2005	1,043,288	1,095,047	1,078,272	1,131,341
2006	2,041,936	2,123,395	1,876,813	1,962,946
2007	1,456,194	1,515,020	519,019	542,203
2008	4,003	4,022	8,762	9,052
Total mortgage loans receivable	\$5,217,118	\$5,442,174	\$4,021,046	\$4,223,461

Average age of mortgage loans receivable (years)	6.9	6.7	7.2	6.9
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Geographic Location	One- to Four-Family		Home Equity	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
California	\$2,465,272	\$2,568,709	\$1,271,641	\$1,333,317
New York	369,465	386,380	298,165	313,148
Florida	349,397	368,319	284,149	298,860
Virginia	229,137	235,019	182,488	192,143
Other states	1,803,847	1,883,747	1,984,603	2,085,993
Total mortgage loans receivable	\$5,217,118	\$5,442,174	\$4,021,046	\$4,223,461

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Delinquent Loans

The following table shows total loans receivable by delinquency category as of March 31, 2013 and December 31, 2012 (dollars in thousands):

	<u>Current</u>	<u>30-89 Days Delinquent</u>	<u>90-179 Days Delinquent</u>	<u>180+ Days Delinquent</u>	<u>Total</u>
March 31, 2013					
One- to four-family	\$ 4,635,019	\$ 220,208	\$ 99,893	\$ 261,998	\$ 5,217,118
Home equity	3,850,935	76,101	52,535	41,475	4,021,046
Consumer and other	722,017	15,796	2,007	—	739,820
Total loans receivable	<u>\$ 9,207,971</u>	<u>\$ 312,105</u>	<u>\$ 154,435</u>	<u>\$ 303,473</u>	<u>\$ 9,977,984</u>
December 31, 2012					
One- to four-family	\$ 4,834,915	\$ 233,796	\$ 94,652	\$ 278,811	\$ 5,442,174
Home equity	4,028,936	89,347	64,239	40,939	4,223,461
Consumer and other	819,468	19,101	6,178	195	844,942
Total loans receivable	<u>\$ 9,683,319</u>	<u>\$ 342,244</u>	<u>\$ 165,069</u>	<u>\$ 319,945</u>	<u>\$ 10,510,577</u>

Nonperforming Loans

The Company classifies loans as nonperforming when they are no longer accruing interest. Nonaccrual loans include loans that are 90 days and greater past due, TDRs that are on nonaccrual status for all classes of loans and certain junior liens that have a delinquent senior lien. As of March 31, 2013, the Company had nonaccrual loans of \$644.4 million, \$223.9 million and \$2.0 million for one- to four-family, home equity and consumer and other loans, respectively. As of December 31, 2012, the Company had nonaccrual loans of \$639.1 million, \$247.5 million and \$6.4 million for one- to four-family, home equity and consumer and other loans, respectively.

Allowance for Loan Losses

The following table provides a roll forward by loan portfolio of the allowance for loan losses for the three months ended March 31, 2013 and 2012 (dollars in thousands):

	<u>Three Months Ended March 31, 2013</u>			<u>Total</u>
	<u>One- to Four-Family</u>	<u>Home Equity</u>	<u>Consumer and Other</u>	
Allowance for loan losses, beginning of period	\$ 183,937	\$ 257,333	\$ 39,481	\$480,751
Provision for loan losses	(16,616)	55,248	4,018	42,650
Charge-offs	(18,786)	(57,409)	(16,241)	(92,436)
Recoveries	12,500	7,954	3,613	24,067
Charge-offs, net	<u>(6,286)</u>	<u>(49,455)</u>	<u>(12,628)</u>	<u>(68,369)</u>
Allowance for loan losses, end of period	<u>\$ 161,035</u>	<u>\$ 263,126</u>	<u>\$ 30,871</u>	<u>\$455,032</u>

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	Three Months Ended March 31, 2012			Total
	One- to Four- Family	Home Equity	Consumer and Other	
Allowance for loan losses, beginning of period	\$ 314,187	\$ 463,288	\$ 45,341	\$ 822,816
Provision for loan losses	15,867	42,977	13,103	71,947
Charge-offs	(90,452)	(225,075)	(12,881)	(328,408)
Recoveries	—	9,825	2,995	12,820
Charge-offs, net	(90,452)	(215,250)	(9,886)	(315,588)
Allowance for loan losses, end of period	\$ 239,602	\$ 291,015	\$ 48,558	\$ 579,175

During the three months ended March 31, 2013, the allowance for loan losses decreased by \$25.7 million from \$480.7 million at December 31, 2012. The general allowance for loan losses also included a qualitative component to account for a variety of factors that are not directly considered in the quantitative loss model but are factors the Company believes may impact the level of credit losses. The qualitative component was \$60 million and \$44 million at March 31, 2013 and December 31, 2012, respectively.

During the first quarter of 2013, the Company agreed to a settlement with a third party mortgage originator specific to loans sold to the Company by this originator. A one-time payment of \$12.5 million was agreed upon to satisfy in full all pending and future repurchase requests with this specific originator. The full amount of the settlement was applied as recoveries to the allowance for loan losses in the first quarter of 2013, resulting in a corresponding reduction to net charge-offs as well as provision for loan losses.

Impaired Loans—Troubled Debt Restructurings

TDRs include loan modifications completed under the Company's programs that involve granting an economic concession to a borrower experiencing financial difficulty, as well as loans that have been charged off based on the estimated current value of the underlying property less estimated selling costs due to bankruptcy notification. Upon being classified as a TDR, such loan is categorized as an impaired loan and is considered impaired until maturity regardless of whether the borrower performs under the terms of the loan. Impairment on TDRs is measured on an individual basis.

TDR loan modifications are accounted for as nonaccrual loans at the time of modification and return to accrual status after six consecutive payments are made in accordance with the modified terms. TDRs are classified as nonperforming until six consecutive payments have been made.

The unpaid principal balance in one- to four-family TDRs was \$1.2 billion at both March 31, 2013 and December 31, 2012. For home equity loans, the recorded investment in TDRs represents the unpaid principal balance. As of March 31, 2013 the Company had \$206.7 million recorded investment of TDRs that had been charged-off due to bankruptcy notification, \$108.1 million of which were classified as performing. As of December 31, 2012 the Company had \$216.6 million recorded investment of TDRs that had been charged-off due to bankruptcy notification, \$119.2 million of which were classified as performing.

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The following table shows a summary of the Company's recorded investment in TDRs that were on accrual and nonaccrual status, in addition to the recorded investment of TDRs as of March 31, 2013 and December 31, 2012 (dollars in thousands):

	Accrual TDRs ⁽¹⁾	Nonaccrual TDRs			Recorded Investment in TDRs
		Current ⁽²⁾	30-89 Days Delinquent	90+ Days Delinquent	
March 31, 2013					
One- to four-family	\$ 748,986	\$166,945	\$115,571	\$185,065	\$1,216,567
Home equity	193,369	34,939	17,467	29,187	274,962
Total	<u>\$ 942,355</u>	<u>\$201,884</u>	<u>\$133,038</u>	<u>\$214,252</u>	<u>\$1,491,529</u>
December 31, 2012					
One- to four-family	\$ 785,199	\$142,373	\$118,834	\$182,719	\$1,229,125
Home equity	196,199	35,750	17,634	27,440	277,023
Total	<u>\$ 981,398</u>	<u>\$178,123</u>	<u>\$136,468</u>	<u>\$210,159</u>	<u>\$1,506,148</u>

(1) Represents TDRs that are current and have made six or more consecutive payments.

(2) Represents TDRs that are current but have not yet made six consecutive payments and certain junior lien TDRs that have a delinquent senior lien.

The following table shows the average recorded investment and interest income recognized both on a cash and accrual basis for the Company's TDRs during the three months ended March 31, 2013 and 2012 (dollars in thousands):

	Average Recorded Investment		Interest Income Recognized	
	Three Months Ended		Three Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
One- to four-family	\$1,220,664	\$ 990,961	\$ 8,445	\$ 8,093
Home equity	281,362	387,038	5,043	2,685
Total	<u>\$1,502,026</u>	<u>\$1,377,999</u>	<u>\$13,488</u>	<u>\$10,778</u>

Included in the allowance for loan losses was a specific valuation allowance of \$148.1 million and \$171.4 million that was established for TDRs at March 31, 2013 and December 31, 2012, respectively. The specific allowance for these individually impaired loans represents the forecasted losses over the estimated remaining life of the loan, including the economic concession to the borrower. The following table shows detailed information related to the Company's loans that were modified in a TDR as of March 31, 2013 and December 31, 2012 (dollars in thousands):

	March 31, 2013			December 31, 2012		
	Recorded Investment in TDRs	Specific Valuation Allowance	Net Investment in TDRs	Recorded Investment in TDRs	Specific Valuation Allowance	Net Investment in TDRs
With a recorded allowance:						
One- to four-family	\$ 480,141	\$ 81,685	\$ 398,456	\$ 503,557	\$ 89,684	\$ 413,873
Home equity	\$ 165,524	\$ 66,421	\$ 99,103	\$ 185,133	\$ 81,690	\$ 103,443
Without a recorded allowance:⁽¹⁾						
One- to four-family	\$ 736,426	\$ —	\$ 736,426	\$ 725,568	\$ —	\$ 725,568
Home equity	\$ 109,438	\$ —	\$ 109,438	\$ 91,890	\$ —	\$ 91,890
Total:						
One- to four-family	\$ 1,216,567	\$ 81,685	\$ 1,134,882	\$ 1,229,125	\$ 89,684	\$ 1,139,441
Home equity	\$ 274,962	\$ 66,421	\$ 208,541	\$ 277,023	\$ 81,690	\$ 195,333

(1) Represents loans where the discounted cash flow analysis or collateral value is equal to or exceeds the recorded investment in the loan.

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Troubled Debt Restructurings—Loan Modifications

The Company has loan modification programs that focus on the mitigation of potential losses in the one- to four-family and home equity mortgage loan portfolio. The Company currently does not have an active loan modification program for consumer and other loans. The various types of economic concessions that may be granted typically consist of interest rate reductions, maturity date extensions, principal forgiveness or a combination of these concessions. Trial modifications are classified immediately as TDRs and continue to be reported as delinquent until the successful completion of the trial period, which is typically 90 days. The loan then becomes a permanent modification reported as current but remains on nonaccrual status until six consecutive payments have been made.

The vast majority of the Company's TDR loan modifications include an interest rate reduction in combination with another type of concession. The Company prioritizes the interest rate reduction modifications in combination with the following modification categories: principal forgiven, principal deferred and re-age/extension/capitalization of accrued interest. Each class is mutually exclusive in that if a modification had an interest rate reduction with principal forgiven and an extension, the modification would only show up in the principal forgiven column in the table below. The following tables provide the number of loans, post-modification balances immediately after being modified by major class, and the financial impact of modifications during the three months ended March 31, 2013 and 2012 (dollars in thousands):

	Three Months Ended March 31, 2013						
	Interest Rate Reduction						
	Number of Loans	Principal Forgiven	Principal Deferred	Re-age/ Extension/ Interest Capitalization	Other with Interest Rate Reduction	Other	Total
One- to four-family	93	\$ 8,074	\$ 2,301	\$ 19,782	\$ 831	\$ 4,792	\$ 35,780
Home equity	66	—	—	1,362	2,353	1,067	4,782
Total	159	\$ 8,074	\$ 2,301	\$ 21,144	\$ 3,184	\$ 5,859	\$ 40,562

	Three Months Ended March 31, 2012						
	Interest Rate Reduction						
	Number of Loans	Principal Forgiven	Principal Deferred	Re-age/ Extension/ Interest Capitalization	Other with Interest Rate Reduction	Other	Total
One- to four-family	179	\$ 9,839	\$ 9,393	\$ 49,423	\$ 3,808	\$ 8,303	\$ 80,766
Home equity	319	—	—	2,286	26,292	1,354	29,932
Total	498	\$ 9,839	\$ 9,393	\$ 51,709	\$ 30,100	\$ 9,657	\$ 110,698

	Three Months Ended March 31, 2013			
	Financial Impact			
	Principal Forgiven	Pre-Modification Weighted Average Interest Rate	Post-Modification Weighted Average Interest Rate	
One- to four-family	\$ 2,989	5.2%	2.3%	
Home equity	—	4.5%	1.3%	
Total	\$ 2,989			

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	Three Months Ended March 31, 2012		
	Financial Impact		
	Principal Forgiven	Pre-Modification Weighted Average Interest Rate	Post-Modification Weighted Average Interest Rate
One- to four-family	\$ 2,842	6.0%	2.5%
Home equity	8	4.2%	1.5%
Total	\$ 2,850		

The Company considers modifications that become 30 days past due to have experienced a payment default. The following table shows the recorded investment of modifications at March 31, 2013 and 2012 that experienced a payment default within 12 months after the modification for the three months ended March 31, 2013 and 2012 (dollars in thousands):

	Three Months Ended March 31, 2013		Three Months Ended March 31, 2012	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
One- to four-family ⁽¹⁾	54	\$ 19,088	84	\$ 35,182
Home equity ⁽²⁾	24	1,117	118	7,189
Total	78	\$ 20,205	202	\$ 42,371

(1) As of the three months ended March 31, 2013 and 2012, \$3.0 million and \$5.7 million, respectively, of the recorded investment in one- to four-family loans that had a payment default in the trailing 12 months were classified as current.

(2) As of the three months ended March 31, 2013 and 2012, \$0.2 million and \$1.3 million, respectively, of the recorded investment in home equity loans that had a payment default in the trailing 12 months were classified as current.

The delinquency status is the primary measure the Company uses to evaluate the performance of TDR loan modifications. The following table shows the TDR loan modifications by delinquency category as of March 31, 2013 and December 31, 2012 (dollars in thousands):

	Modifications Current	Modifications 30-89 Days Delinquent	Modifications 90-179 Days Delinquent	Modifications 180+ Days Delinquent	Recorded Investment in Modifications
March 31, 2013					
One- to four-family	\$ 830,585	\$ 105,032	\$ 54,076	\$ 80,234	\$ 1,069,927
Home equity	187,208	14,023	6,772	6,856	214,859
Total	\$ 1,017,793	\$ 119,055	\$ 60,848	\$ 87,090	\$ 1,284,786
December 31, 2012					
One- to four-family	\$ 838,020	\$ 105,142	\$ 43,905	\$ 79,102	\$ 1,066,169
Home equity	195,021	15,107	6,173	7,118	223,419
Total	\$ 1,033,041	\$ 120,249	\$ 50,078	\$ 86,220	\$ 1,289,588

NOTE 6—ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company enters into derivative transactions primarily to protect against interest rate risk on the value of certain assets, liabilities and future cash flows. Cash flow hedges, which include a combination of interest rate swaps, forward-starting swaps and purchased options, including caps and floors, are used primarily to reduce the variability of future cash flows associated with existing variable-rate assets and liabilities and forecasted issuances of liabilities. Fair value hedges, which include interest rate swaps and swaptions, are used to offset exposure to changes in value of certain fixed-rate assets and liabilities. The Company also recognizes certain

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contracts and commitments as derivatives when the characteristics of those contracts and commitments meet the definition of a derivative. Each derivative is recorded on the consolidated balance sheet at fair value as a freestanding asset or liability. The following table summarizes the fair value amounts of derivatives designated as hedging instruments reported in the consolidated balance sheet at March 31, 2013 and December 31, 2012 (dollars in thousands):

	Notional	Fair Value		Net ⁽³⁾
		Asset ⁽¹⁾	Liability ⁽²⁾	
March 31, 2013				
Interest rate contracts:				
Cash flow hedges:				
Pay-fixed rate swaps	\$2,430,000	\$ —	\$(284,222)	\$(284,222)
Purchased options	1,630,000	8,669	—	8,669
Total cash flow hedges	4,060,000	8,669	(284,222)	(275,553)
Fair value hedges:				
Pay-fixed rate swaps	609,211	7,638	(5,063)	2,575
Total derivatives designated as hedging instruments ⁽⁴⁾	\$4,669,211	\$16,307	\$(289,285)	\$(272,978)
December 31, 2012				
Interest rate contracts:				
Cash flow hedges:				
Pay-fixed rate swaps	\$2,205,000	\$ —	\$(310,079)	\$(310,079)
Purchased options	2,325,000	13,391	—	13,391
Total cash flow hedges	4,530,000	13,391	(310,079)	(296,688)
Fair value hedges:				
Pay-fixed rate swaps	514,180	1,343	(18,385)	(17,042)
Total derivatives designated as hedging instruments ⁽⁴⁾	\$5,044,180	\$14,734	\$(328,464)	\$(313,730)

(1) Reflected in the other assets line item on the consolidated balance sheet.

(2) Reflected in the other liabilities line item on the consolidated balance sheet.

(3) Represents derivative assets net of derivative liabilities for disclosure purposes only.

(4) All derivatives were designated as hedging instruments as of March 31, 2013 and December 31, 2012.

Cash Flow Hedges

The effective portion of changes in fair value of the derivative instruments that hedge cash flows is reported as a component of accumulated other comprehensive loss, net of tax in the consolidated balance sheet, for both active and discontinued hedges. Amounts are included in net operating interest income as a yield adjustment in the same period the hedged forecasted transaction affects earnings. The ineffective portion of changes in fair value of the derivative instrument, which is equal to the excess of the cumulative change in the fair value of the actual derivative over the cumulative change in the fair value of a hypothetical derivative which is created to match the exact terms of the underlying instruments being hedged, is reported in the gains on loans and securities, net line item in the consolidated statement of income.

If it becomes probable that a hedged forecasted transaction will not occur, amounts included in accumulated other comprehensive loss related to the specific hedging instruments would be immediately reclassified into the gains on loans and securities, net line item in the consolidated statement of income. If hedge accounting is discontinued because a derivative instrument is sold, terminated or otherwise de-designated, amounts included in accumulated other comprehensive loss related to the specific hedging instrument continue to be reported in accumulated other comprehensive loss until the forecasted transaction affects earnings.

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The future issuances of liabilities, including repurchase agreements, are largely dependent on the market demand and liquidity in the wholesale borrowings market. As of March 31, 2013, the Company believes the forecasted issuance of all debt in cash flow hedge relationships is probable. However, unexpected changes in market conditions in future periods could impact the ability to issue this debt. The Company believes the forecasted issuance of debt in the form of repurchase agreements is most susceptible to an unexpected change in market conditions.

The following table summarizes the effect of interest rate contracts designated and qualifying as hedging instruments in cash flow hedges on accumulated other comprehensive loss and on the consolidated statement of income for the three months ended March 31, 2013 and 2012 (dollars in thousands):

	<u>For the Three Months Ended March 31,</u>	
	<u>2013</u>	<u>2012</u>
Gains on derivatives recognized in OCI (effective portion), net of tax	\$ 5,975	\$ 8,396
Losses reclassified from AOCI into earnings (effective portion), net of tax	\$ (20,128)	\$ (19,327)
Cash flow hedge ineffectiveness gains (losses) ⁽¹⁾	\$ (145)	\$ 311

⁽¹⁾ The cash flow hedge ineffectiveness is reflected in the gains on loans and securities, net line item on the statement of consolidated income.

During the upcoming twelve months, the Company expects to include a pre-tax amount of approximately \$134.1 million of net unrealized losses that are currently reflected in accumulated other comprehensive loss in net operating interest income as a yield adjustment in the same periods in which the related hedged items affect earnings. The maximum length of time over which transactions are hedged is 10 years.

The following table shows the balance in accumulated other comprehensive loss attributable to active and discontinued cash flow hedges at March 31, 2013 and December 31, 2012 (dollars in thousands):

	<u>March 31, 2013</u>	<u>December 31, 2012</u>
Accumulated other comprehensive loss balance (net of tax) related to:		
Discontinued cash flow hedges	\$(233,933)	\$(247,983)
Active cash flow hedges	(192,305)	(204,358)
Total cash flow hedges	<u>\$(426,238)</u>	<u>\$(452,341)</u>

The following table shows the balance in accumulated other comprehensive loss attributable to cash flow hedges by type of hedged item at March 31, 2013 and December 31, 2012 (dollars in thousands):

	<u>March 31, 2013</u>	<u>December 31, 2012</u>
Repurchase agreements	\$(544,246)	\$(579,763)
FHLB advances	(137,010)	(146,253)
Home equity lines of credit	5,474	7,854
Other	393	116
Total balance of cash flow hedges, before tax	(675,389)	(718,046)
Tax benefit	249,151	265,705
Total balance of cash flow hedges, net of tax	<u>\$(426,238)</u>	<u>\$(452,341)</u>

Fair Value Hedges

Fair value hedges are accounted for by recording the fair value of the derivative instrument and the fair value of the asset or liability being hedged on the consolidated balance sheet. Changes in the fair value of both

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the derivatives and the underlying assets or liabilities are recognized in the gains on loans and securities, net line item in the consolidated statement of income. To the extent that the hedge is ineffective, the changes in the fair values will not offset and the difference, or hedge ineffectiveness, is reflected in the gains on loans and securities, net line item in the consolidated statement of income.

Hedge accounting is discontinued for fair value hedges if a derivative instrument is sold, terminated or otherwise de-designated. If fair value hedge accounting is discontinued, the previously hedged item is no longer adjusted for changes in fair value through the consolidated statement of income and the cumulative net gain or loss on the hedged asset or liability at the time of de-designation is amortized to interest income or interest expense using the effective interest method over the expected remaining life of the hedged item. Changes in the fair value of the derivative instruments after de-designation of fair value hedge accounting are recorded in the gains on loans and securities, net line item in the consolidated statement of income.

The following table summarizes the effect of interest rate contracts designated and qualifying as hedging instruments in fair value hedges and related hedged items on the consolidated statement of income for the three months ended March 31, 2013, and 2012 (dollars in thousands):

	Three Months Ended March 31,					
	2013			2012		
	Hedging Instrument	Hedged Item	Hedge Ineffectiveness ⁽¹⁾	Hedging Instrument	Hedged Item	Hedge Ineffectiveness ⁽¹⁾
Agency debentures	\$ 15,988	\$(15,903)	\$ 85	\$ 31,848	\$(30,117)	\$ 1,731
Agency mortgage-backed securities	(104)	51	(53)	4,331	(4,331)	—
FHLB advances	—	—	—	(1,276)	(791)	(2,067)
Total gains (losses) included in earnings	<u>\$ 15,884</u>	<u>\$(15,852)</u>	<u>\$ 32</u>	<u>\$ 34,903</u>	<u>\$(35,239)</u>	<u>\$ (336)</u>

⁽¹⁾ Reflected in the gains on loans and securities, net line item on the consolidated statement of income.

NOTE 7—DEPOSITS

Deposits are summarized as follows (dollars in thousands):

	Amount		Weighted-Average Rate	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
Sweep deposits ⁽¹⁾	\$18,923,113	\$21,253,611	0.06%	0.05%
Complete savings deposits	4,827,371	4,981,615	0.01%	0.01%
Checking deposits	1,061,751	1,055,422	0.03%	0.03%
Other money market and savings deposits	974,854	995,188	0.01%	0.01%
Time deposits ⁽²⁾	90,659	106,716	1.42%	1.75%
Total deposits ⁽³⁾	<u>\$25,877,748</u>	<u>\$28,392,552</u>	0.05%	0.05%

⁽¹⁾ A sweep product transfers brokerage customer balances to banking subsidiaries, which hold these funds as customer deposits in FDIC insured demand deposit and money market deposit accounts.

⁽²⁾ Time deposits represent certificates of deposit and brokered certificates of deposit.

⁽³⁾ As of March 31, 2013 and December 31, 2012, the Company had \$119.3 million and \$113.1 million in non-interest bearing deposits, respectively.

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NOTE 8—SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND FHLB ADVANCES AND OTHER BORROWINGS

Securities sold under agreements to repurchase, FHLB advances and other borrowings at March 31, 2013 and December 31, 2012 are shown in the following table (dollars in thousands):

	Repurchase Agreements ⁽¹⁾	FHLB Advances and Other Borrowings		Total	Weighted Average Interest Rate
		FHLB Advances	Other		
Due within one year	\$3,509,421	\$ 170,000	\$ 1,170	\$3,680,591	0.41%
Due between one and two years	100,000	100,000	180	200,180	1.04%
Due between two and three years	350,000	—	—	350,000	0.86%
Due between three and four years	500,000	250,000	—	750,000	1.44%
Due between four and five years	—	400,000	—	400,000	0.46%
Thereafter	—	—	427,747	427,747	2.97%
Subtotal	4,459,421	920,000	429,097	5,808,518	0.78%
Fair value hedge adjustments	—	35,134	—	35,134	
Deferred costs	—	(118,742)	—	(118,742)	
Total other borrowings at March 31, 2013	<u>\$4,459,421</u>	<u>\$ 836,392</u>	<u>\$429,097</u>	<u>\$5,724,910</u>	0.78%
Total other borrowings at December 31, 2012	<u>\$4,454,661</u>	<u>\$ 831,749</u>	<u>\$429,167</u>	<u>\$5,715,577</u>	0.83%

⁽¹⁾ The maximum amount at any month end for repurchase agreements was \$4.5 billion for the three months ended March 31, 2013 and \$5.0 billion and for the year ended December 31, 2012.

NOTE 9—CORPORATE DEBT

Corporate debt at March 31, 2013 and December 31, 2012 is outlined in the following table (dollars in thousands):

	Face Value	Discount	Net
March 31, 2013			
Interest-bearing notes:			
6 3/4% Notes, due 2016	\$ 435,000	\$ (5,319)	\$ 429,681
6% Notes, due 2017	505,000	(4,364)	500,636
6 3/8% Notes, due 2019	800,000	(7,069)	792,931
Total interest-bearing notes	1,740,000	(16,752)	1,723,248
Non-interest-bearing debt:			
0% Convertible debentures, due 2019	42,657	—	42,657
Total corporate debt	<u>\$1,782,657</u>	<u>\$(16,752)</u>	<u>\$1,765,905</u>
December 31, 2012			
Interest-bearing notes:			
6 3/4% Notes, due 2016	\$ 435,000	\$ (5,738)	\$ 429,262
6% Notes, due 2017	505,000	(4,601)	500,399
6 3/8% Notes, due 2019	800,000	(7,336)	792,664
Total interest-bearing notes	1,740,000	(17,675)	1,722,325
Non-interest-bearing debt:			
0% Convertible debentures, due 2019	42,657	—	42,657
Total corporate debt	<u>\$1,782,657</u>	<u>\$(17,675)</u>	<u>\$1,764,982</u>

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NOTE 10—SHAREHOLDERS' EQUITY

The activity in shareholders' equity during the three months ended March 31, 2013 is summarized in the following table (dollars in thousands):

	Common Stock/ Additional Paid-In Capital	Accumulated Deficit/Other Comprehensive Loss	Total
Beginning balance, December 31, 2012	\$ 7,322,118	\$(2,417,648)	\$4,904,470
Net income	—	35,124	35,124
Net change from available-for-sale securities	—	(15,105)	(15,105)
Net change from cash flow hedging instruments	—	26,103	26,103
Other ⁽¹⁾	1,241	(6)	1,235
Ending balance, March 31, 2013	<u>\$ 7,323,359</u>	<u>\$(2,371,532)</u>	<u>\$4,951,827</u>

⁽¹⁾ Other includes employee share-based compensation accounting and changes in accumulated other comprehensive loss from foreign currency translation.

Accumulated Other Comprehensive Loss

The following tables present after-tax changes in each component of accumulated other comprehensive loss (dollars in thousands):

	Available- for-sale Securities	Cash Flow Hedging Instruments	Foreign Currency Translation	Total
Beginning balance, December 31, 2012	\$136,972	\$(452,341)	\$ 5,441	\$(309,928)
Other comprehensive income (loss) before reclassifications	(5,314)	5,975	(6)	655
Amounts reclassified from accumulated other comprehensive loss	(9,791)	20,128	—	10,337
Net change	(15,105)	26,103	(6)	10,992
Ending balance, March 31, 2013	<u>\$121,867</u>	<u>\$(426,238)</u>	<u>\$ 5,435</u>	<u>\$(298,936)</u>

	Available- for-sale Securities	Cash Flow Hedging Instruments	Foreign Currency Translation	Total
Beginning balance, December 31, 2011	\$ 68,330	\$(457,953)	\$ 2,994	\$(386,629)
Other comprehensive income before reclassifications	38,380	8,396	725	47,501
Amounts reclassified from accumulated other comprehensive loss	(21,816)	19,327	—	(2,489)
Net change	16,564	27,723	725	45,012
Ending balance, March 31, 2012	<u>\$ 84,894</u>	<u>\$(430,230)</u>	<u>\$ 3,719</u>	<u>\$(341,617)</u>

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The following table presents the income statement line items impacted by reclassifications out of accumulated other comprehensive loss during the three months ended March 31, 2013 (dollars in thousands):

Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Loss	Affected Line Items in the Income Statement
Available-for-sale securities:		
	\$ 15,765	Gains on loans and securities, net
	<u>(5,974)</u>	Tax expense
	<u>\$ 9,791</u>	Reclassification into earnings, net
Cash flow hedging instruments:		
	\$ 2,377	Operating interest income
	<u>(35,269)</u>	Operating interest expense
	<u>(32,892)</u>	Reclassification into earnings, before tax
	<u>12,764</u>	Tax benefit
	<u>\$ (20,128)</u>	Reclassification into earnings, net

NOTE 11—EARNINGS PER SHARE

The following table is a reconciliation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2013	2012
Basic:		
Net income	\$ 35,124	\$ 62,591
Basic weighted-average shares outstanding	<u>286,626</u>	<u>285,478</u>
Basic earnings per share	<u>\$ 0.12</u>	<u>\$ 0.22</u>
Diluted:		
Net income	\$ 35,124	\$ 62,591
Basic weighted-average shares outstanding	286,626	285,478
Effect of dilutive securities:		
Weighted-average convertible debentures	4,125	4,159
Weighted-average options and restricted stock issued to employees	<u>945</u>	<u>380</u>
Diluted weighted-average shares outstanding	<u>291,696</u>	<u>290,017</u>
Diluted earnings per share	<u>\$ 0.12</u>	<u>\$ 0.22</u>

As of March 31, 2013 and 2012, the Company excluded 2.7 million and 2.9 million shares, respectively, of stock options and restricted stock awards and units from the calculations of diluted earnings per share as the effect would have been anti-dilutive.

NOTE 12—REGULATORY REQUIREMENTS

Registered Broker-Dealers

The Company's largest U.S. broker-dealer subsidiaries are subject to the Uniform Net Capital Rule (the "Rule") under the Securities Exchange Act of 1934 administered by the SEC and FINRA, which requires the

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maintenance of minimum net capital. The minimum net capital requirements can be met under either the Aggregate Indebtedness method or the Alternative method. Under the Aggregate Indebtedness method, a broker-dealer is required to maintain minimum net capital of the greater of 6 2/3% of its aggregate indebtedness, as defined, or a minimum dollar amount. Under the Alternative method, a broker-dealer is required to maintain net capital equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions. The method used depends on the individual U.S. broker-dealer subsidiary. The Company's other broker-dealers, including its international broker-dealer subsidiaries located in Europe and Asia, are subject to capital requirements determined by their respective regulators.

As of March 31, 2013 and December 31, 2012, all of the Company's broker-dealer subsidiaries met minimum net capital requirements. Total required net capital was \$0.1 billion at both March 31, 2013 and December 31, 2012. In addition, the Company's broker-dealer subsidiaries had excess net capital of \$0.7 billion at both March 31, 2013 and December 31, 2012. The tables below summarize the minimum excess capital requirements for the Company's broker-dealer subsidiaries at March 31, 2013 and December 31, 2012 (dollars in thousands):

	Required Net Capital	Net Capital	Excess Net Capital
March 31, 2013:			
E*TRADE Clearing LLC ⁽¹⁾	\$ 128,110	\$ 654,097	\$ 525,987
E*TRADE Securities LLC ⁽¹⁾	250	97,026	96,776
G1 Execution Services, LLC ⁽²⁾	1,000	20,091	19,091
Other broker-dealers	4,888	33,879	28,991
Total	<u>\$ 134,248</u>	<u>\$ 805,093</u>	<u>\$ 670,845</u>
December 31, 2012:			
E*TRADE Clearing LLC ⁽¹⁾	\$ 123,656	\$ 658,968	\$ 535,312
E*TRADE Securities LLC ⁽¹⁾	250	79,318	79,068
G1 Execution Services, LLC ⁽²⁾	1,283	10,598	9,315
Other broker-dealers	4,639	36,070	31,431
Total	<u>\$ 129,828</u>	<u>\$ 784,954</u>	<u>\$ 655,126</u>

(1) Elected to use the Alternative method to compute net capital.

(2) Elected to use the Aggregate Indebtedness method to compute net capital.

Banking

E*TRADE Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can trigger certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on E*TRADE Bank's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, E*TRADE Bank must meet specific capital guidelines that involve quantitative measures of E*TRADE Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. In addition, E*TRADE Bank may not pay dividends to the parent company without approval from its regulators and any loans by E*TRADE Bank to the parent company and its other non-bank subsidiaries are subject to various quantitative, arm's length, collateralization and other requirements. E*TRADE Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require E*TRADE Bank to meet minimum total capital, Tier 1 capital and Tier 1 leverage ratios. As shown in the table below, at both March 31,

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2013 and December 31, 2012, E*TRADE Bank was categorized as “well capitalized” under the regulatory framework for prompt corrective action. However, events beyond management’s control, such as a continued deterioration in residential real estate and credit markets, could adversely affect future earnings and E*TRADE Bank’s ability to meet its future capital requirements. E*TRADE Bank’s actual and required capital amounts and ratios at March 31, 2013 and December 31, 2012 are presented in the table below (dollars in thousands):

	Actual		Minimum Required to be Well Capitalized Under Prompt Corrective Action Provisions		Excess Capital
	Amount	Ratio	Amount	Ratio	
March 31, 2013:					
Total capital	\$4,043,765	21.93%	>\$1,844,237	>10.00%	\$2,199,528
Tier 1 capital	\$3,809,682	20.66%	>\$1,106,542	>6.00%	\$2,703,140
Tier 1 leverage	\$3,809,682	9.26%	>\$2,057,339	>5.00%	\$1,752,343
December 31, 2012:					
Total capital	\$4,009,540	20.61%	>\$1,945,669	>10.00%	\$2,063,871
Tier 1 capital	\$3,762,242	19.34%	>\$1,167,401	>6.00%	\$2,594,841
Tier 1 leverage	\$3,762,242	8.68%	>\$2,167,136	>5.00%	\$1,595,106

NOTE 13—COMMITMENTS, CONTINGENCIES AND OTHER REGULATORY MATTERS*Legal Matters**Litigation Matters*

On October 27, 2000, Ajaxo, Inc. (“Ajaxo”) filed a complaint in the Superior Court for the State of California, County of Santa Clara. Ajaxo sought damages and certain non-monetary relief for the Company’s alleged breach of a non-disclosure agreement with Ajaxo pertaining to certain wireless technology that Ajaxo offered the Company as well as damages and other relief against the Company for their alleged misappropriation of Ajaxo’s trade secrets. Following a jury trial, a judgment was entered in 2003 in favor of Ajaxo against the Company for \$1.3 million for breach of the Ajaxo non-disclosure agreement. Although the jury found in favor of Ajaxo on its claim against the Company for misappropriation of trade secrets, the trial court subsequently denied Ajaxo’s requests for additional damages and relief. On December 21, 2005, the California Court of Appeal affirmed the above-described award against the Company for breach of the nondisclosure agreement but remanded the case to the trial court for the limited purpose of determining what, if any, additional damages Ajaxo may be entitled to as a result of the jury’s previous finding in favor of Ajaxo on its claim against the Company for misappropriation of trade secrets. Although the Company paid Ajaxo the full amount due on the above-described judgment, the case was remanded back to the trial court, and on May 30, 2008, a jury returned a verdict in favor of the Company denying all claims raised and demands for damages against the Company. Following the trial court’s filing of entry of judgment in favor of the Company on September 5, 2008, Ajaxo filed post-trial motions for vacating this entry of judgment and requesting a new trial. By order dated November 4, 2008, the trial court denied these motions. On December 2, 2008, Ajaxo filed a notice of appeal with the Court of Appeal of the State of California for the Sixth District. Oral argument on the appeal was heard on July 15, 2010. On August 30, 2010, the Court of Appeal affirmed the trial court’s verdict in part and reversed the verdict in part, remanding the case. The Company petitioned the Supreme Court of California for review of the Court of Appeal decision. On December 16, 2010, the California Supreme Court denied the Company’s petition for review and remanded for further proceedings to the trial court. On September 20, 2011, the trial court granted limited discovery at a conference on November 4, 2011. The testimonial phase of the third trial in this matter commenced on February 21 and 22, 2012 and concluded on June 12, 2012. The parties await decision on whether there will be a second phase of this bench trial. The Company will continue to defend itself vigorously.

On October 2, 2007, a class action complaint alleging violations of the federal securities laws was filed in the United States District Court for the Southern District of New York against the Company and its then Chief Executive Officer and Chief Financial Officer by Larry Freudenberg on his own behalf and on behalf of others

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similarly situated (the “Freudenberg Action”). On July 17, 2008, the trial court consolidated this action with four other purported class actions. Plaintiffs contended, among other things, that the value of the Company’s stock between April 19, 2006 and November 9, 2007 was artificially inflated because the defendants issued materially false and misleading statements and failed to disclose that the Company was experiencing a rise in delinquency rates in its mortgage and home equity portfolios; failed to timely record an impairment on its mortgage and home equity portfolios; materially overvalued its securities portfolio, which included assets backed by mortgages; and based on the foregoing, lacked a reasonable basis for the positive statements made about the Company’s earnings and prospects. The parties entered into a Stipulation of Settlement on May 17, 2012, which was submitted to the Court for approval. The settlement was approved by the Court and the class was certified by a final judgment and order of dismissal dated October 22, 2012. Under the terms of the settlement, the Company and its insurance carriers paid \$79.0 million in return for full releases. Approximately \$11.0 million of the total settlement figure was paid by the Company, which was expensed in the year ended December 31, 2011. As of January 14, 2013, all appeals and requests for attorneys’ fees have been resolved and the settlement is final.

Based upon the same facts and circumstances alleged in the Freudenberg consolidated actions discussed above, a verified shareholder derivative complaint was filed in the United States District Court for the Southern District of New York on October 4, 2007 by Catherine Rubery, against the Company and its then Chief Executive Officer, President/Chief Operating Officer, Chief Financial Officer and individual members of its board of directors. The Rubery complaint was consolidated with another shareholder derivative complaint brought by shareholder Marilyn Clark in the same court and against the same named defendants. On July 26, 2010, plaintiffs served their consolidated amended complaint, in which they also named the Company’s former Capital Markets Division President as a defendant. Plaintiffs allege, among other things, causes of action for breach of fiduciary duty, waste of corporate assets, unjust enrichment, and violation of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The complaint seeks, among other things, unspecified monetary damages in favor of the Company, changes to certain corporate governance procedures and various forms of injunctive relief. The parties agreed to settle this action and a Stipulation of Settlement was signed on October 2, 2012, which included an agreement to implement or maintain certain corporate governance procedures. The parties did not reach an agreement on the issue of plaintiffs’ attorneys’ fees, however. The Court preliminarily approved the Stipulation of Settlement on April 2, 2013 and set a final hearing date for September 13, 2013. The unresolved issue of plaintiffs’ attorneys’ fees will be addressed at the final hearing.

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counterclaim on June 13, 2012 and plaintiff has moved to dismiss the counterclaim. The Company filed a motion for summary judgment. Plaintiffs sought to change venue back to the Eastern District of Texas on the theory that this case is one of several matters that should be consolidated in a single multi-district litigation. On December 12, 2012, the Multidistrict Litigation Panel denied the transfer of this action to Texas. By opinion dated April 4, 2013, the Court denied defendants' motion for summary judgement and plaintiff's motion to dismiss the counterclaims. The Company will continue to defend itself vigorously in this matter.

Several cases have been filed nationwide involving the April 2007 leveraged buyout ("LBO") of the Tribune Company ("Tribune") by Sam Zell, and the subsequent bankruptcy of Tribune. In *William Niese et al. v. A.G. Edwards et al.*, in Superior Court of Delaware, New Castle County, former Tribune employees and retirees claimed that Tribune was actually insolvent at the time of the LBO and that the LBO constituted a fraudulent transaction that depleted the plaintiffs' retirement plans, rendering them worthless. E*TRADE Clearing LLC, along with numerous other financial institutions, is a named defendant in this case, but has not been served with process. One of the defendants removed the action to federal district court in Delaware on July 1, 2011. In *Deutsche Bank Trust Company Americas et al. v. Adaly Opportunity Fund et al.*, filed in the Supreme Court of New York, New York County on June 3, 2011, the Trustees of certain notes issued by Tribune allege wrongdoing in connection with the LBO. In particular the Trustees claim that the LBO constituted a constructive fraudulent transfer under various state laws. G1 Execution Services, LLC (formerly known as E*TRADE Capital Markets, LLC), along with numerous other financial institutions, is a named defendant in this case. In *Deutsche Bank et al. v. Ohlson et al.*, filed in the U.S. District Court for the Northern District of Illinois, noteholders of Tribune asserted claims of constructive fraud and G1 Execution Services, LLC is a named defendant in this case. In *EGI-TRB LLC et al. v. ABN-AMRO et al.*, filed in the Circuit Court of Cook County Illinois, creditors of Tribune assert fraudulent conveyance claims against multiple shareholder defendants and E*TRADE Clearing LLC is a named defendant in this case. There have been several motions filed by various parties to transfer venue and to consolidate these actions. The Company's time to answer or otherwise respond to the complaints has been stayed pending further orders of the Court. The Court has set a motion schedule for omnibus motions to dismiss in 2013. Discovery remains stayed until the pending motions are resolved. A hearing on the motion to dismiss is set for May 24, 2013. The Company will defend itself vigorously in these matters.

In addition to the matters described above, the Company is subject to various legal proceedings and claims that arise in the normal course of business. In each pending matter, the Company contests liability or the amount of claimed damages. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages, or where investigation or discovery have yet to be completed, the Company is unable to reasonably estimate a range of possible losses on its remaining outstanding legal proceedings; however, the Company believes any losses would not be reasonably likely to have a material adverse effect on the consolidated financial condition or results of operations of the Company.

An unfavorable outcome in any matter could have a material adverse effect on the Company's business, financial condition, results of operations or cash flows. In addition, even if the ultimate outcomes are resolved in the Company's favor, the defense of such litigation could entail considerable cost or the diversion of the efforts of management, either of which could have a material adverse effect on the Company's business, financial condition, results of operations or cash flows.

Regulatory Matters

The securities and banking industries are subject to extensive regulation under federal, state and applicable international laws. From time to time, the Company has been threatened with or named as a defendant in lawsuits, arbitrations and administrative claims involving securities, banking and other matters. The Company is also subject to periodic regulatory audits and inspections. Compliance and trading problems that are reported to regulators, such as the SEC, FINRA or OCC by dissatisfied customers or others are investigated by such regulators, and may, if pursued, result in formal claims being filed against the Company by customers or

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disciplinary action being taken against the Company or its employees by regulators. Any such claims or disciplinary actions that are decided against the Company could have a material impact on the financial results of the Company or any of its subsidiaries.

On October 17, 2007, the SEC initiated an informal inquiry into matters related to the Company's mortgage loan and mortgage-related securities investment portfolios. The Company is cooperating fully with the SEC in this matter.

During 2012, the Company completed a review of order handling practices and pricing for order flow between E*TRADE Securities LLC and G1 Execution Services, LLC. The Company is in the process of implementing changes to its practices and procedures recommended during that review and expects to complete them in the near future. Banking regulators and federal securities regulators were regularly updated during the course of the review and may initiate investigations into the Company's historical practices which could subject it to monetary penalties and cease-and-desist orders, which could also prompt claims by customers of E*TRADE Securities LLC. Any of these actions could materially and adversely affect the Company's market making and trade execution businesses.

Insurance

The Company maintains insurance coverage that management believes is reasonable and prudent. The principal insurance coverage it maintains covers commercial general liability; property damage; hardware/software damage; cyber liability; directors and officers; employment practices liability; certain criminal acts against the Company; and errors and omissions. The Company believes that such insurance coverage is adequate for the purpose of its business. The Company's ability to maintain this level of insurance coverage in the future, however, is subject to the availability of affordable insurance in the marketplace.

Estimated Liabilities

For all legal matters, an estimated liability is established in accordance with the loss contingencies accounting guidance. Once established, the estimated liability is adjusted based on available information when an event occurs requiring an adjustment.

Commitments

In the normal course of business, the Company makes various commitments to extend credit and incur contingent liabilities that are not reflected in the consolidated balance sheet. Significant changes in the economy or interest rates may influence the impact that these commitments and contingencies have on the Company in the future.

Other Investments

The Company has investments in low-income housing tax credit partnerships and other limited partnerships. The Company had \$4.4 million in commitments to fund low income housing tax credit partnerships and other limited partnerships as of March 31, 2013.

Securities, Unused Lines of Credit and Certificates of Deposit

At March 31, 2013, the Company had commitments to purchase \$0.1 billion in securities and commitments to sell \$0.1 billion in securities. In addition, the Company had approximately \$0.1 billion of certificates of deposit scheduled to mature in less than one year and \$0.6 billion of unfunded commitments to extend credit.

Guarantees

In prior periods when the Company sold loans, the Company provided guarantees to investors purchasing mortgage loans, which are considered standard representations and warranties within the mortgage industry. The primary guarantees are that: the mortgage and the mortgage note have been duly executed and each is the legal, valid and binding obligation of the Company, enforceable in accordance with its terms; the mortgage has been duly acknowledged and recorded and is valid; and the mortgage and the mortgage note are not subject to any right of rescission, set-off, counterclaim or defense, including, without limitation, the defense of usury, and no such right of rescission, set-off, counterclaim or defense has been asserted with respect thereto. The Company is responsible for the guarantees on loans sold. If these claims prove to be untrue, the investor can require the Company to repurchase the loan and return all loan purchase and servicing release premiums. Management does not believe the potential liability exposure will have a material impact on the Company's results of operations, cash flows or financial condition due to the nature of the standard representations and warranties, which have resulted in a minimal amount of loan repurchases.

Prior to 2008, ETBH raised capital through the formation of trusts, which sold trust preferred securities in the capital markets. The capital securities must be redeemed in whole at the due date, which is generally 30 years after issuance. Each trust issued trust preferred securities at par, with a liquidation amount of \$1,000 per capital security. The trusts used the proceeds from the sale of issuances to purchase subordinated debentures issued by ETBH.

During the 30-year period prior to the redemption of the trust preferred securities, ETBH guarantees the accrued and unpaid distributions on these securities, as well as the redemption price of the securities and certain costs that may be incurred in liquidating, terminating or dissolving the trusts (all of which would otherwise be payable by the trusts). At March 31, 2013, management estimated that the maximum potential liability under this arrangement, including the current carrying value of the trusts, was equal to approximately \$436.6 million or the total face value of these securities plus dividends, which may be unpaid at the termination of the trust arrangement.

NOTE 14—SEGMENT INFORMATION

The Company reports its operating results in two segments, based on the manner in which its chief operating decision maker evaluates financial performance and makes resource allocation decisions: 1) trading and investing; and 2) balance sheet management. Trading and investing includes retail brokerage products and services; investor-focused banking products; market making; and corporate services. Balance sheet management includes the management of asset allocation; loans previously originated by the Company or purchased from third parties; customer cash and deposits; and credit, liquidity and interest rate risk. The balance sheet management segment utilizes the vast majority of customer cash and deposits and compensates the trading and investing segment via a market-based transfer pricing arrangement, which is eliminated in consolidation. Customer cash and deposits utilized by the balance sheet management segment include retail deposits and customer payables.

The Company does not allocate costs associated with certain functions that are centrally-managed to its operating segments. These costs are separately reported in a corporate/other category, along with technology related costs incurred to support centrally-managed functions; restructuring and other exit activities; and corporate debt and corporate investments.

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The Company evaluates the performance of its segments based on the segment's income (loss) before income taxes. Financial information for the Company's reportable segments is presented in the following tables (dollars in thousands):

	Three Months Ended March 31, 2013			
	Trading and Investing	Balance Sheet Management	Corporate/ Other	Total
Net operating interest income	\$ 134,115	\$ 107,214	\$ —	\$241,329
Total non-interest income	162,565	15,971	—	178,536
Total net revenue	296,680	123,185	—	419,865
Provision for loan losses	—	42,650	—	42,650
Total operating expense	198,240	50,087	47,208	295,535
Income (loss) before other income (expense) and income taxes	98,440	30,448	(47,208)	81,680
Total other income (expense)	—	—	(24,313)	(24,313)
Income (loss) before income taxes	\$ 98,440	\$ 30,448	\$(71,521)	57,367
Income tax expense				22,243
Net income				\$ 35,124

	Three Months Ended March 31, 2012			
	Trading and Investing	Balance Sheet Management	Corporate/ Other	Total
Net operating interest income	\$ 170,448	\$ 114,403	\$ 1	\$284,852
Total non-interest income	170,389	34,169	(13)	204,545
Total net revenue	340,837	148,572	(12)	489,397
Provision for loan losses	—	71,947	—	71,947
Total operating expense	211,541	58,595	36,103	306,239
Income (loss) before other income (expense) and income taxes	129,296	18,030	(36,115)	111,211
Total other income (expense)	—	—	(45,217)	(45,217)
Income (loss) before income taxes	\$ 129,296	\$ 18,030	\$(81,332)	65,994
Income tax expense				3,403
Net income				\$ 62,591

Segment Assets

	Trading and Investing	Balance Sheet Management	Corporate/ Other	Total
As of March 31, 2013	\$ 9,440,818	\$ 34,806,263	\$ 719,233	\$ 44,966,314
As of December 31, 2012	\$ 9,505,280	\$ 37,305,600	\$ 575,859	\$ 47,386,739

ITEM 4. CONTROLS AND PROCEDURES

- (a) Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 ("Exchange Act") Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report, have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

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- (b) Our Chief Executive Officer and our Chief Financial Officer have evaluated the changes to the Company's internal control over financial reporting that occurred during our last fiscal quarter ended March 31, 2013, as required by paragraph (d) of Exchange Act Rules 13a-15 and 15d-15, and have concluded that there were no such changes that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 27, 2000, Ajaxo, Inc. ("Ajaxo") filed a complaint in the Superior Court for the State of California, County of Santa Clara. Ajaxo sought damages and certain non-monetary relief for the Company's alleged breach of a non-disclosure agreement with Ajaxo pertaining to certain wireless technology that Ajaxo offered the Company as well as damages and other relief against the Company for their alleged misappropriation of Ajaxo's trade secrets. Following a jury trial, a judgment was entered in 2003 in favor of Ajaxo against the Company for \$1.3 million for breach of the Ajaxo non-disclosure agreement. Although the jury found in favor of Ajaxo on its claim against the Company for misappropriation of trade secrets, the trial court subsequently denied Ajaxo's requests for additional damages and relief. On December 21, 2005, the California Court of Appeal affirmed the above-described award against the Company for breach of the nondisclosure agreement but remanded the case to the trial court for the limited purpose of determining what, if any, additional damages Ajaxo may be entitled to as a result of the jury's previous finding in favor of Ajaxo on its claim against the Company for misappropriation of trade secrets. Although the Company paid Ajaxo the full amount due on the above-described judgment, the case was remanded back to the trial court, and on May 30, 2008, a jury returned a verdict in favor of the Company denying all claims raised and demands for damages against the Company. Following the trial court's filing of entry of judgment in favor of the Company on September 5, 2008, Ajaxo filed post-trial motions for vacating this entry of judgment and requesting a new trial. By order dated November 4, 2008, the trial court denied these motions. On December 2, 2008, Ajaxo filed a notice of appeal with the Court of Appeal of the State of California for the Sixth District. Oral argument on the appeal was heard on July 15, 2010. On August 30, 2010, the Court of Appeal affirmed the trial court's verdict in part and reversed the verdict in part, remanding the case. The Company petitioned the Supreme Court of California for review of the Court of Appeal decision. On December 16, 2010, the California Supreme Court denied the Company's petition for review and remanded for further proceedings to the trial court. On September 20, 2011, the trial court granted limited discovery at a conference on November 4, 2011. The testimonial phase of the third trial in this matter commenced on February 21 and 22, 2012 and concluded on June 12, 2012. The parties await decision on whether there will be a second phase of this bench trial. The Company will continue to defend itself vigorously.

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ITEM 1A. RISK FACTORS

There have been no material changes in the Company's risk factors from those disclosed in its Annual Report on Form 10-K for the year ended December 31, 2012.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

10.1	Employment Agreement dated January 17, 2013 by and between E*TRADE Financial Corporation and Paul T. Idzik. (Incorporated by reference to Exhibit 10.15 of the Company's Form 10-K filed on February 26, 2013.)
*10.2	Employment Agreement dated May 1, 2013 by and between E*TRADE Financial Corporation and Navtej S. Nandra.
*31.1	Certification—Section 302 of the Sarbanes-Oxley Act of 2002
*31.2	Certification—Section 302 of the Sarbanes-Oxley Act of 2002
*32.1	Certification—Section 906 of the Sarbanes-Oxley Act of 2002
*101.INS	XBRL Instance Document
*101.SCH	XBRL Taxonomy Extension Schema Document
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herein.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: May 7, 2013

E*TRADE Financial Corporation
(Registrant)

By /s/ PAUL T. IDZIK

Paul T. Idzik
Chief Executive Officer
(Principal Executive Officer)

By /s/ MATTHEW J. AUDETTE

Matthew J. Audette
Chief Financial Officer
(Principal Financial and Accounting Officer)

EMPLOYMENT AGREEMENT

This Employment Agreement (this "**Agreement**") is made and entered into by and between E*TRADE Financial Corporation (the "**Company**") and Mr. Navtej S. Nandra ("**Executive**") as of May 1, 2013 (the "Effective Date").

1. *Position and Duties:* As of the Effective Date, Executive will be appointed as President of E*TRADE Financial Corporation. Executive will report to the Company's Chief Executive Officer and will be located in New York, New York.
Executive agrees to devote all necessary time, energy and skill to Executive's duties at the Company. The Company acknowledges that Executive may have continued involvement in charitable, educational, and philanthropic activities and may manage personal/family investments, so long as those activities do not interfere unreasonably with his employment with the Company or create a business or competitive conflict with the activities of the Company. In addition, with the prior consent of the Company, Executive may serve on other corporate boards of directors.
The Company shall provide Executive with the same indemnification and D&O insurance protection provided from time to time to its officers and directors generally. Notwithstanding anything to the contrary in this Agreement, the rights of Executive to indemnification and the D&O insurance coverage with respect to all matters, events or transactions occurring or effected during the Executive's period of employment with the Company shall survive the termination of Executive's employment.
2. *Term of Agreement:* This Agreement shall remain in effect through December 31, 2014 (the "**Term**"), unless Executive's employment is terminated earlier by either party, subject to payments under Section 5 hereof to the extent applicable. The Term of this Agreement shall automatically renew for additional one-year periods unless either party provides at least ninety days' prior written notice of termination of the Agreement; *provided* that in the event of a Change in Control during the term of this Agreement, this Agreement may not be terminated until 24 months following such Change in Control. Executive's employment with the Company shall be "at-will". Unless Executive terminates Executive's employment prior to the end of the Term pursuant to the terms of this Agreement (for the avoidance of doubt, including to the extent an Involuntary Termination occurs following the Company's delivery of notice of its non-renewal of this Agreement pursuant to the preceding sentence), Executive's continued employment following the end of the Term shall continue to be on an at-will basis and on such terms and conditions as the parties may agree.
3. *Compensation:* During the Term, Executive shall be compensated by the Company for Executive's services as follows:
 - (a) *Base Salary:* Executive shall be paid an annualized base salary of \$750,000 per year, subject to applicable withholding, in accordance with the Company's normal payroll procedures. Executive's base salary may be adjusted from time to time in the discretion of the Company, subject to the provisions of Section 5 (incorporating the definitions set forth in Section 7) (this is referred to as the "**Base Salary**").

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- (b) *Performance Bonus*: Executive shall have the opportunity to earn an annual performance bonus. The performance bonus shall be earned upon the Executive and the Company meeting pre-established performance targets. Executive's current cash bonus target amount is \$1,650,000, provided that the actual cash bonus for 2013 performance shall not be less than the cash bonus target amount. The annual cash bonus, if earned, will be paid at the same time and in the same manner as payments to similarly situated executives of the Company and, except as expressly provided otherwise in this Agreement or in the applicable bonus plan document, shall not be earned unless Executive remains employed with the Company on the date of payment.
- (c) *Sign-on Bonus*. Within thirty (30) days following the Effective Date, Executive shall receive a one-time cash sign-on bonus of \$250,000 (the "Sign-on Bonus") which shall be subject to Section 5(d) below.
- (d) *Benefits*: Executive shall have the right, on the same basis as other senior executives of the Company, to participate in and to receive benefits under any of the Company's employee benefit plans, as such plans may be modified from time to time.
4. *Equity Compensation*.
- (a) For calendar year 2013, Executive shall receive a long term incentive equity grant with an aggregate initial value of no less than \$1,650,000 (based on the grant date fair value as determined by the Company under its practices for recognizing compensation expense in accordance with stock compensation accounting guidance), which shall consist of restricted stock units and shall vest annually over four years (the "**Initial LTI Award**"). If Executive remains employed at such time, Executive shall receive the Initial LTI Award at the same time as such awards are made to similarly situated executives of the Company for 2013 performance, but no later than March 31, 2014.
- (b) Executive will be eligible to receive equity compensation awards from time to time if the Company's Board of Directors or its designee, in its sole discretion, determines that such an award(s) is appropriate.
5. *Effect of Termination of Employment During the Term*:
- (a) *Involuntary Termination outside a Change in Control Period*: If Executive's employment with the Company is terminated as a result of an Involuntary Termination outside of a Change in Control Period, then subject to Executive signing and not revoking the Release (so long as such Release is signed in a period such that the payments under clauses (i) and (ii) below may be made no later than 2 and 1/2 months following the end of the year in such termination of employment occurs), Executive shall receive the following benefits, in addition to any compensation and benefits earned and unpaid under Section 3 through the date of Executive's termination of employment:
- (i) a lump sum cash severance payment equal to one times the sum of (x) Executive's annual Base Salary and (y) Executive's annual cash performance bonus at the target payment level, which payment shall be paid within 30 days following the effectiveness of the Release;
- (ii) a pro rata share of the target performance bonus for the year in which termination of employment occurs, *provided* that the Company's

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- performance meets the target performance level for the year of termination, as determined at year-end, which payment shall be paid no later than 2 and 1/2 months following the end of the year in such termination of employment occurs; *provided further* that if the termination occurs prior to payment of Executive's cash performance bonus for 2013, this clause (ii) shall be satisfied by payment of the \$1,650,000 cash bonus for 2013 as set forth in Section 3(b) regardless of 2013 performance and shall not be prorated;
- (iii) only if the Involuntary Termination occurs prior to the grant of the Initial LTI Award, then Executive shall receive an additional cash payment of \$1,650,000 in satisfaction of such Initial LTI Award;
 - (iv) reimbursement for the cost of medical coverage at a level equivalent to that provided by the Company immediately prior to termination of employment, through the earlier of: (A) 12 months following Executive's termination of employment, or (B) the time Executive begins alternative employment with medical coverage; *provided* that (x) it shall be the obligation of Executive to inform the Company that new employment has been obtained and (y) such reimbursement shall be made by the Company subsidizing or reimbursing COBRA premiums or, if Executive is no longer eligible for COBRA continuation coverage, by a lump sum payment based on the monthly premiums immediately prior to the expiration of COBRA coverage;
 - (v) 100% accelerated vesting of outstanding options, restricted stock awards, restricted stock units and other equity awards (collectively, "**Equity Grants**"); *provided* that the vesting of the Equity Grants shall be subject to Executive's compliance with Section 6(a)(i) and therefore shall not be deemed vested or issued to Executive until the first anniversary of the date of Executive's separation from service with the Company.
- (b) *Involuntary Termination during a Change in Control Period*: If Executive's employment with the Company is terminated as a result of an Involuntary Termination during a Change in Control Period, then subject to Executive signing and not revoking the Release (so long as such Release is signed in a period such that the payment may be made no later than 2 and 1/2 months following the end of the year in such termination of employment occurs), Executive shall receive the following benefits, in addition to any compensation and benefits earned and unpaid under Section 3 through the date of Executive's termination of employment:
- (i) a lump sum cash severance payment equal to two times the sum of (x) Executive's annual Base Salary and (y) Executive's annual cash performance bonus at the target payment level, which payment shall be paid within 30 days following the effectiveness of the Release;
 - (ii) a pro rata share of the target performance bonus for the year in which termination of employment occurs, *provided* that the Company's performance meets the target performance level for the year of termination, as determined at year-end, which payment shall be paid no later than 2 and 1/2 months following the end of the year in such termination of employment occurs; *provided further* that if the termination occurs prior to payment of Executive's cash performance bonus for 2013, this clause (ii) shall be satisfied by payment of the \$1,650,000 cash bonus for 2013 as set forth in Section 3(b) regardless of 2013 performance and shall not be prorated;

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- (iii) only if the Involuntary Termination occurs prior to the grant of the Initial LTI Award, then Executive shall receive an additional cash payment of \$1,650,000 in satisfaction of such Initial LTI Award;
 - (iv) 100% accelerated vesting of the Equity Grants as of the later of the date of Executive's termination of employment or the last day following Executive's execution of the Release on which Executive may revoke such Release under its terms;
 - (v) reimbursement for the cost of medical coverage at a level equivalent to that provided by the Company immediately prior to termination of employment, through the earlier of: (A) 24 months following Executive's termination of employment, or (B) the time Executive begins alternative employment with medical coverage; *provided* that (x) it shall be the obligation of Executive to inform the Company that new employment has been obtained and (y) such reimbursement shall be made by the Company subsidizing or reimbursing COBRA premiums or, if Executive is no longer eligible for COBRA continuation coverage, by a lump sum payment based on the monthly premiums immediately prior to the expiration of COBRA coverage.
- (c) *Death or Disability.*
- (i) In the event of Executive's death, all Equity Grants held by Executive, to the extent then outstanding, shall become fully vested and, if applicable, exercisable (and any forfeiture provision shall lapse) as of the date of Executive's death.
 - (ii) In the event the Executive's employment terminates as a result of Executive's death or Permanent Disability, Executive (or Executive's estate, as applicable) shall be entitled to a pro rata share of the Executive's cash or other performance bonus to the date of death or Permanent Disability.
- (d) *Other Termination:* In the event of a termination of Executive's employment not specified under Section 5(a), Section 5(b) or Section 5(c) above, including, without limitation, a termination for Cause, Executive shall not be entitled to any compensation or benefits from the Company, other than those earned and unpaid under Section 3 through the date of Executive's termination and, in the case of each stock option, restricted stock award or other Company stock-based award granted to Executive, the extent to which such awards are vested through the date of Executive's termination or as otherwise provided in the applicable award agreement. In addition, the Company may seek to recover the Sign-on Bonus if a termination of Executive's employment not specified under Section 5(a), Section 5(b) or Section 5(c) above, including, without limitation, a termination for Cause occurs within one-year of the Effective Date.
6. *Agreement Not to Compete:*
- (a) (i) During Executive's employment with the Company and for twelve (12) months thereafter, Executive shall not hold any position, or engage in any activities as an employee, agent, contractor, or otherwise, with TD Ameritrade, Charles Schwab & Co., Inc., or Fidelity Investments ("Competitors"), or any of Competitors' affiliates,

subsidiaries, successors or assigns. (ii) During Executive's employment and for six (6) months thereafter, Executive shall not hold any position, or engage in any activities as an employee, agent, contractor, or otherwise, with any entity that competes with the Company in the financial products or services industry if such position or activities involve: (A) responsibilities, in the context of providing services competitive with those offered or provided by the Company, that are similar to responsibilities Executive had or performed for the Company at any time during the twelve (12) months preceding the Separation Date; (B) supervision of employees or other personnel in the provision of services that are similar to or competitive with those offered or provided by the Company at any time during the twelve (12) months preceding the Separation Date; (C) development or implementation of strategies or methodologies related to the provision of services similar to or competitive with the services offered or provided by the Company at any time during the twelve (12) months preceding the Separation Date; or (D) responsibilities in which Employee would utilize or disclose Proprietary Information, or in which such Proprietary Information would likely assist the Company's Competitors.

- (b) Executive acknowledges that the restrictions contained in this Section 6, in view of the nature of the business in which the Company is engaged, are reasonable and necessary in order to protect the legitimate interests of the Company, and that any violation thereof would result in irreparable injuries to the Company, and the Executive therefore acknowledges that, in the event of Executive's violation of any of these restrictions, the Company shall be entitled to obtain from any court of competent jurisdiction preliminary and permanent injunctive relief (without the posting of any bond) as well as damages and an equitable accounting of all earnings, profits and other benefits arising from such a violation, which rights shall be cumulative and in addition to any other rights or remedies to which the Company may be entitled.
- (c) The invalidity or unenforceability of any provision or provisions of this Section 6 shall not affect the validity or enforceability of any other provision or provisions of this Section 6, which shall remain in full force and effect. If any provision of this Section 6 is held to be invalid, void or unenforceable in any jurisdiction, any court or arbitrator so holding shall substitute a valid, enforceable provision that preserves, to the maximum lawful extent, the terms and intent of this Agreement and shall correspondingly modify the Company's obligations under Section 5.

7. *Certain Tax Considerations:*

(a) *Section 409A:*

- (i) The payments under Section 5 are intended to qualify for the short-term deferral exception to Section 409A of the Code ("**Section 409A**") described in the regulations promulgated under Section 409A (the "**Section 409A Regulations**") to the maximum extent possible, and to the extent they do not so qualify, they are intended to qualify for the involuntary separation pay plan exception to Section 409A described in the Section 409A Regulations to the maximum extent possible. To the extent Section 409A is applicable to this Agreement, this Agreement is intended to comply with Section 409A, and shall be interpreted and construed and shall be performed by the parties consistent with such intent, and the Company shall have no right, without Executive's consent, to accelerate any payment or the provision of any benefits under this Agreement if such payment or provision of such benefits would, as a result, be subject to tax under Section 409A.

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- (ii) Without limiting the generality of the foregoing, if Executive is a “specified employee” within the meaning of Section 409A, as determined under the Company’s established methodology for determining specified employees, on the date of termination of employment, then to the extent required in order to comply with Section 409A, amounts that would otherwise be payable under this Agreement during the six-month period immediately following such termination date shall instead be paid (together with interest at the then current six-month LIBOR rate) on the first business day after the first to occur of (i) the date that is six months following Executive’s termination of employment and (ii) the date of Executive’s death.
- (iii) Except as expressly provided otherwise herein, no reimbursement payable to Executive pursuant to any provisions of this Agreement or pursuant to any plan or arrangement of the Company covered by this Agreement shall be paid later than the last day of the calendar year following the calendar year in which the related expense was incurred, and no such reimbursement during any calendar year shall affect the amounts eligible for reimbursement in any other calendar year, except, in each case, to the extent that the right to reimbursement does not provide for a “deferral of compensation” within the meaning of Section 409A of the Code.
- (iv) For purposes of this Agreement, the terms “terminate,” “terminated” and “termination” mean a termination of Executive’s employment that constitutes a “separation from service” within the meaning of the default rules of Section 409A of the Code; *provided*, however, that, in the event of the Executive’s Permanent Disability, “separation from service” means the date that is six months after the first day of disability.
- (b) *280G Limitation*: If the payments and benefits provided to Executive under this Agreement, either alone or together with other payments and benefits provided to Executive from the Company (including, without limitation, any accelerated vesting thereof) (the “**Total Payments**”), would constitute a “parachute payment” (as defined in Section 280G of the Code) and be subject to the excise tax (the “**Excise Tax**”) imposed under Section 4999 of the Code, the Total Payments shall be reduced if and to the extent that a reduction in the Total Payments would result in Executive retaining a larger amount than if Executive received all of the Total Payments, in each case measured on an after-tax basis (taking into account federal, state and local income taxes and, if applicable, the Excise Tax). The determination of any reduction in the Total Payments shall be made at the Company’s cost by the Company’s independent public accountants or another firm designated by the Company and reasonably approved by Executive, and may be determined using reasonable, good faith interpretations concerning the application of Sections 280G and 4999 of the Code. The Company shall pay Executive’s costs incurred for tax, accounting and other professional advice in the event of a challenge of any such reasonable, good faith interpretations by the Internal Revenue Service.

8. *Certain Definitions:* For the purposes of this Agreement, the following capitalized terms shall have the meanings set forth below:

- (a) **“Cause”** shall mean any of the following:
- (i) Executive’s theft, dishonesty, willful misconduct, breach of fiduciary duty for personal profit, or falsification of any material employment or Company records;
 - (ii) Executive’s conviction (including any plea of guilty or nolo contendere) of any criminal act involving fraud, dishonesty, misappropriation or moral turpitude, or which impairs Executive’s ability to perform Executive’s duties with the Company;
 - (iii) Executive’s intentional and repeated failure to perform stated duties after notice from the Company of, and a reasonable opportunity to cure, such failure;
 - (iv) Executive’s improper disclosure of the Company’s confidential or proprietary information;
 - (v) any material breach by Executive of the Company’s Code of Professional Conduct, which breach shall be deemed “material” if it results from an intentional act by Executive and has a material detrimental effect on the Company’s reputation or business; or
 - (vi) any material breach by Executive of this Agreement or of any agreement regarding proprietary information and inventions, which breach, if curable, is not cured within thirty (30) days following written notice of such breach from the Company.

In the event that the Company terminates Executive’s employment for Cause, the Company shall provide written notice to Executive of that fact prior to, or concurrently with, the termination of employment. Failure to provide written notice that the Company contends that the termination is for Cause shall constitute a waiver of any contention that the termination was for Cause, and the termination shall be irrebuttably presumed to be an involuntary termination without Cause. However, if, within thirty (30) days following the termination, the Company first discovers facts that would have established “Cause” for termination, and those facts were not known by the Company at the time of the termination, then the Company shall provide Executive with written notice, including the facts establishing that the purported “Cause” was not known at the time of the termination, and the Company will pay no severance.

- (b) **“Change in Control”** shall mean the occurrence of any of the following events:
- (i) (X) any “person” (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended) becomes the “beneficial owner” (as defined in Rule 13d-3 under said Act), directly or indirectly, of securities of the Company representing more than fifty percent (50%) of the total combined voting power represented by the Company’s then outstanding voting securities other than the acquisition of the Company’s common stock by a Company-sponsored employee benefit plan or through the issuance of shares sold directly by the Company to a single acquiror; or (Y) any “person” (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended) becomes the “beneficial owner” (as defined in Rule 13d-3 under said Act), directly or indirectly, of securities of the Company representing less than fifty percent (50%) of the total combined voting power represented by the Company’s then outstanding voting securities, but in connection with the person’s acquisition of securities the person acquires the right to terminate the employment of all or a portion of the Company’s management team;

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- (ii) the Company is party to a merger or consolidation which results in the holders of the voting securities of the Company outstanding immediately prior thereto failing to retain immediately after such merger or consolidation direct or indirect beneficial ownership of more than fifty percent (50%) of the total combined voting power of the securities entitled to vote generally in the election of directors of the Company or the surviving entity outstanding immediately after such merger or consolidation;
 - (iii) a change in the composition of the Board occurring within a period of twenty-four (24) consecutive months, as a result of which fewer than a majority of the directors are Incumbent Directors;
 - (iv) effectiveness of an agreement for the sale, lease or disposition by the Company of all or substantially all of the Company's assets; or
 - (v) a liquidation or dissolution of the Company.

The Incumbent Directors shall have the right to determine whether multiple sales or exchanges of the voting stock of the Company, which, in the aggregate, would result in a Change of Control, are related, and its determination shall be final, binding and conclusive.

- (c) **"Code"** means the Internal Revenue Code of 1986, as amended.
- (d) **"Change in Control Period"** shall mean the period commencing on the earlier of: (i) 60 days prior to the date of consummation of the Change in Control; (ii) the date of the first public announcement of a definitive agreement that would result in a Change in Control (even though still subject to approval by the Company's stockholders and other conditions and contingencies); or (iii) the date of the public announcement of a tender offer that is not approved by the Incumbent Directors and ending on the two year anniversary date of the consummation of the Change in Control.
- (e) **"Change in Control Period Good Reason"** shall mean any of the following conditions:
 - (i) a decrease in Executive's Base Salary other than as part of any across-the-board reduction (of not more than 20%) applying to all senior executives of an acquiror;
 - (ii) a material, adverse change in Executive's title, authority, responsibilities or duties, as measured against Executive's title, authority, responsibilities or duties immediately prior to such change; provided that for purposes of this subsection (ii), in addition to any other material, adverse change in title, authority, responsibilities or duties, a material diminution in the authority, duties, or responsibilities of the supervisor to whom the Executive is required to report shall constitute an event of "Change in Control Period Good Reason";
 - (iii) the relocation of Executive's principal workplace to a location greater than fifty (50) miles from the prior workplace;
 - (iv) any material breach by the Company of any provision of this Agreement, which breach is not cured within thirty (30) days following written notice of such breach from Executive, or the Company's delivery of written notice of non-renewal of this Agreement (other than as a result of a termination for Cause) pursuant to Section 2 hereof;

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- (v) any failure of the Company to obtain the assumption (by operation of law or by contract) of this Agreement by any successor or assign of the Company; or
 - (vi) any purported termination of Executive's employment for "material breach of contract" which is purportedly effected without providing the "cure" period, if applicable, described in Section 7(a)(vi), above;

provided that Executive shall have provided written notice to the Company of the existence of the condition constituting Good Reason within 90 days of the initial existence of the condition.

- (f) "**Incumbent Directors**" shall mean members of the Board who either (i) are members of the Board as of the date hereof, or (ii) are elected, or nominated for election, to the Board with the affirmative vote of at least a majority of the Incumbent Directors at the time of such election or nomination (but shall not include an individual whose election or nomination is in connection with an actual or threatened proxy contest relating to the election of members of the Board).
- (g) "**Involuntary Termination**" shall mean the occurrence of one of the following:
 - (i) termination by the Company of Executive's employment with the Company for any reason other than Cause at any time;
 - (ii) Executive's resignation from employment for Non Change in Control Period Good Reason within six months following the occurrence of the event constituting Non Change in Control Period Good Reason; or
 - (iii) during a Change in Control Period, Executive's resignation from employment for Change in Control Period Good Reason within six months following the occurrence of the event constituting Change in Control Period Good Reason.
- (h) "**Non Change in Control Period Good Reason**" shall mean any of the following conditions first occurring outside of a Change in Control Period and occurring without Executive's written consent:
 - (i) a decrease in Executive's Base Salary other than as part of any across-the-board reduction (of not more than 20%) applying to substantially all other senior executives;
 - (ii) a material, adverse change in Executive's title, authority, responsibilities or duties, as measured against Executive's title, authority, responsibilities or duties immediately prior to such change; provided that for purposes of this subsection, a material, adverse change shall not occur merely by a change in reporting relationship; or
 - (iii) the relocation of Executive's principal workplace to a location greater than fifty (50) miles from the prior workplace;
 - (iv) any material breach by the Company of any provision of this Agreement, which breach is not cured within thirty (30) days following written notice of such breach from Executive, or the Company's delivery of written notice of non-renewal of this Agreement (other than as a result of a termination for Cause) pursuant to Section 2 hereof;

provided that Executive shall have provided written notice to the Company of the existence of the condition constituting Good Reason within 90 days of the initial existence of the condition.

- (i) “**Permanent Disability**” shall mean Executive’s permanent and total disability within the meaning of Section 22(e)(3) of the Code.
 - (j) “**Proprietary Information**” is information that was developed, created, or discovered by or on behalf of the Company, or which became or will become known by, or was or is conveyed to the Company, which has commercial value in the Company’s business. “Proprietary Information” includes, but is not limited to, software programs and subroutines, source and object code, algorithms, trade secrets, designs, technology, know-how, processes, data, ideas, techniques, inventions (whether patentable or not), works of authorship, formulas, business and product development plans, vendor lists, customer lists, terms of compensation and performance levels of Company employees, and other information concerning the Company’s actual or anticipated business, research or development, or which is received in confidence by or for the Company from another person or entity.
 - (k) “**Release**” shall mean a general release of all known and unknown claims against the Company and its affiliates and their stockholders, directors, officers, employees, agents, successors and assigns substantially in a form reasonably acceptable to the Company, which has been executed by Executive and not revoked within the applicable revocation period; *provided* that such Release shall not release the right to indemnification or any of the compensation and benefits Executive is due under Section 5 hereof upon the applicable termination of employment.
9. *Insider Trading Policy*: Executive agrees to abide by the terms and conditions of the Company’s Insider Trading Policy, as it may be amended from time to time.
10. *Dispute Resolution*: In the event of any dispute or claim relating to or arising out of this Agreement (including, but not limited to, any claims of breach of contract, wrongful termination or age, sex, race or other discrimination), Executive and the Company agree that all such disputes shall be fully and finally resolved by binding arbitration conducted by the American Arbitration Association in New York, New York in accordance with its National Employment Dispute Resolution rules. Executive acknowledges that by accepting this arbitration provision Executive is waiving any right to a jury trial in the event of such dispute. In connection with any such arbitration, the Company shall bear all costs not otherwise borne by a plaintiff in a court proceeding.
11. *Attorneys’ Fees*: The prevailing party shall be entitled to recover from the losing party its attorneys’ fees and costs incurred in any action brought to enforce any right arising out of this Agreement. The Company shall pay Executive’s reasonable legal fees in connection with the review and negotiation of this Agreement and any ancillary services related thereto.

12. *General.*

- (a) *Successors and Assigns:* The provisions of this Agreement shall inure to the benefit of and be binding upon the Company, Executive and each and all of their respective heirs, legal representatives, successors and assigns. The duties, responsibilities and obligations of Executive under this Agreement shall be personal and not assignable or delegable by Executive in any manner whatsoever to any person, corporation, partnership, firm, company, joint venture or other entity. Executive may not assign, transfer, convey, mortgage, pledge or in any other manner encumber the compensation or other benefits to be received by Executive or any rights which Executive may have pursuant to the terms and provisions of this Agreement, except to the extent permitted by the applicable plan for financial or estate planning purposes.
- (b) *Amendments; Waiver:* No provision of this Agreement shall be modified, waived or discharged unless the modification, waiver or discharge is agreed to in writing and signed by Executive and by an authorized officer of the Company. No waiver by either party of any breach of, or of compliance with, any condition or provision of this Agreement by the other party shall be considered a waiver of any other condition or provision or of the same condition or provision at another time.
- (c) *Notices:* Any notices to be given pursuant to this Agreement by either party to the other party may be effected by personal delivery or by overnight delivery with receipt requested. Mailed notices shall be addressed to the parties at the addresses stated below, but each party may change its or Executive's address by written notice to the other in accordance with this Paragraph:

Mailed notices to Executive shall be addressed to the last known address provided by Executive to the Company, with a copy to:

Wayne N. Outten,
Outten & Golden LLP
3 Park Avenue
New York, NY 10016.

Mailed notices to the Company shall be addressed as follows:

E*TRADE Financial Corporation
Time & Life Building
1271 Avenue of the Americas
14th Floor
New York, NY 10020-1302

Attention: Executive Vice President Human Resources

- (d) *Entire Agreement:* This Agreement constitutes the entire employment agreement between Executive and the Company regarding the terms and conditions of Executive's employment and any amounts due on termination of such employment, with the exception of (i) the Agreement Regarding Employment and Proprietary Information and Inventions between the Company and Executive, (ii) any stock option, restricted stock, restricted stock unit award or other Company stock based award agreements between Executive and the Company to the extent not modified by this Agreement, (iii) any indemnification agreement referenced in Section 1 and (iv) the Company's

employee benefit plans referenced in Section 3(c). This Agreement (including the documents described in (i) through (iv) herein) supersedes all prior negotiations, representations or agreements between Executive and the Company, whether written or oral, concerning Executive's employment by or service to the Company.

- (e) *Withholding Taxes*: All payments made under this Agreement shall be subject to reduction to reflect taxes required to be withheld by law.
- (f) *Counterparts*: This Agreement may be executed by the Company and Executive in counterparts, each of which shall be deemed an original and which together shall constitute one instrument.
- (g) *Headings*: Each and all of the headings contained in this Agreement are for reference purposes only and shall not in any manner whatsoever affect the construction or interpretation of this Agreement or be deemed a part of this Agreement for any purpose whatsoever.
- (h) *Savings Provision*: To the extent that any provision of this Agreement or any paragraph, term, provision, sentence, phrase, clause or word of this Agreement shall be found to be illegal or unenforceable for any reason, such paragraph, term, provision, sentence, phrase, clause or word shall be modified or deleted in such a manner as to make this Agreement, as so modified, legal and enforceable under applicable laws. The remainder of this Agreement shall continue in full force and effect.
- (i) *Construction*: The language of this Agreement and of each and every paragraph, term and provision of this Agreement shall, in all cases, for any and all purposes, and in any and all circumstances whatsoever be construed as a whole, according to its fair meaning, not strictly for or against Executive or the Company, and with no regard whatsoever to the identity or status of any person or persons who drafted all or any portion of this Agreement.
- (j) *Further Assurances*: From time to time, at the Company's request and without further consideration, Executive shall execute and deliver such additional documents and take all such further action as reasonably requested by the Company to be necessary or desirable to make effective, in the most expeditious manner possible, the terms of this Agreement and to provide adequate assurance of Executive's due performance hereunder.
- (k) *Governing Law*: Executive and the Company agree that this Agreement shall be interpreted in accordance with and governed by the laws of the State of New York.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date and year written below.

Dated: May 1, 2013

E*TRADE Financial Corporation

/s/ Paul T. Idzik

Paul T. Idzik

Chief Executive Officer

Dated: May 1, 2013

/s/ Navtej S. Nandra

Navtej S. Nandra

**CERTIFICATION PURSUANT TO RULE 13a-14(a)/15d-14(a), AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Matthew J. Audette, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of E*TRADE Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 7, 2013

E*TRADE Financial Corporation
(Registrant)

By _____ /s/ MATTHEW J. AUDETTE
Matthew J. Audette
Chief Financial Officer
(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The certification set forth below is being submitted in connection with this Quarterly Report on Form 10-Q of E*TRADE Financial Corporation (the "Quarterly Report") for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Paul T. Idzik, the Chief Executive Officer and Matthew J. Audette, the Chief Financial Officer of E*TRADE Financial Corporation, each certifies that, to the best of their knowledge:

1. the Quarterly Report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. the information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of E*TRADE Financial Corporation.

Dated: May 7, 2013

/s/ PAUL T. IDZIK

Paul T. Idzik
Chief Executive Officer
(Principal Executive Officer)

/s/ MATTHEW J. AUDETTE

Matthew J. Audette
Chief Financial Officer
(Principal Financial and Accounting Officer)

