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MANAGEMENT DISCUSSION SECTION

Operator: Good evening and thank you for joining the E*TRADE Financial Fourth Quarter and Full Year 2013 Earnings Conference Call. Joining the call today are Chief Executive Officer, Paul Idzik; and Chief Financial Officer, Matthew Audette.

Today’s call may include forward-looking statements which reflect management’s current estimates or beliefs and are subject to risks and uncertainties that may cause actual results to differ materially. During the call, the company may also discuss non-GAAP financial measures. For a reconciliation of such non-GAAP measures to the comparable GAAP figures and for a discussion of additional risks and uncertainties that may affect the future results of E*TRADE Financial, please refer to our earnings release furnished with Form 8-K and our 10-Ks, 10-Qs and other documents the company has filed with the SEC. All of these documents are available at about.etrade.com.

This call will present information as of January 23, 2014. The company disclaims any duty to update forward-looking statements made during the call. This call is being recorded and a replay will be available via phone and webcast later this evening at about.etrade.com. No other recordings or copies of this call are authorized or may be relied upon.

With that, I will now turn the call over to Mr. Idzik.
Thank you, Jasmine. Good evening. Thank you for joining us. Twelve months ago, almost to the day, I joined E*TRADE as the company's CEO and member of the board of directors. It's been quite an eventful year and one of tremendous progress for the company.

To summarize a few of the highlights; we made good progress on our Capital Plan resulting in regulatory approval of two consecutive quarterly dividends after eight quarters of hiatus; installed a highly experienced new management team bringing fresh ideas and a more rigorous operating mindset; decided to exit our noncore market making business; enhance in a significant manner our enterprise risk management framework; and delivered an unambiguous commitment to our E*TRADE colleagues, board and owners to refocus our efforts on our core business.

In addition, the improving operating environment put some wind in our sails as DARTs were at a two-year high, margin loan balances were at a five-year high, and we maintained solid growth in accounts and assets including our managed accounts, which ended the year at an impressive $2.4 billion.

Our risk profile also continued to improve with our legacy loan portfolio down 19% from a year ago and charge-offs and provisions at multi-year lows. We posted earnings of $0.20 for the quarter and $0.70 for the year excluding the impact of our decision to sell G1X.

When I arrived here, I found an incredibly resilient brokerage franchise and a brand punching above its weight class. I also found a set of colleagues that were very much in need of renewed leadership and a clearer articulation of our purpose and customer focus across the entire organization.

With sharper focus, we spent the latter part of 2013 setting ourselves up for growth. We assessed the organization for strengths and areas for improvement. Beyond the changes to the executive suite, we made some important appointments within the business and supplemented the existing team with outside talent; including bringing on new leadership in our Corporate Services Business and a new head of customer service and branches.

This shifting mindset is also manifested in changes to how we approach investments and our overall cost base. During 2013, the team completed some heavy lifting on the cost reduction front whereby $110 million in gross expenses were eliminated from our controllable recurring expense base. This exercise did more than position us for an improved bottom line, it forced the company to critically examine its cost structure, positioning us for continued growth in the business and creating capacity for investments in the proper areas when the time is right.

As I mentioned in my opening remarks, 2013 was a tremendous year, not just because the improving environment fueled solid results, but because of actions that we took to enhance the franchise and prepare for its future. Now with the vast majority of our legacy issues squarely in the rearview mirror or quickly diminishing in terms of relative concern, we find ourselves able to focus more acutely on the core business and what needs to be done to grow purposefully.

With much consideration, we decided the time is right for us to turn up the level of investment in the core business. We’re excited about the road ahead of us and with the engine running more smoothly, predominantly resulting from actions taken by our pit crew over the last year, we feel good about starting to put our foot on the gas, after years of covering the brake pedal.
Now, metaphors aside, we are directing our investment dollars towards the following. First, we are focused on making foundational enhancements. While the company has done a great job of balancing legacy risk management and its associated costs with investing in our business, we no longer have to make this unfortunate trade-off. We are turning our focus and dollars towards making our already robust foundation best-in-class.

Second, our colleagues have shown a tremendous amount of resilience and grit over the past several years, in many cases operating without optimal tools and resources. Our recent positive momentum has allowed us to focus on building out our talent and resources while being fair and competitive in compensating our colleagues. A best-in-class business starts with best-in-class talent.

Third, in an improved operating environment, we can achieve a higher marginal return on our investment and marketing dollars. This is the same rationale that drove our cost-cutting activities when the environment was less than attractive. Accordingly, we are modestly investing to expand our brand with our customers. This is an area where we remain nimble in our level of spend, dynamically adjusting for changes in the operating environment.

Finally, with refined focus we are directing our efforts to enhancing the digital experience of our customers when they’re online, while at the same time delivering a more seamless and synchronized offline experience through our network of dedicated financial consultants and customer service professionals.

With that as context, we have a number of initiatives we are looking at for 2014, environment permitting, as well as several already underway. These are beginning to be reflected in our Q4 results. Matthew will provide you with more details, but I would lastly note that we obviously maintain the flexibility to dial back our expenses should the environment require. Frankly, I’m excited that the customer is in a place to be investing in 2014 and I am looking forward to the company doing so following on movements with our customers. I’m looking forward to working with the team to further position E*TRADE for growth in 2014 and beyond.

Moving on to our results for the fourth quarter and all of 2013, we posted fourth quarter earnings of $0.20 per share driven by positive trends in retail engagement and continued reduction of costs related to our legacy risks. DARTs of 160,000 for the quarter were the highest level in over two years and have continued their impressive trajectory through January, currently averaging approximately 190,000, up over 20% from December. Options continue to be an important component of our trades at roughly a quarter of the total. And our customers are increasingly engaged with us via mobile, with 9% of total trades executed through our award-winning E*TRADE Mobile application.

Further evidence of customer engagement is seen in our five-year high margin loan balances. Our average balances were $6.4 billion, up 8% sequentially and 10% year-over-year. Our net new brokerage assets for the quarter of $3.2 billion represented an annualized growth rate of 6.4%. For the year, our net new assets were a record $10.4 billion, modestly above last year's level.

We also brought on 95,000 net new brokerage accounts for the full year, including 22,000 in Q4. Annual attrition was at a record low 8.8% in 2013 and was at 8.9% in Q4. Our customer metrics on the whole were incredibly positive in 2013. Within these numbers, what I’m especially pleased with is the progress we’ve made in our retirement, investing and savings area. This is a critically important focus for us as we work to do more for our customers and earn more of their business. It also diversifies and provides for a steadier revenue stream.

In this regard, we made some good progress during the fourth quarter. We brought in $1 billion in retirement assets, representing a 10% annualized growth rate, and ending the year with $43 billion. We attracted 5,000 net new retirement accounts, ending the year with 826,000. And managed accounts, we ended the year at $2.4
billion, representing annual growth of approximately 85%, all very solid proof of our early successes in expanding this key area of our business.

Turning to an update on our leadership team, as of the first of this year, Michael Pizzi, an E*TRADE veteran, took over as our Chief Risk Officer, following Paul Brandow's decision to retire and move into a role as a senior advisor to the company. Michael has been with the company for more than a decade, and was most recently our Bank and Corporate Treasurer. He is widely regarded as one of the company's brightest minds, and I am delighted to have him on the executive team. Managing risk is an integral part of a Treasurer's role, providing Mike with a great foundation for his new role as Chief Risk Officer. He leaves the Treasury department in great shape having built out a talented group of individuals.

Understanding, managing and controlling our risks is paramount to the success of this company and we've worked hard under Paul Brandow's aegis to integrate risk management into our culture. I am confident these efforts will continue on Mike's watch.

We are fortunate that Paul Brandow has graciously agreed to act as an advisor to the company. Paul is an invaluable resource with a wealth of industry knowledge and ever-sage counsel and expertise. As a shareholder, I am particularly pleased that Paul has remained involved with the company.

In closing, I couldn't be more proud of the team and the way we executed in my first 366 days on the job. These are exciting times at E*TRADE. I am very pleased to be here working with an exceptional set of colleagues. We have much in store for 2014 and look forward to sharing more with you throughout the year.

And with that, I will turn the call over to our implacable CFO, Matthew Audette.

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

Implacable, very nice, thank you, Paul. I certainly echo your sentiment with respect to the changing tide here internally. While we continue to benefit from the favorable migration of our balance sheet and the corresponding reduction of risk, the last year has been a welcome shift towards exhibiting true progress in our capital plans and benefiting from improvements in the operating environment.

As for our results, for the fourth quarter, we reported net income of $58 million, or $0.20 per share, an improvement from net income of $47 million or $0.16 per share in the prior quarter, and also an improvement from the year ago quarter where we posted a net loss of $186 million or $0.65 per share, which included a $257 million charge related to our $1.3 billion debt refinance.

For the year, reported net income of $86 million or $0.29 per share. Excluding the impact of our decision to exit the market making business, our full year net income was $204 million or $0.70 per share. Our fourth quarter net revenues were $447 million, up from $417 million in the prior quarter, and down from $468 million in the year ago quarter, which included deleveraging related gains.

Revenues included net interest income of $257 million, up $16 million quarter-over-quarter. As Q4 net interest spread improved 10 basis points sequentially while our average balance sheet grew by $900 million. Fourth quarter spread of 240 basis points brought our full year spread to 233 basis points, down just 6 basis points from 2012's average. For full year 2014, our expectation is for spread to remain in the mid-230s basis points.
There are of course a number of factors that can impact our actual results, but this is our best assumption based on the current shape of the forward curve, and our expectations for balance sheet size, which with our deleveraging complete, will grow naturally with customer cash, growth which obviously improves net interest income, but can have a dilutive impact to spread.

Commissions, fees and service charges, principal transactions and other revenue in the fourth quarter were $178 million, up 9% from the prior quarter and up 18% from the same quarter of 2012. Average commission per trade of $10.97 was down $0.18 from the prior quarter and $0.13 from the year ago period. The sequential decrease related to a lower portion of stock plan trades. For the full year, average commission per trade was $11.13, an improvement of $0.12 from 2012, primarily attributable to higher stock plan trades.

Principal transactions revenue increased $4 million from Q3 as revenue capture improved significantly. A quick reminder, upon the closing of the sale of our market making unit, the principal transactions line will be going away as it relates solely to this business. Our fees and service charges revenue will then benefit from increased payment for order flow as 100% of our order flow will be routed to third parties.

We have been working diligently to prepare for the closing of the sale of this business. While there is still more work to be done and regulatory approvals to obtain, we feel good about getting the transaction closed by the end of Q1. Revenue this quarter also included $12 million of net gains and loans and securities in line with our previously communicated expectations. We continue to expect this line to decline in 2014 if interest rates follow the forward curve and increase.

Our operating expenses for the full year, excluding goodwill impairment were $1.1 billion, a decrease of $29 million or 3% from 2012. For the quarter, our expenses were $295 million, an increase of 9% from the prior quarter and 3% from the year-ago quarter.

As Paul mentioned, we have begun investing more in the business, and that is included to a certain extent in our Q4 numbers. In addition to those investments, the quarter included $5 million of restructuring costs and approximately $10 million in other operating expenses that I would categorize as clean-up items, including write-offs of internally developed software that we decided not to continue and an estimated penalty related to the escheatment of customer assets.

While the clean-up costs I just mentioned are likely non-recurring in nature, we do plan to continue to invest in the business. Accordingly, we currently expect our 2014 quarterly run rate for operating expenses to fall within a range of $270 million to $280 million, keeping in mind that Q1 will likely be above that range due to seasonality as well as the inclusion of G1X's operating expenses prior to the closing sale. It is important to note that unlike our cost cutting, which had a very specific scope, our investment plans for 2014 will be dynamic as opportunities are solidified, or as the environment demands. So while this is our expected range of expenses today, we will be critically reviewing our spending plans each quarter.

As far as where the investments will occur, the majority will be in head count, so compensation and professional services. We'll also be spending a bit more in marketing where we expect to be up approximately 10% versus 2013 for the full year.

As Paul mentioned, in the current environment, the returns on marketing dollars are much more attractive and we are going to take advantage of that. And while we've set aside a certain amount of money to do so, not all of that has been committed. We will be mindful of the environment as we proceed and maintain the ability to dial back some of these investments should conditions warrant, but I can tell you that it feels good to be talking about investing in the business after focusing on cost cutting for so long.
Turning to our loan portfolio, this quarter's provision for loan losses was $17 million compared with $37 million in the prior quarter. Home prices exhibited exceptionally strong performance during the quarter, improving 6% across our portfolio and driving charge-offs and provision below our expected range. To provide some perspective, at the end of 2012, we expected home price appreciation of 2% throughout the full year 2013. Home prices greatly outperformed expectations, growing approximately 25% through 2013. This dramatic improvement in home prices was a significant driver of the decline in provision and charge-offs in 2013. Home price appreciation also drove down average CLTVs, which are now below 100% for both our first mortgage and home equity portfolios.

For 2014, our current expectation is for quarterly provision to be within the range of $15 million to $35 million, which includes a 6% expected improvement in home prices and our current expectations on the performance of our portfolio as the home equity conversions enter our forecast period. The total portfolio contracted approximately $450 million this quarter, driven by pay-downs of $425 million. The portfolio's 19% decline in 2013 is consistent with each of the past five years where the book has come down by 18% to 20%. We expect this will continue in 2014, placing quarterly runoff at around $400 million over the next quarter or two, declining towards $350 million by year-end.

Our loan portfolio ended the quarter at $8.6 billion, and our allowance ended the quarter at $453 million, decreasing $6 million from the prior quarter. While the portfolio balance continues to decline and the relative performance and quality continue to demonstrate improvement, we are mindful of future conversions in the home equity portfolio. Currently there are $0.7 billion of these loans set to convert in 2015 and another $1.1 billion in 2016. We keep a close watch on this population and intend to be aggressive in mitigating losses, should their performance deteriorate with modification as a potential tool in this regard.

I would also remind you that our borrowers continue to make principal payments ahead of schedule as approximately 40% of borrowers in their draw period made voluntary principal reductions of at least $500 during 2013. And just under half of those made voluntary principal payments of at least $2,500. With a relatively small average loan size of $74,000, these numbers are meaningful.

As our total portfolio is now down 74% from its peak size, I would like to make mention that going forward we will no longer report loan performance data in our monthly activity reports. With the diminishing size of the portfolio, the intra-quarter numbers are no longer as meaningful to our financial performance as they once were.

Moving to our Capital Plan, we have come a long way in the 18 months since our original submission in June of 2012. And I am incredibly proud of what we have accomplished in such a short period of time. We entered 2013 with some positive momentum after completing a refinancing of our highest cost corporate debt. From there, we completed or made progress on all elements of our Capital Plan. To recap, we completed over $8.7 billion of deleveraging action through sweep deposit transfers, directing cash to money funds and reduction of wholesale funding.

We completed a rigorous review of our expense base and eliminated $110 million in gross operating expenses, positioning us well for growth, environment permitting. We continue to build out our enterprise risk management capabilities, making important progress towards the heightened regulatory expectations. We achieved our target Tier 1 leverage ratio at the Bank through a combination of earnings generation and deleveraging. And finally, we rounded out 2013 with two consecutive quarterly dividends from the Bank to the Parent, totaling $175 million.

I'm impressed with what the team accomplished here. The dividends we received are crucial milestones in our efforts to achieve a more efficient capital structure. As we move into the New Year, we are focused on continuing to meet the objectives laid out in our Capital Plan. Over the near-term, we intend to continue requesting quarterly
dividends up to the level the Bank's net income for the prior quarter. Over the long-term, our plans remain to request capital in excess of the Bank's Tier 1 leverage ratio threshold outlined in the plan.

The next critical step for us in determining how our request for dividends will be shaped will be the upcoming stress testing required for submission at the end of March. While we have been running substantially similar tests internally for some time now and sharing the results with our regulators, these formal submissions should play an important role in assessing our capital strength, hopefully resulting in more clarity on our long-term dividend plans.

We ended the quarter with $415 million in corporate cash, approximately $200 million above our target of two years of debt service coverage. Continued approvals of dividend request would only serve to grow Parent cash as will closing the sale of our market maker for which we expect approximately $75 million in proceeds to make it to the Parent.

As we analyze the best usage for this capital, we are mindful that both our regulators and board will be involved in the decision-making process. At this point, we are still focused on reducing Parent debt as the likely first use of this cash. As for our capital ratios, we feel good about our position as we improved across most measures of both the Bank and the Parent. Our Bank's Tier 1 leverage ratio ended the quarter at our targeted 9.5%, with approximately $165 million of capital generation, funding of $75 million dividend, and balance sheet growth of $700 million. We also remain well-positioned under the new Basel III capital rules which would significantly improve our risk-based capital ratios across the board.

To sum it all up, 2013 was a banner year for E*TRADE, an improving operating environment and increasing customer engagement helped to produce solid financial results. Our business continued to demonstrate its strengths as we reached all-time highs in several key customer metrics. And finally, we have truly turned the corner with respect to the financial position of the company. It has been a long and trying road and the lessons learned are ever present in each step we take today. And while there is still plenty of work to do, I am pleased with where we are as we begin 2014.

And with that, operator, we'll open the call for questions.
QUESTION AND ANSWER SECTION


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

Q

Yeah, good evening, Paul. Good evening, Mr. Implacable. And my first question is on the expenses. So I get the investment – the plan to invest in 2014. I’m just trying to see, what is the amount – if we’re looking at a mid $260s million prior, we’ll look at a mid $270 million per quarter, now is it a $40 million sort of planned investment? And then the other part would be, what’s the revenue expectations tied to this $40 million in expense investment?

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

A

Yeah, Rich, it’s Mr. Implacable here. So, I think, a couple of spaces, so in the prepared remarks, we kind of focused on the investments going forward are really going to be in people, right? The areas, I think Paul covered pretty well, making foundational enhancements, focusing on our talent, increasing the marketing dollars a bit and then focusing on our customers’ online experience. But the amount, I think you got it right, going from a mid $260s million run rate to the $270 million, $280 million, that's about $10 million a quarter, $40 million a year. I think that’s a good way to think about it. I think the returns are on the growth and the value of the business overall. I think, this is not the type of spending where each and every single dollar is a project where it has an individual ROI. I think we're looking at the overall franchise.

I think now is the time for us to, as Paul said, put our foot on the gas a bit here and make some very focused and prudent investments. I’d be remiss to say if I didn’t make the points that I made in the prepared remarks that we are very focused on shareholder money and shareholder dollars, making sure that we’re spending it wisely. So we’re going to look at this in a very deliberate way. We’re going to look at the environment we’re in. We’re going to be looking at the projects that we’re working on. But I think everything we said today is what we view right now. Now is the time to turn the investments up.

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

Q

Got it. Thanks. And one follow-up, it would be on the provision, so the guidance is $15 million to $35 million. The build in the home equity allowance dropped materially. And I think we’re all understanding that your modeling is a little bit more complex in the real estate prices, et cetera. But can you give – if the provision stayed in that range, how much do you plan to build the home equity allowance in front of the amortization that’s coming in 2015 and 2016?

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

A

Yeah, Rich, I think the trends that we’ve seen in the individual buckets, so the one-to-four versus home equity over the last several quarters. You’re going to see that trend continue, which is that the home equity is the one that's building and the one-to-four that’s coming down. I think the quarterly volatility, just looking at the recent past, right, if you look at the past few quarters, those are the quarters where we're really – where we're building the
reserves for the balloon loans, right? Within the home equity book, we've got a subset that are – they don't actually convert to amortize and they're balloon loans, so they mature. It's a relatively small portfolio, under $250 million, but we've fully reserved for the estimated losses over the life of that portfolio.

So I think that was driving a bit of the large build that you saw in the last few quarters, so that you're still going to have lumpiness like that depending on the amounts that are entering in our forecast period going forward, but I think at least the balloons kind of explain the large builds in the past few quarters prior to this one.

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

Got it. Thank you and congrats on an excellent top-line quarter. Thanks.

Operator: And our next question comes from the line of Alex Blostein of Goldman Sachs. Please proceed with your question.

Alex Blostein  
Analyst, Goldman Sachs & Co.

Thanks. Hey, good evening, everybody. First, I guess on – Matt, on capital, can you walk through, I guess dynamic that it looks like if credit continues to get better, provision looks a little bit lower, you guys will probably build a little bit more capital at the Bank than we've seen in the past and you're paying out less than you're generating, so to an extent, where Tier 1 leverage actually builds over the next few quarters at the Bank, is there anything else you could do with respect to bringing back the deposits a bit sooner? I think you guys had $8 billion or $9 billion off balance sheet as of the last filing.

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

Yeah. Hey, Alex, so I think the – our view on capital is really, hasn't really changed. Over the near term, we're focused on the up to the Bank earnings from the prior quarter. Over the long-term, bringing that leverage ratio down from the 9.5% to 8%, and that long-term could be and likely at some point would be bringing deposits back on balance sheet. But where we are today, I think we're really focused on the stress test. It's really the primary next step here on getting comfort with our capital adequacy, right, and that's not too far off. These are due at the end of this quarter. We would likely be in a position to have active, constructive dialogue on that in the second quarter and be in a position to be, I think, better informed at the end of the second quarter, so I think until then our views are really just focused on the prior quarter Bank earnings.

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

Sure. So the increase in the quarter was primarily driven by the security book, specifically a slowdown in prepayments. You can see that in the two lines, the available for sale securities and in the held to maturity prepayments. You can see that in the two lines, the available for sale securities and in the held to maturity amortization? Looks like there are a couple of buckets that where the yields actually came up a little bit. I'm assuming that's what really drove that and maybe you can just kind of give us a sense what the reinvestment yields are today in the securities portfolio?
securities. Those securities are brought on the books, mostly at premium, so when you have prepayments; that’s going to impact your spread; when those prepayments slow down, it’s going to improve it nicely.

The prepayments in Q4 were at quite historic low levels for us, even though there’s really a little incentive to refinance, especially if rates are going up in the future. There is a base level of refinance rate, whether its people are buying new houses or getting new jobs and moving to different cities, we would expect a little bit of an increase in that prepayment next year. So you’ve got a little bit of a headwind pushing that spread down from 240 basis points.

The reinvestment rates have improved a little bit. They’re in, I’d say, in the $175 million to $200 million range, but with a growing balance sheet that $175 million to $200 million, while it’s going to help net interest income, as I said in the prepared remarks, it’ll be a little bit dilutive to spread. But I think all those things come together to bias net interest income up in 2014 versus 2013.

Alex Blostein
Analyst, Goldman Sachs & Co.

I understand. Thanks so much.

Operator: And the next question comes from the line of Steven Chubak of Nomura. Please proceed with your question.

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

Hi. Good evening. Concerning the redemption of high cost corporate debt, how should we think about the minimum level of cumulative pre-tax income generation required at the Bank to ensure that you can generate sufficient capital to redeem the first two tranches under the current cost schedule?

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

Well, so the first time we can call anything is the 6% notes of $500 million at the end of this year. So if you just look at – not that we cannot predict the future here, but if you just assume that the $75 million dividends continue on a quarterly basis and we close the sale of G1X which is also $75 million, you’d be reasonably in a position – be in a position to call those at the end of the year. But I think we don't want to get too far ahead of ourselves here. We’ve got a lot of good momentum. We’ve been doing a lot of good things that I think had led to the two dividends that we’ve received to-date. So our focus is just on keeping on doing those things. And as we get towards the end of the year, if we're in a good enough position to be able to do something there, of course, we'll be talking to you about it.

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

Okay. Fair enough. And actually as a follow-up to that, you noted that the dividends thus far reflect earnings generation at the Bank exclusively and thus does not appear to include any additional benefit relating to the consumption of disallowed DTA at the Bank. I didn't know how we should be thinking about the timing, size or even mechanics for up-streaming higher levels of capital which reflects the benefit of both levers, i.e. the Bank earnings as well as future DTA utilization.
Matthew J. Audette  
Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.

Yeah. So we’re definitely generate – the capital generated certainly more than the earnings, after-tax earnings over at the Bank to your point on deferred tax asset. I think our view here is that that’s how – that’s what we’re focused on in the near term. Longer-term obviously would be we’d be moving more capital above that if we’re going to move the leverage ratio down to that 8%, but I think that our near-term focus here is really on the stress test. There is really – that’s the main thing to get comfortable, both ourselves, our regulators and any other constituency involved with the capital sufficiency. So a long way of saying, I think we’ll be in a much better position at the end of the second quarter to have a view on that.

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

Okay. And it’s very helpful. Thank you. And then last one for me, some of your competitors have actually provided NIM guidance based on the current trajectory of the fed fund futures curve. And based on the current curve, I don’t know if you can give us a sense of what level of NIM improvement one could reasonably expect beyond 2014, so in 2015 and 2016?

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

Yeah. So you can guess that we plan and manage to that, but no – I don’t have anything for you beyond 2014 which would be in the mid $230 million.

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

All right. That’s it for me. Thank you for taking my questions.

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

Sure.

Operator: And the next question comes from the line of Joel Jeffrey of KBW. Please proceed with your question.

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

Good evening, guys.

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

Hi, Joel.

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

Just some of your peers have commented that they’ve seen some improvements in margin balances end of January; just wondering if you could comment if you’ve seen similar trends since year-end?
Matthew J. Audette  
Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.

Yeah. So we didn’t provide an update on January margin. I mean margin on a daily basis is something that can move around pretty substantially with customer buying and selling activities. So I think we get focused more on the months and the quarters. And as I think we covered in the prepared remarks, we’re at a five-year high in March, right it keep trucking up from $6 billion a couple quarters ago, ending this year at $6.4 billion. So we feel good about the margin growth, but not getting too hung up in the short-term in January so far.

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

Okay. And just as a quick follow-up to that, was the decline in the yield on that due to just a mix shift? Or was there anything else going on there?

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

It was. It was. I mean, the growth we had was on the higher balances which get the lower rates, so just a mix.

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

Okay. And then just lastly from me, the tax rate came in a little bit higher than what we were looking for. Was this sort of a one-time thing? Or is there a different way we should be thinking about taxes going forward?

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

Yeah. So no different way of thinking about it, I mean, our effective tax rate should be in the 40% range. Q4 is a notorious quarter for tax, because you’re truing up all your estimates that you made in the first three quarters to get to your overall effective rate for the year. Exclusive of the impact of the decision to sell G1X, our effective rate for the year was around 40%. You just had a bunch of true-ups in the fourth quarter. And that’s our expectation for next year as well, around 40%.

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

Great. Thanks for taking my questions.

Operator: And the next question comes from the line of Chris Harris with Wells Fargo Securities. Please proceed with your question.

Chris M. Harris  
Analyst, Wells Fargo Securities LLC

Thanks. Hey, guys. So first question on retail reengagements, you guys are posting really great trading numbers along with everybody else. And I guess what I’m trying to figure out, if we look at your activity rates today and compare them maybe back to prerecession peaks, it seems like you and others are kind of already back up to that level. So I guess what I’m wondering, do you think this cycle we could see higher highs in activity levels given you have other things going on like growth in mobile trading or growth in derivatives? Or do you think that we’re kind of getting to the upper band of how much higher activity levels can go?
Matthew J. Audette
Chief Financial Officer & Executive Vice President, E*TRADE Financial Corp.

Yeah, Chris, so we're definitely not clairvoyant on that. But I think just looking of what we've seen so far in January, the month is not over yet but three weeks into it, we're at $190,000. Right, those are levels that we have not seen in a very long time, especially versus the $160,000 in Q4. So we see some increased activity. If you would ask me in December, would I have thought January to be at $190,000 there's no way I would have thought that, so things are definitely picking up. But knowing anything beyond that's just – it's hard to tell.

Chris M. Harris
Analyst, Wells Fargo Securities LLC

Okay. But I mean you have seen that mobile trading and derivatives and all the rest is having a pretty big impact on some of the uptick you're seeing. I mean we just didn't have that back in 2006 and 2007. And I'm just wondering if that's playing a pretty big factor in kind of the acceleration.

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

Yeah. I mean we're getting more of our trades through mobile, right. We're getting around 9%, which has been a big increase obviously versus many, many years ago where it was zero. It's hard to know if that increase is trading versus it's just a better way for customers to access us, better way for customers to be engaged with us. It's hard to tell if that's incremental trades or not. I think as a broad point, as our platform improves and all of our digital experience improves, I think that only – there's a tailwind for customer growth and customer activity going forward. But it's just hard to tell if that's an exact cause in the short-term.

Chris M. Harris
Analyst, Wells Fargo Securities LLC

Okay. Second question then relates to the loan portfolio. Being so sensitive to home values and you guys are assuming a rise of 6% in 2014, can you give us some sense as to the sensitivity on how that outlook could change if home values change? So in other words, if you get maybe up 12% as opposed to up 6%, what that might do to your provision estimate?

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

Well, I mean I don't have that level of precision. I think it's a pretty fair assumption that we came up with a range and highlighted home prices and the home equity transition as the two things that are included there. We did that for a reason. But I don't have a precise breakout for you exactly on how those two impacted.

Chris M. Harris
Analyst, Wells Fargo Securities LLC

Okay. Thanks, guys.

Operator: [Operator Instructions] The next question comes from the line of Chris Allen with Evercore. Please proceed with your question.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Evening, guys. Just wondering if you could provide some additional detail in terms of some of the foundational enhancements the investment’s been whether that's investing in areas such as customer service, trading technology, product development or whether it's just fairly broad-based.

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

Well, let me – thank you for your question. Let me just answer where we're directing the investment, and along the way with that point out some foundational issues. The first place we're investing is to improve the customer experience, whether that's products and services, better skills and staffing in the customer service areas, adding financial consultants in the branches, et cetera, that's one area of investment. The second is on regulatory matters where it's an industry-wide issue, and financial services have rising expectations from a number of regulators for better performance and better demonstrability of performance regarding regulatory matters.

The third is really volume-related, and in there you’ll have some foundational elements as we try and make sure we're running a safe and secure highway, but also making sure that we're able to handle the higher levels of customer engagement and higher level of customer activities which we’re seeing, and as you can see compare favorably across the industry over the last quarter.

And then the fourth is in marketing as we seek to expand what we offer our existing customers, making sure we tell them about it as well as attracting new customers and reaching those customers and prospects in a more sophisticated, analytical way than we've done in the past. So you see that fall in four categories, but in terms of the foundational elements, I'd point particularly to the third, which is responding to volume increases and also ensuring that we're running a safe and secure network and platform for our customers to trade with confidence.

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

Great. That's helpful. That's all I got. Thanks.

**Operator:** And the next question comes from the line of Mike Carrier with Merrill Lynch. Please proceed with your question.

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

Thanks, guys. Just on the net interest income, when we think about the outlook you gave the spread, what your expectation is. Just in terms of the growth, the balance sheet, I guess, when you look at the new money that's coming in from the clients, should we assume a fairly consistent growth rate in the balances throughout 2014? Or should we expect any change there relative to what's coming in?

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

Yeah, Mike. That's hard to predict, right. The customer flows coming in, the net new assets is a little bit more of a steady number, but customer activity is also a big driver, right. So net buying and selling can impact in a pretty meaningful way the amount of cash that's coming through. So it's hard to predict. If you just look at the last couple of quarters, the balance sheet is growing in the $500 million to $700 million range per quarter. We've got a lot of cash off balance sheet so to the extent that those balances grow, obviously that doesn't impact cash, on balance sheet cash or balance sheet side. So it's hard to tell. The best thing I can point you to is just looking at the past few quarters as a guide.
Michael R. Carrier  
**Analyst, Bank of America Merrill Lynch**

Okay. And then just as a follow-up, in terms of the new investments, you gave some color there. I guess, just two things; I just want to make sure we got it right. If I look at last quarter, I think your run rate was around $265 million, and I think that includes like the G1X. So if we expect that to be stepping down, but still expect like a $270 million to $280 million run rate, I just want to make sure that we had that right. I know you said the first quarter would be elevated because G1X would still be in there, but I just want to make sure we're understanding that right. And then, in terms of the investments and what the payoff is, all the areas that you mentioned in terms of customer service, that makes sense. I guess I'm just wondering when you think about whether it's account growth, DARTs, net new assets, in terms of the drivers of revenues, what are your expectations? Of if you look 12 months in the future, where would things be to say, okay, those investments were successful?

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

Yes. So, Mike, on the G1X point, that's correct. So G1X is, I was highlighting, that was in there, likely going to be above that range in the first quarter because of seasonality in G1X. So that $270 million to $280 million range assumes that the G1X costs are gone. I think on the returns, I mean I would just reiterate what I had said earlier, right? We're very mindful of spending the dollars, shareholders money on these investments. This is just not the type of stuff where you can measure it with an individual investment ROI, right? We're investing, as Paul just highlighted in pretty good detail, we're investing in a lot of foundational and franchise items. So I think the proof points are just in the franchise growing over the long term. So it's not something where you can pinpoint metrics in the short term on.

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

Yeah, makes sense. All right. Thanks, guys.

**Operator:** [Operator Instructions] And the next question comes from the line of Kenneth Hill. Please proceed with your question.

Kenneth W. Hill  
**Analyst, Barclays Capital, Inc.**

Hi. Good evening, guys. I just wanted to follow up on DARTs here real quick. I think you guys said the volume from options was around 25% for the quarter. Just wondered how that compared to past quarters. And maybe what your outlook is for the mix of derivatives overall going forward and maybe what kind of actions might kind of move that higher over time, whether it's more advertising or adding technology or functionality for customers?

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

It's been fairly consistent over the past several quarters at about a quarter of our volume. Predicting what's going to happen in the future is much more difficult as investors take different positions and different sentiments on the economy. We will certainly be putting in the hands of our customers better tools and providing them enhanced education, so that when they do decide to engage with us in these type trades, they can do so with more confidence and a better perspective on their overall financial health. So, whether that leads to more or less in terms of the mix, that's not what drives our daily activity in trying to provide the best experience for our customers.
Okay, fair enough. And then I think when we talked with you, it was probably then – close to when you started about a year ago, you talked about you had a lot of the data at the company right now, was more about listening to the customers and harnessing kind of what's already available. It seems like you're starting the next phase of that as far as investing in the platforms again. Just kind of wondering if you still think you've gotten to a good point where you understand what the customers want? Is that going to be more about developing internally, or is that going to be purchasing some of that additional capacity, I guess, going forward?

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

I think what's important is that listening to our customers is a bit of a never-ending game, because what they want and are interested in changes as a result of their own personal circumstances of what happens in the economy. A lot of what we're going to do is really aimed at internally using that data and using it every day in what we do. Certainly, we'll be bringing in some outside tools that have already been developed, because there's no reason to redevelop those things that we can buy off the shelf. We want to be responsible with that investment. But a lot of it will be adding tools and skills to people who are already working at E*TRADE, and making those available to engage better with their customers, as well as driving more inside as we think about product development and our education resources. But I'd say the majority of the mix there will be on internal resources, not external.

Kenneth W. Hill  
Analyst, Barclays Capital, Inc.

Okay, great. Thanks for taking my questions.

Operator: And we have a question coming from the line of Devin Ryan of JMP Securities. Please proceed with your question.

Devin P. Ryan  
Analyst, JMP Securities LLC

Hi, good evening. Most of my questions have been already answered, but I just want to follow up on your interest rate sensitivity and kind of – maybe dig in a little bit on your long-term outlook for net interest income and the eventual impact of rising rates. I guess my question is really once the balance sheet has been fully transformed, how are you guys thinking about the liability side of the equation and that 300 basis point net interest spread level that you've disclosed once rates normalize? I know a lot of companies have really given differing views around how much of the benefit they think they'll be able to retain versus how to pass along to customers. So, I'd just be interested to hear your thoughts on that matter?

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

Yeah, sure, Devin. So our balance sheet is liability driven. So I think that over the long term in a more normalized rate environment where we expect to earn a spread of 300 basis points, it is a customer deposit driven balance sheet. Meaning, the wholesale funding book has run off other than some short-term liquidity needs and you've got deposits and customer payables funding the balance sheet. I think when you look at the price sensitivity of that cash, which I think is probably – sounds like the core of your question, we've been through a lot of rate cycles with this cash, right. And, I think, at it's very core, folks don't have cash with us because they are seeking a high rate. They have cash with us because they are looking to invest it in.
So it’s really not a rate product, it’s a convenience product to be ready to invest in the market if the customer so chooses or so decides. So, I think we felt confident in the pricing in a more normalized environment that underlies our assumption that we would achieve a spread of 300 basis points. So that’s our view there.

Devin P. Ryan  
*Analyst, JMP Securities LLC*

Okay, great. Thank you.

Operator: And Mr. Idzik, there are no further questions over the phone lines at this time. I will now turn the call back over to you for any closing remarks or to continue with the presentation.

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

I would just like to thank all of you for calling in and hope you have a good evening. Thank you very much.

Operator: Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.

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